

# NON-CONSOLIDATED ANNUAL FINANCIAL STATEMENTS

# 2018



**SHIPYARD**

**VIKTOR LENAC**

*Member of Palumbo Group*

---

April 2019

## CONTENTS

Statement on responsibility for financial statements	3
Auditor's Report	4
<b>Financial Statements</b>	
Financial position	9
Comprehensive Income Statement	10
Cash Flow Statement	11
Statement of Changes in Equity	12
Notes to Financial Statements	13
<b>Annual Report</b>	<b>41</b>

## STATEMENT ON RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

We acknowledge our responsibility for the preparation and presentation of the financial statements for the year 2018 in accordance with the International Financial Reporting Standards applied in the European Union and Croatian Law on Accounting to give a true and fair view of financial performance and financial results of the joint stock company "Brodogradilište Viktor Lenac" for the year.

Based on the research conducted, the Management Board reasonably assumes that the Company has got adequate funds to continue with its operations for the foreseeable future. We have, therefore, made the financial statements under the assumption that the Company shall continue to operate indefinitely.

In the preparation of financial statements the Board acknowledges their responsibility for:


- the implementation and consistent application of the appropriate accounting policies.
- giving reasonable and conservative estimates.
- the fair presentation of the financial statements in accordance with applicable financial reporting standards, disclosure and interpretation of any significant deviation in the financial statements.
- producing the financial statements under the assumption of the continuity of business for an indefinite period, unless it is inappropriate to assume that the Company shall continue running its business activities.

We acknowledge our responsibility for keeping proper and accurate accounting records, which shall at any time reflect the financial results and business performance of the Company with acceptable accuracy and precision as well as their compliance with the International Financial Reporting Standards and Accounting Law in force in Republic of Croatia.

We, also, acknowledge our responsibility for taking care of the Company's assets and for undertaking reasonable measures for preventing and revealing embezzlements and other irregularities.

The financial statements have been approved as of 19 April 2019.



  
Sandra Uzelac, Member of the Board

## INDEPENDENT AUDITOR'S REPORT

To the Owners of Brodogradilište Viktor Lenac d.d.

### Report on the Audit of the Financial Statements

#### Opinion

We have audited the financial statements of Brodogradilište Viktor Lenac d.d. ("the Company"), which comprise the statement of financial position as at 31 December 2018, the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies ("the financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company as at 31 December 2018, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union ("IFRS").

#### Basis for Opinion

We conducted our audit in accordance with the Audit Act and International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) and we have fulfilled our ethical responsibilities in accordance with the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

#### Key Audit Matters

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

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

The company was registered at Zagreb Commercial Court: MBS 030022053; paid-in initial capital: Kn 44,900.00; Board Members: Branislav Vrtačnik, Marina Tonžetić, Juraj Moravek and Dražen Nimčević; Bank: Zagrebačka banka d.d., Trg bana Josipa Jelačića 10, 10 000 Zagreb, bank account no. 2360000-1101896313; SWIFT Code: ZABHR2X IBAN: HR2723600001101896313; Privredna banka Zagreb d.d., Radnička cesta 50, 10 000 Zagreb, bank account no. 2340009-1110098294; SWIFT Code: PBZGHR2X IBAN: HR3823400091110098294; Raiffeisenbank Austria d.d., Petrinjska 59, 10 000 Zagreb, bank account no. 2484008-1100240905; SWIFT Code: RZBHR2X IBAN: HR1024840081100240905.

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as "Deloitte Global") does not provide services to clients. Please see [www.deloitte.com/hr/about](http://www.deloitte.com/hr/about) to learn more about our global network of member firms.

## INDEPENDENT AUDITOR'S REPORT (continued)

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

#### Key audit matter (continued)

##### Revenue from sales

For the accounting policies, see notes 2.2.a and 28. For additional information related to identified key audit matter, see note 3 to the financial statements.

Key audit matter	How our audit addressed the key audit matter
<p>The Company recognizes revenue from sales in the amount of 228,539,674 kuna. The Company recognizes revenue at the date of delivery of goods and/or services, i.e. with invoice issuing. When recognizing revenue, the Company considers requirements of International Financial Reporting Standards 15: <i>Revenue from contracts with customers</i>.</p> <p>We consider this area as a key audit matter due to potential significant effect to the financial statements if the revenue is recognized in an incorrect and inaccurate amount compared to actually earned.</p>	<p>In order to respond to risks related to revenue from sales, identified as the key audit matter, we designed audit procedures that enabled us acquiring sufficient appropriate audit evidence for concluding on this matter.</p> <p>We conducted the following audit procedures to address the revenue from sales:</p> <ul style="list-style-type: none"> <li>• Testing of design and operating effectiveness of main internal controls over the process of sale;</li> <li>• Based on results from testing the design and operating effectiveness of main internal controls over the process of sale, we have determined the extent and type of testing for control of accuracy and correctness of calculating and recognizing revenue from sales;</li> <li>• Testing of revenue from sales through tests of details, whereby auditing contracts based on which invoices were issued as a basis for revenue recognition.</li> </ul>

## **INDEPENDENT AUDITOR'S REPORT (continued)**

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

#### **Other Matter**

The Financial Statements of the Fund for the year ended 31 December 2017, were audited by another auditor who expressed an unqualified opinion on those financial statements on 20 April 2018.

#### **Other Information**

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

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

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. With respect to the Management Report and the Corporate Governance Statement, which are included in the Annual Report, we have also performed the procedures prescribed by the Accounting Act. These procedures include examination of whether the Management Report and Corporate Governance Statement include required disclosures as set out in the Articles 21 and 22 of the Accounting Act and whether the Corporate Governance Statement includes the information specified in the Article 22 of the Accounting Act.

Based on the procedures performed during our audit, to the extent we are able to assess it, we report that:

- 1) Information included in the other information is, in all material respects, consistent with the attached financial statements.
- 2) Management Report has been prepared, in all material respects, in accordance with the Article 21 of the Accounting Act.
- 3) Corporate Governance Statement has been prepared, in all material aspects, in accordance with the Article 22, paragraph 1, items 3 and 4 of the Accounting Act, and includes also the information from the Article 22, paragraph 1, point 2, 5, 6 and 7.

Based on the knowledge and understanding of the Company and its environment, which we gained during our audit of the financial statements, we have not identified material misstatements in the other information.

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

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

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

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

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

## **INDEPENDENT AUDITOR'S REPORT (continued)**

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

#### **Auditor's Responsibilities for the Audit of the Financial Statements**

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

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

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

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

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

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

## INDEPENDENT AUDITOR'S REPORT (continued)

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


We were appointed as the statutory auditor of the Company at the General Shareholders' Meeting held on 19 September 2018 to perform audit of accompanying financial statements. Our total uninterrupted engagement has lasted 1 year and covers period 1 January 2018 to 31 December 2018.

We confirm that:

- our audit opinion on the accompanying financial statements is consistent with the additional report issued to the Audit Committee of TNG on 27 April 2018 in accordance with the Article 11 of Regulation (EU) No. 537/2014 of the European Parliament and the Council;
- no prohibited non-audit services referred to in the Article 5(1) of Regulation (EU) No. 537/2014 of the European Parliament and the Council were provided.

There are no services, in addition to the statutory audit, which we provided to the Company and its controlled undertakings, and which have not been disclosed in the Annual Report.

The engagement partner on the audit resulting in this independent auditor's report is Vanja Vlák.



**Branislav Vrtačnik**  
President of the Board



**Vanja Vlák**  
Certified auditor

Deloitte d.o.o.

15 April 2019  
Radnička cesta 80,  
10 000 Zagreb,  
Croatia

## FINANCIAL POSITION AS AT 31 DECEMBER 2018

			HRK
Description	Note	2017	2018
<b>Assets</b>			
<b>Fixed assets</b>	15,17,18	<b>294.254.725</b>	<b>292.815.991</b>
Intangible Assets	15	8.579.730	5.597.518
Buildings, plants and equipment	15	275.522.134	277.301.592
Investments in subsidiaries	16	1.151.321	778.259
Investment in securities	17	-	292.736
Financial assets	18	8.487.114	8.381.042
Deferred tax assets		514.426	464.844
<b>Short-term assets</b>		<b>108.240.269</b>	<b>66.970.640</b>
Inventories	19	19.021.976	17.960.373
Financial assets	18	17.640	130.211
Trade and other receivables	20	57.326.461	38.508.485
Money in bank and cash in register	21	31.874.192	10.371.571
<b>Total Assets</b>		<b>402.494.994</b>	<b>359.786.631</b>
<b>Off balance sheet items, equity and liabilities</b>		<b>-</b>	<b>-</b>
<b>EQUITY AND LIABILITIES</b>			
<b>Equity and reserves</b>	22	<b>244.261.812</b>	<b>222.146.923</b>
Share capital	22	168.132.470	168.132.470
Provisions		39.102.484	75.027.051
Retained profit/loss	22	37.026.858	(21.012.598)
<b>Minority interest</b>		<b>-</b>	<b>-</b>
<b>Long-term liabilities</b>		<b>65.374.966</b>	<b>54.254.556</b>
Debentures with interest charge	23	46.877.286	38.137.709
Provisions	26	1.533.909	1.518.259
Other long-term liabilities	27	16.963.771	14.598.588
<b>Short-term liabilities</b>		<b>92.858.216</b>	<b>83.385.152</b>
Debentures with interest charge	23	15.551.811	18.562.903
Profit tax liabilities	24	8.360.609	-
Trade and other payables	24	66.575.120	64.134.806
Provisions	26	2.370.676	687.443
<b>Total Liabilities</b>		<b>158.233.182</b>	<b>137.639.708</b>
<b>Total Equity and Liabilities</b>		<b>402.494.994</b>	<b>359.786.631</b>



## COMPREHENSIVE INCOME STATEMENT AT 31 DECEMBER 2018

HRK

Description	Note	2017	2018
<b>OPERATING REVENUES</b>		<b>514.005.595</b>	<b>252.867.418</b>
Revenues from sales	4	480.494.796	227.249.933
Other operating revenues	5	33.510.799	25.617.485
<b>OPERATING EXPENSES</b>		<b>460.398.516</b>	<b>271.016.837</b>
Changes in inventories value of unfinished production		3.367.976	110.546
Material expenses	6	337.383.753	168.374.457
Employee expenses	7	70.568.255	68.620.939
Depreciation	8	26.501.036	22.823.547
Value adjustment	9	4.525.953	808.920
Provisions	10	3.393.797	820.831
Other expenses	11	12.977.954	8.878.684
Other operating expenses	11	1.679.792	578.913
<b>EBIT</b>		<b>53.607.079</b>	<b>(18.149.419)</b>
<b>NET FINANCIAL EXPENSES/REVENUES</b>	12	<b>(8.011.010)</b>	<b>(2.863.179)</b>
Financial revenues	12	236.961	253.664
Financial expenses	12	8.247.971	3.116.843
<b>PROFIT/(LOSS) FROM OPERATING REVENUES BEFORE TAX</b>		<b>45.596.069</b>	<b>(21.012.598)</b>
<b>PROFIT TAX</b>	13	<b>8.569.211</b>	-
<b>PROFIT/(LOSS) FOR THE YEAR</b>	13,14	<b>37.026.858</b>	<b>(21.012.598)</b>
Earnings per share (HRK)		2,32	(1,31)
<b>Net profit/loss for the year</b>		<b>37.026.858</b>	<b>(21.012.598)</b>
Profit/loss based on revaluating financial assets measured at fair value through other comprehensive income		(342.863)	(80.326)
Deferred tax assets		61.715	14.459
<b>COMPREHENSIVE INCOME/(LOSS) FOR THE YEAR</b>		<b>36.745.710</b>	<b>(21.078.465)</b>

## CASH FLOW STATEMENT AS AT 31 DECEMBER 2018

Description	Note	HRK	
		2017	2017
<b>CASH FLOW FROM OPERATING ACTIVITIES</b>			
Profit/loss before taxation	13,14	45.596.069	(21.012.598)
<b>Adjustment for:</b>			
Depreciation of real estates, facilities and equipment		26.501.036	22.823.547
Gains and losses from sale and value adjustment of tangible and intangible assets		2.917.974	12.794
Gains and losses from sale, unrealized gains and losses and value adjustment of financial assets		2.476.301	204.267
Impairment of inventories		535.358	-
Revenue from interests and dividends		(236.961)	(253.664)
Interest expenses		3.300.464	2.424.592
Provisions		2.097.642	(1.698.883)
Exchanges rate difference (unrealized)		216.377	536.929
Profit tax		(8.995.118)	-
Increase/decrease of accrued revenues and costs		12.548.235	(11.455.644)
<b>Profit from operating activities before changes in working capital</b>		<b>86.957.377</b>	<b>(8.418.660)</b>
Increase/decrease in inventories		8.089.875	1.059.073
Increase/decrease in short-term receivables		20.953.530	28.378.186
Increase/decrease in liabilities		(15.964.804)	(932.234)
Profit tax paid		(664.166)	(9.394.170)
Interest paid		(2.983.175)	(2.504.364)
<b>CASH FLOW FROM OPERATING ACTIVITIES</b>		<b>96.388.637</b>	<b>8.187.831</b>
<b>INVESTING ACTIVITIES</b>			
Acquisition of real estates, facilities and equipment and intangible assets		(36.824.772)	(21.671.339)
Income from sale of long-term assets		1.650	40.280
Investment into financial assets		(15.000)	147.547
Cash flow from interests		226.437	13.247
Cash flow from dividends		9.845	3.692
Granted loans		-	(170.000)
Inflows of loans		140.445	39.789
Other outflows of investing activities		-	-
<b>CASH FLOW FROM INVESTING ACTIVITIES</b>		<b>(36.461.395)</b>	<b>(21.596.784)</b>
<b>FINANCIAL ACTIVITIES</b>			
Inflows from debentures with interest charge		11.826.440	4.045.760
Repayment of debentures with interest charge		(48.213.451)	(12.139.428)
Dividend paid out		(1.438.925)	-
<b>CASH FLOW FROM FINANCIAL ACTIVITIES</b>		<b>(37.825.936)</b>	<b>(8.093.668)</b>
<b>TOTAL INCREASE/DECREASE OF CASH FLOW</b>		<b>22.101.306</b>	<b>(21.502.621)</b>
CASH AND CASH EQUIVALENTS AS AT 1 JANUARY		9.772.886	31.874.192
<b>CASH AND CASH EQUIVALENTS AS AT 31 DECEMBER</b>	<b>21</b>	<b>31.874.192</b>	<b>10.371.571</b>

## STATEMENT ON CHANGES IN EQUITY

	Share capital	Legal reserves	Reserves for own shares	Own shares	Other reserves	Fair value of financial instruments available for sale	Profit for the year	HRK Total
<b>Status as at 1 Jan 2017</b>	<b>168.132.470</b>	<b>8.406.624</b>	<b>12.540.000</b>	<b>(8.055.772)</b>	<b>26.585.806</b>	<b>(107.216)</b>	<b>1.453.115</b>	<b>208.955.027</b>
Profit/(Loss) for the year	-	-	-	-	-	-	37.026.858	<b>37.026.858</b>
Changes in reserves of the fair value of financial instruments available for sale	-	-	-	-	-	(281.148)	-	<b>(281.148)</b>
Profit / dividend pay out	-	-	-	-	(1.438.925)	-	-	<b>(1.438.925)</b>
Redirected into reserves per 2015 profit allocation	-	-	-	-	1.453.115	-	(1.453.115)	-
<b>Status as at 31 Dec 2017</b>	<b>168.132.470</b>	<b>8.406.624</b>	<b>12.540.000</b>	<b>(8.055.772)</b>	<b>26.599.996</b>	<b>(388.364)</b>	<b>37.026.858</b>	<b>244.261.812</b>
Profit/(Loss) for the year	-	-	-	-	-	-	(21.012.598)	<b>(21.012.598)</b>
Changes in provisions of the fair value of financial instruments available for sale	-	-	-	-	-	(65.867)	-	<b>(65.867)</b>
<b>Total comprehensive profit/loss for 2018.</b>	-	-	-	-	-	<b>(65.867)</b>	<b>(21.012.598)</b>	<b>(21.078.465)</b>
First implementation of IFRS 9	-	-	-	-	(1.036.424)	-	-	<b>(1.036.424)</b>
Redirected into provisions per 2017 profit allocation	-	-	-	-	37.026.858	-	(37.026.858)	-
<b>Status as at 31 Dec 2018</b>	<b>168.132.470</b>	<b>8.406.624</b>	<b>12.540.000</b>	<b>(8.055.772)</b>	<b>62.590.430</b>	<b>(454.231)</b>	<b>(21.012.598)</b>	<b>222.146.923</b>

## NOTES TO FINANCIAL STATEMENTS

## 1. GENERAL INFORMATION

The joint-stock company "Brodogradilište Viktor Lenac", headquartered in Rijeka, Croatia at Martinšćica bb, (hereinafter referred to as „Company“) has been registered under the Company's Registration Number 040000358 in the register of the Commercial Court of Rijeka.

The share capital of the Company amounts to 168,132,470 HRK and is divided in:

- 15.988.060 non-materialized ordinary shares in name, each having a nominal value of hrk 10,
- 825.187 own shares, each having a nominal value of HRK 10.

According to the Notice on classification of legal entities by National classification of economic activities of the Central Bureau of Statistics in Zagreb, the Company has been classified under the subclass number 3011 – building of ships and floating vessels, having its registration number 03333710 and VAT number 27531244647.

The Company's main activity is building, repair, conversion and other services relating to ships and other floating vessels. The Parent Company has been registered for other activities such as steel constructions, trade, engineering and other diverse services.

The Company's shares are listed on the regularly operating market of Zagreb stock exchange.

On the day of 31 December 2018, the Company employed 441 employees.

On the day of 05 December 2018, the Supervisory Board of the Viktor Lenac Shipyard consisted of five members: John Karavanić as Chairman of the Supervisory Board, Elvis Pahljina as Vice-Chairman of the Supervisory Board, Hrvoje Markulinčić, Luka Kolanović as members and Zoran Košuta as workers' representative and 5th member.

At the extraordinary session of the General assembly held on 05 December 2018, new members of supervisory board were elected: President of the Supervisory board Mr. Antonio Palumbo, First deputy head of the Supervisory Board Mr. Raffaele Palumbo and Members of the Supervisory board Messrs. Francesco Ciaramella and Giorgio Filippi. Mr. Zoran Košuta continues to hold his function as workers' representative and 5th member of the Supervisory board.

In 2018 the Company's Committee for Audit was composed of the following members: Elvis Pahljina, Genari Sutlović and Ines Mirković, appointed by the Company's Supervisory Board.

On the day of 31 December 2018. members of Viktor Lenac's Management Board were Aljoša Pavelin, President of the Board and Sandra Uzelac, Member of the Board.

The Company had the following ownership structure as at 31 December 2018:

	Shareholder	Number of Shares	Percentage of Equity
1	Palumbo Group S.p.A. Italy	10.035.888	59,69
2	Interkapital vrijednosni papiri d.o.o./Guardianship account	3.745.572	22,28
3	Brodogradilište viktor lenac d.d.	825.187	4,91
4	Jadroagent d.d.	324.766	1,93
5	Croatian Centre for Restructuring and Sales/Republic of Croatia	122.669	0,73
6	R.L.E., t.p., Drniš	105.211	0,63
7	Weiss Branka Maria	77.308	0,46
8	Kera Ivana	58.321	0,35
9	HPB d.d./HPBS-6	48.186	0,29
10	Other	1.440.031	8,74
	<b>Total:</b>	<b>16.813.247</b>	<b>100,00</b>



Until June of 2018, the mayor individual shareholders were Tankerska plovdba Jsc. with its share of 36,95% and Uljanik Jsc with its share of 34,67%. In June of 2018 italian shipbuilding company Palumbo Group S.p.A. in cooperation with P&L Shiprepair Holding S.p.A. from Malta, acquired over 25% of the Company's capital which resulted in Takeover bid in August of 2018, as mandatory as according to Act on the Takeover of Joint-Stock Companies.

The takeover bid was accepted by significant number of shareholders and subsequently Palumbo Group S.p.A. became single largest Company's owner.

In accordance with the International Financial Reporting Standards and Croatian law, the Consolidated Financial Statements of the Company and its subsidiary companies shall be published as separate document upon disclosure of the Non-Consolidated Financial Statements.

On 19 April 2018 the Management Board of the Company approved the Non-Consolidated Financial Statements for submission to the Supervisory Board.

The accounting policies given below have been applied consistently for all periods presented in these financial statements.

## 2. BASIC ACCOUNTING POLICIES

Basic accounting policies applied in the preparation of the financial statements are as set forth below. These accounting policies have been consistently applied for all periods included in these reports unless otherwise stated.

### 2.1. STATEMENT ON COMPLIANCE AND BASICS OF REPORTING

Financial Statements for 2018 have been prepared in accordance with the law frame of the financial reporting applicable in the Republic of Croatia and International Financial Reporting Standards applied in the European Union.

Viktor Lenac shipyard Jsc is a parent company of Viktor Lenac Group which consolidated financial statements are being prepared in accordance with International Financial Reporting Standards, and are not as yet finalised. The management is preparing consolidated financial reports which will be published shortly after publishing of non-consolidated financial reports.

At the time of preparing these financial reports, there were no significant information of potential risks or uncertainties which could have a major impact on future business activities of the Company.

Financial Statements of the Company have been prepared under the fundamental accounting assumption that effect of transaction is recognized when occurred and is recorded in the period to which the transaction refers, and under the assumption of continuity of business for an indefinite period.

Accounting policies applied in the preparation of the 2018 Financial Statements have not changed compared with the previous year. Financial Statements have been prepared by principle of historical cost, except for certain financial instruments recorded as per fair value.

The financial statements of the Company have been prepared in Croatian Kuna (HRK) as measuring or reporting currency.

According to IFRSs, all foreign currency receivables and liabilities as well as receivables and liabilities with foreign currency clause have been adjusted to the midpoint exchange rates of the Croatian National Bank at 31 December 2018 as follows:

1 EUR = HRK 7,417575	(31.12.2017. 1 EUR = 7,513648 HRK)
1 USD = HRK 6,469192	(31.12.2017. 1 USD = 6,269733 HRK)
1 NOK = HRK 0,742716	(31.12.2017. 1 NOK = 0,765589 HRK)
1 GBP = HRK 8,205282	(31.12.2017. 1 GBP = 8,467991 HRK)

## 2.2. STANDARDS AND INTERPRETATIONS THAT HAVE BEEN IN FORCE FOR THE CURRENT PERIOD

### First application of new amended existing standards which are relevant for current reporting period

Standards, amendments to effective standards and clarifications issued by International Accounting Standards Board (IASB) and adopted by European Union, effective in current reporting period are:

- **IRFS 9 "Financial Instruments"** as adopted in the European Union on 22 November 2016 (effective for annual periods beginning or after 1 January 2018);
- **IRFS 15 "Revenue from Contracts with Customers"** and amendments of IRFS 15 "Effective Date of IRFS 15" as adopted in the European Union on 22 September 2016 (effective for annual periods beginning or after 1 January 2018);
- **Amendments to IRFS 2 "Share-based Payment"** – classification and measurement of share-based payment transactions, " as adopted in the European Union on 27 February 2018 (effective for annual periods beginning or after 1 January 2018);
- **Amendments of IRFS 4 "Insurance Contracts"** – implementation of IRFS 9 "Financial Instruments" in conjunction with IRFS 4 "Insurance Contracts" as adopted in the European Union on 3 November 2017 (effective for annual periods beginning or after 1 January 2018 or those annual periods which are for the first time affected by IRFS 9 "Financial Instruments");
- **Amendments of IRFS 15 "Revenue from Contracts with Customers"** – Clarifications of IRFS 15 "Revenue from Contracts with Customers" as adopted in the European Union on 31 October 2017 (effective for annual periods beginning or after 1 January 2018);
- **Amendments of IRFS 40 "Investment Property"** - applies to the accounting for property, as adopted in the European Union on 14 March 2017 (effective for annual periods beginning or after 1 January 2018);
- **Amendments of IRFS 1 and IAS 28 named "Improvements of IRFSs 2014-2016 cycle"** resulting from Annual improvements to IRFSs (IRFS 1, IRFS 12 and IAS 28) considering clarifications and compliances as adopted in the European Union on 7 February 2018 (amendments of IRFS 1 and IRFS 28 are effective for annual periods beginning or after 1 January 2017, amendments of IRFS 12 are effective for annual periods beginning or after 1 January 2018);
- **IRFS 22 "Foreign Currency Transactions and Advance Consideration"** as adopted in the European Union on 28 March 2018 (effective for annual periods beginning or after 1 January 2018);

Adopting these amendments to effective standards has not led to any significant changes in the Company's financial statements.

## Amendments of existing standards issued by IASB and adopted in the European Union, but not yet effective

On the date of approval of financial statements, following new standards and amendments of existing standards have been issued by IASB but not yet adopted by European Union:

- **IFRS 16 “Leases”** as adopted in the European Union on 31 October 2017 (effective for annual periods beginning or after 1 January 2019);
- **Amendments of IFRS 9 “Financial instruments”** - prepayment features with negative compensation and modifications of financial liabilities, as adopted in the European Union on 22 March 2018 (effective for annual periods beginning or after 1 January 2019);
- **IFRIC 23 “Uncertainty over Income Tax Treatments”** - as adopted in the European Union on 23 October 2018 (effective for annual periods beginning or after 1 January 2019);

The Company chose not to implement new standards, amendments to existing standards and clarifications before the date they become effective. The Company does not expect that implementation of these standards and amendments to existing standards, to lead to operative changes of financial reports in period of First implementation of standard.

## New standards and amendments of existing standards issued by IASB and not yet adopted in the European Union

IFRSs currently adopted in the European Union do not differ significantly from regulations adopted by the International Accounting Standards Board (IASB), except for the following standards, amendments to standards and interpretations, which have still not been adopted by the European Union as at the date of publishing of this financial report (effective dates referred to below apply to IFRS as a whole):

- **IFRS 14 “Regulatory Deferral Accounts”** (effective for annual periods beginning on or after 1 January 2016) - The European Commission has decided to postpone the transposition of this transitional standard until publication of its final version;
- **IFRS 17 “Insurance Contracts”** (effective for annual periods beginning on or after 1 January 2021);
- **Amendments to IFRS 3 “Business Combinations”** - definition of a Business (effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 January 2020 and to asset acquisitions that occur on or after the beginning of that period);
- **Amendments to IFRS 10 “Consolidated Financial Statements and IAS 28 Investments in Associates and Joint Ventures”** - Sale or Contribution of Assets between an Investor and its Associate or Joint Venture and subsequent amendments (originally established effective date postponed until completion of a research project on application of the equity method);
- **Amendments to IAS 1 “Presentation of Financial Statements” and IAS 8 “Accounting Policies, Changes in Accounting Estimates and Errors”** – materiality definition (effective for annual periods beginning on or after 1 January 2020);
- **Amendments to IAS 19 “Employee Benefits”** - plan amendments, curtailments, and settlements (effective for annual periods beginning on or after 1 January 2019);
- **Amendments to IAS 28 “Shares in Associates and Joint Ventures - Long-term Investments in Associates and Joint Ventures”** (effective for annual periods beginning on or after 1 January 2019);
- **Amendments to various standards through Annual Improvements to IFRS Standards 2015–2017 Cycle** (IFRS 3, IFRS 11, IAS 12 and IAS 23), intended primarily to clarify guidance and wording, or to correct for relatively minor unintended consequences, conflicts or oversights (effective for annual periods beginning on or after 1 January 2019);
- **The revised Conceptual Framework for Financial Reporting** (effective for annual reporting periods beginning on or after 1 January 2020).

The Company estimated that implementation of above mentioned new standards and amendments to existing standards would not have significant operative changes on financial reports.

Accounting policy regarding asset protection techniques, which principles are not yet adopted in European Union, is still not regulated.

The Company estimated that implementation of Accounting policy regarding asset protection techniques in accordance with IAS 39: "Financial Instruments: Recognition and Measurement" would not have significant impact on financial reports, if exercised on the balance sheet date.

## First implementation of new standards

First implementation of IFRS 9 – "Financial instruments" was effective on 01 January 2018 and the Company estimated expected credit losses of trade as on 01 January 2018. By applying an average rate of reduction of trade and other receivables as determined for previous periods, the effect of recognition of expected credit loss on 01 January 2018 amounted to HRK 1,036,424.

Apart the effects of estimated expected credit losses of trade and other receivables, the Company did not stated other effects, that is, effects considering other financial assets of minor significance.

	IAS 39		IFRS 9		
	Measurement	Carrying amount in 000 HRK	Measurement	Carrying amount in 000 HRK	Business model
<b>Financial assets</b>					
Money and assets with CNB	Depreciated cost (loans and receivables)	10,372	Depreciated cost	10,372	Hold to collect
Trade and other receivables	Depreciated cost (loans and receivables)	39,006	Depreciated cost	38,508	Hold to collect
Long term financial assets	Depreciated cost (loans and receivables)	9,452	Depreciated cost	9,452	Hold to collect

First implementation of IFRS 15 – "Revenue from Contracts with Customers" did not have significant impact on financial reports.

First implementation of IFRS 16 – "Leases", effective 01 January 2019 will not have significant impact on financial reports because the Company as 31 December 2018 does not have leases on which this standard applies.

## 2.3. KEY ASSUMPTIONS, ESTIMATES AND UNCERTAINTY IN PREPARING FINANCIAL STATEMENTS

In preparing non-consolidated financial statements, the Management Board used estimates, judgements and assumptions which can affect accounting value of assets and liabilities of the Company, disclosure of potential items on balance sheet date and disclosed revenues and expenses of the period then ended.

The following estimates were used, including, without limitation: calculation of depreciation and remaining value of real-estate, plants, equipment and intangible assets, decrease in value, value adjustment of inventories and doubtful receivables, provisions for employees' salaries and wages, and litigations. More details on accounting policies relative to estimates can be found in other parts of this note as well as other notes of the financial statements. The impact of future events cannot be anticipated with certainty. Accounting estimates, therefore, call for judgements. Judgements made in preparing financial statements are subject to changes due to new events, additional information, new experience or changes in business environment. Actual results may differ from estimates.

**The basic accounting policies applied in the preparation of financial statements for the year 2018 are as set forth below:**

## a) Revenues

Revenues are recognized upon reliable measurement of their amount and economic benefits for the Company, and when they fulfil specific criteria for all activities of the Company.

Revenues from sales of goods and services are recognized if:

- the Company has a contract with a customer, written or verbal, which determines rights and obligations, conditions and due dates, and there is a liable probability that the Group will collect rightful recompense for negotiated obligation,
- the Company can determine its obligations based on contract with customer, i.e. obligations to transfer goods or services, deferred, related or involved with other resources required to provide service to customer,
- the Company can, based on a contract, determine or estimate selling price of the rightful transaction in exchange for goods or services to customers, which price can be determined by contract, price list, past doings or usual commercial practice,
- the price of the transaction can be separated for each contractual obligation, i.e. separate actions, which can be determined in contract or reliably estimated using a price list, past doings or usual commercial practice,
- the Company fulfilled its contractual obligation completely at a given time or partially in longer period in time, when is so stipulated in the contract.

Revenues resulting from contractual obligations which are fulfilled during a period of time, the Company states in proportion to executed, under following conditions:

- the price of the partial performance can be determined or reliably estimated,
- the customer accepted goods or services and/or has control over accepted goods and services, or the Company is improving customer's assets while under the control of the customer, or
- the Company generated expenses of resources and inputs for delivered goods or services.

Measuring progress towards complete satisfaction of a performance obligation over time can be based on the:

- output methods - based on direct measurement of the value to the customer of the goods or services transferred to date relative to the remaining goods or services promised under the contract,
- input methods - measuring progress based on costs generated to recognise revenue on a straight-line basis if the entity's efforts or inputs are spread evenly throughout the performance period,
- combination of output and input methods which is used to question and evaluate credibility of both methods in order to fair valuation of stated revenues

Government grants are recognized as revenues in the period when related expenses will occur, if:

- the terms of the grants have been met
- is likely that the grants will be received.

Financial revenues include interests on invested funds, positive exchange rate differences, revenues from dividends and other financing revenues.

Revenues from interests are recognized on a time proportional basis, with regards to the real income on the invested funds, pursuant to concluded contracts.

## **b) Expenses**

The policy of expenses is recorded in such way that the periodic accountancy system determines expenses which are applicable to recognition in the calculation of current year result.

The recognition of expenses occurs if:

- expenses result in decrease of funds or increase of liabilities that can be reliably measured;
- expenses have direct relation to occurred costs and revenues;
- when it is expected to achieve revenues in multiple reporting periods, recognition of expenses is performed by allocation on reporting periods;
- expense is immediately recognized in the reporting period when outflow does not achieve future economic benefit, and there are no conditions to be recognized as assets in the Balance Sheet;
- expense is immediately recognized in the reporting period upon appearance of liability, and there are no conditions to be recognized as an asset.

Losses that can be identified as expenses are classified as expenses. In that case losses should be related to occurring revenues. Losses are covered with revenues of the reporting period.

Financial expenses include expenses for interests against loans, discounts from sales of securities and receivables prior to their maturity, interests arising from delayed payments, negative exchange rate differences, losses from sales of shares and business portions, as well as other financing expenses.

Financing expenses are recognized on time proportional basis, respectively in the period when they occurred.

Negative exchange rate differences are not capitalized but are included in the expenses of the period.

## **c) Financial result and profit tax**

Profit/loss before taxation is determined in such way that the total accounting expenses are subtracted from total accounting revenues.

Profit tax liability (current tax) is determined pursuant to valid regulations of Law on Profit Tax.

Deferred tax assets and deferred tax liabilities are recognized in case of changes of valuation of financial and other assets of the Company, which haven't produced profit or loss consequently creating temporary difference between accounting profit and taxable profit. The carrying amount of deferred tax assets are reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow the benefit of part or all of that deferred tax asset to be utilised. Any such reduction is subsequently reversed to the extent that it becomes probable that sufficient taxable profit will be available. Deferred tax liabilities refer to future liability for tax payments on current not yet realised profits.

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

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised based on tax laws and rates that have been enacted or substantively enacted at the reporting date.

The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Company expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

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

## **d) Profit/loss based on revaluating financial assets measured at fair value through other comprehensive income**

In the case of selling long-term financial assets measured at fair value through other comprehensive income, the effects are recorded in profit/(loss) statement.

## **e) Fixed intangible assets**

Fixed intangible assets comprise of non-monetary assets that are identifiable without physical substance. Fixed intangible assets are recognized if they met the following conditions:

- it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity,
- the cost of the asset can be measured reliably, and
- its single acquisition value exceeds HRK 3,500.

If the criteria are not met, the costs are recorded as current period expenses.

After initial recognition, intangible asset is recorded based on its acquisition cost decreased for value adjustment (accumulated depreciation) and for accumulated losses from decrease.

Intangible assets are excluded from the Balance Sheet in case of disposal or if there are no expected future economic benefits from it. Gains or losses (difference between revenues from disposal and book value) arising from disposal or withdrawal of intangible assets are recognized as revenues or expenses of the current period. Intangible assets are depreciated as every single item by linear method against the rate of 5-25% annually.

Depreciation is recorded from the first day of the following month after the fixed intangible asset has been activated. Depreciation for sold, given, or in any other way disposed or destroyed fixed intangible assets is recognized as expense up to the end of month when the assets were still in use.

## **f) Fixed tangible assets**

Fixed tangible assets comprise of property, plants and equipment which the Company:

- Owns and uses in business operations, administrative purposes or for rental to others;
- Acquires or builds with intention of continuous use;
- Does not sell through its basic operations and is expected that those assets will be in use for more than one period.

Fixed tangible assets are recognized if following fulfilled:

- it is probable that the expected future economic benefits that are attributable to the asset will flow to the Company,
- the cost of the asset can be measured reliably,
- its single acquisition value exceeds HRK 3,500 and useful period of life exceeds one year.

Except, if the single value of the asset does not exceed HRK 3,500 and it is undoubtedly evaluated that its useful period of life exceeds one year, it is considered as fixed tangible asset and is completely written-off as expense of the current period.

Fixed tangible assets that do not exceed value of HRK 3,500 nor its useful period of life exceeds one year are recorded as inventory and therefore are completely written-off upon activation.

Upon acquisition, fixed tangible assets are recorded in the business books at acquisition value.

Goods and services produced internally and included in use as fixed tangible assets are recorded at their production value, under condition that the production value does not exceed net market value. Production value does not include internal profits, unusual values of waste material, work and other assets.

The production cost is determined pursuant to IAS 2 – Inventories. Additional costs are included in the book value of the assets or, if needed, are recognized as separate assets only if the Company expects to have future economic benefits of those assets, or if their expense can be reliably measured.

After initial recognition, property, plant and equipment are recorded based on their acquisition cost decreased for accumulated depreciation and accumulated losses from decrease. Basis for depreciation is acquisition value (gross book value) of the single asset.

Facilities and equipment are withdrawn from use and are disposed when there are no expected economic benefits from them or market values.

If while in use a fixed tangible asset has been damaged or withdrawn from active use, the asset is depreciated up to the end of month when it was withdrawn from active use. If its net book value exceeds its sale value, the difference is recorded as expense upon sale (net principle recording). In case its sale value exceeds its book value, the difference is recorded as revenue of the current period (net principle recording).

Depreciation is charged for each single asset, against linear method at rates suitable for disposal of acquisition value through its evaluated useful period of life. Land and assets under construction are not depreciated.

Rates applied for depreciation are as follows:

• buildings	2,5-10%
• ships and docks	2,5-5%
• cranes and plants	6,67-10%
• production equipment	10-12%
• transportation vehicles	20%
• office computer and related equipment	10-20%

The Company evaluates useful life of fixed tangible assets on a regular basis and based on the Management's decisions uses legally recognized accelerated depreciation rates.

Depreciation and recognition of expense starts from the first day of the month followed by activation of the fixed tangible asset.

Depreciation for sold, given, or in any other way disposed or destroyed fixed tangible assets is recognized as expense up to the end of month when the assets were still in use.

Fixed assets are recorded in the Balance Sheet even if they are completely written-off, up to sale, gift, or disposal of any kind.

## ***g) Long-term financial assets***

Long-term financial assets represent investment of cash, goods and assignment of rights for generating revenue. Return on the investment is expected in period exceeding one year.

Accounting policy and procedures differ depending whether the investments occurred from:

Investments in participation at others up to 20% of voting power;

Investment into associated companies

Investments through business relations with partners in market.

Initial investment in associated and dependent companies is recorded at acquisition cost increased for transaction expenses. On the financial statements date these investments are recorded depending on the portion in these associated companies.

Long-term financial investments in associates (share of 20% - 50%) are recorded in the books by the cost method affected by eventual depreciations, whilst the equity method is used in consolidated reports.

## ***h) Investments in subsidiary companies***

Investments in subsidiary companies refer to investments of cash, goods and assignment of rights with the purpose of generating revenue by related parties in the subsidiaries, i.e. shareholding equal greater than 50%. Return on the investments is expected in period exceeding one year.

Long-term financial investments in subsidiaries are accounted using the cost method.

## ***i) Inventories***

Inventories of raw and other material are valued according to their acquisition value (average weighted price principle) or their net market value, depending on which one is lower.

Reduction of inventory value is performed by charging expenses of the current period based on evaluation made by professional services on damage, deterioration of inventory and in case when recoverable value (value that can be realized by sale or use of those inventories) is lower than acquisition cost.

If the professional services evaluate that use of certain inventories in future contracts is doubtful, respectively that some products on stock are not spendable, the Company performs write-off of inventories, which is



recorded as expense of the current period. When and if there are no circumstances that caused the prior reduction of value, respectively write-off of inventories, the value of inventories should be increased up to the acquisition cost, meaning up to value that can be realized and expended in regular production.

Small inventory and tools are being written-off completely upon activation.

Inventories that are damaged upon manipulation and storage, as well as inventories that lose their usage value are being written-off and charge operating expenses through inventory taking or by special committees with permission granted by a responsible person and within frames of tax legislations.

If the Company, up to the reporting period, does not conclude the initiated commercial contract, and if the criteria for revenue recognition under IRFS 15 weren't met, the value of inventories for production in progress is recorded as of the end of the period.

The value of production in progress is recorded at actual costs that can be related to a specific contract.

The actual costs comprise of direct and indirect costs of production which occurred by the end of the reporting period:

Variable and fixed direct costs of production that can be directly related to the specific contract on a reasonable basis, such as costs of built in material, direct work and services of others directly involved in rendering services

Variable and fixed general costs of production that are being allocated by a key to specific contracts, respectively in proportion to direct costs, meaning that are being assigned to the value of inventories for production in progress based on normal capacity (normal realized capacity in regular circumstances of operations through a certain period).

The total amount of recorded costs of production in progress decrease expenses of the period, respectively are recognized as expenses of the period at the same time as revenues are being recognized upon completion of works and delivery of the total project.

Cost i.e. value of inventories for production in progress does not include profit or general operation expenses and administrative expenses which cannot be related to rendering of services, but charge expenses of the period when they occurred.

## ***j) Receivables***

Trade receivables, receivables from state, employees and other legal and private persons are recorded in the business books based on valid documentation of their occurrence and data on their value.

Trade receivables from customers in abroad shown in foreign exchange currencies are recorded in Croatian currency, calculated based on mean exchange rate of Croatian National Bank as of the date of recording the receivable.

Upon collection of receivables, the differences that occur due to exchange rate are recorded as revenues or expenses of the Company.

Open balances of trade receivables from customers in abroad as of the Balance Sheet date are set at mean exchange rate of Croatian National Bank and the exchange rate differences are recorded as revenues or expenses.

Increase of receivables for interests is based on the contract and calculations of the legal interest rates as prescribed by law.

Value adjustment of receivables is performed based on evaluation that the receivable has not been collected when due, i.e. that it is uncollectible and claimed on court. The Decision on value adjustment of receivables is made by the Management.

Value adjustment of receivables is recorded in the Profit and Loss Account of the Company (Note 30).

## ***k) Short-term financial assets***

Short-term financial assets comprise of investment of cash, property, rights and granted merchandize loans for generating revenues, whose benefits are expected to arise within one year.

Short-term financial investments within one year are recorded in the business books at investment cost. The value is determined for each investment.

### ***Impairment on short-term financial assets, receivables included***

Estimation of future expected credit losses is calculated applying an average depreciation rate in previous periods and it's applying on not-revaluated short-term financial assets as per date of balance sheet (Note 29). Upon acknowledging larger risk of collecting and terminated litigations, short term financial assets are revaluated. The Decision considering later revaluation is made by the Management Board.

## ***l) Cash and cash equivalents***

Cash and cash equivalents include cash in banks, in register and short-term deposits at banks with contracted maturity of up to 3 months. The balance of the cash in bank is recorded at nominal value in Croatian currency. Foreign exchange funds in bank and register is set at mean exchange rate of Croatian National Bank.

Exchange rate differences arising from setting foreign exchange funds to mean exchange rate of Croatian National Bank are recorded as revenues / expenses of the current period.

## ***m) Prepaid expenses and accrued income***

Outflows that covered expenses referring to future periods are recorded according to the amounts specified in valid documentation supporting the business event.

Discrepancy of the calculation period of prepaid expenses at the end of the year creates a balance which is transferred into the following period as a Balance Sheet position.

Generated revenues that do not meet the criteria to be recorded as receivables, are recorded in the calculated amount specified in the valid documentation supporting the business event and are being transferred as a Balance Sheet position to the following period in which they are carried over to the receivables once they meet the criteria.

## ***n) Equity***

Equity is own source for financing assets and is expressed pursuant to articles of International Financial Reporting Standards as remaining of the assets after deduction of all liabilities. Subscribed capital is recorded in the amount that is subscribed in the court registry upon establishment, i.e. change of subscribed value of



capital in the commercial registry. Policy of recording reserves depends on their shape and policy of the Company (legal, statutory and similar).

## ***o) Provisions***

Provisions should be recognized when the Company has a present obligation (legal or constructive) because of a past event or it is probable that an outflow of resources embodying economic benefits will be required to

settle the obligation, and a reliable estimate can be made of the amount of the obligation. Provisions are reviewed at balance sheet date and adjusted to the latest best evaluations.

Provisions arising from contracts, such as provisions for severance wages, provisions for expenses in guaranty periods, and provisions for expenses arising from initiated court claims are also recognized as an expense of the period for risk provisions based on legal and other regulations.

## ***p) Long-term liabilities***

Long-term liabilities are recorded in the business books in the amounts specified in valid documentation or contract supporting the event. Long-term liabilities refer to liabilities with maturity exceeding 12 months starting from the date of financial statements. Classification of the long-term and short-term liabilities is performed on each day of the Balance Sheet.

## ***r) Short-term liabilities***

Short-term liabilities are recorded in the business books in the amount specified in valid documentation or contract supporting the event. Short-term liabilities refer to liabilities with maturity less than 12 months. Classification of the long-term and short-term liabilities is performed on each day of the Balance Sheet.

Short-term liabilities recorded in foreign exchange funds and those with currency clause are being set at mean exchange rate of the Croatian National Bank in Croatian currency. Upon settlement of these liabilities, the differences that occur as exchange rate differences are recorded as revenues or expenses of the Company.

Open balances of liabilities shown in the foreign exchange currencies are being set at mean exchange rate of Croatian National Bank as of the Balance Sheet Date and exchange rate differences that occurred are recorded as revenues or expenses of the Company.

## ***s) Accrued expenses and deferred income***

Expenses that occurred in the current period for which the Company did not receive invoices or has incomplete documentation for their booking, but it is possible to determine their amount (for example rental costs, audit fees based on contract) are recorded in the Balance Sheet as accrued expenses, since the liability will be recorded in the future period. Incurred expenses which do not meet the criteria to be recorded as liabilities, are recorded at the amount specified in the documentation which anticipated the business event and are transferred as a Balance Sheet position in the following period in which they are carried over to liabilities once they meet the criteria.

Those revenues not meeting the criteria to be recognized in the current period are deferred for future periods.

## 3. SEGMENT REPORTING

Based on management approach of IFRS 8, the Company controls its actions in only one segment, according to specifics of its activities. Ship repair and conversions, being the main activity of the Company, constitute over 98% sales revenues, i.e. over 90% of total operating revenues. All processes within main activity of the Company are interrelated by matrix organisation. Matrix organisation connects various resources provided by functional organisational units that are required for simultaneously realisation of several different projects. Thus, the Company, uses its non-direct resources and infrastructure which can not be allocated to each project, for all projects within ship repair activities. Profitability of each projects vary depending on availability of needed resources, especially labour force, which are combined depending on level of their employment. Each project has its own specificities due to client's requirements and needs, affecting different approaches in combining different production duties, which may and may not be compatible in realisation of contracted services. Such business environment does not allow segment reporting of organisational units or activities.

The Company monitors its project operations, which combine different productional activities, in different proportions depending on various work specifications of each project. Internal managerial reports are used for whole segment of activity, in which indicator of business performance is based on gross margin (relation between revenues and direct costs) and EBITDA (profit before, taxes, interests and depreciation).

Included in basic activity of the Company, are subsidiaries Viktor Servisi Ltd and VL Steel Ltd which activities are closely related or equal to the Company's activity, so there can be no different segments of activities. In business model of the Company, subsidiaries act like subcontractors in business activities of the Company in periods of higher employment or for projects that require large labour force or specific artisans. It is to be noted that subsidiaries have a total impact of 1% to consolidated financial reports.

## 4. REVENUES FROM SALES

	HRK	
	31.12.2017	31.12.2018
Revenues from sales on domestic market	15.518.285	28.862.433
Revenues from sales on foreign market	463.622.784	197.628.335
Revenues from sales – subsidiary company	97.768	140.511
Revenue from sales – related parties	1.255.959	618.654
<b>Total</b>	<b>480.494.796</b>	<b>227.249.933</b>

Structure of revenues from sales:

	HRK		
	Domestic market	Foreign market	Total
Shiprepair	26.743.724	197.223.801	223.967.525
Shiprepair – related parties	618.654	-	618.654
Offshore	82.358	-	82.358
Other revenues	2.036.351	404.534	2.440.885
Other revenues – subsidiary company	140.511	-	140.511
<b>Total</b>	<b>29.621.598</b>	<b>197.628.335</b>	<b>227.249.933</b>

Revenue from sales – related parties refer to Uljanik Group which was, up until 30 June 2018 together with Tankerska plovdba Ltd, major owner of the Company. By acquiring large number of shares, Palumbo Group S.p.A. became mayor single shareholder with which the Company didn't have any business relations in 2018.

## 5. OTHER REVENUES

		HRK
	31.12.2017	31.12.2018
Revenues from sales of material	3.734.943	1.654.592
Revenues from sales of material – subsidiary companies	16.165	52.925
Rentals	857.244	825.820
Rentals - subsidiary companies	194.388	204.798
Rentals – related parties	-	1.170
Revenues from withdrawal of long-term reserves ( <i>note 26</i> )	1.160.400	2.290.713
Insurance claim income	17.848	10.076
Income from disputed claims ( <i>note 20</i> )	-	684.277
Revenues from sales of property, plant and equipment	1.650	40.280
Income from discontinued liabilities	-	963.516
Retrospectively estimated income from past years	15.720	-
Government grants	22.200	-
Other revenues	748.425	1.471.189
Other revenues - subsidiary company	55.941	57.640
Otjer revenues - related parties	160	360
Revenue based on the use of own products, goods and services	26.685.715	17.360.129
<b>Total</b>	<b>33.510.799</b>	<b>25.617.485</b>

Revenues from withdrawal of long-term reserves in the current period involved withdrawal of reserves for unused holiday leave allowances for 2017 and litigations, as recorded on 31 December 2017. Leave allowances remained on 31 December 2017 were used have been subsequently used and therefore provisions were released.

Income from disputed claims in mayor part refer to paid claims form Uljanik Group Jsc, which have been written down in 2017.

Rental revenues refer to revenues from leasing commercial premises and production equipment to subcontractors who are involved in production activities of the Company.

Rentals revenue and other revenue – related parties refer to Uljanik Group which was, up until 30 June 2018 together with Tankerska plovdba Ltd, major owner of the Company. By acquiring large number of shares, Palumbo Group S.p.A. became mayor single shareholder with which the Company didn't have any business relations in 2018.

Revenue based on the use of own products, goods and services refer to investments that the Company undertook, consuming its own productional resources, in its own long-term tangible assets, mainly crafts, which will result in increasing of value and longevity of said assets.

## 6. MATERIAL EXPENSES AND COST OF GOODS SOLD

	HRK	
	31.12.2017	31.12.2018
<b>Raw and other material</b>		
Consumed raw and other material	60.968.693	33.062.629
Consumed raw and other material – subsidiary companies	17.456	61.751
Consumed raw and other material – related parties	12.948	684
Consumed energy	14.497.320	10.713.683
Small inventory and spare parts	696.741	522.713
<b>Total raw and other material</b>	<b>76.193.158</b>	<b>44.361.460</b>
<b>Other external expenses</b>		
Transportation, phone, post and similar services	715.800	705.985
Services used in production of outputs	153.625.827	60.422.466
Services used in production of outputs - subsidiary companies	222.574	3.526.546
Services used in production of outputs - related parties	206.316	496.598
Subsupplier services	80.833.223	42.905.997
Subsupplier services - subsidiary companies	2.371.532	2.639.761
Subsupplier services - related parties	24.420	59.339
Maintenance services	14.436.321	7.930.376
Maintenance services - subsidiary companies	40.788	402.370
Maintenance services - related parties	26.203	6.323
Rental expenses	4.834.127	1.032.824
Rental expenses - related parties	123.400	173.050
Intellectual services	1.754.698	1.472.292
Other services	1.975.366	2.239.070
<b>Total other external expenses</b>	<b>261.190.595</b>	<b>124.012.997</b>
<b>Total material expenses</b>	<b>337.383.753</b>	<b>168.374.457</b>

Services used in production of outputs involve subcontractor cost of the Company's production activity. Subsupplier services are third-party services that are normally provided outside the Company's location or are carried out by means of service providers.

Rental expenses refer to variable costs of equipment leases for production purposes, depending on specific requirements of each project and are, as a rule, one-off costs that vary on production capacity and volume.

Consumed raw and other material – related parties and other external expenses – related parties refer to Uljanik Group which was, up until 30 June 2018 together with Tankerska plovdba Ltd, major owner of the Company. By acquiring large number of shares, Palumbo Group S.p.A. became mayor single shareholder with which the Company didn't have any business relations in 2018.

In 2018, the costs of financial statement auditing were HRK 166,916 which included costs of auditing of subsidiary companies, the tax consultancy service amounted to HRK 48,000, while the cost of offshore consultancy amounted to HRK 20,000. All listed services were provided by various domestic legal entities.

Legal costs of the Company in 2018 amounted to HRK 254,516 of which HRK 242,914 refer to services provided by domestic lawyers and the remaining amount of HRK 11,602 to services provided by foreign attorneys. Since the Company does not have its own legal department, legal services are outsourced when required.

## 7. EMPLOYEE COST

		HRK
	2017	2018
Net salaries and wages	39.311.125	37.839.457
Social security contributions and taxes paid by employer	15.651.631	15.367.437
Social security contributions and taxes paid by employee	10.224.067	9.898.522
Severance pay	144.000	306.100
Compensations for travelling costs, daily allowances, annual bonuses	5.237.432	5.209.423
<b>Total</b>	<b>70.568.255</b>	<b>68.620.939</b>

## 8. DEPRECIATION

		HRK
	2017	2018
Intangible assets, property, plant and equipment	26.501.036	22.823.547
<b>Total</b>	<b>26.501.036</b>	<b>22.823.547</b>

In 2018 the depreciation rate of assets was 67% (2017: 65%).

## 9. VALUE ADJUSTMENT

In 2018, the Company recorded revaluation of assets in the amount of HRK 808,920 (2017: HRK 4,525,953) which refer to revaluated non collectible receivables for which there is an uncertainty in recovering, receivables registered in insolvency proceedings (HRK 792,826) and definitive write-down of receivables (HRK 16,094).

## 10. PROVISIONS

In 2018, the Company made costs provisions in amount of HRK 820,831 (2017: HRK 3,393,797) which refer to expenses for unused annual vacations in amount of HRK 607,481 (2017: 2,223,944) and litigation costs for seized court cases in amount of HRK 213,350 (2017: HRK 1,089,891)

Due to low occupancy rates in 2018 the provisions for unused annual vacations significantly decreased compared to 2017.

## 11. OTHER EXPENSES

		HRK
	2017	2018
Representation and gifts	2.376.406	1.111.795
Insurance premiums	4.456.730	3.552.762
Bank services	539.472	368.123
Tax and contribution not dependant on the result	2.879.679	2.289.966
Other expenses	2.725.667	1.556.038
<b>Total</b>	<b>12.977.954</b>	<b>8.878.684</b>

# 2018 NON-CONSOLIDATED FINANCIAL STATEMENTS



Other expenses refer to costs of education, personal protective equipment, other work safety related costs and compensation costs for members of Supervisory Board and Company's Committee for Audit.

In addition to above stated figures, in 2018 the Company generated other operating expenses amounting to HRK 578,913 (2017: HRK 1,679,792) largely referring to net book value of depreciated long-term assets, deficit in material and other operating expenses.

## 12. FINANCIAL EXPENSES AND REVENUES

	HRK	
	2017	2018
<b>Financial revenues</b>		
Interests	227.116	249.972
Dividend revenues	9.845	3.692
Positive exchange rate differences	-	-
<b>Total financial income</b>	<b>236.961</b>	<b>253.664</b>
<b>Financial expenses</b>		
Interests	3.300.464	2.424.592
Negative exchange rate differences	4.947.507	692.251
<b>Total financial expenses</b>	<b>8.247.971</b>	<b>3.116.843</b>
<b>Net financial (expenses)/revenues</b>	<b>(8.011.010)</b>	<b>(2.863.179)</b>

## 13. PROFIT TAX

From the difference between revenues and expenses in the period from 1 January to 31 December 2018 the Company produced a loss in the amount of HRK 21,012,598 and has no obligations for profit tax payment.

In 2018 the Company stated deferred tax assets in amount of HRK 14,459 and did not deduct deferred tax assets in produced loss.

	u kunama	
	2017	2018
<b>Accounting profit/loss before taxation</b>	<b>45.596.069</b>	<b>(21.012.598)</b>
Profit tax rate 18 %	8.207.292	-
Effect of non deductible costs	924.230	145.451
Effect of deductible costs	(562.311)	(102.274)
<b>Total</b>	<b>8.569.211</b>	<b>43.177</b>
Effect of non deductible deferred tax assets on retained produced loss	-	-
Amount of produced loss not effected by deferred tax assets	-	-
<b>Cost of profit tax</b>	<b>8.569.211</b>	<b>-</b>

## 14. EARNINGS PER SHARE

	HRK	
	31.12.2017	31.12.2018
Net profit	37.026.858	(21.012.598)
Total number of shares	16.813.247	16.813.247
Shares exclusive of own shares	15.988.060	15.988.060
<b>Basic earnings/(loss) per share</b>	<b>2,32</b>	<b>(1,31)</b>
<i>Diluted earnings/(loss) per share</i>	<i>2,20</i>	<i>(1,25)</i>

## 15. FIXED TANGIBLE AND INTANGIBLE ASSETS

Description	Land	Buildings	Plants and equipment	Tools, inventory and transportation vehicles	Investment in tangible assets in progress	Advances for tangible assets	Total tangible assets	Intangible assets	Investment in intangible assets in progress	Total
<b>ACQUISITION VALUE</b>										
Balance 31 Dec.2016	12.504.214	70.251.516	610.125.119	73.354.344	7.347.528	1.471.486	775.054.207	13.206.838	79.464	788.340.509
Transfer from investments in progress and advances	-	-	35.617.339	2.311.506	(35.588.586)	(2.340.259)	-	4.391.182	(4.391.182)	-
Acquisition during the year	-	-	-	-	35.661.409	936.699	36.598.108	-	226.665	36.824.773
Sold, written-off and discounted assets during the year	-	-	(5.477.052)	(506.475)	(2.572.769)	-	(8.556.296)	-	-	(8.556.296)
Transfers	-	-	-	-	(4.085.053)	-	(4.085.053)	-	4.085.053	-
Balance 31 Dec 2017	12.504.214	70.251.516	640.265.406	75.159.375	762.529	67.926	799.010.966	17.598.020	-	816.608.986
Transfer from investments in progress and advances	-	-	17.457.355	1.558.787	(19.170.440)	154.298	-	36.120	(36.120)	-
Acquisition during the year	-	-	-	-	21.635.219	-	21.635.219	-	36.120	21.671.339
Sold, written-off and discounted assets during the year	-	-	(202.290)	(717.728)	-	-	(920.018)	-	-	(920.018)
Transfers	-	-	-	-	(115.250)	-	(115.250)	115.250	-	-
Surplus, Deficit, Adjustment	-	-	-	-	-	-	-	-	-	-
Balance 31 Dec 2018	12.504.214	70.251.516	657.520.471	76.000.434	3.112.058	222.224	819.610.917	17.749.390	-	837.360.307
<b>VALUE ADJUSTMENT</b>										
Balance 31 Dec 2016	6.958.527	65.495.710	366.037.481	67.284.845	-	-	505.776.563	5.866.193	-	511.642.756
Depreciation during the year	-	257.224	21.099.800	1.991.915	-	-	23.348.939	3.152.097	-	26.501.036
Sold and written-off assets during the year	-	-	(5.174.477)	(459.855)	-	-	(5.634.332)	-	-	(5.634.332)
Surplus, Deficit, Adjustment	-	-	-	(2.338)	-	-	(2.338)	-	-	(2.338)
Balance 31 Dec 2017	6.958.527	65.752.934	381.962.804	68.814.567	-	-	523.488.832	9.018.290	-	532.507.122
Depreciation during the year	-	179.841	17.695.443	1.814.681	-	-	19.689.965	3.133.582	-	22.823.547
Sold and written-off assets during the year	-	-	(159.302)	(710.170)	-	-	(869.472)	-	-	(869.472)
Surplus, Deficit, Adjustment	-	-	-	-	-	-	-	-	-	-
Balance 31 Dec 2018	6.958.527	65.932.775	399.498.945	69.919.078	-	-	542.309.325	12.151.872	-	554.461.197
Book value 31 Dec 2017	5.545.687	4.498.582	258.302.602	6.344.808	762.529	67.926	275.522.134	8.579.730	-	284.101.864
Book value 31 Dec 2018	5.545.687	4.318.741	258.021.526	6.081.356	3.112.058	222.224	277.301.592	5.597.518	-	282.899.110

During 2018, investment in long-term assets involved purchase of new equipment for horizontal transport vehicles, measurement devices and control apparatus, welding equipment and other production equipment. The investment also included steel renewal of Dock 5 and Dock 11 to extend their useful life.

The Company on 31 December 2018 states assets of net value in amount of HRK 9.997.281 that is financed by long term lease.



A portion of tangible assets of Company is held as long-term credit insurance (Note 32) and the net book value of these assets on 31 December 2018 amounts to HRK 233,880,574.

In 2018 the depreciation rate of assets was 67% (2017: 65%).

## 16. INVESTMENT IN ASSOCIATES

Net book value of investment in associates as of 31 Dec 2018 related a limited liability company Viktor Servisi in which the Company holds a 100% equity interest that amounts to HRK 763,259 and the liability company VL Steel in which the Company holds a 75% equity interest that amounts to HRK 15,000.

## 17. SECURITIES INVESTMENTS

The Company owns 5,000 shares of Uljanik Jsc recorded at nominal value in the amount of HRK 450,000. On 31 December 2018, the Company performed revaluation of these shares in accordance with the notification of Central Depository & Clearing Company Inc. Zagreb, so that the reported amount of these shares equals HRK 54,000.

The Company owns 6,153 shares of Tankerska next generation Jsc recorded at nominal value in the amount of HRK 399,945. On 31 December 2018, the Company performed revaluation of these shares in accordance with the notification of Central Depository & Clearing Company Inc. Zagreb, so that the reported amount of these shares equals HRK 238,736.

## 18. FINANCIAL ASSETS

Long-term financial assets in the amount of HRK 8,381,042 referred to a cash deposit for long-term loan for development financing in amount of HRK 8,159,333 and bank guarantee in the amount of HRK 221,709.

Short-term financial assets in the amount of HRK 130,211 refer to granted loans.

## 19. INVENTORIES

	HRK	
	31.12.2017	31.12.2018
Raw and other material	15.971.326	14.907.385
Raw and other material under delivery	486	2.946
Fabrication of flanges	-	110.424
Production in progress	3.050.164	2.939.618
Small inventory	8.435.144	8.654.941
Small inventory value adjustment	(8.435.144)	(8.654.941)
<b>Total</b>	<b>19.021.976</b>	<b>17.960.373</b>

The production in progress involved 4 unfinished shiprepair projects at the end of the year. Termination and delivery of shiprepair projects which are included in "production in progress", is expected until the end of April 2019.

# 2018 NON-CONSOLIDATED FINANCIAL STATEMENTS



The Company initiated the process of fabrication of flanges which, when finished, will become part of Raw and other material.

## 20. TRADE AND OTHER RECEIVABLES

	HRK	
	31.12.2017	31.12.2018
<i>Receivables from customers - gross</i>	79.865.064	58.147.022
<i>Receivables from customers – value adjustment</i>	32.412.246	39.606.938
Receivables from customers – net	47.226.289	18.472.949
Receivables from customers - subsidiary company	61.329	67.135
Receivables from customers - related parties	165.200	-
Receivables from employees	3.068	197.073
Receivables from state	6.523.071	4.359.099
Prepaid expenses and accrued income	2.944.253	14.182.434
Advances	396.607	1.169.488
Advances – subsidiary company	4.775	60.307
Other receivables	1.869	-
<b>Total</b>	<b>57.326.461</b>	<b>38.508.485</b>

### *Movement of value adjustments of trade receivables*

	HRK
	2018
<b>Status 31 December 2017</b>	32.412.246
Effect of implementation of IFRS 9 on 01 January 2018	1.036.424
Depreciation of value in current year	7.444.824
Recovery of previously write-downs	(684.277)
Definitive write-down of previously revaluated receivables	(63.492)
Adjustment of expected kredit loss - IFRS 9 (Note 4)	(538.787)
<b>Status 31 December 2018</b>	<b>39.606.938</b>

In 2018 the Company produced a loss in the amount of HRK 21,551,385 and has no obligations for profit tax payment. Profit tax annuities paid in 2018 are considered as receivables from state for prepaid taxes. According to Tax office, the Company is entitled to profit tax refund in amount of HRK 1,143,576.

Prepaid expenses and accrued income, mainly in the amount of HRK 13,523,270, refer to accrued income from overhaul project of USNS Yuma which started in December of 2018 and was terminated in February of 2019.

According to requirements of IFRS 9, the Company revaluated receivables from customers for 2018.

Age structure of matured receivables from customers:

	HRK	
	31.12.2017	31.12.2018
1-90 days	46.743.411	10.750.144
91-180 days	194.999	861.408
181-365 days	477.810	5.961.536
Over 365 days	36.598	1.464.633
Receivables value adjustment	-	(497.637)
<b>Total</b>	<b>47.452.818</b>	<b>18.540.084</b>

Age structure of value adjusted receivables from customers:

		HRK
	31.12.2017	31.12.2018
1-90 days	346.230	2.673.835
91-180 days	-	2.062.335
181-365 days	767.074	2.708.654
Over 365 days	31.298.942	31.664.477
Receivables value adjustment	-	497.637
<b>Total</b>	<b>32.412.246</b>	<b>39.606.938</b>

Structure of trade receivables by currency:

		HRK
	31.12.2017	31.12.2018
HRK	5.780.255	10.810.868
EUR	17.344.170	5.643.827
USD	24.328.393	2.583.026
Receivables value adjustment	-	(497.637)
<b>Total</b>	<b>47.452.818</b>	<b>18.540.084</b>

## 21. CASH AND CASH EQUIVALENTS

		HRK
	31.12.2017	31.12.2018
Money in bank	14.352.956	10.365.409
Cash in register	18.893	6.162
Time deposits	17.502.343	-
<b>Total</b>	<b>31.874.192</b>	<b>10.371.571</b>

## 22. EQUITY AND RESERVES

- (i) On 31 December 2018, the issued share capital of the Company, fully paid, amounted to HRK 168,132,470 and was divided in 16.813.247 ordinary shares each having a nominal value of HRK 10.

Owners of ordinary shares are entitled to dividends and one vote per share. In 2018 the Company did not pay out dividends on the account of profit generated in 2017, instead the profit was relocated in general reserves fund in accordance with the Company's General Assembly's decision. In 2017 the Company paid out the amount of 0.09 HRK per share (0.75 HRK per share in 2015). During the years before 2015, no dividend to shareholders was paid out.

- (ii) On the day of 31 December 2018, the Company owned 825.187 own shares (31 December 2017: 825.187), making 4.91% of the share capital.
- (iii) On the day of 31 December 2017, the statutory reserves within the frame of the statutory and other reserves, amounted to HRK 8,406,624 (2017: HRK 8,406,624). The statutory reserves were formed in

# 2018 NON-CONSOLIDATED FINANCIAL STATEMENTS



accordance with the Croatian law stipulating that 5% of the profit for the year is transferred to the statutory reserves until it grows to 5% of the issued share capital.

In accordance with the Company's General Assembly's decision, the profit generated in 2017 in the amount of HRK 37,026,858 was allocated to the general reserve fund.

The statutory reserves, which amount to 5% of equity and reserves for own shares in the amount of HRK 20,946,624 (2016: HRK 20,946,624) cannot be allocated between shareholders.

- (iv) According to requirements of IFRS 9, the Company revaluated receivables from customers in amount of HRK 1,036,424 which debited other reserves.

## 23. DEBENTURES WITH INTEREST CHARGE

Below is the overview of debentures on which interest is paid according to the repayment dynamics as at 31 December 2018:

	HRK				
31 Dec 2018	Total	1 year or less	2-5 years	More than 5 years	Total long-term
Financial lease	8.055.836	2.702.136	5.353.700	-	5.353.700
Long-term loan for financing development	41.526.411	8.742.402	32.784.009	-	32.784.009
Short-term loan for working capital	7.118.365	7.118.365	-	-	-
<b>Total</b>	<b>56.700.612</b>	<b>18.562.903</b>	<b>38.137.709</b>	<b>-</b>	<b>38.137.709</b>

Financial lease is related to purchase of production equipment and passenger cars. Short-term loan for working capital in the amount of HRK 7,118,365 refers to bank account overdraft (HRK 5,781,953) and short-term loan (HRK 1,336,412).

## 24. TRADE AND OTHER LIABILITIES

	HRK	
	31.12.2017	31.12.2018
Trade payables	49.643.486	35.450.017
Trade payables – subsidiary interest	1.420.285	1.832.444
Trade payables – related parties	55.890	-
Employee payables	3.977.472	3.957.905
Tax and contribution	3.361.081	3.127.951
Received advances	1.029.860	13.352.330
Other liabilities	3.487.424	3.348.499
Accrued expenses and deferred income	3.599.622	3.065.660
<b>Total</b>	<b>66.575.120</b>	<b>64.134.806</b>

In 2018 the Company produced a loss in the amount of HRK 21,551,385 and has no obligations for profit tax payment. Profit tax annuities paid in 2018 are considered as receivables from state for prepaid taxes. According to Tax office, the Company is entitled to profit tax refund in amount of HRK 1,143,576.

Other liabilities include current liabilities towards HEP ESCO Ltd. for a commercial credit granted to the Company for the energy-efficiency project in the amount of HRK 2,562,281.

# 2018 NON-CONSOLIDATED FINANCIAL STATEMENTS



Accrued expenses amount to HRK 820,482. These expenses include insurance premiums and agency fees and other costs which were negotiated but not have been charged in 2018.

Accrued revenues amounted to HRK 2,245,177 refer to overhaul of ship Korčula, project that on 31 December 2018 was in the phase of unfinished production and hadn't met the requirements for revenue recognition.

Structure of trade payables by currency:

	31.12.2017	31.12.2018
HRK	45.787.151	33.585.841
EUR	2.166.934	2.638.965
USD	2.836.662	825.952
GBP	328.914	231.703
<b>Total</b>	<b>51.119.661</b>	<b>37.282.461</b>

## 25. RELATIONS WITH RELATED PARTIES

Transactions between related enterprises are carried out under normal market conditions.

Related enterprises and related parties	2017	2018
<b>Sale to related parties</b>		
<b>Sale to subsidiary companies</b>	<b>364.261</b>	<b>455.874</b>
Viktor Servisi Ltd	359.786	366.874
VL Steel Ltd	4.475	89.000
<b>Sale to related parties</b>	<b>1.256.119</b>	<b>620.184</b>
Tankerska plovdba Jsc	321.438	-
Uljanik Grupa Jsc	934.681	620.184
<b>Purchase from related parties</b>		
<b>Purchase from subsidiary companies</b>	<b>2.652.350</b>	<b>6.630.427</b>
Viktor Servisi Ltd	2.577.650	3.220.163
VL Steel Ltd	74.700	3.410.265
<b>Purchase from related parties</b>	<b>393.287</b>	<b>735.993</b>
Tankerska plovdba Jsc	-	-
Uljanik Grupa Jsc	393.287	735.993
<b>Receivables from related parties</b>		
<b>Receivables from subsidiary companies</b>	<b>61.329</b>	<b>127.442</b>
Viktor Servisi Ltd	55.735	67.135
VL Steel Ltd	5.594	60.307
<b>Receivables from related parties</b>	<b>165.200</b>	<b>-</b>
Tankerska plovdba Jsc	-	-
Uljanik Grupa Jsc	165.200	-
<b>Liabilities to related parties</b>		
<b>Liabilities to subsidiary companies</b>	<b>1.420.285</b>	<b>1.832.444</b>
Viktor Servisi Ltd	1.420.285	1.832.444
VL Steel Ltd	-	-
<b>Liabilities to related parties</b>	<b>55.890</b>	<b>-</b>
Tankerska plovdba Jsc	-	-
Uljanik Grupa Jsc	55.890	-

Relations with related parties refer to Uljanik Group which was, up until 30 June 2018 together with Tankerska plovdba Ltd, major owner of the Company. By acquiring large number of shares, Palumbo Group S.p.A. became mayor single shareholder with which the Company didn't have any business relations in 2018.

## Key management

The Management Board of the Company on 31 December 2017 is composed of the President of the Board and one Member of the Board. During 2018, Mr. Aljoša Pavelin held the position of President of the Board whereas position of Member of the Board was held by Mrs. Sandra Uzelac.

On 25 March 2019 Supervisory board of Viktor Lenac Shipyard Ltd, Rijeka has accepted the proposal of Mr. Aljoša Pavelin, resigning from his function of the President of the Board and termination of his employment contract which became effective 25 March 2019.

Until assignment of the new President of the Board, all representing functions of the Company are appointed to Mrs. Sandra Uzelac, member of the Management board.

The total gross compensation for the members of the Board for 2018 and efficiency bonifications for 2017 paid in 2018, amounted to HRK 2,946,802. Members of the Supervisory Board and Committee for Audit in 2018 received total gross compensation in amount of HRK 486,071. The Company has not granted any loans to the members of the Supervisory Board or Company's Board.

## 26. PROVISIONS

Long-term provisions in the amount of HRK 1,518,529 refer to provisions for seised court cases. Short-term provisions in the amount of HRK 687,443 involve warranty repairs and provisions for unused vacation leave in 2018.

	Court cases	Annual leave	Other	Total
<b>Status 1 January 2018</b>	1.533.909	2.223.944	146.732	3.904.585
Reversed provisions	-	(2.223.944)	(66.769)	(2.290.713)
Actualised	(229.000)	-	-	(229.000)
New provisions	213.350	607.480	-	-
<b>Status 31 December 2018</b>	<b>1.518.259</b>	<b>607.480</b>	<b>79.963</b>	<b>2.205.702</b>

## 27. OTHER LONG-TERM LIABILITIES

Other liabilities as at 31 December 2018 in the amount of HRK 14,598,588 involve obligations to HEP ESCO Ltd. for the energy-efficiency project in the amount of HRK 10,424,808 and contingent liabilities for disputed claims of creditors and related litigation costs in the amount of HRK 4,173,780 where litigation proceeding is not yet finalized.

## 28. FINANCIAL INSTRUMENTS

### Equity management

The main goal of equity management is to ensure support to business operations and maximize shareholder value. The Company adjusts its equity policy in accordance with economic changes. With purpose to maintain or adjust its equity structure, the Company may re-adjust dividends pay-outs or return on capital or place a new emission of shares. There were no changes in the goals, policies or processes during t 2018 and 2017.

### Risk management

Operations of the Company bear various financial risks involving market risk and price risk, currency risk and interest rate risk. The Company does not use derivative financial instruments as an active security from exposure to financial risks.

### Currency risk

Most of the Company's revenues from sale is generated on the international market, mainly in EUR and depending on circumstances and various projects, in USD. Therefore, alterations in exchange rate movements can affect ultimate operating results. However, because of a relatively rapid turnover of receivables and foreign currency, currency risk is not significant, and the Company does not use active hedging techniques in foreign currency transactions. Depending on estimate of the future USD/EUR trend, the Company will, if necessary, use hedging instruments. On the other hand, the Company's obligations have not been exposed to significant currency risk, since most of these obligations are denominated in domestic currency (HRK).

Structures of trade payables and receivables by currency, assets and liabilities which are under mild currency risks, are presented in tables in Notes 20 and 24.

In regards to stated amounts on the date of reporting, eventual changes of domestic currency rate exchange in relations to Euro in rate of 1%, with premise that all other indicator retain unchanged, will not have significant impact on Company's assets and ebit for reporting period, according to the Board's estimation of positive/negative exchange rate differences ratio in respect to collectables, payables, loans and credits. In such case the negative impact on net profit would amount cca HRK 600 thousand.

### Interest rate risk

Apart long term deposit, the Company has not any significant interest generating assets which would be under influence of interest rate changes. As for the liabilities, long term investment loan interest rate is determined by Bank and is not prone to changes due to the methodology for setting the interest rates. The major part of other loans is negotiated by fixed interest rates, resulting in insignificant impact on financial statements, in case of rate changes. Short term loans received from commercial banks have a high turnover and are negotiated depending on production purposes and consequently do not bear significant interest rate risks.

## Default risk

Default risk implies non-fulfilment of contractual obligations of other counterparties that could produce a monetary loss, primarily referring to trade receivables. The Company uses different payment terms depending on client's financial capability assessment. The objective is to do business with steady customers, whose credibility can be assessed more safely having in mind long-term cooperation. In case there is a higher payment risk, the objective is to agree payment in full before redelivery. Guarantees and commitments are not a custom in overhaul and repair business activities, but Viktor Lenac exercises the right to arrest a ship, in accordance to maritime law, as a mean of recovery. Trade receivables involve many customers, so the payment risk is dispersed. Trade receivables are discounted for doubtful receivables that generally make less than 1% of total turnover, which makes default risk low. There is no other significant default risk focus.

## Liquidity risk

Liquidity risk aka cash flow risk is related to market risk which involves oscillations in the capacity utilisation rate. The Company manages the liquidity risk through continuous monitoring of the projected and actual cash flows. For larger projects involving the Company that can significantly affect outflows, especially in the preparatory phase of project when there are no inflows, the Company uses short-term loans for project financing.

Following, is analysis of remaining period until expected maturity date of non-realizable financial assets and receivables and negotiated maturity dates of financial liabilities of the Company. This analysis provides a better comprehension of modalities the Company uses to manage liquidity risk, based on net amounts of assets and liabilities.

In 000 HRK						
	Structure of maturity buckets					Total
	up to 1 m	1 – 3 m	3 m - 1 y	1 – 5 y	over 5 y	
<b>Assets, status</b>						
<b>31 December 2018</b>						
With interests	186	-	130	8.159	-	8.476
Interests free	21.487	8.832	576	45	146	31.087
<b>Total</b>	<b>21.673</b>	<b>8.832</b>	<b>706</b>	<b>8.205</b>	<b>146</b>	<b>39.562</b>
<b>Liabilities, status</b>						
<b>31 December 2018</b>						
With interests	2.708	1.046	14.426	38.202	318	56.701
Interests free	33.468	20.670	2.820	9.518	1.104	67.580
<b>Total</b>	<b>36.176</b>	<b>21.717</b>	<b>17.246</b>	<b>47.720</b>	<b>1.422</b>	<b>124.280</b>
<b>Liabilities net</b>	<b>(14.503)</b>	<b>(12.885)</b>	<b>(16.540)</b>	<b>(39.515)</b>	<b>(1.276)</b>	<b>(84.718)</b>

## Fair value

The Company makes estimates of the fair value of financial assets and liabilities, following which, if necessary, valuation adjustments are made. It has been established that the fair value does not differ from the book value. The fair value of the financial assets and liabilities is based on the quoted market price as at the balance sheet date, if available. Where the market price is not available, the Company makes an estimate of the fair



value based on the publicly disclosed information from external sources or based on the discounted cash flow method if applicable.

It is considered that the value of the receivables/liabilities with less than one year to maturity corresponds to the fair value.

## 29. POTENTIAL LIABILITIES

As of 31 December 2018, the Company was involved in several disputes which have arisen from its business operations and a few disputes over indemnity obligations deriving from employment relationships. The Company has already made provisions in its books for such claims in case of unfavourable outcomes (notes 10 and 26).

On 31 December 2017, the Company litigated in 26 proceedings worth about cca HRK 1,8 million as the defendant, and 5 proceedings having a capital value of approximately HRK 11,71 million as the plaintiff, all in Republic of Croatia.

In 2018 the Company completed a dispute that was held in Republic of Panama. The conclusion did not have any consequences on the financial position of the Company

## 30. IMPORTANT ACCOUNTING ESTIMATES AND JUDGEMENTS

In application of accounting policies, the Company's Management Board made following judgements, independently of those which include estimates, and which have the most important influence on the amounts shown in the financial statements.

### Revenue recognition principle

Revenue is recognized when the goods have been delivered or services have been rendered, or when the risks and rewards of ownership of goods have been substantively transferred to the customer. In case of partial execution of commercial contract or rendered services, revenues are recognized in accordance with extent of fulfilled stadium which can be undoubtedly charged and eventually collected. Estimation of claims to services carried out is deducted from sales revenue and accounted under liabilities or provisions. Estimation of discounts represent a decrease in sales revenue. Estimation is made based on contractual obligations, historical trends and experience.

### Profit tax

Since in 2018 the Company produced a loss, it has no obligations for profit tax payment.

### Decrease in value of receivables

Estimation of irretrievable value of sales of goods and services is made on the balance sheet date (plus monthly) based on the estimated probability of collection of doubtful receivables. Each client is evaluated separately concerning its status (a client having its account blocked, or legal action has been started; competitive position), matured receivables, legal proceedings status or payment security instruments such as promissory note.



## Provisions for potential liabilities

The Company recognizes provisions which result from court disputes in which the Company is defendant most likely to have unfavourable outcomes and where the outflows may be reliably estimated. In estimating such provisions, the Company regularly consults with legal professionals.

## 31. EVENTS AFTER BALANCE SHEET DATE

On 25 March 2019 Supervisory board of Viktor Lenac Shipyard Ltd, Rijeka has accepted the proposal of Mr. Aljoša Pavelin, resigning from his function of President of the Board and termination of his employment contract which became effective 25 march 2019.

Until assignment of the new President of the Board, all representing functions of the Company are appointed to Mrs. Sandra Uzelac, member of the Management board.

All major events are regularly disclosed to public via the Zagreb Stock Exchange website.


## 32. MORTGAGES

The Company has signed the pledge over its fixed assets in favour of the Raiffeisenbank Austria bank Zagreb for repayment of a loan for financing of development investment program and a debt arising from two credits for short-term financing of operations and issuance of performance guarantees. The pledge right has been registered over the floating docks: Dock 5, Dock 11 and Dock RI38, motor vessels Kostrena and Pećine, a real-estate in Rijeka, land that in nature makes parking and forest in the cadastral municipality of Kostrena Lucija, including some movable property. The obligations under the loans secured as specified as at 31 December 2018 amounted to HRK 47,308,364, of which HRK 41,526,411 involves the investment loan, and the remaining amount is cost overrun.

## 33. PREPARATION AND APPROVAL OF FINANCIAL STATEMENTS

Financial statements have been prepared and approved by the Management Board of the Company on 19 April 2018.



  
Sandra Uzelac, Member of the Board



# ANNUAL REPORT 2018



**SHIPYARD**

1896

**VIKTOR LENAC**

*Member of Palumbo Group*

---

April 2019

## CONTENTS

FOREWORD.....	3
AN ADDRESS TO SHAREHOLDERS .....	4
BUSINESS ENVIRONMENT .....	7
BUSINESS ACTIVITIES .....	9
SALES.....	9
PRODUCTION .....	11
TECHNOLOGICAL DEVELOPMENT AND INVESTMENT .....	17
ORGANISATION, QUALITY MANAGEMENT SYSTEM, INFORMATION AND COMMUNICATION .....	18
SAFE WORK, HEALTH AND SAFETY AT WORK, FIRE PROTECTION .....	21
ENVIRONMENTAL PROTECTION.....	23
HUMAN RESOURCES .....	24
FINANCIAL RESULT .....	28
MAIN RISKS AND EXPOSURES .....	32
OWNERSHIP STRUCTURE .....	35
CORPORATE GOVERNANCE.....	36
SUPERVISORY BOARD AND MANAGEMENT BOARD.....	37
SUPERVISORY BOARD .....	37
MANAGEMENT BOARD .....	37
FOR INFORMATION.....	39

### ENCLOSURES

Non-Financial Reporting – Sustainability Report

Statement on Implementation of the Corporate Governance Code

Consolidated Annual Financial Statements

Non-Consolidated Annual Financial Statements

## FOREWORD

The Management Board of the joint stock company Viktor Lenac Shipyard presents its Annual Report for 2018 to all its shareholders, clients, employees, business partners and the entire public. Annual Report 2018 is the review of the Company's business and financial performance for the year. It includes Consolidated and Non-Consolidated Annual Financial Statements, Auditor's Report and Non-Financial Report. In a separate enclosure to the Report, the Corporate Governance rules applied by the Company are described.

### Annual Report in Croatian and English

Viktor Lenac Shipyard's Annual Report 2018 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 2018 shall be submitted to the General Assembly as an integral part of Annual Report 2018, whereas the Supervisory Board's Report shall be submitted to the General Assembly as a separate document.

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.

Annual Report 2018 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.

Annual Report 2018 includes Non-Financial Reporting – Sustainability Report, made in accordance with the new GRI Standards and provisions of Article 21a of the Law on Accounting.

### Subsidiary Company, Consolidated Financial Statements

Viktor Lenac Shipyard is a joint stock company with two subsidiary companies: a limited liability company *Viktor Servisi, Rijeka* that is a wholly owned subsidiary of the Viktor Lenac Shipyard, and a limited liability company *VL Steel, Rijeka*, a 75% subsidiary of the Company.

Consolidated and Non-Consolidated Financial Statements form an integral part of the Annual Report. The difference between the consolidated and non-consolidated financial statements is not significant in material terms, as the revenues and assets of both subsidiaries participate with less than 1% in the Group's revenues respectively assets. The annual report focuses on business result of the parent company - Viktor Lenac Shipyard.

### Abbreviations

In the Annual Report, *Brodogradilište Viktor Lenac d.d.* is referred to as the "Shipyard" or "Viktor Lenac" or "Company"; the Company together with its subsidiary companies 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
2018	7,4176	7,4139
2017	7,5136	7,4605
2016	7,5578	7,5271
2015	7,6350	7,6173

## AN ADDRESS TO SHAREHOLDERS



Dear Shareholders, Clients, Business Partners, Employees and everyone reading this report,

After a very good 2017 in which we achieved a historical result in terms of net profit, 2018 showed all the unpredictability of the shiprepair market.

Despite an effective cost management and an above average number of shiprepair contracts, the Company recorded a 20% shortfall in revenues against the target, which resulted in a net loss of HRK 21 million. Such a shortfall in revenues was a result of an unexpected drop in average project value by as much as 27% compared to 2017, not counting projects with the US Navy. There are two fundamental causes of the drop in average project value:

- 1) Reduction in sales prices due to an increasing competition in the shiprepair market particularly with respect to Turkish competitors;
- 2) Significantly reduced scope of work in shiprepair as shipping companies continue to cut down on fleet costs and only take the necessary repair and maintenance works.

With the Turkish shipbuilding capacity that continues to increase and their low cost strategies, a dramatic fall of Turkish lira against European and US currency has enabled Turkish shipyards to further lower their prices. The Turkish currency weakened throughout the year and in September 2018 it lost 40% of its value against

the euro. In order to maintain competitiveness, Viktor Lenac had to lower prices, but even at low prices, almost 60% of the contracts were lost for Turkish competitors. This was especially evident in the last quarter both in terms of lower prices and lower occupancy rates, resulting in a significant increase in loss compared to the previous quarter. If we were able to charge 10% more for the same number of projects carried out, we would end up with a positive net result. There is no question that the shiprepair price decline was a significant contributor to the financial result 2018.

At the expense side, we managed to keep our direct and indirect costs below the target, despite the fact that we carried out a total of 84 projects at significantly increased subcontractor costs with respect to the two previous years. This means that we have continued to improve production process management and that the operational efficiency has been raised to a higher level. Unfortunately, despite the changes that have been made, it is obvious that the dynamics of change was not fast enough, and we were not able to achieve sufficient cost reductions to offset the decline in revenue. The market has changed faster than us.

It is quite certain that such market trends will continue, and we do not consider it a crisis, but a new standard, which is why we must bring the costs to a level that will restore our competitiveness. Given that in our cost structure, the cost of labour (own employees and subcontractors) is the most significant, it is clear that only by reducing labour costs we can make a true savings. We intend to achieve such savings by improving labour productivity and workforce optimization in accordance with our needs. According to the standards of the world's leading shipyards, we should carry out at least 30% more average shiprepair projects annually with the existing labour capacity, with respect to the results we achieve today. Unfortunately, such a growth is unrealistically achievable in the context of the existing employee structure and their productivity and the structure of employees has to change. As part of the process, the number of employees at the beginning of 2019 was reduced by 10%, of which some workers have retired and some employment contracts terminated due to necessities of the business, work or the workplace.

Further dynamics of the optimization of business processes and workforce will depend on the market development. It should be emphasized that optimization does not only mean reducing the number of employees but also increasing productivity through better planning and organization of work and multi-skill mode of operation. After another reorganization of the Technical and Production Division made in the third quarter, we simplified the process of management and achieved a flatter organizational structure. In this respect, we expect further progress in the planning and organization segments of production activities, production process efficiency and work discipline. A change in thinking about efficiency and focus on efficiency improvement for all employees remains our key challenge.

The negative impacts of events in the Uljanik Group have affected the domestic labour market, resulting in an

additional decline in quality and productivity of subcontractors' workforce and increase in subcontractor costs. In this context, the establishment of our own company, VL Steel d.o.o., proved to be a good move by which we managed to absorb the impact at least in one production segment. Our intent in this regard remains the gradual return of quality young workers from abroad.

The ultimate goal is to transform Viktor Lenac into a modern, dynamic shipyard that will offer clients shorter deadlines and new services, with the already known quality of workmanship and reliability.

The key elements on which we base our plan are the knowledge and expertise of our people, high work discipline, efficient processes and new technology.

Employee training and education has been intensified at all levels. In addition to professional education, emphasis is put on managerial skills, cost management and interpersonal relationships. Number and age structure of employees requires us to make certain adjustments throughout the following year to remain competitive, in line with the dynamics of market development. By reducing our fixed cost and increasing productivity we will be able to shorten project redelivery times, thus creating space to increase our overall production capacity.

Despite an extremely challenging year, all workers' material rights as stipulated in the Collective Agreement were fully exercised, with additional benefits beyond the Collective Agreement. Transparent determination of the variable component of the salary and introducing performance and result-based reward systems, as defined in the new Collective Agreement signed in 2017, proved to be a positive and stimulating change.

Employer's interest is the same as the worker's interest - a motivated and productive worker. There is less disagreement in understanding the true proportions of motivation and productivity. I believe that we have achieved a high level of mutual understanding and I am convinced that the changes that we will make in the foreseeable future will enable further increase of the material rights and benefits of employees.

An effective business management system requires a systematic and structured approach to business. In that sense, the Shipyard has been recertified according to ISO 9001:2015 and we acquired ISO 50001 certification for the first time. Certification processes for ISO 14001 and ISO 27001 continue.

The results achieved in 2018 caused a decrease in cash flow from operating activities, but the Board, predicting a challenging year, proposed allocating the 2017 profit to retained earnings, thus securing a reserve of financial resources that enabled the Company to settle all its liabilities in an orderly manner, including long-term and short-term loans, as well as financing of long-term investments. We have also continued with reconstruction of our floating docks and machinery.

The turnover process was completed in the last quarter and Italy's Palumbo Group became majority shareholder. A process of creating synergy and alignment of production and sales activities at the group level began with the aim of achieving additional savings in operations and better market entry.

2019 will be another challenging one for shipyard industry in terms of fierce competition and cost reduction efforts, while seeking to maintain operational capabilities and quality. There are always opportunities in the market, and we expect, together with our new owners, to make the most of it. Cooperation with the US Navy is developing in a positive direction and is noticeably growing in terms of value and scope of work, which gives us a certain level of security and stability. By continuing to improve productivity, we will also shorten project deadlines and thus create space for increasing existing production capacity, with the aim of being able to offset a decrease in average project value with a larger number of contracts. At the same time, measures undertaken to reduce fixed costs, primarily labour cost, and increase efficiency in all business processes, will also help to achieve significantly better results compared to the previous year even with lower occupancy rates with the aim to finish 2019 with good results. The result achieved in the first quarter of 2019 is the reason for such optimism.

Sandra Uzelac  
Member of the Management Board



## KEY FINANCIAL FIGURES

### Consolidated Financial Figures

	000 HRK			000 EUR *		
	2018	2017	Index	2018	2017	Index
Total Revenues	<b>254.246</b>	514.803	0,49	<b>34.079</b>	69.004	0,49
Total Expenses	<b>275.285</b>	469.505	0,59	<b>36.899</b>	62.932	0,59
Operating Revenues	<b>253.986</b>	514.560	0,49	<b>34.044</b>	68.972	0,49
Operating Expenses	<b>272.152</b>	461.249	0,59	<b>36.479</b>	61.826	0,59
Operating Profit (or Loss)	<b>-18.167</b>	53.311	-0,34	<b>-2.435</b>	7.146	-0,34
Profit and Loss before Tax	<b>-21.039</b>	45.298	-0,48	<b>-2.820</b>	6.072	-0,46
Net Profit and Loss	<b>-21.068</b>	36.766	-0,57	<b>-2.824</b>	4.928	-0,57
Total Assets	<b>362.015</b>	404.550	0,89	<b>48.805</b>	53.842	0,91
Equity	<b>224.973</b>	247.165	0,91	<b>30.330</b>	32.895	0,92

### Non-Consolidated Financial Figures

	000 HRK			000 EUR *		
	2018	2017	Index	2018	2017	Index
Total Revenues	<b>253.121</b>	514.243	0,49	<b>33.928</b>	68.929	0,49
Total Expenses	<b>274.134</b>	468.646	0,58	<b>36.745</b>	62.817	0,58
Operating Revenues	<b>252.867</b>	514.006	0,49	<b>33.894</b>	68.897	0,49
Operating Expenses	<b>271.017</b>	460.399	0,59	<b>36.327</b>	61.712	0,59
Operating Profit (or Loss)	<b>-18.149</b>	53.607	-0,34	<b>-2.433</b>	7.186	-0,34
Profit and Loss before Tax	<b>-21.013</b>	45.596	-0,46	<b>-2.817</b>	6.112	-0,46
Net Profit and Loss	<b>-21.013</b>	37.027	-0,57	<b>-2.817</b>	4.963	-0,57
Total Assets	<b>359.787</b>	402.495	0,89	<b>45.505</b>	53.569	0,91
Equity	<b>222.147</b>	244.262	0,91	<b>29.949</b>	32.509	0,92

\* 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 2018 respectively 2017. Assets, share capital and reserves have been converted into euros according to the midpoint exchange rate by the Croatian National Bank on 31 December 2018 respectively 31 December 2017 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 2018, generated revenues from its normal business activity consisting in providing specialized and licensed services in shipbuilding, and VL Steel Ltd., a 75% subsidiary of the Company, founded in October 2017 for providing services in shipbuilding and related metallurgical branches.

In 2018, the Group generated total revenues in the amount of 253.7 million Croatian Kuna and total expenses in the amount of 275.3 million Croatian Kuna, after annulment of their reciprocal transactions and after balancing positive and negative exchange rate differences.

Comparing consolidated financial statements with non-consolidated ones, it can be concluded that the influence of subsidiaries is irrelevant. Viktor Servisi Ltd. generated a net profit in the amount of 192,000 Croatian Kuna, whereas VL Steel Ltd. generated a net loss in the amount of 260,000 Croatian Kuna, of which 75% is associated to the Group, while 25% refers to minority interest of a third party), with the Group's loss being only 0.02% higher than the loss realized by the Parent Company. Revenues and expenses of the Parent Company make more than 99% of revenues respectively expenses of the Group. Likewise, the assets of the Parent Company make 99% of the Group's assets.

Annual Report 2018, therefore, reports on the financial result and balance sheet of the Parent Company.

## BUSINESS ENVIRONMENT

It is very likely that what has been described as recession in activity across the shipping market is a new normality. 2018 continued rolling in the same direction, though it showed mild changes within some shipping segments. The market continues to offer a greater supply than the demand for ship space, along with an additional increase in the global fleet. 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. Shipping companies will continue to cut down on fleet costs and only take the necessary repair and maintenance works to meet requirements of the classification societies. Global trends in the shipping market, therefore, are not likely to change significantly in 2019.

Reducing operating costs and fleet maintenance costs will still be of critical importance for shipping companies, which means the pressure continues to be exerted on the shiprepair market. Competition between shipyards in the Mediterranean and Black Sea area tends to increase in intensity and put pressure on prices. Shipyards must continually seek new ways of achieving operational excellence, by increasing productivity and efficiency to be able, through innovation, to maintain their competitiveness.

A challenge of shortage of qualified workers in shipbuilding jobs has intensified due to recent events related to the Uljanik Group. The negative trend continues, and the shortage of quality and productive workers can only be overcome through structural reforms in terms of stronger incentives for the manufacturing industry. Viktor Lenac continues to overcome this disadvantage by periodically targeted engagement of foreign labor force, taking full account of cost-effective management. It remains to be noted that the problem is not in the number of workers, but in their quality or productivity. This is also a key area for increasing overall production capacity because, due to the drop in the average value of project, it is necessary to shorten deadlines and carry out a larger number of projects per year.

The expected wave of Ballast Water Treatment System installation projects didn't happen in 2018, as shipping companies use their advantage of a 5-year postponement, so a considerable number of such installation projects is expected from 2019 on. Until then, BWTS projects will be sporadic. In 2018, the Shipyard carried out a total of 5 BWTS installation projects.



On the other hand, IMO's 2020 Global Sulphur Cap will initiate scrubber installation projects. Viktor Lenac plans to make 4 to 5 BWTS installation projects and 3 to 4 scrubber installation projects this year.

Intensified cooperation with the US Navy resulted in a total of 10 shiprepair projects successfully carried out on board US Navy ships at the Shipyard or on the outside locations during 2018. The total value of the projects was significantly lower than the value of the 2017 USS Mount Whitney project, but important is that the cooperation intensified. We expect to continue good cooperation in 2019 through several standard shiprepair projects.

Offshore industry is not likely to recover in 2019, therefore, we do not expect significant revenue in this business segment.

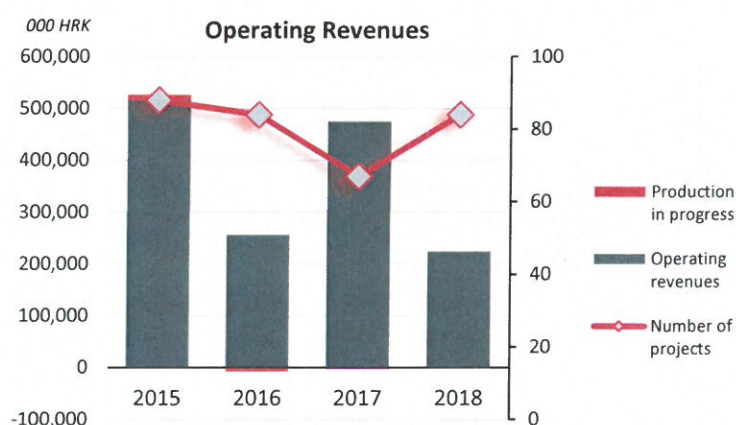


## BUSINESS ACTIVITIES

### SALES

#### Realized Revenue

In 2018, Viktor Lenac generated a total of EUR 30.3 million of revenues from its core activity, or HRK 224.3 million, which is twice as low as in the previous year. Put in relation with 2016, which is comparable to the project structure, revenues generated in 2018 were lower by 12%, although the number of projects was equal in both years. This is a result of strong competition and a drop in sales prices, but also a reduction in average standard shiprepair work scope. It needs to be reminded that 2017, as well as comparable 2015, were marked by extensive modernization works carried out onboard the US Navy's 6th fleet flagship *USS Mount Whitney*.



Out of a total of 84 different projects completed in 2018, 10 shiprepair and maintenance service projects were carried out onboard 4 ships of the US Navy's 6th fleet, which generated a total of about EUR 9.4 million or almost one third of 2018 operating revenues from core activities. Major projects involved repairs of *USNS Trenton* carried out in April having a value of EUR 3 million and *USNS Carson City* carried out in May totaling EUR 2.6 million. The works onboard *USNS*

*Yuma* started in November having a total value of works, accounted by the end of the year, in the amount of EUR 1.8 million.

Of the remaining shiprepair projects involving merchant ships, 3 projects exceeded the individual value of EUR 1 million, whereas 9 had a value from EUR 500,000 to 1 million.

In 2018, the Shipyard carried out 5 BWTS installation projects and continues to strengthen its market position in this segment. Although it was expected that the demand for BWTS installation would be significant in recent years, shipowners continue to use their advantage of a 5-year postponement, so a considerable number of such projects is expected in the period from 2020 to 2021. The expected number of BWTS installation contracts for 2020 is 4 to 5, which would enable the Shipyard to continue building thrust with clients in terms of workmanship quality, meeting deadlines and prices in this segment.



## Market Analysis

Put in perspective of the market structure, operating revenues derived from 12 different countries.

Unlike the previous year, where only 3% of revenues were generated from the domestic market, in 2018, 23 projects worth EUR 3.7 million were carried out for domestic owners, up by 80% in revenue or 35% in the number of projects compared to 2017, accounting for about 12% of revenue in the core activity.

A share of 31% of total revenue was generated from the US market involving 10 shiprepair projects for the US Navy's 6th Fleet.

Of other foreign markets, a significant share of revenues was generated from the Greek, Italian and German markets. The most numerous were Italian clients, for which 17 different projects were carried out, while 10 projects were carried out for German owners.

## Sales

2018 was characterized by intensive marketing strategies and efforts to conclude as many shiprepair contracts as possible in order to maximally compensate for lower sales prices and reduced average standard shiprepair work scope. In addition to sales through our agents, the Shipyard intensified its direct sales activities including more frequent visits to major and potential clients and participation in international shipping exhibitions.

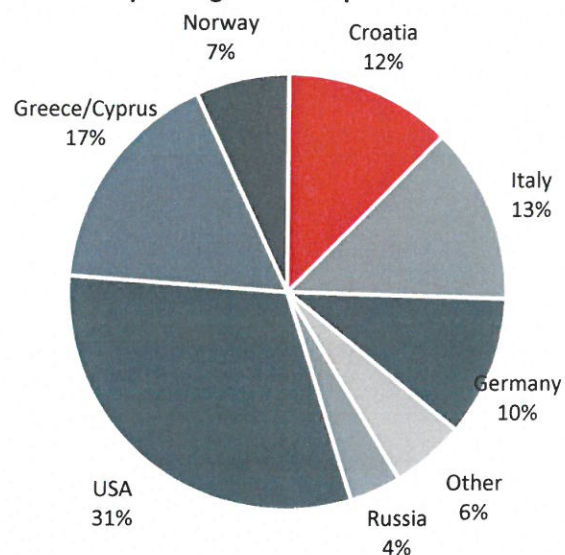
During 2018, the Shipyard received about 400 inquiries from shipowners for various shiprepair works, of which about 20 inquiries were not processed due to unavailability of dry dock / repair facilities in the requested period.

A large number of inquiries was the result of intense market competition and the fact that shipowners are increasingly looking for new shipyards to find cheaper shiprepair services, which also contributes to a sharpened competition in the Mediterranean.

The Shipyard's selective sales approach is aimed at focusing on deals 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 shiprepair works and reduction of the sales prices at global level.

A total of 84 contracts resulted out of 350 quotations. Despite a large number of contracts awarded, the production capacity was not fully utilized in certain periods, due to oscillations in occupancy at the beginning and end of the year, as well as due to the fact that the average shiprepair work scope has been reduced, where the production capacity utilization was not balanced. According to customer feedback, the main reason for not awarding a shiprepair contract involved deviation from the voyage due to the Shipyard's geographic location that implies additional costs and requires a longer period of time for docking and shiprepair, whereas in some cases the reason was the price mainly when put in relation to Turkish competitors.

**Operating Revenues per Market**



## Contracts concluded to quotations issued

	2012	2013	2014	2015	2016	2017	2018
Number of inquiries received	330	312	347	401	350	350	400
Number of quotations produced	308	295	317	317	310	320	350
Number of contracts concluded	58	62	77	86	85	67	84
Contracting rate	19%	21%	24%	27%	27%	20%	24%

After the Palumbo Group became majority shareholder at the end of the year, a process of optimization and alignment of sales activities at the group level began and the headquarters office took over responsibility for coordination of sales activities for all companies. By common market entry, all the companies in the group expanded their client base, increased efficiency in offering their services and broadly expanded the knowledge base. A real synergistic effect of this power and potential pooling is only expected to happen.

## PRODUCTION

### Number and types of projects

A total of 83 various projects, including 4 projects that were under progress at the end of the year, were completed, of which 76 projects involved shiprepair and maintenance service projects carried out at the Shipyard, while 10 projects were carried out outside of the Shipyard on voyage locations.

Standard shiprepair projects involved 20 tankers of various purpose, 15 ferries or RO-RO and RO-PAX ships, 8 container ships, 8 bulk carriers, 6 tug vessels, 5 general cargo ships, 3 barges, 2 reefer ships, 2 suppliers, 1 cement carrier and 1 LPG tanker. A total of 5 shiprepair contracts involved 4 US Navy's ships that underwent repairs at the Shipyard, while 6 projects related to voyage repairs of the 6th Fleet.

Major projects involved *USNS Trenton* and *USNS Carson City* that included aluminium works, crane repairs, maintenance of wastewater treatment plants, maintenance of high-pressure air compressors, installation of thermal insulation on water pipes, switchboard thermography and maintenance of other ship and navigation equipment.

Five BWTS installation projects were successfully completed in 2018, where *Bordeira* and *NS Point* underwent a large scope of shiprepair works.

Production works carried out in other projects were mainly of standard type mostly involving steel renewal, anti-corrosion treatment and coating, mechanical, pipe and electrical works.

Slow periods were used to renew steel structure onboard the Shipyard's Floating docks 5 and 11 to extend dock useful life.



### Production activity structure

Of the total production activity in 2018, one-fifth involved anti-corrosion treatment works.

Anti-corrosion treatment works mean various anti-corrosion mechanisms on steel surfaces in ships such as washing and degreasing, blasting and other techniques that remove old paint and rust, followed by coating.

Gritblasting technology is replaced, where it is technically possible, by advanced, efficient and environmentally-friendly technology of ultra high-pressure water blasting. In 2018, a total of 150 sqm of ship surface was gritblasted. Additional 33,000 sqm was washed under ultra high-pressure water (UHPW), up by almost seven times more compared to the previous year. Spot coating was applied to about 190,000 sqm, while full coating was applied to over 760 sqm of surface area. Silicone coating technique was used in several projects.



Put in the perspective of production activity structure, participation of steel works was lower than usual 20% when speaking of standard shiprepair works largely as a result of reduced scope of steel renewal works caused by a decrease in steel renewal work demand within the reach area where Viktor Lenac can hardly compete against the Turkish shipyards with respect to this type of works. In 2018, a total of 400 tons of steel was renewed, of which more than half of related to steel renewal on the Shipyard's Floating docks. The number of effective hours used in steel works was halved compared to the previous year.

	2015	2016	2017	2018
Anti-corrosion treatment works	16,0%	16,5%	11,8%	19,7%
Steel works	13,2%	24,2%	15,1%	14,9%
Mechanical works	9,3%	8,9%	7,0%	12,8%
Transportation	8,3%	8,9%	7,5%	9,5%
Outfitting	8,1%	6,0%	5,8%	7,9%
Pipe works	8,7%	9,0%	9,2%	7,0%
Electrical works	14,3%	6,8%	14,4%	6,8%
Insulation works	2,5%	1,8%	6,7%	1,9%
Other works	19,6%	17,9%	22,5%	19,5%
	100,0%	100,0%	100,0%	100,0%

Mechanical works recorded a high share, down by only 8.3% compared to the previous year, despite the fact that total occupancy rate had dropped twice as much as previous year score. Major mechanical works involved overhaul of eight propulsion units onboard US Navy catamarans, stern bearing outer diameter rectification works onboard two merchant ships, rudder cone and shaft rectification, complete overhaul of shaftlines and fabrication

of intermediate shaft bearings and shaftline/gearbox alignment as well as numerous other works onboard almost all ships that underwent repair works at the Shipyard during the year.

A total of 126,000 cum of scaffolding were erected, of which about 48,000 cum involved quick-assembly scaffold.

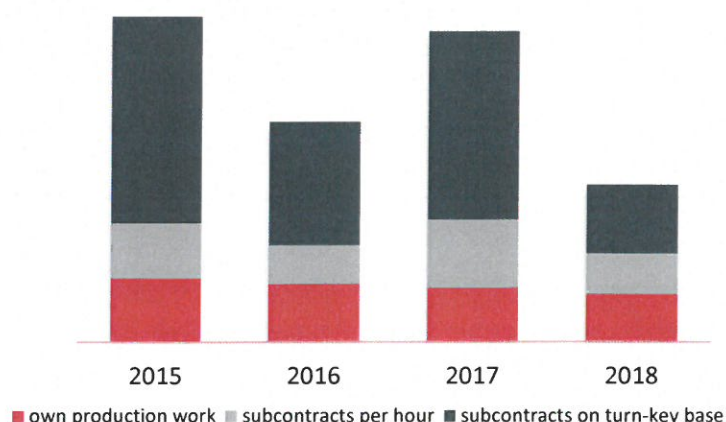
## Labour Capacity and Cost Structure of Production

Shiprepair industry is labour-intensive. Material cost represents up to 30% of the total production cost in the shiprepair activity, whereas the remaining part is labour cost, relating to own production workers or subcontractor workers. The same relationship applies also to maintenance works (facilities and equipment) and investment in floating units.

Own direct production workers of all trades are fixed cost. In 2018, own production workers produced a total of 350,000 effective hours, of which about 330,000 hours were produced in direct production, while 20,000 effective hours were produced in property maintenance.

Fluctuations in occupancy in the shiprepair activity and changing structure of works in the core activity produce different workforce needs. In some periods, the Shipyard can face a shortage or surplus of own production workers in terms of total number and trade. 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.

Effective Hours per Source

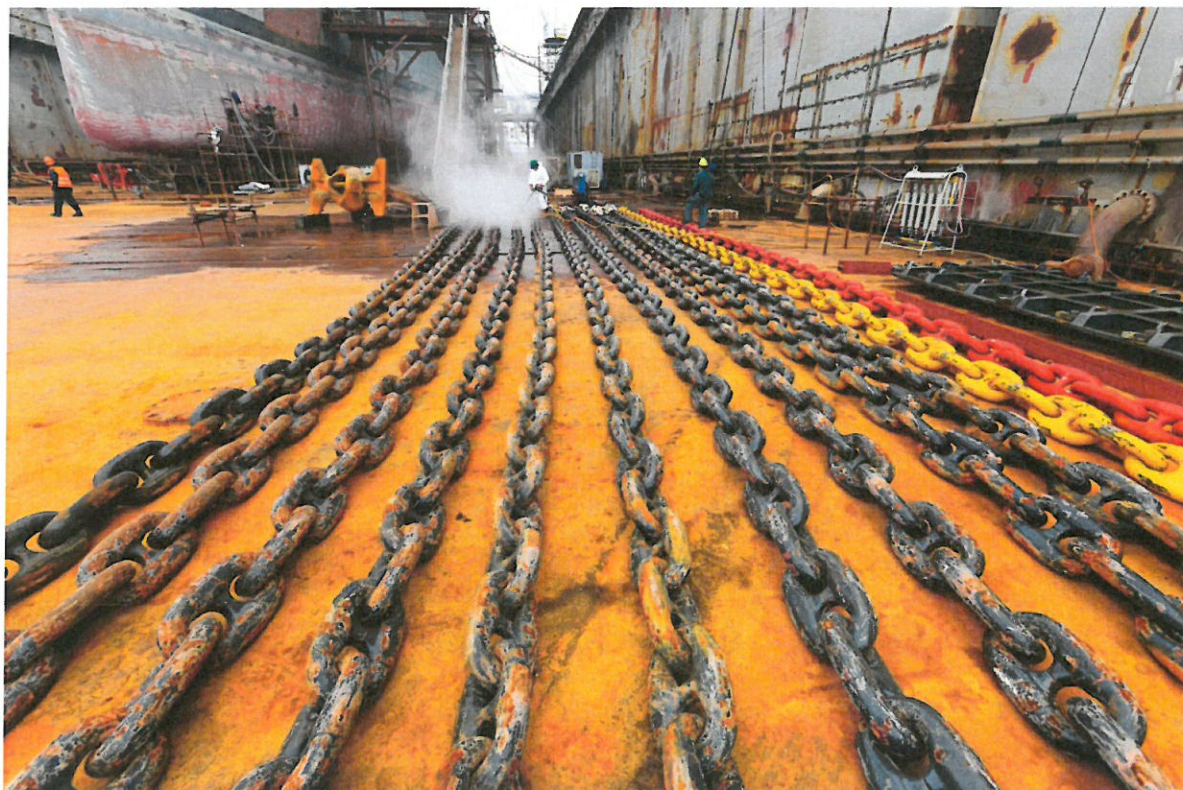


Declining occupancy rates in 2018 resulted in a reduction of effective hours used in production for twice compared to 2017 that was marked by high occupancy rates. Participation of own workers in the total production activity was almost twice higher compared to the previous year, despite the decrease in the number of workers and fluctuations in occupancy that had been pronounced during 2018. In some periods of extremely low occupancy, the own labour capacity was not fully utilized, while in some other periods it was necessary to engage subcontractor workforce.

The production activity structure and measures undertaken to improve production process efficiency have contributed to a reduction in the number of effective hours used per unit of product. This trend is particularly noticed when compared to 2016, which is more comparable in terms of revenue, where the number of effective hours recorded a bigger drop when put in relation to a decrease in generated revenues.

Apart from own production activity, 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, and may involve provision of materials for manufacture of products intended to be installed onboard a vessel. Examples of such services are custom made manufacture, finishing, processing, tug and port services as well as waste disposal. In specific types of works, such as licensed service and electrical works, subcontract works may also involve purchasing of specific materials and using subcontractors' own equipment, especially in contracts stipulated on turn-key base.

In figures, the total direct production cost relating to the core activity and own investment amounted to HRK 79.9 million, down by more than twice compared to the previous year. Direct external service cost amounted to HRK 45.6 million, down by 45% compared to the previous year.



## Dock and Berth Utilization Rate

Viktor Lenac disposes of three floating docks (Dock 5, Dock 11 and Dock RI-38) allowing for flexibility required in accommodation of vessels of different size.

Comparing results of the few last years, in 2018 Viktor Lenac recorded significantly lower occupancy rates both as compared to the previous year and the comparable 2016. In the absence of major projects, which would have occupied production capacities for a longer time, in 2018, as well as in 2016, Viktor Lenac recorded a significantly larger number of smaller-scope projects. However, due to the reduced scope of work per project in average and considering that some projects were carried out outside the Shipyard, the total 2018 occupancy rate was lower than in the comparable 2016.

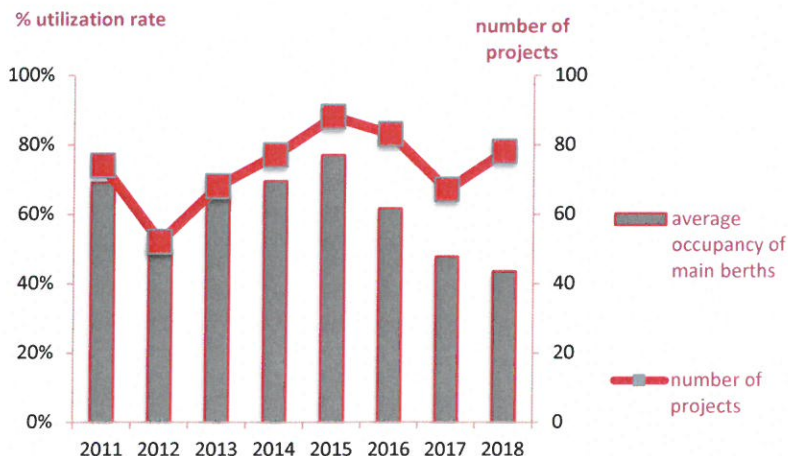
Dock	Dock utilisation rate		
	2016	2017	2018
Dock 5	79,7%	63,90%	79,7%
Dock 11	87,9%	83,80%	79,2%
Dock RI 38	78,1%	62,70%	74,8%

The Shipyard's main operative berths - 1, 2 and 3 are located in the immediate vicinity of the production shops, plants and warehouses. The operative berths 8 and 9 are of special purpose and are used when main operative berths are not sufficient to fulfil operations needs. During the last few years the operative berths 4, 5 and 6 had been accommodating vessels for mooring only; however, these berths have been increasingly used for core

shiprepair 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, or occupancy rate. Despite an increase in the number of ships that underwent repairs in 2018 compared to 2017, the berth utilization rate was lower in 2018, as a result of the reduced scope of work and shorter deadlines. This is evident even in comparison to 2016, in which an equal number of projects was carried out.

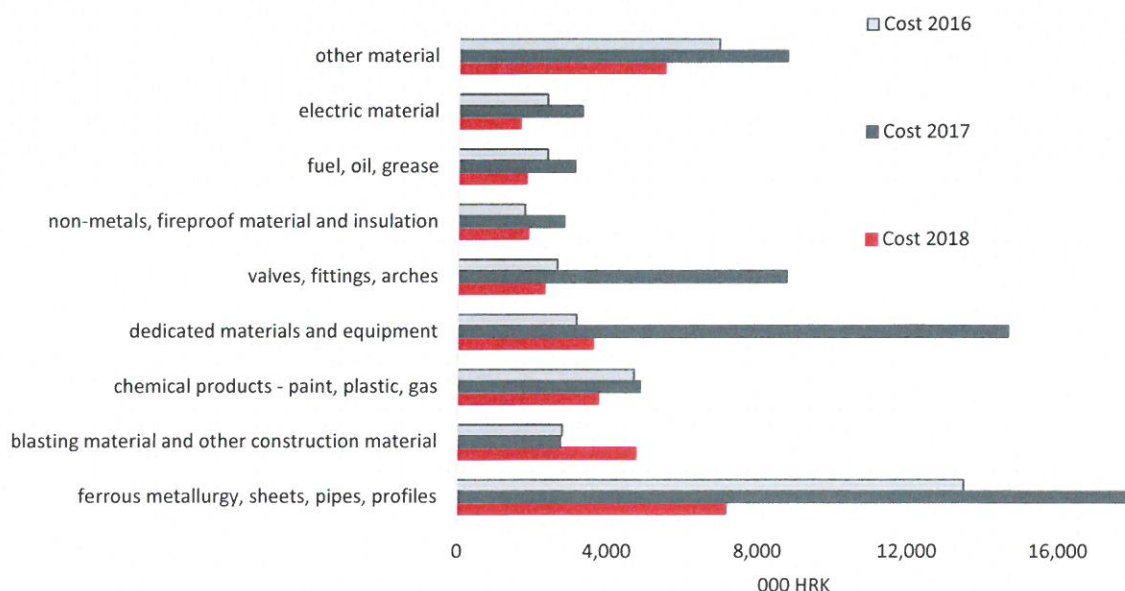
**Berth utilization Rate vs. Number of Projects**



## Raw Material and Energy

The cost of raw material and energy generally participates with 20%, 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 shiprepair projects. The share in which raw material and equipment participate in the revenue structure also depends on whether procurement of raw material and equipment intended for installation onboard a vessel is the Shipyard or client's obligation.

**Material Cost Structure**



In 2018, which was marked by occupancy decrease, a total of HRK 43 million of raw material and energy cost was recorded, representing about 16% of the total operating cost.

A total of HRK 32 million of various material and equipment was used respectively built in in production and other activity, which was more than twice as less compared to the previous year or down by 20% compared to 2016.

The material cost structure depends on work type. Ferrous metallurgy materials (plates, profiles and pipes), grit or sand used in anti-corrosion treatment, technical gases and fuel, regularly used in technological processes or installed onboard vessels undergoing repairs, are the most relevant groups of material.

In 2018, the highest material cost referred to ferrous metallurgy materials, although in a significantly lower amount than in the previous years. The only group of material that recorded higher cost compared to 2017, was a group of material that includes grit for grit blasting.

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.

Energy consumption	UM	2014	2015	2016	2017	2018
Electric power	000 kWh	11.806	19.339	13.560	19.031	11.694
Fresh water	000 m <sup>3</sup>	65	93	63	77	56
Technological water	000 m <sup>3</sup>	199	265	262	201	210
Oxygen & acetylene	t	590	672	558	476	357
Light fuel	t	450	485	331	168	144

In total, the Shipyard consumed significantly less energy in 2018 compared to the previous years. This was the result of occupancy decrease as well as implementation of measures to reduce energy consumption and new energy solutions for space and water heating. Water from the public water supply system is replaced with technological water in the production process everywhere where it is possible to so.

In 2017, Viktor Lenac implemented an energy management system according to ISO 50001, which was certified in early 2018. This made energy management a permanent process aimed at raising awareness on efficient exploitation and saving of energy in order to achieve decrease in production cost.

A decrease in consumption of oxygen and acetylene was a result of decrease in steel works.

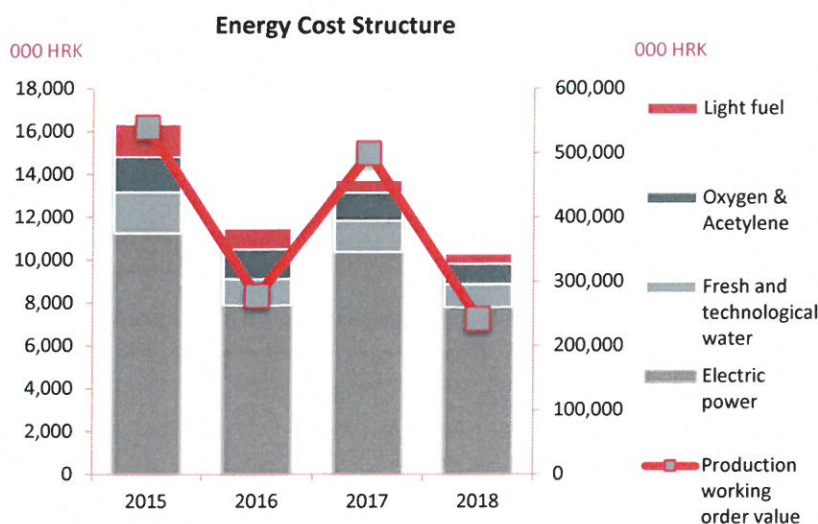
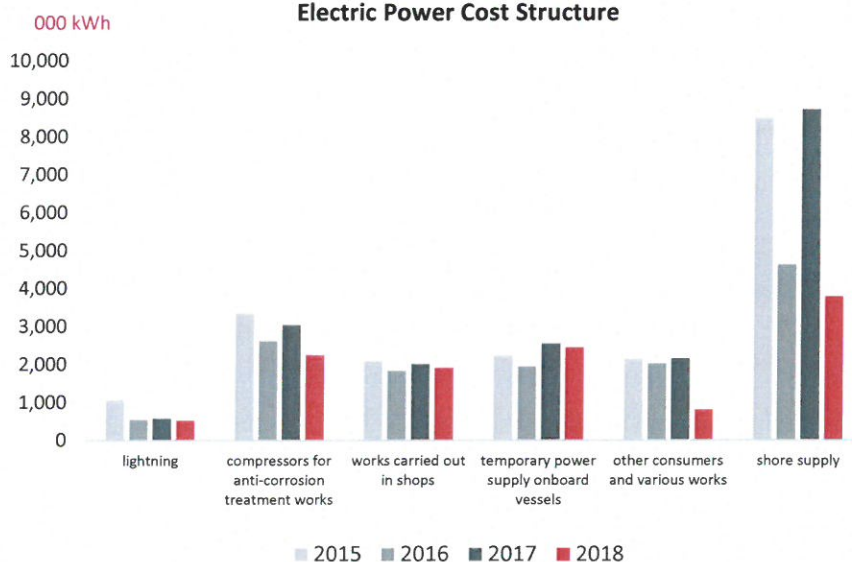
A large amount of electricity is used for ship power supply. Both 2015 and 2017 recorded high electricity consumption rate due to an extended period of power supply onboard the vessel *USS Mount Whitney*. In 2018, in all segments of electric power consumption was recorded a decrease compared to previous years. Consumption decrease was a result of occupancy decrease and implementation of energy efficiency measures, with the greatest savings being achieved in modernization of permanent and temporary lighting. In 2018, the Shipyard continued investing in energy efficient lighting systems such as explosive-proof temporary lighting for use onboard ships, office lighting and outdoor dock lighting.

Energy cost totaled HRK 10.3 million, down by 25% or HRK 3.4 million compared to 2017. Compared to 2016 in terms of revenue, energy cost in 2018 decreased by 10% or HRK 1.2 million.

It should also be considered that unit prices have increased especially of electricity. Compared to 2017, the cost of electric power decreased by only 25%, although actual consumption, measured by the number of kWh, decreased by 38.6%.

Compared to 2016, the cost of electric power decreased by only 1.1%, although actual consumption, measured by the number of kWh, decreased by 13.8%. Electric power cost represents 75% of total energy cost.

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 is achieved by installing additional technological water pipelines aimed at using technological water at larger scope.



Investments made over the last two years in hot water and heating systems have significantly reduced consumption of light fuel, which is accounted as fixed cost. The light fuel cost decreased by 20.9% compared to 2017 or even 52.5% compared to 2016.

## TECHNOLOGICAL DEVELOPMENT AND INVESTMENT

Technological development and investments in capital, production and other assets of Viktor Lenac continued in 2018, albeit with reduced intensity compared to previous years.

Total investments in fixed assets amounted to HRK 21.7 million, down by HRK 15 million compared to the previous year. Own investment amounted to HRK 17.4 million, while the remaining HRK 4.3 million accounted for acquisition of long-term assets.

Of the total amount invested in long-term assets during 2018, the most significant amount of HRK 13.8 million was invested in reconstruction of Floating docks 5 and 11 to increase the value and useful life. A total of HRK 1.6 million of own investment funds were invested in fabrication of steel keel blocks for accommodation of vessels.



In 2018, the Company launched an energy-efficient lighting investment project having a total value of HRK 4.9 million. The project involves replacement of existing office lighting with new T5 lighting fixtures, and outdoor lighting on Berth 8 and all three floating docks with energy-efficient LED lighting fixtures. These investments, in addition to saving electricity, will also ensure better working conditions. Apart from indoor and outdoor lighting, the project also includes procurement of Ex GalaLED portable lightning for temporary lighting used onboard ships where explosive-proof working conditions must be provided while improving efficiency and reducing the number of working hours needed to install the lighting compared to the conventional mode so far. By the end of 2018, the project, financed by a long-term loan issued by a commercial bank, was realized in half of its value (HRK 2.4 million). It is estimated that the Company will achieve annual savings of about 1.7 million kWh of electricity.

The remaining investments were related to production and other equipment.

## ORGANISATION, QUALITY MANAGEMENT SYSTEM, INFORMATION AND COMMUNICATION

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 and accelerating every single business process.

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.

Complex organization is reflected in linking functional and project organization into a matrix organization where resources are allocated to several projects in repairs, conversions and offshore activities that are carried out parallelly.

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. Key business indicators for all business processes have been defined, aimed to raise awareness and responsibility of operations management for individual business results on monthly basis.

By the end of 2018, the business process reorganization was completed in the following areas:

- Managing shipbuilding, pipe, carpentry and insulating works;
- Managing use and maintenance of tools;
- Managing operations support services, focusing on power supply services, scaffolding and rigging works;
- Managing floating units.

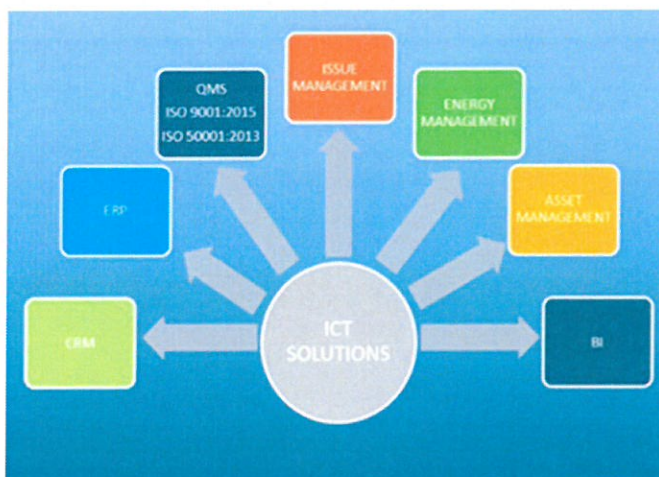
Changes in business processes have caused changes in organizational structure of the Technical and Production Division and Procurement and Warehousing Department resulting in modifications in related job descriptions. Accordingly, the organizational structure became flat, fast and efficient in communication and decision making, deprived of unnecessary hierarchical management structures. These organizational changes became effective in the beginning of 2019.

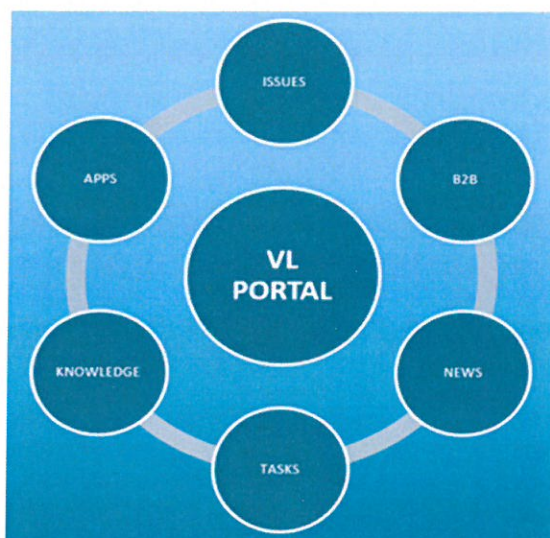
Organizational development is closely related to the development of IT system, as a tool for the automation of business processes and activities. During 2018, the Company continued upgrading its existing information services. The focus of IT support was on business intelligence solutions, information security, data protection and electronic data interchange among various physical devices made of electronic assemblies, sensors and software for monitoring energy management system (IOT – Internet of things).

Existing information systems have been upgraded to new functionalities. The ERP system has been enriched with new opportunities for preparation of quotations, project management, and analytical and synthetic monitoring of project costs. A new mobile application has been developed to enable employees report incident situations and inconsistencies.

Those employees in charge of quality assurance, occupational safety and environmental protection now can handle all the non-conformities related to management systems at one place and have at any time feedback on the status of solving reported problems.

As part of own development activity, a new intranet portal has been designed as a center that contains the basic information needed for each employee to perform their activities such as corporate news, knowledge database in the form of documentation related to a particular job from all management systems (quality, safety at work, environmental protection, energy management), tasks to be performed, list of equipment being in charge of, and links to application solutions.





The new portal contains a part related to business partners where they can get access to quality management documentation and non-conformities observed in their work.

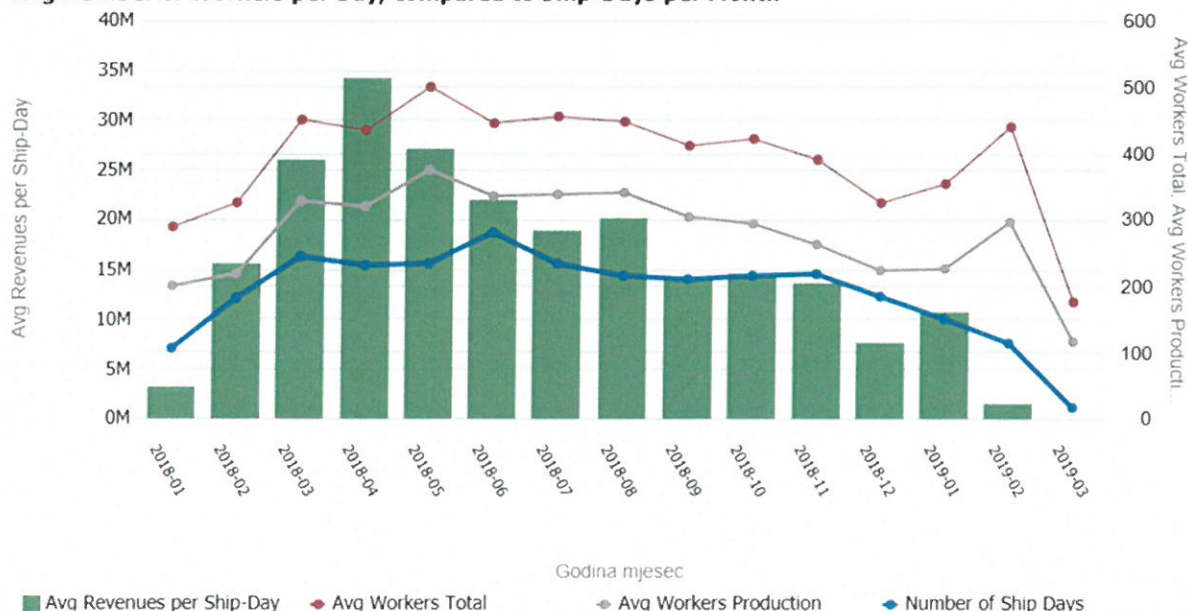
Access rights are defined by business processes and workplaces so that every user gets insight into information that is only relevant to his/her scope of work.

The first steps in development of a vehicle tracking device for the purpose of timely vehicle maintenance, better diagnostics, reduced fuel consumption and better organization of transport equipment have been made. So far, this project has covered 20% of vehicles. Further development of a system for collecting data on electricity and water consumption is planned for the same platform. In this way, all data on energy consumption in real time

would be stored in one place improving consumption data analysis.

In cooperation with our business partners, we constantly develop tools for business decision making. An Oracle's BI platform-based KPI watchlist has been developed for management needs.

**Avg Number of Workers per Day, compared to Ship-Days per Month**



Information security and data protection is exceptionally important. Certain steps have already been made during the last few years to raise information security by virtualization of all servers creating a base for fast system recovery and collocation of server resources on a separate disaster recovery site outside Viktor Lenac headquarters.

The Company abides by legal frameworks and guidelines relating to information security. A newly-formed team has passed training related to GDPR and ISO 27001 and has almost completed analysis of personal and sensitive data processing by using method of assessment of impact on privacy from multiple aspects such as business processes, business applications, information infrastructure and legislation. Action plans have been developed for implementation of management, logic and physical control of business processes.

In September 2018, the Shipyard's Quality Management System was recertified by Bureau Veritas according to ISO 9001:2015. No nonconformances were found. Also, during the year, the Shipyard underwent several audits conducted by their business partners. The Internal Audit Plan involved all business processes and organizational units.

ISO 50001:2011 Energy Management System certification process was successfully completed on 24 January 2018 by Bureau Veritas. During the audit, representatives of the certification society commended Management's commitment as well as competences and approach of the Shipyard's energy management team regarding analysis and possibilities of improvement of energy efficiency. No nonconformances were found.

Aimed at continuous improvement of all business processes, the Management Board has decided to start the certification process according to ISO 27001 (Information Security Management), ISO 45001 (Occupational Health and Safety Management) and ISO 14001 (Environmental Protection Management). As part of the preparation activity for certification, teams responsible for producing documentation and aligning business processes with new requirements have undergone training. Completion of the certification processes is expected by the end of 2019.



## 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 addition to standard activities in implementation of occupational safety and health system such as training workers for safe work, testing machinery and devices characterized by increased hazard, monitoring implementation of occupational safety regulations, inspections at work place and activities in specific hazardous conditions, issuing permits for entry and work in enclosed and confined spaces and similar, new measures aimed at improving occupational safety and health have been introduced:

- Introducing visitors with the Shipyard's safety rules upon arrival to the main gate;
- Reporting non-compliances related to safety, which is a prerequisite for systematic continuous monitoring and reporting of all events that are recognized as unsafe or potentially hazardous events;
- Improving protection system by installing additional video cameras at locations inside and around the Shipyard.



Shipyard's workers employed at posts characterized with special work conditions pass obligatory medical examination at the Institute of Occupational Medicine. Aware of the importance of preventive healthcare, Viktor Lenac has continued practice of annual preventive medical exams and other medical services aimed at raising health care standard, early detection of illnesses and raising motivation of workers to take care of their own

health. The Company concluded a contract with a reputable medical establishment “Medico” in the last quarter of 2018. The main reason why the funds intended for employee health protection were significantly lower than in previous years is that the contract was concluded at the end of the year.

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

	2013	2014	2015	2016	2017	2018
Annual preventive medical exams	376.875	618.546	655.688	675.861	570.298	88.391
PPE	653.745	783.165	680.286	654.411	1.053.274	627.400
	1.030.620	1.401.711	1.335.974	1.330.271	1.623.572	715.791

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.

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 injury severity, usually it comes to minor injuries mostly involving concussions, wounds and sprains.

Nevertheless, 2018 was marked with an increase in the number of injuries at work. A total of 15 injuries were recorded with a total of 413 lost working days. Although a drop in the number of lost working days was recorded compared to the previous year, considering a decrease in the total number of effective hours, this resulted in an increase in frequency index and injury severity score. Of the total number of injuries incurred during 2018, six (up by 1 compared to 2017) were severe mostly involving extremity fracture.

#### Injury indicators:

	2013	2014	2015	2016	2017	2018
Number of effective hours	925.669	957.147	937.020	864.292	883.716	792.694
Number of injuries	23	18	17	18	10	15
Total number of days lost due to sick leave	738	556	354	416	424	413
Frequency index	24,85	18,81	18,14	20,83	11,32	18,92
Number of injuries / Effective hours						
Severity index						
Total lost days due to sick leave / Total effective hours	79,73	58,10	37,78	48,13	47,98	52,10
Number of injuries / Number of workers	4,44	3,58	3,45	3,64	2,04	3,24

Most injuries (9), and the biggest number of lost working days (265), involved fall accidents. A total of 175 lost working days related to a single fall accident. Calculating without this injury, the severity score for all remaining injuries would be 30.2, which is significantly lower than in all previous years. Even 13 out of the total 15 injuries happened for not following safety rules. For this reason, the Shipyard has undertaken additional measures to train workers to work in a safe manner, such as day-to-day safety toolbox meetings conducted by direct executives with their employees with the focus on implementing security-related procedures related to a specific job.

The Shipyard's Fire Protection System integrates a spectrum of preventive measures among which regular inspections of facilities and work sites, training of new employees, procurement and maintenance of firefighting equipment, testing of installations and equipment, all in order to detect potential fire hazards. In addition to preventive action, activities also include technical interventions of rescuing people and property endangered by fire and other disasters. With the aim of rapid and efficient interventions, firefighting equipment is deployed at various production locations, which increased its availability and operational readiness for firefighting and rescue interventions for people and property.

Hot works such as welding, grinding and cutting can be carried out only after a preventive inspection has been performed and a hot work permit has been issued. In 2018, a total of 8,767 hot work permits were issued. Also, more than 450 gas-free certificates were issued for works in tanks onboard tankers.

As part of preventive fire protection activity, a seminar was organized for all workers who are in any way responsible for hot works (project managers, managers in production, own and subcontractors' foremen) in order to provide additional training for fire prevention in soldering, welding and related work techniques. A total of 70 attendees successfully passed the exam. Also, a total of 36 new employees and students on professional study programs underwent fire safety training.

Fire drills and simulations are conducted regularly in accordance with the Internal Fire Protection Plan and may be carried out at shipowner's request. A total of 48 drills were carried out during the year. At the request of the US Navy's representatives, additional 12 drills were carried out during repairs of their ships.

During the year, 4 initial fires and 2 technical interventions were recorded but did not cause any significant material damage (in total HRK 1,000), which can be considered extremely low having in mind potential dangers and threats that may arise from a fire incident in shiprepair industry.

## 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.

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. In 2017, an additional set of the equipment to be used in Dock 5 was purchased.

The Shipyard's Waste Management System, apart from legally defined frameworks and improvement obligations, largely depends on the possibilities of waste management in the Republic of Croatia. Therefore, the Company must constantly seek new waste management opportunities that can meet environmental and economic conditions. Knowing that a way in which wastes are managed can lead to either gain or increase costs, Viktor Lenac has opted for a flexible waste management system, ready to follow trends that will be continually aligned with changes.



Disposing waste in designated dumping areas is the most unfavorable way of dealing with waste both ecologically and economically. The most cost-effective way of waste management is to separate waste at production site. In order to reduce quantity of waste for disposal, the Shipyard makes continuous efforts in educating workers and encouraging waste sorting behavior, providing appropriate equipment and constant monitoring. The waste sorting process must be followed by an appropriate recovery practice such as recycling. In Croatia, new opportunities for waste use and recovery are opening up and Viktor Lenac develops its strategies for waste management in line with the development of waste management possibilities.

During 2018, the Shipyard generated a total of 11,655 tons of various waste, of which 66% of non-hazardous waste and 34% of hazardous waste.

Waste management cost amounted to HRK 5.8 million, while HRK 1 million was earned by selling waste as secondary raw materials.

More detailed information on environmental protection and waste management are given in the Sustainability Report for 2018.

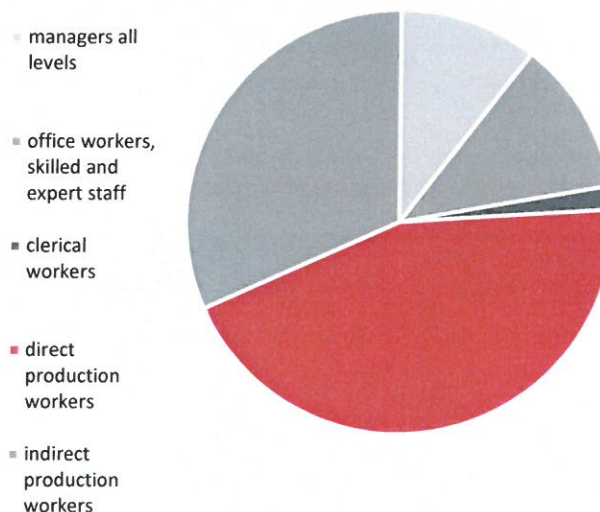
## HUMAN RESOURCES

### Number and Structure of Employees

On 31 December 2018, Viktor Lenac had 441 employees, down by 47 employees or 9.6% compared to the previous year. The average number of employees, according to the number of employees at the end of each month during 2018, was 463, down by 27 employees or 5.5% compared to the 2017 average. During the year, 67 employees left, of which 25 retired and 6 finished their contracts of employment of definite term, while one worker died. The remaining 31 employees terminated their contracts by agreement. In the last quarter of 2018, the Company's organizational change and introduction of new systematization of workplaces, with the aim of adapting to market demands and increasing the efficiency of work, resulted in a reduction of number of employees. By the end of the year, 3 employment contracts were terminated for business or personal reasons, and 1 employee was dismissed for unacceptable behavior.

Considering fluctuations in occupancy and the fact that in low occupancy own production workers are fixed cost, Viktor Lenac relies in large part on subcontractors' services in its production activities. New workers are employed in those activities in which it is not possible or not efficient to employ external labour. The employment policy aims to maintain a quality employee structure with the aim of raising the quality and efficiency of work, in order to mitigate the consequences of the downward trend in the availability of labor force, which has been more and more present in Croatia and the EU countries in recent years. In

**Organizational Structure**



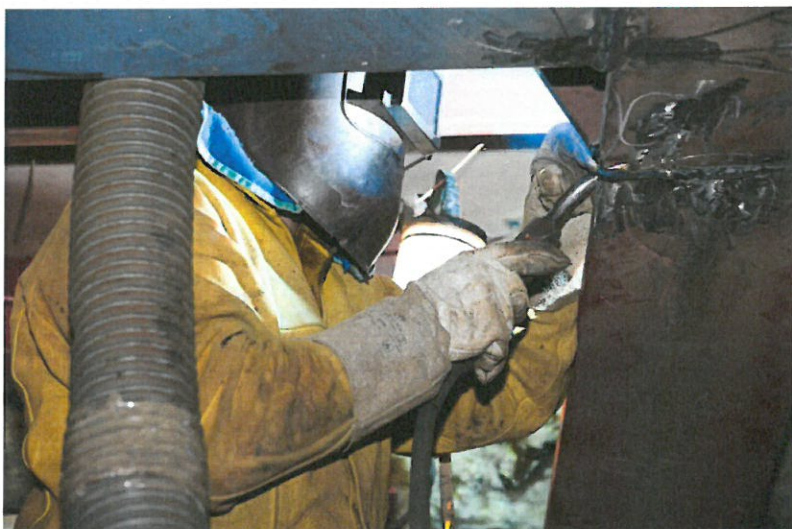
such circumstances, the aim is to maintain an optimal structure of workers, combined with the availability of high-quality subcontractors, to match the needs of the market, other productive resources and the targeted level of employment.

On 31 December 2018, of the total number of employees, 422 workers or 95.7% had employment contracts of indefinite term, up by 4.5% compared to 2017.

Out of the total number of workers, only 7.5% are women, which is not unusual for this industry.

Compared to the previous year, Viktor Lenac's subsidiary company *Viktor Servisi Ltd.* had two employees less and on 31 December 2018 had a total of 15 employees, of which 12 maintenance and repair technicians. On 31 December 2018, the subsidiary company *VL Steel Ltd.*, founded in October 2017, had a total of 39 employees, of which 37 direct production workers. Total consolidated number of employees on 31 December 2018 was 495, down by 19 compared to 2017.

The employee structure is stable, without significant fluctuations. Put in the perspective of the total organisational structure of employees, there are 335 production workers (76% of total number of employees), of which 195 direct production workers. A total of 140 workers 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 (52 employees), clerical staff (8 employees), and project managers, heads of departments and unit leaders (total 46 employees). Of the total 54 employees employed with the subsidiary companies, 49 are production workers, thus the consolidated share of production workers is 77.5%.



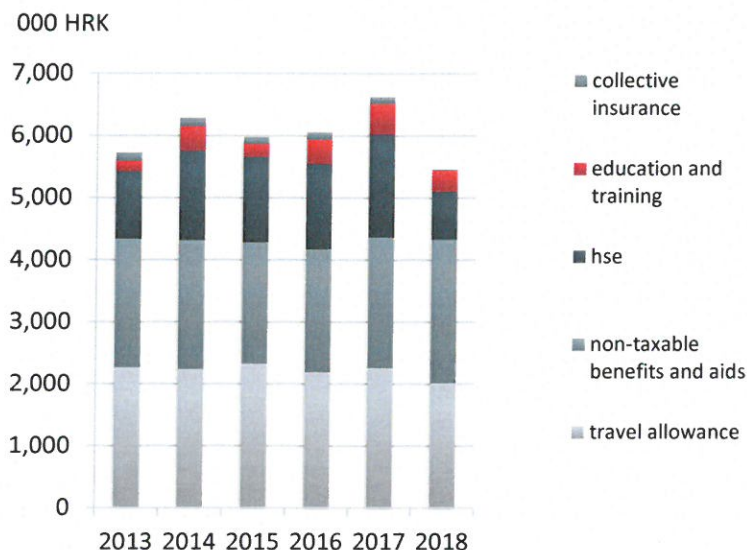
Viktor Lenac's employee structure in terms of qualification and profession is satisfactory. There are only 62 workers (65 at the Group level) who are either semi-qualified or without qualifications or additional formal training, mainly in cleaning jobs and in simple manufacturing jobs for which they have been internally trained. The average age of the Shipyard's employees is 46 years. The Company's goal in the coming years remains rejuvenating the age structure of employees.

## Structure of Hours Worked and Salaries

In 2018, Viktor Lenac's employees worked a total 969,284 hours in normal working hours, of which 76.3% or 739,600 were effective work hours, down by 5% compared to the previous year as a result of lower occupancy rates and higher oscillations in occupancy compared to 2017. Non-effective hours equal hours produced in vacation (11.7%), sick leave (7.4%), national holidays (3.9%) and paid or non-paid non-effective hours (0.7%).

During 2018, employees produced a total of 33,000 overtime hours, which was 7,000 hours less compared to the previous year. Despite lower occupancy rates, overtime work is still required due to oscillations in occupancy and unpredictable situations inherent to shiprepair industry. Oscillations in occupancy 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.

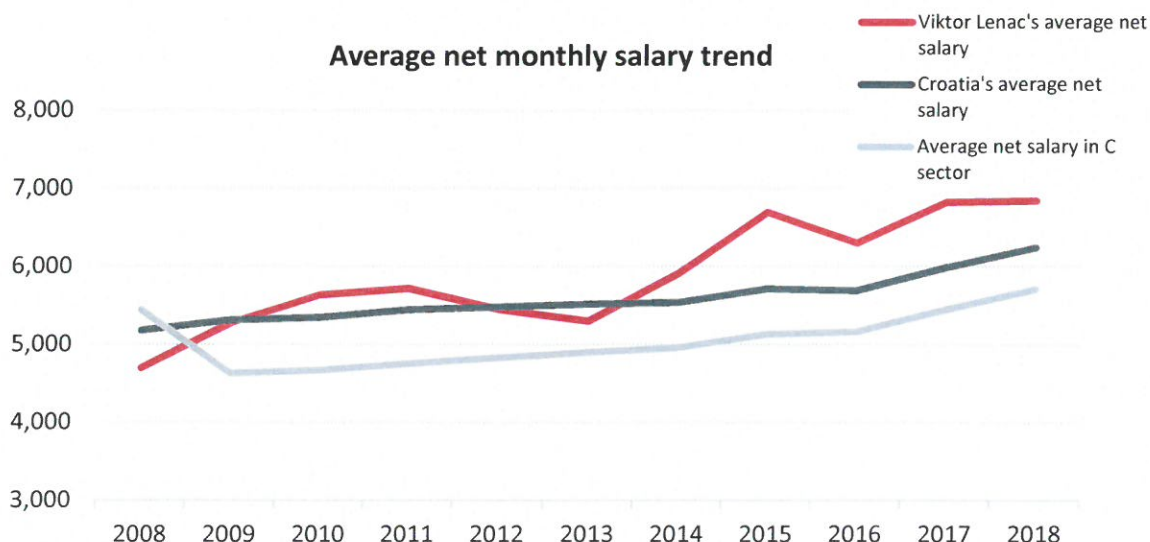
## Employee allowances and benefits



In 2018, Viktor Lenac paid a total of 67.7 million Croatian Kuna on the account of employee salaries, allowances and benefits, down by HRK 2.3 million or 3.3% compared to the previous year, of which 63.1 million Croatian Kuna referred to salaries, down by 3.2% compared to the previous year, while 4.6 million Croatian Kuna referred to allowances and benefits to which employees are entitled based on the Collective Agreement and Labour. The ratio of payroll expenses to number of employees should be taken cautiously as at the end of December 2018, an increased number of workers retired, which reduced the average number of employees but

did not affect the payroll expenses.

## Average net monthly salary trend



Calculated in accordance with the State Statistics Institute's calculation methods, the average net salary per month in 2018 amounted to HRK 6,845.00, which is at the average salary level of the previous year. Although the average net salary in Viktor Lenac recorded a slow growth compared to the previous year, it is still significantly higher than the average net salary in the Republic of Croatia, up by 9.7% compared to the total net average of the Republic of Croatia or up by 19.9% compared to the average net salary for the 'C' sector (manufacturing industry). The salary is composed of a fixed part and a variable part allowing increase or decrease depending on operating results and occupancy rates. The Company's average net 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. Compared with the previous year, total payroll expenses have been reduced largely due to a decrease in the average number of employees and lower occupancy rates, or a decrease in the number of total working days, which to a

large extent affect costs associated with occupational safety and transportation cost. Compared to the previous year, the cost of non-taxable payments increased, mainly as a result of the increased retirement rate, which affected the increase in severance payments.

## Employee Education

Viktor Lenac has been continuously investing in education and professional training of their employees at all levels of business activity and continued so during 2018, though somewhat reduced in intensity.

Leadership education and training at all levels aimed at improving and developing business management and managerial skills to increase efficiency, reduce costs and raise individual responsibility was completed last year as planned. These education activities were organized as in-house training in cooperation with an external educational institution for performance development, and the program included managers of all business functions.

Other educational activities involved improving negotiating skills in sales and foreign language skills. Certain number of workers attended a school of professional higher education in fire protection. Employees have attended various seminars in customs, safety, fire protection and environmental protection, GDPR regulations, quality management systems, including education for quality audit. Part of the production workers started training for simpler production and operations support tasks that go beyond the narrow scope of their jobs, with the aim of further introducing and improving multi-skill work and increasing efficiency.

Direct costs of education and training activities in 2018 amounted to 347,800 Croatian Kuna, down by 30% compared to the previous year.

## Social Dialogue

The year 2018 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 2018, the Workers' Council held four sessions, of which all workers have been informed through their representatives and by the minutes of these sessions. Two Workers' Assemblies were held where the President of the Board addressed the workers and directly informed them on business operations, development plans and other issues relevant to the workers position.

During the process of change in the ownership, by which Italy's Palumbo Group became the majority owner of Viktor Lenac, workers were regularly informed by the Workers' Council and trade union organizations about the takeover process. Upon completion of the process, the new owner held meetings with trade union representatives, the president of the Workers' Council and some of the managers, where they were informed on the Company's business development goals.

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. In February 2017, at Unions' initiative, started collective bargaining renegotiation between the Unions and the employer. New Collective Agreement, signed in June 2017, will provide an increase in statutory minimum wage rates and an increase in basic salary, hot meal allowances and an increase in longevity allowances. Other benefits and allowances have remained unchanged, some of them increased, such as severance pay.

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.

## FINANCIAL RESULT

### Revenues and Expenses

Revenues generated in 2018, both at the level of the Parent Company and at the level of the Group, decreased by almost half compared to the previous year. Such a drastic decline in occupancy and drop in revenue was primarily due to a lack of major projects such as extensive overhaul and modification of a US Navy's military ship that had marked 2017, which was an exceptionally successful year. In addition, a decrease in demand for standard shiprepair works within the reach area or reduced average scope of work in shiprepair, further strengthening of Turkish competitors on the account of a dramatic fall of Turkish lira against European and US currency and losses generated by shipping companies have caused unit sales prices to fall, which also affected Viktor Lenac. The revenues decreased by 10% with respect to the plan, which can be directly attributed to lower prices and a reduction in the scope of work in shiprepair. During 2018, over 80 shiprepair contracts were completed. The average value of standard shiprepair works carried out onboard merchant ships decreased by more than 25% compared to 2017.

000 HRK

	Parent Company			Group			Influence of subsidiaries' results on the Group's result 2018
	2017	2018	2018/2017	2017	2018	2018/2017	
Sales	480.495	227.250	47,3%	481.247	228.540	47,5%	0,6%
Revenues from using own products	26.686	17.360	65,1%	26.686	17.360	65,1%	0,0%
Sale of material and waste	3.751	1.708	45,5%	3.751	1.658	44,2%	3,0%
Other operating revenues	3.074	6.549	213,0%	2.894	6.428	222,2%	1,9%
<b>Total operating revenue</b>	<b>514.006</b>	<b>252.867</b>	49,2%	<b>514.560</b>	<b>253.986</b>	49,4%	0,4%
Financial income	237	253	106,8%	243	260	107,0%	2,7%
<b>Total revenues</b>	<b>514.243</b>	<b>253.120</b>	49,2%	<b>514.803</b>	<b>254.246</b>	49,4%	0,4%
Material cost*	340.147	168.950	49,7%	337.906	163.514	48,4%	3,3%
Salaries*	65.791	62.639	95,2%	68.258	68.109	99,8%	8,0%
Depreciation	26.501	22.824	86,1%	26.652	23.013	86,3%	0,8%
Other cost	27.959	16.604	59,4%	28.433	17.516	61,6%	5,2%
<b>Total operating expense</b>	<b>460.398</b>	<b>271.017</b>	58,9%	<b>461.249</b>	<b>272.152</b>	59,0%	0,4%
Financial expense	8.248	3.116	37,8%	8.256	3.133	37,9%	0,5%
<b>Total expenses</b>	<b>468.646</b>	<b>274.133</b>	58,5%	<b>469.505</b>	<b>275.285</b>	58,6%	0,4%
<b>Profit/Loss before tax</b>	<b>45.596</b>	<b>-21.013</b>	-46,1%	<b>45.298</b>	<b>-21.039</b>	-46,4%	0,1%
Profit tax	8.569			8.569	29	0,5%	100,0%
Loss attributed to minority interest				-37	-65		
<b>Net profit</b>	<b>37.027</b>	<b>-21.013</b>	-56,8%	<b>36.766</b>	<b>-21.003</b>	-57,2%	0,0%

\* Adjusted for increase or decrease of work in progress

The low occupancy period was used for investment works on the Shipyard's Floating docks to increase docks useful life and value. Other operating revenues, composed of sale of material and waste, provisions reversed, income from receivables previously written off, write-offs and other operating and extraordinary income, participated with only 3% of total operating revenues.

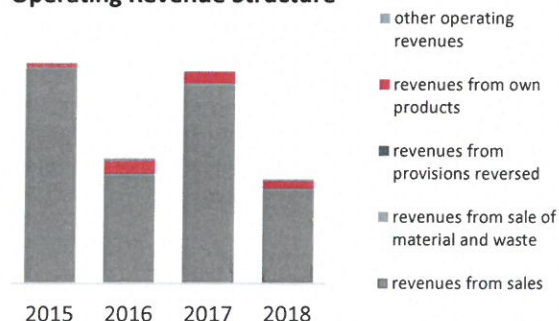
Besides the fact that 2018 was marked by lower revenues from sale, an additional problem was oscillations in occupancy, which had an impact on the increase in fixed costs due to lower utilization of production capacity, whereas in short periods of high occupancy that caused a progressive growth of variable production costs. The increase in variable production costs was primarily due to a shortage of quality workforce and its migration to Western European countries, which is no longer news, however, actual situation in domestic shipbuilding industry further aggravated the problem. For the reasons described and fixed cost share, the fall in revenues could not be proportionally accompanied by the fall in total costs, therefore, the Company, both at the level of the Parent Company and at the level of the Group, produced a loss.

Put in the perspective of the total structure of operating expenses, the material costs were the most significant, representing more than 60% of total operating expenses, most of which were related to variable production costs, largely in line with revenue trends. Of the total material costs incurred in 2018, 26.0% referred to material and energy costs, 67.2% were subcontractors and other external services, and 6.8% accounted for other services related to utilization and maintenance of production and other capacities. Salary cost is fixed cost, approximately equal in absolute amount but different in relative ratio depending on capacity utilisation rate where in periods of high occupancy subcontractors' workforce is engaged.

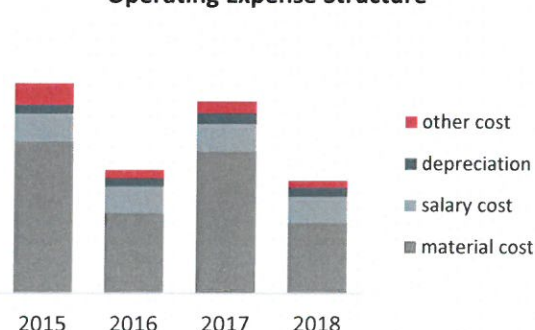
In 2018, the salary cost accounted for about 23% of total operating expenses, similar as in 2016, also marked by lower occupancy, unlike 2017 when the salary cost represented 15% of total operating expenses. Other costs involved various operating costs, mainly administrative costs that are relatively independent of the volume of operating revenues such as various non-taxable employee benefits, insurance premiums, bank and utility fees. Other expenses as shown in the graph include accrued annual leave, litigation contingencies, value adjustments and other operating expenses.

Costs are allocated to direct working orders as carriers of revenue generation or assets creation. Of the total operating expenses incurred in 2018 (excluding depreciation), 35% referred to overhead cost, or overhead and general and administrative expenses, which are largely fixed costs. Their share in total expenses therefore varies; in periods marked by high occupancy their share is lower, such as

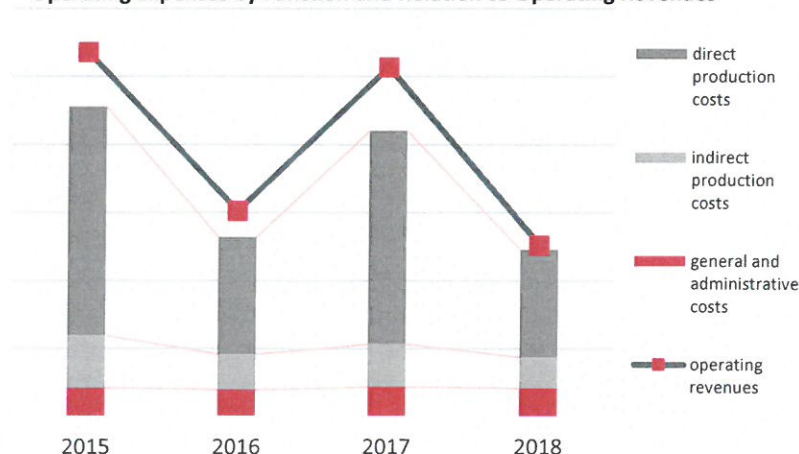
**Operating Revenue Structure**



**Operating Expense Structure**



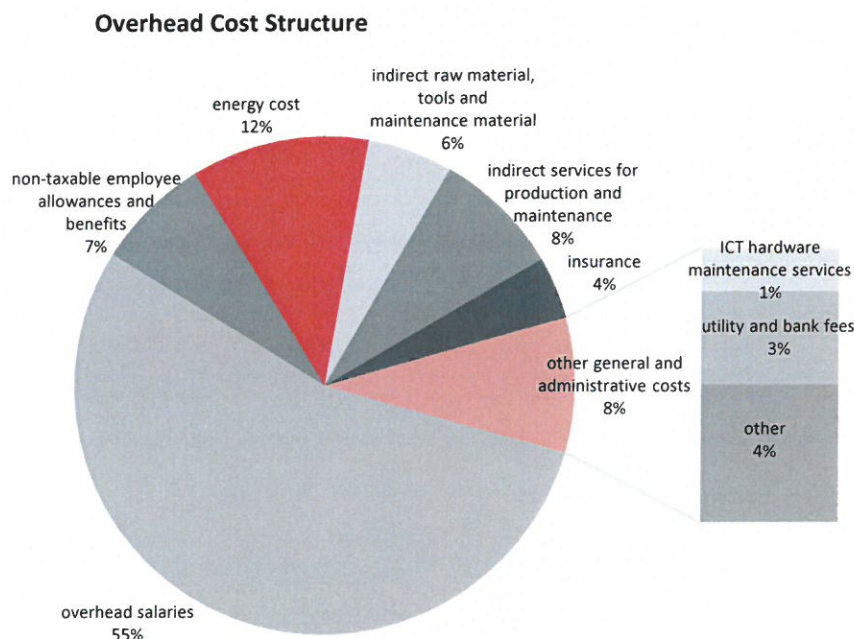
**Operating Expenses by Function and Relation to Operating Revenues**



was in 2017 and 2015, whereas in periods of low occupancy or oscillations in occupancy the share of such costs in total costs is higher. General and administrative expenses are fixed costs. Overhead cost or indirect production costs are partly variable, but to a significant extent they are of a fixed nature on the account of passive standby operation regime. The most significant overhead costs are salaries paid to overhead workers and direct production workers for non-effective work hours and work hours not directly related to revenue generation or assets creation, energy costs, property maintenance costs, overhead material in production, non-taxable employee allowances, personal protective equipment, insurance premiums, utility and bank fees.

Cost reduction is a continuous process of improvement, having in mind that high cost produced in passive standby operation regime imposes a considerable burden especially in periods of oscillations in occupancy and considering that recent years have been marked by an increasing reduction in the scope of work in shiprepair and drop in sales prices. Despite the increase in the number of shiprepair contracts, a decrease in average and total revenues results in lower gross margins, which may not be sufficient to cover all general and administrative costs, including depreciation and financial expenses, as was the case in 2018, in which Viktor Lenac produced a loss, although a positive EBITDA was achieved.

Further overhead cost reduction is not likely to be achieved since overhead costs mostly depend on prices that the Company cannot influence and derive from the very nature of the activity and are set by regulations and rules. Significant savings can be achieved by reducing labor costs by increasing efficiency and improving organization of work activities, or by better utilizing work resources. This is a permanent and continuous process, as the market is becoming more competitive and prices are under constant pressure to drop, and often the process is not flexible enough to adapt promptly to market needs and requirements.



The difference between operating revenues and expenses, including provisions for costs and value adjustments of property in 2018, resulted in an operating profit before depreciation in a total amount of HRK 4.7 million (Group: HRK 4.8 million), representing a 1.9% rate in relation to operating revenues compared to a 15% rate in 2017.

Depreciation cost amounted to HRK 22.8 million (Group: HRK 23.0 million), down by HRK 3.6 million compared to the previous year.

The difference between financial income and expense generated a total negative balance of HRK 2.9 million, of which net interest expenses amounted to HRK 2.2 million, while the net negative exchange rate difference was HRK 0.7 million, almost at entirely referred to the Parent company. 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.

After calculating the cost of depreciation and net financial expense, Viktor Lenac generated a net loss in the amount of HRK 21.0 million. The subsidiary company *Viktor-Servisi* earned HRK 234,000 in profit, while the other

subsidiary company *VL Steel* produced a loss in the amount of HRK 260,000. After calculating a profit tax in the amount of HRK 29,000 (subsidiary company *Viktor-Servisi*) and a minority interest amounting to HRK 65,000 (*VL Steel*), the consolidated net loss of the Group almost equaled the loss of the Parent company.

## Assets and Liabilities

	Parent Company			Group			Influence of subsidiaries' results on the Group's Balance Sheet 2018
	2017	2018	2018/2017	2017	2018	2018/2017	
Long-term assets	294.255	292.816	99,5%	294.563	293.157	99,5%	0,1%
Short-term assets	108.240	66.971	61,9%	109.987	68.922	62,7%	2,8%
Long-term liabilities	65.375	54.335	83,1%	65.401	54.355	83,1%	0,0%
Short-term liabilities	92.858	83.305	89,7%	91.984	82.687	89,9%	0,7%
Equity and reserves	244.262	222.147	90,9%	247.165	224.973	91,0%	1,3%
<b>Total assets/resources</b>	<b>402.495</b>	<b>359.787</b>	<b>89,4%</b>	<b>404.550</b>	<b>362.015</b>	<b>89,5%</b>	<b>0,6%</b>

The total value of Viktor Lenac's assets on 31 December 2018 amounted to HRK 360 million, of which HRK 293 million or 80% of fixed assets. The fixed assets of the subsidiary companies amounted to only about HRK 300,000. During 2018, investments in long-term tangible and intangible assets totaled less than the accrued depreciation, so the total value of long-term assets was reduced by HRK 1.4 million. There were no new investments in long-term financial assets or release of assets, resulting in changes without any material significance due to the effect of exchange rate differences or adjustments to market value of investments.

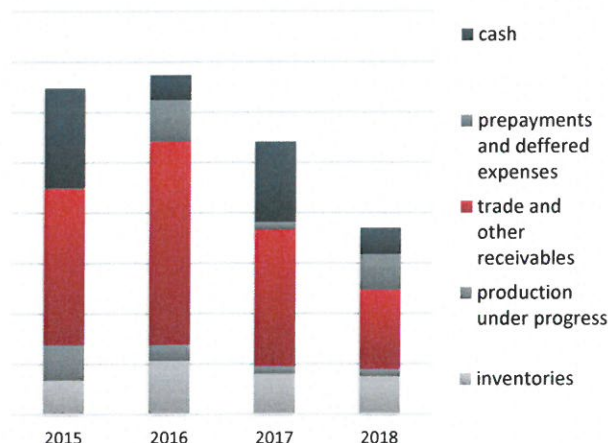
Tangible assets accounted for 95% of total long-term assets, with the most significant value being floating docks. The value of land and buildings is not significant, as production and business activities take place on a maritime good, based on a concession contract.

Compared to 2017, short-term assets decreased by HRK 41 million. Lower occupancy and a lack of major projects resulted in a decrease in trade receivables and receivables for advance payments. The loss generated in 2018, including changes in working capital, resulted in a decrease in available cash for HRK 21.5 million, precisely in the amount of the loss, so that the available cash at the end of 2018 was somewhat above HRK 10 million.

Inventories amounted to HRK 15 million and made up one fifth of short-term assets. Trade receivables, production under progress and prepayments and deferred expenses, which are directly related to shiprepair services and have a rapid turnover, are liquid assets.

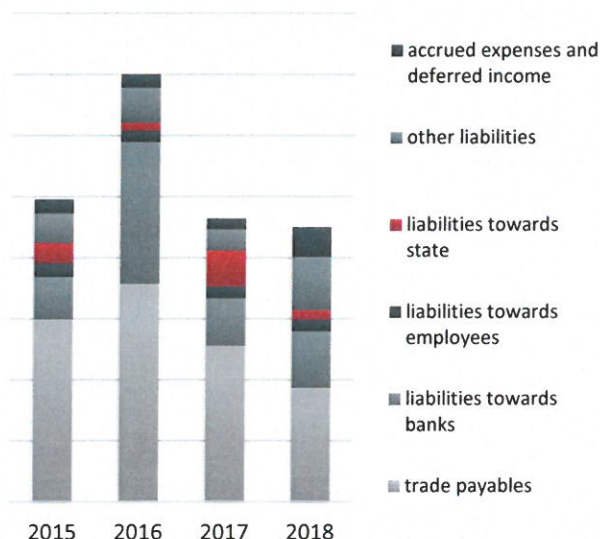
The loss caused a change in the working capital, and the decline in short-term assets was not accompanied by a corresponding reduction in short-term liabilities. Trade payables were lower on the account of a decrease in occupancy and reduced engagement of subcontractors. Liabilities to the state remained at an usual level, without taking into account profit tax liabilities, which is why their level was higher in 2017 and 2015. Compared to 2017, liabilities towards banks increased as the Company needed working capital financing and due to transfer of

### Short-term Asset Structure as of 31 Dec



current maturities of long-term loans. There was an increase in other liabilities primarily on the account of advance payments received.

**Short-term Liability Structure as of 31 Dec**



over 50%.

Short-term liabilities exceeded short-term assets by HRK 16 million, resulting in a decrease in working capital of HRK 31 million (accruals included). Compared to 2017, long-term liabilities decreased by HRK 11 million. Of the total HRK 54 million in long-term liabilities, HRK 34 million related to long-term investment loans, HRK 5 million were long-term financial leasing liabilities and HRK 10 million were liabilities derived from financing of energy efficiency projects completed in 2015 and 2016. The remaining HRK 5 million involves litigation contingencies where the Company is defendant, most of which relates to provisions for disputed claims of former bankruptcy creditors.

Total equity and reserves of Viktor Lenac on 31 December 2018 amounted to HRK 222 million, or HRK 225 million for the Group, which in both cases exceeds the amount of total liabilities by

## 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. However, a crisis situation and unemployment characterizing the nearby Croatian newbuilding shipyards have adversely affected the survival and the possibility of retaining joint subcontractors. This affects the shortage of quality workforce used by Viktor Lenac, reducing workmanship quality and increasing labor costs caused by lower efficiency.

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, whether it is for EU customers or clients from third countries.

### 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. The competitiveness of Viktor Lenac and its positioning vis-à-vis its major competitors - Turkish shipyards, was largely influenced by currency fluctuations in Turkey. The Turkish lira weakened against US and European currencies, which further increased the competitiveness of Turkish shipyards, putting more pressure on Viktor Lenac to reduce its prices.

## Price Risk

Due to a shortage of qualified workforce on domestic labour market, Viktor Lenac can expect further labour 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. The import of labour from abroad, even from less developed countries, does not solve the problem of rising labour costs, primarily because of the high costs of accommodation and food, which are additionally burdened by taxation, which employers must provide.

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

Shortage in skilled workers is a problem that has been present in the shipbuilding industry for a long time. Given that the production activity of the Company is labour intensive, personnel risk is assessed as a very important risk for total business. 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. Additional risk is the ever-increasing migration of high-quality workforce to Western European countries, and therefore, pressure to increase labour costs in order to attract and retain quality workers. In periods characterized by high occupancy rates, Viktor Lenac seeks to hire foreign workers, especially from Ukraine and Bulgaria. Labour cost increase is compensated 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 US Navy contracts stipulated in US dollars may result in higher negative exchange rate differences, accounting for less than 1% of operating revenue, therefore, the US dollar currency risk is not considered particularly significant. 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 implies non-fulfilment of contractual obligations of other counterparties that could produce a monetary loss, primarily referring to trade receivables. Viktor Lenac uses different payment terms depending on client's financial capability assessment. The objective is to do business with steady customers, whose credibility can be assessed more safely having in mind long-term cooperation. In case there is a higher payment risk, the objective is to agree payment in full before redelivery. 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. Trade receivables are discounted for doubtful receivables that generally make less than 1% of total turnover, which makes default risk low. There is no other significant default risk focus.

## 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 and currency risk. 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.



## OWNERSHIP STRUCTURE

On the day of 31 December 2017, 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 2018, the Zagreb Stock Exchange recorded 2220 transactions in trading of Viktor Lenac's stocks having a trade transaction value of 82,701,634 HRK from 9,026,463 shares, with the average cost of HRK 9.16 per share, with the lowest trading price being HRK 5.70, and the highest HRK 14.70 per share.

In June 2018, Italy's shipbuilding group Palumbo Group S.p.A. from Naples, in accordance with the Croatian regulations, after having acquired 25% of the share capital of the Company, published the takeover bid. After the takeover process had been completed and approved by the Croatian Financial Services Supervisory Agency (HANFA), Palumbo Group S.p.A. has acquired a total of 10,035,888 shares of the Company, representing 59.69% of the Company's share capital, and the associated company P & L Shiprepair Holding Limited, Malta, with which the Palumbo Group operated jointly, has acquired an additional 3,745,572 of shares or 22.28% in the Company's share capital. The shares were offered to the shareholders at a price of HRK 9.26 per share. More detailed information on the takeover process is published on the Zagreb Stock Exchange website.



The Company holds 825,187 of its own shares, representing 4.91% of the total share capital of the Company, which were acquired until 2011 pursuant to decisions of the General Assembly of the Company. In the takeover process, the Company retained its own shares in its entirety.

After the completion of the takeover process by the Palumbo Group, the Company retained a large number of small shareholders or 757 as of December 31, 2018. All small shareholders or those holding less than 5% of the share capital, represent 13.13% of the Company's ownership structure.

## Ownership structure as of 31 December 2018:

	Shareholder	Number of Shares	Percentage of Equity
1	Palumbo Group S.p.A. Italy	10.035.888	59,69
2	Interkapital vrijednosni papiri d.o.o./Guardianship account	3.745.572	22,28
3	Brodogradilište Viktor Lenac d.d.	825.187	4,91
4	Jadroagent d.d.	324.766	1,93
5	Croatian Centre for Restructuring and Sales/Republic of Croatia	122.669	0,73
6	R.L.E., t.p., Drniš	105.211	0,63
7	Weiss Branka Maria	77.308	0,46
8	Kera Ivana	58.321	0,35
9	HPB d.d./HPBS-6	48.186	0,29
10	Other	1.440.031	8,74
	<b>Total:</b>	<b>16.813.247</b>	<b>100,00</b>

## 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 2018, 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 was convened in August 2018, but was postponed to September for lack of quorum.

In June 2018, Italy's shipbuilding group Palumbo Group S.p.A. from Naples, in accordance with the Croatian regulations, after having acquired 25% of the share capital of the Company, published the takeover bid. After the takeover process had been completed and approved by the Croatian Financial Services Supervisory Agency (HANFA), Palumbo Group S.p.A. has acquired a total of 10,035,888 shares of the Company, representing 59.69% of the Company's share capital, and the associated company P & L Shiprepair Holding Limited, Malta, with which the Palumbo Group operated jointly, has acquired an additional 3,745,572 of shares or 22.28% in the Company's share capital. An extraordinary session of the General Assembly was held in December 2018, where new members of the Supervisory Board were elected in accordance with changes in the Company's ownership structure.

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 BOARD 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 was composed until December 2018 of the following members: John Karavanić (Chairman), Elvis Pahljina (Vice-Chairman), and Hrvoje Markulinčić and Luka Kolanović as members of the Supervisory Board. Following the changes in the ownership structure of the Company and based on the decision of the Extraordinary General Assembly of the Company, on December 5, 2018, the new Supervisory Board was appointed composing of Antonio Palumbo as Chairman, Raffaele Palumbo as Vice-Chairman, Giorgio Filippi and Francesco Ciaramella as members.

A workers' representative in the Supervisory Board is elected by the Workers' Council for the period of three years. In April 2017, a new Workers' Council was elected for a new three-year term with Zoran Košuta in quality of a new representative of workers in the Supervisory Board.

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

The total remuneration for the members of the Supervisory Board and Committee for Audit for 2018 amounted to HRK 486,071.00, including all taxes and contributions.

### MANAGEMENT BOARD

The Company's Management Board is composed of the following members: Aljoša Pavelin, President of the Board & CEO and Sandra Uzelac, Member of the Board. The Supervisory Board appointed 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. Sandra Uzelac was appointed to the position of Member of the Board in April 2013 for a term of five years.

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 and bonuses (for results achieved in 2017) paid to the members of the Management Board for the year 2018 was 2,946,802 Croatian Kuna, including all taxes and contributions.

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.

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



## FOR INFORMATION

### Management

**Bojan Kavazović**, 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

Deloitte d.o.o. Zagreb

### Contact Details

Brodogradilište Viktor Lenac d.d.  
Martinšćica bb, p.p 210  
HR- 51000 Rijeka

tel: +385 51 40 55 55

fax: +385 51 21 71 75

email: [viktor.lenac@lenac.hr](mailto:viktor.lenac@lenac.hr)

[http: //www.lenac.hr](http://www.lenac.hr)

Pursuant to Article 272.p and with reference to Article 250.a of the Companies Act (Official Gazette No. 111/93, 34/99, 121/99, 52/00, 118/03, 107/07, 146/08, 137/09, 125/11, 152/11, 11/12, 68/13 and 110/15 hereinafter referred to as 'CA'), and pursuant to Article 22 of the Law on Accounting (Official Gazette No. 78/15, 134/15, 120/16 and 116/18, hereinafter referred to as 'LOA'), the Management Board of Viktor Lenac Shipyard (hereinafter referred to as 'Company'), on this April 19, 2019, 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 2018, 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 31 December 2018, ten largest shareholders were the following ones:

	Shareholder	Number of Shares	Percentage of Equity
1	Palumbo Group S.p.A. Italy	10.035.888	59,69
2	Interkapital vrijednosni papiri d.o.o./Guardianship account	3.745.572	22,28
3	Brodogradilište Viktor Lenac d.d.	825.187	4,91
4	Jadroagent d.d.	324.766	1,93
5	Croatian Centre for Restructuring and Sales/Republic of Croatia	122.669	0,73
6	R.L.E., t.p., Drniš	105.211	0,63
7	Weiss Branka Maria	77.308	0,46
8	Kera Ivana	58.321	0,35
9	HPB d.d./HPBS-6	48.186	0,29
10	Other	1.440.031	8,74
	<b>Total:</b>	<b>16.813.247</b>	<b>100,00</b>

The General Assembly meets in regular sessions in accordance with the Company's Articles of Association and legal regulations. Shareholders may participate either personally or through a person granted by a power of attorney. Decisions of the General Assembly are made by a majority of the members present and voting, or by a two-thirds majority on statutory issues. The General Assembly is chaired by the Chairman of the General Assembly, appointed by the Supervisory Board of the Company. The General Assembly has the authority to make decisions in accordance with the provisions of the Companies Act and the Company's Articles of Association.

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, Aljoša Pavelin holding the position of the President of the Board and Sandra Uzelac performing the duties of the Member of the Board. 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 was composed of the following members: John Karavanić (Chairman), Elvis Pahljina (Vice-Chairman), and Hrvoje Markulinčić and Luka Kolanović as members of the Supervisory Board until December 5, 2018 when they were replaced by the new members: Antonio Palumbo (Chairman), Raffaele Palumbo (Vice-Chairman) and Giorgio Filippi and Francesco Ciaramella as members of the Supervisory Board. Zoran Košuta in his position of the workers' representative is the fifth member of the Supervisory Board. The change in the composition of the Supervisory Board was carried out following changes in the ownership structure of the Company.

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 2018, 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 2018, the Committee held four sessions to evaluate Company's financial performance. Members of the Committee for Audit are: Elvis Pahljina, Genari Sutlović and 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 2018.

Member of the Board

Sandra Uzelac





2018

# Non-Financial Reporting **SUSTAINABILITY REPORT**



**SHIPYARD**

**VIKTOR LENAC**

*Member of Palumbo Group*

---

April 2019

## GRI 102 General disclosures



The photo shows children of the Shipyard's employees who participated in the Educational Ecological Workshop held on the Earth Day on April 22, 2018. The workshop was organized by the Environmental Protection Unit in cooperation with marines from the US Navy's *USNS Trenton*, which at that time was undergoing repairs at the Shipyard.

## Organizational profile

### 102-1 Name of the organization

Brodogradilište Viktor Lenac d.d. Rijeka

### 102-2 Activities, brands, products, and services

*Brodogradilište Viktor Lenac* (hereinafter referred to as Viktor Lenac) is a ship repairing yard whose core activity is shiprepair and conversion as well as construction of steel structures intended for offshore oil and gas production.

The shiprepair activity includes repair and maintenance works carried out onboard a ship involving its structure, equipment and systems. Conversion is modification of the size and/or type of a vessel including modification of ship systems. The shiprepair and conversion activity is significantly different from shipbuilding (newbuildings) and is labour-intensive, where labour participation rate tends to reach 70%, whereas material participates with approximately 30% in total resources. The shiprepair activity is characterized by a rapid turnover with short works performance periods of 10 to 15 days in average, and in some cases somewhat shorter or longer, depending on the scope of work. The average number of shiprepair projects carried out per year is about 80. On the other hand, conversion projects take longer and can last several months to a maximum of one year, depending on the specificity and scope of project.

The drop in oil prices in recent years has significantly reduced the number of offshore oil and gas exploitation projects in which Viktor Lenac can participate, so the offshore activity is marginalized in total project realization.

Shiprepair and conversion works are carried out on various types of merchant and military ships of up to Suezmax size, which can be accommodated in the Shipyard's largest Floating dock 11.

The Shipyard provides a whole range of services such as standard drydocking and extensive steel renewal, anti-corrosion treatment and coating of ship surfaces, various mechanical, electrical, insulation and other types of work.

### 102-3 Location of headquarters

Martinšćica bb, Rijeka, Croatia

### 102-4 Location of operations

Viktor Lenac operates in the Republic of Croatia at a production site located in the headquarters, in a marine aquatorium within the borders of a maritime good, used based on a concession contract. The Shipyard provides shiprepair and conversion services, which by their nature have impacts on employees' health and safety and the environment. Its location of operations is situated near residential and recreational facilities and thus affects the local community.

The Shipyard has a very small percentage (less than 1%) of its operations at other locations outside the location of operations, depending on project needs and clients' requests. These operations are of no material significance.

## 102-5 Ownership and legal form

Viktor Lenac is a joint-stock company. The Company's shares have been included in quotation of the Zagreb Stock Exchange.

By mid-2018, Viktor Lenac had domestic ownership, when the former owners Tankerska plovodba jsc from Zadar and Uljanik jsc from Pula, offered their shares for sale. In June 2018, Italy's shipbuilding group Palumbo Group S.p.A. from Naples, after having acquired 25% of the share capital of the Company published the takeover bid in accordance with the Croatian regulations. After the takeover process had been completed and approved by the Croatian Financial Services Supervisory Agency (HANFA), Palumbo Group S.p.A. has acquired a total of 10,035,888 shares of the Company, representing 59.69% of the Company's share capital, and the associated company P & L Shiprepair Holding Limited, Malta, with which the Palumbo Group operated jointly, has acquired an additional 3,745,572 of shares or 22.28% in the Company's share capital.

Following all the changes in the ownership, as of 31 December 2018 ten largest shareholders were the following ones:

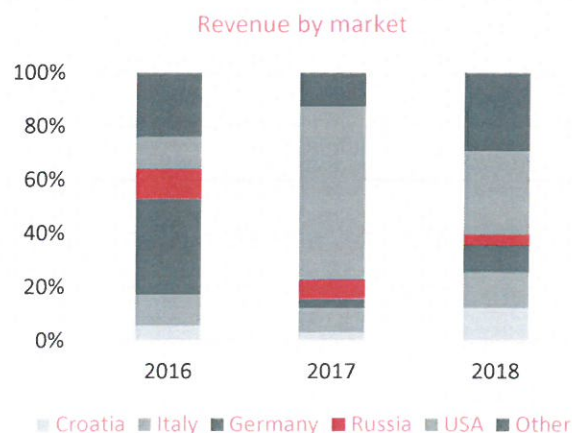
	Shareholder	Number of Shares	Percentage of Equity
1	Palumbo Group S.p.A. Italy	10.035.888	59,69
2	Interkapital vrijednosni papiri d.o.o./Guardianship account	3.745.572	22,28
3	Brodogradilište viktor lenac d.d.	825.187	4,91
4	Jadroagent d.d.	324.766	1,93
5	Croatian Centre for Restructuring and Sales/Republic of Croatia	122.669	0,73
6	R.L.E., t.p., Drniš	105.211	0,63
7	Weiss Branka Maria	77.308	0,46
8	Kera Ivana	58.321	0,35
9	HPB d.d./HPBS-6	48.186	0,29
10	Other	1.440.031	8,74
	<b>Total:</b>	<b>16.813.247</b>	<b>100,00</b>

## 102-6 Markets served

Viktor Lenac operates in the Republic of Croatia at a production site located in the headquarters. The Shipyard's shiprepair and conversion services are mostly offered onboard merchant ships of international fleets.

More than 90% of clients are foreign shipowners or shipping companies, mostly of EU origin. In terms of revenue and average project value, the most important client both in 2017 and 2018 was the US Navy.

During the last three years, Viktor Lenac's has served clients from 20 different countries, of which 13 participated in operating revenues 2018.



## 102-7 Scale of the organization

	2018	2017	2016
000 HRK			
Number of employees in the Parent company	441	488	488
Consolidated number of employees	495	514	506
Total revenues	252.582	514.243	302.991
Consolidated total revenues	253.708	514.803	303.613
Equity	225.457	244.262	208.955
Consolidated equity	222.645	247.160	212.124
Total assets	366.954	402.495	421.558
Consolidated total assets	369.182	404.550	423.466
Total number of shiprepair and special projects	84	67	84

## 102-8 Information on employees and other workers

Total number of employees by employment contract						
	Group			Parent company		
	permanent	temporary	total	permanent	temporary	total
2016	440	66	506	422	66	488
2017	462	52	514	445	43	488
2018	460	35	495	422	19	441

Total number of employees by gender						
	Group			Parent company		
	male	female	total	male	female	total
2016	477	29	506	460	28	488
2017	481	33	514	457	31	488
2018	460	35	495	408	33	441

Women are participating with only 7% of the total number of employees, which is not unusual for metal-working industry. Of the total number of female workers, only one female, employed with the Parent company, has got a temporary employment contract.

All employees are full-time employees and perform their tasks at the location of headquarters not being under the influence of any seasonal or other oscillations.

The largest number of employees are production workers, both in the Parent company and the subsidiaries.

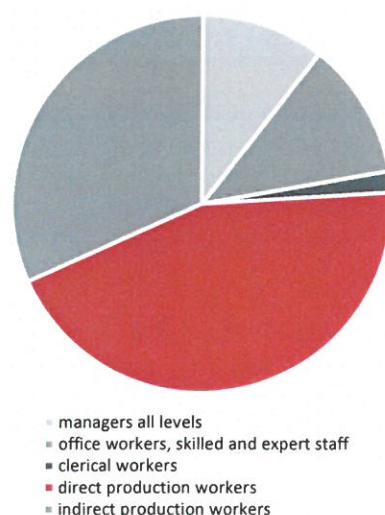
Total number of employees by job function:

Job function	Parent company	Subsidiaries
Managers all levels	46	3
Office workers, skilled and expert staff	52	
Clerical workers	8	2
Direct production workers	195	47
Indirect production workers	140	2

In addition to its own workforce, Viktor Lenac uses subcontractor workers to overcome the unwanted effects of oscillation in utilization of its capacities, which are characteristic of shiprepair and conversion activities. Put in relation to average capacity utilization rates, own production work participates with 30-40%, while subcontractor work makes a share of 60-70%. Subcontractors' services are offered within the location of operations, using both subcontractors' equipment and Shipyard's equipment, whereas all material is provided by the Shipyard. Subcontractors are contracted on turn-key base or per hour cost.

Daily work attendance for both Shipyard's employees and subcontractors' workers is recorded via the Employee Attendance application, which allows for planning, contracting and keeping records of daily work attendance.

Organizational structure by job function



## 102-9 Supply chain

Shiprepair and conversion activities are labour-intensive. A significant part of Viktor Lenac's supply chain involves subcontractor's workforce used to compensate for a shortage in own workforce in shipbuilding and related trades.

Material cost participates with only about 20-30% in the total value of operations and involves various types of material of different value and product group.

The process of procurement and selection of suppliers starts with a product and service request. The product and service request is an ERP document launched based on production or commercial needs, which contains purpose and description of product and service and must be approved by responsible persona that may involve a user or a manager in accordance with the product and service request approval procedure. Upon receipt and processing of such request, the Procurement Department prepares and submits inquiries to all approved and potential suppliers. Collected offers are sent to the request applicant for technical verification, after which the best offer, among those that are technically acceptable, is selected by commercial terms. The final order is approved by functional executives, in accordance with predefined authorizations depending on the value of order. The procurement and selection process involve responsible persons from different organizational parts – user's

organizational unit, project team and Procurement Department with the aim of promoting the principles of transparency, business ethics, fair competition and anticorruption.

All suppliers and subcontractors must meet high standards required by good shipbuilding practice, and often the selection of supplier is determined by requirements and preferences of the client, or the specificity of a specific product or service.

All suppliers and subcontractors must be approved on the list of authorized suppliers and are evaluated on a regular basis after initial verification. Ability to meet the deadline and quality of products and services are the most important evaluation criteria, as supplier's products and services are incorporated by Viktor Lenac into their services offered to their clients, so the quality of the supplier directly reflects the quality of Viktor Lenac.

Viktor Lenac is pursuing a socially responsible business approach, focusing on occupational health and safety and environmental protection, as well as energy management since 2017, which is reflected in its relationships with suppliers and subcontractors, who, apart from being evaluated by quality of products and services and ability to meet the deadline, are evaluated based on social responsibility impacts.

Subcontractors or supplies of labour are evaluated based on the following criteria:

- Fulfilment of prescribed HSE measures during work performance period;
- Neatness and order in the workplace before and after work;
- Fulfilment of PPE requirements;
- Valid equipment in terms of HSE requirements;
- Valid documents and certificates for own equipment and material used in operations in terms of HSE requirements;
- Energy-efficient behaviour in use of resources, according to the prescribed measures for improving energy efficiency.

Suppliers of products and equipment are evaluated based on the following criteria:

- Valid documents and certificates for own equipment and material used in work in terms of HSE requirements;
- Energy efficiency of material and equipment supplied according to user experience.

Subcontractor evaluation is performed once a year or after completion of a more demanding project according to the judgment of the Head of the Procurement Department. Subcontractor selection is based on the effects of impact of a product or service on the quality of the final product. The subcontractor must obtain a score of 3 or more on a scale of 1-5 to be included in the list of approved subcontractors. If is ranked below 3, business cooperation with that subcontractor is suspended until the subcontractor has submitted evidence on implementation of improvements as suggested by responsible persons of the Shipyard. If the subcontractor did not implement the proposed improvements within the defined deadline, that subcontractor is removed from the list of approved subcontractors. The right to re-qualify for a list of approved subcontractors shall be acquired after the expiration of one year.

During 2018, Viktor Lenac engaged 740 different suppliers of products and services or other service providers, of which 524 with whom Viktor Lenac had business relationship over the past two years. Many suppliers offer both products and services and in 2018 there were about one hundred of such type.

There were 216 of new suppliers in 2018, or those with whom Viktor Lenac had no business relationship over the past two years.

Suppliers by geographic location						
Geographic location of suppliers	Number of suppliers	2018		Number of suppliers	2017	
		Percentage in the total number of suppliers	Percentage in the total value of deliveries		Percentage in the total number of suppliers	Percentage in the total value of deliveries
Croatia	616	83,2%	85,5%	640	84,1%	85,7%
EU countries	79	10,7%	8,4%	83	10,9%	8,2%
Non-EU countries	45	6,1%	6,1%	38	5,0%	6,1%
	<b>740</b>	<b>100,0%</b>	<b>100,0%</b>	<b>761</b>	<b>100,0%</b>	<b>100,0%</b>

Domestic suppliers and subcontractors have the highest participation rate, both in total number of suppliers and total value of delivered products and services, which is logical given that shiprepair activity is labour-intensive. Most products are supplied by domestic vendors given that shiprepair activity does not justify importing and holding larger quantities of the same type of material in stock.

The import totalled about 15%, where the import of products had a slightly higher participation rate with respect to services.

Suppliers by geographic location and scope of supply in 2018						
	Number of suppliers	Products		Number of suppliers	Services	
		Percentage in the total number of suppliers	Percentage in the total value of deliveries		Percentage in the total number of suppliers	Percentage in the total value of deliveries
Domestic	268	81,5%	82,1%	441	85,8%	88,0%
Import (EU and non-EU countries)	61	18,5%	17,9%	73	14,2%	12,0%
	<b>329</b>	<b>100,0%</b>	<b>100,0%</b>	<b>514</b>	<b>100,0%</b>	<b>100,0%</b>

## 102-10 Significant changes to the organization and its supply chain

During 2018, there were no significant changes to the Company's core strategy and operations. Considering that almost entire operations involved standard shiprepair projects, there were no significant changes to the supply chain, either as regards demand for specific or unusual services, products and equipment or the procurement market.

Changes to the supply chain included:

- Decrease in occupancy in 2018 compared to 2017 and decrease in the scope of production activities, which caused a decrease in the import of foreign workforce or, in other words, oscillations in occupancy were such that there was no need for engaging foreign workforce as was the case in the previous year;
- Actual events in the domestic shipbuilding environment and a significant drop in the activities of the nearby shipbuilding yards, which caused a reduction in the available subcontractor workforce used by the Shipyard that caused an increase in labour costs compared to previous years.

#### 102-11 Precautionary Principle or approach

In order to protect the environment, the Company applies the precautionary approach according to its capabilities. Environmental protection has been an integral part of the Company's business policy for years. The objective is to get certified according to ISO 14001 for environmental management in near future. All activities of the Shipyard are assessed in terms of contribution to environmental impacts and preventive measures for environmental protection are undertaken accordingly, including intervention and corrective measures. When there is a threat of serious or irrevocable damage, lack of full scientific certainty shall not be used as a reason for postponing cost-effective measures to prevent environmental degradation. The organization's impacts on the environment are continuously monitored both internally and externally, where particular attention is paid to waste management.

#### 102-12 External initiatives

Key principle is to provide the best quality service, in a safe way and on time. In accordance with its quality management policy, the Company is committed to a long-term stable and profitable business in order to meet expectations of shareholders, employees and the range of stakeholders. The Company's quality management system, which integrates HSE and energy management subsystems, has been developed in compliance with standards and principles deriving from law, requirements, guidelines, recommendations and good practice principles, of which most significant are the following:

- Labour Act
- Occupational Health and Safety Act
- Environmental Protection Act
- ISO 9001:2015
- ISO 50001:2011

Observing principles of transparency in public knowledge, Viktor Lenac endorses the initiatives of timely, accurate and relevant information to all the stakeholders, as required by:

- Capital Market Act
- Accounting Act
- Zagreb Exchange Corporate Governance Code

#### 102-13 Membership of associations

In 2018, Viktor Lenac maintained membership in the following associations:

- Croatian Employers' Association
- Croatian Chamber of Commerce
- Electrotechnical Association Zagreb

Viktor Lenac participates in the Economic Council of the County Chamber Rijeka, represented by the President of the Board.

Total membership fees for 2018 amounted to HRK 42,094.60.

## Strategy

### 102-14 Statement from senior decision-maker

Dear Readers, Dear Stakeholders,

You are reading a non-financial report of Viktor Lenac, which, as one of the leading ship repairing yards in the Mediterranean, causes significant economic, environmental, and social impacts that affect its environment and stakeholders.

This is just the second non-financial report that presents material topics and indicators we consider to be the most relevant for our organization and our attitude towards our stakeholders, however, we have been pursuing sustainable development as an integral part of our long-term business strategy.

We seek to continuously develop and improve our management systems to effectively manage all impacts of responsible business - economic, social and environmental, with the aim of ensuring a safe and stable development and growth of the Company and improving our position in the market. We strive to reduce any negative impacts that are linked to our activities and create the greatest possible value for all the stakeholders.

Sustainability strategy and its relevance for the organization is built into our quality management system in accordance with ISO 9001, as the initiative we endorse since 1997, which also incorporates determinants of occupational health and safety management and environmental management. Aware of the significance of energy management, in the beginning of 2018 we got certified according to ISO 50001 Energy Management. In order to improve all business processes and to strengthen the relevance of management systems oriented to responsible business, we have also decided to initiate the process of certification according to ISO 45001 Occupational Health and Safety Management and ISO 14001 Environmental Management and we expect the process to be completed by the end 2019.

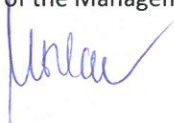
The reporting 2018 was extremely demanding both in terms of occupancy and employee structure. Due to a shortfall in revenues on one side and increase in labour cost on the other side, in the context of actual unfavourable developments in the domestic shipbuilding industry, we have not been able to maintain positive results, but ended the year with a loss. Nevertheless, in the given circumstances, we consider that we have managed to maintain responsible business towards all the stakeholders in all business segments, primarily on the account of the above-average results achieved in the previous year.

Our sustainable growth and development is based on continuous improvements and a flexible approach to commercial and production activities in highly dynamic and changing market and environment, while appreciating all material topics of sustainability and investing in welfare of the range of stakeholders, from employees to shareholders through suppliers and subcontractors, all the way to the local community.

We believe that 2019 and the following year will bring results that will enable us to make new positive achievements and achieve new goals of sustainability, new values for our customers, employees, business partners and the environment. Some decisions will be neither simple nor easy, but all will aim at improving our business, increasing resource utilization, reducing negative environmental impacts and achieving other core values and principles for our sustainable business.

Sandra Uzelac

Member of the Management Board



## Ethics and integrity

### 102-16 Values, principles, standards, and norms of behaviour

Our values and principles entail from our vision and mission. Company's vision is to be the first choice for our clients when choosing a trusted shipyard in the Mediterranean. Our mission is to be support to our clients when they need us, delivering the top-quality service, in a safe way and on time.

Basic values that Company promotes are open communication, valuation of knowledge, work and results, taking responsibility for work and concern and respect for workers.

In April 2017, the Company established the Code of Business Conduct. The Company believes in responsible social and ethical behaviour. The obligation for all employees is to observe high standards of integrity and transparency. The Code of Business Conduct shall imply:

- Legal compliance;
- Prohibiting the use of child labour and forced or compulsory labour;
- Freedom of association and collective bargaining;
- Transparency, non-discrimination and equal opportunities;
- Promoting open approach in respecting labour relations, promotion at work and teamwork;
- Evaluating employees exclusively according to their knowledge, commitment and attitude towards colleagues and success of the Company;
- Ensuring safe working environment and reducing the risk associated with workplace hazards;
- Observing laws and regulations and promoting environmental protection and sustainability projects;
- Fair market competition;
- Social responsibility and supporting local and regional community;
- Observing laws and regulations of other countries and foreign clients;
- Preventing fraud, bribery and corruption from affecting business;
- Avoiding workplace conflicts of interest;
- Promoting open communication, reporting and transparency towards all stakeholders.

## Governance

### 102-18 Governance structure

The Company's governance structure follows the two-tiered board system consisting of Supervisory Board and Management Board.

Members of the Supervisory Board are elected and dismissed by the General Assembly where shareholders exercise their rights according to provisions of the Companies Act and Company's Articles of Association.

The Supervisory Board supervises how the Management Board manages organization's business, appoints and dismisses members of the Management Board, approves financial statements and gives its consent for certain business operations according to the Articles of Association. The Supervisory Board is composed of five members, of which four are elected by the General Assembly, while the fifth member as Workers' representative in the Supervisory Board is elected by the Workers' Council.

Members of the Supervisory Boards in 2108 were: John Karavanić, Chairman of the Supervisory Board, Elvis Pahljina, Vice-chairman of the Supervisory Board, Hrvoje Markulinčić and Luka Kolanović, Members of the Supervisory Board and Zoran Košuta the fifth member as Workers' representative.

The Committee for Audit 2018, established by the Supervisory Board, was composed of the following members: Elvis Pahljina, Chairman of the Committee for Audit, Genarij Sutlović, Vice-chairman of the Committee for Audit and Ines Mirković, Member of the Committee for Audit.

Following changes in the ownership (See 102-5) and based on decisions adopted by the General Assembly, new members of the Supervisory Board as of December 5, 2018 are: Antonio Palumbo (Chairman), Raffaele Palumbo (Vice-Chairman) and Giorgio Filippi and Francesco Ciaramella as Members of the Supervisory Board, whereas Zoran Košuta remained as the fifth member as Workers' representative.

The Management Board was composed of the President of the Management Board & CEO, Aljoša Pavelin and Member of the Management Board & CFO, Sandra Uzelac.

The Management Board is responsible for decision-making on economic, environmental, and social topics based on proposals made by executive-level positions that respond directly to the Management Board.

## Stakeholder engagement

- 102-40 List of stakeholder groups
- 102-42 Identifying and selecting stakeholders
- 102-43 Approach to stakeholder engagement
- 102-44 Key topics and concerns raised

A list of stakeholder groups engaged by the organization, including their needs and expectations that are under impacts which can be directly linked to Viktor Lenac's activities, has been established based on the organization's quality management system and legislation relevant for its specific activity:

Stakeholder groups	Stakeholders' needs and expectations as a basis for their involvement	Key topics for stakeholders
Customers	Price, Reliability, Value, Quality, Occupational Safety	Economic Impact, Occupational Health and Safety, Energy
Shareholders	Profitability, Financial Stability, Reporting and Growth of Value to Society	Economic Impact, Occupational Health and Safety, Environmental Compliance
Employees	Security in Business Continuity, Growth in Living Standards	Economic Impact, Employment, Occupational Health and Safety, Education, Market Presence

Trade unions	Security in Business Continuity, Growth in Living Standards	Employment, Occupational Health and Safety, Market Presence
Suppliers, subcontracts and other business partners	Sustainable Business Cooperation	Procurement Practice, Assessment of Supplier Impact on the Environment, Occupational Health and Safety
Law and regulatory bodies	Compliance with Regulations and Reporting	Energy, Water and Effluents, Waste, Emissions, Occupational Health and Safety, Environmental Compliance
Local community	Improving Quality of Life and Raising Living Standards of the Population in the Environment	Energy, Water and Effluents, Waste, Emissions, Environmental Compliance, Civil Society Relationships, Market Presence
Financial community	Profitability, Financial Stability, Creditworthiness, Reporting	Economic Impact

Relationships with key stakeholders are defined by the Code of Business Conduct established in April 2017.

Economic topics are relevant for all stakeholders engaged by Viktor Lenac either in terms of distribution of newly created value among employees, shareholders, suppliers, financial community and state or by strengthening value of the Company and its sustainable stability for the benefit of clients and development of local community.

Environmental topics mostly impact the local community and employees in terms of preserving healthy working and living environment.

Social topics mostly impact employees, clients, suppliers and subcontractors through implementation of safety and health protection of employees, clients and all business partners while staying or working at the Shipyard, and also ethical business conduct that promotes equal opportunities, transparency, anti-corruption, non-discrimination, human liberties and dignity.

Apart through legislation that initiates and regulates topics and interests that are significant for the stakeholders, the Company communicates with its stakeholders in various ways, which has in part defined material topics included in this report.

The Company communicates with its workers through annual workers' assemblies and monthly meetings with representatives of the Workers' Council and trade union organizations. All important information is regularly published on bulletin boards and the Company's Intranet portal.

Viktor Lenac communicates with its local community through regular correspondence in writing involving all necessary and specific issues and participation in the Commission for Environmental Protection of the Kostrena Municipality.

The Company communicates with its owners regularly through sessions of the Supervisory Board and General Assembly and in other convenient ways pursuant to provisions of the Company's Articles of Association. As a subject of public interest, the Company regularly discloses all significant events and reports to the public.

In all relationships with its stakeholders, Viktor Lenac identifies material topics relevant to socially responsible business and in that direction seeks to shape its business process management system.

#### 102-41 Collective bargaining agreements

The right to form and join trade union organizations is one of the fundamental principles Viktor Lenac endorses in long-term and is committed to promoting social dialogue with the trade unions and workers. All our employees are free to join an existing or form another association at free will, get organized and negotiate collectively and individually. No employee shall be harassed or under threat of penalty for exercising these rights.

There are two trade unions in Viktor Lenac with a total membership of 365 workers embracing 82.8% of the total number of employees:

- Metalworkers Trade Union of Croatia, Industrial Trade Union, Viktor Lenac Branch, with a total membership of 273 workers as of 31 December 2018;
- Viktor Lenac Shipyard Trade Union, with a total membership of 97 workers as of 31 December 2018.



A worker may be a member of both trade unions, and there were five such workers as of 31 December 2018.

In December 2008, the Company's Management Board and the trade unions concluded a collective agreement, which stipulates all workers' rights in terms of working hours, annual leave, minimum wages and other salary related issues as well as other material rights, occupational health and safety related issues and other. In February 2017, at the trade unions' initiative, started a process of collective bargaining renegotiation. New collective agreement, signed in June 2017, has provided an increase in statutory minimum wage rates and an increase in basic salary, hot meal allowances and an increase in longevity allowances. Other benefits and allowances have remained unchanged, some of them increased, such as severance pay. During 2018, all provisions as stipulated by the collective agreement were applied to mutual satisfaction of all interested parties.

Collective agreement provisions apply to all company workers as defined in the Collective Agreement, while provisions addressing wages, working hours and other material and non-material benefits have been incorporated in the Company's Labour Regulations.

The collective agreement concluded between the Parent company and the trade union organizations shall apply to the subsidiary company Viktor Servi d.o.o., in which out of the total of 15 employees,

13 were members of the trade union organizations as of 31 December 2018. The subsidiary company VL Steel d.o.o. did not sign the Collective Agreement.

## Reporting practice

### 102-45 Entities included in the consolidated financial statements

The Group statements and reports where Brodogradilište Viktor Lenac d.d. is the Parent company, include consolidation of the two subsidiary companies: a limited liability company *Viktor Servisi, Rijeka* that is a wholly owned subsidiary of the Viktor Lenac Shipyard, and a limited liability company *VL Steel, Rijeka*, established in October 2017, a 75% subsidiary of the Company. The influence of the subsidiaries on the Group's consolidated financial statements is only about 1%.

Both subsidiaries provide services within the production activity of Viktor Lenac. The business relationship between the Parent company and subsidiary companies is the same as the relationship between Viktor Lenac and other subcontractors engaged in the production activity. Accordingly, this report also applies to the subsidiaries, and wherever of material significance, the data relating to the subsidiaries are separately listed.

All the Parent company's statements and reports and Group's consolidated reports are available on the website of the Parent company [www.lenac.hr](http://www.lenac.hr).

### 102-46 Defining report content and topic Boundaries

In order to define the content of the report, the Company established a team of experts from those Company's organizational units which are directly linked to economic, environmental and social impacts.

The team defined and listed all significant impacts which are caused or contributed to by the Shipyard's operations, involving economic, environmental and social topics, defined key stakeholders in each category and topic, analysed market and institutional requirements as well as own determinants recognized as relevant for sustainable business.

Each topic was analysed considering its relevance in relation to the nature and structure of the activity, its significance in relation to other topics and frequency of occurrence of positive and negative impacts. Topic Boundaries have been defined depending on topic relevance to the Company's operations and internal stakeholders as well as to external stakeholders.

After having analysed all topics, a matrix of material topics was established with 22 topics being identified as those that best illustrate the Company's operations and its position and orientation in economic, environmental, and social topics in sustainable business.

## 102-47 List of material topics

### GRI 200 Economic topics

GRI 201	Economic performance
GRI 202	Market presence
GRI 204	Procurement practices

### GRI 300 Environmental topics

GRI 302	Energy
GRI 303	Water and effluents
GRI 305	Emissions
GRI 306	Effluents and waste
GRI 307	Environmental compliance

### GRI 400 Social topics

GRI 401	Employment
GRI 403	Occupational health and safety
GRI 404	Training and education

## 102-48 Restatements of information

No effect of any restatements of information given in previous reports is found.

## 102-49 Changes in reporting

The Company's Sustainability Report 2017 was prepared according to the GRI G4 guidelines. This report has been drawn up according to new GRI standards.

Compared to the previous report, the Company has estimated that some of the topics that were included in the previous report have minor significance or are not characteristic of the Company's activities, or are related to other material topics or the Company's attitude to those topics can be deduced from general or other specific disclosures in this report.

102-50	Reporting period
102-51	Date of most recent report
102-52	Reporting cycle

The Sustainability Report 2018 is the second issue of Company's non-financial reporting. The reporting period is for the fiscal year from 1 January to 31 December 2018. The Sustainability Report 2017 was published in April 2018 and is an integral part of the Annual Report published on the Company's website.

## 102-53 Contact point for questions regarding the report

The contact point for questions regarding the report or its contents:

- Maja Kriška, for Environmental impacts (Environmental Protection and Waste Management): [maja.kriska@lenac.hr](mailto:maja.kriska@lenac.hr)
- Zdenko Vidmar, for Environmental impacts (Energy Management): [zdenko.vidmar@lenac.hr](mailto:zdenko.vidmar@lenac.hr)
- Aleksandar Jurčević, for Social impacts (Labour and Labour Relations): [aleksandar.jurcevic@lenac.hr](mailto:aleksandar.jurcevic@lenac.hr)
- Dražen Bevanda, for Social impacts (Occupational Health and Safety): [drazen.bevanda@lenac.hr](mailto:drazen.bevanda@lenac.hr)
- Dolores Kuzmić, for Supplier topics (all impacts): [dolores.kuzmic@lenac.hr](mailto:dolores.kuzmic@lenac.hr)
- Sandra Uzelac, Member of the Management Board, for Economic impacts: [sandra.uzelac@lenac.hr](mailto:sandra.uzelac@lenac.hr)

## 102-54 Claims of reporting in accordance with the GRI Standards

This report has been prepared in accordance with the GRI Standards: Core option.

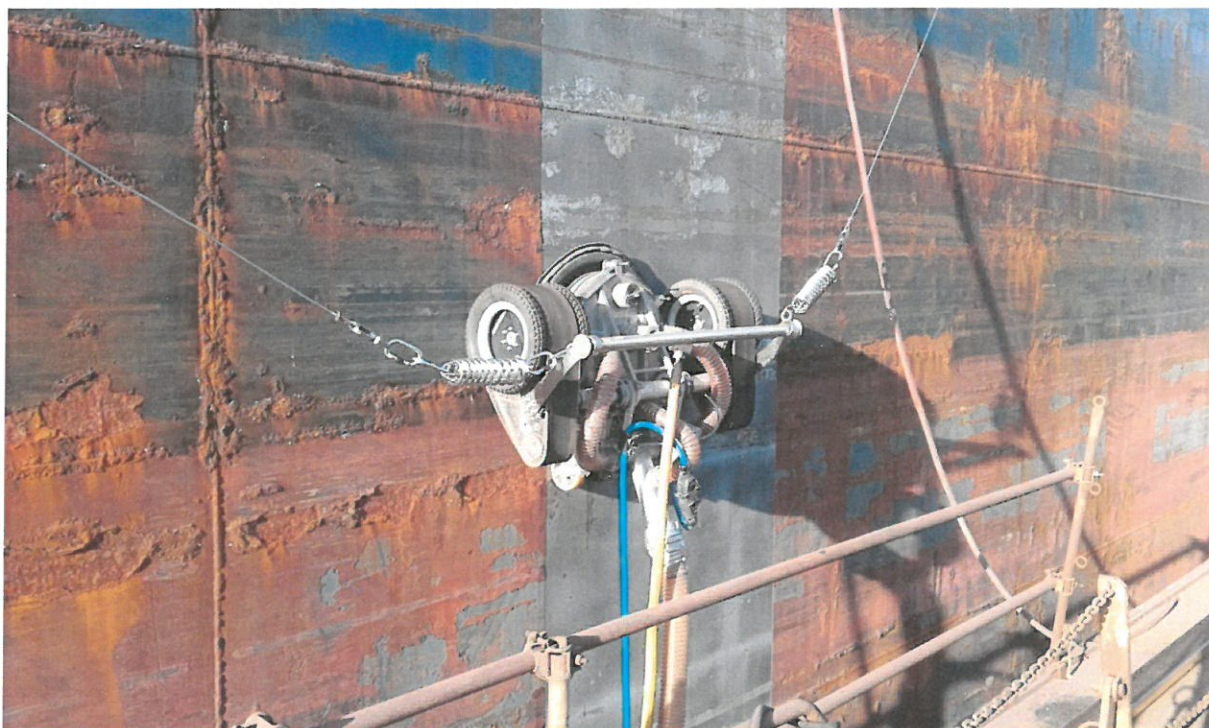
## 102-55 GRI content index

<b>GRI 102 General disclosures</b>	<b>3</b>
Organizational profile	4
102-1 Name of the organization	4
102-2 Activities, brands, products, and services	4
102-3 Location of headquarters	4
102-4 Location of operations	4
102-5 Ownership and legal form	5
102-6 Markets served	5
102-7 Scale of the organization	6
102-8 Information on employees and other workers	6
102-9 Supply chain	7
102-10 Significant changes to the organization and its supply chain	9
102-11 Precautionary Principle or approach	10
102-12 External initiatives	10
102-13 Membership of associations	10
Strategy	11
102-14 Statement from senior decision-maker	11
Ethics and integrity	12
102-16 Values, principles, standards, and norms of behaviour	12
Governance	12
102-18 Governance structure	12
Stakeholder engagement	13
102-40 List of stakeholder groups	13
102-42 Identifying and selecting stakeholders	13
102-43 Approach to stakeholder engagement	13
102-44 Key topics and concerns raised	13
102-41 Collective bargaining agreements	15
Reporting practice	16
102-45 Entities included in the consolidated financial statements	16
102-46 Defining report content and topic Boundaries	16
102-47 List of material topics	17
102-48 Restatements of information	17
102-49 Changes in reporting	17
102-50 Reporting period	18
102-51 Date of most recent report	18

102-52	Reporting cycle.....	18
102-53	Contact point for questions regarding the report .....	18
102-54	Claims of reporting in accordance with the GRI Standards .....	18
102-55	GRI content index.....	19
<b>GRI 200</b>	<b>Economic topics .....</b>	<b>22</b>
GRI 201	Economic performance.....	23
103-1	Explanation of the material topic and its Boundary .....	23
103-2	The management approach and its components.....	23
103-3	Evaluation of the management approach .....	23
201-1	Direct economic value generated and distributed .....	24
201-4	Financial assistance received from government .....	24
GRI 202	Market presence.....	24
103-1	Explanation of the material topic and its Boundary .....	24
103-2	The management approach and its components.....	25
103-3	Evaluation of the management approach .....	25
202-1	Ratios of standard entry level wage by gender compared to local minimum wage .....	25
202-2	Proportion of senior management hired from the local community .....	25
GRI 204	Procurement practices .....	26
103-1	Explanation of the material topic and its Boundary .....	26
103-2	The management approach and its components.....	26
103-3	Evaluation of the management approach .....	26
204-1	Proportion of spending on local suppliers.....	27
<b>GRI 300</b>	<b>Environmental topics .....</b>	<b>28</b>
GRI 302	Energy .....	29
103-1	Explanation of the material topic and its Boundary .....	29
103-2	The management approach and its components.....	29
103-3	Evaluation of the management approach .....	29
302-1	Energy consumption within the organization .....	29
302-4	Reduction of energy consumption .....	31
GRI 303	Water and effluents.....	32
103-1	Explanation of the material topic and its Boundary .....	32
103-2	The management approach and its components.....	32
103-3	Evaluation of the management approach .....	33
303-5	Water consumption .....	33
GRI 305	Emissions .....	33
103-1	Explanation of the material topic and its Boundary .....	33
103-2	The management approach and its components.....	34

103-3	Evaluation of the management approach .....	34
305-7	Nitrogen oxides (NOX), sulfur oxides (SOX), and other significant air emissions.....	35
GRI 306	Effluents and waste .....	37
103-1	Explanation of the material topic and its Boundary .....	37
103-2	The management approach and its components.....	37
103-3	Evaluation of the management approach .....	37
306-1	Water discharge by quality and destination.....	38
306-2	Waste by type and disposal method .....	39
GRI 307	Environmental compliance .....	39
103-1	Explanation of the material topic and its Boundary .....	39
103-2	The management approach and its components.....	39
103-3	Evaluation of the management approach .....	40
307-1	Non-compliance with environmental laws and regulations.....	40
GRI 400	Social topics .....	41
GRI 401	Employment.....	42
103-1	Explanation of the material topic and its Boundary .....	42
103-2	The management approach and its components.....	42
103-3	Evaluation of the management approach .....	42
401-1	New employee hires and employee turnover .....	42
GRI 403	Occupational health and safety .....	43
103-1	Explanation of the material topic and its Boundary .....	43
103-2	The management approach and its components.....	43
103-3	Evaluation of the management approach .....	44
403-1	Occupational health and safety management system .....	44
403-9	Work-related injuries.....	44
GRI 404	Training and education .....	47
103-1	Explanation of the material topic and its Boundary .....	47
103-2	The management approach and its components.....	47
103-3	Evaluation of the management approach .....	48
404-1	Average hours of training per year per employee.....	48

## GRI 200 Economic topics



## GRI 201 Economic performance

### 103-1 Explanation of the material topic and its Boundary

Economic performance is a material topic for all key stakeholders, especially customers, shareholders, employees and the financial community. All these impacts have been interwoven with the idea of achieving economic performance and its distribution, but also with the aim of creating security in business continuity.

Viktor Lenac manages economic performance through its business processes, resource management and market relationships. External global circumstances also contribute to economic performance, both on the shipping market and on the labour market, where labour is the most important resource for achieving economic performance.

As Viktor Lenac mostly mobilizes domestic and local resources, the distributed value, in terms of paying for operational resources or payments to the state, banks, shareholders and suppliers of products and services or investments in the local community directly influences the growth and development of entities in the environment, and increasing living standards in the region.

### 103-2 The management approach and its components

Viktor Lenac manages economic performance through continuous relationships with its clients, offering its services on the market, receiving and processing inquiries for shiprepair projects with the aim of concluding shiprepair contracts involving such scope of work and gross margin that will be sufficient to cover relatively high costs of functioning of the Shipyard and creating additional value for shareholders. On the other hand, the Company seeks to increase economic performance through its production and business process management systems and reduce the use of limited production resources, primarily labour. Shiprepair is a traditional, labour-intensive activity, slower in implementing new technologies, where operations tend to be simplified by using available technologies or innovative approaches aimed at shortening works performance periods and increasing efficiency and freeing production capacities for new projects.

The most important business management and economic performance elements are defined within the ISO 9001 and ISO 50001 Management Systems, which include policies, procedures and working instructions for all important business functions defining the goals, authorities and responsibilities of individual management levels. The business processes are supported by an ERP system, which ensures selective and transparent management and control over the parts of the business.

### 103-3 Evaluation of the management approach

The effectiveness of the Company's management approach is monitored and evaluated through external and internal auditing, shiprepair contract performance analysis and ratings, reporting to the public in accordance with legal regulations and stakeholder feedback.

## 201-1 Direct economic value generated and distributed

	2016	2017	2018
Sales revenue	254.459.595	477.879.519	228.429.128
Direct income generated from assets	28.754.188	26.685.715	17.360.129
Other revenues	4.729.176	4.683.525	3.268.661
Revenues from financial investments	355.361	243.176	260.790
<b>Direct economic value generated</b>	<b>288.298.320</b>	<b>509.491.935</b>	<b>249.318.708</b>
Operating costs	189.891.047	342.103.327	168.071.047
Employee wages and benefits	71.982.643	75.702.828	75.851.362
Payments to providers of capital	15.800.602	5.252.033	2.805.492
Community investments	173.083	328.638	83.461
Taxes and levies	2.848.306	11.876.482	2.292.993
<b>Economic value distributed</b>	<b>280.695.681</b>	<b>435.263.308</b>	<b>249.104.355</b>
<b>Economic value retained</b>	<b>7.602.639</b>	<b>74.228.628</b>	<b>214.353</b>

Significantly lower economic value generated and retained rates achieved in 2018 were the result of decreased occupancy rates compared to the previous year. A decrease in occupancy directly affected to a decrease in the economic value distributed of all stakeholders except for own workers, which to a large extent represent a fixed production resource.

## 201-4 Financial assistance received from government

Viktor Lenac has not received any financial assistance from the government.

Occasionally, to a very small extent, the Company applies for government aids in competitiveness, employment and other. The Company (Group) has not received any financial assistance from the government in 2018. In 2017, the Company received a financial assistance in the total amount of HRK 22,200 by the Croatian Employment Service.

## GRI 202 Market presence

### 103-1 Explanation of the material topic and its Boundary

Market presence is a material topic for Viktor Lenac's role as a responsible and desirable employer. The topic has been selected as materially significant because of expectations of its key stakeholders - employees, trade unions and the local community. With wage rates that are higher than minimum wages, Viktor Lenac seeks to keep existing and attract new high-quality workforce or prevent its further outflow. By joining the EU, the outflow of the workforce is becoming more and more evident and becomes a problem not only to Viktor Lenac, but also to other companies of the same or related activity. The difference between the basic salary in Viktor Lenac and the minimum wage is not very large, so the goal for the next period is to increase the standard and the benefits for own employees. This is possible only by effective management, creating additional economic value available for distribution to workers. It is therefore important to educate and give confidence to executive-level

positions who come mainly from the local community, as they can communicate in better way with workers coming from the local community as well. In this sense, Viktor Lenac is directly linked to economic impacts through its own internal processes and operations. However, economic performance is also under external global socioeconomic and political impacts in the country, region and the European Union.

### 103-2 The management approach and its components

Viktor Lenac manages this topic primarily through education and development of managerial skills and knowledge of managerial staff with the aim of increasing productivity, selective approach when choosing the right work activity, and development of KPI systems and rewards that will motivate accountability for results, at all levels and all job functions, and further salary growth, all of which should contribute to the Company's reputation and recognition as a desirable employer in the labour market and the local community environment.

There is no difference between the remuneration for men and women who are working in Viktor Lenac. The salary system is established based on job title and function, regardless of gender. Salaries are determined by Collective Agreement or Labour Regulations according to the systematization of workplaces. The salary is composed of a fixed part, which includes allowances and benefits, which is guaranteed, and a variable part, which may vary depending on business performance and employee assessment.

### 103-3 Evaluation of the management approach

The management approach is monitored and evaluated mainly between the Management Board and trade unions and the Workers' Council. All material rights of workers are duly exercised. In addition, the management approach is also evaluated by interviewing employees who are leaving the Company, especially when it comes to unwanted fluctuation.

### 202-1 Ratios of standard entry level wage by gender compared to local minimum wage

	2016	2017	2018	2018/2017	2017/2016
Starting gross salary in Viktor Lenac	3.139,83	3.619,20	3.619,20	100%	115%
Local gross minimum wage	3.120,00	3.276,00	3.439,80	105%	105%
Viktor Lenac / Republic of Croatia	101%	110%	105%		

### 202-2 Proportion of senior management hired from the local community

All executive-level positions in Viktor Lenac, both involving senior management and line management come from the local community.

## GRI 204 Procurement practices

### 103-1 Explanation of the material topic and its Boundary

The Company's procurement activity involves procurement of material and equipment for installation onboard vessel, representing approximately 30% of total scope of procurement, and procurement of subcontractors' workforce and services in production, representing approximately 70% of total scope of procurement. Most of the procurement budget is used in the local market involving provision of products and services by domestic subcontractors, manufacturers and vendors. Viktor Lenac tends to contribute to procurement practices through its own business model, internal processes and production related activities. On the other side, specific projects or clients implying procurement of special and specific material and equipment that are not supplied by local suppliers or manufacturers also contribute to the topic. Suppliers, with their delivery practices and commercial terms and conditions, contribute to procurement practices of Viktor Lenac. Recently, the Company's procurement practices have been affected by labour migration within and outside the EU, where occupancy rates and availability of domestic labour force contribute to the supply chain, which leads to importing foreign workers to meet the needs and requirement of the labour. Suppliers and subcontractors have been identified as key stakeholders for this topic. In addition, Viktor Lenac contributes significantly to the development of the local community, which is also considered a stakeholder in this regard, through its procurement practices. Economic value generated almost entirely by exports is mainly distributed in the domestic procurement market, which directly impacts development of the local community, growth of the living standard of the local population and consumption, which also benefits the state by collecting taxes. Employees and clients are also involved as stakeholders for the topic of procurement practices, as procurement business model decisions contribute to the quality of service provided to customers and the distribution of economic value between employees and suppliers or subcontractors, which may also represent a conflict of interest.

### 103-2 The management approach and its components

Although Company's operations sometimes have import requirements, Viktor Lenac prefers domestic suppliers and especially domestic labour workforce as often more cost-effective and more favourable in terms of cash flow, and more appropriate to the number, value and turnover of core projects. Procuring products from domestic retailers and wherever possible, manufacturers, requires less financing and faster delivery, whereby Viktor Lenac opted for the just-in-time option wherever possible aimed at optimal use of other resources.

When procuring subcontractor services and other services related to provision of shiprepair services, Viktor Lenac prefers domestic workforce, given its quality, cost, availability and flexibility.

Procurement processes from planning to delivery are supported by ERP management systems, with clearly defined authorities and responsibilities.

### 103-3 Evaluation of the management approach

The procurement practice management approach is evaluated through supplier evaluation and project analysis.

Each supplier or subcontractor must meet the evaluation criteria defined by the quality management system to be listed in the list of approved suppliers to demonstrate ability to perform its obligations. Evaluation of suppliers and subcontractors is a continuous process that ensures selection by quality of service. The criteria for supplier evaluation are the price and quality of the delivered product or service,

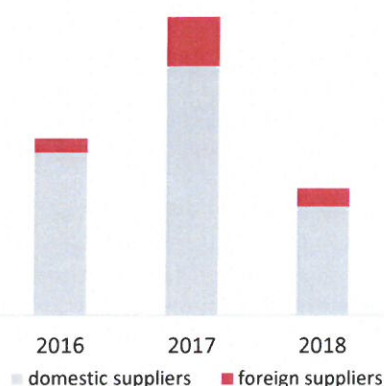
ability to meet the deadline, terms of payment, technical support quality, response to specific procurement requirements, timely delivery of required documentation and number of complaints. Subcontractor evaluation criteria include the ability to fulfil HSE requirements. Selecting the best evaluated suppliers and subcontractors enables the Company to ensure quality increase, cost reduction and increased customer satisfaction, while at the same time contributing to all the range of stakeholders.

## 204-1 Proportion of spending on local suppliers

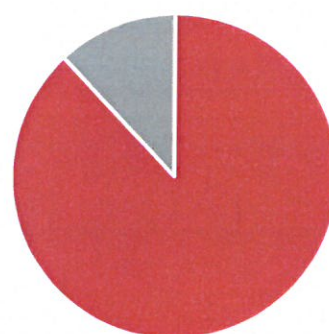
Domestic suppliers and subcontractors are suppliers from Croatia. Foreign suppliers and subcontractors include suppliers from other EU countries and outside the EU.

Products and services are delivered in the location of operations where Viktor Lenac performs its production activity (see GRI 102-4).

Proportion of spending on domestic suppliers 2016-2018

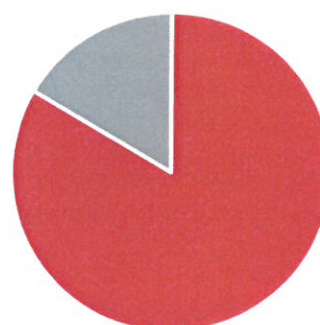


Proportion of spending on domestic suppliers in 2018



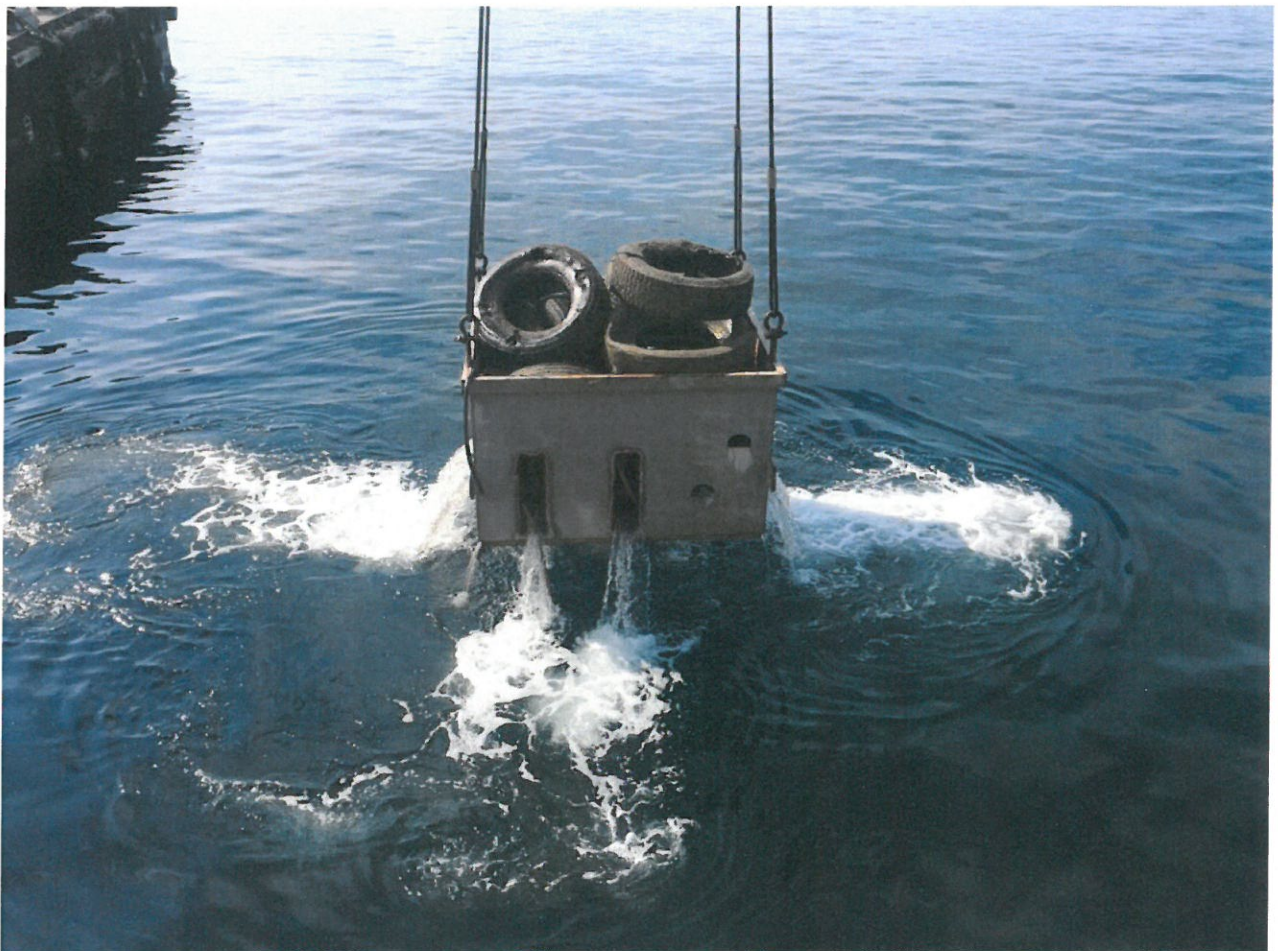
■ domestic suppliers ■ foreign suppliers

Proportion of spending on domestic suppliers in 2017



■ domestic suppliers ■ foreign suppliers

## GRI 300 Environmental topics



The photo shows a detail of a sea cleanup mission.

## GRI 302 Energy

## 103-1 Explanation of the material topic and its Boundary

The topic of energy and energy management is a material topic for Viktor Lenac, its operations and a range of stakeholders. Amongst all stakeholders, Viktor Lenac has identified legislative and regulatory bodies, the local community and the customers as key stakeholders for this topic. The basis of operations is energy. The share of energy cost in the total cost of resources is relatively high and tending to grow and Viktor Lenac has limited possibilities of energy connection. Viktor Lenac is directly linked to the topic through its production activities which determine energy management. On the other hand, energy supply and consumption are under impacts of external factors, primarily suppliers, as global impacts that determine the energy price. Customers tend to contribute to the topic in terms of their shore connection requirements.

Energy management system is also significant for other stakeholders, primarily the local community and regulatory bodies, as rational use of energy contributes to reduction of emissions into the environment, while technological advancement and development of new products in energy consumption introduced by Viktor Lenac contribute to development of the local community.

## 103-2 The management approach and its components

Viktor Lenac has been managing energy supply and resources through a long-term monitoring system that is continuously improved to reduce energy consumption, ensure energy availability, as well as designing and implementing various solutions aimed at reducing energy demand and consumption. In cooperation with HEP ESCO or independently, several projects have already been implemented to achieve savings in energy consumption, and the effects are already visible. The latest project was carried out in 2018 involving lighting modernization in production and other areas within the Shipyard, which continues to be a good practice of energy savings. Viktor Lenac seeks to reduce energy consumption through energy control systems within its own activities and finding more efficient solutions in procurement of products and equipment. A further step was made by completion of the certification process according to ISO 50001: 2011 Energy Management. An effective energy management has become a continuous approach in utilization and procurement of energy-efficient equipment and raising awareness of workers on energy efficiency issues through educational activities.

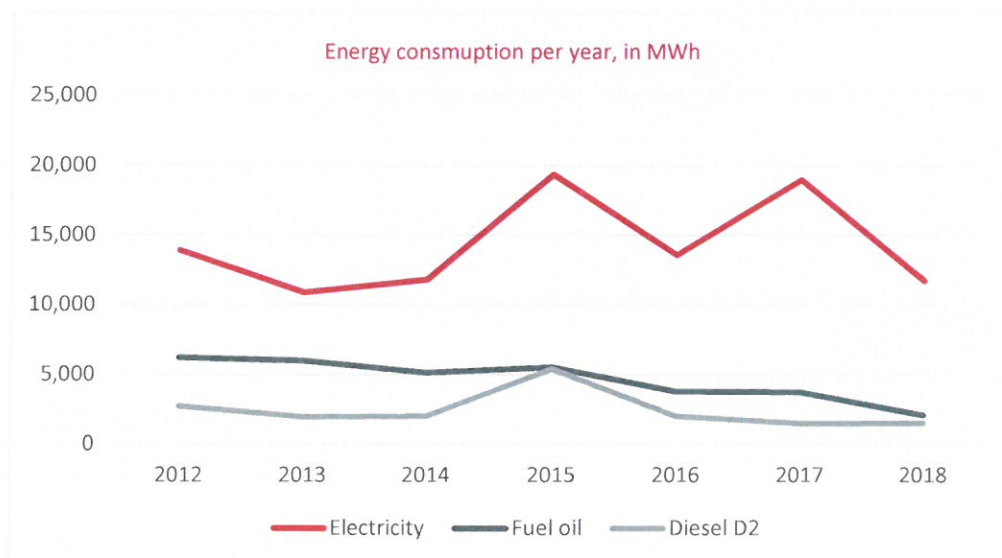
## 103-3 Evaluation of the management approach

The energy management approach is evaluated through a management system that includes energy KPIs that are monitored and analysed on regular basis in accordance with ISO 50001: 2011. The management approach to this topic is also evaluated through internal and external auditing of the energy management system.

## 302-1 Energy consumption within the organization

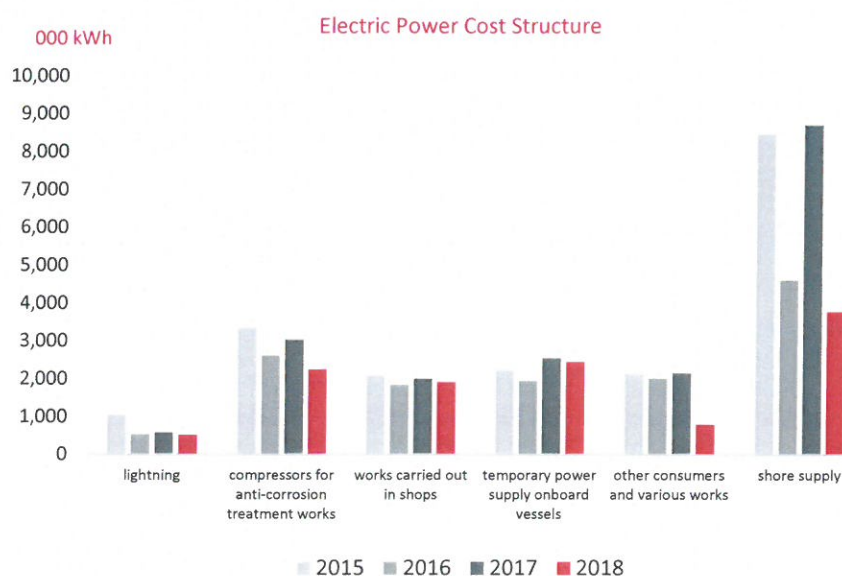
The basic types of energies used by Viktor Lenac in its operations are electricity and fuel oil, consumption of which over the years has been shown graphically. Viktor Lenac consumes significant amounts of energy in its operations, so monitoring and managing energy consumption is of great significance. The most significant energy source is electrical energy that is consumed in all manufacturing activities and for supply of ships under repairs. Another significant energy source is fuel oil used for heating and D2 diesel fuel used for transportation vehicles, 440V 60Hz power supply for ships under repairs, and for peak loads when docking and undocking.

Electricity consumption has increased since 2014 as Viktor Lenac started using static frequency converters (SFCs) for 440V 60Hz ship power supply (aggregate utility was 47%), thus increasing efficiency of energy consumption by 53 %. During the period 2014 - 2017, 21880 MWh was consumed via static frequency changers, which means approximately equal savings in energy consumption without using the aggregate for this purpose. 2015 and 2017 were marked by very high SFC-based energy consumption rates given the specific and high demand of power supply for a US Navy's military ship that underwent repairs at the Shipyard during the aforementioned periods.



2018 recorded a decrease in electricity consumption on the account of a decreased scope of production activities compared to the previous year and new energy management solutions that have been implemented.

Electricity is used mostly for supply of facilities and ships undergoing repairs both in dock and on berth, representing one-third of the total electricity consumed in 2018.



## 302-4 Reduction of energy consumption

Viktor Lenac consumes significant amounts of energy in its operations, so monitoring and managing energy consumption is of great significance. The Company's energy management system has been focused in the long-term on monitoring the use of energy sources and procuring new energy-efficient equipment.

Investment in the reconstruction of temporary lighting for ships undergoing repairs, outdoor lighting and lighting onboard floating docks, production shops and offices and the introduction of more energy-efficient LED lighting and fluorescent lighting with a T5 source resulted in savings in electricity amounting to over 2,500 megawatts per year. The full annual effect of the reported savings was achieved in 2018.

Savings were calculated in relation to 2015 in which Viktor Lenac began more significant investments, and the calculation is based on the new-for-old replacement budget.

A total of 567 VTF 450W fixtures and 1000V halogen floodlights in the shops, with total annual consumption of 996.5 MWh or 3.587 GJ, have been replaced with new 200W T5 light bulbs, with total annual consumption of 340.2 MWh or 1.225 GJ. The electricity savings totalled 656.3 MWh or 2.363 GJ for estimated 10 hours of daily use or 25 days a month. Safety and working conditions in workplace have been significantly improved from 250 to 300 lux to 500 lux.

A total of 4,500 GalaLED fixtures have been purchased for temporary power supply of ships under repairs. The savings have been calculated based on 2500 light bulbs. The savings per lightning fixture is 83W, which for 2500 units and 24 hours of operation 25 days per month results to annual savings of 1,494 MWh or 5,378 GJ. The safety and working conditions in all spaces onboard ships under repairs have been significantly improved.

The dock lighting for ship bottom has been modernized with portable LED floodlights (on a trolley). A total of 90 1000W halogen floodlights have been replaced with 150W LED floodlights of better characteristics. The average hours of floodlight is 15 hours a day, 25 days, and annual savings are 330 MWh or 1.187 GJ.

Investment in energy-efficient equipment involved new fans for ventilation of ship spaces under repairs during welding and anti-corrosion treatment works. New fans meet the same technical characteristics of pressure and flow rates but require less engine power for 3.5 kW due to more efficient ventilation. The annual savings for 20 units on a 24-hour basis, 25 days a month amount to 403 MWh or 1452 GJ.

A total of 20 new energy-efficient REL welding apparatus have been purchased, consuming 7.74 kW less per apparatus for the same welding effects. The annual savings for 20 units on an 8-hour basis, 25 days a month amount to 223 MWh or 803 GJ.

Another significant energy source is fuel oil used for heating and D2 diesel fuel used for transportation vehicles, 440V 60Hz power supply for ships under repairs, and for peak loads when docking and undocking.

The implementation of a hot-water heating system project resulted in total savings in fuel oil in the amount of 1.855 MWh or 6.676 GJ and CO<sub>2</sub> emissions decreased by 496.8 tons.

Savings were calculated in relation to 2016, in which Viktor Lenac started more significant investments, and the calculation is based on the feasibility study made by HEP ESCO, which predicted a savings of 1,315 MWh or 4,734 GJ. The total savings in fuel oil achieved in 2017 compared to 2016 for the hot-water heating system amounted to 1,855 MWh or 6,676 GJ. The trend has continued, so in 2018, compared to 2017, a decrease in fuel oil consumption was recorded by 280 MWh or 1,007 GJ.

## GRI 303 Water and effluents

### 103-1 Explanation of the material topic and its Boundary

Technological processes use potable water, water from the water supply system and water from the Javor stream. By using water from the Javor stream, Viktor Lenac reduces potable water consumption, which contributes to preservation of natural resources of Croatia.

Viktor Lenac contributes to water consumption through its internal business processes and operations, by selecting appropriate technologies and investing in technological solutions that enable higher consumption of technological water than potable water. In addition to internal impacts, the topic is under external impacts, which involve legislative and regulatory requirements that determine obligations and approaches in water management, including wastewater discharge. Circulations of precipitation water drainage in the location of operations is under the impact of the local community because of the proximity of villages and roads that are at a higher altitude. Client's needs also tend to contribute to water consumption and wastewater generation, since each shiprepair project is specific. Local community and regulatory bodies have been identified as key stakeholders for this topic.

### 103-2 The management approach and its components

Water consumption has been monitored since 1996 as part of the energy monitoring system, when water consumption was measured at three locations. A systematic water consumption management was introduced in 2011 by implementing a water consumption monitoring system 24 hours a day, 365 days a year involving remote water consumption monitoring and uncontrolled consumption alarm system. This resulted in a decrease in water consumption by about 220,000 cum annually. After eliminating any leaks, water consumption was reduced from 2012 to 2018 from an average of 73,000 cum to 56,000 cum per year, so today the monthly consumption rate is from 4,500 cum to 5,000 cum. By mid-2018, water management was entrusted to an external company, when Viktor Lenac took control of its own resources.

Water from the Javor stream, which runs along the shipyard's boundary and flows into the sea, started to be used in the beginning of 2000. The system has been upgraded with the aim of maximizing consumption of technological water for all activities where applicable to reduce potable water. Water from the Javor stream is used for technological purposes: cooling, high pressure washing and boiler room. Technological water consumption varies from 160,000 cum to 260,000 cum, depending on the scope of production activities.

Wastewater drainage is managed in accordance with legislative provisions and regulations. A new project of precipitation water discharge is to be launched and improvements are to be done in grey water drainage originating from ships under repairs.

Water and effluents management has been incorporated in the Company's quality management system. The implementation of a separate environmental management system in accordance with ISO 14001 will additionally contribute to the topic.

## 103-3 Evaluation of the management approach

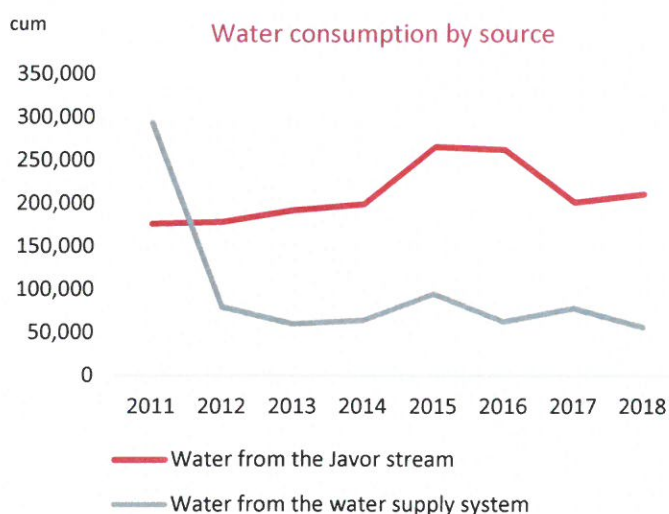
The water and effluents management approach is evaluated through continuous water consumption monitoring and analysing deviations in relation to planned, expected or regular targets. Compliance with requirements is assessed through internal quality auditing, including procedures and working instructions related to water management. In addition, the management approach is evaluated through external control carried out by the County Teaching Institute of Public Health, which assesses the quality of water and sea in the aquatorium to evaluate drainage management.

## 303-5 Water consumption

Water consumption measurement is carried out through a continuous water consumption monitoring system, 24 hours a day, 24/7.

	Water from the Javor stream in cum	Water from the water supply system in cum
2013	191.753	60.139
2014	199.001	64.102
2015	265.044	94.938
2016	261.956	62.803
2017	201.185	78.110
<b>2018</b>	<b>210.221</b>	<b>56.051</b>

Note: 1000 cum = 1 megalitre



## GRI 305 Emissions

### 103-1 Explanation of the material topic and its Boundary

The topic of emissions has been identified as material considering that Viktor Lenac is undoubtedly directly linked to its environmental impacts considering its shiprepair operations, involving energy production technological processes, anti-corrosion treatment and coating, and various mechanical, electrical and other works tend to emit pollutants to the atmosphere. Viktor Lenac is directly linked to the topic considering its internal production activities that produce emissions as a result of thermal energy production, utilization of volatile organic compounds for coating, dust particle emissions in the air during anti-corrosion treatment works and noise generated by production activities, particularly docking and berthing of ships. The Boundary of the topic is defined by proximity of roads and villages, as well as other economic operators in the immediate vicinity. The topic may also be under impacts of maritime traffic that is not necessarily linked to the Company's activities and over which Viktor Lenac cannot have permanent and full control. Since the Company's activity is labour-intensive and involves

a large number of workers (both own and subcontractors) and that the location of operations is situated near the populated areas, employees (and trade unions), local community and legislative and regulatory bodies have been identified as key stakeholders for the topic.

### 103-2 The management approach and its components

The emissions management approach is an integral part of the Company's quality management system, which includes environmental protection policy. The Company's Environmental Protection Department Unit established 20 years ago, is responsible for implementing preventive and corrective activities of environmental protection, defining operational activities related to production activities, determining mode of operation that are optimal and least damaging to the environment. In cooperation with ecologists and other experts in technology application, Viktor Lenac is investing in new technologies and procedures, such as new thermal energy production system, new equipment for anti-corrosion treatment, reducing the emission of volatile organic compounds, protection of workplaces from emissions into the environment, procurement of shore connection equipment with the aim of reducing particulate matter emissions and noise to preserve the environment. The topic is managed through education and supervision of both own and subcontractor workforce in terms of work and equipment used, and the evaluation and selection of suppliers according to the environmental criteria.

In mid-2016, Viktor Lenac introduced a hot-water heating system that resulted in a significant reduction in fuel oil consumption and combustion gas emissions. CO<sub>2</sub> emissions in 2018 almost reached the limit value.

Volatile organic compounds are found in paints that are used to coat metal ship surfaces. The volatile organic compounds contained in paints are emitted in the air. In accordance with the obligation to reduce emissions that Croatia took over in the EU accession negotiations, Viktor Lenac has developed a program for reduction of volatile organic compounds emissions. By using paints with lower VOC content, Viktor Lenac has managed to significantly reduce total emissions of these compounds.

Emissions of particulate matter is a consequence of a series of technological processes, and the most significant contribution comes from anti-corrosion treatment technology. Monitoring of emissions of particulate matter of less than 10 microns (PM<sub>10</sub>), total solids and contained metals is carried out by continuous measurement of emission in the surrounding villages.

### 103-3 Evaluation of the management approach

The emissions management approach is evaluated through internal and external auditing, which includes environmental protection management, as well as monitoring or continuous measurement of emissions in the surrounding villages conducted by independent institutions or organizations. The management approach to the topic has resulted in a decline in the number of pollutant emissions, of which the most significant are presented in the following disclosures.

All the measures that have been undertaken have resulted in a stable trend of reduced emissions of SO<sub>x</sub>, NO<sub>x</sub>, CO and CO<sub>2</sub> and PM<sub>10</sub>.

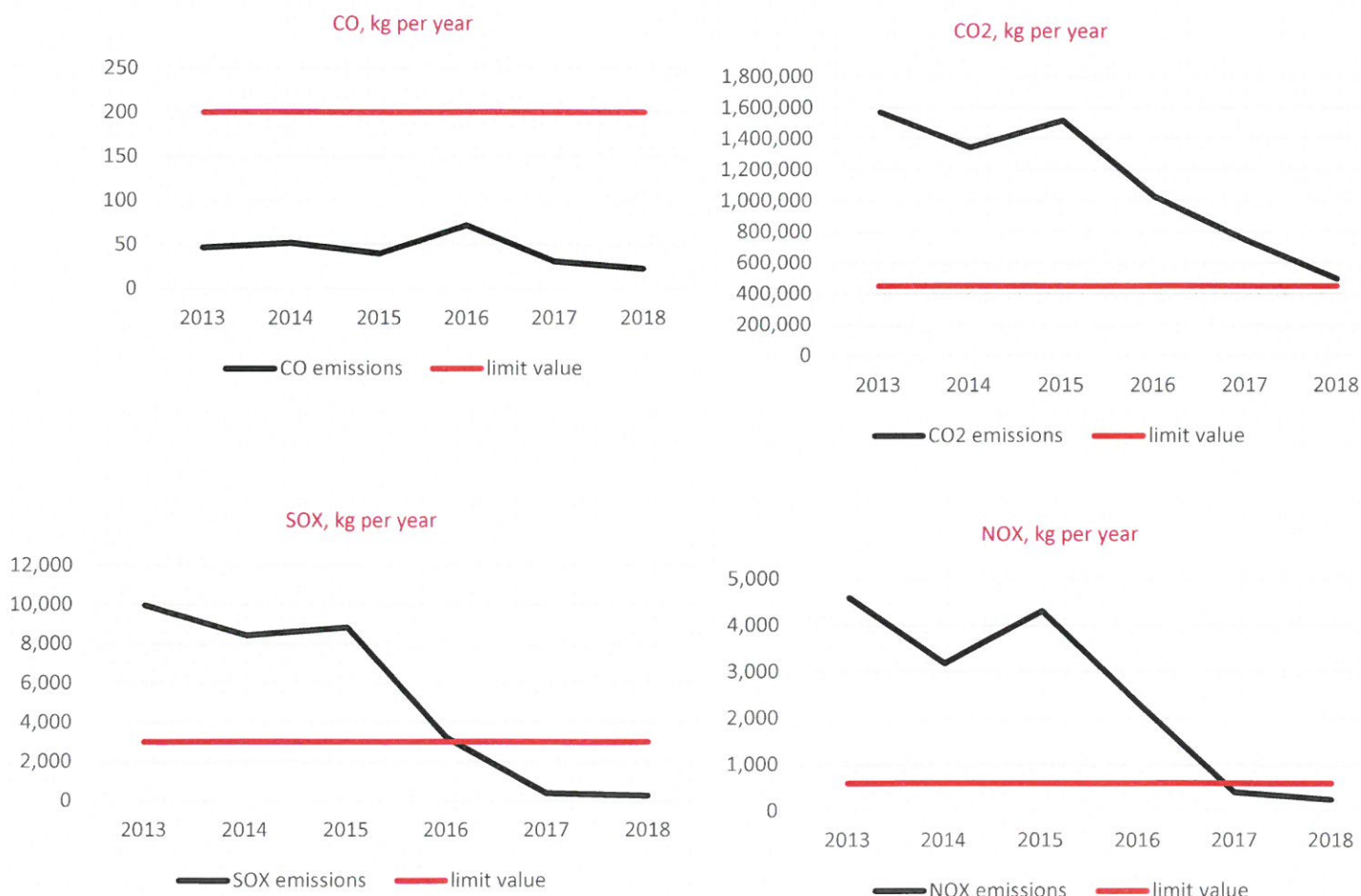
The emission values of SO<sub>x</sub>, NO<sub>x</sub> and CO are below the prescribed emission limit values, while the CO<sub>2</sub> and PM<sub>10</sub> values are still above the prescribed limit values, but almost reached in 2018.

The results of measurements of particle matter emissions continuously conducted in the surrounding

villages are below the limit values so the air quality is classified into the Category I or pure or slightly polluted air.

## 305-7 Nitrogen oxides (NOX), sulfur oxides (SOX), and other significant air emissions

In mid-2016, Viktor Lenac launched a new thermal energy production system, which significantly reduced the emissions of combustion gases. Heating system was upgraded from steam to hot water. Instead of light fuel oil, we started to use extra light fuel oil. The Company managed to reduce its consumption of heating fuel by recovering waste heat from air cooled compressors. In addition, two large production halls are heated by heat pumps that use part of heat produced by the Javor stream to warm up water in the heating system. Hot-water heating system significantly decreased fuel consumption and CO<sub>2</sub> emissions. The measures that have been undertaken have resulted in a stable trend of decline in pollutant emissions: SOX, NOX, CO and CO<sub>2</sub> and PM<sub>10</sub>.



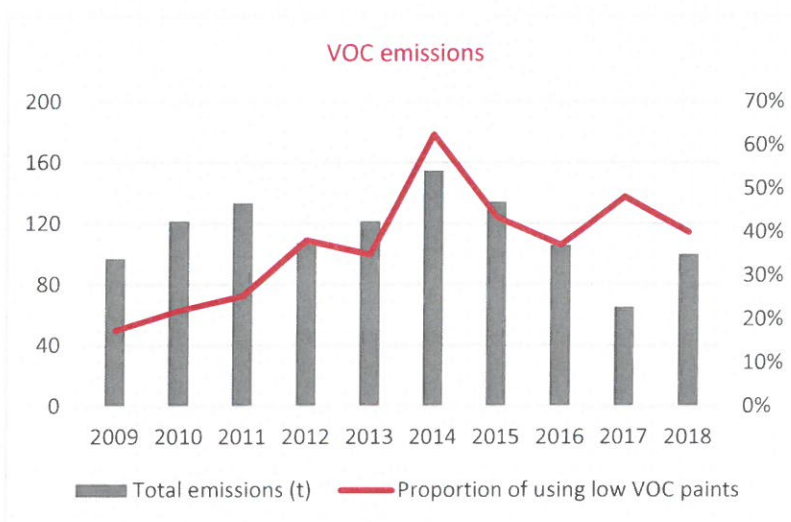
The Shipyard is currently exploring the possibility of using natural gas for boiler operation, which will eliminate the use of light fuel oil. The natural gas allows operation of hot water boilers in a condensing mode, thus achieving an increase in energy efficiency by 10%. In addition to reducing the energy cost, maintenance costs will also be reduced.

## Contents

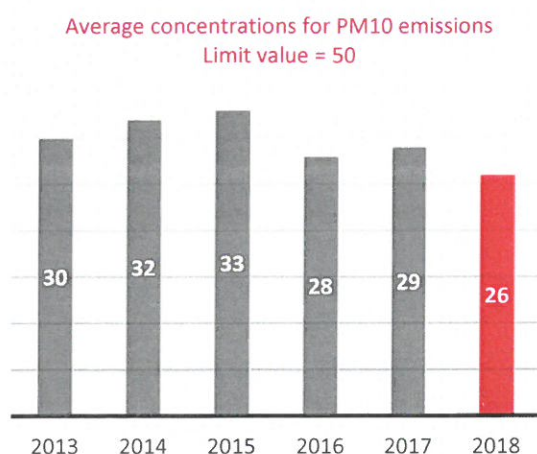
<b>GRI 102</b>	<b>General disclosures</b>	<b>3</b>
	Organizational profile	4
	Strategy	11
	Ethics and integrity	12
	Governance	12
	Stakeholder engagement	13
	Reporting practice	16
<b>GRI 200</b>	<b>Economic topics</b>	<b>22</b>
GRI 201	Economic performance	23
GRI 202	Market presence	24
GRI 204	Procurement practices	26
<b>GRI 300</b>	<b>Environmental topics</b>	<b>28</b>
GRI 302	Energy	29
GRI 303	Water and effluents	32
GRI 305	Emissions	33
GRI 306	Effluents and waste	37
GRI 307	Environmental compliance	39
<b>GRI 400</b>	<b>Social topics</b>	<b>41</b>
GRI 401	Employment	42
GRI 403	Occupational health and safety	43
GRI 404	Training and education	47

The natural gas will also be used for heating shops (panel gas heaters), thus eliminating the need to use steam as a heating medium, and steam boilers would not be used anymore for that purpose. The introduction of natural gas for this purpose will significantly reduce energy consumption (up to 30%) and thereby reduce CO2 emissions.

Volatile organic compounds are found in paints that are used to coat metal ship surfaces. The volatile organic compounds contained in paints are emitted in the air. In accordance with the obligation to reduce emissions that Croatia took over in the EU accession negotiations, Viktor Lenac has developed a program for reduction of volatile organic compounds emissions. Using paints with lower VOC content, Viktor Lenac has managed to significantly reduce total emissions of these compounds.



Emissions of particulate matter is a consequence of a series of technological processes, and the most significant contribution comes from anti-corrosion treatment technology. Monitoring of emissions of particulate matter of less than 10 microns (PM10), total solids and contained metals is carried out by continuous measurement of emission in the surrounding villages. The results of measurements of particle matter emissions are below the limit values so the air quality is classified into the Category I or pure or slightly polluted air.



## GRI 306 Effluents and waste

## 103-1 Explanation of the material topic and its Boundary

Viktor Lenac produces significant quantities of waste and wastewater in its production activity. The topic of effluents and waste has been identified as material in view of current possibilities of waste management in Croatia. Waste management affects the local community, which has been recognized as a key stakeholder to this topic, as well as legislative and regulatory bodies considering that the waste management system is prescribed by law. Viktor Lenac is directly linked to waste management impacts but given the underdeveloped possibilities of waste management in Croatia, the impacts occur outside the boundaries of the organization. The external boundary affects Viktor Lenac in a way that it must constantly seek for new possibilities of waste management to meet environmental and economic requirements. Wastewater generation is directly linked to the Shipyard's technological activities and clients' requirements related to their ships during stay at the Shipyard. Wastewater drainage and effluent disposal is regulated by legislative and regulatory bodies.

## 103-2 The management approach and its components

Knowing that a way in which wastes are managed can lead to either gain or increase costs, Viktor Lenac has opted for a flexible waste management system, ready to follow trends that will be continually aligned with changes. Disposing waste in designated dumping areas is the most unfavourable way of dealing with waste both ecologically and economically. The most cost-effective way of waste management is to separate waste at production site. In order to reduce quantity of waste for disposal, therefore, the Shipyard makes continuous efforts in educating workers and encouraging waste sorting behaviour, providing appropriate equipment and constant monitoring. The waste sorting process must be followed by an appropriate recovery practice such as recycling, treatment, waste-to-energy etc. In Croatia, new opportunities for waste use and recovery are opening up and Viktor Lenac develops its strategies for waste management in line with the development of waste management possibilities.

Effluent disposal is carried out in accordance with legislative regulations, while respecting all the principles of environmental protection against spillage, whereby Viktor Lenac is continuously investing in the wastewater drainage system.

## 103-3 Evaluation of the management approach

The effluents and waste management approach is evaluated both through internal auditing within the internal quality management system and external auditing and supervision conducted by legislative and regulatory bodies and, indirectly, through waste collection authorities' supervision systems that allow to execute control over management of waste generated in technological processes.

As effluent discharge most significantly affects the sea and marine biology, Viktor Lenac tends, through an authorized institution, to continuously monitor the quality of the sea, sediment and marine biology. Given that there is no categorization of the sea in terms of quality, the results of measurement are compared with the sea quality measurements conducted in the bay of Svežanj (Kostrena), which is in the tourist and recreational zone and is considered clean. All tested parameters have been proven at very low concentrations.

### 306-1 Water discharge by quality and destination

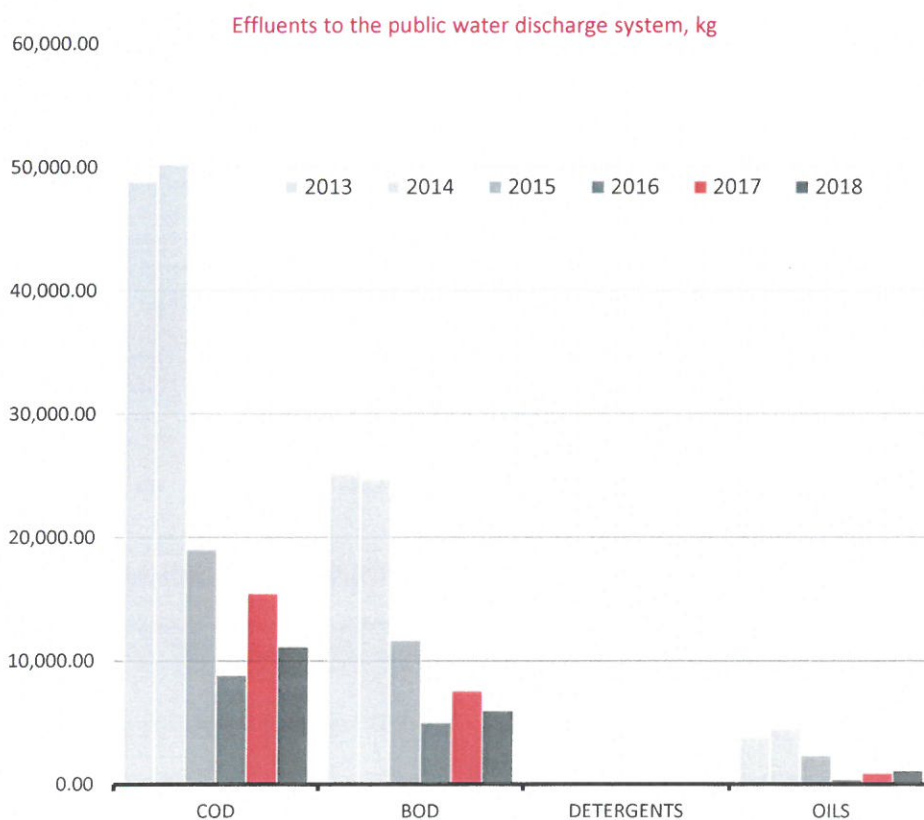
Technological processes use potable water, water from the water supply system and water from the Javor stream. Using water from the Javor stream, Viktor Lenac reduces potable water consumption, which contributes to preservation of natural resources of Croatia.

Wastewater category	Quantity of wastewater discharged in cum	Wastewater destination
Precipitant water	397.216	sea
Grey water	56.051	public drainage system
Technological water for machinery washing	214	disposed as waste
Ship system cooling	114.341	sea
Technological water for ship hull washing	95.666	sea

Grey water is discharged into a public drainage system. The test results on chemical oxygen demand (COD), biochemical oxygen demand (BOD), detergents, oils and other pollutants meet the discharge criteria. Technological waters generated by cleaning and washing of ship engine parts are not discharged but are disposed of as waste. Technological water generated by washing of ship hull and ship engine cooling are discharged into the sea.

The total amount of pollutants discharged into the public drainage system amounted to 18,249 kg in 2018.

During a ship's stay in the port of the Shipyard, the ship uses shore connections, including water connection for crew's needs. Grey water from the ship is accepted into shore receiving tanks and handled by a waste collecting authority. In order to reduce grey water manipulative and disposal costs, the Shipyard plans to build fixed shore connections to accept grey water from ships and drain to the public drainage system.



### 306-2 Waste by type and disposal method

During 2018, a total of 11,655 tons of various waste (2017: 14,768 tons) was generated in the production process, of which two-thirds of non-hazardous waste.

Waste management procedure	Non-hazardous waste kg	Hazardous waste kg	Total kg	Percentage
Energy-from-waste	14.870	158.226	173.096	1,5%
Treatment		3.689.790	3.689.790	31,7%
Disposal	565.150	3.050	568.200	4,9%
Landfill site covering	6.104.760		6.104.760	52,4%
Recycling	1.046.981	9.695	1.056.676	9,1%
Burial		62.280	62.280	0,5%
<b>Total</b>	<b>7.731.761</b>	<b>3.923.041</b>	<b>11.654.802</b>	<b>100%</b>
	<b>Percentage</b>	<b>66,3%</b>	<b>33,7%</b>	<b>100,0%</b>

Waste is disposed by using services of waste collecting authorities that fully meet all legislative requirements and possess all waste collection, transportation and disposal permits in accordance with legislative regulations.

Data on quantities of waste are collected at the place of waste generation and during the waste management process. Waste register is a mandatory document in the waste management system intended for the Company and waste collecting authorities.

## GRI 307 Environmental compliance

### 103-1 Explanation of the material topic and its Boundary

Business continuity and sustainability require alignment with all environmental protection requirements and compliance with legislative regulations. Viktor Lenac is directly linked to the topic through organization of its production activities that take place in the same place at the same time, which increases the risk of nonconformities. Local community and legislative and regulatory bodies have been identified as key stakeholders to this topic. By meeting environmental compliance requirements Viktor Lenac seeks to be responsible in coexistence with the local community.

### 103-2 The management approach and its components

The management approach to the topic of environmental compliance has been raised to a high level of awareness by incorporating policies, procedures, working instructions and practices related to ecological issues in the Company's quality management system. Environmental awareness is promoted in all relationships with customers, partners, suppliers and workers. Production activities are organized in such a manner that the least possible number of activities that complementary increase the risk of ecological non-compliance are performed in the same place at the same time. Non-compliances may arise from situations in which many activities are performed in the same place at the same time, such as blasting and painting of ship surfaces, especially in high occupancy periods. Such

activities, therefore, tend to be limited, postponed or additional environmental protection measures are undertaken aimed at preventing emissions of pollutants or noise.

## 103-3 Evaluation of the management approach

Apart from monitoring sea, water, air and noise parameters and recording their values and any deviations thereof, providing data for analysis and assessment of environmental protection management, the management approach to the topic of environmental compliance is evaluated by the local community through complaints and praises in citizens' reviews. Environmental compliance is also supervised by a regulatory body authorized for supervision of the aquatorium. Non-compliances may result in penalties prescribed by an inspection or other supervisory body. The frequency and extent of such penalties give a true rating for the management approach to this topic.

## 307-1 Non-compliance with environmental laws and regulations

Penalties paid by Viktor Lenac in 2018 on the account of non-compliance with noise regulations involved violations of regulations in 2016, where the penalty order was not received until this year.

Penalties for sea pollution paid in 2018, referring to violations of regulations in 2016, totalled HRK 42,000 kuna, including one penalty in the amount of HRK 10,000 for sea pollution from paint particles.



## GRI 400 Social topics



## GRI 401 Employment

## 103-1 Explanation of the material topic and its Boundary

The topic of employment is material in terms of labour capacity as the most significant resource in the production activity from both the availability and quality aspect of labour. Viktor Lenac is directly linked to the topic through a number and scope of shiprepair contracts manifested in lower or higher occupancy rates with the aim of maintaining continuity in the number of workers and creating a desired working climate to reduce unwanted fluctuation. In labour-intensive activities, creating a desirable employer image to attract labour is of an extraordinary significance. In addition to internal contributions, the topic is under external impacts reflected in global labour market trends, unrestricted migration of active population, success and volume of manufacturing companies of similar activities in the environment that affects labour retention and Croatia's educational system in terms of trades required by the organization. Employees, trade unions and the local community from which employees come have been identified as key stakeholders.

## 103-2 The management approach and its components

Viktor Lenac manages employment related topics through systematization of workplaces, salary system involving fixed and variable part of the salary to motivate quality employees and rewarding system. The Company concluded a collective agreement with trade union organizations, which regulates all employee material rights. When recruiting, the candidate is assessed in terms of qualifications, work and psychological abilities. The organizational structure offers possibilities for transferring workers from one to another organizational unit, based on the employee's characteristics and preferences and the expected effects in accordance with internal needs. When and where the production process allows to do so, workers are offered flexible working hours through a system of redistribution of working hours depending on occupancy requirements, which leads to fixed cost reduction and allows workers to take a break. In addition, various educational activities tend to increase productivity and offer workers wider opportunities for personal development.

## 103-3 Evaluation of the management approach

The management approach to employment involving various activities, among other, recruiting, minimizing negative external influences of migration, increasing labour quality through educational activities, are internally evaluated through the employee performance assessment system carried out by immediate superiors. External evaluation of the topic management approach is reflected in unwanted labour fluctuations.

## 401-1 New employee hires and employee turnover

The number of employees by the end of 2018 and new employee hires were adjusted to market changes. In order to maintain competitiveness, it was required to take a rational approach to labour force utilization and decrease the number of job executors by managing outflows primarily through retirement, without an aliquot number of new employee hires to replace retired employees.

Number of employees as of 1 January 2017	485				
	Turnover by age			Turnover by gender	
	<30	30-50	50>	M	F
New employee hires 2017	10	33	7	43	7
Employees who left in 2017	9	22	21	50	2
Number of employees as of 31 December 2017	488				
New employee hires 2018	2	16	1	17	2
Employees who left in 2018	6	33	38	67	/
<b>Number of employees as of 31 December 2018</b>	<b>441</b>				

Reported data refer to the Parent company. Turnover rate recorded in 2018 by the subsidiary company Viktor Servi d.o.o. was not materially significant, while the subsidiary company VL Steel d.o.o., established in the last quarter of 2017, recorded a target increase in the number of workers by 29.

## GRI 403 Occupational health and safety

### 103-1 Explanation of the material topic and its Boundary

The Company's production activity is labour-intensive. It can be defined as a traditional activity compared to other industrial branches and is rated as hazardous for health and safety at work. The topic of occupational health and safety has been in focus over the last few years not only in terms of internal contributions of the organization in the matter of commitment to increase healthcare and safety of persons involved in operations but also in terms of external contributions where shipowners include occupational health and safety criteria in procedures for evaluating and selecting ship repair facilities. Such requirements are even more pronounced when referring to specific projects, such as ship modernization or conversion, since works on such projects take much longer than in standard shiprepair, so safety hazards and risks are higher.

### 103-2 The management approach and its components

Viktor Lenac has implemented a comprehensive occupational health and safety system managed through occupational health and safety, fire protection, environmental protection and security.

Directly involved is the Workers' Committee for Occupational Health and Safety and employees' commissioner for occupational health and safety, appointed by trade union organizations.

Occupational health and safety is also implemented and supervised as part of duties and obligations of persons duly authorized by the employer – immediate superiors - to implement occupational health and safety measures in both production and non-production processes. A total of 150 employees were authorized by the employer for implementation of occupational health and safety in 2018.

Key issues of the occupational health and safety topic have been incorporated in the Collective Agreement and Labour Regulations and are regularly discussed between social partners - Management Board and trade union organizations or Workers' Council.

Safety procedures are established for all core activity projects, especially those requiring longer works performance periods or characterized by specific working conditions, depending on types of work on case by case basis.

There are special safety requirements for hot works where work sites are inspected prior to commencement of works such as cutting, grinding, welding and similar work in order to minimize the risk of explosion, ignition and other related risks.

Immediate superiors as employees' commissioner for occupational health and safety are obliged to educate and raise awareness among workers about importance of safety working conditions, inspecting and ensuring workplace safety, health care and protection of property of the Company and clients. Special attention is paid to use of personal protective equipment that includes an overall, a helmet and footwear adapted to production conditions, as well as eye protection recently introduced as mandatory PPE.

### 103-3 Evaluation of the management approach

Activities undertaken to prescribe, plan, supervise and control workplace safety are evaluated through internal auditing that includes occupational health and safety as well as external auditing, sometimes conducted by Viktor Lenac's clients. Supervision over the implementation of health and safety regulations is also carried out by inspection services. The best indicator of the management approach to this topic is risk assessment and workplace injury analysis based on which causes of injuries are investigated and preventive and corrective actions are undertaken. A systematic approach to managing occupational health and safety has resulted in a reduction in the number of injuries at work and severity score.

### 403-1 Occupational health and safety management system

Viktor Lenac applies a quality management system according to ISO 9001: 2015 as a framework for occupational health and safety risk management with the aim of reducing and preventing injuries at work or professional diseases to ensure safe and healthy workplace. Safety procedures and working instructions on occupational health and safety are continuously revised in accordance with changes in production processes and aligned with law and regulations and clients' requirements under responsibility of the OHS Department Unit, which employs 3 occupational health and safety specialists, 1 trainee and the leader of the unit in cooperation with other organizational units. The working instruction RU2121 on work in restricted areas has been revised and partly modified.

The rules of conduct prescribed to ensure health care and safety of all persons apply to anyone who contributes in any way to production processes, from own workers, through subcontractors to clients, including visitors, where the scope of rules of conduct varies by groups, depending on the estimated risks.

### 403-9 Work-related injuries

Systematic records of injuries, indicators and incidents have been kept on a long-term basis and involve all own workers of the Shipyard.

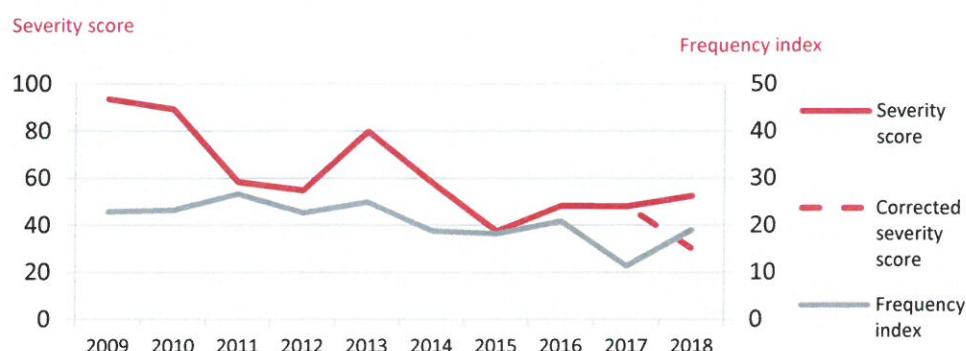
2018 recorded an increase in the number of injuries at work. A total of 15 injuries at work were recorded, which resulted in 413 lost working days. Although a drop in the number of lost working days was recorded compared with the previous year, due to a decrease in the total number of work hours, the outcome was an increase in the frequency index and severity score. Of the total number of injuries sustained during 2018, 6 injuries (or one more than in the previous year) were characterized as severe injuries, most commonly fractures in the extremities. The remaining 9 injuries that occurred in 2018

were minor injuries, mostly sprains, surface wounds and cuts. All work-related injuries occurred within production processes, which involves a very small number of female workers, so all injuries are related to men.

One injury at work (fall from height) resulted in as many as 175 lost working days, which significantly worsened the total severity score, which, excluding that injury, would have recorded 30.2 and the Company would have shown a faster downward trend in severity and frequency.

	Number of injuries	Number of professional diseases	Number of deaths	Number of lost working days
2013	23	-	-	738
2014	18	-	-	556
2015	17	-	-	354
2016	18	-	-	416
2017	10	-	-	424
<b>2018</b>	<b>15</b>	<b>-</b>	<b>-</b>	<b>413</b>

By cause of injury, most injuries were due to fall from height. Even 13 out of the total 15 injuries happened for not following safety rules, which reveals the need for further training of workers to work safely.



No injuries at work have ended with significant and severe consequences for workers or profound and severe disability.

Cause of injury	Number of injuries	Number of lost working days
Falls from height	9	265
Crush injuries from tools or other objects	3	51
Crush injuries or other injuries due to being caught or stuck between objects	1	13
Influence of heat, cold, noise or vibration	1	6
Excessive physical strain or wrong movements	1	78
<b>Total</b>	<b>15</b>	<b>413</b>

Due to the increased frequency index and severity score, and with reference to causes of injuries, the Shipyard has undertaken additional measures to train workers to work in a safe manner, such as day-to-day safety toolbox meetings conducted by immediate superiors with the focus on implementing safety procedures related to a specific job.

Indicators of injury at work	2013	2014	2015	2016	2017	2018
Number of effective hours	925.669	957.147	937.020	864.292	883.716	792.694
Number of injuries	23	18	17	18	10	15
Total number of days lost due to sick leave	738	556	354	416	424	413
Frequency index	24,85	18,81	18,14	20,83	11,32	18,92
Number of injuries / Effective hours						
Severity index						
Total lost days due to sick leave / Total effective hours	79,73	58,10	37,78	48,13	47,98	52,10
Number of injuries / Number of workers	4,44	3,58	3,45	3,64	2,04	3,24

\* Note: The calculations are based on 1,000,000 work hours

Hazards associated with production processes that carry an increased risk of injury with potential significant consequences for health of workers, are described in the Risk Assessment produced by an occupational health and safety authority. The document stipulates measures of safety, education, prevention and control over the implementation of these measures to reduce the risk of injury. The most important activities to reduce injuries at work involve inspections of workplaces and issuance of work permits. HSE duty services are available outside the regular daily working hours depending on the needs of the production process.

Since 2018, all visitors get acquainted with the safety rules immediately upon arrival to the main entrance where they watch a safety video and learn about basics of safety during their stay at the Shipyard.

New employees and students undertaking professional practice are obliged to attend education on occupational health and safety and pass the exam as proof of qualification. Subcontractors' workers are obliged to submit proof of their ability to work in a safely manner in shipbuilding environment and get acquainted with the entire Company's documentation on occupational health and safety which makes an integral part of the quality management system.

Continuous monitoring and reporting of all events that are recognized as unsafe or potentially dangerous is enabled through a digital HSE non-conformities system. A non-conformity analysis is the basis for revision of internal regulations and procedures to further minimize dangerous events.

The Company keeps records of work-related injuries occurring to subcontractors' workers. However, the records are not complete as subcontractors are independent in most of production operations, so data reported in this report involve only Shipyard's own workers. The objective is to establish a complete record of all work-related incidents involving all workers working in the Shipyard both own and subcontractors'.

## GRI 404 Training and education

## 103-1 Explanation of the material topic and its Boundary

The topic of training and education is of considerable material significance to Viktor Lenac and involves training of own workers and collaboration with educational institutions. Viktor Lenac is directly contributing to workers' efficiency and performance through training thus influencing productivity and quality of workmanship, directly affecting Company's results and customer's satisfaction.

Collaboration with educational institutions creates a positive employer image, thus attracting quality employees, and having direct impact on creating future employees. Collaboration with educational institutions has a significant impact on the local community as it enables best practical training solutions for pupils and students who get integrated into the business community in a faster and easier way and tend to more effectively contribute to the local community's economic development.

The organization is directly linked to this topic by choosing to invest in specific types of training and education for its own workers, as well as deciding on priorities and modalities in cooperation with external educational institutions.

## 103-2 The management approach and its components

Viktor Lenac is constantly investing in training and education of its employees, thus ensuring the quality of its products and the competitiveness of its workers. 2018 training and education programs focused on business process management and occupational health and safety.

In 2018, a total of 191 employees participated in in-house education organized by the ICT department. The ICT department developed a business support system designed for the Shipyard's subcontractors to improve business relationships and speed up response time and enable the Company to conduct a more comprehensive analysis of business processes in order to improve productivity. The Human Resource Department conducted workshops for foremen in order to develop and improve their leadership skills, while the HSE Department conducted workshops in occupational health and safety. Various other educational activities were carried out in collaboration with various educational institutions and professional associations.

Intensified collaboration with educational institutions resulted in the conclusion of a cooperation agreement with the Faculty of Maritime Studies in Rijeka, whereby Viktor Lenac has been awarded the status of the Professional Human Resource Training Base. We also provided our support to the Faculty in the EU funding application process for financing MEDUSA program for development and improvement of maritime educational standards in shipping and shipping management. In this way, the Company provides support to the local community in terms of development of educational programs.

The Company also concluded a cooperation agreement on practice-based professional learning with the Mechanical Engineering School from Rijeka for trade, craft and industrial jobs with a special emphasis on welder training. The Company concluded a cooperation agreement with the Karlovac Technical School, which has been awarded the Center for competence for subsectors in engineering, electrical engineering and computing. Based on previous contracts concluded with IVORA Educational Institution and the Croatian Employment Service, several unemployed persons have been trained for welding jobs.

All measures that have been undertaken are aimed at maximizing labor capacity, increasing workmanship quality, motivating workers, reducing costs caused by unwanted fluctuations, and promoting development of a positive economic climate by fostering collaboration between businesses

and scientific community and educational institutions, thereby achieving benefiting not only for workers and trade unions but also customers and the local community.

### 103-3 Evaluation of the management approach

Quality of educational programs provided by external educational partners is evaluated by participants and the Shipyard tends to continue to collaborate with those educational institutions that have been rated best. Knowledge received through internal educational programs is evaluated through its application, where necessary, corrections are made. External evaluation of the topic management approach is manifested in productivity and application of new technologies and knowledge in all business processes.

The results of collaboration with educational institutions will be revealed over a long period, primarily through analysis of achievement of program tasks from cooperation agreements.

### 404-1 Average hours of training per year per employee

Gender	Number of employees participating in education	Total number of hours of education	Average number of hours of education per worker
M	66	1464	22,2
F	9	248	27,5
Total	75	1712	22,8

In addition to educational programs shown in the table, the ICT Department conducted in-house workshops attended by a total of 191 employees.

	Total number of hours of education	Number of employees participating in education	Average number of hours of education per worker
Managers of levels	408	12	34
Office workers, skilled and expert staff	528	13	40,6
Direct and indirect production workers	776	50	15,5
Total	1712	75	22,8

2017 was marked by educational programs involving leadership skills intended for managers at all levels, while in 2018 the Company focused on education and training of direct and indirect workers in production.