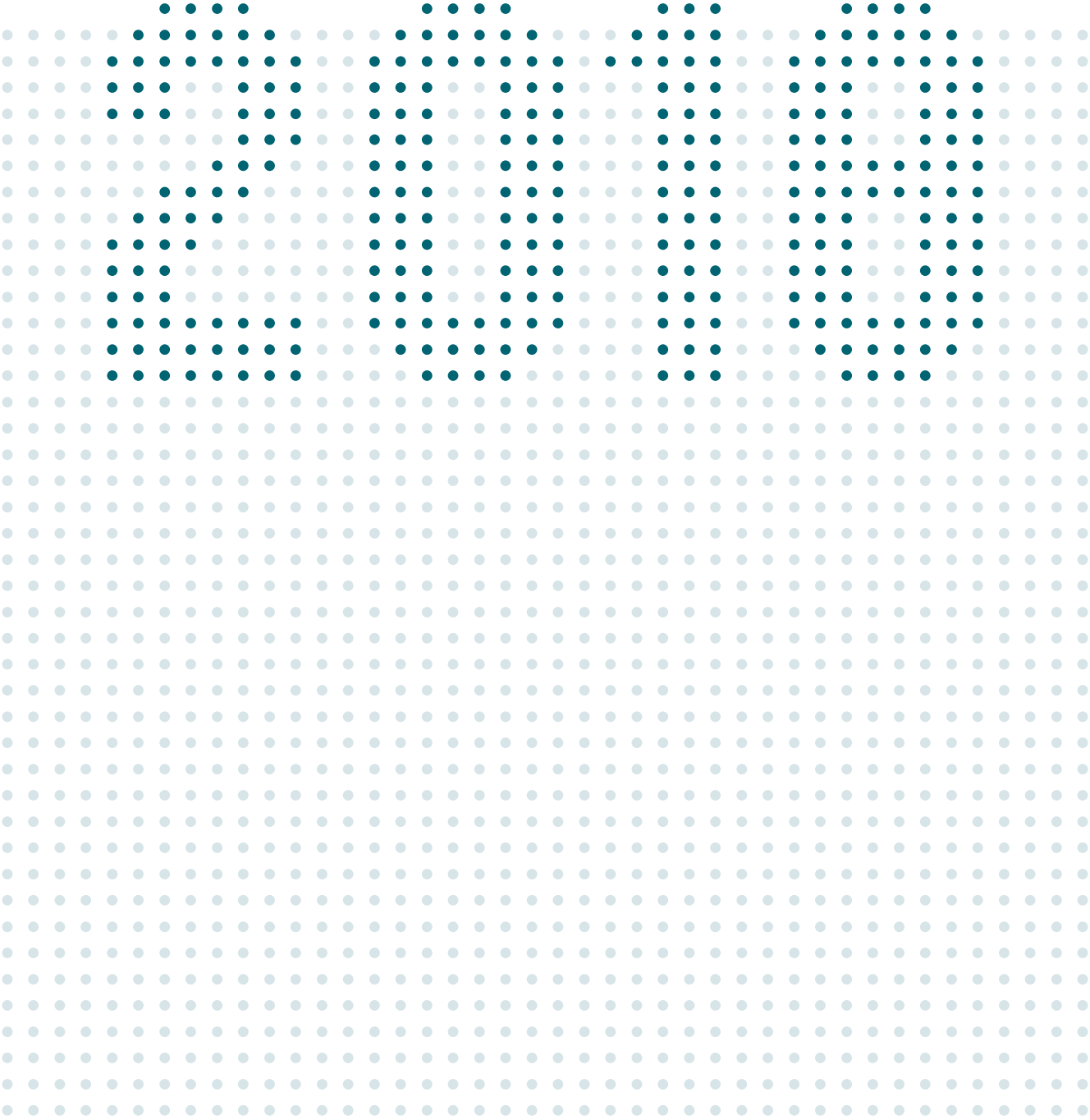
elering
GENERATING OPPORTUNITIES



Annual Report

elering
GENERATING OPPORTUNITIES

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Principal business activity:	Electricity and gas transmission
Chairman of the Management Board:	Taavi Veskimägi
Owner:	The Republic of Estonia
Auditor:	AS PricewaterhouseCoopers

Annual Report **2018**

MANAGEMENT REPORT – ELERING

STATEMENT BY THE CHAIRMAN OF THE MANAGEMENT BOARD

TAAVI VESKIMÄGI
chairman of the management board

A focus on security of supply of electricity and gas

Over its nearly 10 years of independent operation, Elering has grown used to doing big things, in terms of both impact and price tag. 2018 was no different in this regard. The focus of our activity lay on the clear goal of increasing the security of supply of electricity and gas to Estonian consumers: first, the synchronization of the Baltic electricity system with continental Europe by the year 2026; second, the establishment of Balticconnector along with a regional gas market; and third, developing digital solutions for more efficient management of the energy system and active inclusion of consumers on the energy market.

The first of these projects will reduce risks to Estonian electricity consumers' security of supply through desynchronizing from Russia and joining the Continental Europe frequency area by the year 2026. In synchronizing with the continental European electricity system, the Baltic states will develop the capability to manage their own electricity system, including frequency and electricity flow. Synchronization will also give us control of development of our power grid, bringing an end to the situation where electricity of third-country origin arrives in the Baltics and competes on the local energy market on an unfair footing.

Synchronization with continental European frequency area is not unreasonably expensive. In actuality, joining the continental European system will not raise but rather lower network charges. The Connecting Europe Facility will cover part of the investments – which we would also have to make if we remained synchronized with the Russian grid – so the expenses will not be passed on to consumers in the form of network charges.

To achieve synchronization, Estonia needs to renovate the existing two connections with Latvia and build a third connection. Work on the new connection began in 2018, and not a cent of Estonian electricity consumers' money will be spent on this investment. Thanks to the synchronization project, the renovation of the lines running from the Narva area via Valga to Latvia will likewise be accomplished largely with support from the European Union, which means these renovations will prove much less costly for consumers compared to a situation where solely consumers' money was used for that purpose.

As the second focus area, we are connecting Estonian and Finnish gas infrastructure and launching a regional gas market starting in 2020. By building the EstLink2 electrical connection, we established a joint Estonian-Finland electricity market, thanks to which people in Estonia have since 2014 enjoyed a lower electricity price than it would have been on a regulated market closed to competition. As of 2018, construction on Balticconnector are in full swing and we reached agreement with Finnish and Latvian colleagues on forming an interconnected gas market effective 1 January 2020. Similarly to the electricity market, the common gas market will mean the lowest possible prices and reduce dependence on gas from Russia even further.

The third central direction in our efforts is more active inclusion and empowerment of consumers on the energy market. The market needs digital solutions in which consumers are involved. Technological advances and digital solutions have brought us to a point where consumers can, by conscious choice or using smart devices, take part as equal parties on the market, deciding when and what price they are ready to consume or produce energy. Inclusion of consumers on the market and digital solutions also make it possible to supply electricity at the minimum costs as consumption peaks are levelled, allowing pointless investments in the network to be avoided.

To finance Balticconnector and desynchronization, Elering carried out a bond issue in 2018, raising 225 million euros. The bond featured the lowest fixed coupon achieved by a euro-denominated corporate issuance in the CEE region in the last 15 years. The successful issue will significantly reduce Elering's financial expenses and give certainty that major investments will be made.

With their diligent work, Elering's more than 200 employees are all doing their part to keep the lights on and the rooms warm in Estonian homes. 2018 was also a record-setting year in terms of the operational reliability of the transmission network managed by Elering, posting its lowest number of outages and a near record in terms of energy not served. I would like to thank all of Elering's personnel and partners for that achievement. The high reliability of the energy system is the foundation that gives us the societal trust to work on realizing strategic projects going forward. It should definitely be borne in mind that Estonian consumers' security of supply in the field of electricity and gas is, more than ever before, an international and not a domestic matter. Elering sets the bar for the quality of its activities and capability according to the highest international standards of excellence.

A SHORT INTRODUCTION TO ELERING

Important events in

2018

- Conclusion of Balticconnector construction contracts and the start of construction
- Start of construction of the third Estonian-Latvian electricity connection
- Submission of the first request for funding for the synchronization of the electricity system
- Refinancing of bonds

885
km of gas pipelines

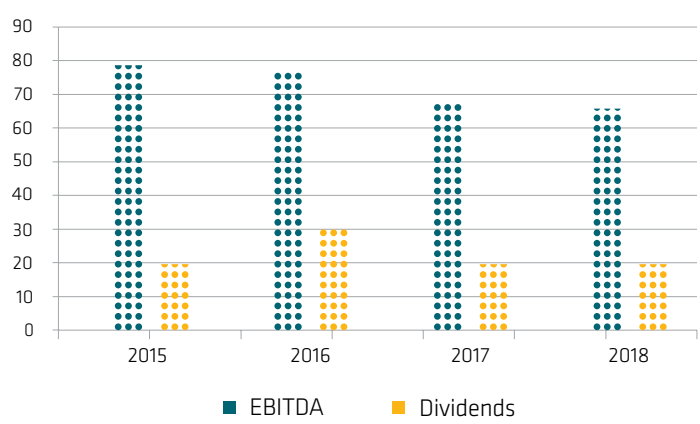
36
gas distribution stations

3
gas metering stations

5403
km of high voltage overhead and underground transmission lines

148
substations

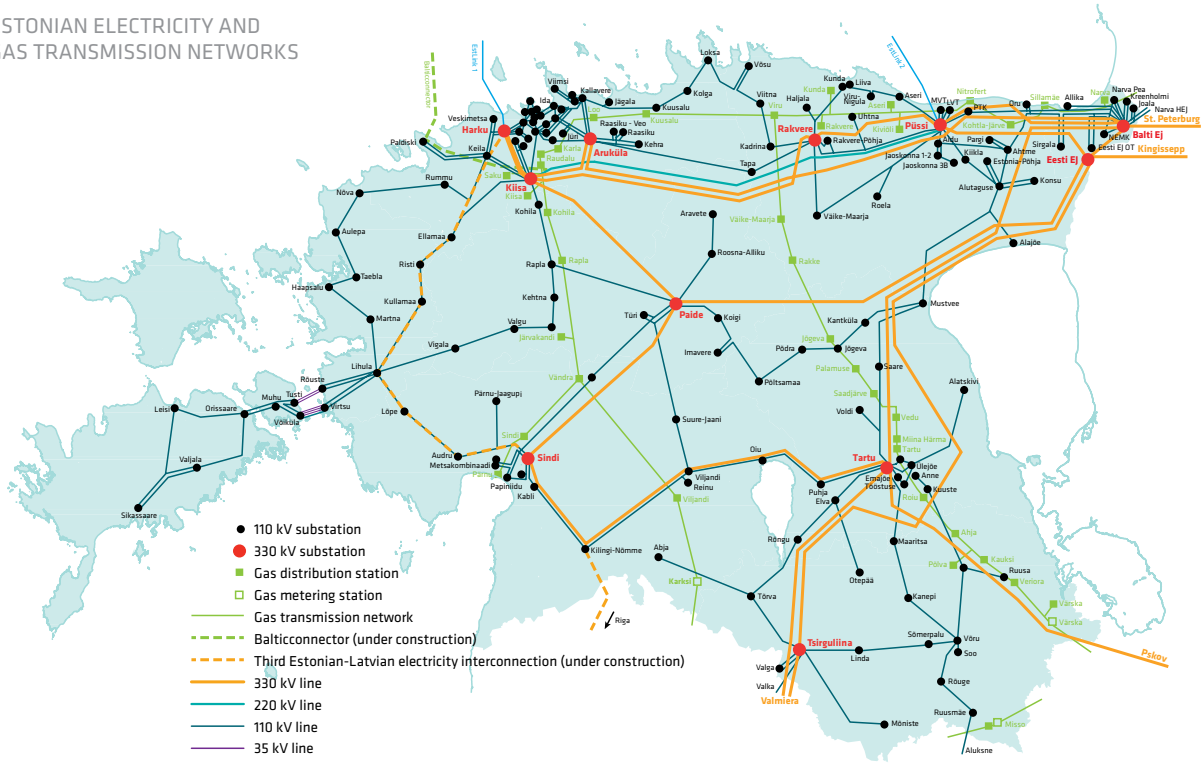
EBITDA and dividends



2
converter stations

139
km of EstLink underground transmission lines

ESTONIAN ELECTRICITY AND
GAS TRANSMISSION NETWORKS



Main financial indicators (MEUR)

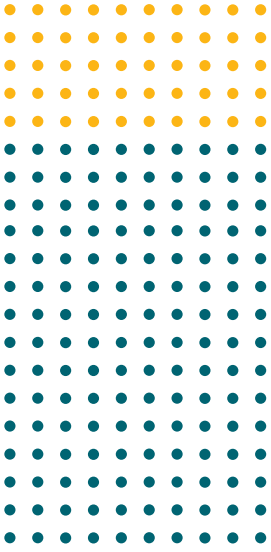
	2015	*2016*	*2017*	2018
Revenue	132.4	135.9	131.9	144.8
Operating expenses	90.9	98.1	98.8	113.9
Operating profit	41.6	37.8	33.1	31.0
Financial expenses	11.4	11.4	11.0	7.3
Corporate income tax	5.0	7.8	5.0	5.0
Net profit	25.1	18.7	17.1	18.6
Loans	379.2	367.4	362.3	353.7
Owner's equity	329.4	349.1	346.2	384.8
Assets	861.9	903.7	909.6	948.4
EBITDA	78.6	76.0	67.6	65.7
Investments	93.1	26.7	32.2	125.0
Dividends	20.0	31.0	20.0	20.0
Ratios				
ROE	7.8%	5.5%	4.9%	5.1%
Owner's equity / Assets	38%	39%	38%	41%
Net loans / EBITDA	4.1	4.1	4.1	4.4

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

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

221

people, of whom
25% are women



average age **44**

average length of employment **13**

voluntary employee turnover **5.1%**

OVERVIEW OF MAIN ACTIVITIES

Elering is an independent power and gas system operator whose main duty is to ensure the availability of a high-quality energy supply to consumers in Estonia. Elering connects a system of manufacturers, various network operators and consumers into a single whole.
In addition to the physical electricity and gas networks, Elering is also developing an IT infrastructure for the energy sector that gives service providers the opportunity to develop and deliver smart solutions for energy production and consumption. Smart grid solutions enable energy producers and consumers to analyse the created data and thus increase the efficiency of energy production and consumption. Elering's smart grid services and applications are available from the e-elering client portal.

KEY INDICATORS OF THE ESTONIAN ENERGY SYSTEM

Last year, Estonia's domestic electricity consumption together with network losses totalled 8.7 terawatt-hours, which is a three percent increase compared to 2017. Electricity production decreased by a total of six percent from last year, amounting to 10.6 terawatt-hours.

On the whole, last year's power production exceeded consumption by 21 percent in Estonia, amounting to 1.9 terawatt-hours of net exports.

Eelectricity balance, GWh	*2018*	*2017*	*Change %*
Electricity production in Estonia	**10,583**	**11,234**	**-6%**
Domestic production of electricity supplied to Elering's network	10,225	10,925	-6%
Production of renewable energy in Estonia	1,665	1,653	1%
Electricity supplied to the network from foreign transmission lines	**3,485**	**2,313**	**51%**
· including power supplied to the network from Finland	2,391	1,679	42%
· including power supplied to the network from Latvian and Russian transmission lines	1,094	634	72%
Total power supplied to the network	**14,068**	**13,547**	**4%**
Electricity consumption in Estonia	**8,717**	**8,500**	**3%**
Elering's domestic transmission service for consumption	7,980	7,865	1%
Elering network losses	380	325	17%
Electricity supplied from the network to foreign transmission lines	**5,350**	**5,047**	**6%**
· including electricity from the network supplied to Finland	874	872	0%
· including electricity from the network supplied to Latvian and Russian transmission lines	4,477	4,175	7%
Total electricity capacity that passed through the network	**14,068**	**13,547**	**4%**
Balance	**1,866**	**2,734**	**-32%**

In 2018, the amount of gas supplied for internal consumption via the Elering gas transmission network - 5.2 terawatt-hours - remained at the same level compared to last year.

Gas Balance, GWh	*2018*	*2017*	*Change %*
Transit Flow (Misso)	15,155	12,983	17%
Gas supplied to the transmission network internationally	5,241	5,234	0%
Gas supplied from the transmission network for domestic consumption	5,216	5,219	0%
Transmission network losses, including own consumption	12	16	-22%
Change in transmission network capacity	**4**	**-3**	**-204%**

Security of Supply

Elering's mission is the security of the electricity and gas supply for Estonian consumers. The security of the supply of electricity 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. The Estonian gas system's security of supply will be significantly improved by the completion of Balticconnector, a Finnish gas connection, which was started in 2018 and is scheduled for completion at the end of 2019.

Market Development

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. An important step was taken in mid-2018 and the European intra-day electricity market XBID was opened, allowing for intra-day electricity trading with a large part of Europe. In the gas market, an important step was taken in the development of the regional gas market, where Estonia, Finland and Latvia agreed on the opening of a harmonised gas market in early 2020. This coincides with the completion of the Balticconnector gas connection between Estonia and Finland. 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. According to the plan, Estonia and Latvia will be merged into a unified balance zone in 2020 and Finland will join the balance zone in 2022.

Reliability of energy networks

In 2018, Elering's gas and electricity networks both transmitted energy with required reliability. The gas network experienced no dangerous incidents or interruptions for gas consumers. The power network experienced the lowest ever total number of failures. The amount of energy that was not transmitted to customers as a result of failures was also very small. In general, cross-border electricity connections worked very well, with only one extended failure occurring in the EstLink 1 Espoo converter station in Finland. The extent of restrictions imposed on cross-border electricity trade was minimal. The main reliability indicators are shown in the following table.

Reliability indicators	*2018*	*10-year average*
Number of outages, pcs	86	174
Energy not served, MWh	18.5	145

DEVELOPMENT OF ENERGY SYSTEMS

KALLE KILK
member of the management board

In 2018, Elering started construction works on two strategically important projects - the Balticconnector gas interconnection between Estonia and Finland and the third electricity interconnection between Estonia and Latvia. In the synchronisation project between the Baltic States and continental Europe, a political agreement was reached on the solution to be used, which allows the start of the realisation of the investments necessary for the synchronisation.

The construction contract for the offshore part of the Balticconnector gas interconnection was signed in March 2018, and most of the preparatory work of the seabed had been carried out by the end of the year, which allows the pipeline installation to begin in the summer of 2019. By the end of the year, the offshore pipelines had been manufactured by the factory and placed in storage awaiting pre-installation transport. Contracts were signed regarding the onshore parts of the pipeline, the compressor stations and the Karksi gas metering station. In the sub-projects for the onshore pipeline and gas metering station, design works were carried out and construction works were started on the site. With regard to the compressor stations, design work was undertaken and the procurement of equipment was carried out under the construction contract. The Balticconnector interconnection will be wholly available to the gas market by 2020.

The synchronisation of the Baltic States with continental Europe has been under preparation for more than ten years. In 2018, based on a number of large-scale studies it was finally possible to reach a solution suitable for all parties involved. On 28 June 2018, the Prime Ministers of Estonia, Latvia and Poland, the President of Lithuania and the President of the European Commission signed an agreement, according to which the Baltic States will be connected to the continental Europe network through Poland in 2025. Based on this agreement, a formal merger procedure was initiated – on 21 September 2018, the Polish transmission network operator submitted to the relevant regional group of the European Network of Transmission System Operators (ENTSO-E) an application for extension of the continental European networks to the Baltic States. The Baltic States also jointly submitted an application to the Connecting Europe Facility for co-financing the investments made during the first phase.

Within the framework of the Estonian-Latvian third electricity interconnection, construction works started on the Pärnu side of the Harku-Sindi transmission line that will continue stage-by-stage towards Tallinn. A transmission line of approximately 175 km in length will be completed by the end of 2020 and the associated construction costs will amount to nearly 60 million EUR. Additionally, to complete the project, a transmission line section from the Kilingi-Nõmme substation to the Latvian border must be constructed and transmission line connections to substations must be established.

Regarding domestic electricity network construction works, the works enabling client connections were completed at the Illuka and Kuusalu substations. The substations of Ida, Kullamaa, Tabasalu, Kopli, Sindi, Vändra and Orissaare were reconstructed to renew the electricity network.

OVERVIEW OF ECONOMIC ACTIVITY

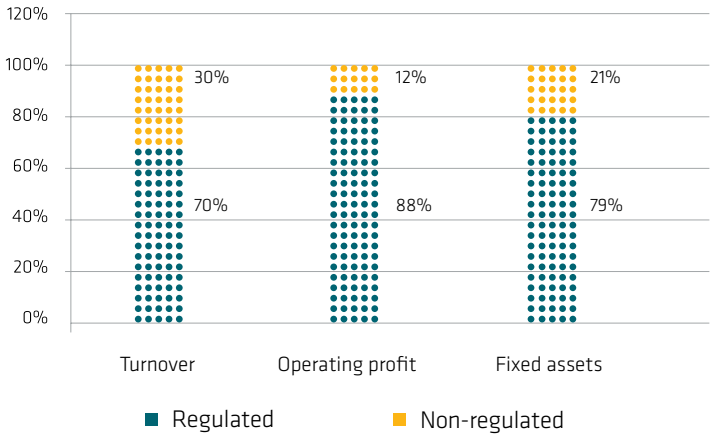
PEEP SOONE
member of the management board

Nature of Economic Activities

Elering's economic activities can 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, as can be seen from the graph below.



The regulation of network activity consists of determining the maximum allowable revenue for the transmission of electricity and gas, which consists of the expenses necessary for the activity and the operating profit. The operating profit is obtained by multiplying regulated assets with the reasonable return on capital (WACC). As network activity is regulated, the network charges are approved by the regulator, i.e. the Estonian Competition Authority. The regulator assesses whether the costs presented in the network charges application are justified and prescribes a reasonable return, which is calculated based on the *Capital Asset Pricing Model*.

The company has a total of 28 electricity network service customers and 11 gas network service customers. Most network service revenues (89%) come from customers that are regulated distribution network operators, which operate as natural monopolies. The largest customer by far is Elektrilevi OÜ (77% of the network service revenues), a distribution network operator that is part of the Eesti Energia AS group, which in turn is owned by the Republic of Estonia.

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

To ensure a stable frequency of electricity in the electricity system, the system must be balanced, i.e. production must be equal to consumption at any given time. To do this, all market participants need to be similarly in balance and most of them buy their electricity balance balancing services from balance providers. Elering, in turn, provides balance providers (a total of eight providers) with their electricity balance balancing service.

The principles of balancing the gas system are generally the same. The only difference is that the gas system does not have to be balanced at all times. If gas consumption is higher than the inflow, the pressure in the system starts to drop 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 the balance providers (a total of nine providers).

The balancing service does not have a significant impact on Elering's profit because the price of the balancing service is calculated in such a way that the revenues earned from it cover the expenses necessary for its provision.

Financial Results

Total revenue amounted to 144.8 MEUR (2017: 131.9 MEUR). The most important source of revenue was the sale of network services, totalling 102.7 MEUR (2017: 98.9 MEUR). This came from electricity network services (90%) and gas network services (10%). 94% of the revenue from network services came from network tariffs.

Balancing and regulation services totalled 35.3 MEUR (2017: 27.2 MEUR).

The main reason for the increase in revenue was increased income from balancing services, which was caused by the new unified Baltic electricity balance management system and regulation market that was launched on 1 January 2018.

Operating expenses totalled 113.9 MEUR (2017: 98.8 MEUR). The growth was mainly due to two factors: the increase in balancing and regulation services (+8.1 MEUR) and an increase in the cost of electricity network losses. The costs of balancing and regulation services increased for the same reason as the corresponding revenue, i.e. because of the launch of a new unified Baltic balance market. The increase in the cost of network losses was caused by the increase in power exchange prices within the Nord Pool Estonian price area. In 2017, the average price was 33.2 €/MWh, but in 2018, it had increased to 47.1 €/MWh.

The difference in revenue and operating expenses was 31.0 MEUR (2017: 33.1 MEUR).

Net financial expenses were 7.3 MEUR (2017: 11.0 MEUR) and corporate income tax expense was 5.0 MEUR (2017: 5.0 MEUR). Net profit was 18.6 MEUR (2017: 17.1 MEUR).

Investments

The company's investments can be divided into ordinary and cross-border.

Ordinary investments primarily consist of the replacement of depreciated parts of the electricity and gas networks. On average, such investments amount to approximately 30 MEUR per year.

In addition to ordinary investments, Elering has initiated an intensive extraordinary investment 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 chapter on Development of energy systems. The projected amounts of cross-border investments are shown in the table below.

MEUR	*Total investment*	*<= 2018*	*2019-2023*	*2024+*	*Investment*
Estonian-Latvian third electricity interconnector	80	29	51	0	2017-2020
Synchronisation	377	0	196	182	2018-2025
Estonian-Finnish gas interconnector	144	65	79	0	2013-2020
Estonian-Latvian gas interconnector	47	11	36	0	2015-2020
GIPL (Gas Interconnection of Poland-Lithuania)	1,5	0,0	1,5	0	2021
Total	**649**	**105**	**363**	**182**	

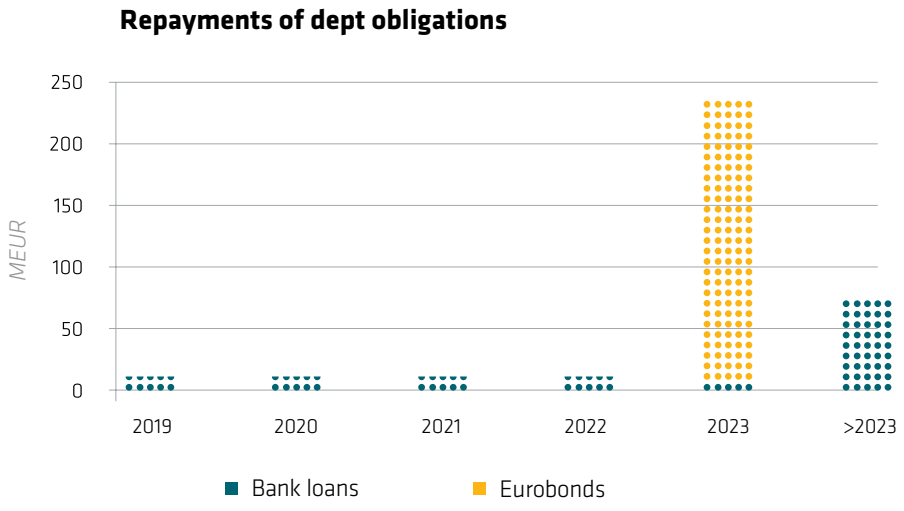
Financing

The company's interest-bearing liabilities as of the balance sheet date are as follows:

MEUR	
Depreciable portion of long-term bank loans	11
Short-term interest-bearing liabilities	**11**
Eurobonds	224
Long-term bank loans	119
Total long-term interest-bearing liabilities	**343**
Total interest-bearing liabilities	**354**

Elering has Eurobonds in the nominal amount of 225 MEUR, listed on the London Stock Exchange. Their maturity is 03.05.2023 and the coupon is 0.875%.

Bank loans have been taken from the European Investment Bank and the Nordic Investment Bank. Loans are amortising and their final instalment payment is set to occur in 2033. The repayment schedule for the debt obligations is as follows:



In addition to the interest-bearing liabilities, Elering also finances investments from sources that do not incur expenses on interest. The primary source is non-repayable EU grants. The company has entered into financing agreements with the EU agency INEA to finance the following projects:

a. Electricity transmission line connecting Estonia and Latvia;
b. The sub-sea gas pipeline connecting the Estonian and Finnish gas networks along with the accompanying infrastructure;
c. Strengthening the connection between Estonian and Latvian gas networks.

Additionally, on 15.02.2019 the European Commission approved the proposal from the Connecting Europe Facility Coordination Committee to grant non-repayable aid to the first phase of the synchronisation in the amount of 141 MEUR.

Summary of expected EU aid for cross-border investments:

In MEUR	*EU aid, projected*	*including EU aid, already decided*	*Receipt of EU aid, <= 2018*	*Receipt of EU aid, 2019-2023*	*Receipt of EU aid 2024+*
Total	**362**	**307**	**30**	**215**	**117**

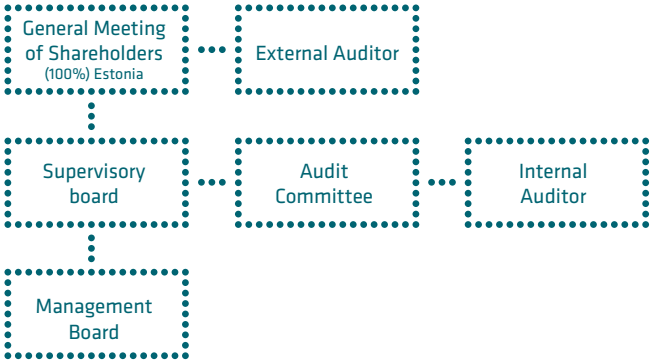
Another source of financing that does not involve expenses on interest is congestion revenue. This comes about in situations where differences in prices occur between different price areas (countries) and the power exchange transfers the funds that were accrued as a result of the price differences to the transmission network operators. In accordance with EU legislation, the money thus obtained must be used primarily to increase cross-border transmission capacity. As of year-end 2018, Elering has accrued 75 MEUR in this way.

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

CORPORATE GOVERNANCE

The management of Elering is based on the Commercial Code, the State Assets Act, Elering's Articles of Association and the Corporate Governance Code (CGC), which has been prepared by the Estonian Financial Supervision Authority and OMX Tallinn Stock Exchange. Elering is dedicated to complying with corporate governance best practices and strives for continuous improvement in that area. We consider this a prerequisite for achieving our strategic objectives and in designing our organisational culture. A more detailed report regarding compliance with the CGC in 2018 is available from Elering's website: **https://elering.ee/investorile#tab2.**

Corporate governance structure



General meeting of shareholders

The general meeting is Elering's highest governing body. The competences of the general meeting include making amendments to the articles of association, increasing and decreasing share capital, electing and removing members of the supervisory board, electing auditors, appointing a special audit, approving the annual report and distributing the profit and making a decision 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.).

At the general meeting, the owner is represented by the Minister of Economic Affairs and Infrastructure, who was Kadri Simson in 2018.

In 2018, one general meeting was held on 29 May, which approved the annual report for 2017 and the profit distribution.

Supervisory Board

The interests of the owner are guaranteed by the 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.

Supervisory board membership and remuneration

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, based on a recommendation from an independent nominating committee. The chairman of the supervisory board organises the work of the supervisory board. The chairman of the supervisory board determines the agenda of the supervisory board meeting, chairs the

meetings of the supervisory board, monitors the efficiency of the work of the supervisory board, organises the prompt disclosure of relevant data to the members of the supervisory board, ensures that the supervisory board has sufficient time to access the data and prepare the decisions and represents the supervisory board in its relations with Elering's management board. For the purposes of organising the work of the supervisory board, the general meeting has established the rules of procedure of the supervisory board.

In 2018, there were four ordinary and two special meetings. The supervisory board approved the annual report for 2017 before submitting it to the annual general meeting of shareholders for approval and approved Elering's strategy for 2019-2028 and the 2018 business and investment budgets. At its meetings, the supervisory board usually addresses issues arising from regulations and laws, financial issues and other important issues concerning Elering's main activities.

In 2018, Elering's supervisory board consisted of the following members:

- Timo Rajala, chairman of the supervisory board since 14.06.2017 (entrepreneur), participated in four meetings and two electronic votes.
- Timo Tatar from 26.03.2012 (Head of the Energy Department at the Ministry of Economic Affairs and Communications), participated in four meetings and two electronic votes;
- Indrek Kasela from 21.08.2016 (entrepreneur), participated in four meetings and two electronic votes;
- Tarmo Porgand from 22.05.2017 (Deputy Head of the State Assets Department at the Ministry of Finance), participated in four meetings and two electronic votes.
- Toomas Põld from 22.05.2017 (entrepreneur), participated in four meetings and two electronic votes.

In 2018, the remuneration for the members of the supervisory board of Elering AS, including taxes, amounted to 71.8 thousand EUR. There is no severance pay or other benefits paid to the members of the supervisory board.

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 Elering's governing body, which represents and manages the company's day-to-day operations pursuant to relevant laws and the articles of association of the company and also organises the company's accounting. Elering's management board 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 about the economic situation of the company and the most important circumstances with regard to the economic activity and inform the supervisory board of the most important circumstances with regard to the economic activity, as necessary.

Management board membership and remuneration

According to the articles of association, the management board can have one to three members. A member of the management board is elected by the supervisory board for up to five years. According to Elering's articles of association, 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 as well as specify the member's remuneration.

For the entirety of 2018, Elering's management board consisted of three members:

- Taavi Veskimägi, as the chairman of the management board, among other things, performs 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 Elering's financial activities, administration and information technology related matters;

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

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. A bonus can be paid to a member of the management board on the basis of annual results, or on a different basis, based on a supervisory board decision. The remuneration of the members of the management board is fixed and stipulated in the contract concluded with the management board member. Elering has no long-term bonus schemes in place. 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.

In 2018, the remuneration paid to the members of the management board of Elering AS, including taxes, was 528.1 thousand EUR.

Avoiding conflict 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. In 2018, Elering has not engaged in any transactions with members of its management board or any related parties.

Audit committee

The supervisory board elects an audit committee of up to five members, charged with overseeing risk management, internal control and financial reporting. The audit committee is an advisory body to the supervisory board in the areas of accounting, sworn auditor's independence control, risk management, internal control and audit, conducting oversight and budgeting and ensuring legal compliance 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. Members of the audit committee are remunerated for their participation in the audit committee, totalling 4.7 thousand EUR in 2018 including taxes. Until 28 March 2018, all members of the supervisory board of Elering were members of the audit committee. From 29 March 2018, the members of the audit committee are:

- 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 at the Ministry of Finance).

In 2018, the audit committee met four times: on 02.04, 25.05, 26.09 and 29.11. The audit committee dealt with the following internal audits: administration; managing large investment projects; renewable energy management; IT management.

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. The management board and the supervisory board work together to develop the company's strategy. 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 mana-

gement 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, the decisions of and the goals set by the general meeting and the supervisory board meetings.

Publication of Information

The Elering website www.elering.ee contains information that is subject to publication pursuant to relevant laws. The website presents annual reports, financial results, performance indicators, an overview of main activities, the structure, a summary of the strategy, news and announcements and other information necessary for investors and the general public. The site can also be read in English. The information (including news and announcements) on www.elering.ee is constantly updated.

Financial Reporting and Auditing

Elering's management board 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 together 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 recognised 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 with the auditor sets out the auditor's duties, schedule and remuneration. A contract concluded with an auditor may not obstruct the auditor in any way in assessing the activities of the company.

In spring 2017, a new procurement was carried out to find an auditor for 2017-2021. The tender was awarded to 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 No 537/2014 that entered into force in 2016.

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 2018:

- 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

Elering's risk management is in accordance with the principles of ERM (*Enterprise Risk Management*). Elering's risk management goals are to:

- manage and describe the company's risk management processes;
- define the roles and responsibilities of those involved in the risk management process;
- ensure that all risks are identifiable, measurable and can be rapidly responded to;
- enable managers to better understand and manage risks.

The principles of Elering's risk management policy must ensure that:

- the company's culture, processes and structure favour the achievement of the company's strategic goals and, at the same time, allow the identification, management, monitoring and, where possible, mitigation of risks;
- the company's risk monitoring and management and the internal control system are all based on the internationally recognised risk management model "*Enterprise Risk Management* (ERM) Model", developed by COSO (*Committee of Sponsoring Organizations of the Treadway Commission*);
- the company's risk management takes into account all relevant laws, standards, regulations and contractual obligations as well as the requirements and expectations of the society;
- the company constantly improves its risk management related activities.

The management board is responsible for the functioning of the company's internal control system. To ensure the functioning of the internal control system, the services of an internal auditor are contracted from an auditing company. With regard to the auditing activities, the internal auditor reports to the audit committee.

From 2017-2019, the internal auditing service is provided by KPMG Baltics OÜ. In carrying out its internal audit function, the company complies with the laws of the Republic of Estonia and the internal audit guidelines published by the International Association of Internal Auditors (IIA), including European Union Regulation No 537/2014 that entered into force in 2016.

An internal audit is an independent, objective advisory activity that provides security and is designed to add value to and improve the performance of an organisation. It contributes to the achievement of the organisation's goals by using a systematic and orderly approach to assess and improve the effectiveness of risk management, control and administrative processes. The internal audit function is independent of the areas being audited and reports to the company's audit committee.

Equal treatment

As a system operator, Elering has system responsibility pursuant to the Electricity Market Act, i.e. the obligation to ensure the security of supply and balance of the power system at all times. The system operator exercises its rights and performs its obligations in accordance with the principle of equality of treatment.

To ensure the equality of treatment, Elering has established internal procedures and, based on national and European Union legislation, including network codes, has prepared various standard terms, methodologies and other rules that are published on the company's website and approved by the Estonian Competition Authority.

ORGANISATION AND PEOPLE

The foundation of Elering's sustainable economic growth is its stable, highly educated and experienced workforce.

At the end of 2018, Elering employed 221 people. The employees' average length of employment is just over 13 years and the average age is almost 44 years. Nearly three quarters of the workforce are men.

Elering has always been characterised by low labour turnover, in 2018, it was 5.1 percent (voluntary turnover). Low labour turnover is a strategically important indicator for maintaining the high level of competence necessary for Elering's main activities. To maintain this level, it is important to engage in good dialogue with the 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 students and people engaged in continuing studies flexible working arrangements and additional days of study leave for energy students. To keep Elering as an energy sector employer easily accessible to students, Elering scholarships are awarded. Within the framework of the programme, graduate students and doctoral students studying in Estonian universities receive support to conduct research on cutting-edge topics related to energy. The scholarship programme is implemented to improve and promote Elering's energy competence centre.

Elering's human resource management and personnel related activities are guided by Elering's human resource management policy, 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. Resulting from the summary of the biennial employee commitment survey, and in cooperation with all Elering's leaders, an action plan titled "Our Elering" ("Meie Elering") was prepared at the beginning of 2018, the implementation of which is coordinated by a steering group established for this specific purpose.

In Elering, the year 2018 kicked off with a company-wide annual seminar “The Learning Elering” ("Õppiv Elering"), where topics related to IT, digitalisation and organisational learning were discussed in addition to the previous year's summary and an introduction of the goals for the upcoming year. 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. To create better synergies between different activities, and to 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 different topics and provide broader perspectives and challenges for the employee. Collaboration within and between teams is also promoted through team-building meetings and team-to-team collaboration 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 way, both new and experienced, younger and older Elering people can establish good contact by sharing experiences and learning from each other. The annual joint events, such as the annual seminar and reception on Elering's Independence Day, sports day, summer seminar and celebration of the anniversary of the creation of a combined system operator that takes place in the autumn, have all become part of a great tradition.

We support a healthy lifestyle and therefore, in addition to a sports compensation, we also hold various sporting events and weekly supervised recreational calisthenics at the office. Compulsory health examinations are carried out every two years, and employees aged 40+ can undertake an exercise stress test.

In 2018, the month of January in Elering was the "Recognise Your Colleague" month and May was the "Health Month". With these thematic months, we offered our employees a variety of ways to recognise their co-workers and improve their own mental and physical well-being as well as that of their colleagues'.

Approximately one fifth of Elering's current employees are retiring in the next five years, while universities admit fewer students to energy related study programmes. Elering cooperates with universities to promote energy education and create a pool of potential future employees by annually organising a traineeship programme specifically for energy students. In 2018, we conducted an employer reputation survey among energy students and according its results, Elering is among the top three most preferred employers. Conducting the survey consistently, and implementing necessary improvements based on feedback received from energy students, forms the basis for ensuring a sufficient number of future employees for Elering. We also involve more IT students in our internship opportunities, and we have participated in the "Choose IT" ("Vali IT") programme to help people from other disciplines retrain to become IT specialists.

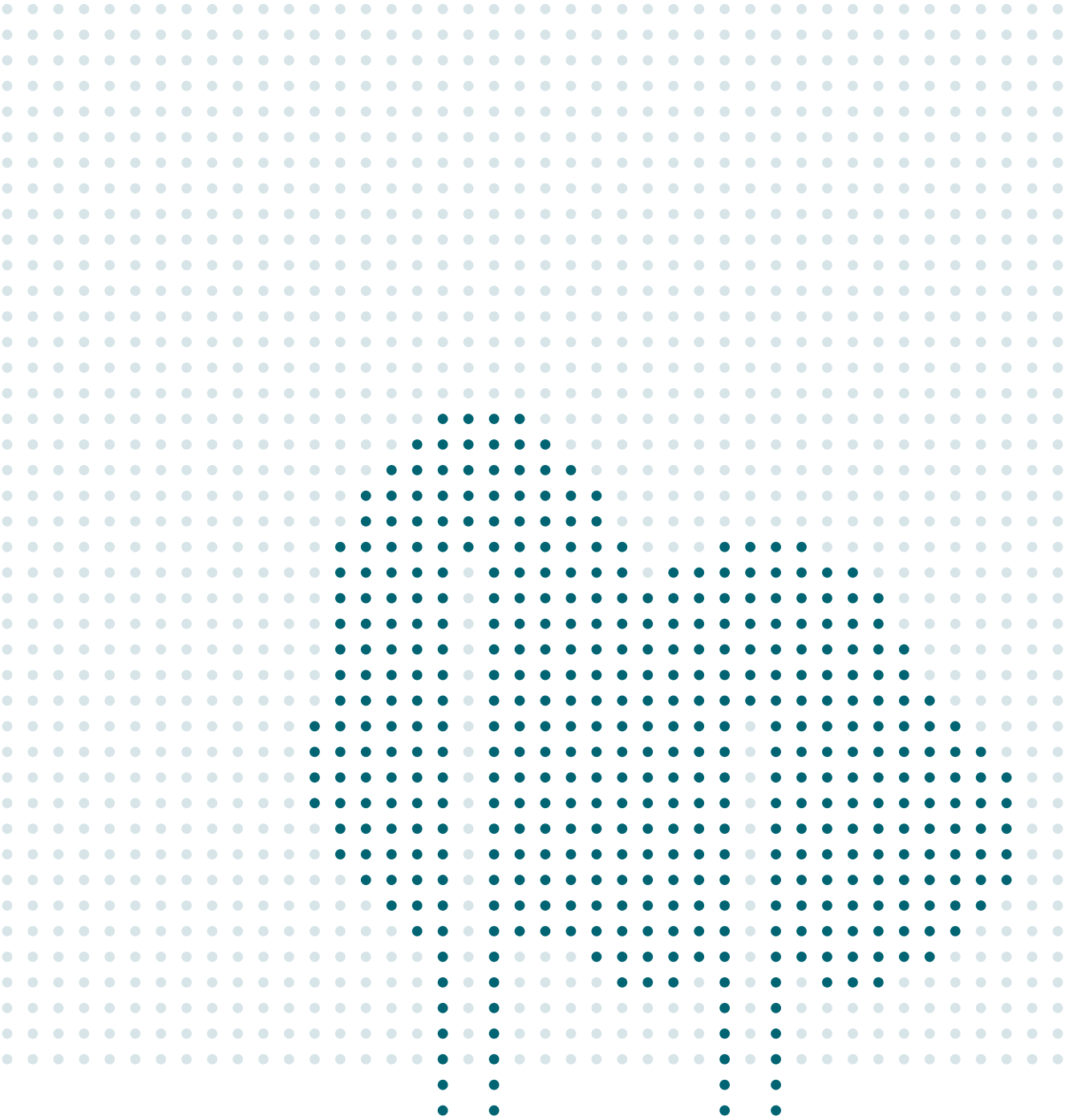
Close to 90 new employees have joined Elering in the last five years, which means that organising systematic induction and development activities is essential. The duration of the induction programme is approximately 2-3 months. In the course of the programme, new employees meet with representatives 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 2018, 27 employees participated in the mentoring programme that takes place within the new employee induction programme.

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 know-how within the company. To better disseminate know-how in-house, we have launched a series of "Seminar Fridays", where different Elering specialists introduce the latest developments in their field. In 2017, we developed the Elering Academy development programme meant for professionals with a high development potential and seven of our young colleagues were the first graduates of the programme in 2018. To support the development of our leaders, we formulated Elering's good management practices guide together with our leaders, and we also collected valuable feedback about its performance in our teams.

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 necessary conditions for people with special needs to be able to work in the same work environment (lifts, comfortable entry into rooms). For all office workers, the new office building offers workspaces with a spacious, bright and modern interior and good indoor climate. It is possible to use quiet and private workspaces and ergonomic tables in the office. Employees working on the transmission lines wear specific clothing and have comfortable extra rooms for showering, dressing and drying their clothes.

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 by having 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. The following are some of Elering's most important environmental activities in 2018.

Transmission line maintenance works

In addition to constructing new transmission lines, it is equally important to properly maintain existing transmission lines. In 2018, we dismantled 308 meters of oil cables along with cable ducts and wells, and we disposed of 10 power pylons and foundations.

In the case of construction work and, in part, maintenance work, the vehicles used for accessing the power transmission lines may damage the fields when driving over them. For this purpose, Elering tries to conduct works during periods when the damage is less significant (for example, after the harvest time). In cooperation with various parties (landowners, local government, the regulator, subcontractors), Elering has been looking for ways to ensure that the ground underneath the power transmission lines can be taken into use as a field after it has been cleared of scrub. Subcontractors conducting transmission line maintenance have purchased large mills at the request of Elering, which help turn the land underneath the transmission lines into arable land – this activity starts in the beginning of 2019. Any trees felled near the transmission lines are the property of the landowner, which go to the landowner for further use. When clearing scrub from underneath the transmission lines, landowners are consulted on how to use the scrub, which may not have any calorific value, in the most appropriate way.

Elering have introduced a digital solution to better assess and manage the durability of transmission lines. Instead of still using paper, we now store information about the status of the transmission lines in a special digital environment by using tablets, which allows us to discover more defects. The level of unawareness is therefore lower and the information necessary for extending the lifetime of the transmission lines is more easily accessible.

Extended infrastructure lifetime reduces its impact on the environment. The new substations will have a 30-year lifetime, 50 years for power transmission lines and 60 years for pylons. Over time, however, some power system equipment still needs to be replaced to extend the overall lifetime of the equipment. Extending the lifetime is also enhanced by proper maintenance. From 2017-2018, Elering found solutions for upgrading pylon foundations in cooperation with TalTech and suppliers of concrete products. To prevent rusting, pylons are regularly painted over, and concrete pylons are repaired (Elering has developed technologies on how to do this). To protect the pylons, so-called pylon caps are also installed, which were missing from pylons installed in Soviet times, i.e. the pylons were hollow and the weather decreased their service lifetime.

Activities at substations

At Elering's substations, environmental pollution can be caused by oils, chemicals and hazardous waste (mainly battery packs) that may leak from the transformers. Potential environmental hazards may also arise from the substation transformers when taking oil samples and electrolyte samples from battery packs, wherein small amounts of hazardous substances may be released into the environment.

In connection with the reconstruction of substations in 2018, existing transformer oil collection systems at the substations of Kullamaa, Kuusalu, Orissaare, Rõngu and Vändra were renovated to reduce the potential negative environmental impact.

Noise protection walls were installed on the electricity transformer at the Tapa substation to reduce the amount of noise emitted into the surrounding environment from the substation's equipment.

Measurements of noise emittance from the substation's equipment were also performed at Tartu substation. The results of the measurements did not exhibit any exceedance of the limit values and there is no need to install noise protection walls.

Protection of birds

Flying into the power transmission lines is life-threatening to birds. In cooperation with the Estonian Ornithological Society, Elering is exploring possible solutions to make power transmission lines more visible and safer for birds. As one of the solutions, bird barriers are installed above the pylon insulators and on the transmission lines, preventing birds from sitting on them.

In 2018, we started marking the section of transmission lines on the Harku-Lihula-Sindi high-voltage overhead transmission lines from the Lihula substation to the Harku one with transmission line markers or so-called "bird scarers". The purpose of the activity is to reduce the death rate of birds and thus the negative environmental impact of the transmission line. We are marking around 20 sections totalling 40 km in length by installing a total of 9,000 transmission line markers.

New directions in construction

The new Harku-Sindi-Riga transmission line, the construction of which launched in 2018, employs a novel set of construction principles in comparison with practices. In the past, pylons that occupied a large plot of land were used, but on this transmission line, we are using freestanding pylons on sections that run over arable land, which take away a smaller piece of land from the farmers' use.

Local residents are also more pleased with underground transmission lines instead of overhead ones. In 2018, we replaced the overhead transmission line with an underground one on the Veskimetsa-Järve section.

As a vital service provider, it is currently difficult to find additional alternatives that can reduce the environmental footprint. Elering has also consulted network operators in other countries. The primary area in which Elering can reduce the footprint of its activities is the reduction of electricity losses. To this end, increased attention is paid to network optimisation in the planning process – resolving the from-to construction question and making a choice between alternatives that have different losses. Elering's energy systems planning unit is looking for solutions on how to use existing tracks and optimise them when upgrading transmission lines and routes, so a single transmission line can be built instead of multiple ones.

The new energy efficient main building was completed

At the turn of the year 2017/2018, Elering started work on a renovated main building on Kadaka rd. in Tallinn, which corresponds to the energy efficiency class A (a near-zero energy building). Energy-efficient and renewable energy technologies have been used in the construction of the building, including solar cells with a total capacity of 80 kilowatts for energy production, and rainwater is recycled into the toilet flushing cisterns.

New sub-sea transmission lines in the Suur and Väike Strait

In 2018, we signed contracts for the construction of new sub-sea transmission lines for the Suur and Väike Straits with a cost of 14 MEUR. The purpose of the investment is to increase the security of supply for Saaremaa and Hiiumaa, which have so far depended entirely on the Väike Strait overhead transmission lines. With new sub-sea transmission lines, the islands will have two independent electricity connections in the future. Additionally, the sub-sea transmission line allows for a decrease in the number of high-voltage power transmission line wires over the causeway by half, and the remaining overhead transmission lines can be made more visible to birds. The installation of new transmission lines starts in the spring of 2020 and ends by autumn of the same year.

Gas network activities

During the period in which the pipelines have been in the possession of Elering (since 2015), no major leaks have occurred. In 2018, we made several investments in the gas transmission network that belongs to Elering, which increased the safety of the gas network and improved the overall condition of the environment. The investments made included the following:

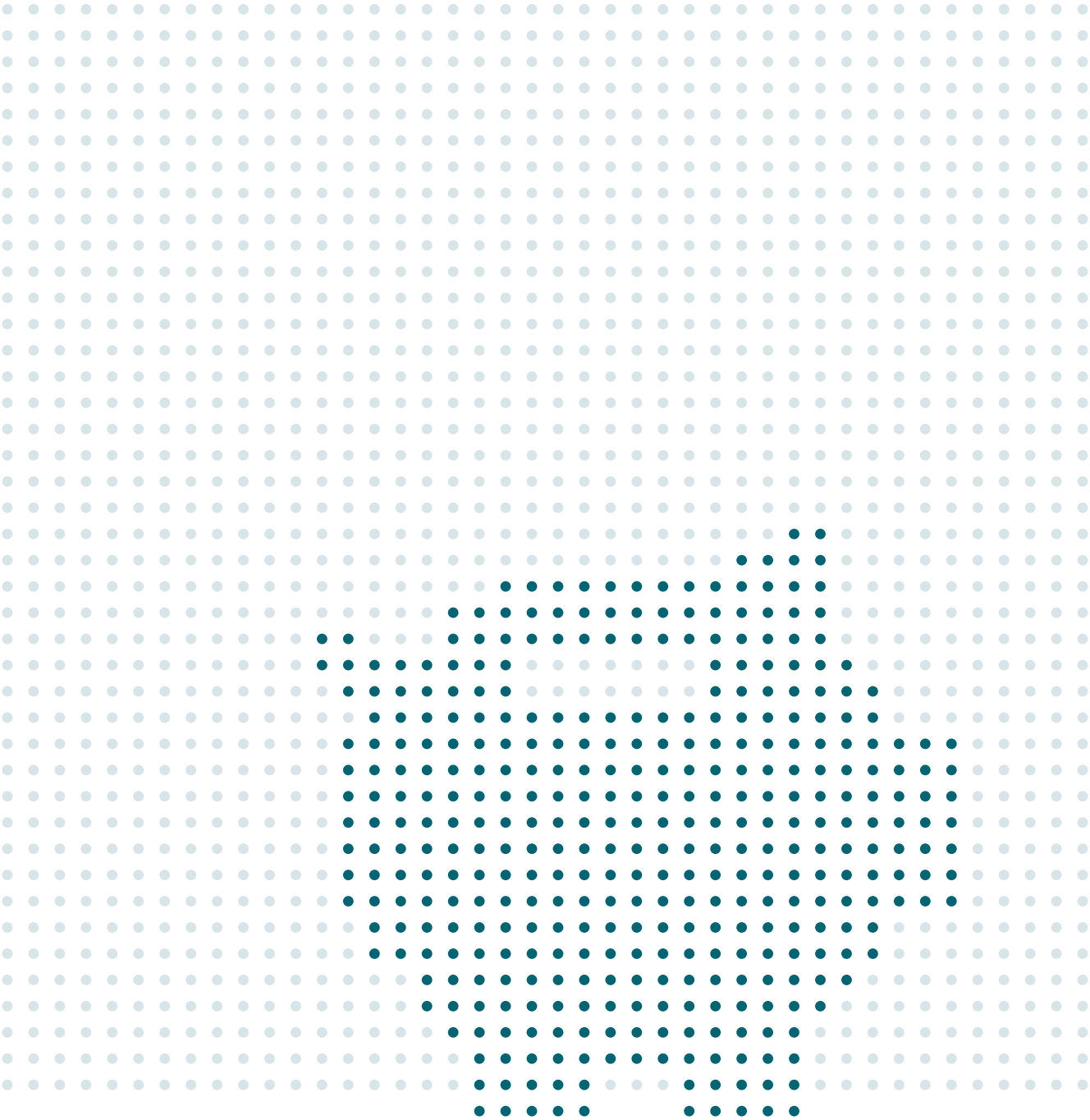
- We replaced the reserve electricity supply generators at the Kiviõli and Järvakandi gas distribution stations and the Värska gas metering station with environmentally friendly generators that run on natural gas. The new generators emit fewer pollutants and lower noise levels;
- We replaced the heating system boilers at the Järvakandi and Põlva gas distribution stations with more economical, natural gas fired condensing boilers. Additionally, we have replaced the heating systems of the Kohila, Rapla and Saku gas distribution stations to optimise the combustion of the gas fuel used in the boilers and the use of the heat;
- We replaced the Vändra gas distribution station's natural gas odourising equipment with a new, closed-system device. The new device ensures that the air surrounding the station is free from possible odour pollution;
- We replaced 770 metres of old gas pipes;
- We replaced 1100 metres of gas pipeline insulation (over-insulation);
- We replaced nine pipeline cathode stations with stations that consume less electricity.

Improving environmental awareness

Since the work on Elering's transmission lines is carried out by subcontractors, it is very important to Elering that the subcontractors are fully aware of potential environmental risks. One of the most important training topics is environmental safety – avoiding forest fires, avoiding creating life-threatening situations for humans and animals, not felling trees on the transmission lines and properly maintaining equipment. Elering ensures continuous training and supervision for people carrying out the work on a scale larger than the requirements actually prescribe. For Elering's own employees, it is important to ensure complete awareness of equipment safety through proper maintenance – all maintenance workers are trained on general safety issues 2-3 times a year, and additionally, more specific topics such as the maintenance of power transmission lines and gas transmission lines are addressed in smaller groups.

To prevent potential negative environmental impact on our sites, Elering has been party to an environmental management consultancy contract with the consulting company Skepast & Puhkim OÜ since 2014.

ANNUAL REPORT



Statement of financial position

In thousands of euros	*Note*	*31.12.2018*	*31.12.2017*
ASSETS			
Current assets			
Cash and cash equivalents	7	62,716	81,997
Short term deposits	7	0	40,000
Trade and other receivables	8	35,273	27,715
Inventories	9	3,936	3,727
Total current assets		**101,925**	**153,439**
Non-current assets			
Investments in equity instruments	2	1,946	0
Available-for-sale financial assets	2	0	1,946
Property, plant and equipment	10	831,533	746,503
Intangible assets	11	12,970	7,755
Total non-current assets		**846,449**	**756,204**
TOTAL ASSETS		**948,374**	**909,643**
LIABILITIES			
Current liabilities			
Borrowings	12	10,558	232,824
Trade and other payables	13	29,005	36,000
Total current liabilities		**39,563**	**268,824**
Non-current liabilities			
Borrowings	12	343,160	129,439
Deferred income	14	180,825	165,191
Total non-current liabilities		**523,985**	**294,630**
TOTAL LIABILITIES		**563,548**	**563,454**
EQUITY			
Share capital	15	229,890	189,890
Statutory reserve capital	15	13,754	12,898
Retained earnings	15	141,182	143,402
TOTAL EQUITY		**384,826**	**346,190**
TOTAL LIABILITIES AND EQUITY		**948,374**	**909,643**

The notes on pages 46-85 are an integral part of these financial statements.

Statement of comprehensive income

in thousands of euros	*Note*	*2018*	*2017*
Revenue	16	142,967	130,349
Other income	17	1,879	1,586
Goods, raw materials and services	18	-65,182	-49,905
Other operating expenses	19	-5,303	-6,374
Staff costs	20	-8,691	-8,049
Depreciation and amortization	10;11	-34,719	-34,486
Operating profit		**30,951**	**33,121**
Financial income	21	67	71
Financial costs	21	-7,382	-11,074
Profit before income tax		**23,636**	**22,118**
Income tax expense	15	-5,000	-5,000
Profit for the year		**18,636**	**17,118**
Total comprehensive income for the year		**18,636**	**17,118**

The notes on pages 46-85 are an integral part of these financial statements.

Cash flow statement

in thousands of euros	*Note*	*1.01.2018-31.12.2018*	*1.01.2017-31.12.2017*
Cash flows from operating activities			
Profit before income tax		23, 636	22,118
Adjustments for:			
· Profit from sale of property, plant and equipment	17	-51	-53
· Depreciation, amortisation and impairment	10,11	34,719	34,486
· Dividends received from long-term financial investments	17	-68	-118
· Government grants expended and amortised	17	-1,193	-1,174
· Interest expenses	21	7,378	11,068
· Interest income	21	-67	-71
· Changes in inventories	9	-209	-184
· Changes in receivables and prepayments related to operating activities	8	-7,492	-1,825
· Changes in liabilities and prepayments related to operating activities	13	-8,604	8,709
· Changes in deferred income from connection and other service fees	14	1,884	1,401
Cash generated from operations		**49,933**	**74,355**
Income tax paid	15	-5,000	-5,000
Interest paid	13, 21	-10,845	-10,929
Interest received	8, 21	75	65
Net cash from operating activities		**34,163**	**58,492**
Cash flows from investing activities			
Purchases of property, plant and equipment and intangible assets	10, 11, 13	-119,498	-31,118
Grants to acquire non-current assets	14	7,532	21,717
Proceeds from sale of property, plant and equipment	10, 17	95	271
Deposits collected	7	40,000	0
Dividends received from long-term financial investments	17	68	118
Congestion fees received	8, 13, 14	7,338	5,238
Net cash used in investing activities		**-64,465**	**-3,773**
Cash flows from financing activities			
Repayments of bank loans	12	-8,138	-5,719
Issue of bonds	12	224,159	0
Repayment of bonds issued	12	-225,000	0
Proceeds from contributions to equity	15	40,000	0
Dividends paid to the shareholders	15	-20, 000	-20,000
Net cash from (used in) financing activities		**11,021**	**-25,719**
Net increase/decrease in cash and cash equivalents		**-19,281**	**29,000**
Cash and cash equivalents at the beginning of the year	**7**	**81,997**	**52,997**
Cash and cash equivalents at the end of the year	**7**	**62,716**	**81,997**

The notes on pages 46-85 are an integral part of these financial statements.

Statement of changes in equity

in thousands of euros	*Share capital*	*Statutory reserve capital*	*Retained earnings*	*Total equity*
Balance as of 1.01.2017	**189,890**	**11,962**	**147,220**	**349,072**
Comprehensive income for financial year	0	0	17,118	17,118
Total comprehensive income for the period	**0**	**0**	**17,118**	**17,118**
Transactions with owners:				
Contributions to equity	0	0	0	0
Transfers to statutory reserve capital	0	936	-936	0
Dividends paid	0	0	-20,000	-20,000
Total transactions with owners	**0**	**936**	**-20,936**	**-20,000**
Balance as of 31.12.2017	**189,890**	**12,898**	**143,402**	**346,190**
Comprehensive income for financial year	0	0	18,636	18,636
Total comprehensive income for the period	**0**	**0**	**18,636**	**18,636**
Transactions with owners:				
Contribution to equity	40,000	0	0	40,000
Transfers to statutory reserve capital	0	856	-856	0
Dividends paid	0	0	-20,000	-20,000
Total transactions with owners	**40,000**	**856**	**-20,856**	**20,000**
Balance as of 31.12.2018	**229,890**	**13,754**	**141,182**	**384,826**

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

The notes on pages 46-85 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 2018 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 18 March 2019. 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 recognised 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

Accounting policy starting from 1 January 2018

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 amortised 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 recognised on trade-date, the date on which Elering commits to purchase or sell the asset.

Financial assets are derecognised 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 amortised 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 amortised 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 recognised 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 2018 and 31 December 2018, 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 recognised 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 recognised 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.

Impairment

Elering assesses on a forward-looking basis the expected credit losses ("ECL") associated with its debt instruments carried at amortised 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.

Accounting policies applied until 31 December 2017

Financial assets

The purchases and sales of financial assets are recognised on the trade date – the date on which Elering commits to purchase or sell a certain financial asset. Financial assets are derecognised when the rights to receive cash flows from the investments have expired or have been transferred and Elering has transferred substantially all risks and rewards of ownership.

Depending on the purpose for which financial assets were acquired as well as management's intentions, financial assets are classified into the following categories at initial recognition according to IAS 39:

- financial assets at fair value through profit or loss,
- loans and receivables,
- available-for-sale financial assets.

As at 31 December 2017, Elering had no other classes of financial assets than those classified under the category of 'loans and receivables' and 'available-for-sale financial assets'.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. These assets are initially recognised at fair value plus transaction costs. After initial recognition, loans and receivables are accounted for at amortised cost using the effective interest rate method.

Elering assesses at the end of each reporting period whether there is objective evidence that a financial asset is impaired. A financial asset is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. The criteria that Elering uses to determine that there is objective evidence of an impairment loss include: significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and a breach of contract, such as a default or delinquency in payments for more than 90 days.

The amount of the loss is the difference between the carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account, and the amount of the impairment loss is recognised in profit or loss.

Uncollectible loans and receivables are written off against the related allowance account.

Elering recognises the following financial assets in the category of 'loans and receivables': "Cash and cash equivalents", "Trade and other receivables" and "Bank deposits".

Available-for-sale financial assets

Available-for-sale financial assets are non-derivative financial assets that are either designated in this category or that are not classified in any of the others categories above. Available-for-sale financial assets are carried as non-current financial investments except when the financial asset expires or Elering intends to sell it during 12 months after the end of the reporting period. Available-for-sale financial assets are initially recognised at fair value, including transaction costs. Available-for-sale financial assets are subsequently carried at fair value; gains and losses arising from changes in fair value of available-for-sale financial assets are included in the statement of comprehensive income. Generally, the basis to determine the fair value is considered to be the market price in the active market or if that is not available, then the value established by using commonly accepted valuation techniques. If the fair value of a financial asset cannot be measured reliably, they are measured at cost less any impairment losses. Dividend income is recognised when the right to receive payment is established.

Available-for-sale financial assets entirely comprise of 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 at the balance sheet date, Elering does not have any current financial information on AS Nord Pool; nor are its shares traded in the financial markets. It is also unlikely that those shares will be actively traded in the future or that the company will start publishing periodic information on future forecasts. Therefore, the fair value of those shares cannot be reliably measured. AS Nord Pool shares are carried at their cost.

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 recognised 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 capitalised 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 recognised 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 derecognised. 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 recognised 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 until 1 December 2017	7-25
Machinery and equipment – electricity and natural gas transmission equipment since 1 December 2017	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 recognised 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 accounting 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 recognised in profit or loss under "Other income" or "Other operating expenses" respectively.

Intangible assets
Intangible assets are recognised 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 recognised 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 amortisation and impairment losses.

Acquired software licences are capitalised 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 recognised 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 amortised 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/amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised 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
Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made or received under operating leases are charged to profit or loss on a straight-line basis over the period of the lease.

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 recognised at fair value, net of transaction costs incurred and are subsequently carried at amortised cost. The amortised 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 amortised cost. The difference between the amortised cost and the redemption value is recognised 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 capitalised 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 capitalised if all of the criteria for recognition specified in IAS 38 have been met. Capitalised development costs are amortised 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 capitalised.

Share capital
Elering does not have any preference shares. Incremental costs directly attributable to the issue of new shares are recognised 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

Accounting policy starting from 1 January 2018

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 recognises 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 recognised 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 recognised 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 recognised 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 recognised 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 recognised 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 recognised on an accrual basis using the effective interest method.

Accounting policies applied until 31 December 2017

Revenue is measured at the fair value of the consideration received or receivable, net of VAT and discounts.

Revenue from sales of goods is recognised at the point of transfer of risks and rewards of ownership of the goods, normally when the goods are shipped.

Sales of services are recognised in the accounting period in which the services are rendered.

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.

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.

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.

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.

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 revenue from connection fees is deferred and recognised as income evenly over the estimated customer relationship period. The amortisation period of connection fees is 25 years. Deferred connection fees are carried in the statement of financial position as long-term deferred income.

Interest income is recognised 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 electricity exchange every hour. The electricity exchange collects the aforementioned price difference through its trading mechanism and transfers it to respective transmission system operators.

2. At auctions of long-term transmission capacity, i.e. at Limited Physical Transmission Rights (PTR-Limited) auctions, Elering offers, in cooperation with the Latvian transmission system operator Augstsprieguma tīkls AS, those market participants that have bought transmission capacity the right to the hourly auction proceeds of the day-ahead market for the same volume. Elering distributes to market participants the hourly auction proceeds received from the power exchange in proportion to the PTR-Limited volume acquired by the market participant.

Net proceeds from the day-ahead market and PTR-Limited auctions are recognised 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 recognised in profit or loss during the period when Elering's right to receive proceeds from the day-ahead market and PTR 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 recognised 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 recognised 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 recognised at its cost, and if the government grant is received in the form of a transfer of a non-monetary asset, it is recognised at its fair value. The amount of the government grant received for the purpose of acquisition of assets is recognised 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 recognises 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.

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 AS is compensated for biogas subsidies by the Ministry of Economic Affairs and Communications. Elering AS 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 AS. 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 recognised 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 recognised as a liability.

If during the reporting period, an employee has provided services for which payment of compensation is to be expected, Elering will recognise 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 recognised 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 declared 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 recognised 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 2018:

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	0.5-2.5% on taxable value of land per annum
Excise tax on electricity	4.47 euros per MWh of electricity
Excise tax on gas	50.65 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 recognised 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 recognised 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. Previous experience has shown that the actual useful lives have sometimes been longer than the estimates. Therefore, the management changed their estimation regarding the useful lives of certain electricity transmission equipment by extending the useful lives as of 1 December 2017, which has reduced the depreciation of property, plant and equipment in 2018 by EUR 1,236 thousand. In the reporting period, depreciation amounted to EUR 33,497 thousand (2017: EUR 33,711 thousand). If depreciation rates were increased/decreased by 10%, the depreciation charge for the year would increase/decrease by EUR 3,350 thousand (2017: EUR 3,371 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 2018 Elering recognised deferred congestion income in the amount EUR 7,411 thousand (2017: EUR 5,668 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 2018:

IFRS 9, Financial Instruments: Classification and Measurement
(effective for annual periods beginning on or after 1 January 2018). Key features of the new standard are:

- Financial assets are required to be classified into three measurement categories: those to be measured subsequently at amortised cost, those to be measured subsequently at fair value through other comprehensive income (FVOCI) and those to be measured subsequently at fair value through profit or loss (FVPL).

- Classification for debt instruments is driven by the entity's business model for managing the financial assets and whether the contractual cash flows represent solely payments of principal and interest (SPPI). If a debt instrument is held to collect, it may be carried at amortised cost if it also meets the SPPI requirement. Debt instruments that meet the SPPI requirement that are held in a portfolio where an entity both holds to collect assets' cash flows and sells assets may be classified as FVOCI. Financial assets that do not contain cash flows that are SPPI must be measured at FVPL (for example, derivatives). Embedded derivatives are no longer separated from financial assets but will be included in assessing the SPPI condition.

- Investments in equity instruments are always measured at fair value. However, management can make an irrevocable election to present changes in fair value in other comprehensive income, provided the instrument is not held for trading. If the equity instrument is held for trading, changes in fair value are presented in profit or loss.

- Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The key change is that an entity will be required to present the effects of changes in own credit risk of financial liabilities designated at fair value through profit or loss in other comprehensive income.

- IFRS 9 introduces a new model for the recognition of impairment losses – the expected credit losses (ECL) model. There is a 'three stage' approach which is based on the change in credit quality of financial assets since initial recognition. In practice, the new rules mean that entities will have to record an immediate loss equal to the 12-month ECL on initial recognition of financial assets that are not credit impaired (or lifetime ECL for trade receivables). Where there has been a significant increase in credit risk, impairment is measured using lifetime ECL rather than 12-month ECL. The model includes operational simplifications for lease and trade receivables.

- Hedge accounting requirements were amended to align accounting more closely with risk management. The standard provides entities with an accounting policy choice between applying the hedge accounting requirements of IFRS 9 and continuing to apply IAS 39 to all hedges because the standard currently does not address accounting for macro hedging.

The adoption of IFRS 9 Financial Instruments from 1 January 2018 resulted in changes in accounting policies, although no adjustments were recognised to the amounts in the financial statements. The new accounting policies are set out in Note 2. In accordance with the transitional provisions in IFRS 9, comparative figures have not been restated.

On 1 January 2018 (the date of initial application of IFRS 9), Elering has assessed which business models apply to the financial assets held by Elering and has classified its financial instruments into the appropriate IFRS 9 categories. On the date of initial application, 1 January 2018, the financial instruments of Elering were as follows, with any reclassifications noted (the reclassifications of the financial instruments on adoption of IFRS 9 did not result in any changes to measurements):

	Measurement category		*Carrying amount (in thousands of EUR)*		
	Original (IAS 39)	**New (IFRS 9)**	**Original**	**New**	**Difference**
Financial assets **Current**					
Cash and cash equivalents	Amortised cost	Amortised cost	81,997	81,997	0
Bank deposits	Amortised cost	Amortised cost	40,000	40,000	0
Trade and other receivables	Amortised cost	Amortised cost	27,715	27,715	0
Non-current assets					
Investments in equity instruments	-	FVOCI	-	1,946	0
Available-for-sale financial assets	Cost	-	1,946	-	0

Certain investments in shares were reclassified from financial assets available-for-sale to financial assets at FVOCI (EUR 1,946 as at 1 January 2018). Elering has assessed that fair value of the shares approximates their cost therefore no fair value gains/losses were recognised. Management measures fair value of the investment based on dividend yield. In recent years, Elering has earned 4.2% from the investment, which is similar to the dividend yield of publicly traded companies with a similar risk profile. Dividend yield has been stable over the years, which gives reason to believe that fair value of the shares has not changed and approximates their cost.

Impairment of financial assets
Elering has the following types of financial assets that are subject to IFRS 9's new expected credit loss model:

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

Elering was required to revise its impairment methodology under IFRS 9 for each of these classes of assets. As a result of the change in of the change in impairment methodology there was no material increase of the loss allowance on 1 January 2018, thus no adjustments were made to the Elering's retained earnings and equity.

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 2018 and 31 December 2018.

IFRS 15, Revenue from Contracts with Customers
(effective for annual periods beginning on or after 1 January 2018). The new standard introduces the core principle that revenue must be recognised when the goods or services are transferred to the customer, at the transaction price. Any bundled goods or services that are distinct must be separately recognised, and any discounts or rebates on the contract price must generally be allocated to the separate elements. When the consideration varies for any reason, minimum amounts must be recognised if they are not at significant risk of reversal. Costs incurred to secure contracts with customers have to be capitalised and amortised over the period when the benefits of the contract are consumed.

Amendments to IFRS 15, Revenue from Contracts with Customers
(effective for annual periods beginning on or after 1 January 2018). The amendments do not change the underlying principles of the standard but clarify how those principles should be applied. The amendments clarify how to identify a performance obligation (the promise to transfer a good or a service to a customer) in a contract; how to determine whether a company is a principal (the provider of a good or service) or an agent (responsible for arranging for the good or service to be provided); and how to determine whether the revenue from granting a licence should be recognised at a point in time or over time. In addition to the clarifications, the amendments include two additional reliefs to reduce cost and complexity for a company when it first applies the new standard.

Elering has adopted IFRS 15 Revenue from Contracts with Customers from 1 January 2018 using the modified retrospective application, with the effect of initially applying this standard recognised at the date of initial application (i.e. 1 January 2018). Accordingly, the information presented for 2017 has not been restated – i.e. it is presented, as previously reported, under IAS 18, IAS 11 and related interpretations. Additionally, the disclosure requirements in IFRS 15 have not been applied to comparative information.

As a result of the application no adjustments were recognised to the amounts in the financial statements at 1 January 2018. Elering has assessed that the new revenue standard does not have a material impact to different revenue sources of Elering. The management has concluded that the connection fees do not represent a separate performance obligation from providing network service; therefore Elering will continue to defer the revenue from connection fees. Also, the management has assessed that the conclusions on whether Elering is acting as an agent or principal, has not changed under the new revenue standard.

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 2018 that would be expected to have a material impact to the Elering.

New or revised standards and interpretations
Certain new or revised standards and interpretations have been issued that are mandatory for Elering's annual periods beginning on or after 1 January 2019, and which Elering has not early adopted.

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 recognise: (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 assessed that the new leasing standard is not expected to have a material impact to Elering as the lease payments are immaterial (refer to Note 22).

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	*31.12.2018*	*31.12.2017*
Cash and cash equivalents (Note 7)	62,716	81,997
Short term deposits (Note 7)	0	40,000
Trade and other receivables (Note 8)	31,758	27,521
Investments in equity instruments (Note 2)	1,946	0
Available-for-sale financial assets (Note 2)	0	1,946
Total financial assets	**96,420**	**151,463**

Financial liabilities

in thousands of euros	*31.12.2018*	*31.12.2017*
Trade and other payables (Note 13)	26,152	32,378
Borrowings (Note 12)	353,718	362,263
Total financial liabilities	**379,870**	**394,641**

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 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	*31.12.2018*	*31.12.2017*
Cash and cash equivalents (Note 7)	62,716	81,997
Short term deposits (Note 7)	0	40,000
Trade and other receivables (Note 8)	31,758	27,521
Total exposure of assets to credit risk in the statement of financial position	**94,474**	**149,518**

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 2018 or 1 January 2018 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 2018 and 1 January 2018 (on adoption of IFRS 9) 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 2018 and 31 December 2018.

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 31.12.2018, Elering had one counterparty (31.12.2017: one counterparty) with an aggregated receivables balance of EUR 18,114 thousand (31.12.2017: EUR 18,487 thousand) or 66% of the total amount of accounts receivable (31.12.2017: 67%). In 2018 as well as in 2017 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 five 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 31.12.2018 and 31.12.2017.

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 31.12.2018 borrowings with fixed interest rate constituted 63% (as of 31.12.2017 62%) of all borrowings carried at amortised cost; the remaining 37% (as of 31.12.2017 38%) of the above mentioned liabilities were long-term bank loans with a floating interest rate carried at amortised 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 31.12.2018 borrowings with a floating interest rate totalled EUR 129,459 thousand (as at 31.12.2017: EUR 137,577 thousand).

As at 31.12.2018, if the interest rates of Elering's borrowings, that are exposed to the cash flow interest rate risk, had been 50 basis points (31.12.2017: 50 basis points) higher with all other variables held constant, profit for the year would have been EUR 647 thousand (2017: EUR 688 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 31.12.2018 and 31.12.2017 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 31.12.2018 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	1,933	0	0	24,815
Borrowings (Note 12)	0	12,812	275,867	77,546	366,225
Total future payments	**22,882**	**14,745**	**275,867**	**77,546**	**391,040**

** including interest expenses*

The maturity analysis of financial liabilities on 31.12.2017 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)	18,373	7,756	0	0	26,129
Borrowings (Note 12)	0	243,892	43,021	88,229	375,141
Total future payments	**18,373**	**251,648**	**43,021**	**88,229**	**401,270**

** including interest expenses*

Elering holds its money in bank deposits. As of 31.12.2018, Elering had cash and cash equivalents EUR 62,716 thousand (as of 31.12.2017: EUR 81,997 thousand). As of 31.12.2018 there were no short-term bank deposits (31.12.2017: EUR 40,000 thousand). 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	*31.12.2018*	*31.12.2017*
Equity	384,826	346,190
Total assets	948,374	909,643
Equity to asset ratio	**41%**	**38%**

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
quoted 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 amortised cost
Carrying amounts of trade and other financial receivables approximate their fair values (level 3).

Liabilities carried at amortised 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 31.12.2018: 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). The following borrowings as of 31.12.2017 consisted of bonds the market value of which was EUR 230,437 thousand (nominal value EUR 225,000 thousand) and bank loans, the market value of which was EUR 137,577 thousand (nominal value EUR 137,577 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 78,840 thousand (2017: EUR 80,254 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, 2018

in thousands of euros	*Regulated electricity network services*	*Regulated gas network services*	*Balancing services*	*Other*	*Transactions between segmentsl*	*Total*
Revenue from external customers	91,013	10,173	35,393	6,388	0	**142,967**
Revenue between segments	-14	67	-53	0	0	**0**
Total revenue	**90,999**	**10,240**	**35,340**	**6,388**	**0**	**142,967**
Other operating income	0	0	0	1,879	0	**1,879**
Total income	**90,999**	**10,240**	**35,340**	**8,267**	**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	-8,674	-3,590	-798	-932	0	**-13,994**
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)	10,342	26,544	30	81,676	0	**118,592**
Additions to intangible assets (Note 11)	2,898	904	235	2,379	0	**6,416**

Segment reporting, 2017

in thousands of euros	*Regulated electricity network services*	*Regulated gas network services*	*Balancing services*	*Other*	*Transactions between segmentsl*	*Total*
Revenue from external customers	88,701	8,739	27,226	5,682	0	**130,349**
Revenue between segments	0	34	0	0	-34	**0**
Total revenue	**88,701**	**8,773**	**27,226**	**5,682**	**-34**	**130,349**
Other operating income	0	0	0	1,586	0	**1,586**
Total income	**88,701**	**8,773**	**27,226**	**7,268**	**-34**	**131,935**
Goods, raw materials and services	-20,812	-1,796	-25,593	-1,739	34	**-49,905**

Other operating expenses and staff costs	-8,861	-3,412	-841	-1,309	0	**-14,424**
EBITDA	**59,028**	**3,566**	**792**	**4,220**	**0**	**67,606**
Depreciation and amortization (Note 10, 11)	-28,194	-3,446	-29	-2,817	0	**-34,486**
Net financial income (costs) (Note 21)	-10,206	-759	-2	-36	0	**-11,003**
Income tax (Note 15)	-5,000	0	0	0	0	**-5,000**
Net profit	**15,628**	**-639**	**761**	**1,367**	**0**	**17,118**
Total assets	**718,182**	**63,082**	**4,726**	**123,653**	**0**	**909,643**
Total liabilities	**345,103**	**29,255**	**3,074**	**186,022**	**0**	**563,454**
Additions to property, plant and equipment (Note 10)	16,519	6,154	0	6,137	0	**28,809**
Additions to intangible assets (Note 11)	2,480	440	79	378	0	**3,376**

Revenue by geographical location of customers, 2018

in thousands of euros	*Regulated electricity network services*	*Regulated gas network services*	*Balancing services*	*Other*	*Total*
Estonia	86,266	9,590	18,860	3,416	**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	**91,013**	**10,173**	**35,393**	**6,388**	**142,967**

Revenue by geographical location of customers, 2017

in thousands of euros	*Regulated electricity network services*	*Regulated gas network services*	*Balancing services*	*Other*	*Total*
Estonia	87,879	8,320	13,442	3,261	**112,903**
Norway	0	0	0	0	**0**
Latvia	0	0	2,660	15	**2,675**
Finland	0	0	1,292	2,033	**3,325**
Lithuania	0	0	9,832	332	**10,164**
Russia	0	419	0	41	**460**
Other	822	0	0	0	**822**
Total revenue	**88,701**	**8,739**	**27,226**	**5,682**	**130,349**

Note 7

BANK ACCOUNTS AND DEPOSITS

in thousands of euros	*31.12.2018*	*31.12.2017*
Cash and cash equivalents	62,716	81,997
Short-term deposits*	0	40,000

*As of 31 December 2017, three contracts in the amount of EUR 30,000 thousand were concluded with Nordea Bank AB Estonia branch. Maturity date of these deposits was 19.01.2018 and the interest rate 0.19%. One contract in the amount of EUR 10,000 thousand was concluded with Swedbank. The maturity date of the deposit was 20.01.2018 and the interest rate 0.1%. All contracts were denominated in euros.

Bank accounts and deposits

in thousands of euros	*31.12.2018*	*31.12.2017*
Bank accounts and deposits at banks		
with Moody's credit rating of Aa2*	42,015	0
with Moody's credit rating of Aa3*	0	119,522
with Moody's credit rating of A3	20,701	0
with Moody's credit rating of A1	0	2,475
Total bank accounts and deposits at banks	**62,716**	**121,997**

** Two banks at which Elering holds its money are Estonia-based subsidiaries of international banks with Moody's credit ratings of Aa2 (2017: Aa3).*

Note 8

TRADE AND OTHER RECEIVABLES

in thousands of euros	*2018*	*2017*
Trade receivables		
Accounts receivable	27,521	27,511
• Incl. PTR-Limited auction receivables	400	327
Other receivables	**4,237**	**9**
• Incl. subsidies due from electricity producers (Note 2,13)	2,992	0
• Incl. accrued ITC receivables	1,244	0
• Incl. interest receivables	1	9
Total financial assets within trade and other receivables in the statement of financial position	**31,758**	**27,521**
Tax receivables	3,395	4
• Incl. VAT receivable	2,118	0
Prepayments	120	190
Total trade and other receivables	**35,273**	**27,715**

Analysis by credit quality of trade receivables is as follows:

in thousands of euros	*31.12.2018*	*31.12.2017*
Accounts receivable not yet due		
· Distribution networks	21,284	21,093
· Other clients	6,051	5,880
Total accounts receivable not yet due	**27,335**	**26,973**
Accounts receivable past due but not classified as doubtful		
· 1 to 90 days overdue	186	538
Total accounts receivable past due but not classified as doubtful	**186**	**538**
Total accounts receivable past due	**186**	**538**
Total trade receivables	**27,521**	**27,511**

In the reporting period and in 2017, 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	*31.12.2018*	*31.12.2017*
Fuel oil	2,551	2,610
Natural gas reserves	284	123
Natural gas balance	369	261
Other materials at warehouses	732	733
Total inventories	**3,936**	**3,727**

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 01.01.2017							
Cost at 01.01.2017	6,071	41,570	502,098	491,453	182	0	1,041,375
Accumulated depreciation	0	-7,578	-153,305	-145,944	-95	0	-306,922
Carrying amount at 01.01.2017	**6,071**	**33,992**	**348,793**	**345,510**	**88**	**0**	**734,453**
Construction in progress	0	0	0	0	0	17,153	17,153
Prepayments	15	0	0	0	0	0	15
Total property, plant and equipment at 01.01.2017	**6,086**	**33,992**	**348,793**	**345,510**	**88**	**17,153**	**751,621**
Movements 01.01.2017-31.12.2017							
Additions	114	0	0	0	0	28,340	28,454
Reclassified from construction in progress	0	7,108	3,756	18,017	25	-28,907	0
Capitalised borrowing costs (Note 21)	0	0	0	0	0	371	371
Disposals and write-offs at carrying amount	-49	0	-4	-165	0	0	-218
Transfers	-15	0	0	0	0	0	-15
Depreciation charge	0	-1,200	-13,462	-19,023	-26	0	-33,711
Total movements 01.01.2017-31.12.2017	**51**	**5,908**	**-9,710**	**-1,171**	**-1**	**-196**	**-5,119**
Property, plant and equipment at 31.12.2017							
Cost at 31.12.2017	6,137	48,575	505,418	506,999	202	0	1,067,330
Accumulated depreciation	0	-8,674	-166,335	-162,659	-115	0	-337,784
Carrying amount at 31.12.2017	**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 31.12.2017	**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	5,782	9,227	313	-16,325	0
Capitalised 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**	**13,141**	**5,519**	**213**	**66,504**	**85,030**
Property, plant and equipment at 31.12.2018							
Cost at 31.12.2018	6,138	49,521	510,041	512,342	515	0	1,078,557
Accumulated depreciation	0	-9,969	-178,545	-177,474	-215	0	-366,204
Carrying amount at 31.12.2018	**6,138**	**39,552**	**331,496**	**334,868**	**300**	**0**	**712,353**
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**	**39,552**	**352,224**	**349,858**	**300**	**83,461**	**831,533**

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

Additions to construction in progress during the financial year include capitalised borrowing costs of EUR 222 thousand (2017: EUR 371 thousand). The capitalisation rate is 1.6% (2017: 3.1%).

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*	*Kokku*
Intangible assets at 01.01.2017			
Cost at 01.01.2017	5,828	1,612	7,440
Accumulated amortisation	-3,675	-135	-3,810
Carrying amount at 01.01.2017	**2,153**	**1,477**	**3,630**
Intangible assets not yet available for use	1,523	0	1,523
Total intangible assets at 01.01.2017	**3,676**	**1,477**	**5,153**
Movements 1.01.2017-31.12.2017			
Additions	2,962	415	3,377
Amortisation charge	-755	-20	-775
Total movements 1.01.2017-31.12.2017	**2,207**	**395**	**2,602**
Intangible assets at 31.12.2017			
Cost at 31.12.2017	6,574	2,027	8,601
Accumulated amortisation	-3,905	-155	-4,060
Carrying amount at 31.12.2017	**2,669**	**1,872**	**4,541**
Intangible assets not yet available for use	3,214	0	3,214
Total intangible assets at 31.12.2017	**5,883**	**1,872**	**7,755**
Movements 1.01.2018-31.12.2018			
Additions	4,207	2,209	6,416
Amortisation 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	4,237	16,015
Accumulated amortisation	-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**

Note 12

BORROWINGS

in thousands of euros	*31.12.2018*	*31.12.2017*
Short-term borrowings		
Current portion of long-term bank loans	10,558	8,138
Bonds issued	0	224,686
Total short-term borrowings	**10,558**	**232,824**
Long-term borrowings		
Long-term bank loan	118,901	129,439
Bonds issued	224,259	0
Total long-term borrowings	**343,160**	**129,439**
Borrowings are denominated in the following currencies:		
Borrowings denominated in euros	353,718	362,263
Total borrowings (Note 5)	**353,718**	**362,263**

Reconciliation of borrowings:

in thousands of euros	*Current portion of long-term bank loans*	*Current portion of bonds issued*	*Long-term bank loan*	*Bonds issued*	*Total borrowings*
Total borrowings on 01.01.2017	**5,704**	**0**	**137,570**	**224,115**	**367,389**
Repayment of borrowings	-5,719	0	0	0	-5,719
Transfers	8,153	224,686	-8,153	-224,686	0
Non-cash movements	0	0	22	571	593
Total borrowings on 31.12.2017	**8,138**	**224,686**	**129,439**	**0**	**362,263**
Repayment of borrowings	-8,138	-225,000	0	0	-233,138
Bonds issued	0	0	0	224,159	224,159
Transfers	10,558	314	-10,558	-314	0
Non-cash movements	0	0	20	414	434
Total borrowings on 31.12.2018	**10,558**	**0**	**118,901**	**224,259**	**353,718**

The average effective interest rate on borrowings was 2.0% in 2018 (2017: 3.1%).

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 99,778 thousand. The maturity date of the loans is 2031 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 4,790 thousand (2017: 2,370)

- **Loans from the Nordic Investment Bank**
  Elering has two loans with outstanding balance of EUR 29,681 thousand. The maturity date of the loans is 2025-2033. Interest rate is floating which is the sum of 6-month Euribor and margin. In the reporting period Elering repaid loans in the amount of EUR 3,348 thousand (2017: EUR 3,349 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.

- **Loans to reduce the refinancing risk of the bonds**
  In December 2017 Elering entered into two loan agreements with Estonian banks in a total volume of EUR 200,000 thousand. The purpose of the loans was to reduce the risk of refinancing Eurobonds. As the issuance of Eurobonds took place on time, these loan agreements were terminated in May 2018.

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	*31.12.2018*	*31.12.2017*
Trade payables	15,145	15,924
Payables for purchased property, plant and equipment and intangible assets	7,737	2,448
Subsidies due to electricity producers	0	7,440
Subsidies due to biogas producers	1,531	1,232
Other payables	402	316
Total financial liabilities within trade and other payables without accrued interests	**24,815**	**27,360**
Accrued interests from borrowings carried at amortised cost (Note 12)	1,338	5,017
Total financial liabilities within trade and other payables in the statement of financial position	**26,152**	**32,378**

Taxes payable		
VAT	0	1,359
Social security tax	362	326
Personal income tax	239	169
Unemployment insurance tax	24	20
Contributions to mandatory funded pension	17	16
Corporate income tax and income tax on fringe benefits	4	9
Excise tax	200	199
Pollution tax	1	1
Total taxes payable	**847**	**2,098**

Accrued expenses - employee benefits		
Wages and salaries	429	364
Bonuses	750	450
Holiday pay	171	139
Social security and unemployment insurance tax	311	199
Termination benefits	0	0
Total accrued expenses - employee benefits	**1,661**	**1,152**

Other payables	**345**	**372**
Total trade and other payables	**29,005**	**36,000**

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	*2018*	*2017*
Deferred income from connection and other service fees at the beginning of the period	**30,286**	**28,707**
Connection and other service fees received	3,633	2,948
Connection and other service fees recognised as revenue (Note 16)	-1,494	-1,369
Deferred income from connection and other service fees at the end of the period	**32,425**	**30,286**

Deferred income from government grants

in thousands of euros	*2018*	*2017*
Deferred income from government grants at the beginning of the period	**66,936**	**68,110**
Grants received	7,769	17
Grants used for operating expenses (Note 17)	-237	-17
Grants recognised as revenue (Note 17)	-1,193	-1,174
Deferred income from government grants at the end of the period	**73,275**	**66,936**

Deferred income from congestion fees

in thousands of euros	*2018*	*2017*
Deferred congestion income at the beginning of the period	**67,969**	**62,479**
Congestion fees received during the period	7,411	5,668
Recognised as income (Note 17)	-255	-178
Deferred congestion income at the end of the period	**75,125**	**67,969**
Total deferred income	**180,825**	**165,191**

Note 15

EQUITY

Elering's share capital consists of 229,890 shares with the nominal value of EUR 1,000 (31.12.2017: 189,890 shares with the nominal value of EUR 1,000). The shares have been paid for in full.

In the reporting period 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 2017, no resolution of sole shareholder was made on increase of share capital.

Dividends totalling EUR 20 million were paid out in 2018 (in 2017 dividends were paid in the amount of EUR 20 million). Dividends per share totalled EUR 87 (2017: EUR 105).

Income tax of EUR 5 million was incurred upon distribution of dividends (2017: EUR 5 million).

As of 31.12.2018, Elering's statutory reserve capital totalled EUR 13,754 thousand (31.12.2017: EUR 12,898 thousand). As at 31.12.2018, Elering has the obligation to additionally transfer EUR 932 thousand (31.12.2017: EUR 856 thousand) to reserve capital. In 2018 Elering transferred to statutory reserve EUR 856 thousand (2017: EUR 936 thousand).

The distributable retained earnings of Elering as of 31.12.2018 amounted to EUR 141,182 thousand (31.12.2017: EUR 143,402 thousand). The income tax applicable to the net profit distributable as dividends is 20/80 (2017: 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. As of 31.12.2018, it would be possible to distribute EUR 107,436 thousand as net dividends (31.12.2017: EUR 114,037 thousand) and the corresponding income tax would amount to EUR 32,814 thousand (31.12.2017: EUR 28,509 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 1,085 thousand.

Note 16

REVENUE

Analysis of revenue by activity

in thousands of euros	*2018*	*2017*
Sales of balancing and regulation services		
Balancing electricity	25,608	19,771
Balancing gas	5,086	5,991
Regulation services	4,646	1,465
Total sales of balancing electricity and regulation services	**35,340**	**27,226**
Sales of electricity and gas network services		
Electricity network services	86,251	87,879
Gas network services	10,240	8,320
Revenue from connection fees (Note 14)	1,494	1,369
Other electricity network services	4,747	1,282
Total sales of network services	**102,732**	**98,851**
Sales of other goods and services		
Lease of transmission equipment (Note 22)	916	916
Sales of scrap metal	0	25
Other services	3,943	3,278
Other goods	36	52
Total sales of other goods and services	**4,895**	**4,272**
Total revenue	**142,967**	**130,349**

Note 17

OTHER INCOME

in thousands of euros	*2018*	*2017*
Government grants related to acquisition of property, plant and equipment (Note 14)	1,193	1,174
Congestion income (Note 14)	255	178
Grants for operating expenses (Note 14)	237	17
Dividends from long-term financial investments	68	118
Fines, penalties and compensations received	67	18
Profit from sale of property, plant and equipment	59	57
Other income	0	25
Total other income	**1,879**	**1,586**

Note 18

GOODS, RAW MATERIALS AND SERVICES

in thousands of euros	*2018*	*2017*
Electricity and gas purchased to provide the balancing service		
Purchase of balancing energy	24,209	17,972
Purchase of power regulation service	4,986	1,929
Purchase of balancing gas	4,421	5,413
Expenses of emergency reserve power plant to provide balancing services	498	249
Total electricity purchased to provide the balancing service	**34,114**	**25,563**
System services		
Operating expenses of emergency reserve power plant	848	1,088
Reactive energy	397	459
Total system services expenses	**1,245**	**1,547**
Losses in electricity and gas network		
Electricity network losses	18,715	11,614
Gas network losses	266	314
Total electricity and gas to compensate for network losses	**18,981**	**11,927**
Maintenance and repair works		
On facilities and equipment related to core activities	7,374	6,835
On production buildings and sites	868	680
Other	309	345
Disassembly works and waste processing	230	295
Total maintenance and repair works	**8,781**	**8,155**
Other costs		
Other costs	1,695	2,298
Operative switching and dispatching management expenses	366	414
Total other costs	**2,061**	**2,713**
Total goods, raw materials and services	**65,182**	**49,905**

Note 19

OTHER OPERATING EXPENSES

in thousands of euros	*2018*	*2017*
Research and consulting	1,255	1,172
Telecommunication	1,010	1,044
Training and other miscellaneous operating expenses	836	844

Information technology	722	801
Research and development costs (R&D)	499	1,289
Office expenses	420	651
Security, insurance and occupational safety	255	239
Transportation and tools	163	158
Other expenses	143	175
Total other operating expenses	**5,303**	**6,374**

Note 20

STAFF COSTS

in thousands of euros	*2018*	*2017*
Base salaries, additional remuneration, bonuses, vacation pay	6,293	5,792
Termination benefits	12	21
Other remuneration	184	193
Total remuneration to employees	**6,489**	**6,007**
Social security tax	2,155	1,999
Unemployment insurance tax	47	43
Total staff costs	**8,691**	**8,049**
· Including compensations to the members of the Management and Supervisory Board		
Salaries, additional remuneration bonuses, vacation pay	420	378
Social security tax	150	136
Fringe benefits	28	28
Income tax on fringe benefits	7	7
Total compensations to the members of the Management and Supervisory Boards	**605**	**549**
Average number of employees	**221**	**222**
Average number of employees by type:		
Persons working under an employment contract	216	219
Persons providing services under law of obligations act	5	3
Members of the Management and Supervisory Boards	8	8
The average monthly pay of all employees	2,351	2,174

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

tuhandetes eurodes	*2018*	*2017*
Financial income		
Interest income	67	71
Total financial income	**67**	**71**
Financial costs		
Interest expenses	-7,600	-11,439
Foreign exchange losses	-2	-4
Other financial costs	-2	-2
Total financial costs	**-7,604**	**-11,445**
Less: capitalised borrowings costs (Notes 10)	222	371
Total financial costs recognised in the statement of comprehensive income	**-7,382**	**-11,074**
Net financial income (costs)	**-7,315**	**-11,003**

Note 22

OPERATING LEASE

Elering as a lessor

Operating lease revenue

in thousands of euros	*2018*	*2017*
Buildings	86	96
Transmission equipment	916	916
Total operating lease revenue	**1,002**	**1,012**

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 31.03.2025. 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	*31.12.2018*	*31.12.2017*
Cost	6,334	6,240
Accumulated depreciation at the end of period	-4,900	-4,732
Carrying amount	**1,435**	**1,508**

Depreciation charge

in thousands of euros	*2018*	*2017*
Depreciation charge	159	171

Estimated future lease payments under operating leases

in thousands of euros	*31.12.2018*	*31.12.2017*
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	1,145	2,061
Total future minimum lease payments	**5,725**	**6,641**

Elering as a lessee

Operating lease expenses

in thousands of euros	*2018*	*2017*
Buildings	92	449
Transport equipment	104	100
Other machinery and equipment	77	101
Total operating lease expenses	**273**	**650**

All operating leases where Elering is a lessee can be terminated upon a short notice.

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	*31.12.2018*	*31.12.2017*
Trade receivables		
Companies controlled or significantly influenced by the State	20,437	20,832
Total trade receivables	**20,437**	**20,832**
▪ incl. from network operators	18,153	18,529
Trade payables and other liabilities		
Companies controlled or significantly influenced by the State	3,689	2,899
Total trade payables and other liabilities	**3,689**	**2,899**

Income and expense items with related parties were as follows

in thousands of euros	*Related party*	*2018*	*2017*
Revenue from sale of goods	Companies controlled or significantly influenced by the State	8,522	7,014
Revenue from sale of services	Companies controlled or significantly influenced by the State	83,886	83,742
Revenue from sale of goods and services		**92,408**	**90,756**
Purchase of goods	Companies controlled or significantly influenced by the State	3,600	4,175
Purchase of services	Companies controlled or significantly influenced by the State	4,985	3,373
Purchase of goods and services		**8,585**	**7,548**
Expenditures on non-current assets	**Companies controlled or significantly influenced by the State**	**3,120**	**349**

- 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.

Transactions with companies under the significant influence of the members of the Supervisory and Management Boards or their close relatives

in thousands of euros	*2018*	*2017*
Purchase of services	0	84

Key management personnel compensations are disclosed in Note 20.

No receivables from related parties were written off in 2018 and 2017.

Note 24

CONTINGENT LIABILITIES AND COMMITMENTS

Obligation to tolerate utility networks.
According to the law, the owners of the infrastructure have to pay fees to the landowners for tolerating utility networks and structures. In 2018, the law changed, resulting in a multiplication of tolerance rates from 1 January 2019. As landowners have time to submit their requests until 30 June 2019, it is not yet clear at the date of this report to which amount applications will be submitted. According to the regulation, the aforementioned costs are included in the calculation of network charges, but there may be a time lag between the payments of compensation and indemnification through network charges, when the payments have to be financed from other sources.

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 31.12.2018, Elering has contractual capital expenditure commitments in respect of property, plant and equipment totalling EUR 167,200 thousand (31.12.2017: EUR 81,701 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.

Note 25

SUBSEQUENT EVENTS

In January 2019 Elering received income from a contractual penalty in the amount of EUR 10,888 thousand for the breach of contract by the counterparty. The contractual penalty was ordered by the ICC arbitral tribunal.

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 2018, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Our opinion is consistent with our additional report to the Audit Committee.

What we have audited

The Company's financial statements comprise:

- the statement of financial position as at 31 December 2018;
- 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 a summary of 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.

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 2018 are disclosed in the management report.

Our audit approach

Overview

Materiality

Overall audit materiality is EUR 1.6 million, which represents approximately 2.5% of profit before interest, tax, depreciation and amortization (EBITDA).

Audit scope

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

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 1.6 million
How we determined it	Approximately 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.

pwc

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 matters	*How our audit addressed the key audit matters*
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 2018 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 118.6 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 2018 the Company has received congestion fees of EUR 7.4 million and the deferred congestion revenue as of 31 December 2018 amounted to EUR 75.1 million. Accounting for congestion fees received depends on the purposes for which it will be used. Congestion fees used for constructions of new interconnection	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 Board minutes of meetings describing future investments and with the capital expenditures budget. We reconciled the balances of deferred congestion income to the respective invoices and subsequent cash receipts.

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.	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 contained in the annual report in addition to 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 7 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

18 March 2019

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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 31.12.2018 were EUR 141,182 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 29,400 thousand
To transfer to the statutory reserve capital	EUR 932 thousand
Not to distribute the remaining retained earnings	EUR 110,850 thousand

SIGNATURES OF THE MANAGEMENT TO THE 2018 ANNUAL REPORT

The signing of Elering AS 2018 Annual Report on 18.03.2019.

Chairman of the Management Board
Taavi Veskimägi

Member of the Management Board
Peep Soone

Member of the Management Board
Kalle Kilk

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 areas of activities*		*2018*	*2017*
35121	Transmission of electricity – transmission through the transmission network:	95,459	92,914
35221	Natural gas transmission	9,658	8,320
35141	Trade of electricity (balancing electricity)	30,253	22,892
35231	Trade of gas (balancing gas)	5,188	6,025
77399	Renting and leasing of other machinery, equipment and tangible goods	916	916
49501	Pipeline transport	583	460
47770	Retail sale of other second-hand goods	36	78
68201	Renting and operating of own or leased real estate	86	96
46699	Other sales	788	305

** EMTAK – classification of Estonian economic activities.*

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GENERATING OPPORTUNITIES

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