elering
CONNECTING ENERGIES

Annual Report for **2019**

elering
CONNECTING ENERGIES

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Main activity:	Power and gas transmission
Chairman of the Management Board:	Taavi Veskimägi
Owner:	Republic of Estonia
Auditor:	AS PricewaterhouseCoopers

Annual Report for **2019**

MANAGEMENT REPORT OF ELERING

CHAIRMAN'S STATEMENT

ELERING 10

On 27 January 2020 it has been 10 years since Elering bought its "freedom" from the Eesti Energia group for 3.2 billion Estonian kroons. It has been a great privilege to work for a company whose purpose is so clear – to keep the lights on and rooms warm in the homes of the people of Estonia. There are not many jobs where one can experience the broader meaning of their work so clearly.

The European energy vision of a single network and a single market, which was placed into a clear framework by the Third Energy Package has allowed for taking on extremely exciting challenges that have a broader meaning for the development of Estonia, starting from the full liberalisation of the electricity and gas markets, implementation of projects leading the way in digitalising the energy system and increasing the reliability of the power grid up to the construction of new electricity and gas infrastructure for a billion euros.

Dear friends, it has been a race. And, luckily, the race does not end here. I would like to point out some individual decisions, choices and results that have a broader meaning for the development of the Estonian energy system and for the development of Elering.

- The decision made in 2009 to separate the electricity system operator from Eesti Energia along with the 110–330 kV power grid.
- The decision made in 2010 to, along with the partial opening of the electricity market, create the Nord Pool Spot price area in Estonia in order to achieve strong integration with the Nordic countries.
- In 2011, the financing of Elering in part by debt instruments and the listing of its bonds on the London stock exchange; the receiving of the A3 credit rating from Moody's (the highest corporate rating in the Baltic states), in order to increase the transparency of the company's operations.
- In 2012, the launching of the Clear the Lines from Trees programme with the aim of quickly reducing the disruptions of the transmission network in order to minimise the energy not transmitted via the transmission network.
- In 2013, the creation of a central data warehouse in Elering for the purpose of ensuring competition in the electricity retail market.
- In 2014, the conclusion of a contract with Fortum to buy majority shareholding in the Estonian gas transmission network company with the aim of replicating in the gas sector the same liberalisation effect that we achieved in the field of electricity.
- The acquisition of Estlink1 and the construction of Estlink2 in order to attain a situation where Estonia is connected to the Nordic countries to an extent where we could, together with the emergency power plants, rely in ensuring our security of supply also on Nordic power plants, where necessary.
- In 2015, the decision to build Balticconnector. The full functional integration of the electricity and gas businesses.
- In 2016, the decision to build a design tower on the Third Estonian-Latvian line in order to more broadly contribute to the creation of the spatial environment.

- The development of the Estfeed data exchange layer in 2017 in order to ensure secure exchange of energy data between sectors and countries and enable cross-border integration of retail markets.

- The implementation of a biomethane support scheme with the aim of making the natural gas sector more carbon emissions-neutral.

- In 2018, Elering developed and launched an interactive map application indicating vacant connection capacities in the substations of the electricity transmission network, which saves time for a prospective connector as well as Elering itself in the connection process.

- The Baltic and Polish prime ministers reached an agreement with the European Commission on connecting the Baltic countries to the continental European electricity system. It was a breakthrough for which we had worked for 10 years and which in the next 5 years will fundamentally change how Elering has kept the lights on in Estonia to date.

- In 2019, Balticconnector was placed at the disposal of the market and Elering made an agreement with the Finnish and Latvian gas system operators to create a single Finnish-Estonian-Latvian gas market as of the start of 2020.

And, of course, we have not done all that alone. On the contrary, it all has been made possible owing to cooperation between many parties, the key partners being the Ministry of Economic Affairs and Communications and the Competition Authority.

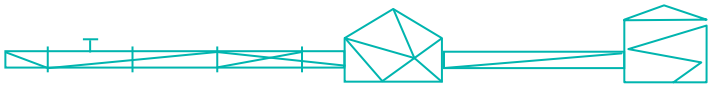
The challenges of Elering do not end with all of this. As of this year, since the work on the Balticconnector cluster has come to an end, Elering's priority shifts to the synchronisation project concerning more or less all of the people in our electricity business. In the course of this process, we need to build Elering's competencies that allow for, in addition to the implementation of the synchronisation project and all of its sub-projects, the readiness to operate the electricity system in the period of transition from the Russian electricity system to the continental European electricity system as well as, after 2025, for operating in the new circumstances in such a manner that the lights would be kept on and rooms warm in homes throughout Estonia. And to do so in a manner that supports the achievement of the climate goals of Estonia and the European Union.

Elering has followed the principle "If you want to go fast, go alone but if you want to go far, go together." Once again, I would like to thank all my dear fellow travellers in Elering, our customers, the state as the owner and the entire society for understanding and supporting our endeavours. Thank you!

TAAVI VESKIMÄGI

Chairman of the Management Board

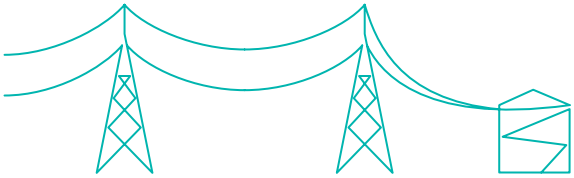
BRIEF OVERVIEW OF ELERING



977
km of gas pipelines

36
gas distribution stations

3
gas metering stations



5,419
km of high voltage overhead and underground transmission lines

150
substations

Important events in
2019

- Completion of the Balticconnector offshore pipeline
- Guaranteeing EU support for the first stage of synchronisation investments
- Having been awarded with the gold label in the Responsible Business Index
- Winning the title of " The Best Transmission Network Brand" at the international CHARGE AWARDS 2019

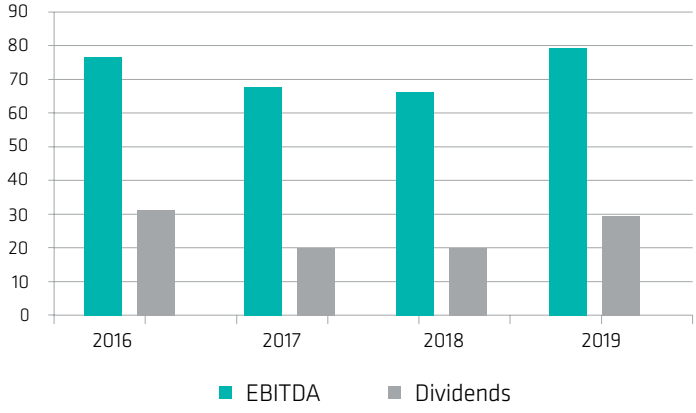
2
converter stations

139
km of EstLink underground transmission lines

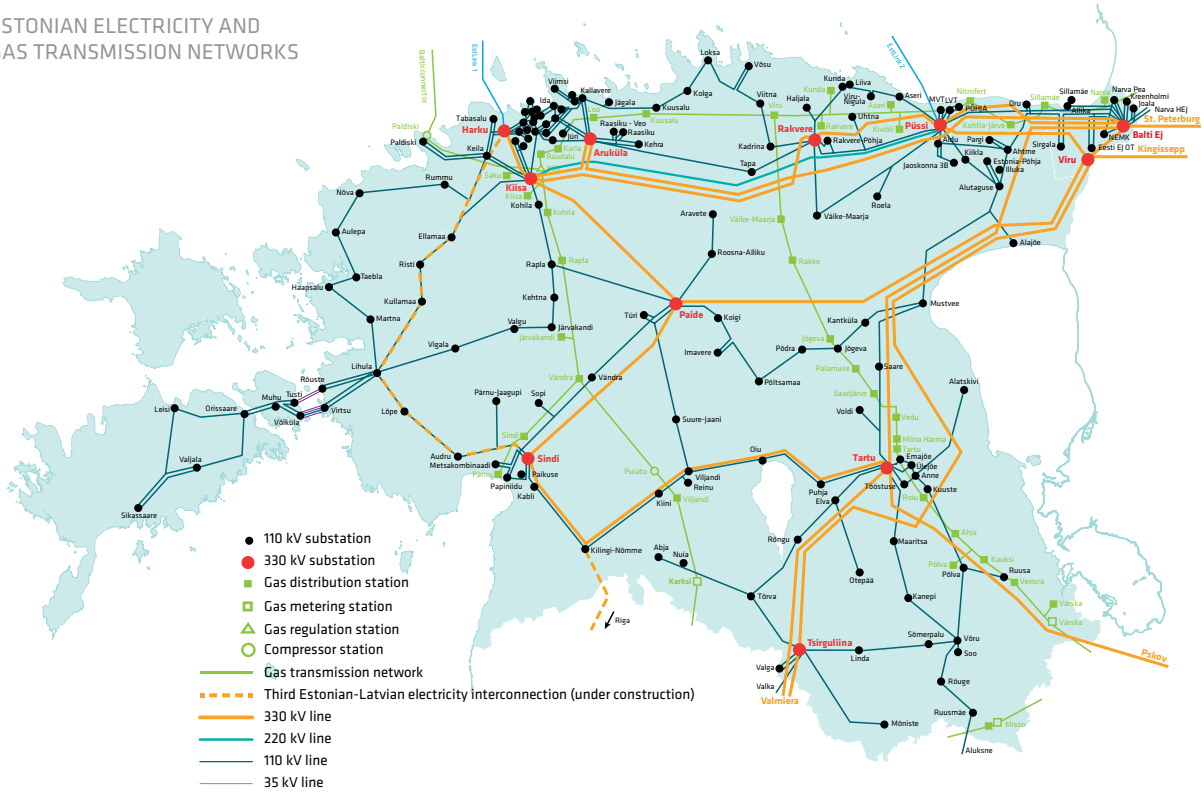
RESPONSIBLE BUSINESS INDEX
GOLD LEVEL 2019

BEST TRANSMISSION BRAND
WINNER
CHARGE
AWARDS 2019
elering

EBITDA and dividends



ESTONIAN ELECTRICITY AND
GAS TRANSMISSION NETWORKS



Main financial indicators (MEUR)

	2016	*2017*	*2018*	2019
Revenue	135.9	131.9	144.8	155.2
Operating expenses	98.1	98.8	113.9	113.4
Operating profit	37.8	33.1	31.0	41.8
Financial expenses	11.4	11.0	7.3	2.1
Corporate income tax	7.8	5.0	5.0	6.8
Net profit	18.7	17.1	18.6	32.8
Borrowings	367.4	362.3	353.7	343.3
Owner's Equity	349.1	346.2	384.8	388.3
Total Assets	903.7	909.6	948.4	1,024.4
EBITDA	76.0	67.6	65.7	78.7
Investments	26.7	32.2	125.0	129.0
Dividends	31.0	20.0	20.0	29.4
Ratios				
ROE	5.5%	4.9%	5.1%	8.5%
Equity/Assets	39%	38%	41%	38%
Net loans/EBITDA	4.1	4.1	4.4	3.8

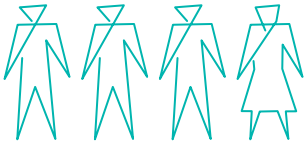
$$ROE = \frac{\textit{Net profit}}{\textit{Annual average equity}}$$

Net loans = Interest-bearing liabilities - cash and cash equivalents
EBITDA = Operating profit + depreciation

average age **43,9**

average length of employment **13,7**

voluntary employee turnover **4,8%**



246

people, of whom
28% are women

OVERVIEW OF MAIN ACTIVITIES

ENERGY BALANCES

6.45 terawatt-hours of electricity was generated in Estonia in 2019, which is 39 per cent less than the year before. The main reason for the decrease in production is the sudden decline of the production of oil shale-based electricity. Consumption decreased by one per cent to 8.65 terawatt-hours. The electricity balance of Estonia in 2018 was surplus by almost two terawatt-hours, but in 2019 the balance was in deficit by around the same amount.

Electricity balance, GWh	*2018*	*2019*	*Change %*
Electricity production in Estonia	**10,583**	**6,447**	**-39%**
Domestic production of electricity supplied to Elering's network	10,225	5,983	-41%
Production of renewable energy in Estonia	1,665	1,946	17%
Electricity supplied to the network from foreign transmission lines	**3,485**	**5,616**	**61%**
· incl. electricity supplied to the network from Finland	2,391	3,818	60%
· incl. electricity supplied to the network from Latvian and Russian transmission lines	1,094	1,798	64%
Total electricity supplied to the network	**14,068**	**12,063**	**-14%**
Electricity consumption in Estonia	**8,717**	**8,646**	**-1%**
Elering's domestic transmission service for consumption	7,980	7,833	-2%
Elering's network losses	380	348	-8%
Electricity supplied from the network to foreign transmission lines	**5,350**	**3,417**	**-36%**
· incl. electricity from the network supplied to Finland	874	298	-66%
· incl. electricity from the network supplied to Latvian and Russian transmission lines	4,477	3,119	-30%
Total electricity capacity that passed through the network	**14,068**	**12,063**	**-14%**
Balance	**1,866**	**-2,198**	**-218%**

The quantity of electricity from renewable sources increased by 17 per cent to 1.95 terawatt-hours in 2019. The increase in wind power was the primary reason for the increase. However, the volume of renewable electricity converted from sunlight increased most rapidly.

Electricity generated from renewable sources, GWh	*2018*	*2019*	*Change %*
Total production	1,665	1,946	17%
Wind power	591	692	17%
Hydropower	19	22	16%
Waste, biomass	1,043	1,179	13%
Sun	13	54	315%

Gas balance, GWh	*2018*	*2019*	*Change %*
Transit flow	15,154.5	19,180.2	+27%
Total gas provided to the transmission pipeline cross-borderly	5,241.0	4,808.3	-8%
Gas supplied from the transmission network for domestic consumption	5,216.4	4,773.2	-8%
Transmission network losses, incl. self-consumption	12.4	12.6	+2%
Change in the transmission pipeline reserve capacity	3.5	8.3	+137%

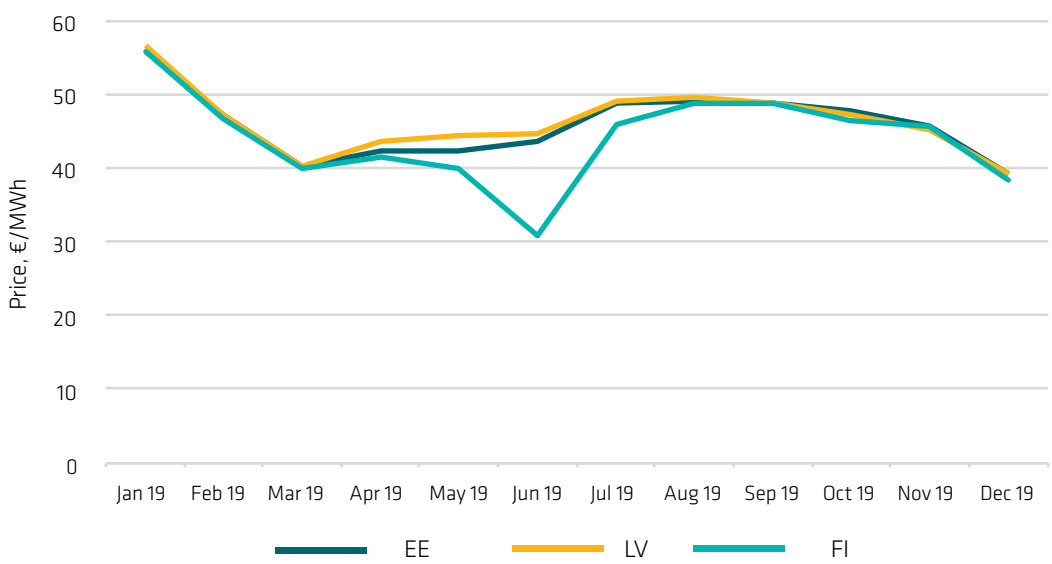
SECURITY OF SUPPLY

Elering's mission is to guarantee the security of the power and gas supply for Estonian consumers. The security of the supply of power is assessed by Elering annually in its security of supply report. According to the assessment report and the best knowledge currently available, the security of supply of Estonia and the region is ensured until 2025 from the combined effects of production and transmission capacities. The likelihood of any shortages of electricity also remains low after 2025, but to bring additional production capacities or consumption management solutions to the market, it is necessary to develop a power market design that gives accurate price signals for investment decisions and would thus ensure the security of supply.

In conditions where Europe has an energy union and a single electricity market, Elering takes a pan-European and regional-level view of long-term security of supply. The analysis of long-term security of supply is threefold. First of all, the security of supply situation is viewed in Europe as a whole on the basis of the ENTSO-E analysis. Estonia is a part of the European electricity market and therefore the assessment is primarily based on a pan-European generation adequacy analysis (Mid-term Adequacy Forecast – MAF) prepared by ENTSO-E. The MAF probabilistic generation adequacy analysis, which was published in autumn 2019 and in which calculations were made as estimates in respect of ca 130 years, has set out two scenarios leading up to 2025. Then, the analysis assesses the Baltic and Finnish regional security of supply and Estonian consumption and generation developments in more detail.

The security of supply of the Estonian gas system has improved significantly as a result of the completion of the Balticconnector gas connection with Finland. Balticconnector gave Estonia an additional gas supply channel and increased preparedness for coping with any faults in the gas system.

Security of supply at the lowest possible costs is ensured to the Estonian consumer by open and well-functioning European energy markets. The power market is moving forward with the pan-European harmonisation of the market as well as moving closer to real-time. The European electricity wholesale markets are well integrated by now and electricity is traded on a day-ahead and intra-day basis jointly from Portugal to Finland. Bulgaria, Croatia, Czech Republic, Hungary, Poland, Romania and Slovenia joined the 'second wave' of pan-European intra-day trading in November 2019. 21 countries are now connected to intra-day trading. The electricity prices on the electricity market of the Baltic Sea region dropped somewhat in comparison with 2018. The average price in Estonia in 2019 was 45.86 euros per megawatt-hour, which is 2.6 per cent lower than the year before (47.07).



On the gas market, an important step was taken in the development of the regional gas market when Estonia, Finland and Latvia opened a harmonised single gas market in early 2020. The gas market region that connects three countries is unique in Europe and enables bigger competition on markets that are otherwise rather small. The common market zone and harmonised rules make it simpler for new market participants to enter the market and thereby increase the quantity of competing gas suppliers. It also simplifies the use of different supply channels, thereby increasing the security of gas supply. In a gas market with harmonised rules, gas can move within the region without any transmission fees, and the region entry fees are the same in all countries.

The Balticconnector gas connection between Estonia and Finland started operating at the same time when the market region of Estonia, Finland and Latvia was launched. The Balticconnector enables bidirectional gas flow between Estonia and Finland. This adds a supply channel to Estonia and a completely new supply channel to Finland in the shape of the Lithuanian LNG terminal.

The start of 2020 has shown that the gas trade is very active. The usable capacity of Balticconnector has been fully utilised every day in the direction from Estonia to Finland, as gas prices in the Baltic States have been somewhat lower than in Finland.

DEVELOPMENT OF ENERGY SYSTEMS

The Balticconnector was the most important project for Elering in 2019 from the strategic view of the development of energy systems. The options of building a gas pipeline between Estonia and Finland has been considered for many years. The project really gained traction after the prime ministers of Estonia and Finland signed a communiqué for the joint development of the gas infrastructure of Estonia and Finland in 2014. In 2015, Elering and its Finnish partner established the project organisation and started preparing for construction. In 2016 the Connecting Europe Facility (CEF) decided to co-finance the project to a large extent and the construction contracts of the most important sub-projects were signed in 2018. The gas pipelines of Estonia and Finland were connected by November 2019 and gas started moving between the systems. The last structures of the Balticconnector will be completed in 2020.

After completion of the Balticconnector, the focus in the development of the energy network of Elering will shift to the synchronisation of electricity networks with Continental Europe. In 2018, the Baltic States, Poland and the European Commission agreed at the highest political level that the Baltic States will be connected to the European networks through Poland in 2025. The agreement for financing the investments in the first stage of the massive project was made in 2019 and based on this agreement the CEF will support the Baltic States to the extent of 75% of 430 million euros, i.e. with 323 million euros. The money helps to strengthen internally the networks in the Baltic States, which in Estonia means the reconstruction of the existing Estonia-Latvia 330 kV power transmission lines and construction of tension regulation systems. In 2019 Elering already organised a design procurement for the first of these transmission lines. Actual construction works are scheduled immediately after completion of the third electricity connection between Estonia and Latvia, which is currently under construction.

In addition to implementation of the investments for which the financing had been already warranted, the company also continued agreeing the volumes for the second phase and preparing the financing applications.

In November 2019, the transmission system operators in the Baltic States and Poland submitted an investment application to national regulators. A funding application can be submitted to CEF after the regulators have made positive decisions.

The completion of the third electricity connection between Estonia and Latvia is an important prerequisite in order to launch the remaining construction activities of synchronisation. The construction works have stayed on schedule despite conditions being extremely complicated at times. More than half of the Harku-Lihula-Sindi line was completed by the end of 2019. The extension of the Harku 330 kV substation required for connecting the line was also completed. The remaining part of the 175 km line will be completed by the end of 2020 and the construction costs will amount to ca 60 million euros.

Kilingi-Nõmme 330 kV substation and a line section from the substation to the Latvian border are also parts of the third electricity connection between Estonia and Latvia. The construction works on Kilingi-Nõmme 330 kV substation were completed in 2019. A contract with the total value of 4.5 million euros was entered into in April 2019 for construction of the 14-kilometre line section, and the deadline for completion of the construction works is in summer 2020.

Construction works in the Ülejõe, Metsakombinaadi, Topi, Sopi, Kiini and Paldiski substations were completed in 2019 within the scope of client connections. Overhead lines in the surrounding electricity network were built and repaired for the connections in Sopi and Põdra substations. Tsirguliina 330 kV substation and Ranna and Rõngu 110 kV substations were reconstructed in order to renew the old substations.

In 2019 two events with a significant impact occurred in the electricity network. The current transformer at the Balti substation broke on 18 May and the subsequent incorrect functioning of the relay protection equipment caused the duplicating side of the substation to switch off, which meant that the city of Narva and the surrounding areas were without electricity for almost an hour. On 27 October, strong winds threw pieces of the tin roof of Võru substation into the switchgear, causing damage to equipment, short circuits and the switch-off of the entire substation. The supply of electricity to the city of Võru and the surrounding region from the Võru substation was restored within six hours. The problems at Balti and Võru substations were related to the poor quality of the construction works performed by the builder during the reconstruction of the stations.

As a result of the aforementioned events, the reliability indicators of the year were somewhat poorer compared to the average performance in recent years, but their trend is still clearly improving.

The gas network performed excellently throughout the year – there were no dangerous incidents or interruptions for gas consumers.

The reliability of cross-border electricity connections was satisfactory and there were no significant restrictions on international electricity trade, apart from a few breakdowns – only two percent of the time there was a bottleneck and price difference on the boarder caused by a lower throughput. The major breakdowns, that deserve to be mentioned are the breakdown of the converter cooling hose at Püssi converter station on 31 March, which cut the Estlink 2 connection for almost two days and the breakdown of the measuring device at Anttila converter station on 27 December that cut the connection for around eight days.

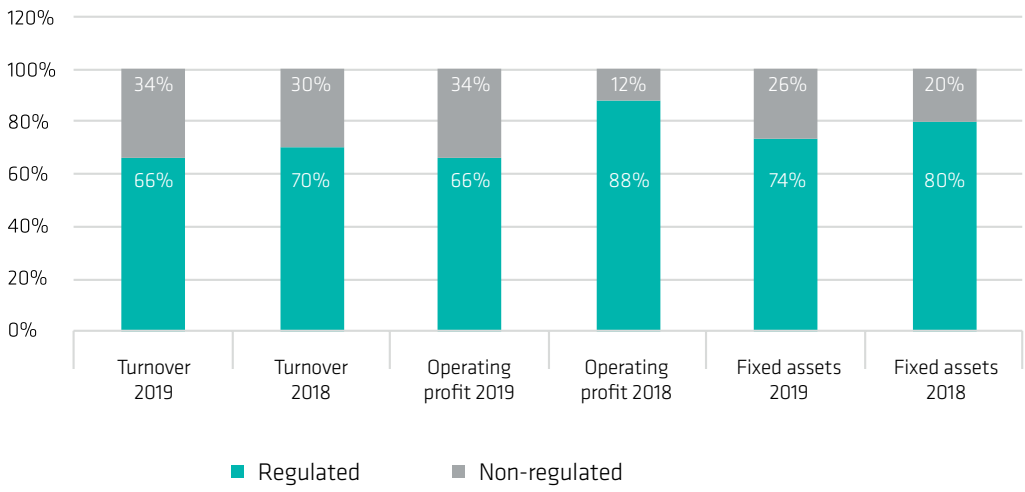
OVERVIEW OF ECONOMIC ACTIVITY

Nature of economic activity

The economic activity of Elering can largely be divided into two categories:

a. regulated electricity and gas network activities
b. non-regulated activities

Regulated network activity consists of the transmission of electricity and gas through the company's electricity and gas transmission networks. Network activity is by far the most important in terms of turnover, profitability and assets.



Network activity is regulated, which means that the Competition authority approves the allowed network charges. The regulator assesses whether the costs presented in the network charges application are justified and also sets a limit to the reasonable return, which is calculated based on the Capital Asset Pricing Model. The network charges consist of the operating expenses, capital expenditure and the allowed rate of return. The operating profit is equal to the result when of multiplying regulated assets with the weighted average cost of capital (WACC).

In total Elering has 29 electricity network service clients and 14 gas network service clients (2018: 28 electricity network service clients and 11 gas network service clients). The majority, i.e. 88% of the network service revenue (2018: 89%) is earned from the natural monopolies operating on a regulated distribution network market. The biggest network services client is Elektrilevi OÜ, whose share in network services revenue is 74.1% (2018: 77.4%). Elektrilevi is a distribution network operator that is part of the Eesti Energia AS group, which is owned by the Republic of Estonia.

Non-regulated activities mainly consist of providing electricity and gas balancing services.

In order to ensure a stable frequency of electricity in the electricity system, the system must be balanced, i.e. electricity production must be equal to consumption at any given time. For this purpose, all market participants also need to be in balance and most of them buy their electricity balance balancing services from balance providers. Elering, in turn, provides the electricity balance balancing service to the balance providers. There are 8 balance providers to whom Elering provides the service (2018: 8).

The principles of balancing the gas system are generally similar to the principles of balancing the electricity system. The only difference is that the gas system does not have to be balanced at all times. When the consumption of gas is higher than inflow, the pressure in the system drops and vice versa. As a gas system operator, Elering's task is to keep the pressure within the permitted limits. For this purpose, Elering buys and sells gas to balance providers. The number of balance providers with whom balancing gas is bought and sold is seven (2018: 9).

The impact of the balancing service on the profit of Elering is insignificant, as the price of the balancing service is calculated in such a manner that the revenues earned cover the expenses of providing the service.

FINANCIAL RESULTS

Revenue

Total revenue in 2019 amounted to 155.2 million euros (2018: 144.8 million euros). The most important source of revenue was the sale of network services, which comprised 73.1% or 103.9 million euros (2018: 71.9% or 102.7 million euros) of revenue. Revenue from electricity network service comprised 88% and revenue from gas network services comprised 12% of network services (2018: 90% and 10%). Revenue regulated with network tariffs comprised 93% of the revenue from network services (2018: 94%).

The sale of the regulated electricity network service dropped by 1%, i.e. one million euros, but this was balanced by the significant increase in the sale of gas network services, which increased by 21%, i.e. 2.1 million euros. Revenue from the electricity network service decreased due to the reduction of electricity transmission volumes (-2.2 million euros), which was compensated by larger revenue from the pan-European electricity transit compensation mechanism (+1.1 million euros). The increase in gas network services revenues was caused by the increase in tariffs, the impact of which was reduced by the reduction of gas transmission volumes. The main reason for the decrease in electricity and gas transmission volumes was the exceptionally warm weather – according to the national weather service, the average temperature in Estonia was 0.5 degrees higher than the year before.

Revenue from the balancing and regulation service decreased by 4.6%, i.e. 1.6 million euros and amounted to 33.7 million euros (2018: 35.3 million euros). The reason for the decrease in revenue from the balancing service was the improved cooperation between Baltic TSOs, which reduced the total energy balance of the Baltic States and increased the efficiency of the Baltic regulation market.

Other operating revenue also increased significantly in comparison with 2018 – from 1.9 million euros to 13.1 million euros. The main reason for the increase was the one-off contractual penalty from a contractor in the amount of 10.4 million euros.

Expenses

Operating expenses totalled 113.4 million euros (2018: 113.9 million euros). The expenses of the financial year decreased because the purchase of the balancing service energy decreased by 4.7% or 1.6 million euros (2018: 33.5% or 8.6 million euros). The decline in balancing energy expenses is related to the same reason as for the decrease in balancing energy revenue, as the balancing service is an area of activity that does create profit. Energy network losses during the financial year were 9.5% or 1.8 million euros lower than in 2018 (2018: 61.1% or 7.1 million euros more). The main reason for the decrease in energy losses was the decrease in physical quantities as well as a certain decrease in the purchase price of electricity. Labour expenses increased by 10.0% or 0.9 million euros in comparison with 2018 and amounted to 9.6 million euros (2018: 8% or 0.6 million euros). In 2019, the company had on average 25 more employees than in 2018.

Depreciation expenses have increased in relation to additional significant investments by 6.3% or 2.2 million euros, amounting to 36.9 million euros (2018: 0.7% or 0.2 million euros).

Operating profit for the financial year amounted to 41.8 million euros (2018: 31.0 million euros).

Net financial expenses amounted to 2.1 million euros (2018: 7.3 million euros). The decrease in financial expenses was mainly caused by the redemption of the bonds issued in 2011 and the issue of new bonds in 2018. The coupon rate of the bond issued in 2018 is 0.875%, which is 3.75% less than the interest of the bond issued in 2011. Elering has issued bonds for 225 million euros in total. Corporate income tax amounted to 6.8 million euros (2018: 5.0 million euros). Net profit for financial year amounted to 32.8 million euros (2018: 18.6 million euros).

Investments

The company's investments can be divided into ordinary and cross-border investments. The usual investments are related to the replacement of depreciated parts of the electricity and gas network as well as the development of the network, connection assets, etc. On average, such investments amount to approximately 29 million euros per year.

The biggest investments in 2019 were related to the cross-border natural gas pipeline Balticconnector. This pipeline connects the gas transmission networks of Estonia and Finland, which in turn improves the security of supply in Estonia and Finland and made it possible to launch the natural gas market that covers Finland, Estonia and Latvia at the start of 2020. The total cost of the Balticconnector cluster exceeds 300 million euros, the majority of which was covered by the European Union at the maximum rate of 75 per cent.

In addition to ordinary investments, Elering has also initiated an intensive special investments programme. These are investments in the construction of cross-border energy networks. A more detailed description of this is provided in the Annual Report's section on Development of the energy systems. The projected amounts of cross-border investments are shown in the table below.

Million euros	*Total investment*	*<=2019*	*2020-2024*	*2025+*	*Investment*
Estonian-Latvian third electricity interconnector	81	54	26	0	2017-2020
Synchronisation	371	0,2	272	99	2018-2025
Estonian-Finnish gas interconnector	140	118	22	0	2013-2020
Estonian-Latvian gas interconnector	48	30	18	0	2015-2020
GIPL (Gas Interconnection of Poland-Lithuania)	1,5	0	1,5	0	2022
Total	**642**	**203**	**340**	**99**	

Financing

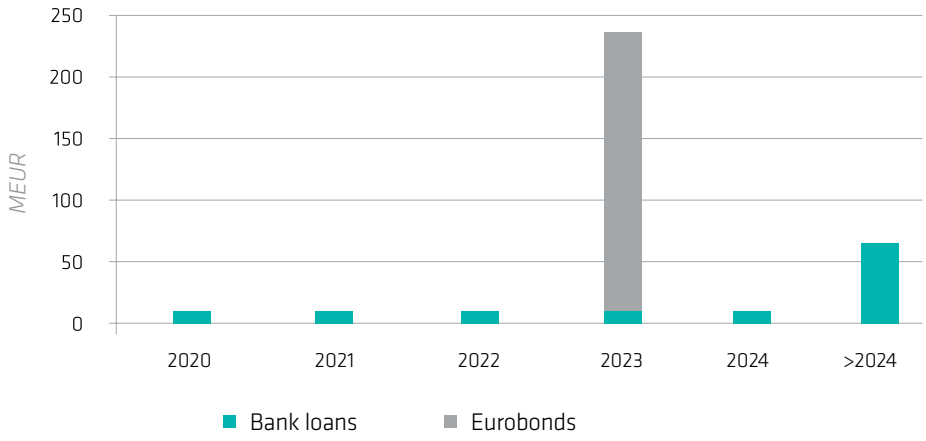
The Company has financed its investments from European Union funds as well as with loans and bonds. The company's interest-bearing liabilities as at the balance sheet date are as follows:

Million euros	*2018*	*2019*
Depreciable portion of long-term bank loans with average interest rate of 0.19% (2018: 0.19%)	10.6	10.6
Total short-term interest-bearing liabilities	**10.6**	**10.6**
Eurobonds with 0.875% coupon rate (until July 2018: 4.625%)	224.3	224.4
Long-term bank loans with average effective interest rate of 0.69% (2018: 2.0%)	118.9	108.3
Total long-term interest-bearing liabilities	**343.2**	**332.7**
Total interest-bearing payables	**353.7**	**343.3**

Elering has issued Eurobonds at the nominal value of 225 million euros. The Eurobonds are listed at the London Stock Exchange with a redemption deadline of 3 May 2023 and coupon rate of 0.875%.

Bank loans have been taken from the European Investment Bank and the Nordic Investment Bank. The balances of these loans as of 31 December 2019 were 92.6 million euros and 26.3 million euros, respectively (2018: 99.8 million euros and 29.7 million euros). The loans taken from the European Investment Bank and the Nordic Investment Bank are amortizing loans. The last repayment of the loans taken from the European Investment Bank will be made in 2030-2033 and the loan taken from the Nordic Investment Bank will be repaid in 2025-2032. The repayment schedule for debt obligations is as follows:

Repayments of dept obligations



In addition to interest-bearing liabilities, Elering also finances investments from sources that do not involve any interest expenses. The main source is the non-repayable aid received from the European Union. The company has entered into financing agreements with the EU INEA (Innovation and Networks Executive Agency) for financing the following projects:

a. electricity transmission line connecting Estonia and Latvia;
b. the offshore gas pipeline connecting the Estonian and Finnish gas networks along with the accompanying infrastructure;
c. strengthening the connection between Estonian and Latvian gas networks.

In addition to this, on 15 February 2019, the European Commission approved the proposal of the Connecting Europe Facility Coordination Committee to grant non-repayable aid for financing the investments of the first stage of synchronisation in the amount of 141 million euros.

Summary of expected EU aid for cross-border investments:

Million euros	*EU aid, projected*	*incl. EU aid, decided*	*Receipt of EU aid, <=2019*	*Receipt of EU aid, 2020-2024*	*Receipt of EU aid, 2025+*
Total	**361**	**310**	**80**	**220**	**61**

Another source of financing that does not involve any interest expenses is congestion income. This appears when the differences in prices occur between different price areas (countries) and the power exchange transfers the funds that were accrued as a result of the price differences to the transmission network operators. In accordance with EU legislation, the congestion income must only be used in order to increase cross-border transmission capacity. As at the end of 2019, Elering has received 87.5 million euros of congestion income (75.1 million euros as at the end of 2018).

Assets built with both EU aid and congestion revenue do not count towards regulated assets, so their capital costs are not included in regulated asset base and hence in network tariffs.

LEADING ROLE OF ELERING IN THE DIGITALISATION OF THE EUROPEAN ENERGY MARKETS

Elering believes that the digitalisation of the energy sector supports the optimisation and development of the market and this in turn is the most efficient way of guaranteeing security of supply. Elering initiated the digital transformation of the company in 2018 by creating a digitalisation vision and converting the vision into specific actions. Special programmes have been launched for implementation of the vision and all the actions are coordinated by a digitalisation steering group that consists of the representatives of different structural units. For example, the digitalisation programmes focus on the collection and analysis of data on the assets of the electricity and gas transmission network, risk-based asset management options, smart solutions in energy system management and system reliability, and in the area of markets, free access to energy data with secure cross-border data exchange.

The energy sector is undergoing rapid changes. The share of production equipment with unpredictable production cycles, participation of consumers in the energy market and the integration of neighbouring systems are growing fast. Coping with said changes alone is not an objective of Elering. We want to step into the leading role in this process and guarantee the biggest socioeconomic benefits possible via better management of the processes.

Information technology possibilities are developing as changes are occurring in energy. Increasingly more measurement data exist, the capacity to analyse data is increasing in terms of hardware and software alike and devices are increasingly better connected to one another. This makes it possible to control the work of many devices better and more accurately as well as plan systems and direct investments better.

Elering performs three main functions to guarantee security of supply: management and operation of the electricity and gas transmission infrastructure, management of the electricity and gas system and guaranteeing the functioning of the energy markets, including balance management and the process of changing the energy seller. The described changes in the fields of energy and information technology have an impact on all three main functions of Elering.

The goals of Elering in digitalisation by area are as follows:

- Elering uses measurement data and big data analysis in asset management, making optimal investments and discovering problems before they appear. Asset maintenance and investments are prioritised on a risk-basis.

- Elering develops the software solutions required for controlling the energy systems of the entire region. We also improve the accessibility of data from substations and installations, which allows us to increase the value of the data.

- In market development, Elering holds the leading position in Europe in the creation of digital solutions for energy markets, which focus on the empowerment of consumers and can be scaled across Europe.

The success story of Elering in the digitalisation of energy markets is based on the data warehouse built in 2013, the 100% transition to smart meters and the high digitalisation of the Estonian society, including the widespread use of the ID card and the X-road solution, which have given Elering an advantage in comparison with the other transmission networks in Europe. The initiatives in the energy market digitalisation cluster are as follows:

- the Energy Data Access Alliance, which allows consumers to share their energy measurement data with third parties throughout Europe
- the flexibility market platform, which allows consumers to buy and sell their energy and capacity on all of the respective markets, including system services
- the renewable energy platform, which allows consumers to see the origin of the energy they have consumed.

INCREASING IMPORTANCE OF CYBERSECURITY

Elering manages information systems that are important to the functioning of the electricity and gas systems and are critical to the functioning of electricity and gas markets. Elering works hard on various options of increasing cybersecurity in order to guarantee their security. No security incidents, which would have caused interruptions in the energy flow transmitted to consumers, occurred in 2019.

Elering created a cybersecurity function in recent years, which is aimed at the development of cross-company security policies, management of security risks, management of security incidents and coordination of activities that improve security. Enhanced capacity allows Elering to contribute more to the design of secure systems and processes and raise the security awareness of the employees and partners. We are also giving increasingly more attention to the use of modern technology in guaranteeing cybersecurity.

Communication with partners in Estonia and abroad is important to the development of cybersecurity – Elering contributes actively to increasing the Estonian cybersecurity network, e.g. we practised cooperation with state authorities at the Cyberstorm (Kübertorm) training event in 2019. We also participate in the cybersecurity working group of the ENTSO-E network and have been a member of ENCS, the non-profit organisation of the European energy companies that value cybersecurity, since early 2020.

CONTRIBUTION OF ELERING TO THE ACHIEVEMENT OF EUROPEAN CLIMATE GOALS

The European Union has set itself very ambitious goals in reducing carbon emissions in the energy sector by 2030+. Thus, the need to increase the share of renewable energy will be one of the most important factors in the development of the gas and electricity network in the near future. Estonia has set three main national goals for 2030 in order to support the European Union's goals of reducing carbon emissions:

- to reduce greenhouse gas emissions by 40 per cent in comparison with 1990
- to generate 27 per cent of energy from renewable energy sources
- to increase energy efficiency by 27 per cent.

The long-term goal of Estonia is to have an economy by 2050 that is competitive but with a low CO_2 intensity by reducing CO_2 emissions by 80-95% in comparison with the reference year (1990).

The achievement of the aforementioned goals sets high challenges for the development of the electricity and gas networks. The developments in the electricity and gas system are characterised by the following trends:

- large quantities of inverter-based and fluctuating energy generation will be added to the network

- the need for short- and long-term flexibility (incl. storage capability) will increase

- the use of fuel with a lower CO_2 content will increase.

Elering has launched the energy network initiative of the Baltic Sea countries for achievement of the European climate policy goals. The cross-sectoral planning of electricity and gas networks and the development of the respective practical solutions will make it possible to reduce CO_2 emissions faster and cheaper in comparison with the separate development of networks. The contact points of electricity and gas systems are various technological solutions from the generation of power from gas (e.g. gas turbine power station) and from hybrid technologies (e.g. hybrid heat pumps) to the production of gas from power (Power-to-Gas, e.g. electrolysis and methaning, or Power-to-X). Closer cooperation between electricity and gas systems helps achieve the climate goals in a more cost effective manner by using the synergy between the two systems.

Although there is still a lot of insecurity in the development of the connections between the power and gas sections, such as the level of electrification of end consumption, the potential for biomethane and hydrogen production and consumption, the development of power-to-gas technologies and the speed of the transfer to electrical and gas transport, planning the development of the power and gas infrastructure must involve certain coordination in order to maximise the efficiency of the investments.

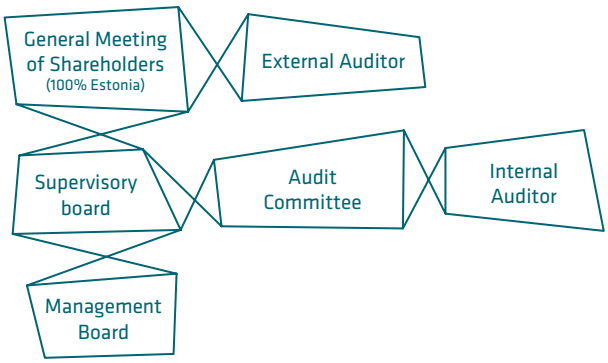
As an operator of the power and gas transmission infrastructure, Elering plans to invest in both infrastructures proceeding from the total socioeconomic benefits of the entire energy sector. Transporting gas instead of electricity and vice versa may become reasonable in the future. The prices of new technologies tend to decrease and the importance of environmental restrictions upon the development of new infrastructure is growing. Based on the above, Elering will map the bottlenecks of the development of the electricity and gas infrastructure and analyse the options of cross-using the infrastructure.

CORPORATE GOVERNANCE

The corporate governance of Elering is based on the Commercial Code, the State Assets Act, the articles of association of Elering and the Corporate Governance Code prepared by the Financial Supervision Authority and the OMX Tallinn Stock Exchange.

Elering has committed itself to following the Corporate Governance Code and wishes to grow further in this area. We consider this a prerequisite for achieving our strategic goals and shaping our organisational culture. Good governance has been implemented in Elering in such a manner that all employees work for the achievement of the company's goals. A more detailed report regarding compliance with the GCGC in 2019 is available on the website of Elering at **www.elering.ee/en/investors#tab2.**

CORPORATE GOVERNANCE STRUCTURE



GENERAL MEETING OF SHAREHOLDERS

The general meeting is the highest managing body of Elering. The general meeting is competent to amend the articles of association, increase and decrease the share capital, elect and remove members of the supervisory board, elect auditors, designate a special audit, approve the annual report and distribute profit and decide on the merger, division, transformation and/or dissolution of the company. In addition to the Commercial Code, the general meeting consults the State Assets Act in carrying out its activities (calling the meeting, disclosing information, etc.).

The owner is represented at the general meeting by the Minister of Economic Affairs and Infrastructure, who was Kadri Simson until 28 April 2019 and is Taavi Aas from 29 April 2019 until the end of the financial year.

One general meeting was held during the year on 7 May 2019, where the annual report for 2018 and distribution of profit were approved.

SUPERVISORY BOARD

The owner's interests in the company are guaranteed by members of the supervisory board. The supervisory board issues guidelines for the management board of the company and supervises the activities of the company's management board. The supervisory board regularly reviews and evaluates the company's strategy, main activities, risk assessments, the annual report and the budget.

In accordance with the articles of association, the meetings of the supervisory board are held when necessary but no less frequently than once every three months.

Composition and remuneration of the supervisory board

The supervisory board consists of three to five members. The number of members of the supervisory board is decided and the members of the supervisory board are elected and removed by the representative of the owner, i.e. the Minister of Economic Affairs and Infrastructure, on the basis of recommendations made by an independent Appointments Committee. The work of the supervisory board is organised by the chairman of the supervisory board. The chairman of the supervisory board sets the agenda for supervisory board meetings, chairs the meetings, observes the efficiency of the work of the supervisory board, organises the operational communication of data to members of the supervisory board, ensures that the supervisory board has enough time for preparing resolutions and examining data and represents the supervisory board in communication with the management board of Elering. In order to organise the work of the supervisory board, the general meeting has established a work procedure for the supervisory board.

Four annual and two special meetings were held in 2019. The supervisory board approved the annual report for 2018 before submitting it to the annual general meeting of shareholders for approval and approved Elering's strategy for 2020-2025 and the 2020 business and investment budgets. At its meetings, the supervisory board usually addresses issues arising from regulations and laws, financial issues, internal control and other important issues concerning the main activity of Elering.

In 2019, the following persons were members of the supervisory board of Elering:

- Timo Rajala (entrepreneur), chairman of the supervisory board as of 14 June 2017, attended four meetings and two special meetings and participated in three electronic votings

- Timo Tatar (Head of the Energy Department, Ministry of Economic Affairs and Communications) as of 26 March 2012, attended four meetings and two special meetings and participated in three electronic votings

- Indrek Kasela (entrepreneur) as of 21 August 2016, attended four meetings and one special meeting, voted electronically in one and participated in three electronic votings

- Tarmo Porgand (Deputy Head of the State Assets Department, Ministry of Finance) as of 22 May 2017, attended four meetings and two special meetings and participated in three electronic votings

- Toomas Põld (entrepreneur) as of 22 May 2017, attended four meetings and two special meetings and participated in three electronic votings.

The remuneration including taxes paid to the members of the supervisory board of Elering AS in 2019 was 71.8 thousand euros (2018: 71.8 thousand euros). There is no provision for the payment of severance benefits or other benefits to members of the supervisory board. The authorities of the members of the supervisory board will expire in the end of 2020 and a new supervisory board will be elected.

Members of the supervisory board must meet the requirements prescribed for members of a supervisory board in the Commercial Code and the State Assets Act and comply with the obligations imposed on the members.

MANAGEMENT BOARD

The management board is a managing body of Elering that represents and manages the everyday activities of the company in accordance with the requirements of law and the articles of association of the company and organises the accounting of the company. The management board of Elering has full discretion, and day-to-day management decisions are made independently of the owner and the supervisory board. The management board needs approval from the supervisory board for transactions and operations that go beyond the day-to-day economic activities of the company. The management board must ensure that the members of the supervisory board are adequately informed of the economic situation of the company and the most important circumstances with regard to economic activity and inform the supervisory board of the most important circumstances with regard to economic activity, as necessary.

Composition and remuneration of the management board

In accordance with the articles of association, the management board may have one to three members. A member of the management board is elected by the supervisory board for up to five years. According to the articles of association of Elering, the company may be represented in all legally binding acts jointly by two members of the management board or alone by the chairman of the management board.

A person authorised by the supervisory board concludes contracts with members of the management board, which set out more precisely the rights and obligations of the management board member with regard to the company and specify the member's remuneration.

The management board of Elering had three members throughout 2019:

- Taavi Veskimägi as the chairman of the management board performs, among other things, the daily responsibilities of Elering's CEO, i.e. manages and represents the company, ensures that activities are in compliance with contracts and relevant laws, organises the work of the management board, coordinates the development of the company's strategy and leads its implementation.

- Peep Soone as a member of the management board serves as the CFO, managing the financial activities and the fields of administration and information technology at Elering.

- Kalle Kilk as a member of the management board performs, among other things, the daily tasks of the head of asset management.

The authorities of Peep Soone expired on 31 December 2019 and the new member of the management board as of 1 January 2020 is Riina Käi, who also serves as the CFO, managing the financial activities and the fields of administration, information technology and renewable energy at Elering.

According to the articles of association, a member of the management board may be remunerated only on the basis of a management board member contract previously concluded with the member. A member of the management board may also be paid additional remuneration, taking into account their performance, of up to four months' regular remuneration. Bonuses may be paid on the basis of annual results or on any other grounds according to a resolution of the supervisory board. The remuneration of the members of the management board is fixed and stipulated in the contract concluded with the management board member. No long-term bonus schemes have been established at Elering. Severance pay may be paid to

a member of the management board only if the member is removed on the initiative of the supervisory board before the member's membership term expires.

The remuneration including taxes paid to members of the management board of Elering AS in 2019 was 494.7 thousand euros (2018: 528.1 thousand euros).

Prevention of conflicts of interest

Members of the management board do not make decisions based on their personal interests and do not use the business offers directed at Elering in their personal interests. A member of the management board notifies the supervisory board and other members of the management board of any conflicts of interest prior to the conclusion of their contract and without delay upon its subsequent occurrence. A member of the management board promptly informs other members of the management board and the chairman of the supervisory board of any business offers related to the company's economic activities directed at the member of the management board, their relatives or other related persons.

The requirement to avoid any conflicts of interest is stipulated in the contract concluded with the member of the management board.

A member of the management board avoids any conflicts of interest arising between the interests of the company and the member of the management board and informs the Elering supervisory board of its direct or indirect interest in the transactions carried out by the company and immediately informs the supervisory board if a conflict of interest occurs or if a situation occurs in which such a conflict may arise. The supervisory board decides on the conduct of transactions with a member of the management board or the conduct of transactions involving the personal interest of a member of the management board and also specifies the terms of such transactions.

Members of the management board must declare any related parties, and the amounts of transactions executed with said related parties are disclosed in the annual report. Elering did not conclude any transactions with members of the management board or parties related to them in 2019 (no transactions were concluded with member of the management board or parties related to them in 2018).

AUDIT COMMITTEE

The supervisory board elects the audit committee, which has up to five members and is responsible for exercising supervision over risk management, internal control and financial reporting. The Committee advises the supervisory board in the area of accounting, financial reporting, verifying the independence of the sworn auditor, risk management, internal control and audit, exercising supervision and preparation of the budget as well as the legality of activities.

Members of the committee are elected for a term of three years and the members elect a chairman from among themselves who organises the activities of the audit committee. The chairman of the supervisory board may not chair the audit committee. The remuneration paid to the members of the Audit Committee for participation in the Committee in 2019 was 5.0 thousand euros (4.7 thousand euros in total in 2018). The members of the Audit Committee in 2019 were:

- Timo Tatar (Head of the Energy Department at the Ministry of Economic Affairs and Communications)
- Indrek Kasela (entrepreneur)
- Tarmo Porgand (Deputy Head of the State Assets Department, Ministry of Finance)

The Audit Committee held four meetings in 2019: on 21 March, 19 September, 19 September and 6 November (four times in 2018). The Audit Committee dealt with the following internal audits: occupational safety, human resources management and assessment of renewable energy projects. It also reviewed the audit plan, assessed the work of the external auditor, analysed the topics of internal control and financial reporting. The internal audit service is outsourced from the external service provider. The internal auditor was paid 11.7 thousand euros for their service in 2019 (2018: 15.8 thousand euros).

COOPERATION BETWEEN THE MANAGEMENT BOARD AND THE SUPERVISORY BOARD

The management board and the supervisory board work in close co-operation to best protect the interests of Elering. They work together to develop the strategy of the company. The management board follows the strategic guidelines provided by the supervisory board when making management decisions.

The management board regularly informs the supervisory board of all material circumstances regarding the planning of the company's activities and business activities and draws special attention to significant changes in Elering's business activities. The management board forwards information to the supervisory board, including any financial reports, in a timely manner before the supervisory board meeting. At the request of the supervisory board, a member of the management board provides the supervisory board with oral or written information regarding the activities of the management board and the company and provides the supervisory board access to any information concerning the management board and the activities of the company.

The management of the company is governed by relevant laws, the articles of association and the decisions of and the goals set by the general meeting and the supervisory board meetings.

DISCLOSURE OF INFORMATION

The website of Elering (www.elering.ee) presents a separate list of data that is subject to disclosure pursuant to legislation. The website presents annual reports, financial results, performance indicators, an overview of principal activities, the structure of Elering, a summary of its strategy, news and announcements as well as other information necessary for investors and the general public. The website is also available in English. The information (incl. news and announcements) on the website is constantly updated.

FINANCIAL REPORTING AND AUDITING

The management board of Elering publishes the annual report every year and the quarterly financial results during the financial year. The annual report has been prepared in accordance with IFRS standards and audited in compliance with ISA guidelines. At the invitation of the supervisory board, the auditor of the company also attends the meeting of the supervisory

board. The annual report, which is signed by the members of the management board, is submitted to the general meeting for approval. A supervisory board report regarding the annual report is submitted to the general meeting along with the annual report.

Elering elects an external auditor by following a public procurement procedure. Tenders are only requested from companies that offer services of internationally recognized quality.

The external auditor is elected by the decision of the general meeting, and the contract for auditing services is concluded by the management board. The contract to be entered into with the auditor sets out the auditor's duties, schedule and remuneration. A contract to be entered into with an auditor may not obstruct the auditor in any way in auditing the activities of the company.

A new procurement for finding an auditor for the period from 2017 to 2021 was carried out in spring 2017. The procurement was won by AS PricewaterhouseCoopers. In carrying out the external audit, the company complies with the laws of the Republic of Estonia, international auditing standards and the risk management rules of the audit firm, including European Union Regulation on audit activities that entered into force in 2016. In 2019, Elering paid 12.3 thousand euros for the audit of the annual report on the basis of the submitted invoices (2018: 12.0 thousand euros).

The activities of the external auditor are overseen by the audit committee pursuant to the Auditors Activities Act.

The activities of the external auditor are overseen by the audit committee pursuant to the Auditors Activities Act. In addition to the audit of the financial statements, the external auditor has provided the following services during 2019:

- an assurance engagement on Activities report in accordance with Electricity Market Act § 17;
- report on audit findings to the National Audit Office of Estonia;
- performed transactions legality control in accordance with requirements of the National Audit Office of Estonia;
- tax advice and some other advisory services that are permissible in accordance with the Auditors Activities Act.

RISK MANAGEMENT AND INTERNAL CONTROL SYSTEM

The risk management of Elering is in compliance with the ERM (Enterprise Risk Management) principles. The risk management objectives in Elering are as follows:

- to manage and describe risk management processes in the company
- to define the roles and responsibilities of the parties to the risk management process
- to ensure that all risks are identifiable, assessable and able to be responded to
- to help managers better understand and manage risks

The principles of the risk management policy in Elering must ensure that:

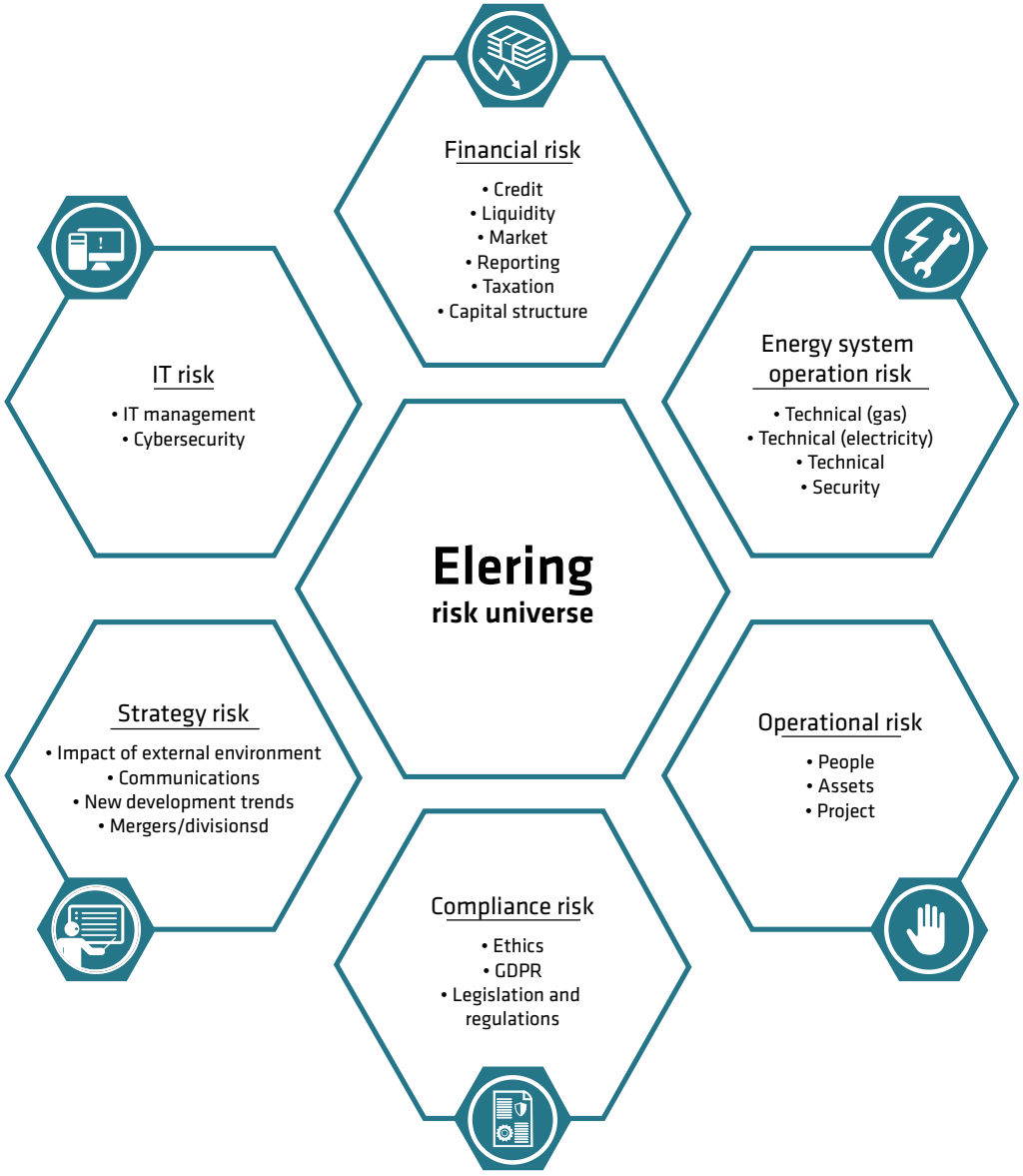
- the culture, processes and structure of the company encourage the fulfilment of the strategic objectives of the company and at the same time the identification, management, monitoring and, if possible, hedging of risks;

- the company's risk monitoring and management and the internal control system are all based on the internationally recognized risk management model Enterprise

Risk Management (ERM) Model, developed by the COSO (Committee of Sponsoring Organisations of the Treadway Commission), a joint initiative to promote good governance;

- all relevant legislation, standards, regulations and contractual obligations as well as requirements and expectations arising from society are taken into account in managing the risks of the company; and
- we continuously improve the risk management activities in the company.

Elering has mapped its risk universe.



The most important risks according to the risk register are:

- data leaks, destruction and breaches;
- the risk of disruption of IT systems;
- breaches in the terms and conditions of loan agreements;
- the partial or full blackout of the electrical system;
- the switch-off of electrical equipment with a significant impact;
- the lack of capacity for re-energising the shut-down electrical system;
- the lack of capacity for regulating frequency (long-term);
- the lack of access to gas stocks for protected customers;
- the refinancing of debts;
- the unexpected islanding of the Baltic electricity system.

The management board is responsible for the functioning of the company's internal control system. In order to ensure the functioning of the system, the internal auditor service is outsourced to an audit company. The internal auditor reports to the Audit Committee.

KPMG Baltics OÜ provided the internal audit service to the company from 2017-2019. In performing the internal audit function, the company is guided by the legislation of the Republic of Estonia and internal audit guidance issued by the Institute of Internal Auditors (IIA), including the Regulation of the European Union related to the field of audit that came into force in 2016. As of 2020, the internal audit service is provided by Ernst & Young Baltic AS and the contract signed with them remains in force until the end of 2022.

The internal audit represents an independent and objective action designed to provide security and advice for, add value to and improve the activities of the company. This helps the company achieve its goals using a systematic and orderly approach to assessing and improving risk management and the effectiveness of control and management processes. The function of the internal audit, which is independent from the areas being assessed, is to report to the Audit Committee of the company.

EQUAL TREATMENT

Pursuant to the Electricity Market Act, system responsibility is attached to Elering as a system operator, which means that it is obliged to ensure the security of supply and balance of the electricity system at all times. The system operator exercises its rights and performs its obligations in compliance with the principles of equal treatment.

In order to ensure equal treatment, Elering has established internal procedures and, based on the legislation of the Republic of Estonia and of the European Union (including network codes), has compiled various standard conditions, methodologies and other rules that have been published on the website of the company and approved by the Estonian Competition Authority.

BUSINESS ETHICS

It is important to Elering that all of its employees and managers adhere to the highest ethical standards. Corruption in any shape or form is impermissible. It is important that our activities are transparent and comply with all laws and ethical standards. The company has established a code of ethics as well as guidelines for the prevention of corruption and conflicts of interest. Regular training is also carried out among employees.

ORGANISATION AND PEOPLE

234 people worked at Elering as at the end of 2019 (2018: 220 people). Employees' average length of employment is just over 13 years and the average age is almost 44 years. Around three-quarters of the employees are men.

Elering is characterised by low labour turnover – voluntary turnover in 2019 was only 4.8% (2018: 5.1%). Low labour turnover is a strategically important indicator for maintaining the high level of competence necessary for the main activities of Elering. To maintain this level, it is important to engage in good dialogue with employees to better understand their expectations and involve them in the development of the organisation.

The vast majority of our employees are university graduates, and nearly half of Elering's employees have a Master's or a doctoral degree. Elering supports the integration of work and study and encourages its specialists to pursue professional and personal development. Elering offers flexible working arrangements and additional days of study leave to employees who are acquiring an education or continuing their education. In order to maintain Elering's reputation as an attractive employer in the energy sector among students, the company awards Elering scholarships and invites students to complete their apprenticeship at Elering. In the scope of the scholarship programme, graduate students and doctoral students studying at Estonian universities receive support to conduct research on cutting-edge topics related to energy. The scholarship programme is also a part of Elering's activities in the development of an energy centre of excellence. Students of sciences who have acquired basic knowledge of their field of study and want to work in the area of energy can participate in the programme. Traineeship consists of introductory seminars and trips to Elering's sites (substations, gas transmission and metering stations). Job-shadowing and information classes at schools are also used to introduce Elering to school and university students.

Human resources management and personnel related activities at Elering are guided by the human resources management policy of Elering, which focuses on the following key points: a unified company and a strong reputation as an employer, an inclusive management culture and systematic talent management. Based on the summary of the employee commitment survey carried out at the end of the year, the managers of Elering will prepare the action plan 'Our Elering' ('Meie Elering'), the implementation of which will be coordinated by the steering committee established for this purpose.

In 2019 the year started with an annual seminar for all employees of the company. In addition to the usual overview of the previous year's results and activities and the introduction of the objectives for the new year, the seminar included a presentation by the representative of ENTSO-E 'The Future of TSO on a Changing Energy Landscape', and the representatives of Fortum spoke to the attendees about the IT transformation of Fortum and what they gained from this. In order to involve employees in the annual strategy renewal process, an open strategic seminar takes place every spring, which gives all employees the opportunity to contribute to Elering's strategy. Elering's summer seminar Responsible Business (Vastutustundlik ettevõtlus) was held in late summer and responsibility from the viewpoint of Elering and the world was introduced via presentations, panels and teamwork.

In order to create better synergy between various activities and implement area-specific policies, we have created permanent steering groups within Elering's structure, which include specialists and managers from different structural units of Elering that enable the company to create synergies between various topics and provide broader perspectives and challenges for the employee. Cooperation in and between teams is also promoted through team-building meetings and team-to-team cooperation seminars.

Elering has a long tradition of cooperation and joint activities for the purposes of developing and maintaining a unified enterprise and cultivating team spirit. This allows new and experienced,

younger and older Elering employees to establish good contact by sharing their experiences and learning from one another. The company's annual joint events, such as the annual seminar, Elering's independence day reception, sports day, the summer seminar and the celebration of the establishment of a joint system operator in autumn, have all become great traditions. An event organisation team has been created to better organise events and guarantee that employees are valued, and they are responsible for organising the internal events of Elering.

We support a healthy lifestyle; therefore, in addition to the sports benefit, we also arrange various sporting events and weekly exercise sessions with instruction at the office. Compulsory health checks are carried out every two years, and employees aged 40+ can undergo an exercise stress test.

January 2019 was a month called "Recognize a Colleague" (Tunnusta kolleegi) and May was "Month of Health" (Tervisekuu) at Elering. During these thematic months, we offered our employees a variety of ways to recognize their co-workers and improve their own mental and physical wellbeing as well as that of their colleagues.

Approximately one fifth of Elering's employees will reach retirement age within the next five years. At the same time, fewer students are being accepted to specialities in the field of energy at universities. Elering cooperates with universities to promote energy education and create a pool of potential future employees – the previously mentioned apprenticeship programme is a part of this. An employer's reputation survey among energy students was carried out in 2019, which indicated that Elering is among the top three most preferred employers in this sector. Conducting the survey consistently and implementing the developments based on the feedback received from students of the speciality ensures that young people will continue to join Elering. We will also include more IT students in the apprentcieships.

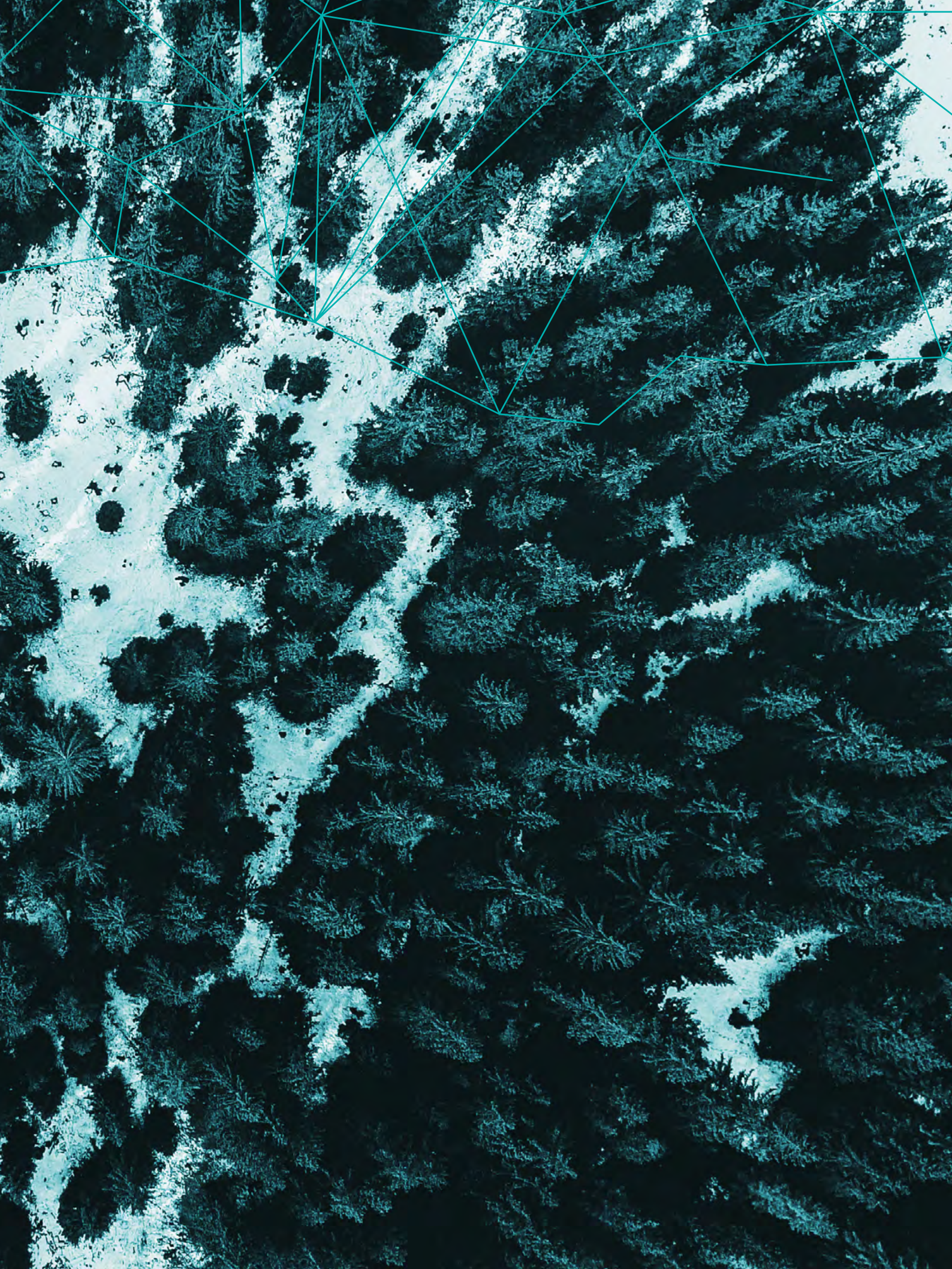
110 new employees have joined Elering over the last five years, which means that organising systematic induction and development activities is essential. The duration of the induction programme is approximately 2-3 months. In the course of the programme, new employees meet with representatives of different structural units and get an overview of the company's fields of activity and the work of different units, corporate values, culture and Elering's role and responsibility in society. Mentoring and supervision are part of the corporate culture.

In addition to training aimed at creating and maintaining professional competence, we also provide other training courses for general competencies that range from modern machine learning techniques and artificial intelligence to time management methodologies. The focus is on combining IT and energy competencies and exchanging knowhow within the company. In order to better distribute knowhow in the organisation, we have launched a series of 'Seminar Fridays', where Elering specialists introduce the latest developments in their field. The Elering Academy development programme is aimed at specialists with great development potential. In order to support the development of our managers, we prepared the good corporate governance practices of Elering with our managers and offered management training.

We are constantly striving to improve the work environment by gathering ideas and needs on a regular basis as well as through biannual collaborative discussions.

The company has created all the necessary conditions for people with special needs to be able to work in the same work environment (lifts, comfortable entry into rooms). Spacious, light and modern workplaces with a good inner climate have been created for all office employees. Employees working on transmission lines wear specific clothing and have comfortable auxiliary rooms for showering, dressing and drying their clothes. It is possible to use quiet and private workspaces and ergonomic tables and chairs in the office. A new and spacious office was opened in Tartu in 2019, which has extra workstations for remote work. The Jõhvi office also acquired new rooms. The interior design and style of the head office has been considered in both offices.

ELERING AND THE ENVIRONMENT



Elering is an infrastructure company of strategic importance and our main activity in ensuring the security of power supply in Estonia is directly related to the environment and has a significant impact on it. Environmental protection is part of our relationship with society and comes from a broader sense of responsibility embedded into the principles and values of Elering. Therefore, regular assessment of environmental impact, both according to its specific legal meaning and in the wider sense is a natural part of our daily activities.

We will now highlight our environmental activities in 2019.

SUBSTATIONS

The biggest environmental hazards where Elering's substations are concerned are oil that can leak from transformers, chemicals and hazardous waste (mainly batteries). Potential environmental hazards may also arise from substation transformers when taking oil samples and electrolyte samples from battery packs, wherein small amounts of hazardous substances may be released into the environment.

The oil collection systems of the transformers at Tsirguliina and Põdra substations were renovated during the reconstruction of substations in 2019 in order to reduce the potential environmental impact.

The equipment of working substations may cause noise that disturbs the surroundings. The noise emitted by substation equipment was measured at Aruküla, Kopli and Orissaare substations. The measurements indicated that no limit values were exceeded and there is no need to take extra measures in order to limit the transmission of noise.

LINE MAINTENANCE WORKS

51 km of old overhead lines were disassembled in relation to the construction of the Harku-Lihula-Sindi 330/110 kV overhead lines. In addition to building new lines, maintenance of the existing lines is also important. In 2019, 1,134 metres of oil-filled cables were disassembled, 21 masts and stands were utilised and 1,090 metres of overhead line cable and 12.4 km of lightning protection cable were disassembled and utilised.

GAS NETWORK OF ELERING

We made several investments in the gas transmission network, which increased the safety of the gas network and improved the overall condition of the environment. The investments made included the following:

- The diesel generators of Kuusalu, Jõgeva and Tartu gas distribution stations and Karksi metering station were replaced with generators that work on natural gas, which are characterised by more environmentally friendly emission levels and a lower noise level.

- The boilers of the heating systems of Kuusalu and Jõgeva gas distribution stations were replaced with the more economic natural gas boilers that operate under the condensation principle. The heating automation systems of Sindi, Pärnu, Vändra and Viljandi gas distribution stations were replaced, which guarantees that the gas fuel used in the boiler equipment is more optimally burnt and heat is better used.

- The natural gas odorization equipment of Sindi gas distribution station was replaced – the new equipment guarantees the lower volatilisation of the odorant to the surrounding environment via the pressure regulation pipeline.

- 2000 m of old gas pipelines were replaced. The new pipelines improve environmental safety. Three pipeline valve stations were renovated or added during the year, which guarantee the faster and safer operation of the gas pipelines.

- 10 cathodic protection stations of pipelines were replaced with automatic stations that consume less energy.

IMPROVEMENT OF THE COMPANY'S ENVIRONMENTAL AWARENESS

In order to prevent the potential negative environmental impact of our sites, we entered into an environmental management consultancy contract with consulting company Skepast & Puhkim OÜ in 2014.

ANNUAL REPORT

Statement of financial position

In thousands of euros	*Note*	*31.12.2019*	*31.12.2018*
ASSETS			
Current assets			
Cash and cash equivalents	7	42,347	62,716
Investments in equity instruments	2	1,900	0
Trade and other receivables	8	39,025	35,273
Inventories	9	3,687	3,936
Total current assets		**86,959**	**101,925**
Non-current assets			
Investments in equity instruments	2	0	1,946
Property, plant and equipment	10	919,956	831,533
Intangible assets	11	17,441	12,970
Total non-current assets		**937,397**	**846,449**
TOTAL ASSETS		**1,024,356**	**948,374**
LIABILITIES			
Current liabilities			
Borrowings	12	10,577	10,558
Trade and other payables	13	46,670	29,005
Total current liabilities		**57,247**	**39,563**
Non-current liabilities			
Borrowings	12	332,751	343,160
Deferred income	14	246,091	180,825
Total non-current liabilities		**578,842**	**523,985**
TOTAL LIABILITIES		**636,089**	**563,548**
EQUITY			
Share capital	15	229,890	229,890
Revaluation reserve	2	-46	0
Statutory reserve capital	15	14,686	13,754
Retained earnings	15	143,737	141,182
TOTAL EQUITY		**388,267**	**384,826**
TOTAL LIABILITIES AND EQUITY		**1,024,356**	**948,374**

The notes on pages 52 to 93 are an integral part of these financial statements.

Statement of comprehensive income

in thousands of euros	*Note*	*2019*	*2018*
Revenue	16	142,115	142,967
Other income	17	13,105	1,879
Goods, raw materials and services	18	-61,700	-65,182
Other operating expenses	19	-5,271	-5,303
Staff costs	20	-9,559	-8,691
Depreciation and amortization	10,11	-36,913	-34,719
Operating profit		**41,777**	**30,951**
Financial income	21	62	67
Financial costs	21	-2,183	-7,382
Profit before income tax		**39,656**	**23,636**
Income tax expense	15	-6,769	-5,000
Profit for the year		**32,887**	**18,636**
Impairment of investments in equity instruments	2	**-46**	**0**
Total comprehensive income for the year		**32,841**	**18,636**

The notes on pages 52 to 93 are an integral part of these financial statements.

Cash flow statement

in thousands of euros	*Note*	*1.01.2019-31.12.2019*	*1.01.2018-31.12.2018*
Cash flows from operating activities			
Profit before income tax		39,656	23,636
Adjustments for:			
· Profit from sale of property, plant and equipment	17	-78	-51
· Depreciation, amortization and impairment	10, 11	36,913	34,719
· Dividends received from long-term financial investments	17	-94	-68
· Government grants expended and amortized	17	-1,359	-1,193
· Interest expenses	21	2,177	7,378
· Interest income	21	-62	-67
· Changes in inventories	9	249	-209
· Changes in receivables and prepayments related to operating activities	8	-4,136	-7,492
· Changes in liabilities and prepayments related to operating activities	13	4,098	-8,604
· Changes in deferred income from connection and other service fees	14	2,260	1,884
Cash generated from operations		**79,624**	**49,933**
Income tax paid	15	-5,201	-5,000
Interest paid	13, 21	-2,282	-10,845
Interest received	8, 21	62	75
Net cash from operating activities		**72,203**	**34,163**
Cash flows from investing activities			
Purchases of property, plant and equipment and intangible assets	10, 11, 13	-117,553	-119,498
Grants to acquire non-current assets	14	51,657	7,532
Proceeds from sale of property, plant and equipment	10, 17	125	95
Deposits collected		0	40,000
Dividends received from long-term financial investments	17	94	68
Congestion fees received	8, 13, 14	13,091	7,338
Net cash used in investing activities		**-52,586**	**-64,465**
Cash flows from financing activities			
Repayments of bank loans	12	-10,558	-8,138
Repayments of lease liabilities	12	-28	0
Issue of bonds	12	0	224,159
Repayment of bonds issued	12	0	-225,000
Proceeds from contributions to equity	15	0	40,000
Dividends paid to the shareholders	15	-29,400	-20,000
Net cash from (used in) financing activities		**-39,986**	**11,021**
Net increase/decrease in cash and cash equivalents		**-20,369**	**-19,281**
Cash and cash equivalents at the beginning of the year	7	**62,716**	**81,997**
Cash and cash equivalents at the end of the year	7	**42,347**	**62,716**

The notes on pages 52 to 93 are an integral part of these financial statements.

Statement of changes in equity

in thousands of euros	*Share capital*	*Statutory reserve capital*	*Retained earnings*	*Revaluation reserve*	*Total equity*
Balance as of 1.01.2018	**189,890**	**12,898**	**143,402**	**0**	**346,190**
Comprehensive income for financial year	0	0	18,636	0	**18,636**
Total comprehensive income for the period	**0**	**0**	**18,636**	**0**	**18,636**
Transactions with owners:					
Contributions to equity	40,000	0	0	0	**40,000**
Transfers to statutory reserve capital	0	856	-856	0	**0**
Dividends paid	0	0	-20,000	0	**-20,000**
Total transactions with owners	**40,000**	**856**	**-20,856**	**0**	**-20,000**
Balance as of 31.12.2018	**229,890**	**13,754**	**141,182**	**0**	**384,826**
Comprehensive income for financial year	0	0	32,887	-46	**32,841**
Total comprehensive income for the period	**0**	**0**	**32,887**	**-46**	**32,841**
Transactions with owners:					
Transfers to statutory reserve capital	0	932	-932	0	**0**
Dividends paid	0	0	-29,400	0	**-29,400**
Total transactions with owners	**0**	**932**	**-30,332**	**0**	**-29,400**
Balance as of 31.12.2019	**229,890**	**14,686**	**143,737**	**-46**	**388,267**

More detailed information on share capital and other equity items is set out in Note 15.

The notes on pages 52 to 93 are an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

Note 1

ELERING AS AND ITS OPERATIONS

The financial statements of Elering AS ("Elering") for the year ended 31 December 2019 have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union. Elering is incorporated in the Republic of Estonia and its registered address is Kadaka tee 42, 12915 Tallinn, Estonia. Elering is engaged in electricity and natural gas transmission in the Republic of Estonia.

The business of Elering is subject to laws of the Republic of Estonia and European Union. Elering's transmission business and balancing service business are regulated by the Estonian Competition Authority, including the approval of network tariffs and standard terms and conditions of such services.

The sole shareholder of Elering AS is the Republic of Estonia.

The Management Board approved these financial statements on 28.02.2020. Pursuant to the Commercial Code of the Republic of Estonia, the annual report shall be presented for approval to Elering's Supervisory Board and the General Meeting of Shareholders.

Note 2

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Bases of preparation
These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union under the historical cost convention. The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated.

Segment reporting
Business segment disclosures are provided in a manner that operating results are regularly reviewed by Elering's chief operating decision maker. The chief operating decision maker responsible for the allocation of resources for business segments and the results of their operations is Elering's management board.

Functional and presentation currency
The financial statements of Elering are presented in thousands of euros which is Elering´s functional and presentation currency.

Foreign currency translation
Foreign currency transactions are translated into the functional currency using the exchange rates of the European Central Bank prevailing on the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies at year-end exchange rates are recognized in profit or loss.

Cash and cash equivalents
In the statement of cash flows, cash and cash equivalents include short-term (up to 3 months) highly liquid investments that can be converted to known amounts of cash and that lack significant risk of market value changes, incl. cash on hand, bank accounts and term deposits with original maturities of three months or less.

Financial assets

Classification
Elering classifies its financial assets in the following measurement categories:

- those to be measured subsequently at fair value (either through other comprehensive income or through profit or loss), and
- those to be measured at amortized cost.

The classification depends on Elering's business model for managing the financial assets and the contractual terms of the cash flows.

Recognition and derecognition
Regular way purchases and sales of financial assets are recognized on trade-date, the date on which Elering commits to purchase or sell the asset.

Financial assets are derecognized when the rights to receive cash flows from the financial assets have expired or have been transferred and Elering has transferred substantially all the risks and rewards of ownership.

Measurement
At initial recognition, Elering measures a financial asset at its fair value plus, in the case of a financial asset not at fair value through profit or loss (FVPL), transaction costs that are directly attributable to the acquisition of the financial asset. Transaction costs of financial assets carried at FVPL are expensed in profit or loss.

Debt instruments

Subsequent measurement of debt instruments depends on Elering's business model for managing the asset and the cash flow characteristics of the asset. All Elering's debt instruments are classified in amortized cost measurement category.

Assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest are measured at amortized cost. Interest income from these financial assets is included in finance income using the effective interest rate method. Any gain or loss arising on derecognition is recognized directly in profit or loss and presented in other income/expenses. Foreign exchange gains and losses and impairment losses are presented as separate line items in profit or loss.

As at 1 January 2019 and 31 December 2019, the following financial assets of Elering were classified in this category:

- trade receivables,
- bank deposits,
- cash and cash equivalents.

Equity instruments
Elering subsequently measures all equity investments at fair value. Where Elering's management has made an irrevocable election to present in other comprehensive income (OCI) the fair value gains and losses on equity investments that are not held for trading, there is no subsequent reclassification of fair value gains and losses to profit or loss following the derecognition of the investment. Dividends from such investments continue to be recognized in profit or loss as other income when Elering's right to receive payments is established.

Changes in the fair value of financial assets at FVPL are recognized in other income/expenses in the statement of profit or loss as applicable. Impairment losses (and reversal of impairment losses) on equity investments measured at FVOCI are not reported separately from other changes in fair value.

The following equity instruments of Elering are measured at FVOCI:

- shares of Nord Pool AS (until 2016 AS Nord Pool Spot). The principal business activity of Nord Pool AS Group, registered in Norway, is the organisation of electricity exchanges in the Nordic countries, Great Britain and the Baltic States. The investment was made with a long-term strategic goal of taking part in the decision-making process concerning the development of electricity market in the Nordic-Baltic region. As the shares are not held for trading, the management has made an irrevocable decision to measure the shares at FVOCI. In December 2019, Elering`s Supervisory Board made a decision to sell all the shares owned by Elering. The write-down has been done to the net selling price of the shares. The impairment loss of EUR 46 thousand is recognized in the statement of comprehensive income.

Impairment

Elering assesses on a forward-looking basis the expected credit losses ("ECL") associated with its debt instruments carried at amortized cost. The impairment methodology applied depends on whether there has been a significant increase in credit risk.

The measurement of ECL reflects: (i) an unbiased and probability weighted amount that is determined by evaluating a range of possible outcomes, (ii) time value of money and (iii) all reasonable and supportable information that is available without undue cost and effort at the end of each reporting period about past events, current conditions and forecasts of future conditions.

For trade receivables Elering applies a simplified approach permitted by IFRS 9 and measures the allowance for impairment losses at expected lifetime credit losses from initial recognition of the receivables. Elering uses a provision matrix in which allowance for impairment losses is calculated for trade receivables falling into different ageing or overdue periods.

For cash and cash equivalents and bank deposits where there is an investment grade it is considered there has been no significant increase in credit risk.

Prepayments

Prepayments are carried at cost less a provision for impairment. A prepayment is classified as non-current when the goods or services relating to the prepayment are expected to be obtained after one year, or when the prepayment relates to an asset which itself will be classified as non-current upon initial recognition. Prepayments to acquire assets are transferred to the carrying amount of the asset once Elering has obtained control of the asset and it is probable that future economic benefits associated with the asset will flow to Elering. Other prepayments are written off to profit or loss when the goods or services relating to the prepayments are received. If there is an indication that the assets, goods or services relating to a prepayment will not be received, the carrying amount of the prepayment is written down accordingly and a corresponding impairment loss is recognized in profit or loss.

Inventories

Inventories are initially recorded at cost, consisting of the purchase costs, production costs and other costs incurred in bringing the inventories to their present location and condition.

The purchase costs of inventories include the purchase price, customs duties and other non-refundable taxes and direct transportation costs related to the purchase, less discounts and subsidies. Inventories are expensed using the FIFO method.

Inventories are measured in the balance sheet at the lower of acquisition cost and net realisable value. Net realisable value is calculated by deducting estimated expenses that are necessary for preparing the product for sale and for completing the sale from the estimated sales price used in the ordinary course of business.

Property, plant and equipment

Property, plant and equipment are tangible assets that are used in business activities and the useful life of which is longer than one year. Property, plant and equipment are carried using the cost method, i.e. at historical cost less any accumulated depreciation and any impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the items. Other than the purchase price, cost of the acquired property, plant and equipment includes transportation and installation expenses, as well as other expenses directly related to acquisition and putting such assets into operation. Cost includes borrowing costs incurred on specific or general funds borrowed to finance construction of qualifying assets. Borrowing costs are capitalized if the borrowing costs and expenditures for the asset have been incurred and the construction of the asset has commenced. Capitalisation of borrowing costs is ceased when the construction of the

asset is completed or when the construction has been suspended for an extended period of time.

Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only if they meet respective criteria for property, plant and equipment. The carrying amount of the replaced part is derecognized. All other repairs and maintenance costs are charged to profit or loss during the financial period in which they are incurred.

If property, plant and equipment consist of components with significantly different useful lives, the components are recognized as separate items of property, plant and equipment.

Land is not depreciated. Depreciation of other items of property, plant and equipment is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives:

	Useful lives in years
Buildings	25-40
Facilities – electricity transmission lines, gas pipelines	30-60
Machinery and equipment – electricity and natural gas transmission equipment	7-40
Other property, plant and equipment	3-20

The expected useful lives of items of property, plant and equipment are reviewed during the annual stocktaking, when subsequent expenditures are recognized and in the case of significant changes in development plans. When the estimated useful life of an asset differs significantly from the previous estimate, it is treated as a change in the accoun¬ting estimate, and the remaining useful life of the asset is changed, as a result of which the depreciation charge of the following periods also changes.

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

Gains and losses on disposals and write-offs determined by comparing proceeds with the carrying amount are recognized in profit or loss under "Other income" or "Other operating expenses" respectively.

Intangible assets

ntangible assets are recognized in the statement of financial position only if the following conditions are met:

- the asset is controlled by Elering,
- it is probable that the future economic benefits that are attributable to the asset will flow to Elering,
- the cost of the asset can be measured reliably.

An intangible asset is initially recognized at its cost, comprising its purchase price, any directly attributable expenditure on preparing the asset for its intended use and borrowing costs that relate to assets that take a substantial period of time to get ready for use. After initial recognition, an intangible asset is carried at its acquisition cost less any accumulated amortization and impairment losses.

Acquired software licences are capitalized on the basis of the costs incurred to acquire and bring them to use.

Personal right of use
Payments made for rights of superficies and servitudes meeting the criteria for recognition as intangible assets are recognized as intangible assets. The costs related to rights of use of land are depreciated according to the contract period, not exceeding 100 years.

Intangible assets and personal of use are amortized using the straight-line method over their useful lives:

	Useful lives in years
Software licences	3-5 years
Personal rights of use	50-100 years

If impaired, the carrying amount of intangible assets is written down to the higher of value in use and fair value less costs of disposal.

Impairment of non-financial assets
Land and assets that are subject to depreciation/amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs of disposal and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets that suffered an impairment loss are reviewed for possible reversal of impairment on each reporting date.

Leases

Accounting policy starting from 1 January 2019

Leases are contracts that transfer the right to control the use of an asset for a specified period of time against payment. For such contracts, IFRS 16 requires the lessee to account for the asset and its lease liability. Assets used under the right of use are depreciated and interest is charged on the liability. Elering has applied a practical expedient for leases with a lease term of 12 months or less without call options and low value assets (immaterial leases). Payments made or received under such operating leases are recognized in the statement of comprehensive income on a straight-line basis over the period of the lease term. The principles of IFRS 16 for lessors remain substantially unchanged from those of IAS 17, namely that a lessor continues to classify its leases into operating and finance leases and recognizes those types of leases differently.

Accounting policies applied until 31 December 2018

Leases
Leases which transfer substantially all the risks and rewards incidental to ownership to the lessee are classified as finance leases. Other leases are classified as operating leases.

Elering as the lessee
Payments made under operating leases are charged to the statement of comprehensive income on a straight-line basis over the period of the lease.

Elering as the lessor
Operating lease payments are recognized as income on a straight-line basis over the lease term.

Financial liabilities
Financial liabilities have the following measurement categories: (a) held for trading which also includes financial derivatives and (b) other financial liabilities. Elering has financial liabilities only in the category of 'other financial liabilities'.

Other financial liabilities are initially recognized at fair value, net of transaction costs incurred and are subsequently carried at amortized cost. The amortized cost of current liabilities normally equals their nominal value; therefore, current liabilities are stated in the statement of financial position in their redemption value. Non-current liabilities are subsequently carried at amortized cost. The difference between the amortized cost and the redemption value is recognized as an interest expense in profit or loss over duration of the contract using the effective interest rate method. The borrowing costs associated with the qualifying assets meeting respective requirements are capitalized as part of cost of the assets.

A financial liability is classified as current when it is due within 12 months after the balance sheet date or Elering does not have an unconditional right to defer the payment for longer than 12 months after the balance sheet date. Borrowings with a due date of 12 months or less after the balance sheet date that are refinanced into non-current borrowings after the balance sheet date but before the approval of the annual report, are classified as current. Borrowings that the lender has the right to recall due to the violation of terms specified in the contract if such right is established by the balance sheet date are also classified as current liabilities.

Provisions and contingent liabilities
Provisions for liabilities and charges are non-financial liabilities of uncertain timing or amount. They are accrued when Elering has a present legal or constructive obligation as a result of past events and, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

Other possible or present obligations arising from past events but whose settlement is not probable or the amount of which cannot be measured with sufficient reliability are disclosed as contingent liabilities in the notes to the financial statements.

Development costs
Development costs are costs that are incurred in applying research findings for the development of specific new products or processes. Development costs are capitalized if all of the criteria for recognition specified in IAS 38 have been met. Capitalized development costs are amortized over the period during which the products are expected to be used. Expenses related to research carried out for collecting new scientific or technical information and training costs are not capitalized.

Share capital
Elering does not have any preference shares. Incremental costs directly attributable to the issue of new shares are recognized as a reduction of equity. Any excess of the fair value of consideration received over the par value of shares issued is recorded as share premium in equity.

Dividends
Dividends are recorded as a liability and deducted from equity in the period in which they are declared and approved. Any dividends declared after the balance sheet date and before the financial statements are authorised for issue are disclosed in the notes to the financial statements.

Statutory reserve capital
Statutory reserve capital is formed to comply with the requirements of the Commercial Code. Reserve capital is formed from annual net profit allocations. During each financial year, at least one-twentieth of the net profit shall be entered in reserve capital, until reserve capital reaches one-tenth of share capital. Reserve capital may be used to cover a loss, or to increase share capital. Payments shall not be made to shareholders from reserve capital.

Revenue

Revenue recognition. Revenue is income arising in the course of Elering's ordinary activities. Revenue is measured in the amount of transaction price. Transaction price is the amount of consideration to which Elering expects to be entitled in exchange of transferring control over promised goods or services to a customer, excluding the amounts collected on behalf of third parties. Elering recognizes revenue when it transfers control of a good or service to a customer.

Electricity transmission service. Elering measures the quantity of electricity transmission by remotely read metres in customers' connection points. The transmission service fees are calculated on the basis of the volumes of electricity transmitted in these points and regulated transmission tariffs. Revenue from providing services is recognized over time in the accounting period in which the services are rendered.

Natural gas transmission service. Elering measures the quantity of natural gas transmission by remotely read metres in customers' connection points. The transmission service fees are calculated on the basis of the volumes of natural gas transmitted in these points and regulated transmission tariffs. Revenue from providing services is recognized over time in the accounting period in which the services are rendered.

Electricity balancing service. Elering prepares on an hourly basis the energy balance in kilowatt-hours (kWh) of the Estonian electricity system that consists of the energy balances of Elering itself and balance providers that have entered into a balance agreement with Elering. Energy balances are prepared by comparing the measurement data of Elering and that received from distribution network operators with balancing plans of balance providers. In a trading period when the real consumption of electricity, based on the measurement data, is bigger than electricity volume presented in the energy balance, Elering sells the balance providers electricity to the extent of shortage. In a trading period when the situation is opposite, Elering buys electricity from the balance providers to the extent of surplus. The sale and purchase prices are calculated by Elering for each trading period using methodology approved by the Estonian Competition Authority. Elering has considered that it is a principal in selling electricity as part of providing the balancing service as Elering is ultimately responsible for keeping the system in balance. Revenue from providing services is recognized at a point of time in the accounting period in which the services are rendered.

Gas balancing service. Elering prepares on a daily basis the gas balance in kilowatt-hours (kWh) of the Estonian gas system that consists of the gas balances of Elering itself and balance providers that have entered into a balance agreement with Elering. Gas balances are prepared by comparing the measurement data of Elering and that received from distribution network operators with balancing plans of balance providers. In a trading period when the real consumption of natural gas, based on the measurement data, is bigger than natural gas volume presented in the gas balance, Elering sells the balance providers gas to the extent of shortage. In a trading period when the situation is opposite, Elering buys gas from the balance providers to the extent of surplus. The sale and purchase prices are calculated by Elering for each trading period using methodology approved by the Estonian Competition Authority. Elering has considered that it is a principal in selling gas as part of providing the balancing service as Elering is ultimately responsible for keeping the system in balance. Revenue from providing services is recognized at a point of time in the accounting period in which the services are rendered.

Recognition of connection fees. When connecting to the electricity network, the clients must pay a connection fee based on the actual costs of infrastructure to be built in order to connect to the network. The management has concluded that the connection fees do not represent a separate performance obligation from providing the ongoing network service, and thus the revenue from connection fees is deferred and recognized as revenue evenly over the estimated customer relationship period, being 25 years. Deferred connection fees are carried in the statement of financial position as long-term deferred income.

Interest income is recognized on an accrual basis using the effective interest method.

Congestion income
In situations where market participants place more requests for cross-border transmission of electricity than is technically possible, transmission rights for cross-border electricity are sold at special auctions (see below). Under the principle used in these auctions, 50% of auction proceeds belongs to the transmission system operator of either country. Types of the auctions:

1. Proceeds from the day-ahead market auction are essentially the difference between the exchange prices of Estonia and neighbouring price regions of the Nord Pool power exchange every hour. The power exchange collects the aforementioned price difference through its trading mechanism and transfers it to respective transmission system operators.

2. An auction of long-term transmission capacity, which is aimed at reducing the inter-regional price risk resulting from a lack of transmission capacity. Estonian and Latvian system operators Elering AS and AS Augstprieguma Tikls offer forward transmission rights (FTRs) (until 31 December 2018, Physical Transmission Rights (PTRs) on an annual, quarterly and monthly basis. Market participants that have bought an FTR capacity have the right to the hourly auction proceeds of the day-ahead market for the same volume. Auctions are organised and the proceeds distributed by the Single Allocation Platform (SAP) under the authority of the pan-European System Operators operated by the Joint Allocation Office (JAO). According to the regulators' decision, no long-term auctions are scheduled at the Finnish border for 2019 and 2018.

Net proceeds from the day-ahead market and FTR (until 31 December 2018 PTR) auctions are recognized in compliance with the requirements of Article 16 of Regulation (EC) No. 714/2009 of the European Parliament and of the Council, pursuant to which congestion income should be used in particular for the construction of new interconnection capacities between countries and for guaranteeing the actual availability of the allocated transmission capacity; if the proceeds cannot be used for these purposes, the proceeds will be taken into account when reducing the network service tariff.

If congestion proceeds are used for the construction of new interconnection capacities, then they are recognized in the financial statements similarly to the government grants. Initially, they are recognized as deferred income, and then are credited to income over the estimated useful life of the asset. If congestion proceeds are used for the reduction of tariffs, then proceeds are recognized as revenue in the period when Elering's right to receive proceeds from the day-ahead market and FTR auctions is established. Beginning from 1 July 2014 Elering has been using auctions proceeds for the construction of new interconnection capacities. See also Note 3.

Accounting for government grants
Government grants are recognized at fair value when there is a reasonable assurance that Elering will comply with all the conditions attached to government grants and that the grant will be received. The government grants are recognized in profit or loss on a systematic basis over the periods in which Elering incurs the related costs which the grants are intended to compensate.

Government grants are presented in the statement of financial position using the gross method, according to which the government grant is recognized at its cost, and if the government grant is received in the form of a transfer of a non-monetary asset, it is recognized at its fair value. The amount of the government grant received for the purpose of acquisition of assets is recognized as deferred income from government grants. The acquired asset is depreciated and the grant is credited to income over the estimated useful life of the asset.

Electricity inter-transmission system operator compensation mechanism (ITC)
ITC is a mechanism for the compensation of cross-border energy flows, as designated by the EU regulation No 838/2010, in which transmission system operators of over 30 countries participate. The mechanism works under the principle that a transmission system operator of a country compensates, through the ITC fund, the other transmission network operators for additional expenses caused by cross-border energy flows in case if that country has exported or imported electricity during the reporting period, and a transmission system operator receives compensation from the fund if a transit flow caused by market participants of other countries has crossed the country. Such accounting is kept by specifically authorised administrators in Switzerland, who submit to the members of the mechanism the data in the form of net amounts to be paid each month. Elering recognizes the net amounts in the statement of comprehensive income depending whether it is net income or net expense under "Revenue" within 'Revenue from other network services' or under "Goods, raw materials and services" within 'Other costs' respectively.

Subsidies to electricity producers
The law obliges Elering to participate in supporting mechanism for eligible electricity producers (first and foremost power plants using renewable sources of energy). Elering collects subsidies from consumers and distribution network operators and pays it out to those electricity producers who meet the criteria.

In accordance with current principles, Elering prepares an estimate of the amount of subsidies for the following calendar year, based on estimates on the amount of electricity produced by these producers, and the amount of network services to be provided to the end users in Estonia. Elering uses these estimates to determine the charge of subsidy for the following calendar year per kWh (kilowatt-hour) of network services, taking into account any difference between estimated and actual amounts of subsidies paid during the previous period (from November to October), interest earned on over collected amounts or interest paid on under collected amounts and justified expenses incurred for management of subsidies.

The customers are charged according to the estimated charge per kWh. For different reasons the actual amounts paid out and received as subsidies always differ from the estimated amounts. Over or under collected subsidies are shown in the statement of financial position as either "Trade and other payables" (in case of surplus) or "Trade and other receivables" (in case of deficit). These balances are taken into account when determining the charge for the next period as described above. Collecting and paying of subsidies has no material impact on profit or loss of Elering. See also Note 8 and 13.

Subsidies to biogas producers
In accordance with law, Elering must participate in the mechanism for subsidising biogas producers that are in compliance with the requirements provided for by law. Elering is compensated for biogas subsidies by the Ministry of Economic Affairs and Communications. Elering as a system operator organises entry into contracts with biogas producers, supervision of use of the subsidies and payment of the subsidies.

Activities necessary for the implementation of the contract are financed as a prepayment on the basis of a quarterly expenditure forecast submitted by Elering. For different reasons the actual amounts paid out and received as subsidies always differ from the estimated amounts. Over or under collected subsidies are shown in the statement of financial position as either "Trade and other payables" (in case of surplus) or "Trade and other receivables" (in case of deficit). Collecting and paying of subsidies has no material impact on profit or loss of Elering. See also Note 8 and 13.

Employee benefits
Employee short-term benefits include wages, salaries and social taxes, benefits related to temporary suspension of employment contracts (holiday or other similar pay). These benefits are recognized in profit or loss in the year in which the associated services are rendered by the employees of Elering. Any amounts unpaid by the balance sheet date are recognized as a liability.

If during the reporting period, an employee has provided services for which payment of compensation is to be expected, Elering will recognize a liability (accrued expense) in the amount of forecasted compensation, from which all amounts already paid, will be deducted.

Income tax
According to the Income Tax Act, the annual profit earned by entities is not taxed in Estonia. Income tax is paid on dividends, fringe benefits, gifts, donations, costs of entertaining guests, non-business-related disbursements and adjustments of the transfer price.

The tax rate on the net dividends paid out of retained earnings is 20/80. From 2019, tax rate of 14/86 can be applied to dividend payments. The more beneficial tax rate can be used for dividend payments in the amount of up to the average dividend payment during the three preceding years that were taxed with the tax rate of 20/80. When calculating the average dividend payment of three preceding years, 2018 will be the first year to be taken into account. The corporate income tax arising from the payment of dividends is recognized as a liability and an income tax expense in the period in which dividends are declared, regardless of the period for which the dividends are paid or the actual payment date. An income tax liability is due on the 10th day of the month following the payment of dividends.

Due to the nature of the taxation system, the companies registered in Estonia do not have any differences between the tax bases of assets and their carrying amounts and hence, no deferred income tax assets and liabilities arise. A contingent income tax liability which would arise upon the payment of dividends is not recognized in the statement of financial position. The maximum income tax liability which would accompany the distribution of retained earnings is disclosed in Note 15 to the financial statements.

Tax rates in Estonia
The following tax rates have been valid through 2019:

Tax	*Tax rate*
Social security tax	33% of the paid payroll to employees and fringe benefits
Unemployment insurance tax	0.8% of the payroll paid to employees
Fringe benefit income tax	20/80 of fringe benefits paid to employees
Land tax	1.0 - 2.5% on taxable value of land per annum
Excise tax on electricity	4.47 euros per MWh of electricity
Excise tax on gas	63.31 euros per thousand cubic meters
Corporate income tax on non-business-related expenses	20/80 on non-business-related expenses

Note 3

CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

Elering makes estimates and assumptions that affect the amounts recognized in the financial statements and the carrying amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Management also makes certain judgements, apart from those involving estimations, in the process of applying the accounting policies. Judgements that have the most significant effect on the amounts recognized in the financial statements and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities within the next financial year include:

Useful lives of property, plant and equipment
The estimated useful lives of items of property, plant and equipment (Note 10) are based on management's estimates regarding the period during which the asset will be used. The estimation of useful lives is based on historical experience and takes into consideration production capacity and physical condition of the assets. In the reporting period, depreciation amounted to EUR 35,249 thousand (2018: EUR 33,497 thousand). If depreciation rates were increased/decreased by 10%, the depreciation charge for the year would increase/decrease by EUR 3,525 thousand (2018: EUR 3,350 thousand).

Congestion income
According to the accounting principles described in Note 2, timing of recognition of congestion income depends on the purposes for which the proceeds is used – for constructions of new interconnection capacities or reduction of current network tariffs. The purposes are outlined in the Article 16 of European Parliament and Council Regulation (EC) No 714/2009. Since 1 July 2014 congestion income has been used for constructions of new interconnection capacities. In 2019 Elering recognized deferred congestion income in the amount EUR 12,708 thousand (2018: EUR 7,411 thousand); see also Note 14. Amounts accrued since 1 July 2014 are used to finance investments in network that will increase the cross-border interconnection capacity, i.e. the construction of the third electricity transmission line between Estonia and Latvia.

Note 4

NEW ACCOUNTING PRONOUNCEMENTS

Adoption of new or revised standards and interpretations
The following new or revised standards and interpretations became effective for Elering from 1 January 2019:

IFRS 16 "Leases"
(effective for annual periods beginning on or after 1 January 2019). The new standard sets out the principles for the recognition, measurement, presentation and disclosure of leases. All leases result in the lessee obtaining the right to use an asset at the start of the lease and, if lease payments are made over time, also obtaining financing. Accordingly, IFRS 16 eliminates the classification of leases as either operating leases or finance leases as is required by IAS 17 and, instead, introduces a single lessee accounting model. Lessees will be required to recognize: (a) assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value; and (b) depreciation of lease assets separately from interest on lease liabilities in profit or loss. IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently.

Elering has revised all existing Elering leases in the light of the new accounting policies in IFRS 16. As of the date of the transition, Elering, as a lessee, holds non-cancellable operating leases with an outstanding value of EUR 85 thousand, including low-value leases totalling EUR 26 thousand. Leases with a term of less than 12 months are still to be recognized as expenses in the statement of comprehensive income.

Elering has applied simplified transition approach since the beginning of 2019 and has not restated comparative information. Lease liabilities previously recognized as operating leases on 1 January 2019 were recognized at the discounted value of their remaining lease payments using the effective interest rate of the lease or, in the absence thereof, the alternative borrowing rate. Elering recognized rights-of-use assets and lease liabilities of EUR 59 thousand. Elering estimates that the company's net profit for 2019 will decrease by EUR 0.4 thousand due to new accounting principles.

There are no other new or revised standards or interpretations that are effective for the first time for the financial year beginning on or after 1 January 2019 that would be expected to have a material impact to Elering.

New or revised standards and interpretations
There are no other new or revised standards or interpretations that are not yet effective that would be expected to have a material impact on Elering.

Note 5

FINANCIAL RISK MANAGEMENT

The risk management function is performed at Elering in accordance with internationally approved Enterprise Risk Management Mode methodology, which has been developed by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Elering's risks are assessed in four categories: strategic, operational, financial and external risks. Financial risk comprises market risk (including electricity and natural gas price risk, currency risk, interest rate risk), credit risk and liquidity risk. The primary objectives of the financial risk management function are to establish risk limits, and then to ensure that exposure to risks stays within these limits. Risk management is monitored at the Management Board level and the results are reported to the Audit Committee. Elering's financial risks are managed at Elering's Finance Department.

The following table provides reconciliation of classes of financial assets and financial liabilities of Elering in accordance with the measurement categories of IFRS 9:

Financial assets

in thousands of euros	*31.12.2019*	*31.12.2018*
Cash and cash equivalents (Note 7)	42,347	62,716
Trade and other receivables (Note 8)	35,624	31,758
Investments in equity instruments (Note 2)	1,900	1,946
Total financial assets	**79,871**	**96,420**

Financial liabilities

in thousands of euros	*31.12.2019*	*31.12.2018*
Trade and other payables (Note 13)	41,602	26,152
Borrowings (Note 12)	343,328	353,718
Total financial liabilities	**384,930**	**379,870**

Credit risk

Elering takes on exposure to credit risk, which is the risk that one party of a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. Exposure to credit risk arises as a result of Elering's sales on credit terms and other transactions with counterparties giving rise to financial assets. In accordance with Elering's risk management principles, Elering's short-term available cash resources can be deposited in the following domestic financial instruments: overnight deposits at acceptable credit institutions or term deposits at credit institutions. The following principles are followed when depositing short-term available cash resources: ensuring of liquidity, capital preservation, interest income generation.

Elering's assets exposed to credit risk as of balance sheet days were as follows:

in thousands of euros	*31.12.2019*	*31.12.2018*
Cash and cash equivalents (Note 7)	42,347	62,716
Trade and other receivables (Note 8)	35,624	31,758
Total exposure of assets to credit risk in the statement of financial position	**77,971**	**94,474**

Elering structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to counterparties or groups of counterparties or by applying additional instruments for credit risk management. Elering established criteria for holding financial assets at credit institutions. According to the given criteria maximum permitted limits depend on the credit rating and equity of the credit institution. Limits on the level of credit risk are approved regularly by management. Such risks are monitored on an ongoing basis and they are subject to an annual review.

Elering's Accounting Department reviews ageing analysis of outstanding trade receivables and follows up on past due balances each week. The results are reported to the CFO of Elering. Elering has identified circumstances under which the collection of debt is passed over to a collection agency. Information about credit risk is disclosed in Note 8.

To measure the expected credit losses, trade receivables have been grouped based on shared credit risk characteristics and the days past due. The expected loss rates are based on the payment profiles of sales over a period of 12 month before 31 December 2019 or 1 January 2019 respectively and the corresponding historical credit losses experienced within this period. The historical loss rates are adjusted to reflect current and forward-looking information on macroeconomic factors affecting the ability of the customers to settle the receivables. Elering has identified the GDP and the unemployment rate of the countries in which it sells its goods and services to be the most relevant factors, and accordingly adjusts the historical loss rates based on expected changes in these factors.

On that basis described above, the loss allowance as at 31 December 2019 and 1 January 2019 was determined immaterial. While cash and cash equivalents and bank deposits are also subject to the impairment requirements of IFRS 9, the identified impairment loss was immaterial as at 1 January 2019 and 31 December 2019.

Credit risk concentration

Elering is exposed to concentrations of credit risk. Management monitors and discloses concentrations of credit risk by reports, which list exposures to counterparty with aggregated balances in excess of 5% of Elering's equity. On 31.12.2019, Elering had one counterparty (31.12.2018: one counterparty) with an aggregated receivables balance of EUR 18,016 thousand (31.12.2018: EUR 18,114 thousand) or 64% of the total amount of accounts receivable (31.12.2018: 66%). In 2019 as well as in 2018 the major part of receivables was to the wholly state-owned company who is monopolist in distribution network. Therefore, Management believes that the credit risk arising from the concentration of receivables is not significant.

Cash in bank is deposited in four banks. The credit ratings of the banks are described in Note 7.

Market risk

Elering is exposed to market risk. Market risk arises mainly from changes in the electricity price, as well as from open positions in foreign currencies and interest-bearing assets and liabilities. Management sets limits on the value of exposed positions that may be accepted, which is monitored on a daily basis. However, the use of this approach does not completely prevent losses outside of these limits but limits their maximum amounts.

Sensitivities to market risks shown below are based on a change in one factor while holding all other factors constant. In practice, this is unlikely to occur and changes in some of the factors may be correlated – for example, changes in the interest rate and changes in foreign currency rates.

Electricity price risk

For compensating network losses, Elering buys electricity primarily in the electricity exchange. The average electricity exchange price of the last period is used for calculation of network tariffs. In a situation where the exchange price differs from the one used for calculation of tariffs, the difference is not compensated in the next tariff period. Elering does not expect the risk of potential loss to be high and therefore it does not use any financial instruments to mitigate this risk.

Price risk of natural gas

Elering purchases natural gas for compensating network losses. In a situation where the price of gas estimated for the calculation of network tariffs differs from its actual price, the difference is not compensated in the next tariff period. This results in a situation where Elering may generate a profit or sustain a loss on the purchased gas in the short-term as the price of gas changes. Elering does not expect the risk of potential loss to be high and therefore it does not employ any financial instruments to mitigate this risk.

Currency risk

Currency risk is the risk that in the future fair value of financial instruments of cash flow will fluctuate due to changes in currency rates. As virtually all of Elering's transactions and balances are denominated in euros, Elering is not exposed to significant currency risk. Elering established separate limits for open currency positions depending on the currency and duration. Transactions in other currencies are insignificant; there were no financial instruments denominated in other currencies as of 31.12.2019 and 31.12.2018.

Interest rate risk

The financial instruments with floating interest rate expose Elering to cash flow interest rate risk, i.e. the risk that an increase in market interest rates will cause an increase in Elering's interest expense. At the same time, in case of short-term deposits, a change in market interest rates has effect on Elering's interest income arising from investment of available resources into new deposits. Elering established the minimum limit for fixed interest-bearing liabilities at 50% of all liabilities. To some extent, Elering is protected against interest rate risk, because according to tariff regulations, the average interest rate of the last five years is included in the calculation of network tariffs. Since Elering does not carry interest-bearing financial instruments at fair value, change in market interest rates does not have effect on balance value of available assets or liabilities, nor interest income or expense arising from them.

As of 31.12.2019 borrowings with fixed interest rate constituted 65% (as of 31.12.2018: 63%) of all borrowings carried at amortized cost; the remaining 35% (as of 31.12.2018: 37%) of the above-mentioned liabilities were long-term bank loans with a floating interest rate carried at amortized cost. More detailed information borrowings items is set out in Note 12.

The floating interest rate of bank loans is based on the 6-month Euribor and it is fixed twice a year.

As at 31.12.2019 borrowings with a floating interest rate totalled EUR 118,920 thousand (as at 31.12.2018: EUR 129,459 thousand).

As at 31.12.2019, if the interest rates of Elering's borrowings, that are exposed to the cash flow interest rate risk, had been 50 basis points (2018: 50 basis points) higher with all other variables held constant, profit for the year would have been EUR 595 thousand (2018: EUR 647 thousand) lower.

Elering's interest-bearing financial assets are overnight deposits and term deposits. The rate for overnight deposits is being fixed once a day and term deposits have a fixed interest rate for the whole term of the deposit. Therefore, Elering is not exposed to cash flow interest rate risk from financial assets.

Elering did not have other financial instruments exposed to risk of change in interest rate.

Liquidity risk
Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities. Elering is exposed to daily calls on its available cash resources. Liquidity risk is managed by the Finance Department of Elering. Elering's objective is to obtain a stable funding base primarily consisting of amounts due to banks and bonds. The liquidity position is monitored and regular liquidity stress testing under a variety of scenarios covering both normal and more severe market conditions is performed by the Finance Department.

The table below shows liabilities on 31.12.2019 and 31.12.2018 by their remaining contractual maturity. The amounts disclosed in the maturity table are contractual undiscounted cash flows. The cash flows for borrowings subsequent periods are calculated on the basis of loan interest rates effective at balance sheet date.

The maturity analysis of financial liabilities on 31.12.2019 is as follows:

in thousands of euros	*On demand and less than 1 month*	*From 1 to 12 months*	*From 12 months to 5 years*	*Over 5 years*	*Total*
Liabilities*					
Trade and other payables (Note 13)	39,682	605	0	0	**40,287**
Borrowings (Note 12)	0	12,721	275,589	66,653	**354,963**
Total future payments	**39,682**	**13,326**	**275,589**	**66,653**	**395,250**

** including interest expenses*

The maturity analysis of financial liabilities on 31.12.2018 is as follows:

in thousands of euros	*On demand and less than 1 month*	*From 1 to 12 months*	*From 12 months to 5 years*	*Over 5 years*	*Total*
Liabilities*					
Trade and other payables (Note 13)	22,882	1,932	0	0	**24,814**
Borrowings (Note 12)	0	12,812	275,867	77,546	**366,225**
Total future payments	**22,882**	**14,744**	**275,867**	**77,546**	**391,039**

** including interest expenses*

Elering holds its money in bank deposits. As of 31.12.2019, Elering had cash and cash equivalents EUR 42,347 thousand (as of 31.12.2018: EUR 62,716 thousand). As of 31.12.2019 there were no short-term bank deposits (as of 31.12.2018 there were no short-term bank deposits). See further information in Note 7.

Capital Management
Elering's main goal in capital risk management is to ensure Elering's sustainability of operations in order to generate return for its shareholder and provide a sense of security to creditors and thereby, preserve an optimal capital structure and lower the cost of capital. In order to preserve or improve the capital structure, Elering can regulate the dividends payable to the shareholders, buy back shares from shareholders, issue new shares or bonds and take new loans.

According to the widespread industry practice, Elering uses the equity to asset ratio for monitoring Elering's capital structure, arrived at by dividing total equity by total assets as of the balance sheet date. Elering's target has been to preserve the ratio of equity to assets at 35% - 45%. The equity to asset ratio is presented in the table below:

in thousands of euros	*31.12.2019*	*31.12.2018*
Equity	388,267	384,826
Total assets	1,024,356	948,374
Equity to asset ratio	**38%**	**41%**

Fair Value of Financial Instruments
Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation, and is best expressed by an active quoted market price.

The tables below analyses financial instruments carried at fair value, by valuation method. The different levels have been defined as follows:

Level 1. Iquoted prices (unadjusted) in active markets for identical assets or liabilities;
Level 2. inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly or indirectly;
Level 3. inputs for the asset or liability that are not based on observable market data.

Estimated fair values of financial instruments have been determined by Elering using available market information, where it exists, and appropriate valuation methodologies. The additional estimations are used for interpreting market data to determine the fair value.

Financial assets carried at amortized cost
Carrying amounts of trade and other financial receivables approximate their fair values (level 3).

Liabilities carried at amortized cost
Carrying amounts of trade and other payables approximate their fair values (level 3).

The estimated fair value of bonds rate is determined using their quoted price (level 1). The estimated fair value of non-current borrowings with a floating interest rate (level 3) is determined using valuation techniques, based on expected cash flows discounted at current interest rates (0.36%) for new instruments with similar credit risk and remaining maturity.

Elering had the following borrowings as of 31.12.2019: bonds, the market value of which was EUR 227,626 thousand (nominal value EUR 225,000 thousand) and bank loans, the market value of which was EUR 115,032 thousand (nominal value EUR 119,013 thousand). The following borrowings as of 31.12.2018 consisted of bonds the market value of which was EUR 227,446 thousand (nominal value EUR 225,000 thousand) and bank loans, the market value of which was EUR 126,601 thousand (nominal value EUR 129,571 thousand).

Note 6

SEGMENT REPORTING

The Management Board is the chief operating decision maker. Elering has determined main products and services that generate external revenues and profit and has built up a methodology of allocation of revenues and expenses, and assets to the products.

The Management Board uses for the purposes of making management decisions and monitoring Elering's performance a product-based reporting.

Elering has distinguished three reportable segments of its business representing its main products and services; a number of minor products and services are presented together as "Other segments":

1. Regulated electricity network services that consist in the transmission of electricity through the electricity transmission networks based on tariffs approved by the regulator, i.e. the Estonian Competition Authority and the revenue from the Inter TSO Compensation Mechanism (ITC);

2. Regulated gas network services that consist in the transmission of gas through the gas transmission networks based on tariffs approved by the regulator, i.e. the Estonian Competition Authority;

3. Balancing services of electricity and gas (while there is a separate reporting for electricity and gas balancing services, the two have been aggregated into one reportable segment as they have common business processes and similar characteristics, clients and regulatory environment);

4. Other segments.

Other segments include minor products and services (e.g. connection fees, government grant, congestion income, lease income, etc.) which individual share of Elering's revenue and EBITDA is immaterial and which is not taken into account by the Estonian Competition Authority for calculating network tariffs and determining principles of charging for balancing services. None of these products and services meet the quantitative thresholds that would require reporting separate information.

The internal reporting provided to the Management Board has been prepared using the accounting policies and presentation consistent with those used in preparation of the financial statements. The income taxes are allocated to regulated electricity segment only.

The Management Board assesses the performance of the operating segments based on revenue, EBITDA (net profit plus income taxes, net finance cost, and depreciation and amortization) and net profit.

Elering is domiciled in Estonia. Non-current assets of Elering are located in Estonia. In the reporting period, Elering had one counterparty with an aggregated revenue more than 10% of Elering´s revenue totalling EUR 76,476 thousand (2018: EUR 78,840 thousand). The largest customer´s revenue is attributable to the electricity transmission segment.

The breakdown of the major component of the total of revenue from external customers is disclosed below.

Segment reporting, 2019

in thousands of euros	*Regulated electricity network services*	*Regulated gas network services*	*Balancing services*	*Other*	*Transactions between segments*	*Total*
Revenue from external customers	89,910	12,323	33,746	6,136	0	**142,115**
Revenue between segments	-17	51	-34	0	0	**0**
Total revenue	**89,893**	**12,374**	**33,712**	**6,136**	**0**	**142,115**
Other operating income	0	0	0	13,105	0	**13,105**
Total income	**89,893**	**12,374**	**33,712**	**19,241**	**0**	**155,220**
Goods, raw materials and services	-26,027	-2,228	-32,559	-886	0	**-61,700**
Other operating expenses and staff costs	-9,447	-3,387	-955	-1,041	0	**-14,830**
EBITDA	**54,419**	**6,759**	**198**	**17,314**	**0**	**78,690**
Depreciation and amortization (Note 10, 11)	-29,306	-4,263	-86	-3,258	0	**-36,913**
Net financial income (costs) (Note 21)	-1,832	-48	-10	-231	0	**-2,121**
Income tax (Note 15)	-6,769	0	0	0	0	**-6,769**
Net profit	**16,512**	**2,448**	**102**	**13,825**	**0**	**32,887**
Total assets	**607,872**	**107,422**	**5,159**	**303,903**	**0**	**1,024,356**
Total liabilities	**299,841**	**48,636**	**3,966**	**283,647**	**0**	**636,089**
Additions to property, plant and equipment (Note 10)	16,578	24,550	0	82,528	0	**123,656**
Additions to intangible assets (Note 11)	2,218	987	227	2,703	0	**6,135**

Segment reporting, 2018

in thousands of euros	*Regulated electricity network services*	*Regulated gas network services*	*Balancing services*	*Other*	*Transactions between segments*	*Total*
Revenue from external customers	91,012	10,173	35,393	6,389	0	**142,967**
Revenue between segments	-14	67	-53	0	0	**0**
Total revenue	**90,998**	**10,240**	**35,340**	**6,389**	**0**	**142,967**
Other operating income	0	0	0	1,879	0	**1,879**
Total income	**90,998**	**10,240**	**35,340**	**8,268**	**0**	**144,846**
Goods, raw materials and services	-27,729	-2,133	-34,174	-1,146	0	**-65,182**
Other operating expenses and staff costs	-8,673	-3,590	-798	-933	0	**-13,994**

in thousands of euros	*Regulated electricity network services*	*Regulated gas network services*	*Balancing services*	*Other*	*Transactions between segments*	*Total*
EBITDA	**54,596**	**4,517**	**368**	**6,189**	**0**	**65,670**
Depreciation and amortization (Note 10, 11)	-27,941	-3,822	-46	-2,910	0	**-34,719**
Net financial income (costs) (Note 21)	-6,827	-272	-8	-208	0	**-7,315**
Income tax (Note 15)	-5,000	0	0	0	0	**-5,000**
Net profit	**14,828**	**423**	**314**	**3,071**	**0**	**18,636**
Total assets	**621,136**	**81,692**	**4,899**	**240,647**	**0**	**948,374**
Total liabilities	**300,216**	**25,355**	**3,808**	**234,169**	**0**	**563,548**
Additions to property, plant and equipment (Note 10)	10,343	26,544	30	81,676	0	**118,593**
Additions to intangible assets (Note 11)	2,898	904	235	2,379	0	**6,416**

Revenue by geographical location of customers, 2019

in thousands of euros	*Regulated electricity network services*	*Regulated gas network services*	*Balancing services*	*Other*	*Total*
Estonia	84,049	11,756	15,950	3,465	**115,220**
Norway	0	0	0	0	**0**
Latvia	0	0	3,709	0	**3,709**
Finland	405	0	4,060	2,656	**7,121**
Lithuania	0	8	10,027	12	**10,047**
Russia	0	559	0	0	**559**
Other	5,456	0	0	3	**5,459**
Total revenue	**89,910**	**12,323**	**33,746**	**6,136**	**142,115**

Revenue by geographical location of customers, 2018

in thousands of euros	*Regulated electricity network services*	*Regulated gas network services*	*Balancing services*	*Other*	*Total*
Estonia	86,265	9,590	18,860	3,417	**118,132**
Norway	3	0	0	0	**3**
Latvia	25	0	3,812	0	**3,837**
Finland	454	0	2,209	2,969	**5,632**
Lithuania	0	0	10,512	3	**10,515**
Russia	0	583	0	0	**583**
Other	4,265	0	0	0	**4,265**
Total revenue	**91,012**	**10,173**	**35,393**	**6,389**	**142,967**

Note 7

BANK ACCOUNTS AND DEPOSITS

in thousands of euros	*31.12.2019*	*31.12.2018*
Cash and cash equivalents	42,347	62,716

Bank accounts and deposits

in thousands of euros	*31.12.2019*	*31.12.2018*
Bank accounts and deposits at banks		
with Moody's credit rating of Aa2*	24,120	42,015
with Moody's credit rating of A3	18,227	20,701
Total bank accounts and deposits at banks	**42,347**	**62,716**

** Two banks at which Elering holds its money are Estonia-based subsidiaries of international banks with Moody's credit ratings of Aa2 (2018: Aa2).*

Note 8

TRADE AND OTHER RECEIVABLES

in thousands of euros	*31.12.2019*	*31.12.2018*
Trade receivables		
Accounts receivable	28,295	27,521
· Incl. FTR-Limited auction receivables	18	400
Other receivables	**7,329**	**4,237**
· Incl. accrued compensation*	5,700	0
· Incl. subsidies due from electricity producers (Note 2,13)	1,354	2,992
· Incl. accrued ITC receivables	175	1,244
· Incl. security deposit	99	0
· Incl. interest receivables	1	1
Total financial assets within trade and other receivables in the statement of financial position	**35,624**	**31,758**
Tax receivables	3,248	3,395
· Incl. VAT receivable	2,645	2,118
Prepayments	153	120
Total trade and other receivables	**39,025**	**35,273**

** According to the agreement between the Estonian and Finnish regulators "Cross-Border Cost Allocation Agreement", Baltic Connector Oy will compensate Elering with EUR 5.7 million, which exceeds the amount provided by the European aid for the construction of the gas infrastructure.*

Analysis by credit quality of trade receivables is as follows:

in thousands of euros	*31.12.2019*	*31.12.2018*
Accounts receivable not yet due		
· Distribution networks	21,124	21,284
· Other clients	7,125	6,051
Total accounts receivable not yet due	**28,249**	**27,335**
Accounts receivable past due but not classified as doubtful		
· 1 to 90 days overdue	46	186
Total accounts receivable past due but not classified as doubtful	**46**	**186**
Total accounts receivable past due	**46**	**186**
Total trade receivables	**28,295**	**27,521**

In the reporting period and in 2018, Elering did not write down any receivables. Further information on receivables from related parties is disclosed in Note 23.

Note 9

INVENTORIES

in thousands of euros	*31.12.2019*	*31.12.2018*
Fuel oil	2,503	2,551
Natural gas reserves	477	284
Natural gas balance	0	369
Other materials at warehouses	707	732
Total inventories	**3,687**	**3,936**

Elering maintains fuel reserves for the purposes of emergency reserve power plants, natural gas reserves and natural gas balance for providing gas-related transmission and balancing services, respectively, and inventories of other materials used for repairs of gas equipment and gas pipelines.

Note 10

PROPERTY, PLANT AND EQUIPMENT

in thousands of euros	*Land*	*Buildings*	*Facilities*	*Machinery and equipment*	*Other*	*Construction in progress*	*Total*
Property, plant and equipment at 01.01.2018							
Cost at 01.01.2018	6,137	48,575	505,418	506,998	202	0	**1,067,330**
Accumulated depreciation	0	-8,675	-166,335	-162,659	-115	0	**-337,784**
Carrying amount at 01.01.2018	**6,137**	**39,900**	**339,083**	**344,339**	**87**	**0**	**729,546**
Construction in progress	0	0	0	0	0	16,957	**16,957**
Total property, plant and equipment at 01.01.2018	**6,137**	**39,900**	**339,083**	**344,339**	**87**	**16,957**	**746,503**
Movements 01.01.2018-31.12.2018							
Additions	23	0	0	0	0	82,628	**82,651**
Reclassified from construction in progress	0	1,002	5,783	9,227	313	-16,325	**0**
Capitalized borrowing costs (Note 21)	0	0	0	0	0	222	**222**
Disposals and write-offs at carrying amount	-22	-5	-18	0	0	-21	**-66**
Prepayments	0	0	20,729	14,991	0	0	**35,720**
Depreciation charge	0	-1,346	-13,352	-18,699	-100	0	**-33,497**
Total movements 01.01.2018-31.12.2018	**1**	**-349**	**13,142**	**5,519**	**213**	**66,504**	**85,030**
Property, plant and equipment at 31.12.2018							
Cost at 31.12.2018	6,138	49,520	510,041	512,341	515	0	**1,078,555**
Accumulated depreciation	0	-9,969	-178,545	-177,474	-215	0	**-366,203**
Carrying amount at 31.12.2018	**6,138**	**39,551**	**331,496**	**334,867**	**300**	**0**	**712,352**
Construction in progress	0	0	0	0	0	83,461	**83,461**
Prepayments	0	0	20,729	14,991	0	0	**35,720**
Total property, plant and equipment at 31.12.2018	**6,138**	**39,551**	**352,225**	**349,858**	**300**	**83,461**	**831,533**
Movements 01.01.2019-31.12.2019							
Additions	4	0	0	0	0	153,929	**153,933**
Reclassified from construction in progress	0	2,591	96,977	31,669	18	-131,255	**0**
Recognition of right-of-use assets (Note 12)	0	0	0	61	0	0	**61**
Capitalized borrowing costs (Note 21)	0	0	0	0	0	218	**218**
Disposals and write-offs at carrying amount	-16	0	0	-30	0	0	**-46**
Prepayments	4	0	-19,905	-10,594	0	0	**-30,495**
Depreciation charge	0	-1,412	-14,267	-19,464	-106	0	**-35,249**
Total movements 01.01.2019-31.12.2019	**-8**	**1,179**	**62,805**	**1,642**	**-88**	**22,892**	**88,422**
Property, plant and equipment at 31.12.2019							
Cost at 31.12.2019	6,126	51,888	604,622	538,425	488	0	**1,201,549**
· Incl. right-of-use assets	0	0	0	61	0	0	**61**
Accumulated depreciation	0	-11,158	-190,416	-191,322	-276	0	**-393,172**
· Incl. right-of-use assets	0	0	0	-29	0	0	**-29**
Carrying amount at 31.12.2019	**6,126**	**40,730**	**414,206**	**347,103**	**212**	**0**	**808,377**
· Incl. right-of-use assets	0	0	0	32	0	0	**32**
Construction in progress	0	0	0	0	0	106,354	**106,354**
Prepayments	4	0	824	4,397	0	0	**5,225**
Total property, plant and equipment at 31.12.2019	**6,130**	**40,730**	**415,030**	**351,500**	**212**	**106,354**	**919,956**

Construction in progress mainly consists of substations, electricity transmission lines and gas pipelines. Upon completion, cost of these assets is recognized as cost of buildings, machinery and equipment and facilities.

Additions to construction in progress during the financial year include capitalized borrowing costs of EUR 218 thousand (2018: EUR 222 thousand). The capitalisation rate is 0.69% (2018: 1.6%).

Further information on operating lease of property, plant and equipment is disclosed in Note 22.

Note 11

INTANGIBLE ASSETS

in thousands of euros	*Acquired software and licenses*	*Right of use of land*	*Total*
Intangible assets at 01.01.2018			
Cost at 01.01.2018	6,574	2,027	**8,601**
Accumulated amortization	-3,905	-155	**-4,060**
Carrying amount at 01.01.2018	**2,669**	**1,872**	**4,541**
Intangible assets not yet available for use	3,214	0	**3,214**
Total intangible assets at 01.01.2018	**5,883**	**1,872**	**7,755**
Movements 1.01.2018-31.12.2018			
Additions	4,207	2,209	**6,416**
Amortization charge	-1,169	-32	**-1,201**
Total movements 1.01.2018-31.12.2018	**3,038**	**2,177**	**5,215**
Intangible assets at 31.12.2018			
Cost at 31.12.2018	11,778	4,236	**16,014**
Accumulated amortization	-5,064	-187	**-5,251**
Carrying amount at 31.12.2018	**6,714**	**4,049**	**10,763**
Intangible assets not yet available for use	2,207	0	**2,207**
Total intangible assets at 31.12.2018	**8,921**	**4,049**	**12,970**
Movements 1.01.2019-31.12.2019			
Additions	3,794	2,341	**6,135**
Amortization charge	-1,610	-54	**-1,664**
Total movements 1.01.2019-31.12.2019	**2,184**	**2,287**	**4,471**
Intangible assets at 31.12.2019			
Cost at 31.12.2019	11,822	6,580	**18,402**
Accumulated amortization	-5,862	-244	**-6,106**
Carrying amount at 31.12.2019	**5,960**	**6,336**	**12,296**
Intangible assets not yet available for use	5,145	0	**5,145**
Total intangible assets at 31.12.2019	**11,105**	**6,336**	**17,441**

Note 12

BORROWINGS

in thousands of euros	*31.12.2019*	*31.12.2018*
Short-term borrowings		
Current portion of long-term bank loans	10,558	10,558
Lease liabilities	19	0
Total short-term borrowings	**10,577**	**10,558**
Long-term borrowings		
Long-term bank loan	108,362	118,901
Bonds issued	224,376	224,259
Lease liabilities	13	0
Total long-term borrowings	**332,751**	**343,160**
Borrowings are denominated in the following currencies:		
Borrowings denominated in euros	343,328	353,718
Total borrowings (Note 5)	**343,328**	**353,718**

Reconciliation of borrowings:

in thousands of euros	*Current portion of long-term bank loans*	*Current portion of bonds issued short-term*	*Long-term bank loan*	*Bonds issued*	*Current portion of lease liabilities*	*Long- term portion of lease liabilities*	*Total borrowings*
Total borrowings on 01.01.2018	**8,138**	**224,686**	**129,439**	**0**	**0**	**0**	**362,263**
Repayment of borrowings	-8,138	-225,000	0	0	0	0	**-233,138**
Bonds issued	0	0	0	224,159	0	0	**224,159**
Transfers	10,558	314	-10,558	-314	0	0	**0**
Non-cash movements	0	0	20	414	0	0	**434**
Total borrowings on 31.12.2018	**10,558**	**0**	**118,901**	**224,259**	**0**	**0**	**353,718**
Lease liabilities	0	0	0	0	28	32	**60**
Repayment of borrowings	-10,558	0	0		-28	0	**-10,586**
Bonds issued	0	0	0	0	0	0	**0**
Transfers	10,558	0	-10,558	0	19	-19	**0**
Non-cash movements	0	0	19	117	0	0	**136**
Total borrowings on 31.12.2019	**10,558**	**0**	**108,362**	**224,376**	**19**	**13**	**343,328**

The average effective interest rate on borrowings was 0.69% in 2019 (2018: 2.0%).

Elering has used the following types of facilities for financing purposes:

- **Loans from the European Investment Bank**
  Elering has two loans with outstanding balance of EUR 92,631 thousand. The maturity date of the loans is 2030 and 2033, the interest rate is floating which is the sum of 6-month Euribor and the margin. In the reporting period Elering repaid loans in the amount of EUR 7,209 thousand (2018: 4,790 thousand euros).

- **Loans from the Nordic Investment Bank**
  Elering has two loans with outstanding balance of EUR 26,382 thousand. The maturity date of the loans is 2025 and 2032, the interest rate is floating which is the sum of 6-month Euribor and the margin. In the reporting period Elering repaid loans in the amount of EUR 3,349 thousand (2018: EUR 3,348 thousand).

- **Eurobonds**
  In 2011, Elering issued Eurobonds with the maturity of seven years and the nominal value of EUR 225 million and these bonds were listed on London stock exchange. Bonds' coupon was fixed at 4.625% p.a. and interest payments were made once a year. The bonds were redeemed on 12 July 2018.

  On 3 May 2018 Elering issued new Eurobonds with the nominal value of EUR 225 million which were used to refinance previous Eurobonds. New bonds' coupon is fixed at 0.875% p.a., maturity date is 3 May 2023 and interest payments are made once a year.

Under its loan agreements, Elering has undertaken to comply with certain financial covenants (shareholder's equity to total assets ratio and net debt to EBITDA ratio). Elering's financial indicators complied with all contractual covenants.

Note 13

TRADE AND OTHER PAYABLES

in thousands of euros	*31.12.2019*	*31.12.2018*
Trade payables	19,924	15,145
Payables for purchased property, plant and equipment and intangible assets	19,758	7,737
Subsidies due to biogas producers	283	1,531
Other payables	322	401
Total financial liabilities within trade and other payables without accrued interests	**40,287**	**24,814**
Accrued interests from borrowings carried at amortized cost (Note 12)	1,315	1,338
Total financial liabilities within trade and other payables in the statement of financial position	**41,602**	**26,152**
Taxes payable		
Social security tax	482	362
Personal income tax	286	239
Unemployment insurance tax	32	24
Contributions to mandatory funded pension	23	17
Corporate income tax and income tax on fringe benefits	1,574	4
Excise tax	525	200
Pollution tax	0	1
Total taxes payable	**2,922**	**847**
Accrued expenses - employee benefits		
Wages and salaries	478	429
Bonuses	761	750
Holiday pay	233	171
Social security and unemployment insurance tax	336	311
Total accrued expenses - employee benefits	**1,808**	**1,661**
Other payables	**338**	**345**
Total trade and other payables	**46,670**	**29,005**

Further information on payables to related parties is disclosed in Note 23.

Note 14

DEFERRED INCOME

Income from connection and other service fees

In thousands of euros	*2019*	*2018*
Deferred income from connection and other service fees at the beginning of the period	**32,425**	**30,286**
Connection and other service fees received	4,265	3,633
Connection and other service fees recognized as revenue (Note 16)	-1,670	-1,494
Deferred income from connection and other service fees at the end of the period	**35,020**	**32,425**

Deferred income from government grants

in thousands of euros	*2019*	*2018*
Deferred income from government grants at the beginning of the period	**73,275**	**66,936**
Grants received for acquisition of property, plant and equipment	51,657	7,532
Grants received for operating expenses	209	237
Grants used for operating expenses (Note 17)	-209	-237
Grants recognized as revenue (Note 17)	-1,359	-1,193
Deferred income from government grants at the end of the period	**123,573**	**73,275**

Deferred income from congestion fees

in thousands of euros	*2019*	*2018*
Deferred congestion income at the beginning of the period	**75,125**	**67,969**
Congestion fees received during the period	12,708	7,411
Recognized as income (Note 17)	-335	-255
Deferred congestion income at the end of the period	**87,498**	**75,125**
Total deferred income	**246,091**	**180,825**

Note 15

EQUITY

Elering's share capital consists of 229,890 shares with the nominal value of EUR 1,000 (31.12.2018: 229,890 shares with the nominal value of EUR 1,000). The shares have been paid for in full.

During the reporting year, the sole shareholder has not made a decision to increase the share capital.

In 2018, share capital was increased by EUR 40 million by resolution of sole shareholder and it was paid for in cash. The share capital was registered on 6 April 2018.

In 2019 dividends totalling EUR 29.4 million were paid out and dividends per share totalled EUR 128 (in 2018 dividends were paid in the amount of EUR 20 million, dividends per share amounted to EUR 87).

The payment of dividends resulted in an income tax expense of EUR 6.8 million (2018: EUR 5.0 million), of which EUR 5.2 million was paid in 2019 and EUR 1.6 million is recognized as a liability in the statement of financial position.

As of 31.12.2019, Elering's statutory reserve capital totalled EUR 14,686 thousand (31.12.2018: EUR 13,754 thousand). As at 31.12.2019, Elering has the obligation to additionally transfer EUR 1,644 thousand (31.12.2018: EUR 932 thousand) to reserve capital. In 2019 Elering additionally transferred to statutory reserve capital EUR 932 thousand (2018: EUR 856 thousand).

The distributable retained earnings of Elering as of 31.12.2019 amounted to EUR 143,737 thousand (31.12.2018: EUR 141,182 thousand). From 2019, tax rate of 14/86 can be applied to dividend payments. The more beneficial tax rate can be used for dividend payments in the amount of up to the average dividend payment during the three preceding years that were taxed with the tax rate of 20/80. When calculating the average dividend payment of three preceding years, 2018 will be the first year to be taken into account. As of 31.12.2019, it would be possible to distribute EUR 108,006 thousand as net dividends (31.12.2018: EUR 107,436 thousand) and the corresponding income tax would amount to EUR 34,087 thousand (31.12.2018: EUR 32,814 thousand). These numbers are calculated taking into account the obligation to transfer certain amount of retained earnings to statutory reserve capital. The amount of income tax calculated at more beneficial rate is EUR 2,681 thousand.

Note 16

REVENUE

Analysis of revenue by activity

in thousands of euros	*2019*	*2018*
Sales of balancing and regulation services		
Balancing electricity	24,134	25,608
Balancing gas	4,863	5,086
Regulation services	4,715	4,646
Total sales of balancing electricity and regulation services	**33,712**	**35,340**
Sales of electricity and gas network services		
Electricity network services	84,031	86,251
Gas network services	12,374	10,240
Revenue from connection fees (Note 14)	1,670	1,494
Other electricity network services	5,862	4,747
Total sales of network services	**103,937**	**102,732**
Sales of other goods and services		
Lease of transmission equipment (Note 22)	917	916
Other services	3,469	3,943
Other goods	80	36
Total sales of other goods and services	**4,466**	**4,895**
Total revenue	**142,115**	**142,967**

Note 17

OTHER INCOME

in thousands of euros	*2019*	*2018*
Fines, penalties and compensations received*	10,584	67
Government grants related to acquisition of property, plant and equipment (Note 14)	1 359	1 193
Congestion income (Note 14)	335	255
Grants for operating expenses (Note 14)	209	237
Dividends from long-term financial investments	94	68
Profit from sale of property, plant and equipment	78	59
Other income	446	0
Total other income	**13,105**	**1,879**

** In January 2019, Elering received a contractual penalty in the amount of EUR 10,440 thousand for the breach of contract by the counterparty. The contractual penalty was ordered by the ICC arbitral tribunal.*

Note 18

GOODS, RAW MATERIALS AND SERVICES

in thousands of euros	*2019*	*2018*
Electricity and gas purchased to provide the balancing service		
Purchase of balancing energy	24,221	24,209
Purchase of balancing gas	4,378	4,421
Purchase of power regulation service	3,906	4,986
Expenses of emergency reserve power plant to provide balancing services	10	498
Total electricity purchased to provide the balancing service	**32,515**	**34,114**
System services		
Operating expenses of emergency reserve power plant	844	848
Reactive energy	368	397
Total system services expenses	**1,212**	**1,245**
Losses in electricity and gas network		
Electricity network losses	16,943	18,715
Gas network losses	343	266
Total electricity and gas to compensate for network losses	**17,286**	**18,981**
Maintenance and repair works		
On facilities and equipment related to core activities	6,985	7,374
On production buildings and sites	1,024	868
Other	510	309
Disassembly works and waste processing	464	230
Total maintenance and repair works	**8,983**	**8,781**
Other costs		
Other costs	1,339	1,695
Operative switching and dispatching management expenses	365	366
Total other costs	**1,704**	**2,061**
Total goods, raw materials and services	**61,700**	**65,182**

Note 19

OTHER OPERATING EXPENSES

in thousands of euros	*2019*	*2018*
Research and consulting	1,314	1,255
Telecommunication	1,005	1,010
Training and other miscellaneous operating expenses	976	836
Information technology	901	722
Office expenses	400	420
Security, insurance and occupational safety	288	255
Transportation and tools	119	163
Research and development costs (R&D)	86	499
Other expenses	182	143
Total other operating expenses	**5,271**	**5,303**

Elering's statement of comprehensive income includes expense relating to short-term leases and leases of low-value assets in the amount of EUR 275 thousand.

Note 20

STAFF COSTS

in thousands of euros	*2019*	*2018*
Base salaries, additional remuneration, bonuses, vacation pay	6,932	6,293
Termination benefits	7	12
Other remuneration	195	184
Total remuneration to employees	**7,134**	**6,489**
Social security tax	2,372	2,155
Unemployment insurance tax	53	47
Total staff costs	**9,559**	**8,691**
· Including compensations to the members of the Management and Supervisory Board		
Salaries, additional remuneration bonuses, vacation pay	430	420
Social security tax	153	150
Fringe benefits	28	28
Income tax on fringe benefits	7	7
Total compensations to the members of the Management and Supervisory Boards	**618**	**605**
Average number of employees	**246**	**221**
Average number of employees by type:		
Persons working under an employment contract	239	216
Persons providing services under law of obligations act	7	5
Members of the Management and Supervisory Boards	8	8
The average monthly pay of all employees	2,682	2,351

Three members of the Management Board receive compensation for premature termination of their employment contracts, such compensation amounts up to the three months' salary.

Note 21

FINANCIAL INCOME AND COSTS

in thousands of euros	*2019*	*2018*
Financial income		
Interest income	62	67
Total financial income	**62**	**67**
Financial costs		
Interest expenses	-2,395	-7,600
Foreign exchange losses	-3	-2
Other financial costs	-3	-2
Total financial costs	**-2,401**	**-7,604**
Less: capitalized borrowings costs (Notes 10)	218	222
Total financial costs recognized in the statement of comprehensive income	**-2,183**	**-7,382**
Net financial income (costs)	**-2,121**	**-7,315**

Note 22

OPERATING LEASE

Elering as a lessor

Operating lease revenue

in thousands of euros	*2019*	*2018*
Buildings	84	86
Transmission equipment	917	916
Other	2	0
Total operating lease revenue	**1,003**	**1,002**

Transmission equipment

Elering has an operating lease contract under which the free fibres of the fibre-optic cable fixed to the line masts are leased out. This cable also acts as a lightning protection cord for the lines and the fibres are used by Elering for its technical communication. The free fibres have been leased out to Tele2 Eesti AS. The lease contract contains a restriction under which Elering cannot give its transmission equipment out for use by other companies operating in the telecommunications field. The contract is effective until 31 March 2025. Annual lease payments vary depending on the length of fibres leased out during the year.

Information about assets (facilities) leased out under operating leases

in thousands of euros	*31.12.2019*	*31.12.2018*
Cost	5,718	6,335
Accumulated depreciation at the end of period	-4,850	-4,900
Carrying amount	**868**	**1,435**

Depreciation charge

in thousands of euros	*2019*	*2018*
Depreciation charge	156	159

Estimated future lease payments under operating leases

in thousands of euros	*31.12.2019*	*31.12.2018*
Not later than 1 year	916	916
Later than 1 year and not later than 5 years	3,664	3,664
Later than 5 years	229	1,145
Total future minimum lease payments	**4,809**	**5,725**

Note 23

BALANCES AND TRANSACTIONS WITH RELATED PARTIES

Parties are generally considered to be related if the parties are under common control or if one party has the ability to control the other party or can exercise significant influence or joint control over the other party in making financial and operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

In preparing financial statements of Elering, the following parties have been considered as related parties:

I Republic of Estonia and the entities under its control or significant influence;
II Management and Supervisory Boards of Elering;
III Close family members of the persons described above and the entities under their control or significant influence.

The outstanding balances with related parties were as follows

in thousands of euros	*31.12.2019*	*31.12.2018*
Trade receivables		
Companies controlled or significantly influenced by the State	19,982	20,437
Total trade receivables	**19,982**	**20,437**
incl. from network operators	18,059	18,153
Trade payables and other liabilities		
Companies controlled or significantly influenced by the State	6,553	3,689
Total trade payables and other liabilities	**6,553**	**3,689**

Income and expense items with related parties were as follows

in thousands of euros	*Related party*	*2019*	*2018*
Revenue from sale of goods	Companies controlled or significantly influenced by the State	8,431	8,522
Revenue from sale of services	Companies controlled or significantly influenced by the State	79,131	83,886
Revenue from sale of goods and services		**87,562**	**92,408**
Purchase of goods	Companies controlled or significantly influenced by the State	5,046	3,600
Purchase of services	Companies controlled or significantly influenced by the State	4,729	4,985
Purchase of goods and services		**9,775**	**8,585**
Expenditures on non-current assets	**Companies controlled or significantly influenced by the State**	**1,115**	**3,120**

- Revenue from sale of goods is incurred by the sale of imbalance energy and imbalance gas.
- Revenue from sale of services is incurred mainly from sale of electricity and gas network services.
- The purchase of goods results from the purchase of imbalance energy and gas.
- The purchase of services results from regulation, operative switching, dispatching management and maintenance and repair services.

There were no transactions with companies in which the members of the Supervisory Board and the Management Board or their close relatives have significant influence in the reporting period.

Key management personnel compensations are disclosed in Note 20.

No receivables from related parties were written off in 2019 and 2018.

Note 24

CONTINGENT LIABILITIES AND COMMITMENTS

Capital expenditure commitments

The network operator must develop the network within its service area in a way that ensures the continued provision of network services in accordance with the set requirements. At 31.12.2019, Elering has contractual capital expenditure commitments in respect of property, plant and equipment totalling EUR 85,700 thousand (31.12.2018: EUR 167,200 thousand).

Tax legislation

The tax authorities have the right to verify Elering's tax records up to 5 years from the time of submitting the tax declaration and upon finding errors, impose additional taxes, interest and fines. Elering's management estimates that there are not any circumstances which may lead the tax authorities to impose additional significant taxes on Elering.

Independent auditor's report

To the Shareholder of Elering AS

(Translation of the Estonian original)*

Report on the audit of the financial statements

Our opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Elering AS ("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.

Our opinion is consistent with our additional report to the Audit Committee dated 28 February 2020.

What we have audited

The Company's financial statements comprise:

- the statement of financial position as at 31 December 2019;
- the statement of comprehensive income for the year then ended;
- the cash flow statement for the year then ended;
- the statement of changes in equity for the year then ended; and
- the notes to the financial statements, which include significant accounting policies and other explanatory information.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

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 the ethical requirements of the Auditors Activities Act of the Republic of Estonia. We have fulfilled our other ethical responsibilities in accordance with the IESBA Code and the ethical requirements of the Auditors Activities Act of the Republic of Estonia.

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To the best of our knowledge and belief, we declare that non-audit services that we have provided to the Company are in accordance with the applicable law and regulations in the Republic of Estonia and that we have not provided non-audit services that are prohibited under § 59[1] of the Auditors Activities Act of the Republic of Estonia.

The non-audit services that we have provided to the Company in 2019 are disclosed in the management report on page 33.

Our audit approach

Overview

Materiality	• Overall Company materiality is EUR 1,967 thousand, which represents 2.5% of profit before interest, tax, depreciation and amortization (EBITDA).
Key audit matters	• Estimates involved in capitalisation of capital expenditures and determining their useful lives • Accounting for congestion income

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we considered where the Management Board made subjective judgments; for example, in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits, we also addressed the risk of management override of internal controls, including among other matters, consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

Materiality

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

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

Overall audit materiality	EUR 1,967 thousand
How we determined it	2.5% of profit before interest, tax, depreciation and amortization (EBITDA), as disclosed in Note 6.
Rationale for the materiality benchmark applied	We have applied EBITDA as the benchmark because, as described in Note 6, it is one of the key measures the management uses to assess the Company's performance.

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.

Key audit matter	How our audit addressed the key audit matter
Management's estimates involved in capitalisation of capital expenditures and determining their useful lives (refer to Note 2 "Summary of significant accounting policies", Note 3 "Critical accounting estimates and judgments in applying accounting policies" and Note 10 "Property, plant and equipment" for further details). In 2019 the Company capitalised additions to property, plant and equipment (PPE), mainly related to the construction of electricity and gas transmission network, in the amount of EUR 123.7 million. Expenditures are capitalised if they create new or enhance the existing assets, and expensed if they relate to repair or maintenance of the assets. Classification of the expenditures involves judgment. The useful lives of PPE items are based on management's estimates regarding the period during which the asset or its significant components will be used. The estimates are based on historical experience and market practice and take into consideration the physical condition of the assets. Capital expenditure is not considered to be an area of significant risk for our audit but as it requires considerable time and resource to audit due to its magnitude, it is considered to be a key audit matter.	We assessed whether the Company's accounting policies in relation to the capitalisation of expenditures are in compliance with IFRS. We obtained a listing of capital expenditures incurred during the year and, on a sample basis, inspected contracts and underlying invoices to ensure the classification between capital and operating expenditure was appropriate. We evaluated whether the useful lives determined and applied by the management were in line with historical experience and the market practice. We checked whether the depreciation of self-constructed PPE items was commenced timely, by comparing the date of the reclassification from construction in progress to finished projects, with the date of the act of completion of the work. As a result of our work, we noted no material exceptions
Accounting for congestion income (refer to Note 2 "Summary of significant accounting policies – Congestion income", Note 3 "Critical accounting estimates and judgments in applying accounting policies" and Note 14 "Deferred income" for further details). In 2019 the Company has received congestion fees of EUR 12.7 million and the deferred	We assessed whether the Company's accounting policy in relation to accounting for the congestions revenue is in compliance with IFRS. We evaluated the management's assessment on whether and when the congestion fees will be used for constructions of new interconnection capacities. We corroborated the information received with the Management and Supervisory

congestion revenue as of 31 December 2019 amounted to EUR 87.5 million.

Accounting for congestion fees received depends on the purposes for which it will be used. Congestion fees used for constructions of new interconnection capacities are recognised as deferred income (similarly to government grants), until such constructions are completed. Congestion fees used for the reduction of network tariffs are recognised in profit and loss.

Determining the appropriate accounting requires judgment. Due to the size and related estimation uncertainty, it is considered a key audit matter.

Board minutes of meetings describing future investments and with the capital expenditures budget.

We reconciled the balances of deferred congestion income to the confirmation letter by the third party.

Furthermore, we assessed the adequacy of the disclosures related to congestion income.

As a result of our work, we noted no material exceptions.

How we tailored our audit scope

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

The audit team performed full scope audit procedures for the Company.

Other information

The Management Board is responsible for the other information. The other information comprises the Management report (but does not include the financial statements and our auditor's report thereon).

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above 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. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the Management Board and those charged with governance for the financial statements

The Management Board is responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards as adopted by the European Union, and for such internal control as the Management Board 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, the Management Board 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 the Management Board 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.

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 scepticism 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 the Management Board.
- Conclude on the appropriateness of the Management Board'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 to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the 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.

Report on other legal and regulatory requirements

Appointment and period of our audit engagement

We were first appointed as auditors of the Company, as a public interest entity, for the financial year ended 31 December 2011. Our appointment has been renewed by tenders and shareholder resolutions in the intermediate years, representing the total period of our uninterrupted engagement appointment for the Company, as a public interest entity, of 8 years. In accordance with the Auditors Activities Act of the Republic of Estonia and the Regulation (EU) No 537/2014, our appointment as the auditor of the Company can be extended for up to the financial year ending 31 December 2030.

AS PricewaterhouseCoopers

Lauri Past
Certified auditor in charge, auditor's certificate no.567

28 February 2020

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

PROFIT ALLOCATION PROPOSAL

The retained earnings of Elering AS as of 31.12.2019 were EUR 143,737 thousand.

The Management Board of Elering AS proposes to the sole shareholder to allocate the retained earnings as follows:

To pay as dividends to the shareholder	EUR 20,600 thousand
To transfer to the statutory reserve capital	EUR 1,644 thousand
Not to distribute the remaining retained earnings	EUR 121,493 thousand

SIGNATURES OF THE MANAGEMENT TO THE 2019 ANNUAL REPORT

The signing of Elering AS 2019 Annual Report on 28.02.2020.

Taavi Veskimägi
Chairman of the Management Board

Riina Käi
Member of the Management Board

Kalle Kilk
Member of the Management Board

THE REVENUE OF ELERING AS ACCORDING TO EMTAK 2008

The revenue of Elering AS is divided by the main areas of activities as follows:

*EMTAK * classification*	*2019*	*2018*
35121 Transmission of electricity – transmission through the transmission network:	94,218	95,459
35221 Natural gas transmission	11,697	9,658
35141 Trade of electricity (balancing electricity)	28,849	30,253
35231 Trade of gas (balancing gas)	4,863	5,188
77399 Renting and leasing of other machinery, equipment and tangible goods	917	916
49501 Pipeline transport	678	583
47770 Retail sale of other second-hand goods	80	36
68201 Renting and operating of own or leased real estate	84	86
46699 Other sales	729	788

** EMTAK – classification of Estonian economic activities.*

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