

# NON-CONSOLIDATED ANNUAL FINANCIAL STATEMENTS

# 2019

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.



**SHIPYARD**

**VIKTOR LENAC**

*Member of Palumbo Group*

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April 2020



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## STATEMENT ON RESPONSIBILITY FOR FINANCIAL STATEMENTS

We acknowledge our responsibility for the preparation and presentation of the financial statements for the year 2019 in accordance with the International Financial Reporting Standards applied in the European Union and Croatian Accounting Act 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 Management 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 Act in force in the 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 on 20 April 2020.



Sandra Uzelac  
Member of the management Board

## INDEPENDENT AUDITOR'S REPORT

To the Owners of Brodogradilište Viktor Lenac d.d., Rijeka

### Report on the Audit of the Financial Statements

#### Opinion

We have audited the separate financial statements of Brodogradilište Viktor Lenac d.d. ("the Company"), which comprise the unconsolidated statement of financial position as at 31 December 2019, the unconsolidated statement of comprehensive income, the unconsolidated statement of changes in equity and the unconsolidated 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 2019, 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.

#### Emphasis of Matter

We draw attention to Note 2.1 *Statement of compliance* to the financial statements, stating that the consolidated financial statements, which comprise the Company and its subsidiaries ("Group"), are issued as at 20 April 2020. The consolidated financial statements are prepared in accordance with International Financial Reporting Standards as adopted by the European Union. Users should read consolidated financial statements together with these financial statements for better understanding of the Group as a whole. Our opinion is not modified in respect of this matter.

#### 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.

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The company was registered at Zagreb Commercial Court: MBS 030022053; paid-in initial capital: Kn 44,900.00; Directors: Marina Tonžetić 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: RZBHHR2X IBAN: HR1024840081100240905.

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## 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 2.3.a and 30. For additional information related to identified key audit matter, see note 4 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 295,915,757 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 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.

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## **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.

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## 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 14 June 2019 to perform audit of accompanying financial statements. Our total uninterrupted engagement has lasted 2 year and covers period 1 January 2018 to 31 December 2019.

We confirm that:

- our audit opinion on the accompanying financial statements is consistent with the additional report issued to the Audit Committee of the Company on 20 April 2020 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 Marina Tonžetić.

**Marina Tonžetić**

Director and Certified auditor

For signatures, please refer to the original Croatian auditor's report, which prevails.

Deloitte d.o.o.

20 April 2019

Radnička cesta 80,

10 000 Zagreb,

Croatia



## NON-CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2019

Description	Note	HRK	
		2018	2019
<b>ASSETS</b>			
<b>Fixed assets</b>		<b>292,815,991</b>	<b>286,213,589</b>
Intangible Assets	15	5,597,518	5,477,339
Buildings, plants and equipment	15	277,301,592	270,765,295
Investments in subsidiaries	16	778,259	778,259
Financial assets measured at fair value through other comprehensive income	17	292,736	290,422
Financial assets measured at amortized cost	18	8,381,042	8,378,261
Deferred tax assets		464,844	524,013
<b>Short-term assets</b>		<b>66,970,640</b>	<b>132,142,746</b>
Inventories	19	17,960,373	14,925,987
Financial assets measured at amortized cost	18	130,211	76,318
Trade and other receivables	20	38,508,485	100,514,363
Money in bank and cash in register	21	10,371,571	14,618,842
Assets held for sale	15	-	2,007,236
<b>Total Assets</b>		<b>359,786,631</b>	<b>418,356,335</b>
<b>EQUITY AND LIABILITIES</b>			
<b>Equity and reserves</b>	22	<b>222,146,923</b>	<b>242,918,740</b>
Share capital	22	168,132,470	168,132,470
Reserves		75,027,051	53,948,514
Retained profit/loss	22	(21,012,598)	20,837,756
<b>Long-term liabilities</b>		<b>54,254,556</b>	<b>42,815,223</b>
Debentures with interest charge	23	38,137,709	29,175,819
Provisions	26	1,518,259	1,405,998
Other long-term liabilities	27	14,598,588	12,233,406
<b>Short-term liabilities</b>		<b>83,385,152</b>	<b>132,622,372</b>
Debentures with interest charge	23	18,562,903	33,267,346
Profit tax liabilities	24	-	232,818
Trade and other payables	24	64,134,806	97,589,510
Provisions	26	687,443	1,532,698
<b>Total Liabilities</b>		<b>137,639,708</b>	<b>175,437,595</b>
<b>Total Equity and Liabilities</b>		<b>359,786,631</b>	<b>418,356,335</b>

## NON-CONSOLIDATED COMPREHENSIVE INCOME STATEMENT AS AT 31 DECEMBER 2019

Description	Note	HRK	
		2018	2019
<b>OPERATING REVENUES</b>		<b>252,867,418</b>	<b>319,629,741</b>
Revenues from sales	4	227,249,933	295,915,757
Other operating revenues	5	25,617,485	23,713,984
<b>OPERATING EXPENSES</b>		<b>271,016,837</b>	<b>296,180,068</b>
Changes in inventories of finished goods and work in progress		110,546	2,939,618
Material expenses	6	168,374,457	195,577,990
Employee expenses	7	68,620,939	63,155,567
Depreciation	8	22,823,547	21,224,878
Value adjustments	9	808,920	1,143,900
Provisions	10	820,831	1,607,356
Other expenses	11	8,878,684	9,497,380
Other operating expenses	11	578,913	1,033,379
<b>EBIT</b>		<b>(18,149,419)</b>	<b>23,449,673</b>
<b>NET FINANCIAL INCOME/EXPENSES</b>		<b>(2,863,179)</b>	<b>(2,107,852)</b>
Financial income	12	253,664	179,898
Financial expenses	12	3,116,843	2,287,750
<b>PROFIT/(LOSS) FROM OPERATING REVENUES BEFORE TAX</b>		<b>(21,012,598)</b>	<b>21,341,821</b>
<b>PROFIT TAX</b>	13	-	<b>504,065</b>
<b>PROFIT/(LOSS) FOR THE YEAR</b>	13,14	<b>(21,012,598)</b>	<b>20,837,756</b>
Earnings per share (HRK)		(1.31)	1.30
<b>NET PROFIT/(LOSS) FOR THE YEAR</b>		<b>(21,012,598)</b>	<b>20,837,756</b>
Profit/loss after revaluation of financial assets held for sale		(80,326)	(66,356)
Deferred tax assets		14,459	417
<b>COMPREHENSIVE INCOME/(LOSS) FOR THE YEAR</b>		<b>(21,078,465)</b>	<b>20,771,817</b>

## CASH FLOW STATEMENT AS AT 31 DECEMBER 2019

Description	Note	HRK	
		2018	2019
<b>CASH FLOW FROM OPERATING ACTIVITIES</b>			
(Loss)/Profit before taxation	13,14	(21,012,598)	21,341,821
<b>Value adjustments in respect of:</b>			
Depreciation of real estates, facilities and equipment		22,823,547	21,224,878
Gains and losses from sale and value adjustments in respect of tangible and intangible assets	5,15	10,264	682,792
Gains and losses from sale, unrealized gains and losses and value adjustments in respect of financial assets	9	270,134	249,127
Value adjustments in respect of inventories	9	-	225,068
Shortage, surplus and expense of material inventories, net	5,11	1,171	125,170
Income from interests and dividends	12	(253,664)	(179,898)
Interest expenses	12	2,424,592	1,949,524
Provisions	5,10	(1,698,883)	813,844
Exchanges rate difference (unrealized)	12	536,929	(459,290)
Profit tax cost	13	-	(562,818)
Increase in accrued revenues and costs	20,24	(11,455,644)	(480,048)
<b>Profit from operating activities before changes in working capital</b>		<b>(8,354,152)</b>	<b>44,930,170</b>
Decrease in inventories		1,060,432	2,684,148
(Decrease)/Increase in short-term receivables		28,312,319	(30,832,644)
Decrease in liabilities		(932,234)	(2,889,452)
Profit tax paid		(9,394,170)	(440,000)
Interest paid		(2,504,364)	(1,869,177)
<b>CASH FLOW FROM OPERATING ACTIVITIES</b>		<b>8,187,831</b>	<b>11,583,045</b>
<b>INVESTING ACTIVITIES</b>			
Acquisition of real estates, facilities, equipment and intangible assets	15	(21,671,339)	(17,297,335)
Inflow from sale of long-term assets	5	40,280	38,905
Investment into financial assets		147,547	76,203
Inflow from interests		13,247	179,898
Inflow from dividends		3,692	-
Granted loans		(170,000)	-
Inflows on loans		39,789	53,893
<b>CASH FLOW FROM INVESTING ACTIVITIES</b>		<b>(21,596,784)</b>	<b>(16,948,436)</b>
<b>FINANCIAL ACTIVITIES</b>			
Inflows from debentures with interest charge		4,045,760	32,569,219
Repayment of debentures with interest charge		(12,139,428)	(22,956,557)
<b>CASH FLOW FROM FINANCIAL ACTIVITIES</b>		<b>(8,093,668)</b>	<b>9,612,662</b>
<b>TOTAL INCREASE/DECREASE OF CASH FLOW ( I+II+III)</b>		<b>(21,502,621)</b>	<b>4,247,271</b>
CASH AND CASH EQUIVALENTS AS AT 1 JANUARY		31,874,192	10,371,571
<b>CASH AND CASH EQUIVALENTS AS AT 31 DECEMBER</b>	<b>21</b>	<b>10,371,571</b>	<b>14,618,842</b>

## STATEMENT ON CHANGES IN EQUITY

HRK

	Share capital	Legal reserves	Reserves for own shares	Own shares	Other reserves	Retained profit/loss	Total
<b>Status as at 1 January 2018</b>	168,132,470	8,406,624	12,540,000	(8,055,772)	26,211,632	37,026,858	244,261,812
Profit/(Loss) for the year	-	-	-	-	-	(21,012,598)	(21,012,598)
Changes in reserves of the fair value of financial instruments held for sale	-	-	-	-	(65,867)	-	(65,867)
<b>Total comprehensive income/loss for 2018</b>					<b>(65,867)</b>	<b>(21,012,598)</b>	<b>(21,078,465)</b>
Impact of the first application of IFRS 9	-	-	-	-	(1,036,424)	-	(1,036,424)
Redirected into reserves per 2017 profit allocation	-	-	-	-	37,026,858	(37,026,858)	-
<b>Status as at 31 December 2018</b>	<b>168,132,470</b>	<b>8,406,624</b>	<b>12,540,000</b>	<b>(8,055,772)</b>	<b>62,136,199</b>	<b>(21,012,598)</b>	<b>222,146,923</b>
Profit/(Loss) for the year	-	-	-	-	-	20,837,756	20,837,756
Changes in reserves of the fair value of financial instruments held for sale	-	-	-	-	(65,939)	-	(65,939)
<b>Total comprehensive income/loss for 2019</b>					<b>(65,939)</b>	<b>20,837,756</b>	<b>20,771,817</b>
Redirected into reserves per 2018 profit allocation	-	-	-	-	(21,012,598)	21,012,598	-
<b>Status as at 31 December 2019</b>	<b>168,132,470</b>	<b>8,406,624</b>	<b>12,540,000</b>	<b>(8,055,772)</b>	<b>41,057,662</b>	<b>20,837,756</b>	<b>242,918,740</b>

## NOTES TO FINANCIAL STATEMENTS

### 1. GENERAL INFORMATION

The joint-stock company "Brodgradilište 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 HRK 168,132,470 and is divided in:

- 15,988,060 registered ordinary shares in non-materialized form, 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 newbuilding, ship repair and conversion and other services carried out onboard ships and other floating vessels. The Company has been registered for other activities such as steel constructions, organization, trade, engineering and other services.

The Company's shares are listed on the regularly operating market of Zagreb stock exchange. The Company's LEI code is 74780060BA4DPK8V1P23, the home member state is the Republic of Croatia, while the security code is V-LEN.

On the day of 31 December 2019, the Company employed 370 employees.

In 2019, the Company's Supervisory Board consisted of the following five members: Antonio Palumbo, President of the Supervisory board; Raffaele Palumbo, Vice-President of the Supervisory Board; and Francesco Ciaramella and Giorgio Filippi, Members of the Supervisory board. Zoran Košuta continues to hold his position of Workers' Representative and 5th Member of the Supervisory board.

At the extraordinary General Assembly held on January 15, 2020, new members of the Supervisory Board were elected, Vittorio Carratù and Antonio Gennarelli, replacing Antonio Palumbo and Raffaele Palumbo. Vittorio Carratù has been appointed President of the Supervisory Board.

In 2019, the Company's Committee for Audit was composed of the following members: Vittorio Carratù, Francesco Ciaramella and Giorgio Filippi, appointed by the Company's Supervisory Board.

On the day of 31 December 2019, the Management Board was composed of one member of the Management Board, Sandra Uzelac.

The Company had the following ownership structure as at 31 December 2019:

	Shareholder	Number of Shares	Percentage of Equity
1	PALUMBO GROUP S.P.A. (1/1)	8,354,563	49.69
2	INTERKAPITAL VRIJEDNOSNI PAPIRI D.O.O./ GUARDIANSHIP ACCOUNT	5,426,897	32.28
3	BRODOGRADILIŠTE VIKTOR LENAC D.D. (1/1)	825,187	4.91
4	JADROAGENT D.D. (1/1)	324,766	1.93
5	R.L.E., T.P. (1/1)	105,211	0.63
6	WEISS MARIJA BRANKA (1/1)	77,308	0.46
7	CROATIAN CENTRE FOR RESTRUCTURING AND SALES/REPUBLIC OF CROATIA	59,119	0.35
8	KERA IVANA (1/1)	54,327	0.32
9	RAZMAN ENES	52,500	0.31
	Others	1,533,369	9.12
	<b>Total:</b>	<b>16,813,247</b>	<b>100.00</b>

In accordance with the International Financial Reporting Standards and Croatian law, the Consolidated Financial Statements of the Company and its subsidiaries shall be published as a separate document. The Management Board of the Company approved the Non-Consolidated Financial Statements for submission to the Supervisory Board on 20 April 2020.

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 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 2019 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.

The non-consolidated financial statements of the Company have been prepared using the basic accounting assumption of the occurrence of an event, according to which the effects of transactions are recognized when they occurred and are presented in the financial statements for the period to which they relate, and using the basic accounting assumption of continuity of business for an indefinite period.

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union ("IFRS") for Viktor Lenac Shipyard and its subsidiaries (the "Group") and were published on April 20, 2020. For a better understanding of the Group as a whole, users should read the consolidated financial statements associated with these non-consolidated financial statements.

Accounting policies applied in the preparation of the 2019 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 Company's financial statements 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 2019 as follows:

1 EUR = HRK 7.442580	(31 Dec 2018: 1 EUR = 7.417575 HRK)
1 USD = HRK 6.649911	(31 Dec 2018: 1 USD = 6.469192 HRK)
1 NOK = HRK 0.754336	(31 Dec 2018: 1 NOK = 0.742716 HRK)
1 GBP = HRK 8.724159	(31 Dec 2018: 1 GBP = 8.205282 HRK)

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

#### First application of new amendments to effective standards which are relevant for current reporting period

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

- **IRFS 16 “Leases”** as adopted in the European Union on 31 October 2017 (effective for annual periods beginning on or after 1 January 2019);
- **Amendments to IRFS 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 on 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 on or after 1 January 2019);
- **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 adoption of these amendments to the effective standards and interpretations did not result in any material changes in the Company's financial statements.

#### **New standards and amendments to effective standards issued by IASB and not yet adopted in the European Union**

IFRSs, 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 statement (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);
- **The revised Conceptual Framework for Financial Reporting** (effective for annual reporting periods beginning on or after 1 January 2020).
- **Amendments to IFRS 9, IAS 39 and IFRS 7** (published on 26 September 2019 and effective for annual periods beginning on or after 1 January 2020).

The Company estimated that implementation of the new standards and amendments to effective standards would not have a material impact on the financial statements.

Hedge accounting of a portfolio of financial assets and liabilities not adopted in the EU remains unregulated.

#### **First implementation of new standards**

First implementation of IFRS 16, effective from 1 January 2019, did not have significant impact on financial statements because the Company as at 31 December 2019 did not have any leases to which the standard applies.

IFRS 9: Prepayment Features with Negative Compensation (Amendments) - Amendments allow the measurement of financial assets with the features of advances that allow or prohibit the parties from paying or receiving early termination fees (from the perspective of the owner of the financial asset, this may also be negative compensation) at amortized cost or at fair value through other comprehensive income. The Management Board estimates that the amendment does not have any material impact on the financial statements of the Company and the Group.

IAS 28: Long-term Interests in Associates and Joint Ventures (Amendments) - The amendment considers whether the measurement of long-term interests in associates and joint ventures forming part of a net investment in associates and joint ventures (primarily impairment requirements) values based on the provisions of IFRS 9, IAS 28 or a combination thereof. The amendments clarify that the entity applies IFRS 9 Financial Instruments before IAS 28 for such long-term interests for which the equity method is recognized. In applying IFRS 9, the Company does not take into account value adjustments in respect of the carrying amounts of long-term interests arising from the application of IAS 28. The Management Board estimates that the amendments do not have any material impact on the financial statements of the Company and the Group.

IFRIC Interpretation 23: Uncertainty over Income Tax Treatments - Interpretation refers to the accounting treatment of income taxes when tax transactions involve uncertainty affecting the application of IAS 12. The interpretation provides guidance on the consideration of uncertain tax transactions, individually and collectively, for oversight by tax authorities and an appropriate method for reflecting uncertainty and accounting for changes in facts and circumstances. The Management Board estimates that the amendments do not have any material impact on the financial statements of the Company and the Group.

IAS 19: Plan Amendment, Curtailment or Settlement (Amendments) - The amendments require the Company to use updated actuarial assumptions to determine current employee cost and net interest for the remainder of the annual reporting period after an amendment, shortening, or payment has occurred. The amendments also clarify how the accounting treatment of a supplement, shortening or payment of plans affects the application of the limits on the amount of recognized assets. The Management Board estimates that the amendments do not have any material impact on the financial statements of the Company and the Group.

**The IFRS Committee has issued the Annual Improvements to IFRSs 2015-2017, which are a set of changes and changes to IFRSs. The Management Board estimates that the amendments do not have any material impact on the financial statements of the Company and the Group.**

IFRS 3: Business Combinations and IFRS 11: Joint Arrangements - Amendments to IFRS 3 clarify that, when taking control of a business in which the Company has joint management, the Company reassesses its previous interests in that business. The amendments to IFRS 11 clarify that when acquiring joint control of a business that is jointly managed, the Company does not re-evaluate previous interests in that business.

IAS 12: Income Taxes - The amendments clarify that the effects of income taxes on financial instruments classified as equity should be recognized in a position in which past transactions or events that have generated distributable profit are recognized.

IAS 23: Borrowing Costs - The amendments clarify paragraph 14 of the standard. When qualifying assets are ready for use or sale and some specific borrowing costs associated with the property remain outstanding at that point, borrowing costs should be included in the amount of cash generally borrowed by the Company.



### 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, impairment estimates, value adjustments in respect of inventories and doubtful receivables, provisions for employees' salaries and wages, and litigations. More details on accounting policies relative to these estimates can be found in other parts of this note as well as other notes to 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 preparation of financial statements for the year 2019 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 Company 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, when is so stipulated in the contract.

Revenues resulting from contractual obligations which are fulfilled during a period of time, are recognized to the extent that they have been incurred, under following conditions:

- The cost of partial deliveries 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 or 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 to question and evaluate credibility of both methods for the purpose of fair valuation of reported revenues.

Government grants are recognized in income for the period in which the related costs will be incurred, if:

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

Financial income includes 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 managed in such a way that periodic accounting system determines expenses which are applicable to recognition in the calculation of the financial result of the current year.

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 reported 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 the 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 have not produced profit or loss consequently creating temporary difference between accounting profit and taxable profit. Deferred tax assets refer to tax losses carried forward, unused tax benefits and deductible temporary differences, and are offset in subsequent tax periods when the conditions for recognizing previously unrecognized unrealized losses are fulfilled, or represent previously paid income taxes for return in subsequent periods. Deferred tax liabilities refer to future profit tax liability 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 assets are calculated at 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 deferred tax 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 deferred tax 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 to the Company or another taxpayer who intends to settle the current tax liability and assets on a net basis.

**d) Profit/loss after revaluation of 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 impairment.

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, general and common 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 the following conditions are 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.

Exceptionally, 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 created by the undertaking itself and used as 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 Board'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 related companies - companies in which the Company has significant influence but no control, which typically includes 20% to 50% of the voting rights;
- 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.

#### ***(a) Financial assets measured at amortized cost***

Financial assets measured at amortized cost are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for assets with a maturity of more than 12 months after the balance sheet date. Such assets are classified as long-term financial assets. Receivables are stated at amortized cost using the effective interest rate method.

The impairment policy is set out in Note 2.3.j and 2.3.k.

#### ***(b) Financial assets measured at fair value through other comprehensive income***

After initial measurement, for financial assets measured at fair value through other comprehensive income, the gain or loss from the change in fair value is recognized in other comprehensive income. Foreign exchange gains or losses are recognized in profit or loss in the income statement. If the financial assets are derecognised, the cumulative gain or loss previously recognized in other comprehensive income is reclassified from other comprehensive income to profit or loss as reclassification adjustment.

#### ***h) Investments in subsidiaries***

Investments in subsidiaries refer to investments of cash, goods and assignment of rights with the aim of earning revenue through a majority interest in another company, with a share of more than 50%, expected to be repaid over a 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 inventories value is performed by charging expenses of the current period based on evaluation made by professional services on damage, deterioration of inventories 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 unless the circumstances that led to an earlier decrease in value or write-down of inventories, no longer exist, the value of inventories should be increased up to the cost of acquisition or the value that can be realized and consumed as such in regular production.

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

Inventories that are damaged during handling and storage, as well as inventories that lose their useful value, are determined through inventory procedures or by special commissions and, with the approval of the responsible person and in accordance with tax regulations, are written off on the account of regular operating expenses.

If the Company, up to the reporting period, does not conclude an initiated commercial contract, and if the criteria for revenue recognition under IRFS 15 haven't been met, the value of inventories of production in progress is recorded as at 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 production costs, which occurred by the end of the reporting period:

- Variable and fixed direct production costs that can be directly related to a 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 of 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 or 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 or value of inventories of production in progress does not include profit or general and administrative expenses which cannot be related to a service, 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 foreign customers expressed in foreign exchange currencies are recorded in national currency, calculated based on mean exchange rate of the Croatian National Bank as at 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.

Outstanding trade receivables from foreign customers as at the balance sheet date are reported at mean exchange rate of the Croatian National Bank and the exchange rate differences are recorded as revenues or expenses.

Receivables are initially recognized at fair value in the Company's books of account and subsequently measured at amortized cost.

The increase in interest receivable is based on the contract and default interest rate calculations. Value adjustments in respect of receivables are made on the basis that it is established that the receivable has not been collected within the due time or that it is uncollectible and claimed on court. The decision on adjusting the value of receivables is made by the Management Board.

Value adjustments in respect of receivables are recognized in the income statement of the Company (Note 30), and as stated in Note 2.3 k) *Impairment of short-term financial assets, including receivables*.

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

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

Short-term financial investments within one year are recorded in business books at investment cost. The value is determined for each investment. Subsequent measurement of short-term financial investments is recognized at amortized cost.

***Impairment of short-term financial assets, including receivables***

Estimates of future expected credit losses are made based on the average write-off rate in previous years and its application to non-revaluated short-term financial assets at the reporting date (Note 30). The Company uses a simplified approach to allocate receivables to Level 2 and Level 3 as required by IFRS 9. Receivables over 365 days are allocated to Level 3.

Upon acknowledging higher risk of collecting these assets and termination of litigations, where there is evidence of impairment, value adjustments in respect of short-term financial assets are carried out in an amount that reflects the specified parameters. The decision on value adjustments is made by the Management Board.

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

Cash and cash equivalents include money in bank, cash in register and short-term deposits. Money in bank and cash in register is recorded at nominal value in national currency. Foreign exchange funds in bank and in register is recorded at mean exchange rate of the Croatian National Bank.

Exchange rate differences arising from setting foreign exchange funds to mean exchange rate of the 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 an own source for financing assets. Subscribed capital is recorded in the amount that is registered in the court registry upon establishment or change of subscribed value of capital in the commercial registry. Reserves are accounted for depending on their form and Company's policy (statutory and other).

***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 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 balance sheet date.

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

Short-term liabilities are recorded in 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 balance sheet date.

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 national currency. Upon settlement of these liabilities, the differences that occur as exchange rate differences are recorded as revenues or expenses of the Company.

Outstanding liabilities shown in foreign exchange currencies are being set at mean exchange rate of the Croatian National Bank as at the balance sheet date and any exchange rate differences 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 IFRS 8 management approach, the Company controls its activities in only one segment, according to the specifics of the activity itself. Shiprepair and conversions, being the main activity of the Company, constitute more than 98% of sales revenues or more than 90% of total operating revenues. All processes within the main activity are interrelated by matrix organisation. Matrix organisation connects various resources provided by functional organisational units needed to realize a number of concurrent projects. The Company uses its non-direct resources and infrastructure which cannot be allocated to each project, for all projects within shiprepair activities. Profitability of each project 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, requiring different approaches in combining production trades. Such business environment does not allow segment reporting of organisational units or activities.

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

The Company's main activity involve its subsidiaries VIKTOR – SERVISI Ltd. and VL Steel Ltd., which provide services that are closely related or equal to the Company's activity, so there can be no different segments of activities. In the Company's business model, the subsidiaries act like subcontractors in business activities of the Company in periods of high occupancy rates or in projects where the Company does not have its own or does not have a sufficient number of its own workers. It is to be noted that the subsidiaries have a total impact of only 1% to the consolidated financial statements.

## 4. REVENUES FROM SALES

	HRK	
	2018	2019
Revenues from sales on domestic market	28,862,433	27,142,666
Revenues from sales on foreign market	197,628,335	268,741,000
Revenues from sales – subsidiary companies	140,511	32,091
Revenues from sales – related parties	618,654	-
<b>Total</b>	<b>227,249,933</b>	<b>295,915,757</b>



Structure of revenues from sales:

	Domestic market	Foreign market	Total
Shiprepair	26,695,456	262,916,325	289,611,781
Other revenues	447,210	5,824,675	6,271,885
Other revenues – subsidiary companies	32,091	-	32,091
<b>Total</b>	<b>27,174,757</b>	<b>268,741,000</b>	<b>295,915,757</b>

Revenue from sales - related parties, reported for up to the period ended June 30, 2018, related to the Uljanik Group, which was, together with Tankerska plovidba Ltd, the major shareholder of the Company, with their representatives in the Company's Supervisory Board. By acquiring their shares in the second half of 2018, Palumbo Group S.p.A. became mayor single shareholder. The Company did not sell any services to the Palumbo Group during 2018 and 2019.

The Company applied IFRS-15 "Revenue from Contracts with Customers" to account for revenues generated from a total of seven shiprepair projects which were actual on December 31, 2019. Of the total amount of sales revenue, HRK 18,924,919 referred to revenues accounted for by applying IFRS 15.

## 5. OTHER REVENUES

	HRK	
	2018	2019
Revenues based on the use of own products, goods and services	17,360,129	13,239,111
Revenues from sale of material	1,654,592	6,392,103
Revenues from sale of material – subsidiary companies	52,925	44,941
Rentals	825,820	1,113,406
Rentals - subsidiary companies	204,798	226,524
Rentals – related parties	1,170	-
Income from reversal of long-term provisions ( <i>Note 26</i> )	2,290,713	793,512
Insurance claim income	10,076	-
Income from disputed claims ( <i>Note 20</i> )	684,277	994,925
Revenues from sale of property, plant and equipment	40,280	38,905
Income from discontinued liabilities	963,516	6,450
Retrospectively estimated income from past years	-	46,063
Inventory material surplus	1,359	425,034
Other revenues	1,469,830	337,200
Other revenues - subsidiary companies	57,640	55,540
Other revenues - related parties	360	-
<b>Total</b>	<b>25,617,485</b>	<b>23,713,984</b>

Revenues from sale of materials include revenues from sale of waste materials or secondary raw materials, which are generated from core business projects. In 2019, the Company carried out a project of removal of part of the structure of one ship, which resulted in increased revenues but also costs associated with the repurchase and sale of scrap steel.

Income from reversal of long-term provisions reported in the current period involved reversal of provisions for allowances for unused annual leave for 2018 and litigations, as recorded on 31 December 2018. Unused annual leave allowances reported as at 31 December 2018 were used in 2019, which resulted in reversing the provisions. The unused annual leave allowances remaining as at 31 December 2018, which generated income from 2019 long-term provisions reversed, were significantly lower than those booked on 31 December 2017, which

generated this income for the previous year. This is a consequence of a significant decline in occupancy in 2018 compared to the year before, for which reason a relatively larger pool of workers' annual leave hours was used during 2018 and therefore the income generated from reversal of provisions in 2019 was lower.

Income from disputed claims in mayor part related to collected receivables from the Uljanik Group, which were revaluated (written off) in 2017.

Rental income referred to revenues generated from leasing commercial premises and production equipment to subcontractors who are involved in production activities of the Company. Rental income and other income from related parties related to the income generated from the Uljanik Group reported as at 30 June 2018, considering that the parent company of the Uljanik Group represented as at 30 June 2018 one of the largest single shareholders of the Company and participated in the Supervisory Board of the Company. By acquiring majority of shares in the second half of 2018, Palumbo Group S.p.A. became mayor single shareholder. The Company didn't sell any services to the Palumbo Group during 2018 and 2019.

## 6. MATERIAL EXPENSES AND COST OF GOODS SOLD

	HRK	
	2018	2019
<b>Raw and other material</b>		
Consumed raw and other material	33,062,629	43,298,582
Consumed raw and other material – subsidiary companies	61,751	138,338
Consumed raw and other material – related parties	684	
Consumed energy	10,713,683	11,840,132
Small inventory and spare parts	522,713	364,451
<b>Total raw and other material</b>	<b>44,361,460</b>	<b>55,641,503</b>
<b>Other external expenses</b>		
Transportation, phone, post and similar services	705,985	596,520
Services used in production of outputs	60,422,466	64,617,360
Services used in production of outputs - subsidiary companies	3,526,546	5,442,425
Services used in production of outputs - related parties	496,598	-
Subsupplier services	42,905,997	55,699,874
Subsupplier services - subsidiary companies	2,639,761	2,597,537
Subsupplier services - related parties	59,339	-
Maintenance services	7,930,376	4,738,491
Maintenance services - subsidiary companies	402,370	432,102
Maintenance services - related parties	6,323	
Rental expenses	1,032,824	3,001,543
Rental expenses – subsidiary companies	-	17,280
Rental expenses – related parties	173,050	-
Intellectual services	1,472,292	1,149,881
Intellectual services – related parties	-	334,424
Other services	2,239,070	1,309,050
<b>Total other external expenses</b>	<b>124,012,997</b>	<b>139,936,487</b>
<b>Total material expenses</b>	<b>168,374,457</b>	<b>195,577,990</b>

Services used in production of outputs are subcontractor costs. 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 referred to the Uljanik Group which was, up until 30 June 2018 together with Tankerska plovidba Ltd, major shareholder of the Company. By acquiring majority of shares, Palumbo Group S.p.A. became mayor single shareholder of the Company.

In 2019, the costs of auditing the financial statements amounted to HRK 167,458 (2018: HRK 166,916), the costs of tax advisory services amounted to HRK 48,000 (2018: HRK 48,000), and the costs of consulting services provided by one company within the Palumbo Group amounted to HRK 334,424 (2018: HRK 0).

The cost of legal representation of the Company in 2019 amounted to HRK 239,839 (2018: HRK 254,516). This amount related entirely to the services provide by domestic law firms. Since the Company does not have its own legal department, legal services are outsourced when required.

## 7. EMPLOYEE COST

	HRK	
	2018	2019
Net salaries and wages	37,839,457	34,254,937
Social security contributions and taxes paid by employer	15,367,437	14,259,365
Social security contributions and taxes paid by employee	9,898,522	8,501,155
Severance pay	306,100	845,855
Compensations for travelling costs, daily allowances, annual bonuses	5,209,423	5,294,255
<b>Total</b>	<b>68,620,939</b>	<b>63,155,567</b>

Employee expenses include expenses paid by the Company under the Collective Agreement relating to severance pay, jubilee awards, travel allowances and commemorative awards. The decrease in the cost of wages and taxes and contributions is the result of the reduction in the number of own workers in the process of optimizing the organization.

## 8. DEPRECIATION

	HRK	
	2018	2019
Intangible assets, property, plant and equipment	22,823,547	21,224,878
<b>Total</b>	<b>22,823,547</b>	<b>21,224,878</b>

At the end of 2019, the depreciation rate of assets was 68% (2018: 67%).

## 9. VALUE ADJUSTMENTS

In 2019, the Company reported value adjustments in respect of assets in a total amount of HRK 1,143,900 (2018: HRK 808,920) relating to:

- Value adjustments in respect of fixed assets in preparation in the amount of HRK 669,706 (2018: HRK 0) which was estimated to be of no benefit to the Company in the future (Note 15);
- Value adjustments in respect of inventories in the amount of HRK 225,068 (2018: HRK 0) for which the Company's expert services estimated that it was not certain that they would be expended regularly in the further production process, given that part of these inventories had been procured for the needs of special projects, which is why it is no longer certain that those will be spent in the near future with purpose (Note 19);
- Value adjustments in respect of financial assets in the amount of HRK 249,127 (2018: HRK 270,134) relating to value adjustments in respect of trade receivables under IFRS 9 in the amount of HRK 229,938 (2018: HRK 254,040) as the aggregate effect of an adjustment to the value of a trade receivable and a

change based on the application of IFRS 9; and definitive write-off of receivables in the amount of HRK 19,189 (2018: 16,094) (Note 20).

## 10. PROVISIONS

For the year 2019, the Company made provisions for expenses in a total amount of HRK 1,607,356 (2018: HRK 820,831), of which HRK 1,452,736 (2018: HRK 607,481) involved provisions for allowances for unused annual leave and HRK 154,620 (2018: HRK 213,350) for litigation initiated in 2019.

The amount of provisions for unused annual leave cost was significantly higher than in 2018 due to an increase in occupancy rates in 2019 compared to the previous year, which is why workers did not take advantage of more vacation days.

## 11. OTHER EXPENSES

	HRK	
	2018	2019
Representation and gifts	1,111,795	776,389
Insurance premiums	3,552,762	4,047,842
Bank services	368,123	420,517
Tax and contribution not dependant on the result	2,289,966	2,965,637
Other expenses	1,556,038	1,286,995
<b>Total other expenses</b>	<b>8,878,684</b>	<b>9,497,380</b>

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

Also, in 2019, the Company generated other operating expenses amounting to HRK 1,033,379 (2018: HRK 578,913) referring to deficit in materials and fixed assets, the intangible value of tangible assets expended and other operating expenses as follows:

	HRK	
	2018	2019
Inventories written off	-	101,336
Deficit in inventories	2,530	448,868
Tangible fixed assets written off	50,544	51,524
Deficit in tangible fixed assets	-	5,266
Other operating and extraordinary expenses	525,839	426,385
<b>Total other operating expenses</b>	<b>578,913</b>	<b>1,033,379</b>

## 12. FINANCIAL INCOME AND EXPENSES

	HRK	
	2018	2019
<b>Financial income</b>		
Interests	249,972	179,898
Dividend income	3,692	-
<b>Total financial income</b>	<b>253,664</b>	<b>179,898</b>
<b>Financial expenses</b>		
Interests	2,424,592	1,949,524
Negative exchange rate differences	692,251	338,226
<b>Total financial expenses</b>	<b>3,116,843</b>	<b>2,287,750</b>
<b>Net financial expenses</b>	<b>(2,863,179)</b>	<b>(2,107,852)</b>

In 2019, the Company generated foreign exchange gains in a total amount of HRK 977,772 (2018: HRK 2,173,478) and foreign exchange losses in the amount of HRK 1,315,998 (2018: HRK 2,865,729), resulting in net foreign exchange losses in the amount of 338,226 (2018: HRK 692,251).

Out of the total amount of foreign exchange losses in the total amount of HRK 338,226 for 2019 (2018: HRK 692,251), realized net negative exchange rate differences amounted to HRK 797,516 (2018: HRK 155,322), with the remaining unrealized foreign exchange gains in the amount of HRK 459,290 (2018: HRK 536,929 negative) in the balance of assets and liabilities stated in foreign currencies or with a currency clause on 31 December 2019.

## 13. PROFIT TAX

The Company generated a profit of HRK 21,341,821 as a difference in revenues and expenses generated in the period from 1 January 2019 to 31 December 2019. After accounting for the increase and decrease of the tax liability, and the 2018 tax loss carried forward, the profit tax liability amounted to HRK 562,818. The Company has already paid HRK 330,000 through profit tax advances in 2019, leaving the obligation to pay a tax difference in the amount of HRK 232,818.

In 2019, the Company disclosed deferred tax assets after revaluation of financial assets - securities in the amount of HRK 417 (2018: HRK 14,459).

The Company did not recognize deferred tax assets for the loss made in 2018, but recognized deferred tax assets on the basis of write-offs of inventories which the expert services have estimated will not be spent in production process and on the basis of inventories expired or destroyed in the amount of HRK 58,753.

	HRK	
	2018	2019
<b>Accounting profit/loss before taxation</b>	(21,012,598)	21,341,821
Profit tax rate 18 %	-	<b>3,841,528</b>
Effect of non-deductible costs	145,451	475,474
Effect of deductible costs	(102,274)	(15,093)
<b>Total</b>	<b>43,177</b>	<b>4,301,909</b>
Effect of tax loss carried forward	-	(3,739,091)
<b>Cost of profit tax</b>	-	<b>562,818</b>

Of the total reported profit tax expense in the amount of HRK 562,818 for 2019, HRK 504,065 relates to the current tax expense for the period, and the remaining HRK 58,753 relates to deferred tax assets. In accordance with tax regulations, the tax administration may at any time inspect the Company's books and records for a period of three years after the end of the year in which the tax liability is presented, and may impose

additional tax liabilities and penalties. The Company's Management Board is not aware of any circumstances that could lead to potential significant liabilities based on the controls performed.

## 14. EARNINGS PER SHARE

HRK

	31.12.2018	31.12.2019
Net (loss)/profit for the year	(21,012,598)	20,837,756
Total number of shares	16,813,247	16,813,247
Shares exclusive of own shares	15,988,060	15,988,060
<b>Basic (loss)/earnings per share</b>	<b>(1.31)</b>	<b>1.30</b>
<i>Diluted (loss)/earnings per share</i>	<i>(1.25)</i>	<i>1.24</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>										
Status as at 1 Jan 2018	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 tangible assets 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	-	-
Status as at 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
Transfer from investments in tangible assets in progress and advances	-	-	11,023,931	4,615,221	(15,737,025)	(222,224)	(320,097)	434,263	(114,166)	-
Acquisition during the year	-	-	-	-	17,183,169	-	17,183,169	-	114,166	17,297,335
Sold, written-off and discounted assets during the year	-	-	(1,089,555)	(2,491,060)	(669,706)	-	(4,250,321)	(6,900)	-	(4,257,221)
Surplus, Deficit	-	-	-	(2,435)	-	-	(2,435)	-	-	(2,435)
Value adjustments in respect of assets held for sale	-	(3,136,593)	-	-	-	-	(3,136,593)	-	-	(3,136,593)
Status as at 31 Dec 2019	12,504,214	67,114,923	667,454,847	78,122,160	3,888,496	-	829,084,640	18,176,753	-	847,261,393
<b>VALUE ADJUSTMENTS</b>										
Status as at 1 Jan 2018	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)
Status as at 31 Dec 2018	6,958,527	65,932,775	399,498,945	69,919,078	-	-	542,309,325	12,151,872	-	554,461,197
Depreciation during the year	-	179,840	18,806,566	1,684,030	-	-	20,670,436	554,442	-	21,224,878
Sold and written-off assets during the year	-	-	(1,049,527)	(2,466,309)	-	-	(3,515,836)	(6,900)	-	(3,522,736)
Surplus, Deficit, Value adjustments	-	-	-	(15,223)	-	-	(15,223)	-	-	(15,223)
Value adjustments in respect of assets held for sale	-	(1,129,357)	-	-	-	-	(1,129,357)	-	-	(1,129,357)
Status as at 31 Dec 2019	6,958,527	64,983,258	417,255,984	69,121,576	-	-	558,319,345	12,699,414	-	571,018,759
<b>BOOK VALUE 31 DEC 2018</b>	<b>5,545,687</b>	<b>4,318,741</b>	<b>258,021,526</b>	<b>6,081,356</b>	<b>3,112,058</b>	<b>222,224</b>	<b>277,301,592</b>	<b>5,597,518</b>	<b>-</b>	<b>282,899,110</b>
<b>BOOK VALUE 31 DEC 2019</b>	<b>5,545,687</b>	<b>2,131,665</b>	<b>250,198,863</b>	<b>9,000,584</b>	<b>3,888,496</b>	<b>-</b>	<b>270,765,295</b>	<b>5,477,339</b>	<b>-</b>	<b>276,242,634</b>

During 2019, investment in long-term assets involved purchase of explosive-proof portable Gala LED lighting for use onboard vessels undergoing repairs, welding machines and other production equipment. The investment also included continued steel renewal of Dock 5 and Dock 11 to extend their useful life.

A portion of tangible assets is held as long-term credit insurance (Note 32) and the net book value of these assets on 31 December 2019 amounted to HRK 224,835,131 (2018: HRK 233,880,574).

The 2019 depreciation rate at the reporting date was 68% (2018: 67%).

The Company is the owner of a real estate (business premises) situated in Riva 20, which as at December 31, 2019 was recorded as assets held for sale under short-term assets.

## 16. INVESTMENT IN SUBSIDIARIES AND SECURITIES INVESTMENTS

Net book value of investment in subsidiaries as at 31 December 2019 related to a limited liability company VIKTOR – SERVISI in which the Company holds a 100% equity interest, amounting to HRK 763,259, and a limited liability company VL Steel in which the Company holds a 75% equity interest, amounting to HRK 15,000.

## 17. FINANCIAL ASSETS MEASURED AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME

The Company owns 5,000 shares of Uljanik d.d. which are recorded in the Company's books at a nominal value in a total amount of HRK 450,000. On 31 December 2019, the Company made value adjustments in respect of the shares in accordance with the notice of the Central Depository and Clearing Company of Zagreb and considering the fact that the Uljanik company filed for bankruptcy, so that the reported value of these shares at the reporting date was HRK 0 (2018: HRK 54,000).

The Company also owns 6,153 shares of Tankerska next generation company which are recorded in the Company's books at a nominal value in a total amount of HRK 399,945. On 31 December 2019, the Company made value adjustments in respect of the shares in accordance with the notice of the Central Depository and Clearing Company of Zagreb, so that the reported value of these shares at the reporting date was HRK 290,422 (2018: HRK 238,736).

## 18. FINANCIAL ASSETS MEASURED AT AMORTIZED COST

Long-term financial assets in the amount of HRK 8,378,261 (2018: HRK 8,381,042) related to a cash deposit on a long-term investment loan in the amount of HRK 8,186,838 (2018: HRK 8,159,333) and a deposit to secure long-term liabilities to HEP ESCO company in the amount of HRK 191,423 (2018: HRK 211,709). Short-term financial assets in the amount of HRK 76,318 (2018: HRK 130,211) related to granted borrowings.

## 19. INVENTORIES

	HRK	
	31.12.2018	31.12.2019
Raw and other material	14,907,385	14,925,987
Raw and other material under delivery	2,946	-
Fabrication of flanges	110,424	-
Production in progress	2,939,618	-
Small inventory	8,654,941	8,767,932
Value adjustments in respect of small inventory	(8,654,941)	(8,767,932)
<b>Total</b>	<b>17,960,373</b>	<b>14,925,987</b>

The Company applied IFRS 15 “Revenue from Contracts with Customers” for shiprepair projects that were actual on December 31, 2019, which had fulfilled revenue recognition requirements under IFRS 15. Therefore, the Company did not report any value of inventories of unfinished production in 2019.

In 2019, the Company carried out a value adjustment in respect of inventories in the amount of HRK 225,068, which was estimated as being unlikely to be consumed regularly in the further production process, given that a part of those inventories was procured for special projects, due to of which it is no longer certain that it will be expended with purpose in the near future. Inventory on 31 December 2019 established a total shortfall in inventories of materials in the amount of HRK 448,869 and surplus inventories of materials in the amount of HRK 425,034 incurred in the technological process of consuming similar and related materials, which could not be offset for tax reasons. The established deficiency and surplus amounts represent about 1% of total materials consumed during 2019.

## 20. TRADE AND OTHER RECEIVABLES

	HRK	
	31.12.2018	31.12.2019
<i>Receivables from customers - gross</i>	58,147,022	99,776,763
<i>Receivables from customers – impairment</i>	39,606,938	33,289,716
Receivables from customers – net	18,472,949	66,398,254
Receivables from customers - subsidiary companies	67,135	88,793
Receivables from employees	197,073	9,260
Receivables from state	4,359,099	8,564,302
Prepaid expenses and accrued income	14,182,434	22,137,446
Advances	1,169,488	3,316,308
Advances – subsidiary companies	60,307	-
<b>Total</b>	<b>38,508,485</b>	<b>100,514,363</b>

*Value adjustments in respect of trade receivables:*

	HRK	
	2018	2019
<b>Status 1 January 2019</b>	32,412,246	39,606,938
Effect of implementation of IFRS 9 on 1 January 2018	1,036,424	-
Impairment for the current year	7,444,824	2,920,442
Recovery of receivables previously written-off	(684,277)	(994,925)
Definitive write-off of previously revaluated receivables	(63,492)	(8,472,676)
Value adjustments in respect of expected credit loss - IFRS 9	(538,787)	229,937
<b>Status 31 December 2019</b>	<b>39,606,938</b>	<b>33,289,716</b>

Trade receivables as at 31 December 2019 increased significantly compared to the previous year as a result of a significant increase in occupancy rates in the last quarter of 2019.

The receivables from the state related to the value added tax refund claim in the amount of HRK 8,344,658 (2018: HRK 3,018,808) and sick leave benefit claim from the Croatian Institute for Health Insurance in the amount of HRK 219,644 (2018: HRK 240,679).

The prepaid expenses and accrued income mostly related to accrued income (HRK 21,920,649) under IFRS 15 ‘Revenue from Contracts with Customers’ for shiprepair works carried out onboard seven vessels, which were undergoing repairs in the Shipyard on 31 December 2019.



According to IFRS 9 requirements, the Company carried out value adjustments in respect of receivables from customers for 2018 and 2019.

Age structure of matured receivables from customers:

	HRK	
	31.12.2018	31.12.2019
1-90 days	10,750,144	60,490,485
91-180 days	861,408	185,519
181-365 days	5,961,536	881,480
Over 365 days	1,464,633	5,657,137
Value adjustments in respect of receivables	(497,637)	(727,575))
<b>Total</b>	<b>18,540,084</b>	<b>66,487,047</b>

Age structure of impaired receivables from customers:

	HRK	
	31.12.2018	31.12.2019
1-90 days	2.673.835	-
91-180 days	2.062.335	-
181-365 days	2.708.654	2.279.216
Over 365 days	31.664.477	30.282.926
Value adjustments in respect of receivables	497.637	727.574
<b>Total</b>	<b>39.606.938</b>	<b>33.289.716</b>

Trade receivable structure by currency:

	HRK	
	31.12.2018	31.12.2019
HRK	10,810,868	15,152,771
EUR	5,643,827	40,345,116
USD	2,583,026	11,716,734
Value adjustments in respect of receivables	(497,637)	(727,574)
<b>Total</b>	<b>18,540,084</b>	<b>66,487,047</b>

Structure of trade receivables by markets:

	HRK	
	31.12.2018	31.12.2019
Italy	3,039,357	38,967,879
Croatia	10,810,869	15,152,814
USA	2,649,081	11,717,002
Norway	1,674,595	-
Other countries	863,819	1,376,926
Value adjustments in respect of receivables	(497,637)	(727,574)
<b>Total</b>	<b>18,540,084</b>	<b>66,487,047</b>

## 21. CASH AND CASH EQUIVALENTS

	HRK	
	31.12.2018	31.12.2019
Money in bank	10,365,409	14,612,120
Cash in register	6,162	6,722
<b>Total</b>	<b>10,371,571</b>	<b>14,618,842</b>

## 22. EQUITY AND RESERVES

On 31 December 2019, 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. The loss incurred by the Company in 2018 decreased other reserves in 2019 based on the Company's General Assembly's decision to cover the loss incurred in 2018.

On 31 December 2019, the Company owned 825,187 of own shares (31 December 2018: 825,187), making 4.91% of the share capital.

On 31 December 2019, the statutory reserves amounted to HRK 8,406,624 (2018: HRK 8,406,624). The statutory reserves were formed in 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.

Statutory reserves, which amounted to 5% of equity and reserves for own shares in the amount of HRK 20,946,624 (2018: HRK 20,946,624) cannot be allocated between shareholders.

According to IFRS 9 requirements, in 2019, the Company made value adjustments in respect of receivables from customers in the 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 2019:

	31.12.2018				31.12.2019			
	Total	1 year or less	2-5 years	Total long-term portion	Total	1 year or less	2-5 years	Total long-term portion
Financial lease	8,055,836	2,702,136	5,353,700	5,353,700	7,383,011	2,248,798	5,134,213	5,134,213
Long-term investment loan	41,526,411	8,742,402	32,784,009	32,784,009	32,784,008	8,742,402	24,041,606	24,041,606
Short-term loan for working capital	7,118,365	7,118,365	-	-	22,276,147	22,276,147	-	-
<b>Total</b>	<b>56,700,612</b>	<b>18,562,903</b>	<b>38,137,709</b>	<b>38,137,709</b>	<b>62,443,166</b>	<b>33,267,347</b>	<b>29,175,819</b>	<b>29,175,819</b>

Long-term investment loan refers to a loan approved by Croatian Bank for Reconstruction and Development through a commercial bank in 2012 for the purchase of a new floating dock (Dock RI-38), the purchase of dock cranes, UHPWJ equipment and other production equipment totalling HRK 69 million. The repayment of the loan principal began in 2015, for a period of 8 years, and ends in 2023.

The financial lease mainly related to the purchase of production equipment and the purchase of passenger cars, to which only HRK 345,338 applied. Loans for working capital in the amount of HRK 22,276,147 related to overdrafts (HRK 6,834,987) and short-term loans for working capital (HRK 15,441,160), of which a significant part was related to earmarked financing of core business projects.

## 24. TRADE AND OTHER LIABILITIES

	HRK	
	2018	2019
Trade payables	35,450,017	70,580,953
Trade payables – subsidiary interest	1,832,444	2,349,725
Trade payables – related parties	-	133,966
Employee payables	3,957,905	3,927,110
Tax and contribution	3,127,951	2,637,486
Received advances	13,352,330	3,968,591
Other liabilities	3,348,499	3,451,055
Accrued expenses and deferred income	3,065,660	10,540,624
<b>Total</b>	<b>64,134,806</b>	<b>97,589,510</b>

The increase in liabilities to suppliers compared to the previous year is a consequence of the increase in occupancy rates and especially the high occupancy rate recorded at the end of 2019, which significantly affected the structure of external resources needed for execution of core projects.

The largest portion of other liabilities related to the current maturity of liabilities to HEP ESCO company in the amount of HRK 2,562,281 (2018: HRK 2,562,281) involving two commodity loans related to energy efficiency projects undertaken by the Company in previous years.

As at December 31, 2019, the Company recorded costs in the amount of HRK 7,875,223 (2018: HRK 820,482) relating to the costs of the shiprepairers' liability insurance premium for 2019, not yet due, and the agency fees and other expenses for which the invoices had not been received but there is a contractual obligation. As at December 31, 2019, the Company reported revenues for which, in accordance with IFRS 15 'Revenue from Contracts with Customers', the conditions for their recognition had not been met, in the amount of HRK 2,665,400 relating to repairs carried out onboard *AF Claudia* (2018: HRK 2,245,177, based on the repairs carried out onboard *Korčula*).

The Company generated an operating profit for 2019, but due to the loss from 2018 and paid profit tax advances in 2019, the profit tax obligation amounted to only HRK 232,818.

Structure of trade payables by currency:

	HRK	
	31.12.2018	31.12.2019
HRK	33,585,841	64,031,412
EUR	2,638,965	8,407,469
USD	825,952	548,808
GBP	231,703	76,955
<b>Total</b>	<b>37,282,461</b>	<b>73,064,644</b>

## 25. RELATIONS WITH RELATED PARTIES

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

		HRK
	2018	2019
<b>Subsidiaries and key shareholders</b>		
<b>Sale to related parties</b>		
<b>Sale to subsidiary companies</b>	<b>455,874</b>	<b>359,096</b>
VIKTOR – SERVISI Ltd.	366,874	273,041
VL Steel Ltd.	89,000	86,055
<b>Sale to key shareholders</b>	<b>620,184</b>	-
Uljanik Group	620,184	-
<b>Purchase from related parties</b>		
<b>Purchase from subsidiary companies</b>	<b>6,630,427</b>	<b>8,627,683</b>
VIKTOR – SERVISI Ltd.	3,220,163	2,838,323
VL Steel Ltd.	3,410,265	5,789,360
<b>Purchase from key shareholders</b>	<b>735,993</b>	<b>334,424</b>
Uljanik Group	735,993	-
Palumbo Group		334,424
<b>Receivables from related parties</b>		
<b>Receivables from subsidiary companies</b>	<b>127,442</b>	<b>88,793</b>
VIKTOR – SERVISI Ltd.	67,135	55,197
VL Steel Ltd.	60,307	33,596
<b>Receivables from key shareholders</b>	-	-
Palumbo Group	-	-
<b>Liabilities to related parties</b>		
<b>Liabilities to subsidiary companies</b>	<b>1,832,444</b>	<b>2,349,725</b>
VIKTOR – SERVISI Ltd.	1,832,444	1,997,304
VL Steel Ltd.	-	352,421
<b>Liabilities to key shareholders</b>	-	<b>133,966</b>
Palumbo Group	-	133,966

Relations with key shareholders involved relations with the Uljanik Group as at 30 June 2018. In 2018, the parent company of the Uljanik Group was one of the Company's major single shareholders and had its representatives in the Company's Supervisory Board. By acquiring majority of shares in the second half of 2018, the major single shareholder became the Palumbo Group. In 2018, the Company had no business relationship with the Palumbo Group, whereas in 2019 the Company procured services from the Palumbo Group in the amount of only HRK 334,454, resulting in the Company's obligation to the Palumbo Group as at 31 December 2019 in the amount of only HRK 133,966.

### Key management

On 31 December 2019, the Management Board of the Company was composed of one Member of the Board, Sandra Uzelac, representing the Company individually and independently. Until 25 March 2019, when he resigned by mutual consent, the Company's Management Board included also Aljoša Pavelin, who was holding the position of the President of the Management Board.

The gross cost of salaries and severance pay to the Management Board for 2019 amounted to HRK 1,732,820. During the year, members of the Supervisory Board and Committee for Audit received compensation in the total gross amount of HRK 120,378. All foreign members of the Supervisory Board and Committee for Audit waived their compensation for 2019. However, in view of the decision of the General Assembly, according to which all members are entitled to compensation, until the formal settlement of the issue, the Company has maintained the statement of this obligation, except for the members of the Supervisory Board, who resigned from their

positions at the end of 2018, waiving in writing any of its claims against the Company. The Company has not granted any loans to the members of the Supervisory Board or the Management Board.

## 26. PROVISIONS

Long-term provisions in the amount of HRK 1,405,998 related to provisions for initiated litigation.

Short-term provisions in the amount of HRK 1,532,699 related to provisions for unused annual leave allowances for 2019 and for eliminating deficiencies in the warranty periods.

	Court cases	Annual leave	Other	Total
<b>Status 1 January 2019</b>	1,518,259	607,480	79,963	2,205,702
Provisions reversed	(80,850)	(607,480)	-	(688,330)
Actualised	(186,031)	-	-	(186,031)
New provisions	154,620	1,452,736	-	1,607,356
<b>Status 31 December 2019</b>	<b>1,405,998</b>	<b>1,452,736</b>	<b>79,963</b>	<b>2,938,697</b>

## 27. OTHER LONG-TERM LIABILITIES

Other liabilities as at 31 December 2019 in the amount of HRK 12,233,406 (2018: HRK 14,598,588) related to liabilities to HEP ESCO company for implemented energy efficiency projects in the amount of HRK 8,059,625 (2018: HRK 10,424,808) and contingent liabilities for disputed claims of bankruptcy creditors and associated litigation costs (incurred in 2004, shortly after the opening of bankruptcy proceedings, ended in 2008) in the amount of HRK 4,173,780 (2018: HRK 4,173,780), for which the litigation claims have not yet been finalized.

## 28. RISK MANAGEMENT

The Company's activities expose it to various financial risks, including the effects of changes in market prices, changes in foreign exchange rates, liquidity risk and default risk. The Company does not use derivative financial instruments as an active hedge against financial risk exposure.

### 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 dividend pay-outs or return on capital or place a new emission of shares. There were no changes in the goals, policies or processes during 2019 and 2018.

Indicators of the Company's indebtedness are shown in the table below.

	31.12.2018	31.12.2019
Total interest-bearing debt (long-term and short-term loans) (Note 23)	56,700,612	62,443,166
Less: Cash and cash equivalents (Note 21)	10,371,571	14,618,842
Long-term deposit (Note 18)	8,159,333	8,186,838
<b>Net debt</b>	<b>38,169,708</b>	<b>39,637,486</b>
Equity and reserves	222,146,923	242,918,740
<b>Total equity and reserves and net debt</b>	<b>260,316,631</b>	<b>282,556,226</b>
<b>Indicator of indebtedness</b>	<b>15%</b>	<b>14%</b>

### 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, EUR to HRK as well as USD to HRK exchange rate movements can affect operating results. However, due to a relatively short contracting and realization process, 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 to EUR trend in relation to national currency, 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 national currency (HRK). The currency structure of trade receivables and trade payables, as items of assets and liabilities that are moderately exposed to currency risk, is disclosed in Notes 20 and 24.

Relative to the reporting date, if the national currency's exchange rate against the EUR would increase (decrease) by 1%, assuming that all other indicators are unchanged, the Management Board estimates that such change, which is a result of foreign exchange differences from relationships with suppliers, customers, loans received and deposits given, would not have a significant impact on total assets and net profit for the reporting period. In such a case, the negative impact on the net result would be approximately HRK 112,000.

### Interest rate risk

Except for a long-term deposit that is not affected by the interest rate change, 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 and borrowings 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 custom in overhaul and repair business activities, but Viktor Lenac can exercise its right to arrest a ship, in accordance with 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.

#### *The possible impact of COVID-19 pandemic on increasing the Company's default risk*

*Considering the Company's export orientation and the fact that in the last quarter of 2019 the Company generated revenues from clients from Italy whose economy is likely to suffer the financial consequences of the COVID-19 pandemic, the Company estimates the possible difficulty in collecting receivables from the Italian clients, which increases the Company's default risk. The Company estimates that the increase in default risk is temporary and that the measures that EU Member States will provide to their economies in order to overcome the temporary business difficulties caused by the impact of COVID-19 pandemic will ensure all affected entities to bridge their business losses, consequently ensuring their sustainability. In doing so, EU measures would help*

to stabilize the operations of entities from EU Member States faster, which would not only improve the conditions of internal business, but also the international transactions of entities. Nonetheless, the Company has the opportunity, by way of a moratorium on its own loans and with the additional debt to finance its working capital, to bridge the period of increased credit risk affected by COVID-19 pandemic.

#### 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 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 the 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.

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 31 December 2019</b>						
With interests	14,619	-	76	8,187	-	22,882
Interests free	23,961	15,068	25,434	6,114	146	70,723
<b>Total</b>	<b>38,579</b>	<b>15,068</b>	<b>25,510</b>	<b>14,301</b>	<b>146</b>	<b>93,605</b>
<b>Liabilities, status 31 December 2019</b>						
With interests	8,920	5,752	22,522	29,176	-	66,370
Interests free	29,400	46,193	4,002	8,060	-	87,655
<b>Total</b>	<b>38,320</b>	<b>51,945</b>	<b>26,525</b>	<b>37,235</b>	<b>-</b>	<b>154,025</b>
<b>Liabilities net</b>	<b>260</b>	<b>(36,877)</b>	<b>(1,015)</b>	<b>(22,934)</b>	<b>146</b>	<b>(60,420)</b>

#### The possible impact of COVID-19 pandemic on increasing the Company's liquidity risk

Given the Company's export orientation and the measures taken by all countries affected by the COVID-19 pandemic to combat coronavirus infection and its spread, which have a significant impact on international trade due to restrictions on the movement of goods and services, it is obvious that the Company is suffering the effects of the COVID-19 pandemic. The Company assesses the risk of reduced business activities and inflows of new assets in the second quarter of 2020, which will result in a decrease in liquidity to cover the costs of passive operations until the situation normalizes. In the event of a faster successful suppression of the pandemic and liberalization of movement of persons between EU Member States, the risk of illiquidity is significantly reduced. The Company has available working capacities for relatively unimpeded operations, and the flow of goods and materials, although slow and with numerous restrictions, does not represent an insurmountable restriction. However, the Company is oriented towards close cooperation and close contacts with foreign persons, client representatives and specialized contractors, which, under the conditions of closed borders and measures of mandatory quarantine, is a very difficult factor for the organization of production and business activities, as well as for shipowners' decisions on future shiprepair projects, lasting as long as such measures are in place. This is reflected practically in the absence of inquiries for new projects received by the Company and in the notices of shipping companies on the delay of shiprepair activities for the second part of 2020, which is why the Company expects to face a significant decline in business activities during the second quarter of 2020, which will affect a drop in liquidity needed to service at least the cost of passive

*operation and worker retention. However, the measures adopted by the Government of the Republic of Croatia to assist Croatian entities affected by the COVID-19 crisis, deferral of certain public benefits, assistance with payment of salaries to employees and a moratorium on repayment of existing loans should be of great help to the Company in managing liquidity in the coming period. In addition, the Company will take its own measures to reduce costs and facilitate liquidity, in order to overcome the crisis caused by the COVID-19 pandemic.*

#### **Fair value**

The Company makes estimates of the fair value of financial assets and liabilities, following which, if necessary, value 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 receivables/liabilities with less than one year to maturity corresponds to the fair value.

### **29. POTENTIAL LIABILITIES**

As at 31 December 2019, 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 (Note 10).

On 31 December 2019, the Company litigated in 29 proceedings worth about HRK 2.0 million as defendant, and 3 proceedings having a capital value of approximately HRK 591,000 as plaintiff, all in the Republic of Croatia.

### **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 to the extent a critical event has occurred, 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**

In 2019, the Company achieved a positive financial result generating a profit tax liability in the amount of HRK 562,818. The Company has already paid HRK 330,000 on the account of profit tax advances in 2019, resulting in the obligation to pay a tax difference for 2019 in the amount of HRK 232,818.

#### **Impairment 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.



#### **Impairment of inventories**

The impairment of inventories is carried at the expense of current period expenses, based on assessment of damage and deterioration, and in cases where the recoverable amount (the value that can be realized by selling or using those inventories) is less than the cost.

If it is estimated that the use of any inventories is uncertain in respect of future contracts or that some products in inventories are not likely to be used in production, the write-off of inventories is carried out at the expense of current period expenses.

#### **Provisions for potential liabilities**

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

### **31. EVENTS AFTER BALANCE SHEET DATE**

In order to make better use of its production and business resources, the Company decided to discontinue operations of its subsidiary company VIKTOR – SERVISI Ltd. as an independent entity and to merge the subsidiary's workers and assets with the parent company. All workers were offered employment contracts at Viktor Lenac for the same type of work they had previously performed in the subsidiary and without any impairment of their acquired rights. The implementation of the merger followed at the beginning of March 2020 with the employment of the majority of employees of the subsidiary in the Company, starting on 1 March 2020. After all the subsidiary's workers' claims (from salaries and severance pay) have been satisfied, a request for deletion of the entity before the Commercial Court in Rijeka will be initiated, after which the remaining activities of transfer of assets and liabilities will be carried out in accordance with the decision of the Court.

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

#### ***Impact of the COVID-19 pandemic***

Viktor Lenac's main activity – shiprepair involves mainly ships in international navigation, which sail into the Mediterranean and Black Sea. Many ships sail to the ports of Italy and other ports of the Mediterranean and Black Sea countries for unloading of cargo, loading of fuel and other reasons. Viktor Lenac has been cooperating traditionally for many years with many Italian clients.

Although the most important resource in our activity is the labour force involving own and subcontracted workers, certain traffic of goods and persons takes place through foreign countries, of which one negligible part also through Italy.

COVID-19 pandemic, which in the first quarter of 2020 resulted in a reduction in global economic activity, as well as restrictions on the movement of goods and services, and isolation and quarantine measures to prevent the spread of infection, and if they persist, could have a significant negative impact to the business of Viktor Lenac in the coming period. Although Viktor Lenac has recorded a good occupancy rate during the first quarter of 2020, some shipowners that had already confirmed their arrival earlier, have postponed their arrival for later periods, and many others have announced that their activities would be postponed for further periods. The dynamics of normalization in the shiprepair market will depend on the pandemic calming down, as well as the normalization of the global economy.

Activities onboard ships, which are currently undergoing repairs or scheduled to arrive in the next month may be difficult due to a very limited flow of goods, the impossibility for foreign technicians and customer representatives to come to the Shipyard, who are indispensable for the contracted activities, despite all the protection measures that Viktor Lenac has been taking to prevent the spread of the infection.

The impact of the coronavirus pandemic on global business, which would also affect the business of Viktor Lenac, could be reflected in reduced labour migration, which could have a short-term positive impact, but later a

negative impact due to possible stabilization of the situation across the European Union and employers' efforts to make up for the losses caused by the pandemic. This could, in turn, lead to an increased demand for workers, their additional outflow/emigration from Croatia, and thus price pressure on domestic employers and increased demand for more expensive foreign workers.

Globally diminished activity in maritime transport and the employment of different types of ships could influence freight rates and financial viability of shipping companies, and consequently put pressure on shiprepair prices and increase the competition between shipyards.

On the other hand, the way in which the competent bodies of the Republic of Croatia deal with coronavirus infection could have a positive impact on the clients' confidence in safety and environmental protection of our country in which they would entrust the repairs of their ships.

The measures presented by the Government of the Republic of Croatia to assist entities whose operations have been affected by the COVID-19 pandemic, and which have been applied by Viktor Lenac, are estimated to be sufficient for Viktor Lenac to survive the next three to four months until business normalization.

If, for any epidemic or global economic reasons, business normalization does not occur in the next few months, Viktor Lenac could face a monthly passive operation cost of around HRK 5 million. We believe that we will be able to conclude a few contracts to utilize our production capacity and largely cover the costs of the passive operation.

In any case, the uncertainty surrounding the further course of the pandemic and the inability to assess its impact on the global economic situation poses a risk to the future financial position of Victor Lenac, but also of its key suppliers and subcontractors, and the associated liquidity risk.


We believe that the negative effects of the COVID-19 pandemic will not affect our business continuity, and that Viktor Lenac will normalize its operations in the next six months to a year.

### 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 2019 amounted to HRK 49,542,436 (2018: HRK 47,308,364), of which HRK 32,784,008 (2018: HRK 41,526,411) referred to the investment loan and the remaining part involved short-term loans for working capital and overdrafts.

### 33. PREPARATION AND APPROVAL OF FINANCIAL STATEMENTS

Financial statements have been prepared and approved by the Company's Management Board on 20 April 2020.



Sandra Uzelac

Member of the management Board



# ANNUAL REPORT 2019

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.



**SHIPYARD**

**VIKTOR LENAC**

*Member of Palumbo Group*

April 2020



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## FOREWORD

The Management Board of Viktor Lenac Shipyard, a joint stock company, presents its Annual Report for 2019 to all its shareholders, clients, employees, business partners and the entire public. Annual Report 2019 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 information that was included in the Non-Financial Reporting for the past two years, which the Company is under no obligation to make as a separate report for 2019. In a separate enclosure to the Annual Report, the Corporate Governance rules applied by the Company are described.

### Annual Report in Croatian and English

Viktor Lenac Shipyard's Annual Report 2019 has been issued both in Croatian and English. Annual Report is presented to the Company's shareholders at the General Assembly and is published on the Company's website.

### Legal Form

Pursuant to Article 250.a and Article 250.b of the Companies Act, the Company's Annual Financial Statements and business performance report shall be presented to General Assembly as integral parts of this Annual Report, whereas Supervisory Board's Report on the Performed Supervision of the Company's Business shall be presented to the General Assembly as a separate document.

Annual Financial Statements, both Consolidated and Non-Consolidated, have been made in accordance with the Accounting Act and International Financial Reporting Standards and revised according to the International Standards on Auditing.

Annual Report 2019 has been made pursuant to Article 21 of the Accounting Act, and Article 250.a and Article 250.b of the Companies Act, to give an objective assessment of the Company's business and financial performance and development, as well as other crucial information for the Company.

Annual Report 2019 also includes significant non-financial information. The Company is under no obligation to issue a separate non-financial statement for 2019, which it had issued in the previous two years under the provisions of Article 21a of the Accounting Act.

### 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 Company, 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. This Annual Report focuses on business performance 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 at 31 Dec	Average Exchange Rate
2019	7.4426	7.4168
2018	7.4176	7.4139
2017	7.5136	7.4605

## AN ADDRESS TO SHAREHOLDERS



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

With pleasure, I am presenting to you the Annual Report of Viktor Lenac Shipyard for the year 2019, which was characterized by oscillating occupancy rates, insufficient number and reduced quality of skilled workers in marine and shipbuilding trades, intensive changes in organization and management, and a decrease in the number of lower-value added jobs, but also intensive measures and activities aimed at increasing efficiency and effort to maintain our inherent flexibility, which ultimately allowed us to achieve positive results that we can be pleased with.

Outflow of quality and skilled workers into Western European countries and the import of labour from Eastern European countries, which inevitably resulted in a significant increase in the unit labour price, had to be offset to some extent by increases in sales prices, or rather, smaller discounts that the Company may have granted to its customers in earlier periods. In addition, better work performance management, primarily in production and the reduction of the number of workers with the aim of reducing fixed and non-production costs, enabled us to be effective in achieving a net profit of EUR 2.8 million that was

twice as good as we had expected, generated from a total of EUR 43 million revenues, of which EUR 39 million was generated from core activities.

The beginning of the year was characterized with stable occupancy rates where shiprepair projects for the US Navy's Sixth Fleet prevailed, continuing our traditionally good cooperation. Since April, occupancy rates have dropped so, in the third quarter, we generated revenues of just over EUR 7 million. The third quarter was marked by a sharp jump in the unit labour price, primarily due to the need to import foreign workers, which subsequently reflected on the cost of domestic subcontracted workers and preventing them from migrating further to Western European countries. Collapse of the shipbuilding industry in Pula and Rijeka and the cessation of almost all activities during 2019 caused sudden migration of a large number of skilled workers from the region, on whom we had previously relied, and at the same time, due to fluctuations in occupancy, we were not able to keep them in a number required for future occupancy growth. Since September, occupancy rates have increased, which enabled us, in the last quarter, to achieve twice as much revenues as in the previous quarter. The last quarter was marked by extensive shiprepair activities carried out onboard commercial ships, BWTS installation projects, shiprepair projects for the US Navy's Sixth Fleet and shiprepair activities carried out for a domestic national shipping company.

The 2018 results and low occupancy rates in mid-2019 made it difficult to manage available funds, but we succeeded to pay all our liabilities on time. Our liquidity has improved towards the end of 2019 on the account of increased occupancy rates, with full effect in the first two months of 2020. Unfortunately, a drastic drop in occupancy rates experienced in the second quarter of the year, caused by the COVID-19 pandemic, again threatens our liquidity needed to service our liabilities in the coming months, but with measures taken by the Croatian Government to help pandemic affected businesses we expect to bridge this difficult next period.

Optimization of business processes and the number of employees was one of our key activities during 2019. In comparison with the last year, Viktor Lenac reduced the number of employees by 82. Most were retired or left the Company of their own accord, whereas 26 employees received a notice of termination due to business or personally conditioned reasons as a result of organizational changes, where all statutory and internal redundancy rights have been applied. Further optimization of business processes and the number of employees will depend both in terms of number and dynamics, on market development. It should be emphasized that optimization not only means reducing the number of employees, but also increasing productivity through better planning and organization of work and multi-skill approach.



The Management Board has implemented all changes to the organization in consultation with trade unions and the Workers' Council, bringing to the full the unique and common position of both parties on the need and acceptance of the changes, which will ultimately enable the achievement of better business results, and thus lead to increases in employee rights and benefits. In this way, the good social dialogue, which the social partners in Viktor Lenac have traditionally and continuously nurtured, has received another confirmation.

2020 started with full occupancy, so the results of the first quarter are likely to be good. Unfortunately, the consequences of the COVID-19 pandemic also affect our business activities. Restrictions on the movement of goods and people have created logistics problems for ongoing projects since early March, but we have been able to successfully complete them. We have ensured the highest possible protection for all our own workers and subcontractors, ship crews and customer representatives, as the health of all our stakeholders is top priority. We have implemented all the protection measures prescribed by competent bodies, as well as our additional own measures to protect the health of all persons working and finding themselves in the Shipyard, prevent the spread of infection and secure the resources needed to complete the projects. Unfortunately, since mid-March sales activity has almost completely diminished, so that we will not be able to use our production capacity efficiently to cover fixed costs in the coming months. However, with the measures that the Government of the Republic of Croatia has provided to assist pandemic affected businesses, we believe that we will overcome this critical period. Our goal is to maintain quality workforce and be ready to continue providing our services to our clients, in a recognizable quality, within the required deadlines and in a safe manner, as soon as the situation normalizes.

Sandra Uzelac

Member of the Management Board

## KEY FINANCIAL FIGURES

### Consolidated Financial Figures

	000 HRK			000 EUR *		
	2019	2018	Index	2019	2018	Index
Total Revenues	<b>320,962</b>	254,255	1.26	<b>43.275</b>	34.294	1.26
Total Expenses	<b>299,551</b>	275,285	1.09	<b>40.388</b>	37.131	1.09
Operating Revenues	<b>320,774</b>	253,994	1.26	<b>43.250</b>	34.259	1.26
Operating Expenses	<b>297,262</b>	272,152	1.09	<b>40.079</b>	36.708	1.09
Operating Profit (or Loss)	<b>23,512</b>	(18,158)	(1.29)	<b>3.170</b>	(2.449)	(1.29)
Profit (or Loss) before Tax	<b>21,411</b>	(21,030)	(1.02)	<b>2.887</b>	(2.837)	(1.02)
Net Operating Profit (or Loss)	<b>20,893</b>	(21,061)	(0.99)	<b>2.817</b>	(2.841)	(0.99)
Total Assets	<b>420,408</b>	361,979	1.16	<b>56.487</b>	48.800	1.16
Equity	<b>245,765</b>	224,936	1.09	<b>33.021</b>	30.325	1.09

### Non-Consolidated Financial Figures

	000 HRK			000 EUR *		
	2019	2018	Index	2019	2018	Index
Total Revenues	<b>319,810</b>	253,121	1.26	<b>43,120</b>	33,928	1.27
Total Expenses	<b>298,468</b>	274,134	1.09	<b>40,242</b>	36,745	1.10
Operating Revenues	<b>319,630</b>	252,867	1.26	<b>43,095</b>	33,894	1.27
Operating Expenses	<b>296,180</b>	271,017	1.09	<b>39,934</b>	36,327	1.10
Operating Profit (or Loss)	<b>23,450</b>	(18,149)	(1.29)	<b>3,162</b>	(2,433)	(1.30)
Profit (or Loss) before Tax	<b>21,342</b>	(21,013)	(1.02)	<b>2,877</b>	(2,817)	(1.02)
Net Operating Profit (or Loss)	<b>20,838</b>	(21,013)	(0.99)	<b>2,810</b>	(2,817)	(1.00)
Total Assets	<b>418,356</b>	359,787	1.16	<b>56,211</b>	48,505	1.16
Equity	<b>242,919</b>	222,147	1.09	<b>32,639</b>	29,949	1.09

\* 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 2019 respectively 2018. Assets, share capital and reserves have been converted into Euros according to the midpoint exchange rate by the Croatian National Bank on 31 December 2019 respectively 31 December 2018 as listed on page 3 of this Report.

The consolidated financial statements reporting include a fully owned subsidiary Viktor - Servisi Ltd. and a 75%-owned subsidiary VL Steel Ltd. The subsidiaries conducted their regular business activities throughout 2019. Viktor - Servisi provides specialized service in shipbuilding, primarily related to mechanical works, whereas the main activity of VL Steel is provision of services in shipbuilding and related industries.

In 2019, the Group generated total revenues in the amount of 321 million Croatian Kuna and total expenses in the amount of 300 million Croatian Kuna, after annulment of their reciprocal transactions and after balancing positive and negative exchange rate differences.

Comparing consolidated financial statements with the 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 HRK 39,000, whereas VL Steel Ltd. generated a net loss in the amount of HRK 19,000, of which 75% is associated to the Group, while 25% refers to minority interest of a third party). It follows that the results of the subsidiaries did not significantly affect the results of the Parent Company or the Group as a whole. 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. Accordingly, in Annual Report 2019, the focus is on the financial result and balance sheet of the Parent Company.



## BUSINESS ENVIRONMENT

After a slight recovery in the global maritime market during the second and third quarters of 2019, there was a significant drop in freight rates in the last quarter. The Baltic Dry Index, which measures changes in the cost of transporting various raw materials by sea, has fallen by over 80% in just a few months, from September 2019 to February 2020, recording its lowest level in the last four years.

The slowdown in mild global growth, which has also led to a reduction in freight rates on the maritime market, is primarily due to the US-China trade war, and, in recent months, the problems of the COVID-19 pandemic, which has halted global economic growth and is causing significant economic consequences on the entire world economy.

Thus, the positive trends in the world maritime market were interrupted and it cannot be estimated with certainty when will they re-continue, precisely because some global growth forecasts relied on the strengthening of the Chinese economy, which was first hit by the COVID-19 pandemic, after which the economies of all European countries are facing severe consequences of the pandemic, and neither the length of time required for recovery nor the magnitude of the consequences are known.

Shipping companies that barely felt a short-lived growth period, in which they could not have strengthened substantially, have faced lower freight rates and additional costs implied by maritime regulations. With the entry into force of the IMO 2020 Regulation limiting sulphur content in fuel oil, vessel operating costs have been increased, which all together is resulting in reduced earnings. Needless to say, what that means for shipyards, their competitiveness and pricing policy.

In shiprepair, the geographical position, price and off-hire period will continue to play a decisive role. For shipyards, this means a further reduction in operating costs, and considering it is a labour-intensive activity, shipyards will still have to reach for low cost and more efficient labour force, but also to shorten lead times and supply chains, ensure earlier preparation and better coordination with clients, all aimed at reducing deadlines and idle periods. In addition to that, due to increased investment activities that burden shipping companies due to environmental regulations and safety measures and other requirements, those shipyards that will be able to offer shipping companies significantly extended payment deadlines will have a significant competitive advantage.

As of January 1, 2020, IMO regulations enacting a significant reduction in the sulphur content of fuel oil from 3.5% to 0.5% have been introduced, with the aim of reducing the total sulphur oxide emissions caused by ships that use heavy fuel in navigation. In addition, the regulation is expected to drive fuel oil prices with a low sulphur content over existing fuel oils by as much as 30% in the first year, after which a slight decline and price stabilization are expected. In any case, to meet IMO requirements, shipping companies will primarily choose either to use low sulphur fuel oils or to install LNG propulsion or scrubber system, depending on cost-effectiveness of such investments. Scrubber installation is still at a low level, but is still growing, so new scrubber installation projects are expected in 2020.

In addition to a number of such projects done in earlier years, the first of which was completed in 2012, in 2019 Viktor Lenac continued with the installation of scrubber systems, three in total, all within the set deadlines and without technical problems, acquiring good references for contracting new such projects in the coming period.

It has been two years since the International Convention for the Control and Management of Ships' Ballast Water came into force. Ballast water is sea water carried by a vessel in its ballast tanks to ensure its trim, stability and structural integrity. Ballast water is taken in the ship at one port and taken out at the other, causing marine flora and fauna transfer to other unnatural conditions for them, thereby endangering the natural ecosystems of individual locations. For many ships in international navigation, ballast water management implies installation of a ballast water treatment system, and compliance with the convention is demonstrated through renewal of a five-year certificate. This means that increased demand for the installation of such systems is likely to continue for another two to three years. In 2019, Viktor Lenac installed 5 ballast water treatment systems and expects

about 5 more such projects in 2020, one of which has been completed in March and the other contracted project has been delayed as a result of the COVID-19 pandemic.

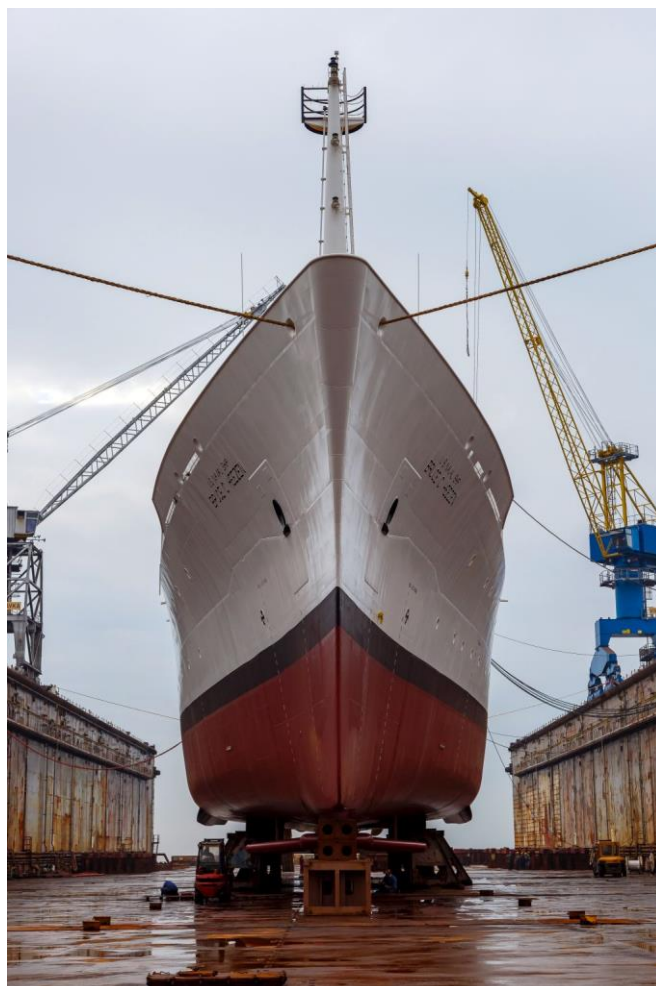
The current and expected future developments in the market, especially in the Mediterranean and Black Sea areas, or in the area of Victor Lenac's reach, are not and are unlikely to change significantly Victor Lenac's competitive position with respect to its main competitors. Turkey's shipyards, with their geographic location and prices, including monetary competitiveness brought by the weak lira exchange rate against the world currencies, will remain the first choice for many shipping companies to whom the price of services will be paramount.

Therefore, our priority will be to increase productivity and efficiency, and improve logistics and support processes in order to reduce all possible costs to improve price capability. Reducing operating costs and reengineering of business processes to make it more cost-effective are necessary to allow Viktor Lenac to adapt to reduced scope of activities while ensuring adequate level of earnings for sustainable growth and production capacity development.

In shiprepair, where the labor cost accounts for the largest share of production resources, both own and subcontracted, it is the only resource where an adequate level of savings may be sought and realized to enable adjustment in relation to competitive abilities. One of the key goals is to improve the quality structure of workforce and optimize the number of employees, aimed at achieving quick and flexible adaptation of the organization to the given market circumstances.

The domestic labour market situation is rated as the most critical in history. The crisis in the nearby domestic shipbuilding industry has resulted in the depletion of labour force and its migration to Western European countries. This significantly reduced and hampered our ability to respond to the demands with flexible and quality resources in a short term, given the occupancy fluctuations and the production dynamics. These problems were most pronounced in July and August, when there was a sudden need for significant resources, primarily for pipe fitting workers, needed for installation of BWTS systems onboard three vessels.

Cooperation with the US Navy has continued throughout the year. In October 2019, an extensive overhaul and repair of *USNS Trenton* began, which is still ongoing due to additional works. *USNS Bruce C Heezen* was undergoing repairs in the last two months of the year and the ship was delivered in early January 2020.



## BUSINESS ACTIVITIES

### SALES

#### Realized Revenue

The first and part of the second quarter were marked by good occupancy rates, but the third quarter yielded the poorest results, both in terms of value and quality of contracted activities and financial results. The first half of the year was marked by shiprepair activities carried out onboard passenger ships for a domestic national shipping company and shiprepair projects awarded by the US Navy's Sixth Fleet in competition with other Mediterranean shipyards.

The third quarter was marked by BWTS installation projects, which involved three vessels and were executed simultaneously, which put Viktor Lenac with the great challenge of hiring the same, extremely scarce workforce, with additional numerous problems in project solutions in two of the projects. However, our flexibility enabled us to successfully resolve all technical problems, but unfortunately the financial results obtained on two such projects were not in line with the invested effort, knowledge, and resources.

In the middle of the year, we were awarded four contracts by the US Navy, involving small-scale voyage repairs on four ships of their fleet.

From September 2019 onwards, the Shipyard recorded high occupancy rates allowing our capacities to be fully utilized by the end of 2019. This period of the year was marked by several demanding and extensive projects, involving activities carried out onboard merchant ships and two US Navy's ships, repairs of a floating dock, three scrubber system installations, dismantling equipment from an offshore drilling vessel and upgrading two barges, including several shiprepair projects carried out for domestic clients.

In 2019, Viktor Lenac started cooperation with a few highly reputable companies, such as Subsea 7, involving repairs and BWTS installation onboard *Seven Pegasus*; Allseas, involving repairs onboard *Bright Spark* and *Audacia*; and Boskalis, in the last quarter, involving a project of dismantling equipment from their offshore drilling vessel *Yan*.

The turbulent quarters of 2019 are a true example of fluctuations in occupancy, requiring rapid and flexible adjustment of the organization in each part, an

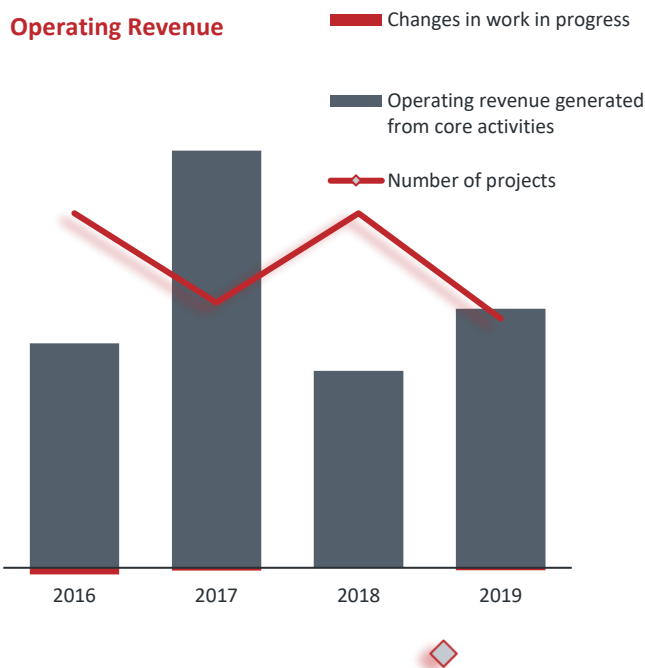


optimal balance between contracts already concluded or in progress and new potential contracts, for which it is often not known the beginning time of the activity, as it depends on a number of external factors that often cannot be influenced by Viktor Lenac or the client. Such oscillations require both a developed and accessible labour market as well as the efficiency of all processes, to reduce negativities that high fixed costs tend to bring in low occupancy periods or the progressive variable costs in high occupancy periods or periods of lower market prices not aligned with high labour costs.

Revenues generated from core projects, observed by quarter, fluctuated from 8 to 16 million euros and reached a total amount of about 39 million euros which was an increase by 30% compared to the previous year. This



result was generated from a total of 64 different projects, which was 20 less than in the previous year indicating that the average scope of work per project increased and hence the average value per project.



Of the 64 different projects completed or still underway at the end of 2019, as many as 11 shiprepair projects involved six different ships from the US Navy's Sixth Fleet, accounting for a third of total revenues from core activities.

Total BWTS installation projects were worth approximately EUR 5 million, associated repair works included, and involved five vessels.

Total scrubber system installation projects were worth approximately EUR 6.8 million, associated repair works included, involving three vessels, where two scrubber systems were installed onboard one vessel.

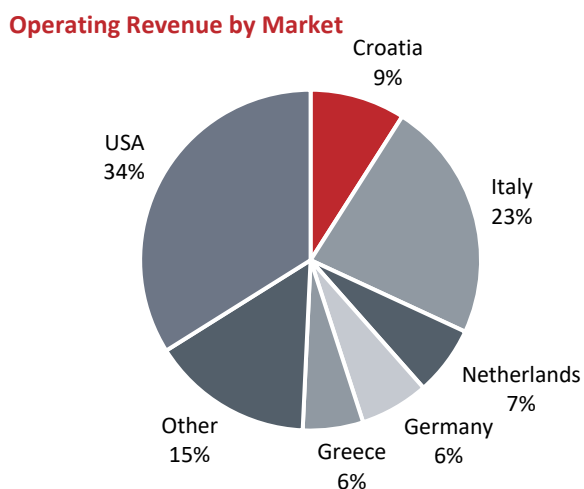
Of the projects that come out of standard shiprepair work, to highlight is the upgrade of steel structure onboard two barges and the afore-mentioned project of dismantling equipment from an offshore drilling vessel, which were underway at the end of the year.

The 2019 revenues included revenues generated from these projects in the amount of EUR 3.1 million.

The remaining 42 projects involved standard shiprepair works onboard merchant ships, of which 19 were for domestic clients, with a total value of EUR 3.6 million and 23 projects for foreign clients, totalling EUR 7.6 million. The average value per shiprepair project was around EUR 190,000 for domestic clients and EUR 333,000 for foreign clients, not incorporating the value of the shiprepair works that were carried out with other previously mentioned special projects.

## Market Analysis

Put in perspective of the market structure, the 2019 operating revenues derived from 15 different countries involving 42 different clients.



Most revenues were generated from the US market, which is typically reported by a high share of revenue as a result of a long good cooperation with the US Navy.

The largest number of projects were carried out for the domestic market, where 9% of the 2019 revenues were generated from 19 projects (accounting for 30% of the total number of projects in 2019).

A high share of revenues was generated from Italian clients that made nearly a quarter of revenues for 2019, involving 13 different projects, which included installation of scrubber systems on three vessels.

Of other foreign markets, a significant share of revenues was generated from German and Dutch clients, involving activities carried out onboard 4 ships for German clients, and 3 projects for Dutch clients.

## Sales

Our sales and marketing activities have undergone a major reorganization during 2019 as a result of efforts to integrate market activities aimed mainly at mutual clients or niche markets with other companies within the Palumbo Group, the largest single shareholder of Viktor Lenac. This created a synergy of coordinated appearance in the market, with the optimization and harmonization of sales policies and sales activities and better utilization of all sales resources of all companies in the group. Clients can choose a preferred shipyard within the group in accordance with their technical capacities and technological possibilities. This saved time for multiple bidding of the same projects and increased efficiency and quality in the preparation of bids to improve communication with clients and subsequent realization of contracted works, and all the group companies expanded their client base and broadened their knowledge base in general.

With some specific clients, oriented solely to Viktor Lenac, either because of the proximity or some specific contractual provisions or relations so far, Viktor Lenac acts independently on them, as well as other shipyards within the Palumbo Group when it comes to operations peculiar to those other shipyards. As a rule, Viktor Lenac and other shipyards act jointly in marketing activities, visits to clients, visits to markets and participation in specialized fairs and exhibitions, and depending on the specifics of an individual client or market, the shipyards may act independently.

The reorganization of sales activities and joint appearance resulted in a decrease in the number of inquiries compared to previous years, but also an increase in the contracting rate for the quotations produced. During 2019, Viktor Lenac received about 290 inquiries for various shiprepair and related works. A total of 69 contracts resulted out of 250 quotations. Of these, 50 projects were completed in 2019, while 19 were intended for 2020, mostly in the first quarter. Several projects have been postponed due to the COVID-19 pandemic.

Part of the inquiries received, mainly for the works foreseen in the last quarter of 2019, were not processed because all docking capacities had been occupied in that period and due to insufficient number of workers for certain types of work, and given their already high intensity in other projects for the same required periods. 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.

### Contracts concluded to quotations issued

	2015	2016	2017	2018	2019
Number of inquiries received	401	350	350	400	290
Number of quotations produced	317	310	320	350	257
Number of contracts concluded	86	85	67	84	69
Contracting rate	27%	27%	20%	24%	27%

## PRODUCTION

### Number and types of projects

A total of 64 various projects were undertaken in 2019, of which eight are being continued in 2020, 23 less compared to the previous year. Although the number of projects decreased by more than a quarter compared to the previous year, the realized value was 30% higher than in 2018. Although this increase in operating revenue also includes the effect of price increase, primarily due to an increase in labour costs, such an increase still reveals an increase in quality and complexity of completed projects.

60 projects were carried out at the Shipyard's site, while four small-scale projects for the US Navy involved voyage repairs.

Nine different contracts were executed on a total of six different US Navy ships during 2019, with two still underway at the end of the year, among which those of greater value involved aluminium catamarans *USNS Carson City*, *USNS Yuma* and *USNS Trenton*. In November, we were awarded the contract for *USNS Bruce C Heezen*, for the first time accommodated in our Shipyard. In addition to that, *USS Mount Whitney* underwent standard overhaul and repairs in the first half of the year.

During 2019, repairs were carried out onboard different types of merchant ships: 10 ferries, 9 tankers, 6 RO-RO ships, 4 tugs, 3 container ships, 3 general cargo ships, 3 bulk carriers, 3 barges and 3 passenger ships, and the remaining contracts involved specific types of ships and floating vessels such as repairs of a floating dock for a foreign client.



Five BWTS installation projects and four scrubber system installation projects, of which two scrubber systems installed on one ship, were successfully completed in 2019.

To highlight is a demanding project of dismantling tower and equipment from the offshore drilling vessel for Netherland's Boskalis, which required particular logistics efforts. In just a few months, from November to January, over 8,000 tons of scrap steel were removed and disposed off by cropping the tower with crane and other equipment between the superstructure and the bow,



with most of the works performed at height. With the application of strict occupational safety rules, despite extremely unfavourable weather conditions during November and December, all works were completed on time, without any incidents, to mutual satisfaction of the client and the Shipyard and all involved contractors in this complex project.

The production works performed on other projects were predominantly of the standard type, with the usual structure of works in which anticorrosion treatment works, steel renewal, mechanical works, pipe fitting and electrical works predominate. A valuable project, not only in terms of its financial value, but also in terms of organization and deadline, despite the shortage of manpower, was carried out for a German client, involving renewal of a total of 100 tons of steel at various hull positions within about a month.

Slow periods were used to renew steel structure onboard the Shipyard's Floating docks 5 and 11 to extend dock useful life. Most works were done in the last quarter, when it was possible to match our own needs and activities for clients with the availability of manpower.



## Production activity structure

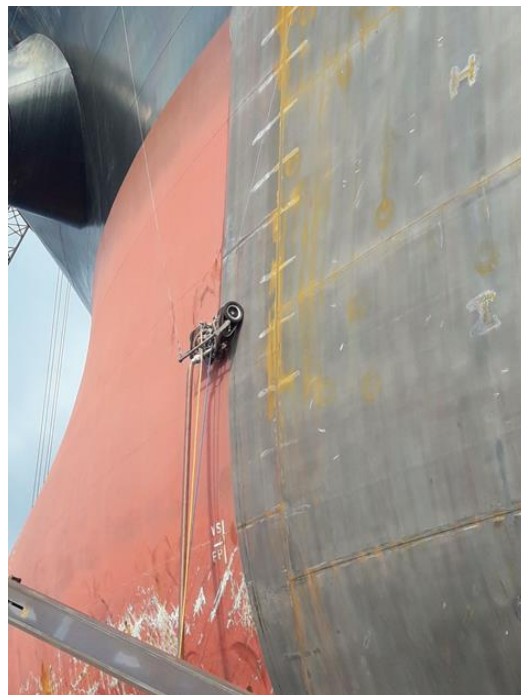
Production work is measured by the number of effective hours, which has been steadily decreasing in the recent years as a result of measures to reorganize production processes, in order to increase efficiency and make better use of the increasingly scarce labour force. The mere number of total effective hours is not a relevant size, given that it is influenced by a variety of factors, ranging from fluctuations in occupancy and the distribution of daily activities, to different production solutions and frequent changes to the specifications of work in progress, where resources may be determined just before the start of the activity. This, on the one hand, requires a high flexibility of all resources, and on the other hand increases the risk of downtime and idle times, especially since all work is interconnected and dependent on one another.

Of the total production activity, more than one quarter involved steel and outfitting works. Compared to the previous year, Viktor Lenac performed a larger scope of steel works, but some of these works were done by

subcontractors outside the site of Viktor Lenac or with their own equipment, so they were not included in the production hours. Standard steel work means renewal of ship steel structure. During 2019, a total of 760 tons of steel was renewed on all projects, which is almost twice that of the previous year, of which around 250 tons related to investments in own floating docks.

Anti-corrosion treatment works mean various anti-corrosion treatment carried out on ship steel surfaces 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 2019, a total of 530,000 sqm of ship surface was cleaned by various techniques, mainly through high pressure washing, followed by rust removal through gritblasting techniques or modern 3000 bar UHPWJ technology. A total of 67,000 sqm was gritblasted, which is more than twice less than in the previous year, while UHPWH technology was applied to 11,000 sqm. Our goal for the coming years is to increase the share of surface treatment with high pressure water and gradually abandon gritblasting technology, which produces significant amounts of waste and is more harmful to the environment. Over 500,000 sqm of surface area was coated.



	2018	2019
Steel works	27%	27%
Anti-corrosion treatment works	15%	13%
Transportation	12%	11%
Pipe fitting works	6%	11%
Mechanical works	11%	9%
Other works including production logistics	29%	29%

2019 was marked by a significant increase in pipe fitting works, related to BWTS and scrubber system installation projects. As usual, transportation and logistics works related to production, delivery of materials, occupational safety and fire protection and other production-related works made a high share in total production work. Scaffolding work involved erection of a total of 111,000 cum stagings intended for execution of steel and pipe fitting works.

## Labour Capacity and Cost Structure of Production

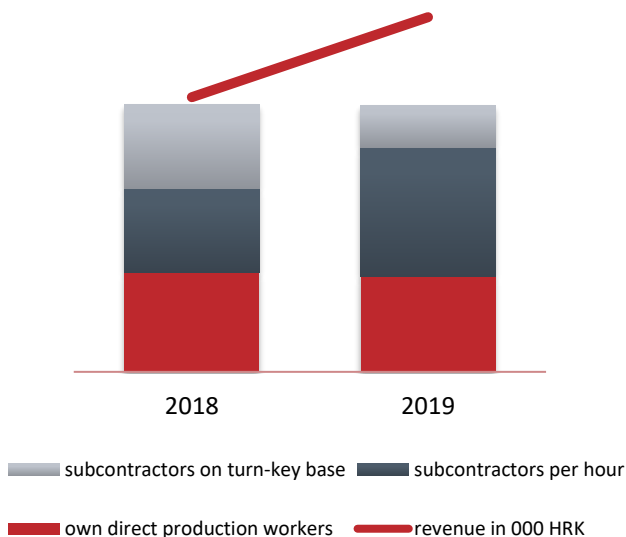
Shiprepair industry is labour-intensive. Raw material cost represents up to 30% of the total production cost in the shiprepair activity, whereas the remaining part is labour cost, relating to own production workers or subcontractor workers. The same relationship applies also to other production activities, such as maintenance activities for maintenance of facilities, plants and equipment, or investments in own floating docks.

Own direct production workers of all trades are fixed cost. In 2019, own production workers produced a total of 330,000 effective hours, of which about 318,000 hours were produced in direct production, while the remaining effective hours were produced in property maintenance.



Fluctuations in occupancy in the shiprepair activity and the 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,

**Effective hours allocated to a resource**



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. Increased occupancy rates and a lack of domestic labour force have imposed the need to engage foreign labour or foreign subcontractors. As non-permanent contractors unfamiliar with our organization and processes, such workers were contracted per hour, which led to an increase in the proportion of labour paid per hour relative to total effective hours.

Despite the number of employees being reduced through organizational changes, the number of effective hours produced by own production workers remained at approximately the same level as in the previous year. This was a result of the decrease in the number of low added value workers, but also the increase in the

number of overtime hours of our own workers in periods of high occupancy rates.

Although there has been an increase in occupancy and a 30% increase in revenue in 2019, the total number of effective hours on working orders has remained at almost the same level, indicating that measures taken to increase efficiency and work capacity utilization are delivering results.





Apart from own production activity, Viktor Lenac also uses external services such as subsupplier services, which involve manufacture and provision of services in core activity that are mainly carried out outside the site of the Shipyard or using subcontractors' means of work, and may involve provision of raw materials for manufacture of products intended to be built on 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, subcontracted activities may also involve purchasing of specific materials and using subcontractors' own equipment, especially in contracts stipulated on turn-key base.

In figures, the total cost of direct labor embedded in production direct working orders (core activities and own investments) amounted to HRK 86.9 million, up by 10% compared to the previous year, which equals the increase in the average hourly labour cost, given that the number of effective hours is approximately the same in both years.

## Dock and Berth Utilization Rate

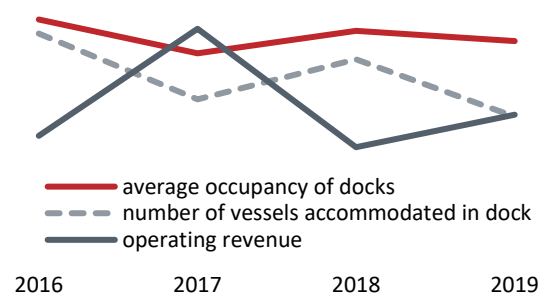
Viktor Lenac disposes of three floating docks (Dock 5, Dock 11 and Dock RI-38) allowing for flexibility required in accommodation of vessels of different size.

Dock	Dock utilisation rate			
	2016	2017	2018	2019
Dock 5	79.7%	63.9%	79.7%	75.1%
Dock 11	87.9%	83.8%	79.2%	78.1%
Dock RI-38	78.1%	62.7%	74.8%	70.1%

Dock utilisation rate is measured by the number of days when docks accommodated vessels, which generally correlates with the number of shiprepair

projects and related projects, although some vessels may occupy docks over a large number of days, even months, due to the extensive work involved. Dock utilisation rate may not be related to revenue trends, which

### Dock Utilisation Rate vs. Number of Projects and Operating Revenue



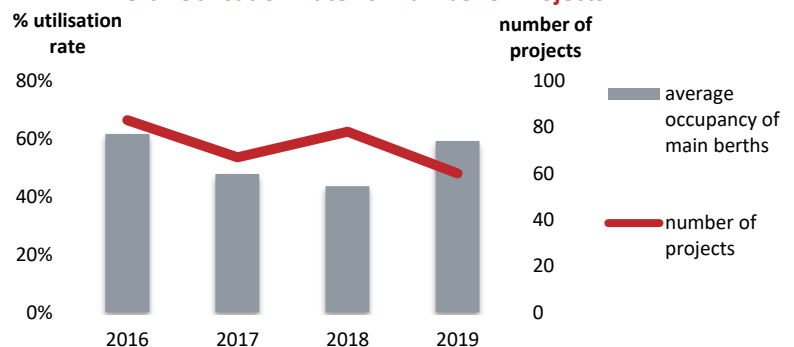
was the case in 2019, where the dock utilisation rate was similar to that in 2018, but with significantly lower number of projects and higher revenue. For example in 2017 total revenue was higher, largely due to the *USS Mount Whitney* project, which occupied Dock 11 for a longer time, while other docks recorded significantly lower utilisation rate.

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 a decrease in the number of ships that underwent repairs in 2019 compared to

### Berth Utilisation Rate vs. Number of Projects





2018, the berth utilization rate was higher in 2019, as a result of the increased average scope of work per project and the consequent longer stay of ships in repairs.

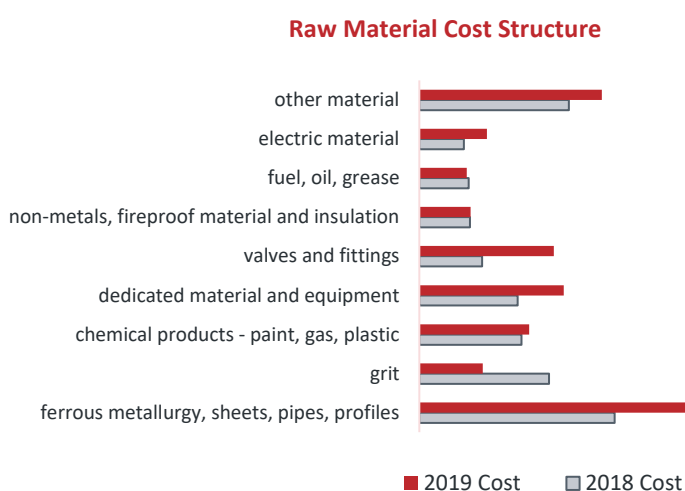
## Raw Material and Energy-Generating Products

The cost of raw material and energy-generating products generally participates with 20% put in relation to total value of completed production working orders that generate these costs. This share may be slightly higher if conversion projects or special projects make a higher share in the structure of core business projects, since such projects make a higher share of raw material and built-in equipment than standard shiprepair projects. The share of raw material and equipment 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.

In production working orders completed during 2019 (core business projects and works on own floating docks) a total of HRK 50 million raw material and energy-generating products were consumed, participating with about 17% in the total operating expenses.

A total of HRK 39 million various raw material and built-in equipment derived from production and related to working orders during 2019, up by about 20% compared to the previous year, which is in line with the increase in occupancy rates and value of core business projects.

The raw material structure follows from the structure of activities in the projects carried out by Viktor Lenac for its clients. The most important groups of raw materials that are regularly built in onboard vessels under repairs or used in technological processes are ferrous metals (sheets, profiles, pipes, grit, technical gases, and fuels).



The ferrous metal cost was the highest, as usual, with an increase compared to the previous year in line with the increase in steel works. Compared to the previous year, the consumption of grit was significantly reduced, which is a result of our efforts to replace gritblasting with environmentally friendly technologies for surface treatment by using

ultra high-pressure water (UHPWJ).

Viktor Lenac uses significant amounts of electric power, fresh water, technological water and gas in its production processes.

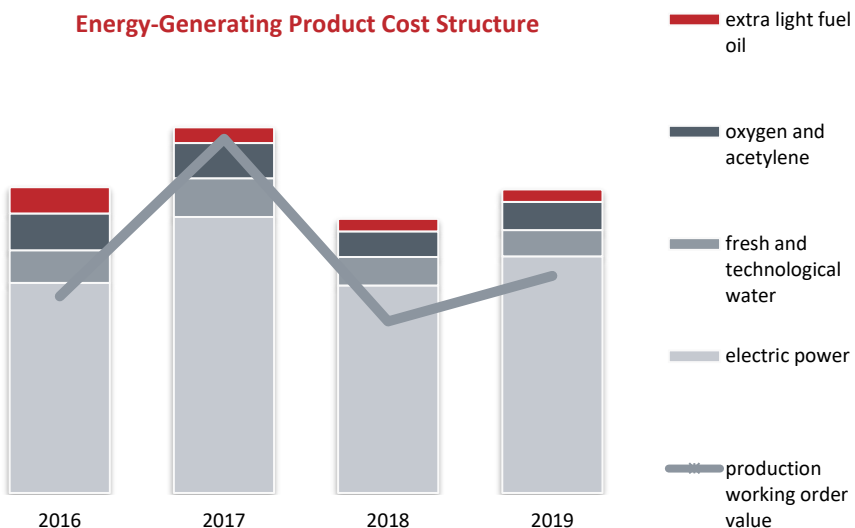
Part of electric power and fresh water is accounted for as fixed cost, while part is accounted for as variable cost, depending on scope of production activity. Technological water, which is not used for drinking, and technological gas such as liquid oxygen and acetylene are variable costs, which depend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

Water is used in technological processes for washing and high-pressure cleaning of ship surfaces and treatment of steel sections. Liquid oxygen and acetylene are gases used in steel cutting and machining.

Energy-Generating Products	UM	2016	2017	2018	2019
Electric power	000 kWh	13,560	19,031	11,694	11,349
FW	000 cum	63	77	56	51
Technological water	000 cum	262	201	210	186
Oxygen and acetylene	t	558	476	357	401
MFO	t	331	168	144	115

Total energy-generating product consumption was significantly lower compared to the previous years. The most significant reduction was recorded in electricity and fuel consumption, which was the result of measures undertaken to reduce energy-generating product consumption by implementing new solutions (new lighting, space and hot water heating, more energy efficient equipment). Already in 2017, Viktor Lenac had implemented an energy management system in accordance with ISO 50001, which was certified in early 2018. In this way, the energy management system has been implemented as a continuous process with the aim of raising awareness of the efficient use and saving of energy-generating products, ultimately resulting in reduction in production costs.

In 2019, we completed implementation of an energy-efficient LED lighting system for indoor and outdoor dock lighting, resulting in savings of 840,000 kWh, or approximately HRK 660,000 annually. Additional annual savings of almost 190,000 kWh or approximately HRK 150,000 have been achieved by implementing a modern LED lighting system for ship's flat bottom. Fluorescent lighting fixtures in the offices have been replaced with new T5 Xenon lighting, which resulted in additional savings of 50 kWh per year, or approximately HRK 40,000, while improving working conditions.



Total energy-generating product costs amounted up to HRK 11.4 million, up by 10.7% compared to 2018 due to increases in electricity prices, although it may appear to be caused by increases in occupancy rate. Although in 2019 it was recorded a decrease in kWh consumption by 3% compared to 2018, the electricity cost was higher by 14% compared to 2018.

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.

In the last three years, Viktor Lenac has been consuming smaller amounts of medium fuel oil and extra light fuel oil used to heat offices, dressing rooms, and by 2016, hot water. Investments in the heating system have significantly reduced the consumption of this energy source, which for the most part is a fixed cost.

## TECHNOLOGICAL DEVELOPMENT AND INVESTMENT

Investments in fixed assets comprise the acquisition and capital improvement of tangible fixed assets aimed at conducting regular activities, increasing energy efficiency, protecting the environment and reducing operating costs continued throughout 2019, with total investments of HRK 17.3 million.

The largest amount, totalling HRK 9.1 million, has been invested in the Floating docks 5 and 11, which, due to their age, are regularly renewed in their steel structure and dock control systems, thus extending their service life. A total of HRK 1 million has been invested in renewal of Dock 5 fire-fighting system, which also enlarged its ship ballast water filling capacity and ship sea water cooling capacity, thereby reducing consumption of technological water.

In 2019, a project for drainage of sanitary-sewage water from docks and berths into the public drainage system, worth approximately HRK 1.5 million, was realized, which resulted in significant savings compared to the previous system, by which these waters had been handled by authorized service providers. As much as 70% of the invested money was returned as early as January and February 2020, by achieving savings in the way the sanitary water was discharged from a cruiser during the repairs, during which period a large number of crew members were staying onboard.



The energy-efficient lighting project launched in 2018, involving modernization of office lighting and exterior lighting on Berth 8 and all floating docks by installing energy-efficient LED light fixtures, was completed in 2019. In addition to interior and exterior lighting, the project included procurement of Ex GalaLED portable lightning for temporary lighting used onboard ships where explosive-proof working conditions must be provided. The new solutions improved efficiency and working conditions, allowing for a significant reduction in electricity consumption. The total value of the investment was approximately HRK 5 million, of which HRK 2.7 million was invested in 2019.

The remaining investments related to various production equipment and personal means of work, means of transport, and other business equipment.

## ORGANISATION, QUALITY MANAGEMENT SYSTEM, INFORMATION AND COMMUNICATION

In 2019, the focus was on improving support processes in order to increase operational efficiency of sales and production functions.

The procedures for carrying out maintenance of tools and issuing tools to workers have become an integral part of the procurement and warehousing function, with the aim of improving control over tool procurement, maintenance and keeping records. Changes in the course of business processes have caused changes in the organizational structure of the Procurement and Warehousing Department and job descriptions within this organizational unit.

Computerization of tool issuing procedure is underway to start keeping electronic records of tool and small inventory issuing. Upon completion of this project, it is planned to introduce new technologies in the warehousing to improve traceability of raw materials across projects.

Continuous internal auditing enables monitoring of business process performance, recording, analyzing and eliminating any non-conformities through a documented quality management system. Accordingly, changes in procedures, working instructions, standards of work and functional roles are incorporated, with the aim of speeding up and optimizing activities while retaining or increasing the quality of the performed works. During 2019, 30 internal audits were conducted by competent auditors in the part related to quality management systems (ISO9001: 2015) and energy management systems (ISO50001: 2013).

Bureau Veritas performed surveillance audits on both management systems. Two minor non-conformities had been found that were promptly eliminated.



The goal for 2020 is to align the energy management systems with the new requirements of the ISO50001: 2018 standard, the introduction of an occupational health and safety management system and an information security management system. Preparatory actions for the planned activities have begun. The fourth quarter of 2020 is planned as a deadline for implementation.

The certificates obtained are an unambiguous and internationally accepted indicator that Viktor Lenac fosters a systematic and structured approach to business, which is a prerequisite for any foreign client to consider entering a business relationship. The energy management system has become an established process with the aim of raising awareness of the efficient use and saving of energy-generating products, the implementation of which has enabled reduction in production costs.

With the introduction of new management systems, Viktor Lenac reaffirms its commitment to the continuous improvement of its business processes, which ultimately results in greater customer satisfaction.

The development of the information system, as an accompanying tool for the automation of business activities and processes, is directly connected with the development of the organization. During 2019, we continued to upgrade existing information services, with emphasis on the development of application solutions in the field of business intelligence, asset management, communication with business partners (subcontractors) through a B2B portal and mobile technologies.

Existing information systems have been upgraded with new functionalities. The ERP system has been enriched with new capabilities related to quotation creation process, project management, and analytical and synthetic approach to tracking of expenses. A new mobile application for quality management has been developed through which employees can report incident situations, non-conformities and requests for intervention.



A new Intranet portal has been created, designed as a centre containing basic information needed by each employee to perform their activities. Basic information includes company-wide news, a knowledge base in the form of documentation from all management systems (quality, occupational safety, environmental protection, energy management), tasks to be performed, a list of the equipment in charge, and links to applicative solutions. Access rights are defined according to business processes and workplaces, so that each user gets insight into information that is only relevant to his or her scope of work.

The area of information security and data protection is of utmost importance in the part of IT support for business continuity. In this area, in the previous years, a step towards a higher level of information security was made by virtualizing all servers and collocating server resources on a separate Disaster recovery site outside the headquarters and regular security upgrades of the complete ICT infrastructure.

## OCCUPATIONAL HEALTH AND SAFETY, FIRE PROTECTION

The occupational safety and health system is defined by the legislation and is an integral part of the organization of work and course of business processes. It is accomplished by performing occupational safety and health tasks and by applying prescribed, contracted and recognized rules of occupational safety and health and rules, which are being adopted and incorporated by Viktor Lenac in the quality management system in accordance with ISO 9001. The goal for 2020 is certification of the occupational safety and health system according to ISO 45001.

In addition to carrying out standard activities in the implementation of occupational safety and health system, such as training workers to work safely, testing machines and devices with increased hazards, monitoring the application of occupational safety regulations, inspections of workplaces and activities for safety of work in specific hazardous areas, the following new activities have been introduced to improve the HSE system:

- A total of 300 toolbox talk courses focusing on safety topics related to the specific project or as part of regular weekly production meetings;
- Microclimate and lighting testing was conducted in all workshops, corridors and offices;
- A new risk assessment for computer work was developed, based on which a list of workers included in the mandatory regular medical examinations of vision in the occupational medicine system was drawn up;
- A plan and program for the training of commissioners of occupational safety and health, which envisages internal education carried out by the Shipyard's experts, as opposed to the external services used so far;
- A new risk assessment for all workplaces was developed and adopted at the regular Occupational Safety and Health Board, based on an assessment of hazards, harmfulness and strain on workplaces and, in addition to satisfying legal regulations, was expanded to meet even stricter standards that are applied in offshore activities.

The increased production activity led to an increase in permits issued for entry and work in closed and confined spaces, which totalled over 5000.

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 service was provided by a reputable Medico Polyclinic.

The PPE cost amounted to HRK 556,000, down by 11% compared to the previous year due to a reduced number of employees. A total of HRK 206,000 was spent on systematic preventive examinations.

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.

#### Injury indicators:

	2015	2016	2017	2018	2019
Number of effective hours	937,020	864,292	883,716	792,694	715,427
Number of injuries	17	18	10	15	18
Total number of days lost due to sick leave	354	416	424	413	259
Frequency index Number of injuries / Effective hours	18.14	20.83	11.32	18.92	25.16
Severity index Total lost days due to sick leave / Total effective hours	37.78	48.13	47.98	52.10	36.20
Number of injuries / Number of workers	3.45	3.64	2.04	3.24	4.53

Nevertheless, with increasing intensity of production activities, 2019 recorded an increase in the number of injuries at work. A total of 18 injuries were recorded, three more than in the previous year, but with fewer total days lost due to sick leave, indicating that these were minor injuries. The 2019 injury severity score is the lowest since 2008, since occupational injury statistics began to be maintained.

According to the nature of injuries at work incurred in 2019, 8 were sprains or strains, while the remaining 10 were superficial injuries, cuts and other wounds. A third of all injuries incurred onboard ships undergoing repairs, while other injuries incurred in workshops, on berths and on the dock. Of all injuries, 10 were the result of malfunctions, slippage and obstruction of passages and surfaces on which work was performed, and six happened for not following safety rules. That is why, during 2019, the education of workers and executives to work properly was intensified, with the frequent toolbox talk courses, with the aim of reducing the number of occupational injuries and non-conformities that also present injury risks, which are monitored. During 2019, the most non-conformities in terms of occupational safety in production activities involved uncleanliness and untidiness of work environment, unsuitable surface for movement and incorrectly erected scaffolds. The non-



conformity database is updated after the inspection of the place of work before the very beginning of work, after which work permits are issued or an order is made for the elimination of non-conformities observed.

In February 2020, in order to protect the health of workers and all other persons involved in business activities and to prevent infection with the COVID-19 virus, specific health protection measures have been prescribed and implemented, still in force at the time of drafting this report.

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 2019, a total of 10,124 hot work permits were issued. Also, a total of 278 gas-free certificates were issued for works in tanks onboard tankers.

As part of preventive fire protection activity, a total of 15 own workers and subcontractors' workers who had not previously participated in the application process for hot work such as soldering, welding and related work techniques participated in a training and successfully passed the written exam.

A total of 16 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 13 drills were carried out during repairs of their ships.

During the year, 6 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 good score 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.

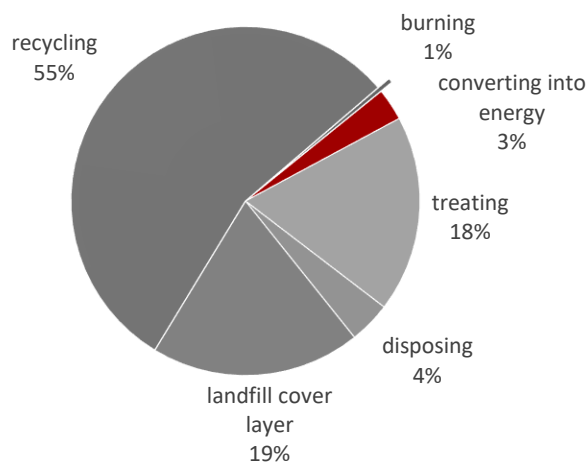
To determine the impact on the environment, Viktor Lenac uses its own measuring equipment to continuously monitor the quality of the components of the environment, especially water, sea and air. Based on the findings, as interpreted by certified laboratories, Viktor Lenac is taking necessary actions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

The 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 options that can meet both environmental and economic conditions. 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 gritblasting for ship surface treatment.

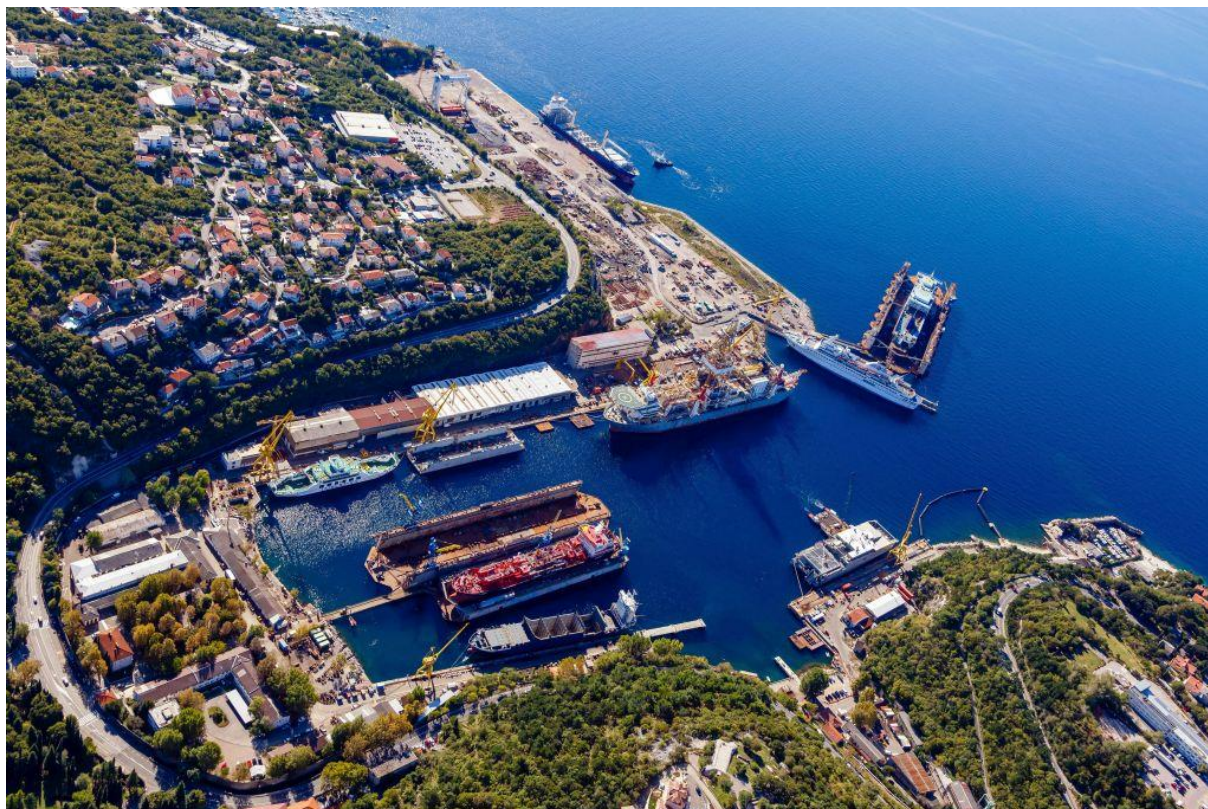
Disposing waste is the most unfavourable way of dealing with waste both ecologically and economically. The most cost-effective way of waste management is to separate waste at production site and Shipyard makes continuous efforts in educating workers and encouraging waste sorting behaviour, providing appropriate equipment and constant monitoring. The waste sorting process must be followed by an appropriate recovery practice such as recycling. 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.

### Waste management



During 2019, the Shipyard generated a total of 10,930 tons of various waste, down by 725 tons compared to the previous year, of which 8,598 tons of non-hazardous waste, or nearly 80%, and 20% of hazardous waste. Compared to 2018, the total amount of hazardous waste decreased by 1,630 tons.

By reducing the amount of hazardous waste in 2019, the cost of disposal of all types of waste was reduced by HRK 3.6 million, which is HRK 2.2 million less than in the previous year. The sale of waste as secondary raw material generated HRK 6.1 million in revenue, which is a significant increase with respect to previous years on the account of scrap steel removed from a vessel being under repairs at Viktor Lenac in 2019.



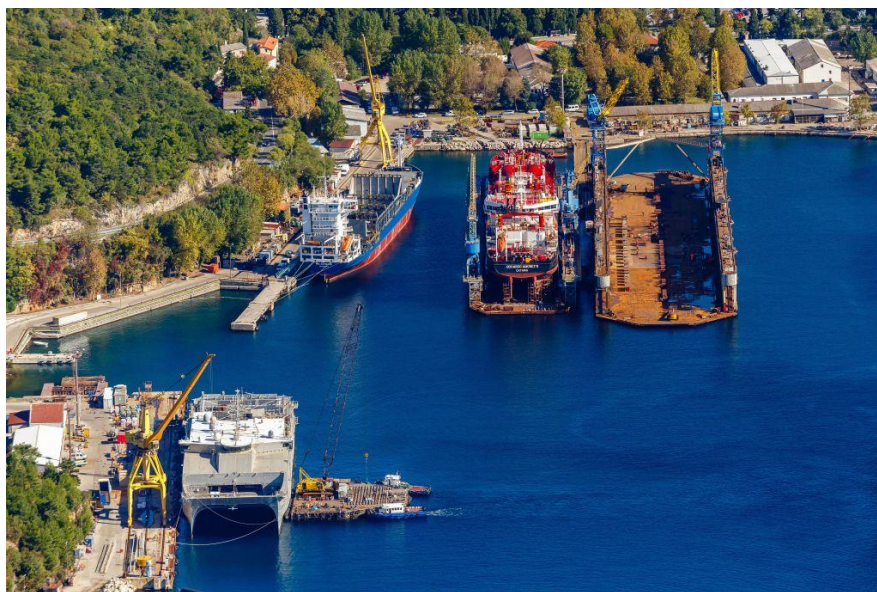
## HUMAN RESOURCES

### Number and Structure of Employees

On 31 December 2019, Viktor Lenac had 370 employees, down by 16% compared to the previous year. The average number of employees, according to the number of employees at the end of each month during 2019, was 397, down by 66 employees or 14% compared to the previous year.

During the year, 82 employees concluded their employment with the Company, of which 16 retired and 2 finished their contracts of employment of definite term, while 38 employees terminated their employment contracts by own free will. A total of 26 employees received a notice of termination due to business or personally conditioned reasons as a result of organizational changes, introduction of new systematization of workplaces, with the aim of adapting to market demands and increasing the efficiency of work, where all statutory and internal redundancy rights have been applied.

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 labour force, which has been more and more present in Croatia and the EU countries in recent years. In such circumstances, the aim is to maintain an optimal structure of workers, combined with the availability of quality subcontractors, to match the needs of the market, other productive resources and the targeted rate of occupancy.

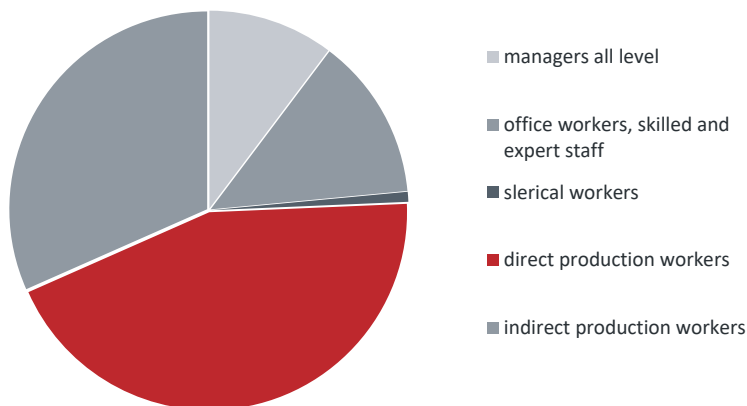
On 31 December 2019, of the total number of employees, 348 workers had employment contracts of indefinite term, whereas 22 workers had fixed-term employment contracts.

Out of the total number of workers, only 7.8% are women, which is not unusual for this industry.

Compared to the previous year, Viktor Lenac's subsidiary company Viktor - Servisi Ltd. had one employee more or a total of 16 employees as at 31 December 2019, of which 13 maintenance and repair technicians. On 31 December 2019, the subsidiary company VL Steel Ltd., founded in October 2017, had a total of 41 employees, of which 39 direct production workers. Total consolidated number of employees on 31 December 2019 was 427, down by 68 compared to 2018.

The structure of workers according to the type of jobs they perform has been stable for many years, without significant fluctuations.

## Organizational structure



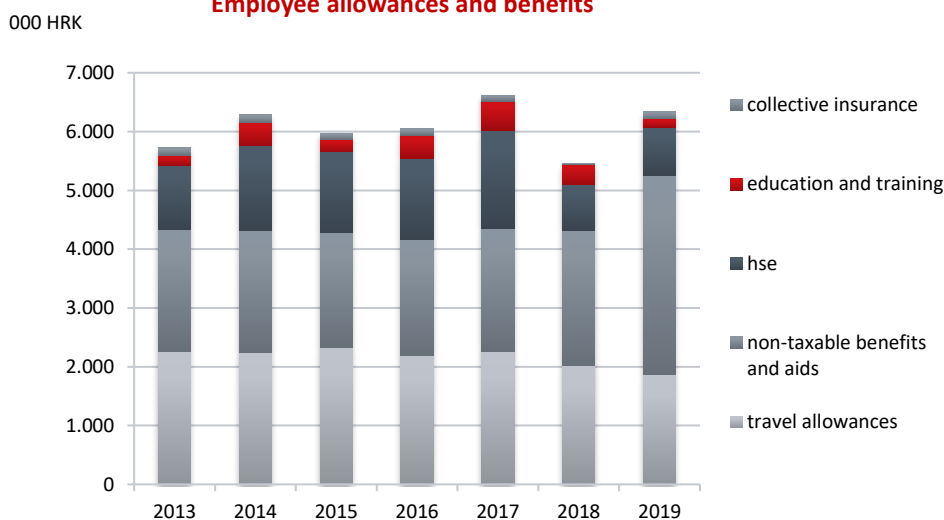
Observing the total organisational structure of employees of the Group, there are 332 production workers (78% of total number of employees), of which 213 direct production workers. A total of 119 workers involve safety and environmental protection, maintenance, quality control, foremen and other production overhead. The remaining number of employees involve technical-commercial and other highly qualified and expert staff (49 employees), clerical staff (5 employees), and project managers, heads of departments and unit leaders (total 41 employees).

## Structure of Effective Hours and Salaries

In 2019, Viktor Lenac's employees worked a total 833,000 hours in normal working hours, of which 79.3% or 631,000 were effective work hours. Compared to the previous year, the utilization of working time was 3 percentage points better as a result of increased occupancy over the past year and more flexible management of labour. Non-effective hours include annual leave (7.8%), sick leave (8.3%), national holidays (3.9%) and paid or non-paid non-effective hours (0.7%).

Increased occupancy rates led to an increase in overtime hours totalling 66,400, twice as much as in the previous year. Overtime work is 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 decrease in overtime hours.

## Employee allowances and benefits

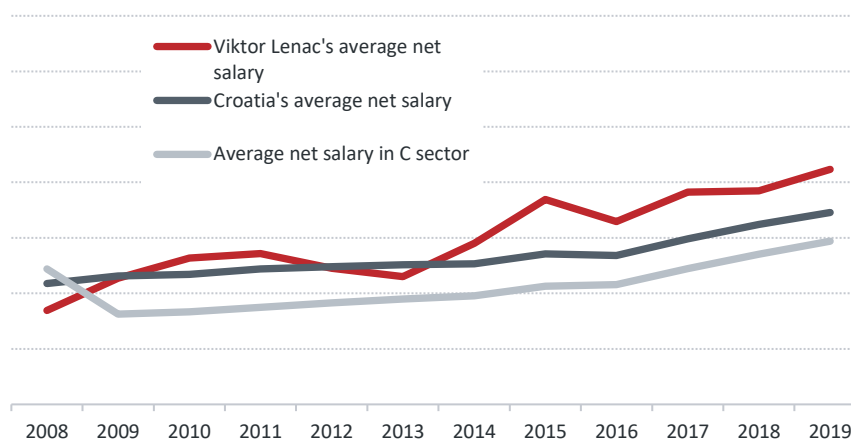


In 2019, Viktor Lenac transferred HRK 62.4 million to the account of employee salaries, allowances and benefits (HRK 5.3 million or 8% less than the previous year), of which HRK 57 million referred to salaries (10% less

compared to the previous year) and HRK 5.4 million referred to allowances and benefits to which employees are entitled based on the Collective Agreement and Labour (an increase by HRK 750,000 compared to the previous year). The disparity in the decrease of total remuneration for salaries and material rights of workers (8% compared to 2018) and the decrease in the average number of workers (14% compared to 2018) stands mainly in relation to the severance payments, which follow the termination of employment contracts due to business or personally conditioned reasons, but also a slightly higher employment within Viktor Lenac and an increased number of overtime hours compared to the previous year, which ultimately resulted in an increase in the average monthly net salary

Calculated in accordance with the State Statistics Institute's calculation methods, the average net salary per month in 2019 amounted to HRK 7,234, an increase by 5.7% compared to the previous year. The average net salary in Viktor Lenac is steadily proven to be higher than the average net salary in the Republic of Croatia, up by 12% compared to the total net average of the Republic of Croatia or up by 21% compared to the average net salary for the 'C' sector (manufacturing industry). The salary is composed of a basic salary and basic salary supplements representing the guaranteed part and a variable salary allowing increase or decrease in salary depending on operating results and occupancy rates. The Company's average net salary, therefore, varies with respect to Croatia's average especially when viewed over a number of years.

**Average net monthly salary trend**



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 to the previous year, a reduction in the number of employees in 2019 resulted in a reduction in allowances for traveling to and from work, whereas deductible payments and gifts increased, mainly due to increased deductible amounts for rewards for job performance.

## 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 2019, though somewhat reduced in intensity, for which purpose, approximately HRK 140,000 was invested during the year for the external costs of educational activities.

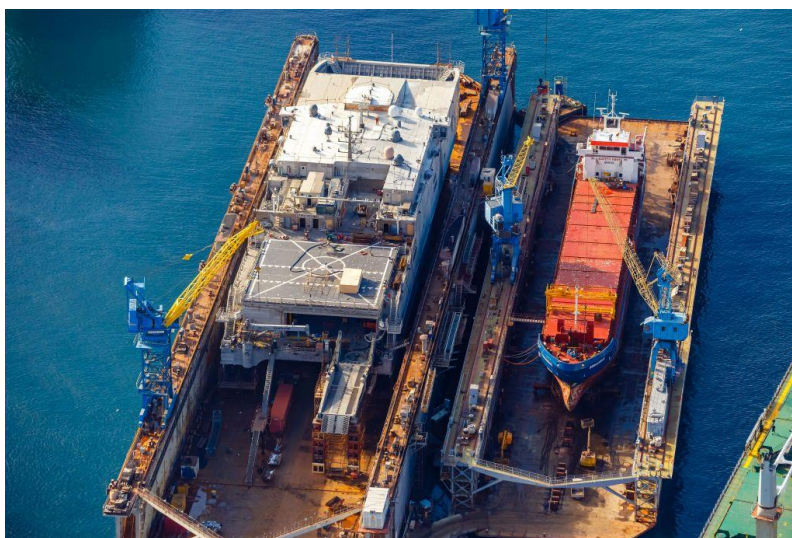
Leadership education and training at all levels aimed at improving and developing business management and managerial skills to increase efficiency, reduce costs and raise individual responsibility have been completed during previous years as planned. In 2019, internal educational activities were mainly focused on HSE and fire protection as well as some specific training such as training programs for compressor operators and power plant operators, training for special techniques within the scope of technical control and other.

The training on the safe handling of hazardous chemicals had begun at the end of 2019 and will continue during 2020, involving all persons who come into contact with such materials while carrying out their work.

## Social Dialogue

Social dialogue between the Company's Management Board and the workers' representatives, organized through the Workers' Council and two trade union organizations operating in the Shipyard, demonstrates the willingness of all social actors to reach agreements and compromise solutions through a longer or shorter negotiating process in respect of each of the parties' interest. This process is associated with the common motivation to contribute to the growth and stability of Viktor Lenac and the well-being of workers.

The Workers' Council participates in the decision-making process through a consultation and co-decision procedure, all in accordance with the provisions of the Labour Act. The Workers' Council holds regular sessions at which the Management Board, as well as other executives of the Shipyard, inform workers' representatives about the status and prospects of the business, and provide all information relevant to the position of the Shipyard workers and their economic and social status. During 2019, the Workers' Council held 7 sessions.



In 2019, one Workers' Assembly was held, at which the Member of the Management Board and the President of the Workers' Council informed the workers about the Company's business performance, development guidelines of the Company and other issues relevant to the position of workers, and workers were able to participate in the discussion and ask questions.

In December 2008, the Management Board 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, collective bargaining renegotiation between the Unions and the employer had started and a new Collective Agreement was signed in June 2017, providing 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 the year, all provisions as adopted by the Collective Agreement were applied to mutual satisfaction of all interested parties.

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

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

## FINANCIAL RESULT

### Revenues and Expenses

The trend shows the fluctuation in occupancy from initial good occupancy rates through low occupancy that marked the third quarter to high occupancy rates recorded in the last quarter of 2019. The revenue and gross margin trends reveal the same fluctuation, with the best results achieved in the last quarter.

During 2019, the Group generated total revenues of HRK 320 million, up by 26% compared to the previous year. Sales revenues grew at a rate of 30%, while revenues from investments in own assets (mainly floating docks) were lower by a quarter than in the previous year. In 2019, higher revenues from the sale of secondary raw materials were also generated as a result of a project of removal of the steel structure from one ship at the end of the year, although these revenues, by themselves, are not relevant to the overall result achieved in 2019. Specifically, sales revenues accounted for as much as 93% of operating, or total, revenues generated by the Company and the Group.

Other operating revenues, generated by the Company in the amount of nearly HRK 4 million, were generated by the Company and accounted for just over 1% of total revenues. They related to revenues generated from collecting receivables previously written off, surplus materials, provisions reversed and rent cancellation, which were partly realized from subsidiaries, explaining why the consolidated other operating revenue is lower than the revenue reported for Viktor Lenac itself.

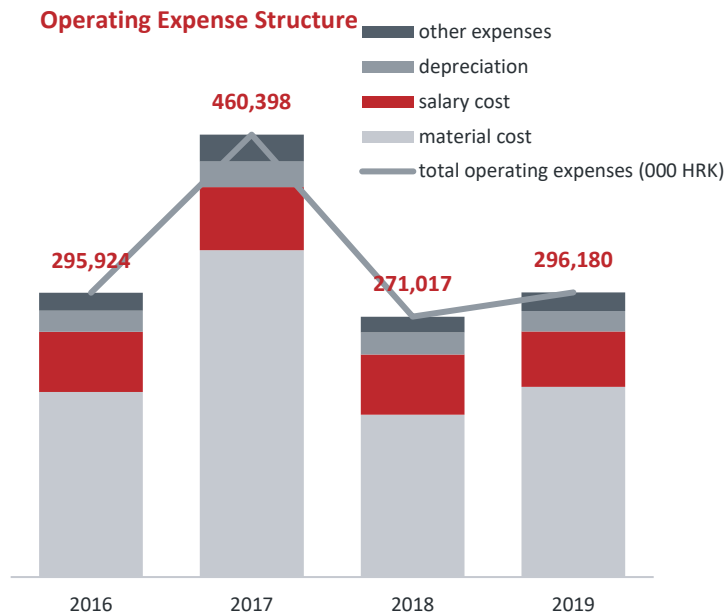
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	Parent Company			Group			Influence of subsidiaries' results on the Group's result 2019
	2018	2019	2019/2018	2018	2019	2019/2018	
Revenues from sales	227,250	295,916	130.2%	228,540	297,178	130.0%	0.4%
Revenues from investments in own assets	17,360	13,239	76.3%	17,360	13,239	76.3%	0.0%
Sale of material and waste	1,708	6,476	379.2%	1,699	6,477	381.2%	0.0%
Other operating revenues	6,549	3,999	61.1%	6,395	3,880	60.7%	3.1%
<b>Total operating revenue</b>	<b>252,867</b>	<b>319,630</b>	<b>126.4%</b>	<b>253,994</b>	<b>320,774</b>	<b>126.3%</b>	<b>0.4%</b>
Financial income	253	180	71.1%	261	188	72.0%	4.3%
<b>Total revenues</b>	<b>253,120</b>	<b>319,810</b>	<b>126.3%</b>	<b>254,255</b>	<b>320,962</b>	<b>126.2%</b>	<b>0.4%</b>
Material cost*	168,950	197,902	117.1%	163,514	188,505	115.3%	5.0%
Salaries*	62,639	57,631	92.0%	68,109	66,611	97.8%	13.5%
Depreciation	22,824	21,225	93.0%	23,013	21,411	93.0%	0.9%
Other cost	16,604	19,422	117.0%	17,516	20,735	118.4%	6.3%
<b>Total operating expense</b>	<b>271,017</b>	<b>296,180</b>	<b>109.3%</b>	<b>272,152</b>	<b>297,262</b>	<b>109.2%</b>	<b>0.4%</b>
Financial expense	3,116	2,288	73.4%	3,133	2,289	73.1%	0.0%
<b>Total expenses</b>	<b>274,133</b>	<b>298,468</b>	<b>108.9%</b>	<b>275,285</b>	<b>299,551</b>	<b>108.8%</b>	<b>0.4%</b>
<b>Profit/Loss before tax</b>	<b>(21,013)</b>	<b>21,342</b>		<b>(21,030)</b>	<b>21,411</b>		0.3%
Profit tax		504		30	523		3.6%
Loss attributed to minority interest				(65)	(5)		
<b>Net profit</b>	<b>(21,013)</b>	<b>20,838</b>		<b>(20,995)</b>	<b>20,893</b>		<b>0.3%</b>

\* Adjusted for increase or decrease of work in progress

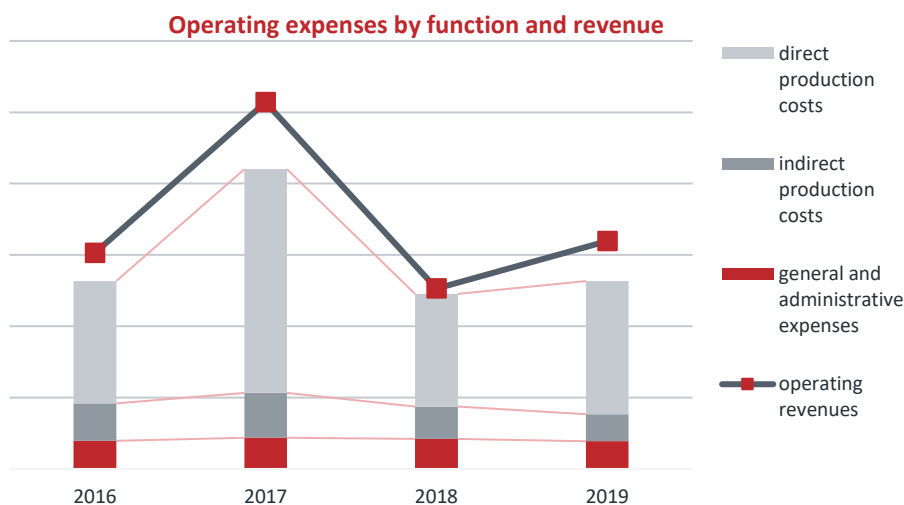
The operating revenue growth was followed by the operating expense growth. However, the operating expenses grew at a lower rate than the growth rate of operating revenues, by as much as 17%, mainly caused by a drop in fixed operating costs, or salary cost, due to the optimization of the organizational structure, as well as better cost management, since the growth of external material operating costs was 9% lower than the growth of operating revenues. Operating revenues were slightly higher due to the increase in sales prices that Viktor Lenac had to

apply in view of rising costs, primarily subcontractor services, mainly due to the need to import labour in the absence of own production workers in the periods of high occupancy. Although labour from eastern countries was hired, the unit price was higher because of the cost of travel and accommodation. However, labour shortages also affected the rise in unit prices of domestic workers, all with the aim of retaining them and preventing further migration to Western European countries.



Put in the perspective of total structure of operating expenses, the material costs were as usual 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 2019, about 30% was related to raw material and energy costs, whereas 30% was related to the services provided by subcontractors and other external contractors, as well as other services related to core business projects and the maintenance of production and business facilities. Salary cost represents a 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. During 2019, there was a decrease in the number of own workers and, consequently, a reduction in total salary costs, which accounted for 22% of the total operating expenses, which was a decrease of 3% compared to the previous year. External material costs increased by 3%. Other costs mainly related to various general operating expenses, mainly administrative expenses, which are generally fixed and independent of the volume of operating revenue, such as various non-taxable employee benefits paid under the Collective Agreement, insurance premiums, which are largely invariant to revenue, bank and utility fees and similar expenses. The expenses shown include the expenses in respect of provisions for unused annual leave, litigation, value adjustments and other operating expenses.



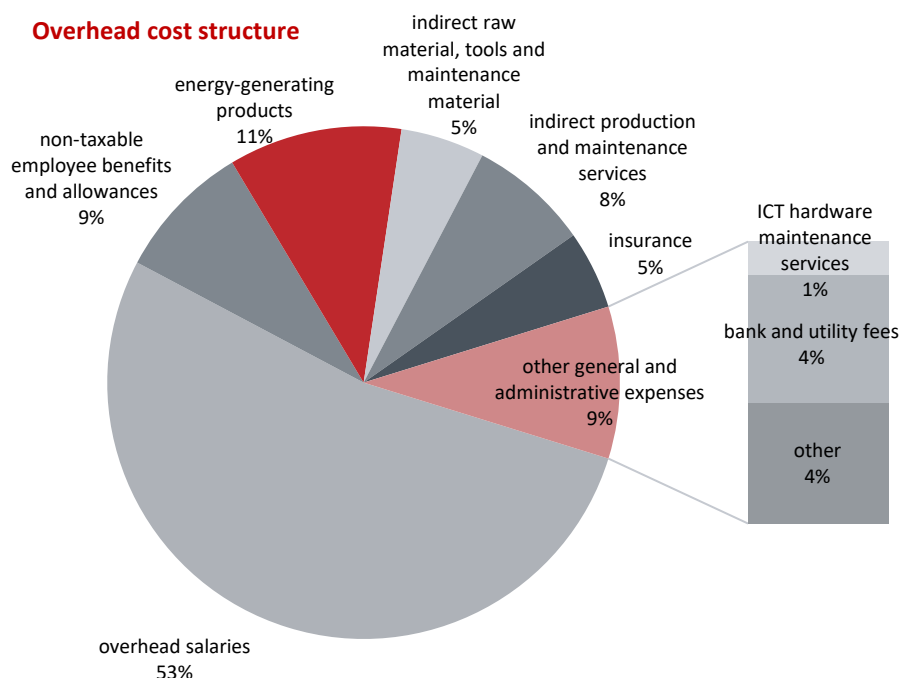
Costs are allocated to direct working orders as carriers of revenue generation or assets creation. Of the total operating expenses incurred in 2019 (excluding depreciation), 29% referred to overhead cost, which are partially variable in terms of production volume, and general and administrative expenses, which are largely fixed costs. Their share in total expenses therefore

varies; in periods marked by high occupancy their share is lower, such as was in 2017, whereas in periods of low occupancy or fluctuations in occupancy the share of such costs in total costs is higher. Overhead cost or indirect



production costs although deriving from supporting activities to manufacturing activities, are largely fixed in nature because of the cost of passive operation and the maintenance of production facilities. 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-generating product costs, property maintenance costs, overhead material in production, non-taxable employee allowances, personal protective equipment, insurance premiums, utility and bank fees.

## Overhead cost structure



The goal in the coming years remains to reduce overall cost, especially overhead, since the high cost of passive operation represents an extremely high burden, especially in oscillating occupancy or low occupancy periods. On the other hand, the shortage of domestic workers has led to a progressive increase in variable costs in the high-occupancy periods, in which the relative gross margin is falling. Increased revenue of one period can no longer, in the same

way as in previous years, compensate for periods of lower occupancy, which is why it remains imperative to reduce overall cost, including overhead and fixed costs, so that fluctuations in occupancy would have smaller effects on the total gross margin of a business year.

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 labour 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 resulted in operating profit before depreciation in the amount of almost HRK 45 million, which is almost ten times more than in the previous year. This brings the EBITDA margin to 14%, up from just 1.9% last year. Taking into account the high level of fixed operating costs, the EBITDA margin of 14% achieved at the level of revenue of approximately EUR 43 million represents a better result than the result achieved by Viktor Lenac in 2017, in which the EBITDA margin of 15.5% was achieved, but with EUR 69 million in revenue.

Depreciation cost amounted to HRK 21 million, down by HRK 1.6 million or 7% compared to the previous year.

The difference between financial income and expense generated a total negative balance of HRK 2.1 million, of which net interest expenses amounted to HRK 1.8 million, whereas the net negative exchange rate difference was HRK 0.3 million. 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.

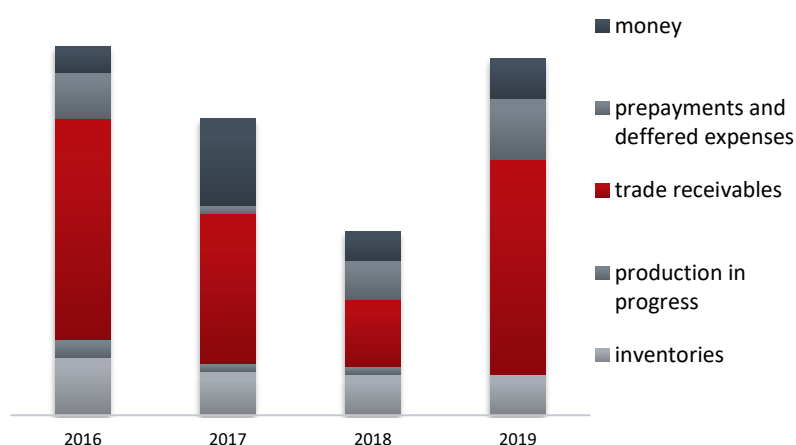
After calculating the cost of depreciation and net financial expense, Viktor Lenac generated a profit before tax in the amount of HRK 21.3 million. By taking advantage of the tax loss carried forward, the estimated profit tax amounts to HRK 0.5 million, resulting in a net after-tax profit of HRK 20.8 million, resulting in a profit margin of 6.5%. The subsidiary Viktor - Servisi generated a profit in the amount of HRK 69,000, whereas the subsidiary VL Steel generated a loss of HRK 19,000 thousand, which has no material significance for the Group's total result.

## Assets and Liabilities

	Parent Company			Group			Influence of subsidiaries' results on the Group's Balance Sheet 2019
	2018	2019	2019/2018	2018	2019	2019/2018	
Fixed assets	292,816	286,213	97.7%	293,093	286,439	97.7%	0.1%
Short-term assets	66,971	132,143	197.3%	68,886	133,969	194.5%	1.4%
Long-term liabilities	54,255	42,815	78.9%	54,275	42,837	78.9%	0.1%
Short-term liabilities	83,385	132,622	159.0%	82,768	131,806	159.2%	0.6%
Equity and reserves	222,147	242,919	109.4%	224,936	245,765	109.3%	1.2%
<b>Total assets/resources</b>	<b>359,787</b>	<b>418,356</b>	<b>116.3%</b>	<b>361,979</b>	<b>420,408</b>	<b>116.1%</b>	<b>0.5%</b>

Total assets as at 31 December 2019 amounted to HRK 418 million, up by 16% compared to the previous year as a result of increased occupancy in the last quarter, which subsequently led to an increase in current assets mainly trade receivables and accrued income. Fixed assets accounted for 68% of total assets, down by HRK 6.6 million compared to the previous year, largely because total investments in fixed tangible assets during 2019 were less than total calculated depreciation and because a real-estate was redirected to available-for-sale assets. Fixed tangible assets, of which the most significant value are floating docks, amounted to almost 95% of total fixed assets. Of the remaining 5% or HRK 15.4 million, the most significant value is the long-term cash deposit as a security for the repayment of an investment loan of HRK 8.4 million and intangible assets consisting of tangible investments in the maritime good and software in the total amount of HRK 5.5 million. The remaining amounts related to investments in subsidiary and deferred tax assets, and there are no other financial fixed assets or long-term receivables.

## Short-term Asset Structure as at 31 December



Compared to 2018, short-term assets increased almost twice, mainly due to triple the trade receivables generated in the last quarter of 2019, which had the highest occupancy rate. As at the end of 2019 Viktor Lenac had several major and more extensive projects in progress, this is also the reason for the unusually high level of receivables from customers. Also, the value of all partially completed projects according to the stage of their completion was calculated, recognizing revenues for all projects, instead of earlier reporting of ongoing production,

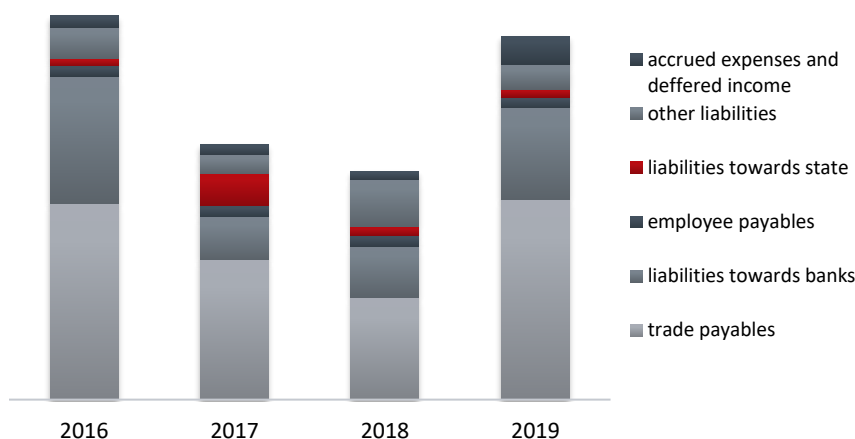
by applying IFRS 15, which also increased the accrual position and derecognized production in progress. Viktor Lenac has all the conditions for the application of IFRS 15, as it can measure the value of the shiprepair services provided, which are inseparable value built into the ships under repairs, which are always ownership of the customers, and therefore exist at all times a realistic expectation of being paid for that part of the work done.

The trade receivables, as well as the calculated value of partially completed works, were mostly realized during the first quarter of 2020.

Side by side as occupancy rate increased, especially in the last quarter, accompanied by an increase in current assets, especially trade receivables, short-term liabilities increased by the end of 2019, but thanks to a positive result, at a rate significantly lower than the growth in short-term receivables. Liabilities to suppliers were double compared to the previous year, and given the high level of trade receivables, Viktor Lenac reached out to short-term debt to finance ongoing projects, which led to an increase in liabilities to banks. Liabilities to banks also included current maturities of long-term loans that are due in 2020. At the end of the year, Viktor Lenac also recorded an increase in accruals and deferred income, mostly related to one project, which was fully invoiced to the client by the departure of the ship from Viktor Lenac by the end of the year, while the remaining obligation was to finish some works later, consequently with IFRS 15 revenue was partially deferred to 2020.

Working capital, which stood at negative HRK 16 million at the end of the previous year, has significantly improved. The profit of HRK 21 million, with the transfer of a portion of long-term liabilities due in 2020 to current maturities, was not sufficient to correct negative working capital as a whole, so at the end of 2019, total short-term liabilities relative to current assets were higher by only HRK 400,000. However, in the structure of current assets, inventories and available-for-sale assets that do not have a relatively rapid turnaround made up only 13%, while cash and receivables, including prepayments and accrued income as a substitute for trade receivables,

**Short-term Liability Structure as at 31 December**



amounted to HRK 115 million. In this way, maturity of the quick assets was largely aligned with the current liabilities, depending on their maturities in 2020.

At the end of 2019, long-term liabilities decreased by HRK 11 million compared to the previous year. Out of the total HRK 42.9 million of long-term liabilities, HRK 26.7 million related to long-term investment loan liabilities, HRK 2.4 million related to liabilities to leasing companies on the

basis of long-term financial leases for the purchase of production and business equipment, and HRK 8.1 million liabilities to HEP ESCO based on ESCO financing of energy efficiency projects implemented in 2015 and 2016. The remaining HRK 5.7 million related to provisions for court proceedings in which Viktor Lenac is the defendant, most of which relating to provisions for disputed claims of former bankruptcy creditors, for which litigation has not yet been finalized.

Total equity and reserves as at 31 December 2019 amounted to HRK 243 million, or HRK 246 million in respect of the Group, exceeding total liabilities by about 40% in respect of both Parent Company or the Group.

## 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. Liberalization of the labor market, combined with labor migration to the EU countries, which in 2019 was also affected by the crisis of nearby Croatian shipyards, has resulted in a significant increase in the average labor cost, especially of subcontractors. However, Viktor Lenac successfully managed to overcome these negativities by increasing efficiency and increasing sales prices.

The status of the Republic of Croatia as a member of the European Union has not significantly affected the revenue position of Viktor Lenac on the foreign market position, since it has been generating over 80% of its revenue on the foreign market for a number of years, whether it is a European Union client or a third country client.

### **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 hard to predict when the global economy and the world shipping trade would recover significantly over time. However, experience suggests that on the long-term it is likely to expect that there will be enough vessels sailing within range of Viktor Lenac that will require 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 fluctuations in occupancy. 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 skilled workforce on domestic labour market, Viktor Lenac can expect further labour cost increase, which will unavoidably result in the need to further increase efficiency and seek for 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 labor from abroad, even from less developed countries, does not solve the problem of rising labor costs, primarily because of high costs of accommodation and food borne by employers. Given the fluctuations in occupancy and the fact that foreign workers require their stay to be at least 6 months to a year, the underutilization of foreign labor increases fixed operating costs or reduces the utilization of foreign labor force.

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. Shiprepair activities and production processes are characterized with 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 approximately 20% and has relatively even impact spread across competition.

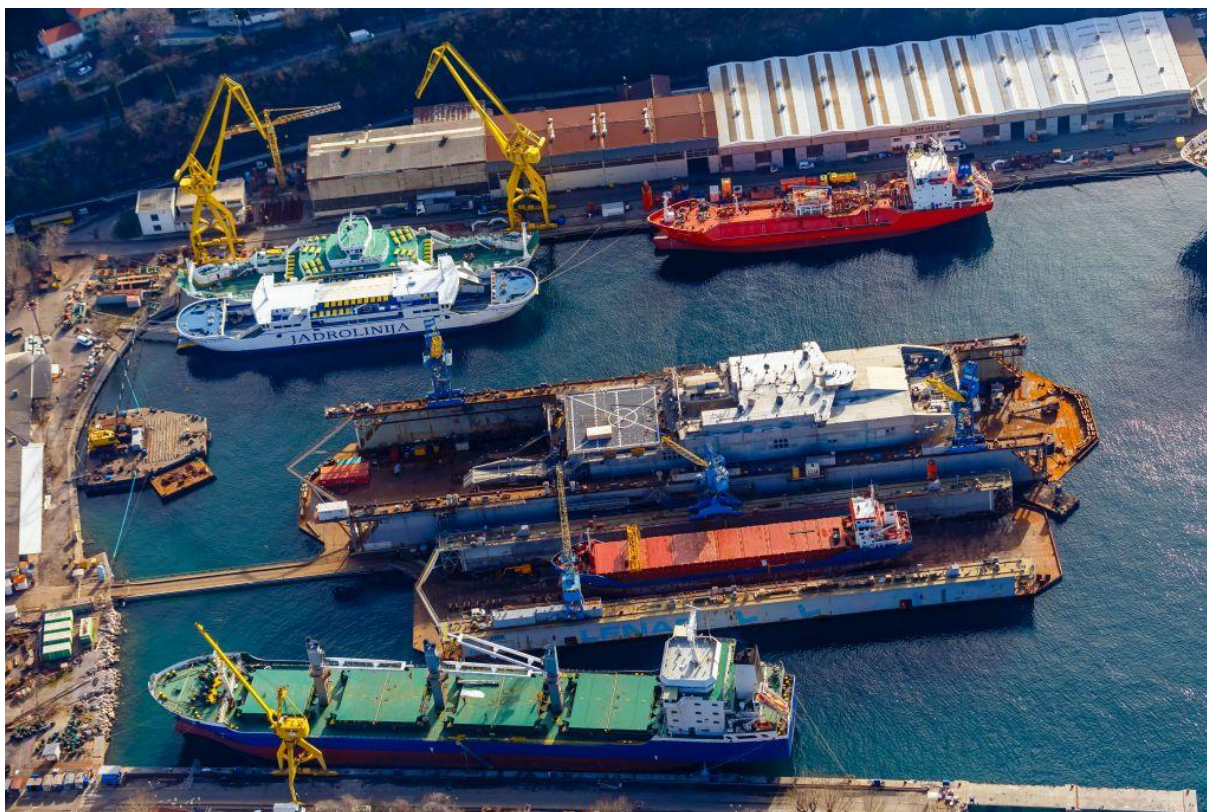
### **Personnel Risk**

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 labor 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 through educational institutions and internal educational activities. Additional risk is the ever-increasing migration of quality

workforce to Western European countries, and therefore, pressure to increase labor 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, Romania 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 fluctuations in occupancy 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.

### Impact of the COVID-19 pandemic

Viktor Lenac's main activity – shiprepair involves mainly ships in international navigation, which sail into the Mediterranean and Black Sea. Many ships sail to the ports of Italy and other ports of the Mediterranean and Black Sea countries for unloading of cargo, loading of fuel and other reasons. Viktor Lenac has been cooperating traditionally for many years with many Italian clients.

Although the most important resource in our activity is the labour force involving own and subcontracted workers, certain traffic of goods and persons takes place through foreign countries, of which one negligible partly also through Italy.

COVID-19 pandemic, which in the first quarter of 2020 resulted in a reduction in global economic activity, as well as restrictions on the movement of goods and services, and isolation and quarantine measures to prevent the spread of infection, and if they persist, could have a significant negative impact to the business of Viktor Lenac in the coming period. Although Viktor Lenac has recorded a good occupancy rate during the first quarter of 2020, some shipowners that had already confirmed their arrival earlier, have postponed their arrival for later periods, and many others have announced that their activities would be postponed for further periods. The dynamics of normalization in the shiprepair market will depend on the pandemic calming down, as well as the normalization of the global economy.

Activities onboard ships which are currently undergoing repairs or scheduled to arrive in the next month, may be difficult due to a very limited flow of goods, the impossibility for foreign technicians and customer representatives to come to the Shipyard, who are indispensable for the contracted activities, despite all the protection measures that Viktor Lenac has been taking to prevent the spread of the infection.

The impact of the coronavirus pandemic on global business, which would also affect the business of Viktor Lenac, could be reflected in reduced labor migration, which could have a short-term positive impact, but later a negative impact due to a stabilization of the situation across the European Union and employers' efforts to make up for the losses caused by the pandemic. This could, in turn, lead to an increased demand for workers, their additional outflow/emigration from Croatia, and thus price pressure on domestic employers and increased demand for more expensive foreign workers.

Globally diminished activity in maritime transport and the employment of different types of ships could influence freight rates and financial viability of shipping companies, and consequently put pressure on shiprepair prices and increase the competition between shipyards.

On the other hand, the way in which the competent bodies of the Republic of Croatia deal with coronavirus infection could have a positive impact on the clients' confidence in safety and environmental protection of our country in which they would entrust the repairs of their ships.

The measures presented by the Government of the Republic of Croatia to assist entities whose operations have

been affected by the COVID-19 pandemic, and which have been applied by Viktor Lenac, are estimated to be sufficient for Viktor Lenac to survive the next three to four months until business normalization.

If, for any epidemic or global economic reasons, business normalization does not occur in the next few months, Viktor Lenac could face a monthly passive operation cost of around HRK 5 million. We believe that we will be able to conclude a few contracts to utilize our production capacity and largely cover the costs of the passive operation.

In any case, the uncertainty surrounding the further course of the pandemic and the inability to assess its impact on the global economic situation poses a risk to the future financial position of Viktor Lenac, but also of its key suppliers and subcontractors, and the associated liquidity risk.

We believe that the negative effects of the COVID-19 pandemic will not affect our business continuity, and that Viktor Lenac will normalize its operations in the next six months to a year.

## OWNERSHIP STRUCTURE

On the day of 31 December 2019, 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 2019, the Zagreb Stock Exchange recorded 1522 transactions in trading of Viktor Lenac's stocks having a trade transaction value of HRK 3,747,503 from 647,987 shares, with the average cost of HRK 5.78 per share, with the lowest trading price being HRK 4.00, and the highest HRK 8.80 per share.

The largest single shareholder of Viktor Lenac is the Italian shipbuilding group Palumbo Group S.p.A. from Naples, which acquired the share capital of Viktor Lenac in 2018. Viktor Lenac holds 825,187 treasury shares, representing 4.91% of the total equity of the Company, which were acquired by 2011 based on the decisions of the General Assembly of the Company.

The Company has a large number of small shareholders holding individually less than 2% of the share capital of the Company and as at 31 December 2019 there were 749 and represented a total of 13.1% of the ownership structure of the Company.

### Ownership structure as at 31 December 2019:

#	Shareholder	Number of Shares	Percentage of Equity
1	Palumbo Group S.p.A. Italy	8,354,563	49.69
2	Interkapital vrijednosni papiri d.o.o./Guardianship account	5,426,897	32.28
3	Brodogradilište Viktor Lenac d.d.	825,187	4.91
4	Jadroagent d.d.	324,766	1.93
5	Rapić Mirko / R.L.E. za popravak i preinake metalnih brodova, Mirko Rapić t.p.	105,211	0.63
6	Others	1,776,623	10.56
	<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 Board 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.

Since 2008, Viktor Lenac's shares have been included in quotation of public joint-stock companies on the Zagreb Stock Exchange and 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)). Also, notification that some information has been published is also given through the Croatian News Agency OTS service.

In 2019, Viktor Lenac's Supervisory Board held five 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 Company's shareholders execute their rights at the General Assembly, where they decide on profit allocation, amendments to the Company's Articles of Association and appointment and revocation of members of the Supervisory Board. Furthermore, the General Assembly decides over performance of the Management Board and the Supervisory Board, appointment of financial auditor and other critical issues stipulated by law and Company's Articles of Association. The General Assembly was held in June 2019.

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 largest individual shareholder and the fifth member is a representative of the Shipyard's workers.

The members of the Supervisory Board are appointed by the General Assembly, except for the workers' representative who is elected, appointed and revoked by the Company's employees in the manner determined by the regulations of the Republic of Croatia.





In 2019, the Supervisory Board was composed of the following members: Antonio Palumbo as President of the Supervisory Board, Raffaele Palumbo as Vice- President of the Supervisory Board, Giorgio Filippi and Francesco Ciaramella as members with Zoran Košuta as the fifth member in quality of a representative of workers in the Supervisory Board.

On 11 December 2019, Antonio Palumbo and Raffaele Palumbo resigned from their positions. On 15 January 2020, the Company held an extraordinary General Assembly where new members of the Company's Supervisory Board were elected: Vittorio Carratù and Antonio Gennarelli. At the Supervisory Board meeting held on the same day, Vittorio Carratù was elected President of the Supervisory Board and Francesco Ciaramella as Vice-President.

The Company also has a Committee for Audit appointed by the Supervisory Board, consisting of three members from the Supervisory Board.

The members of the Supervisory Board and Committee for Audit are entitled to compensation for their work, but all foreign persons who in the course of 2019 performed their duties in the Supervisory Board and Committee for Audit waived their remuneration and were not paid. The total remuneration paid to the Supervisory Board in 2019 was therefore only HRK 120,378, all related taxes and contributions included.

## MANAGEMENT BOARD

The Company's Management Board is composed of one member, Sandra Uzelac. Until 25 March 2019, the Management Board included Aljoša Pavelin in his position of President of the Management Board, when he concluded his employment with the Company. The term of office of Sandra Uzelac in her position of Member of the Management Board is until April 2021.

The remuneration of the members of the Management Board is approved by the Supervisory Board and regulated by employment contracts with individual members.

The cost of salaries and severance pay of the Management Board for 2019 totaled HRK 1,732,820, all related taxes and contributions included.

Sandra Uzelac owns 1,038 shares of the Company, which, as a former bankruptcy creditor of the bankruptcy debtor, she acquired by settling her claims by entering her rights - claims in cash into the share capital of the Company.



## FOR INFORMATION

### Management

**Bojan Kavazović**, Director of Marketing and Sales Division

**Filip Gajski**, Director of Technical and Production Division

**Dolores Kuzmić**, Head of Procurement

**Alen Karnjuš**, Head of ICT & QA

**Aleksandar Jurčević**, Head of Human Resources

### Auditor

Deloitte d.o.o. Zagreb

### Contact Details

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

Rijeka, April 2020

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, 111/12, 68/13, 110/15 and 40/19 hereinafter referred to as 'CA'), and pursuant to Article 22 of the Accounting Act (Official Gazette No. 78/15, 134/15, 120/16 and 116/18, hereinafter referred to as 'AA'), the Management Board of Viktor Lenac Shipyard (hereinafter referred to as 'Company'), on this April 20, 2020, makes the following

## STATEMENT

### on Implementation of the Corporate Governance Code

1. The 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 drawn up by the Croatian Agency for Supervision of Financial Services and Zagreb Stock Exchange. The Code was adopted by a decision of the Croatian Agency for Supervision of Financial Services 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 is published on the Zagreb Exchange Stock's website.
3. During 2019, the Company was applying recommendations of the Code, by publishing all information as stipulated by law, which is in the interest of its shareholders. The Company published all information as stipulated by law on the Company's website and on the Zagreb Stock Exchange's website and informed the users through the Croatian News Agency OTS service that the information has been made public.
4. The Supervision of the Management Board's activities in managing business of the Company 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 Articles of Association. Members of the Supervisory Board are provided with detailed information on the Management Board's activities in managing business of the Company to be able to efficiently fulfil their supervisory role. Report submitted by the Supervisory Board makes an integral part of the Annual Report, which is presented to the General Assembly. The Supervisory Board had proposed new members of the Committee that were appointed at the session of the General Assembly held on 14 June 2019.

The Supervisory Board has not yet established committees that support its work and activities (Nominating and Remuneration Committee and Corporate Governance Committee).

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

The Company applies 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. The Company has not yet established a corporate internal audit to perform the function of independent audit and control and to inform the Management Board through audit reports in the form of findings and proposals for improvement. The Management Board directly supervises all revenue and expense recognition processes of the Company and participates in the preparation of quarterly, semi-annual and annual financial statements of the Company.

6. As at 31 December 2019, ten largest shareholders were the following ones:

#	Shareholder	Number of shares	Percentage of equity
1	PALUMBO GROUP S.P.A. (1/1)	8,354,563	49.69
2	INTERKAPITAL VRIJEDNOSNI PAPIRI D.O.O./ GUARDIANSHIP ACCOUNT	5,426,897	32.28
3	BRODOGRADILIŠTE VIKTOR LENAC D.D. (1/1)	825,187	4.91
4	JADROAGENT D.D. (1/1)	324,766	1.93
5	RAPIĆ MIRKO (1/1) /R.L.E. ZA POPRAVAK I PREINAKE METALNIH BRODOVA, MIRKO RAPIĆ T.P.	105,211	0.63
6	WEISS MARIJA BRANKA (1/1)	77,308	0.46
7	CROATIAN CENTRE FOR RESTRUCTURING AND SALES (0/1) / REPUBLIC OF CROATIA (1/1)	59,119	0.35
8	KERA IVANA (1/1)	54,327	0.32
9	RAZMAN ENES (1/1)	52,500	0.31
10	LIST GMBH AUSTRIA (1/1)	45,992	0.27
	Others	1,487,377	8.85
	<b>Total:</b>	<b>16,813,247</b>	<b>100.00</b>

The corporate governance structure of the Company is dualistic. It consists of the Management Board and the Supervisory Board, which together with the General Assembly make the three fundamental bodies of the Company.

General Assembly meets in regular sessions as stipulated by law and in accordance with the Company's Articles of Association. 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 a shareholder 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 ordinary shares in accordance with law of the Republic of Croatia and Company's Articles of Association. Decision on issuing shares is made by the General Assembly in accordance with Article 172 of the Companies Act and Company's Articles of Association. 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 Articles of Association are made in accordance with the Companies Act.

7. On the day of 31 December 2019, the Company's Management Board was consisted of one Member of the Management Board, Sandra Uzelac, representing the Company individually and independently in accordance with the Articles of Association and the Rules of Procedure of the Management Board. Until 25 March 2019, when he concluded his employment with the Company to mutual consent, the Management Board included Aljoša Pavelin in his position of President of the Management Board.

Management Board has no authority to make business decisions as specified in Article 15 of the Company's Articles of Association (acquisition, alienation or encumbrance of real estate, issuing, alienating and acquiring bonds, providing guarantees except for liabilities of a subsidiary, taking loans and loans outside the ordinary business of the Company, etc.), and in respect with other issues as stipulated by law or in accordance with the Company's Articles of Association or a decision made by the Supervisory Board, without prior consent of the Supervisory Board. The members of the Management Board are appointed by the Supervisory Board for a term

of five years. The appointment of a member of the Management Board may be revoked by the Supervisory Board.

The Supervisory Board of the Company is consisted of five members. Four members are appointed and may be revoked by the General Assembly. The fifth member is elected and appointed and may be revoked by the Company's workers in accordance with law. In 2019, the Supervisory Board was composed of the following members: Antonio Palumbo, President of the Supervisory Board; Raffaele Palumbo, Vice-President of the Supervisory Board; 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.

On the day of 11 December 2019, Antonio Palumbo, President of the Supervisory Board and Raffaele Palumbo, Vice-President of the Supervisory Board resigned from their positions and on 13 December 2019 the Company convened an extraordinary General Assembly, which was held on 15 January 2020 when new members of the Supervisory Board were appointed: Vittorio Carratù and Antonio Gennarelli. At the meeting of the Supervisory Board held on the same day, Vittorio Carratù was appointed President of the Supervisory Board and Antonio Gennarelli as his deputy.

The Supervisory Board acts as a collegial body at meetings held at least once a quarter, at which it discusses and decides on all matters within its competence stipulated by the Companies Act and the Articles of Association. Decisions of the Supervisory Board are made by a majority vote of the members present. In 2019, five Supervisory Board meetings 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 2019, the Committee held three sessions to evaluate Company's financial performance. Members of the Committee for Audit are Vittorio Carratù, Francesco Ciaramella i Giorgio Filippi.

8. The Company promotes 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, item I of the Companies Act, this Statement represents a separate section and makes an integral part of the Company's Annual Report 2019.

Sandra Uzelac

Member of the Board



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