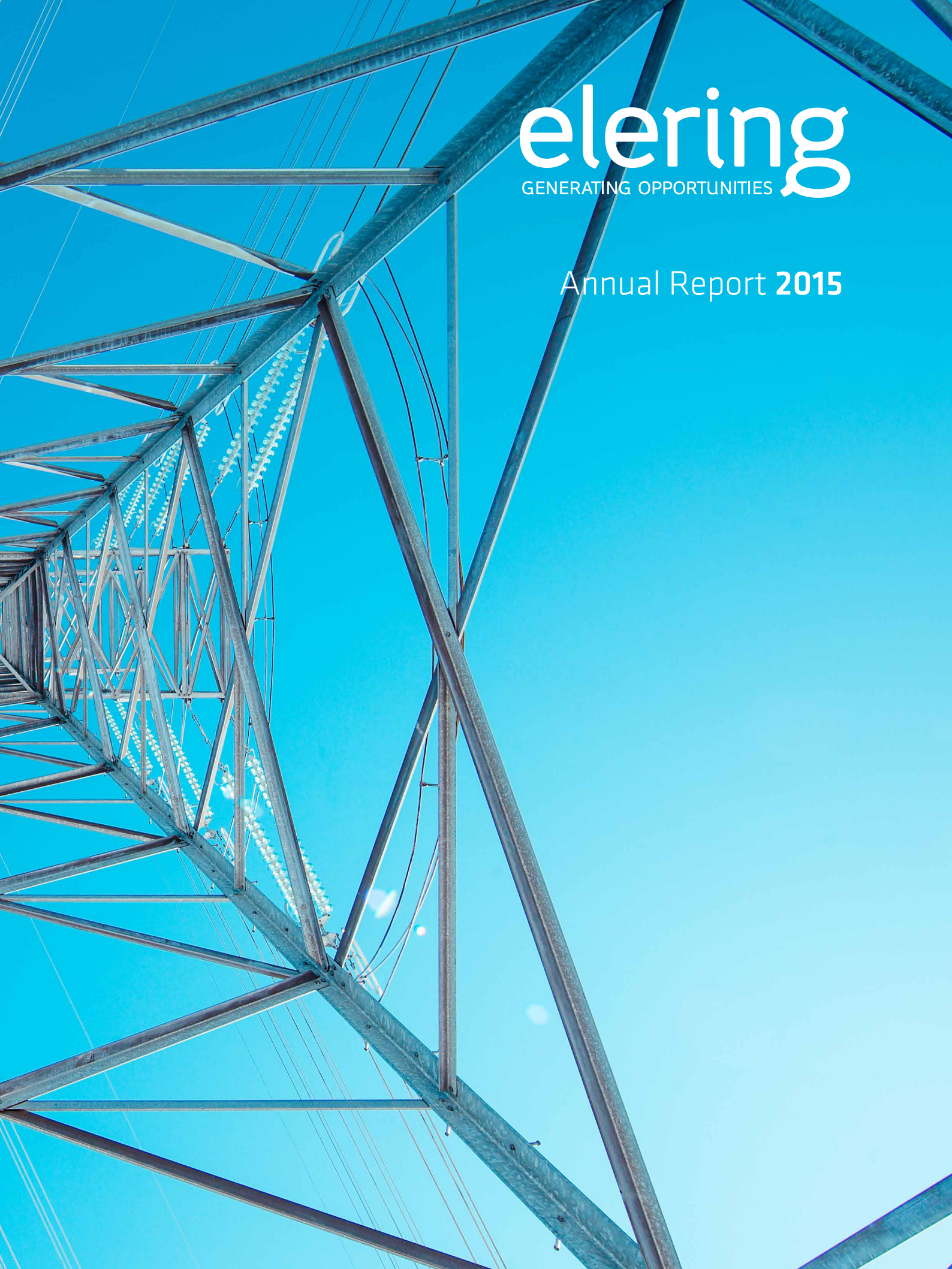
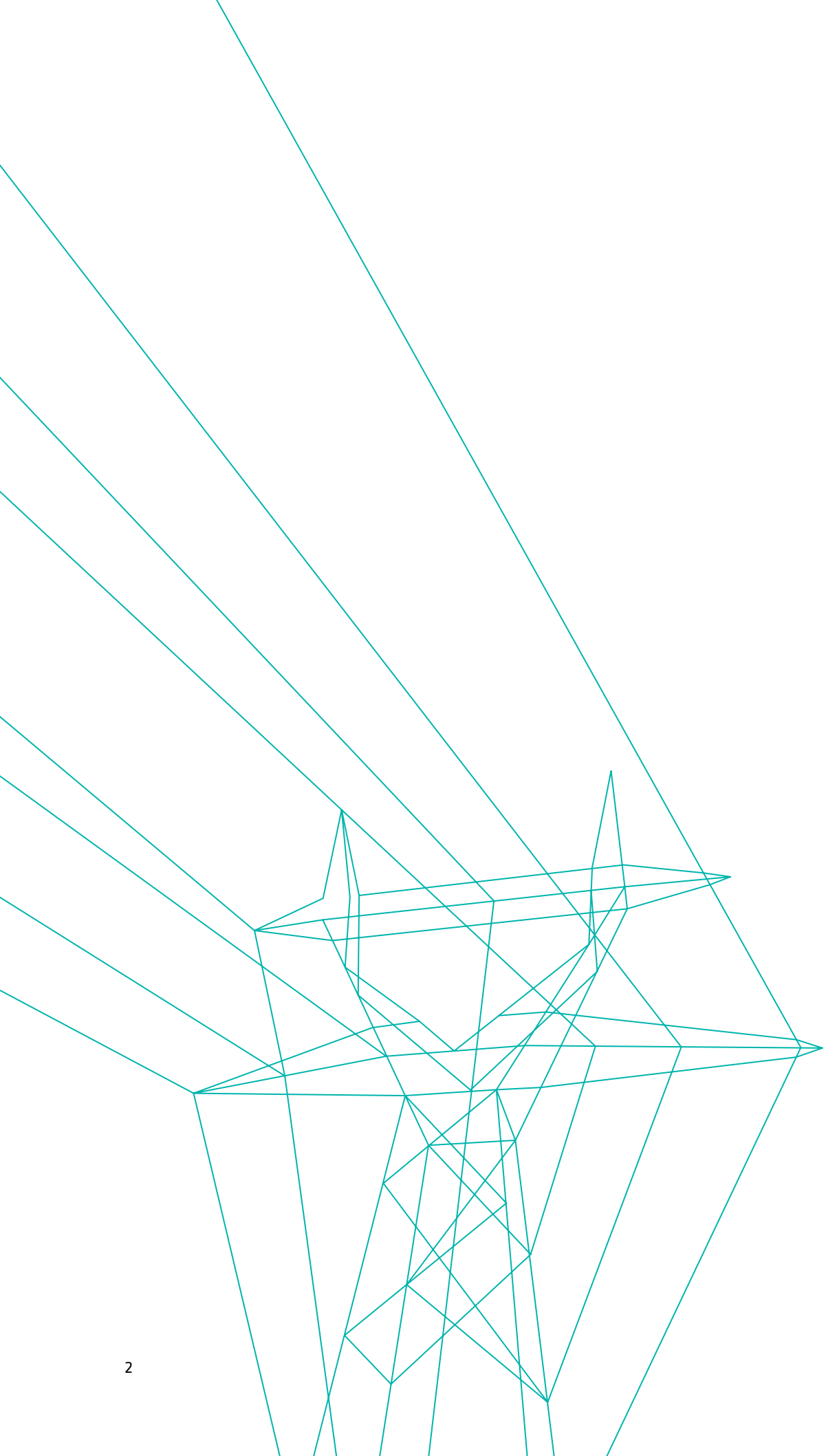


elering

GENERATING OPPORTUNITIES

Annual Report **2015**



Management Report – Elering

TAAVI VESKIMÄGI
Chairman of the Management Board

Statement by the Chairman of the Management Board

Constant change is the new reality
"What Got You Here Won't Get You There" is the title of a 2008 book by American management consultant Marshall Goldsmith. It is a universal thought that can be well adapted to any area of life where constant change is the everyday reality.

This thought certainly describes the energy industry in Estonia, which has never before been as organic a part of the global energy market as it is today. Energy systems are undergoing transformational change around the world. Among other trends, the industry is experiencing significant growth in the share of ICT in the energy system, the integration of energy markets (the European Energy Union), the large-scale addition of production equipment with irregular production cycles in the energy system, growing accumulation possibilities, environmental restrictions, energy efficiency objectives and the disappearing boundaries between the markets of electric power, natural gas and district heat. People need heating and light as opposed to electric power and natural gas. New solutions are increasingly replacing old ones to do the same tasks.

Whereas the former school of thought in the electricity industry was based on the Narva power plants and Estonia's total consumption, we now need to look at each household and company individually – trying to find a unique solution that best meets their needs.

The above also has an effect on the transmission system operator's business. In the natural gas industry, these trends have already had a relatively adverse effect on our business, from the standpoint of gas volumes transported. The electricity transmission business may face the same risks sooner than we expect. Elering aims to reckon with these changes, and not only reckon but to be able take the initiative regarding these trends. One initiative that we need to work on significantly harder than we used to is the establishment of IT infrastructure for the smart control of the energy system. The role of IT will grow significantly in the coming years.

The Estfeed – Estonian energy smart grid platform
Estfeed is a smart grid platform created by Elering in partnership with Elektrilevi, the Estonian Renewable Energy Association, VKG Soojus and Ericsson. This platform should enable Estonian end consumers, energy service providers, decentralised small producers and network companies to improve the efficiency of energy production and consumption through the use of near real-time energy consumption data. Estfeed is a platform similar to the Apple AppStore in the sense that various developers are able to create specific apps for it. The Estfeed Energy Smart Grid platform should become the basic IT infrastructure for the operation of the energy system. Elering itself will not export this system: our development partners will be able to supply this solution to regions that have recently introduced smart meters. Estonia could be a pilot, an illustration of the value offered to new clients. It is a platform that creates value for energy market participants and end consumers on the electric power, natural gas and district heat markets.

Combined transmission system operator of electricity and natural gas

2015 marked the 5th anniversary of the foundation of Elering, an independent electricity transmission system operator. These five years of independent operations have confirmed that the decision to separate the transmission system operator from Eesti Energia was the right one. Setting up an independent system operator has made it possible to create a competitive electricity market in Estonia with multiple market participants.

It is our objective to replicate this in the natural gas industry. In its sixth year of operations, the electricity transmission system operator fully acquired the assets of the natural gas transmission system. Since 2015, the Estonian natural gas transmission network operator has been independent from gas market participants.

As early as 2010, we set ourselves the objective of establishing a single electricity and natural gas transmission system operator in Estonia. Since 1 January 2016, the Estonian combined transmission system operator has had an integrated organisational structure, procedures and business. However, no merger is complete with the creation of a combined organisation alone, and this also applies to the integration of the operations of natural gas and electricity transmission network operators and the achievement of synergies. It will take time to blend the businesses, and one of our current priorities is to come to breathe as one, as was the motto of one of our song festivals. This does not only include electricity and gas people, but different generations, colleagues based in Tallinn and elsewhere in Estonia, people from different educational and cultural backgrounds and experiences, who all need to breathe as one. The nearly 230 employees that started their new work year in Elering form a team that has a variety of strengths. It must be our collective goal to use this vast resource in the best manner possible in order to accomplish the mission statement of Elering: "To ensure the security of the electricity supply to Estonian consumers through efficient regional energy markets, supported by reliable energy networks and competent employees. By achieving this, we contribute to the competitiveness of the Estonian economy."

Clearing power lines of trees

2015 was record-breaking for Elering for several reasons. Two of the most important were the volume of energy not served to Estonian electricity consumers, and the profits generated for the shareholder. Only 10 MWh of electric power went untransmitted in 2015 due to Elering network failures. This is essentially the annual electricity consumption of one household compared to the more than 8 TWh of energy transmitted to cover Estonia's electricity demand. We are proud of such a low failure indicator. The programme we launched in 2011 for clearing power lines of trees with the objective of improving the reliability of lines in any weather conditions has borne fruit.

Consistently strong financial results

In six years of independent operations Elering has generated 53 million euros of added value for its shareholder, as compared to the capital return approved by the regulator. This added value enables Elering to pay substantial dividends into the state budget (20 million euros in 2015). Elering is aiming to increase this amount to 31 million euros in 2016. Elering will be able to accomplish this without compromising on the security of supply provided to Estonian electricity and natural gas consumers.

A single network creates a single market

Experience has shown that infrastructure must be developed first: only then can market development follow. The objective of Elering is a closely integrated electricity and gas market, so that demand and supply can meet at any time from Gibraltar to North Cape, without any limits imposed by transmission capacity or market mechanisms. For us, 2016 will primarily be the year of development of the Balticconnector, the natural gas pipeline between Finland and Estonia, and of a third power transmission line between Estonia and Latvia.

The European Union decided in 2015 to provide 112 million euros in funding for the construction of a third power transmission line between Estonia and Latvia (EstLatIII). Elering will fund its own share of the investment from its income from cross-border transmission capacity auctions. Estonian electricity consumers will not have to pay a single cent for the construction of EstLatIII. Elering has accumulated congestion income from its transmission capacity use between Estonia and Finland, and especially between Estonia and Latvia, totalling almost 86 million euros.

Change keeps us fit

Change keeps any organisation fit. The effective implementation of a combined electricity and natural gas transmission network operator from 2016 is not the end of the story, but rather the start of a new, collective and hopefully successful chapter. Each successfully implemented change provides us with an opportunity to initiate further change. Elering has several plans for expanding its operations in its regulated business without changing the company's risk profile while guaranteeing the security of supply for our electricity consumers in a way that supports Estonia's economic development.

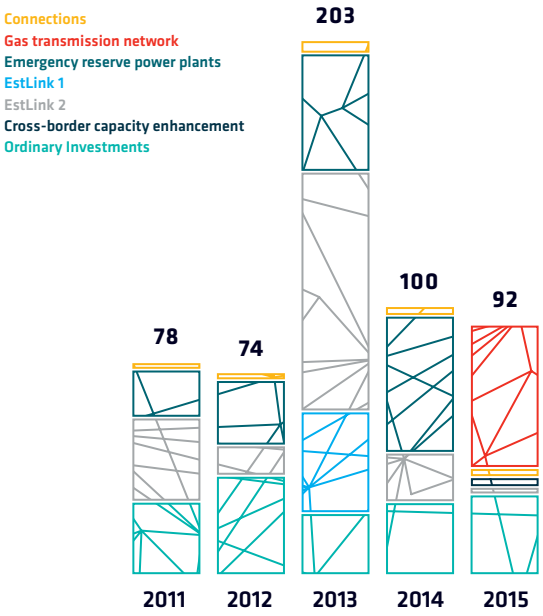
Overview of Elering

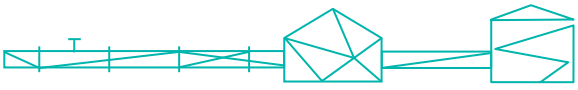
2015

Major projects:

- Acquisition of gas transmission network
- Virtsu-Võiküla 110 kV submarine cable between the mainland and Muhu Island
- Eesti power plant's 330 kV substation
- Ranna-Ida 110 kV underground lines in central Tallinn

Elering`s investments in fixed assets (MEUR)

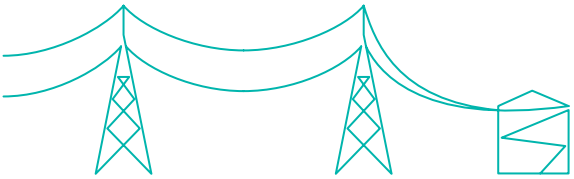




885 km of gas pipelines

36 gas distribution stations

3 gas metering stations



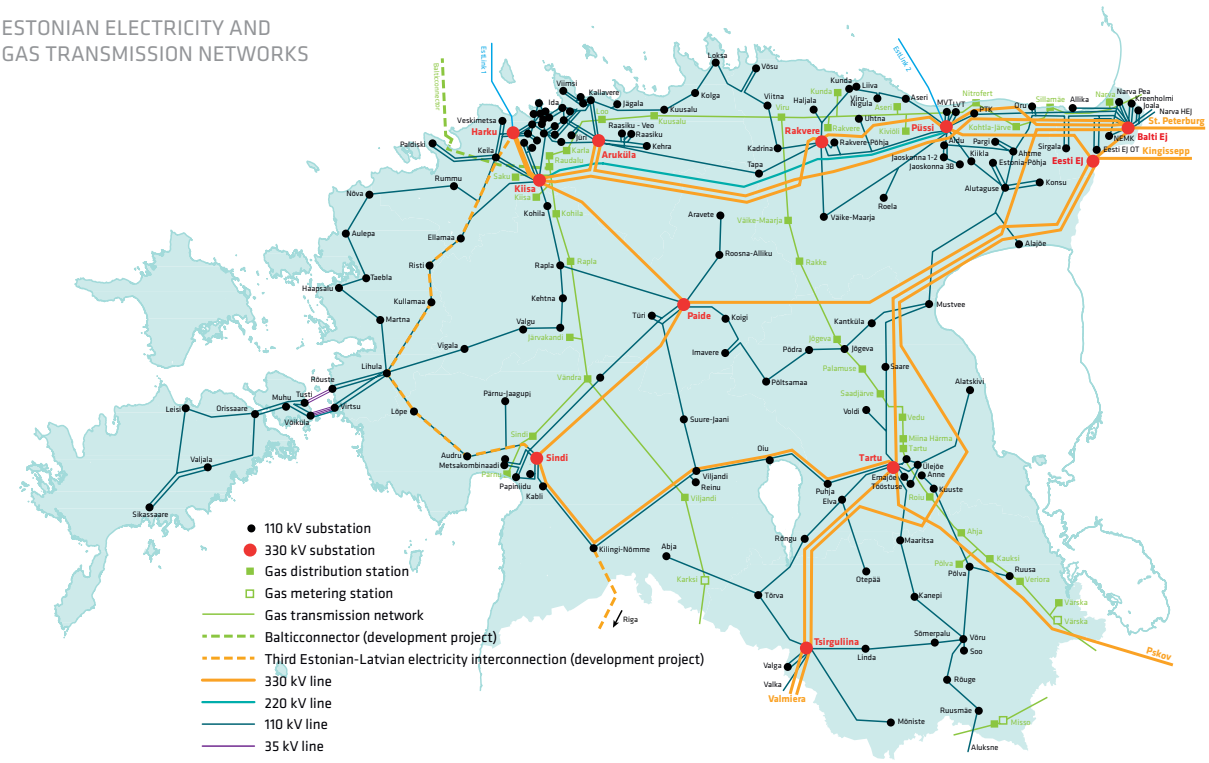
5406 km of AC overhead transmission lines

147 substations

2 converter stations

139 km of EstLink cable lines

ESTONIAN ELECTRICITY AND
GAS TRANSMISSION NETWORKS



average age **45**

average length of service **15**

229

employees
of whom 25% are
women

Financial figures (MEUR)

	2011	*2012*	*2013*	*2014*	***2015***
Revenue	94,4	109,5	134,4	*130,8*	*132,4*
Operating expenses	65,8	68,2	81,1	*80,0*	*90,9*
Operating profit	28,6	41,3	53,3	*50,8*	*41,6*
Income tax	0,0	0,0	0,0	0,0	5,0
Net profit	20,5	34,9	49,0	*40,7*	*25,1*
Borrowings	221,6	227,0	312,4	*347,9*	*379,2*
Equity	190,3	225,1	274,1	*314,8*	*329,4*
Assets	486,4	515,7	670,9	*790,0*	*861,9*
EBITDA	49,8	64,1	77,0	*82,0*	*78,6*
Investments	78,1	73,9	203,3	*100,5*	*93,1*
Dividends	0,0	0,0	0,0	0,0	20,0

Financial ratios

ROE	11,7%	16,8%	19,6%	*13,8%*	*7,8%*
Equity/Assets	39%	44%	41%	*40%*	*38%*
Net Borrowings/EBITDA	4,0	3,3	4,0	*3,9*	*4,1*

$$ROE = \frac{\textit{Net profit}}{\textit{Average equity}}$$

Net Borrowings = interest-bearing liabilities – cash and cash equivalents
EBITDA = Operating profit + depreciation and amortization

Key Indicators of the Estonian Energy System

Electricity balance

In 2015, Estonia's domestic electricity consumption (including network losses) amounted to 8,137 GWh and remained relatively unchanged compared to the year before. Elering's domestic transmission service was also unchanged year-on-year, but transmission network losses increased by 6%. The increase in losses was primarily attributable to increased energy flows between Finland and Estonia.

Electricity generation decreased compared to 2014 by 17% to 9,062 GWh. This decrease was attributable to low prices on the power exchange, which incentivised electricity imports from the Nordic countries. Generation from renewable sources of energy on the other hand increased by 11%, including a 21% increase in wind power generation and a 4% increase in electricity generation from biomass, biogas and waste compared to 2014. The proportion of energy generated from renewable sources increased in the generation mix to one-sixth of overall generation.

For the year as a whole, electricity generation exceeded consumption in Estonia by 11%, resulting in net exports of 925 GWh.

Electricity balance, GWh	*2014*	*2015*	*Change %*
Electricity production in Estonia	**10,905**	**9,062**	**-17%**
Domestic electricity generation provided to Elering network	10,638	8,771	-18%
Production of renewable energy in Estonia	1,357	1,507	11%
Electricity imports from cross-border power lines	**3,764**	**5,344**	**42%**
· incl. physical transmission from Finland	3,517	5,018	43%
· incl. physical transmission from Latvia and Russia	247	326	32%
Total electricity provided to network	**14,669**	**14,406**	**-2%**

Electricity consumption in Estonia	**8,137**	**8,120**	**0%**
Elering's domestic transmission service for consumption	7,443	7,473	0%
Elering network losses	402	381	6%
Electricity exports through cross-border power lines	**6,269**	**6,548**	**-4%**
· incl. physical transmission to Finland	39	42	-7%
· incl. physical transmission to Latvia and Russia	6,230	6 506	-4%
Total electricity taken from network	**14,406**	**14,669**	**-2%**
Balance	**925**	**2,784**	**-67%**

Electricity trade balance

According to the electricity trade balance of 2015, electricity exports decreased by 5% compared to the previous year, whereas electricity imports grew by 44%. 98% of total exports were to Latvia (2% to Finland) and 99% of total imports were from Finland (1% from Latvia). Net electricity exports decreased by 72% compared to 2014, which was attributable to the importing of lower-priced electricity from the Nordic countries.

The cross-border trade balance consists of trade supplies planned and executed by market participants.

Cross-border electricity trade, GWh

	2014	*2015*	*Change %*
Total exports	**6,346**	**6,026**	**-5%**
Exports on Estonian-Latvian border	6,252	5,926	-5%
Exports to Finland	94	100	6%
· incl. exports through Elspot power exchange	6,242	5,917	-5%
· incl. exports through Elbas power exchange	103	109	6%
Total imports	**3,669**	**5,273**	**44%**
Imports on Estonian-Latvian border	46	60	30%
Imports from Finland	3,622	5,213	44%
· incl. exports through Elspot power exchange	3,493	5,100	46%
· incl. exports through Elbas power exchange	176	173	-2%
Electricity trade balance*	**2,677**	**753**	**-72%**
· incl. net exports on Estonian-Latvian border	6,205	5,866	-5%
· incl. net exports on Estonian-Finnish border	-3,529	-5,113	45%

* *The trade balance excludes the system's imbalance and regulation deliveries made to balance the system, the total of which equals the difference between the trade balance and the physical balance of the electricity system.*

Electricity balances in the Nordic countries and Baltic States

Electricity generation grew by 8% year-on-year in Latvia and amounted to 5.32 TWh. The generation of co-generation plants increased in the generation mix. Growth in total generation was negatively affected by the worse availability of hydropower resources – the average inflow into the Daugava river in the 2015 was 348 m3/s compared to an average of 373 m^3/s in 2014. Consumption in Latvia decreased by 1% and the annual deficit amounted to 1.76 TWh. The annual deficit in Lithuania was reduced to 7.18 TWh. This was attributable to a 10% increase in generation and it was also supported by a 2% decrease in consumption.

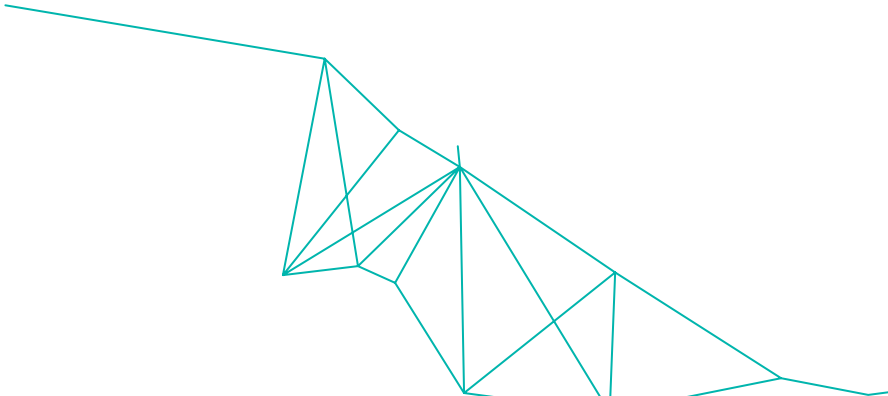
The combined electricity generation in the Baltic States decreased year-on-year by 6% to 17.65 TWh. Combined consumption amounted to 25.67 TWh, a decrease of 1% compared to 2014. The combined electricity balance deficit in the Baltic States amounted to 8.01 TWh, increasing by 13% compared to the previous year. The electricity balance deficit of the Baltic States was covered to the extent of an estimated 61% by imports from the Nordic countries and 39% by imports from third countries.

The electricity balance of the Nordic countries was in a net surplus of 15.86 TWh, growing by more than a third compared to the previous year. The surplus in Sweden was 22.95 TWh, while Norway's surplus amounted to 14.77 TWh. Finland and Denmark imported 16.08 TWh and 5.78 TWh, respectively, to cover their domestic consumption.

Gas balance

Temperatures were higher than average in 2015 due to a warm winter. While this did not reduce electricity consumption compared to the previous year, gas consumption in Estonia decreased to a record low, amounting to approximately 480 million cubic metres (approximately 5,050 GWh) for the whole year including network losses.

The natural gas business in 2015, however, was marked by the entry of new suppliers to the gas market – in addition to Eesti Gaas, four other new balance providers started to supply gas to Estonia. Approximately 21% of gas was supplied from the Lithuanian gas exchange through their portfolios for domestic consumption. The remainder of consumption was covered from the largest supplier's portfolio with imports from Russia and the Latvian natural gas storage facility.

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PEEP SOONE
Member of the Management Board

Summary of the Financial Year

Milestone of gas transmission network acquisition

2015 was marked by Elering's acquisition of a gas transmission network. Elering acquired, through multiple transactions, 100% of the shares in AS Võrguteenus Valdus, which in turn holds 100% of the shares in Elering Gaas AS. As a result of the transactions, the financial results reflect the consolidated financial results of Elering AS, which also include the operations of subsidiaries. The accounting, budgeting and financing functions of subsidiaries were transitioned to the policies of Elering during the year. Even though gas transmission revenues account for less than 7% of the group's consolidated revenue, we believe that we will be able to create value in this business in the future. Electricity and gas transmission businesses are very similar in nature – both represent vital infrastructure for the state of Estonia. Regulations are also almost identical in the two businesses. Most of all we see synergies in the combined financing function and support services.

In 2014 Elering concluded its period of intensive investment in the electricity network, as a result of which we incurred on average 114 million euros in annual capital expenditure during the 2011-2014 period. Capital expenditure in the electricity network decreased to 37 million euros in 2015 and we are not forecasting any significant increase in the near future.

Revenue

The group generated most of its revenues from the sale of network services: a total of 104.7 million euros. This consisted of electricity network services (92%) and gas network services (8%). The decrease compared to the previous year is primarily attributable to a change in the accounting principles of cross-border transmission capacity auction revenues. Until 30 June 2014, such auction revenues (15.8 million euros) were recognised in the income statement, and thereafter as non-current liabilities in the balance sheet. At the same time, network charges increased by 8.9 million euros due to the acquisition of the gas transmission network.

Sales of balancing electricity and regulation services amounted to 19.0 million euros.

In order to ensure stable frequency in the electricity system it is necessary to keep the system balanced, i.e. production must equal consumption at all times. This means that all market participants must also be balanced, and most of them buy their balancing service from balance providers. Elering itself provides the balance providers with the service of balancing their energy balance.

The principles of balancing the natural gas system are generally the same. The only difference is that the gas system does not have to be balanced at all times. If the consumption of natural gas exceeds inflow, the pressure in the system starts to drop, and vice versa. The task of Elering as a gas transmission system operator is to maintain pressure within the permitted range. For this purpose, Elering buys and sells balance gas to gas balance providers.

The balance service has no significant impact on Elering's profit because balance service fees are calculated in such a manner that generated revenues cover the cost of providing the service.

Expenses

Operating expenses in 2015 totalled 90.9 million euros (2014: 81.1 million euros) and financial expenses amounted to 11.5 million euros (2014: 10.0 million euros).

Two of the main reasons for the increase in operating expenses were the acquisition of the gas transmission network and the completion of large capital investment projects (most importantly the completion of an emergency reserve power plant in 2014 at a cost of 134 million euros). The capitalisation of these investments caused an increase in depreciation and also an increase in finance costs as reported in the income statement.

Financing

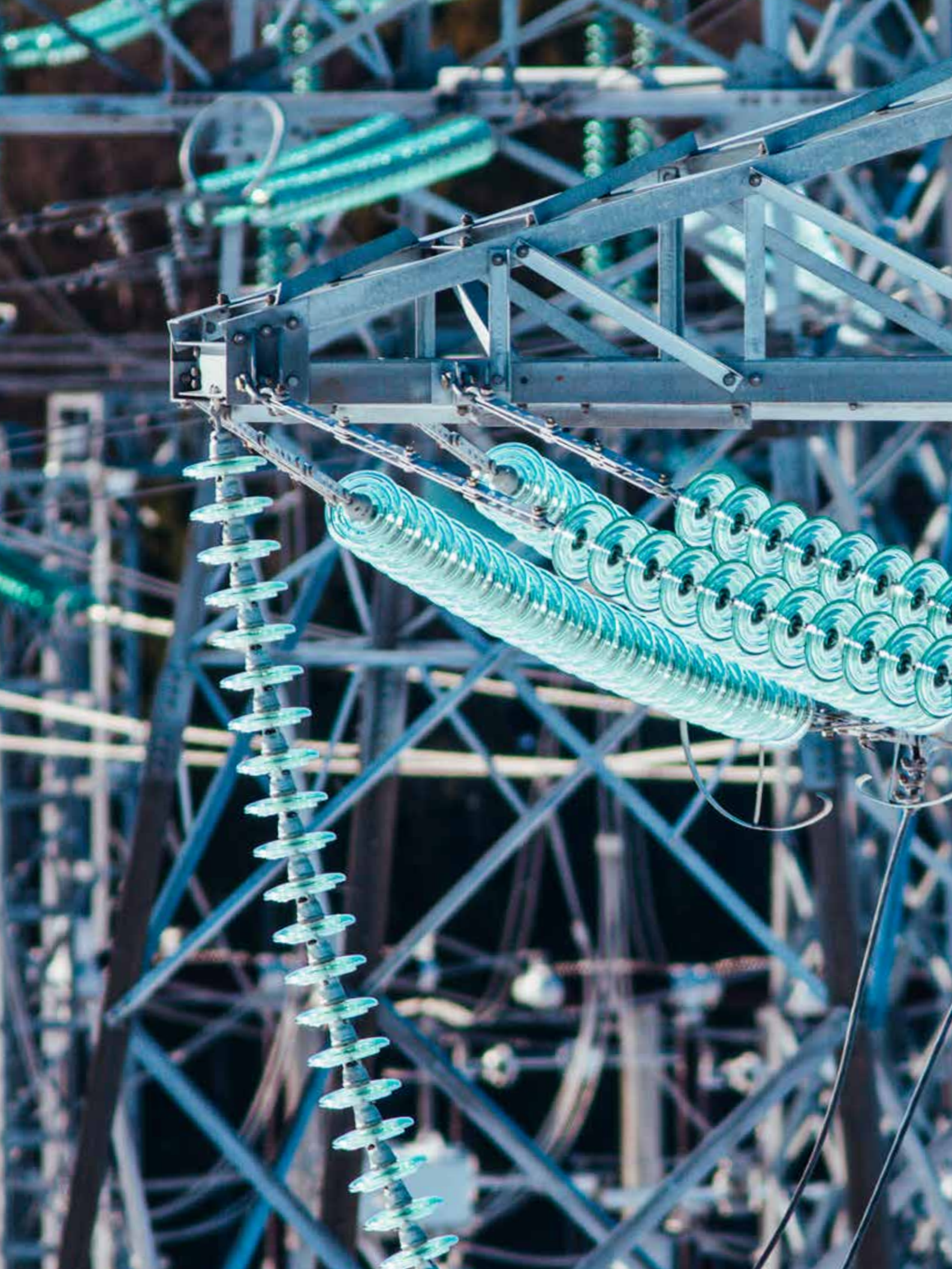
Cash flow from operating activities amounted to 56.1 million euros (2014: 60,4 million euros).

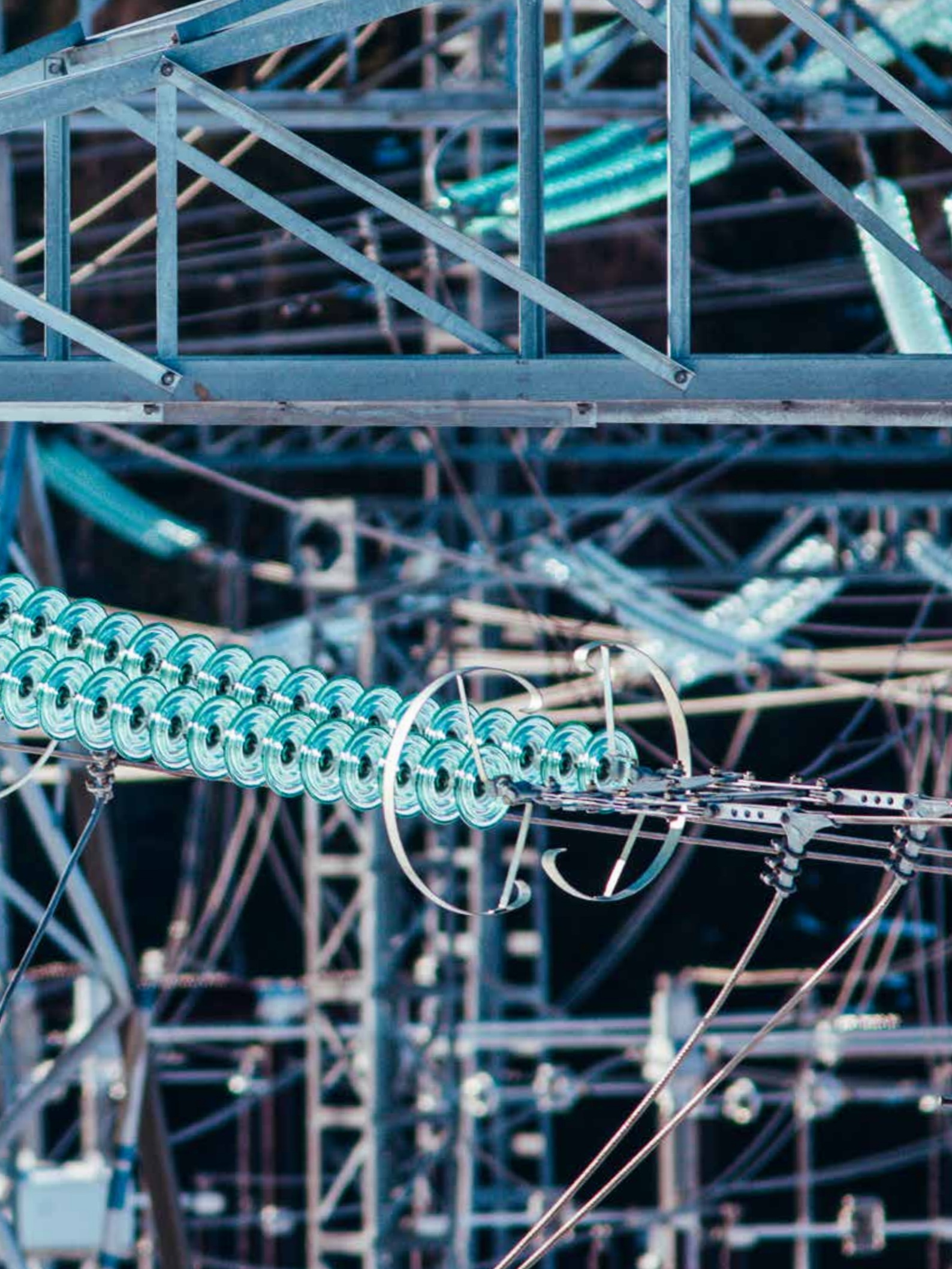
Cash flow from investment activities amounted to 20.2 million euros (2014: 64,7 million euros). The single largest investment was the acquisition of a majority stake (51.4% ownership interest) in a gas transmission system for 26.6 million euros, in addition to 39.8 million euros of other capital expenditure. Proceeds from cross-border transmission capacity auctions were 29.0 million euros, and the final instalment of the European Union grant for the construction of Estlink 2 was collected totalling 15.3 million euros. Proceeds from disposal of non-current assets amounted to 1.8 million euros.

Cash flow from financing activities amounted to 7.3 million euros (2014: 35 million euros). During the year, a loan was obtained from the European Investment Bank of 32.0 million euros, the sole shareholder contributed additional share capital of 8.0 million euros and Elering paid dividends amounting to 20.0 million euros. In addition, this category also includes the 26.1 million euros that was paid for the acquisition of the remaining stake in the gas transmission network (48.6% ownership interest). Loan repayments were made according to an amortization schedule totalling 1.2 million euros.

Summary

2015 was financially successful for Elering. The return on equity was 7.8% and a strong financial position enabled the company to pay dividends to its shareholder: 20 million euros was distributed in 2015, and 31 million euros will be distributed in 2016. The rating agency Moody's raised Elering's credit rating from A3 to A2, which was the highest credit rating assigned to a Baltic company in the year.





KALLE KILK
Member of the Management Board

Development of the Electricity and Gas Transmission Network

Projects completed

Elering invested 36.7 million euros in the electricity network and 2.1 million euros in the gas network in 2015.

Several cable projects were completed as part of electricity network investments. A new electric transmission line between the Virtsu and Võiküla substations was completed in the form of a 110 kV submarine cable used for the first time in Estonia, which serves to significantly improve the security of supply on the islands of Muhu, Saaremaa and Hiiumaa. Before this cable, only 35 kV cables were in use, but these had come to the end of their useful lives and no longer had sufficient capacity. Two cable projects were successfully completed in Tallinn: two 110 kV cables were installed between the Ida substation located in the district of Lasnamäe and the Ranna substation in the city centre; and one cable was installed between the Endla and Veskimetsa substations. The completion of the Endla-Veskimetsa cable line enabled the removal of an obsolete overhead line from the densely populated Kristiine area, which was a notable step towards improving the city.

The largest substation construction project was the expansion of the Sindi substation 330kV switchgear, the completion of which enabled the higher-voltage circuit of the Tartu-Viljandi-Sindi 330/110 kV line completed in 2014 to be adopted. This will ensure improved security of supply in the Pärnu area.

As part of a connection project, a new Põhja 110 kV substation was constructed and an LVT substation was renovated for connection purposes. In addition, a new bay was completed in the Eesti Power Plant 330 kV substation which will be needed to connect a wind farm to the grid.

Estonian-Latvian connections

In order to improve the transmission capacity of lines between Estonia and Latvia, it is necessary to build a third power transmission line between the two countries and also to improve the capacity of the two existing lines. A planning process was carried out in 2015 as part of the new power transmission line project. Public hearings involving the power transmission line planning process were concluded by the end of 2015 for the Harku-Lihula-Sindi section. This will be followed up in 2016 by sending planning materials to the Ministry of Finance for review and, if a positive decision is made, work on the preliminary design and entry into land contracts may start. Construction work on the transmission line is scheduled to begin in 2017 and the line should be completed in 2020. The section from Kilingi-Nõmme to the Estonian-Latvian border reached the planning approval stage in 2015 and further steps involve preliminary design, land contracts and the construction procurement.

There are two potential ways of improving the capacity of the existing transmission lines between Estonia and Latvia: complete reconstruction; or the installation of a high-temperature conductor. Full reconstruction would mean the building of a brand new transmission line, which may take 6-10 years together with the planning process. Therefore, the possibility of replacing the conductor is under serious consideration, as this could be performed in just a few years, assuming that the existing masts are in satisfactory condition. A high-temperature conductor is different from a conventional one due to the fact that its core is made from a new composite material instead of steel, therefore enabling the transmission of significantly higher capacity without the hazard of excessive sag occurring as an effect of the conductor heating. As adjacent regions have no experience in the installation and use of such conductors, it was decided to adopt the innovative conductor as a pilot project, initially in one short section. For this purpose a procurement was organised in mid-2015 for the installation of a composite core conductor on the Tsirguliina-Valmiera 330 kV line stretching 11 km from the Tsirguliina substation to the Estonian-Latvian border. Installation of the conductor was completed in January 2016 and within a few years it will be possible to ascertain whether similar technology will be appropriate in our conditions for expanding the capacity of other transmission lines.

Gas network

The main priority in the development of the gas transmission network is related to preparations for the Balticconnector gas pipeline between Estonia and Finland. This investment is mainly necessary for ensuring the security of supply of natural gas. As market areas are combined, risks arising from the limited number of suppliers and physical connections are reduced. Progress was made in this project in 2015 in preparatory-type activities: the resolution of land issues in the above-ground sections, environmental impact assessment in the submerged sections and application for co-funding from the European Union. A natural part of the project is also the development of the Estonia-Latvia pipeline connection in order to increase its capacity and enable two-way transport. The entire project is due for completion in 2019.

In addition to the Balticconnector project, renovation work continued on the domestic Estonian gas transmission network aimed at the optimal use of the useful lives of existing equipment and the improvement of safety.

- A gas pipeline bushing was replaced under the Kunda River. The entire length of the section was 198 metres, of which a 60-metre section was constructed under the river through the use of closed-loop drilling.
- A node was reconstructed at the Värska gas metering station – the old node was removed and a brand new node was constructed with remote-control features.
- Insulation work was carried out on the Vireši-Tallinn gas pipeline in a section measuring 793 metres (in 69 different locations detected through the use of internal diagnostics data).
- Corroded gas pipelines were replaced in three locations along the Rakvere-Tartu pipeline and two locations along the Irboska-Tartu pipeline, detected through the use of internal diagnostics data, involving a total of 126 metres.

- Areas weakened due to corrosion, detected through the use of internal diagnostics data, were strengthened by installing 120 repair fittings on pipes:
  - Irboska-Tartu-Rakvere pipeline – 95
  - Vireši-Tallinna pipeline – 5
  - Pihkva-Riia II pipeline – 20

Long-term development plan for the electricity network

A long-term development plan for the electricity network (until 2030) was completed in 2015 as a major electricity network planning project in collaboration between Elering and Elektrilevi. Development alternatives were assessed and analysed using a method based on the principles of total cost of ownership and the minimisation of costs for society. If a complete solution comprising a transmission system and distribution network investments is examined only from the point of view of cost minimisation of one part of the network, the development alternative selected in such a manner may not be the most beneficial overall, as it may cause significantly higher costs in the other part of the network. Therefore, it is important to address network development as a complete solution in terms of overall costs incurred by society, even if the parts of the network being developed are within the areas of responsibility of various developers.

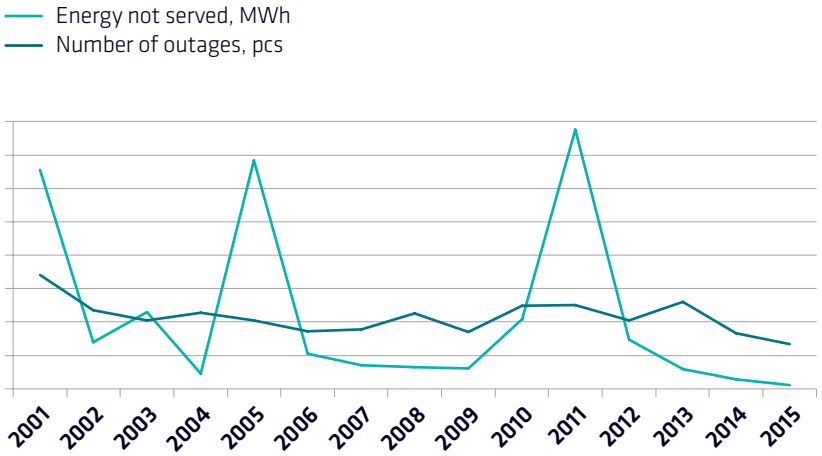
The finalised development plan and solutions proposed therein have been adopted as a guideline for drafting an investment plan to thereby execute network development that will result in the lowest cost incurred by society. The long-term developments called for by the development plan are also provided as input for county plans. Elering intends to regularly modify and update the development plan going forward in order to take into account both changes that have already occurred and updated future prospects, as well as more distant time horizons.

Reliability of networks

The operational reliability of networks was very good in 2015. The gas transmission network did not experience any major disruptions significantly affecting natural gas consumers or third parties. The operational reliability indicators of the electricity network were at their highest levels in many years.

As part of the programme to improve the operational reliability of the electricity network, a total of 14 km of conductors and 244 km of insulation were replaced on Elering's 110 kV voltage lines and 272 km of bird deterrents were installed.

The accomplishment of good operational reliability was admittedly impacted somewhat by a summer with below-average temperatures, meaning that the effects of thunderstorms and bird soiling were reduced. At the same time, contributions to high operational reliability indicators were made to a greater degree in recent years through work carried out to clear line routes of hazardous trees and brush. Thanks to this work, the powerful storms experienced at the end of the year had no significant effect on the Elering network. During 2015, approximately 220 hectares of forest was logged in line protection zones.



ELIS PAAS
Head of the Energy Markets Department

Developments on the Electricity and Natural Gas Markets

Regional development

Highlights of regional electricity market development in 2015 included the introduction of the new network codes of the European Union energy package and new connections that expanded the market area. Working closely with Baltic transmission system operators, Elering analysed the impact of the new direct-current cables being constructed from Lithuania to Poland and Sweden on the Baltic regional market and electricity system. The LitPol Link between Poland and Lithuania commenced power transmission on 9 December 2015, while the first power transmission through the NordBalt connection between Lithuania and Sweden took place at the start of 2016. In addition, the Nord Pool (NP) price area between Finland and Russia has been open since June 2015, with the initial trade capacity being introduced on 8 August 2015.

In August 2015, the first network code addressing the electricity market was implemented – European Commission Regulation No 2015/1222 establishing guidelines on capacity allocation and congestion management across Europe. In the light of the new regulation, transmission system operators from the Baltic States adapted the principles of the calculation and allocation of the cross-border capacities that are in force within the framework of regional cooperation on the internal borders of the European Union and on borders with third countries, which were approved by all regulators in the Baltic States. On the EU's internal borders, all capacities that are available for the day-ahead and intraday market are distributed via implicit auctions. To date,

trading with third countries has only been possible in the day-ahead timeframe and capacities are distributed using the capacity optimisation methodology.

In the natural gas industry, 2015 was the first time that the Estonian natural gas market had the chance to operate on equal conditions of competition. With the change in transmission system operator, new natural gas suppliers were able to enter the market and create real competition. In addition, the liquefied natural gas terminal constructed in Lithuania established a new source of supply in the region, creating a reference price for gas imported from Gazprom in Russia. As a result of challenges involving the liberalisation of the Baltic and Finnish natural gas markets, BASREC (Baltic Sea Region Energy Cooperation), in partnership with the countries' gas system operators, commissioned a study of the development of the natural gas market.

Transparency of market data

While in 2014 Elering mainly focused on the publication of data regarding the Estonian electricity system and market on the ENTSO-E Transparency Platform across Europe being launched on 5 January 2015 pursuant to European Commission Regulation No 543/2013, by 2015 the main focus shifted to REMIT, which was European Commission Regulation No 1227/2011 on wholesale energy market integrity and transparency, and preparation for the publication of data on the natural gas system and market on the ENTSO-G Transparency Platform.

Pursuant to the REMIT regulation and its implementing acts, all market participants on electricity and natural gas markets, including Elering as a system operator, are obliged to report data on all transactions on the market to the Agency for the Cooperation of Energy Regulators (ACER). Energy purchase and sale transactions have had to be reported since October 2015, while cross-border transmission capacity transaction data (purchase/sale of transmission capacity, incl. limited PTRs and nominations) will have to be reported from April 2016.

Elering has been reporting Estonian gas system flows and gas quality data to the ENTSO-G Transparency Platform since January 2016.

Forward capacity allocation instruments on the electricity market

PTR-Limited auction results for 2015	*Sold capacity*	*Auction price*	*Actual price difference NPS EE-LV*	*System operators income/expense*
Product name	(MW)	(EUR/MWh)	(EUR/MWh)	(EUR)
PTR-L Y-2015	200	7,11	10,76	-6,400,036
PTR-L Q1-2015	100	2,41	4,57	-467,774
PTR-L Q2-2015	65	9,94	8,27	237,558
PTR-L Q3-2015	65	16,63	14,69	278,196
PTR-L Q4-2015	100	6,67	15,35	-1,917,550
PTR-L Jan-2015	150	2,70	5,94	-362,083
PTR-L Feb-2015	150	4,81	6,01	-121,026
PTR-L Mar-2015	150	5,26	1,91	373,365
PTR-L Apr-2015	135	4,25	4,31	-5,647
PTR-L May-2015	135	8,20	5,06	315,167
PTR-L Jun-2015	135	16,17	15,54	114,080
PTR-L Jul-2015	50	13,54	16,20	-99,013
PTR-L Aug-2015	50	14,33	15,20	-32,511
PTR-L Sept-2015	135	12,70	12,60	9,540
PTR-L Oct-2015	150	6,58	21,47	-1,663,835
PTR-L Nov-2015	150	6,10	12,87	-731,630
PTR-L Dec-2015	150	2,83	11,62	-981,022

In 2015, the Estonian and Latvian transmission system operators Elering and Augstsprieguma tīkls (AST) decided to replace the PTR-Limited rules which had been valid to that point with Harmonised Allocation Rules (EU HAR) for the allocation of cross-border capacity across Europe. EU HAR were developed and issued by ENTSO-E based on the proposed Network Code on Forward Capacity Allocation for EU transmission capacity as part of an early implementation project. A Regional Annex has been established for Estonian-Latvian cross-border rules, taking into account regional differences. For example, in addition to yearly and monthly allocations as provided in EU HAR, on the Estonian-Latvian border quarterly allocations can also be purchased and full firmness is ensured for all products. The new rules, including regional annexes, apply to forward transmission capacity instruments as of 1 January 2016.

PTR-Limited total net expense(-)/income(+) for Elering in 2015 amounted to -5.73 million euros (compared to -4.24 million euros in 2014).

Summary of 2015 in NP Estonian price area

- The average price in the NP Estonian price area in 2015 was 31.08 EUR/MWh, which was 17% lower than the average price in 2014.
- The average NP system price was 20.98 EUR/MWh, which was 29% lower than the average price in 2014.
- To cover domestic consumption in 2015, Estonian market participants purchased a total of 7.09 TWh of electricity from the day-ahead and intraday market, representing 87.1% of total domestic consumption.
- Of the 9.1 TWh of electricity generated in Estonia in 2015, 86.6% or 7.85 TWh was sold on the day-ahead and intraday markets.
- The NP Estonian and NP Latvian price areas converged on the day-ahead market for 33.9% of hours (2014: 30.4%).
- The NP Estonian and NP Finnish price areas converged on the day-ahead market for 88.0% of hours (2014: 91%).

NP Estonia price area	*2013*	*2014*	*2015*
Openness of electricity market	100 %	100 %	100 %
Eligible consumers	all	all	all
Volume of electricity bought on NP EE day-ahead market (TWh)	7,34	7,14	7,09
Volume of electricity sold on NP EE day-ahead market (TWh)	10,7	9,82	7,85
Congestion income from implicit auction between Estonia and Finland (MEUR)	7,40	2,39	4,18
Congestion income from implicit auction between Estonia and Latvia (MEUR)*	28,24	38,91	31,93
Congestion income from explicit auction between Estonia and Latvia (MEUR)**	0,17	-	-

** Sin The NP ELE price area was opened on 18 June 2012*
*** Since 3 June 2013 total capacity has been allocated through an implicit auction*

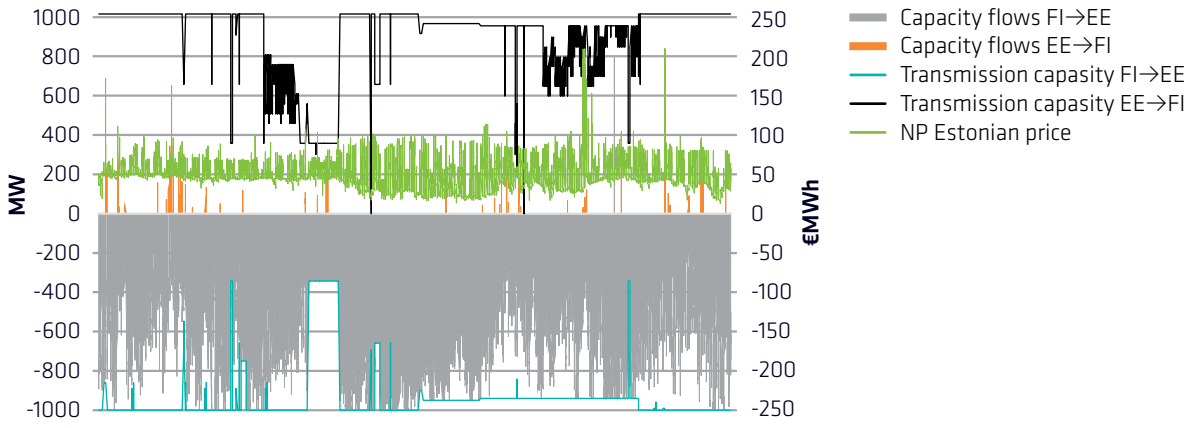
Volumes purchased from the Elbas market totalled 108.9 GWh in 2015, accounting for 1.5% of the total volume purchased in the Estonian price area. The volumes sold during the year amounted to 44.3 GWh, accounting for 0.6% of the total in the Elspot and Elbas NP price area.

Compared to 2014, annual average electricity prices declined in all price areas: the system price declined by 29% to €20.98/MWh (2014: €29.31/MWh). The primary reason for the decline year-on-year was good opportunities for the production of hydro power in the Nordic countries alongside modest growth in consumption (less than 1%). In addition, prices were impacted by the decline in the global oil price.

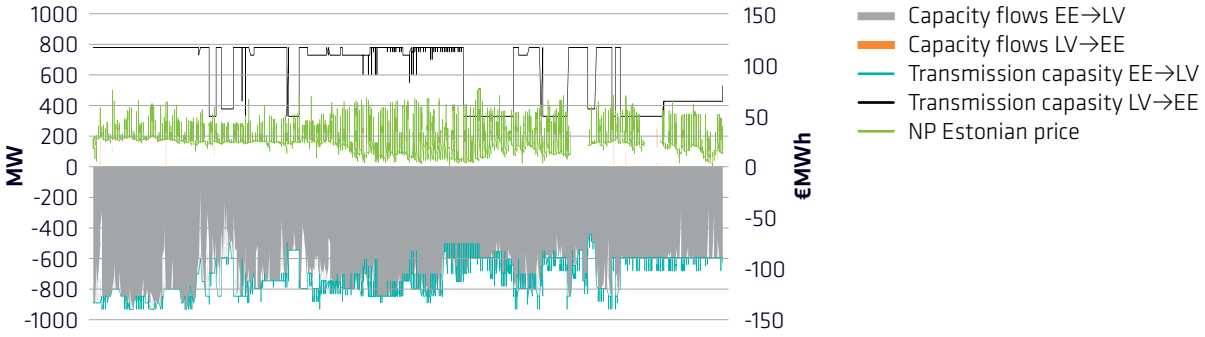
2015 (EUR/MWh)	*Average price*	*Max. price*	*Min. price*	*Average price 2014*
NP system	20,98	69,94	1,14	29,61
NP Finland	29,66	150,06	0,32	36,02
NP Estonia	31,08	150,06	0,32	37,61
NP Latvia	41,85	200,11	4,05	50,12
NP Lithuania	41,92	200,11	4,05	50,13

The average price difference in 2015 between Estonia and Finland was just 1.43 euros, and prices differed only 12% of the time. In comparison, prices in Estonia and Finland differed 9.3% of the time in 2014, but the price difference was on average 1.59 euros. The average price difference between the NP Estonian and NP Latvian price areas in 2015 also decreased: the price in the Latvian price area was on average 10.76 euros higher than that in the Estonian price area (2014: 12.50 euros). In 2015, prices in the NPS Estonian and NPS Latvian price areas differed in 66.1% of hours, while in 2014 prices differed 69.6% of the time.

In 2015, capacity flows were primarily directed from Finland to Estonia 98% of the time and from Estonia to Finland 2% of the time. During a period of four hours, trade between Estonia and Finland was interrupted because of emergency maintenance on the interconnector. On the basis of day-ahead trading results, the EstLink interconnections between NP Estonia and NP Finland were divided from Finland to Estonia at maximum capacity for 11.7% of hours, while from Finland to Estonia they did not operate at maximum capacity at any time.

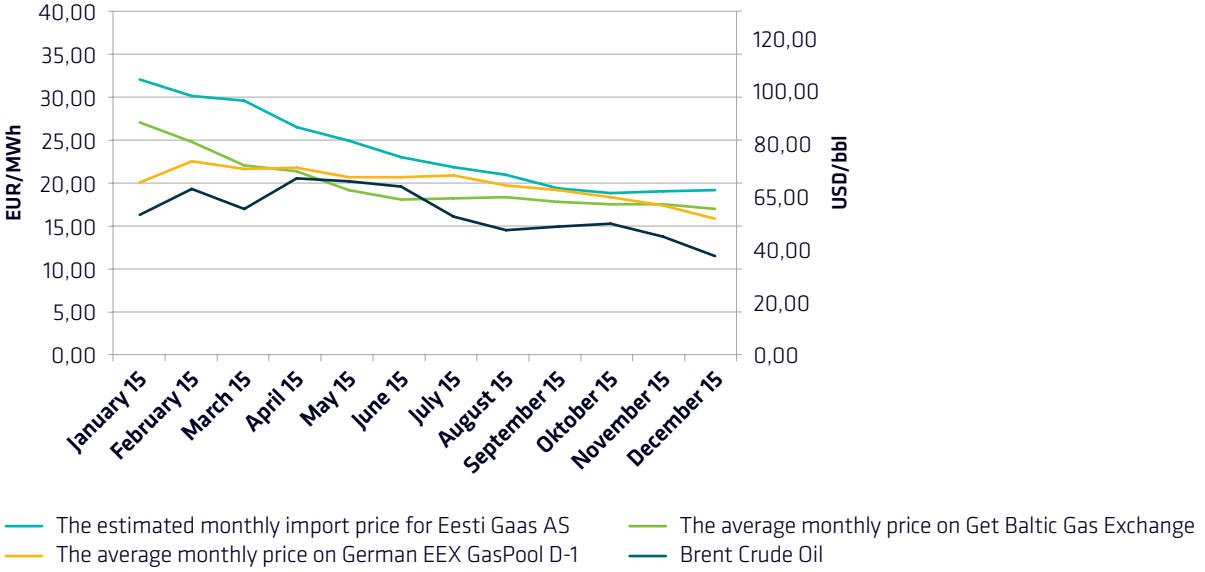


In 2015 as a whole, the commercial flow of electricity after day-ahead and intraday trade was from Estonia to Latvia in 99.8% of all hours. By day-ahead trade results, the NPS Estonian and NPS Latvian connections were in the direction from Estonia to Latvia at maximum capacity in 66% of hours, and after intraday trading 55% of hours. In normal mode (i.e. during the time when transmission capacity was not limited because of maintenance) there was a transmission capacity bottleneck in 5% of hours.



Market prices of natural gas

The global price of oil declined to a 12-year low during 2015 and this fact was also reflected in the decline in price of natural gas. Oil prices started to decline in autumn 2014 as a result of oversupply and the pace of decline increased after OPEC decided not to cut production volume to balance the markets. The import price of Eesti Gaas declined by 40% during the year: the price stood at 32.07 EUR/MWh in January, but had already reached 19.14 EUR/MWh by December. Even though there is no natural gas exchange in Estonia, market participants are able to trade on the Lithuanian gas exchange Get Baltic. On Get Baltic, the price declined by 37% during the year, with the average price in December being 16.97 EUR/MWh. For comparison purposes, the figure also indicates average monthly German EEX GasPool gas exchange day-ahead transaction prices and Brent oil prices (USD/bbl).



Renewable energy in 2015

In the renewable energy sector, a record number of subsidies were paid out in 2015: the generation of 1,253 GWh of renewable energy was subsidised and 151 GWh of efficient cogeneration was subsidised to a value in excess of 72 million euros. For the first time, the 600 GWh annual cap on wind energy subsidies was reached. Total renewable energy production during 2015 amounted to 1,507 GWh. The number of subsidised microproducers using solar panels grew two-fold and exceeded the 400 threshold. Elering simplified and automated the process of registering production equipment and applying for subsidies for small producers.

In March, Elering became a full member of the AIB (Association of Issuing Body), providing Estonian market participants with the opportunity to export and import certificates of origin to and from 22 registers of European Union Member States. Elering updated and improved the usability of the Estonian register of certificates of origin that it manages, as a result of which such certificates were issued for approximately 70% of the renewable energy generated in Estonia, and in excess of 1 TWh in transfers of certificates of origin occurred.

In June, for the first time, Elering developed a methodology for the calculation of residual mix and published its calculations regarding the residual mix for 2014 (residual mix expresses the share of energy sources of uncertified origin in the consumption of electricity). The adoption of the residual mix and certificates of origin allows electricity sellers to inform consumers of the share of renewable energy in the supplied mix.

MÄRT ALLIKA
Head of the Energy System Control Centre

Operation of the Estonian Electricity System

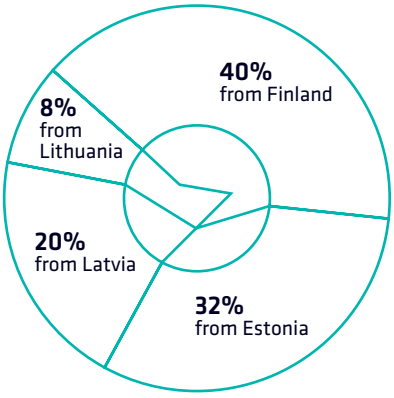
Balancing deliveries

The combined domestic imbalance energy volume of balance providers remained relatively unchanged compared to 2014, however purchases by the transmission system operator from balance providers increased by 5%. The volume of imbalance energy sold to cover the balance providers' deficit decreased by 9%. Overall in 2015, cross-border imports of imbalance energy by the Estonian electricity system amounted to 58 GWh, decreasing by 6% compared to 2014. Cross-border exports of system imbalance energy grew by 8% to 149 GWh.

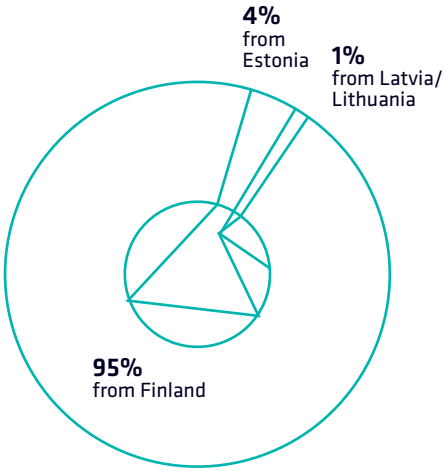
To balance the power balance of the Estonian electricity system, the transmission system operator purchased upward regulation deliveries and deliveries for the activation of emergency reserves in a total volume of 33 GWh. Approximately 40% of activated upward regulation deliveries were purchased from Finland through the Estlink connections. Upward regulation deliveries purchased domestically accounted for a total of 32%, followed by 20% and 8% of purchases of regulation energy offered by the transmission system operators of Latvia and Lithuania, respectively. In the hours when the system had a high surplus of imbalance energy, downward regulation deliveries were sold to balance the capacity balance of the Estonian electricity system in a total volume of 76 GWh. The majority (95%) of such deliveries were sold to the Finnish electricity system.

In 2015, the volume of system services grew by slightly in excess of two-and-a-half times in comparison with 2014. Countertrade deliveries to mitigate overloading on cross-border transmission lines between Estonia and Latvia and to compensate for the emergency trippings occurring in the Estlink interconnector between Estonia and Finland accounted for the majority of the year's system services. The volume of regulation services resold to neighbouring transmission system operators amounted to a total of 23 GWh, having grown by 41% compared to 2014.

Distribution of upward regulation deliveries to maintain balance of Estonian electricity system (incl. activated emergency reserves) by country 2015.



Distribution of downward regulation deliveries sold to maintain balance of Estonian electricity system by country 2015



Prices of imbalance energy

The highest sale price of imbalance energy was €216.20/MWh, which was attributable to the high price of upward regulation deliveries on 8 October between 15:00 and 16:00.

The lowest purchase price of imbalance energy in 2015 was -€6.00/MWh, which was registered on 13 August between 21:00 and 22:00 and which was due to the price of downward regulation deliveries to balance the Estonian electricity balance in that hour.

The decline in the average price of imbalance energy was attributable to the collective open supply agreement of the Baltic States that became effective from the beginning of 2014. As a result of balance settlement as part of the collective open supply agreement of the Baltic States, 29% of the Estonian electricity system imbalance was traded within the Baltic Coordinated Balance Area on the basis of the arithmetic average of Baltic Elspot prices.

Imbalance energy prices 2015, EUR/MWh	*Average price*	*MAX price*	*MIN price*
Sale price of imbalance energy	32,40	216,2	0,54
Purchase price of imbalance energy	28,85	215,2	-6,00

Imbalance energy prices in 2014, €/MWh

Sale price of imbalance energy	44,65	200,85	4,51
Purchase price of imbalance energy	40,88	189,50	3,11


3PP1

KALLE KUKK
Strategy Manager

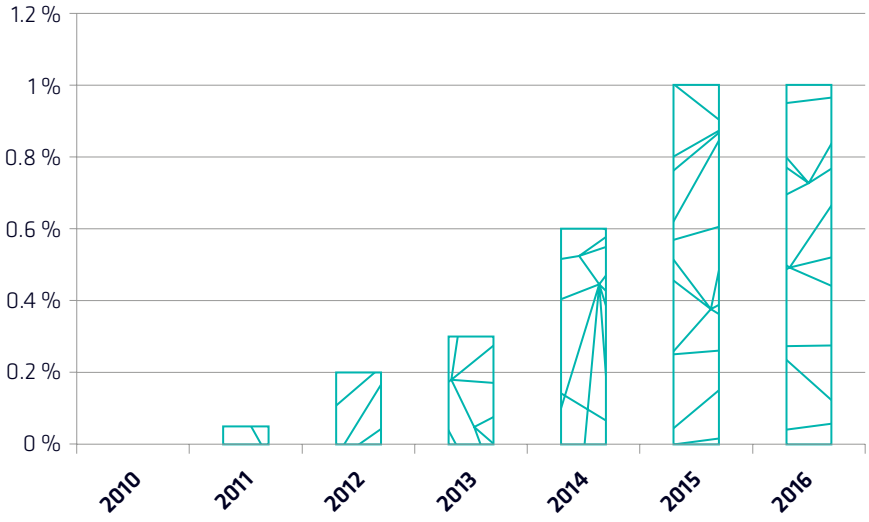
Research and Development at Elering

Elering has been preparing an annual research and development (R&D) plan and a corresponding budget since 2012. Elering is also involved in the R&D committee of ENTSO-E and in collective R&D projects of transmission system operators co-funded by the European Union. It has been our objective to invest 1% of revenue in R&D, projects and we achieved that level in 2015.

Elering has defined smart grid development in its strategy as one of the main trends impacting the energy industry. The smart grid will cause changes in the energy system arising from the broad-based adoption of information and communication technologies, development of demand management and recording technologies, as well as generation that is based on decentralised principles and renewable energy. This will probably lead to significant changes in the grid structure, the transmission of energy in the grid at a lower volume and unpredictable timing.

As a consequence, Elering is investing a substantial portion of its R&D budget in projects related to the smart grid. It is worth noting that these projects are not only significant from the point of view of transmission system development , but also in terms of the fact that they serve the interests of society as a whole. Examples include the development of the Estfeed smart grid platform, progress in demand management and research into electric and natural gas transport.

R&D share of turnover



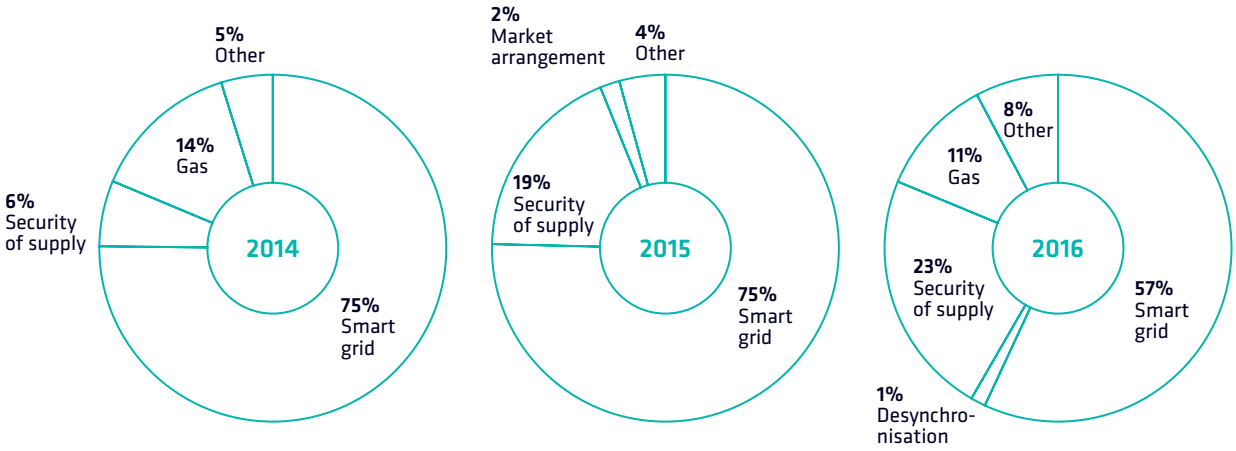
R&D and technical research expenses by functionality, 2012-2016 (EUR)

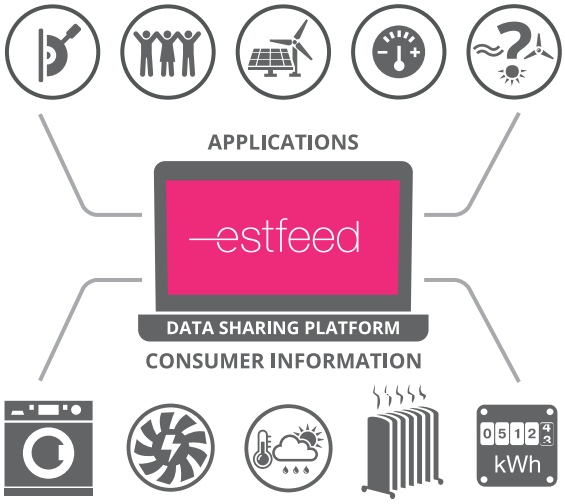
	2012 actual	*2013 actual*	*2014 actual*	*2015 actual*	*2016 budget*
Development	6,500	11,472	5,003	131,394	400,000
Base and applied research	175,670	284,482	380,799	593,132	585,000
Total research & development	**182,170**	**295,954**	**385,802**	**724,526**	**985,000**
Technical studies	201,575	404,901	88,793	32,173	112,000
TOTAL	**383,745**	**700,855**	**474,595**	**756,699**	**1,097,000**

R&D expenses and expenses of technical studies 2012-2016 by field of study (EUR)

	2012 actual	*2013 actual*	*2014 actual*	*2015 actual*	*2016 budget*
Smart grid	88,170	187,916	356,803	570,526	625,000
Desynchronisation	103,235	363,025	0	0	17,000
Security of supply	5,000	12,400	28,999	140,000	250,000
Market arrangement	82,500	94,500	0	14,000	0
Natural gas	92,540	21,065	65,644	0	120,000
Other	12,300	21,950	23,149	32,173	85,000
TOTAL	**383,745**	**700,855**	**474,595**	**756,699**	**1,097,000**

Share of R&D and technical research expenses by functionality, 2014-2016





Estfeed

The energy system is undergoing transformational change, both in Europe and globally. Among other trends, it is worth highlighting the following: the integration of energy markets (the single European energy market); the large-scale addition of equipment with irregular production cycles and decentralised locations in the energy system; increasing opportunities for accumulation and demand management; climate policy and energy efficiency objectives; the addition of market participants in a new category (ESCOs or Energy Service Companies, energy cooperatives, aggregators and virtual power generators); the increase in awareness among energy consumers and demand for new types of services; and the disappearing boundaries between the markets of electric power, natural gas and heat.

All of this will lead to an increasing number of unpredictable energy flows, as well as an exponential growth in information flows in the energy system. Energy network operators must adapt to the new conditions and the grids must become smarter. A smart grid signifies combined changes in the energy system arising from the large-scale adoption of information and communication technologies. A smart grid will enable new services to be provided to consumers. People need heating and light (as well as reasonable energy bills) as opposed to electric power and natural gas. For this purpose, we need to locate efficiency within the network and provide access to the market to market participants who are intent on providing such efficiency. The cheapest, most environmentally friendly and most reliable energy is unconsumed energy.

All of the above also requires the energy system operator to make choices as to how to manage a changing and significantly smarter energy system. In order to assume leadership in the transformation of the energy system, Elering has established a network of companies that it intends to leverage to develop the Estfeed smart energy network platform. The Estfeed platform enables end-consumers, energy service providers, decentralised (small) producers and network operators to increase the efficiency of energy production, transport and consumption through the use of near real-time energy consumption information. This project will lead to Elering becoming an energy smart grid operator in addition to its existing role as an electricity and natural gas transmission system operator.

This project is an initiative to shape, implement and test an open software platform that can be used for the monitoring and administration of energy consumption. It enables interactive communication with energy networks and makes energy consumption more efficient by the use of data flows. The aim of the project is to build a software platform for the integration of different data sources (energy consumption data, information on energy prices, weather information, remotely accessed equipment, public registries and databases) and to provide services aimed at achieving energy efficiency and cost-effectiveness through specific applications.

It has been decided that the central platform will be the X-Road infrastructure used by the state (servers, secure data communication channels, message formats and chip cards). The software components required to ensure consumers' privacy and the functionality of the sector are to be added to it in the course of the project.

The first pilot applications built on the initial platform are planned to be made available to users in summer 2016. The platform is open to anyone interested in developing their own applications.

Communication from the European Commission: *Delivering a New Deal for Energy Consumers*

„An important part of value in the future energy market will stem from large data flows and the wider integration of information and communication technology into energy systems. Therefore, the data collection and processing party in the context of smart metering systems or other services empowering consumers to act should provide direct access to these data to the customer and any third party designated by the consumer. /.../ While data handling can follow different models, the neutrality of the entities managing data access is of the utmost importance."

MIGRATE

In 2015 MIRGATE (Massive InteGRATion of large power Electronic devices), a joint project of European transmission network operators and other partners was greenlit for funding. The project will be funded from the Horizon2020 programme of the European Union and it will be carried out from 2016-2019. The project is aimed at the development and validation of the new technical solutions required for the operation of the single European electricity system in situations where the share of generation units connected through converters forms a majority or up to 100%. The project will examine the short-and the long-term time horizon. The short-term perspective will address today's electricity system and the technical solutions that it requires to handle the number of generation units connected through converters. Subjects addressed relate to system stability, relay protection, wide-area monitoring and power quality. The long-term perspective will address situations where the share of generation units connected through converters is 100%. The objective is to develop innovative management algorithms and approaches that will make it possible.

Socio-economic impact assessment of electric and natural gas powered transport

The objective of the project is to evaluate the socio-economic impact on Estonian society of transitioning to electric and natural gas-powered transport. This transition is defined as transport development projects or development scenarios that may materialise in Estonia by 2030 as a result of which the share of electricity and/or natural gas as a transport fuel in the transport fuel mix would significantly increase compared to 2014. The outcome of the work is a socio-economic analysis of development scenarios of the Estonian transport sector, assessment of their impact on growth in electricity and natural gas consumption and recommendations to Elering in the light of developments in the Estonian transport sector.

Static and dynamic characteristics of the Estonian power system load

This project is aimed at defining the static and dynamic Estonian power system substation voltage and, if possible, frequency characteristics at medium-voltage connection points and/or at 110 kV voltage connection substations. Defining such characteristics will enable network calculations to be performed in a more accurate manner and thereby enhance the analysis and planning of power system operations. Performing the calculations will enable the capacity of lines, the dynamic limits of the power system and other issues related to stability to be more accurately defined. An important part of the project is performing actual measurements at Elering substations and the use of meter-reading data collected over the years through SCADA. In addition, data obtained through quality analysis tools, fault counters and the wide-area monitoring system will also be used in the definition of dynamic characteristics of loads. The load characteristics are analysed using the measurement data, and the static and dynamic load characteristics of Estonian power system substations are defined, taking into consideration the technical requirements of the calculation software (PSCAD and PSS/E). The project will make use of scientific methods to determine the transmission network load definition methodology and applicability in the context of the Estonian power system. The basis and opportunities for the definition of various parameters of the characteristics are assessed based on measurement data that is available. An important part of the project is the comparison and analysis of the load models in use and new models that are being developed. The project is directly related to the need to clarify the models used to perform network calculations. The load models in use today are relatively generic and do not reflect the physical properties of modern substation loads. Furthermore, the dynamic characteristics of loads on the Estonian trans-

mission network level have never been defined. More accurate models will enable the enhanced assessment of the operation of the Estonian power system and thereby ensure higher capacity flows within the system and between systems and to analyse the stability reserve of the system.

Physical properties of aging conductors

This project is studying overhead conductors from the Soviet era in order to determine their condition or so-called residual value and the technical parameters assigned to the conductors in accordance with European standards in order to ensure the accurate post-processing of data collected through laser scanning and the reliability of recalculated conductor sag at defined conductor temperature levels. If the study produces positive results, Elering will be able to use the methodology that is being developed to assess the mechanical condition and useful life of the line conductors and thereby plan for financially optimal line construction and reconstruction work to be carried out.

WAMS system analysis and development

The objectives of this project are to study applications of the WAMS system and possible development trends for the future and to develop the existing system in Elering in the optimal way. The project aims to monitor the possibilities of a wide-area measurement system for the development of a system that could improve the operational planning, control and protection of the system. The project provides an overview of the new concept of the control system and must provide an answer regarding the parameters of the system in order to implement them in Elering's control system. Part of the research is also an emergency fire automation application based on the WAMS/WAMPAC system.

Cable networks and their impact on transmission network performance

This project aims to define the bottlenecks involved in the use of cable networks from the point of view of power system planning and analysis. The project examines transmission network cable line (110 kV and 330 kV) modelling principles in calculation software (PSCAD and PSS/E). The objective is to analyse the technical circumstances of the transition to cables in the transmission networks of Tallinn and Tartu and to define the principles that we must adhere to in the future. Another important objective of the study is to examine the impact of consumer installations (including wind farms) on transmission network performance. The impact of transitional processes that are occurring is evaluated and analysed, as well as methods for its mitigation. An important part of the project is the analysis and modelling of modelling principles of cable lines used in transmission networks in the network calculation software used by Elering.

Demand side response to increase electricity market flexibility

The objective of this research is to provide recommendations for the better use of the benefits of demand side response (DSR) in order to ensure the long-term security of supply of the Estonian electrical system, a functioning energy market and the integration of renewable energy sources. The research proposes DSR mechanisms that provide the greatest socio-economic benefit in the medium and long term and that take into consideration the ever-changing environment. The implementation of demand side response is important to Elering for the purposes of energy market intencifying and development, as well as for system management (acquisition of capacity reserves in the case of desynchronisation, to regulate the system balance, management of network limits and the ability to make consumption decisions based on price signals).

Harmonisation of balance management in the Baltic States

Balance management must be harmonised within the Baltic Coordinated Balance Area, a balance management model must be developed for the region (planning, measurement and clarification) and an imbalance pricing methodology model must be developed for the whole region. Harmonised balance management is a prerequisite for the functioning of a single regulated market that would ensure the equitable treatment of

all market participants. ENTSO-E is currently developing the Network Code on Electricity Balancing (for submission to ACER) for the purposes of the functioning of the single European energy market, which will establish the requirement to implement consistent principles within the regional balance area. The study is expected to reveal the most advantageous methodology for implementation in the Baltic region.

Measurement and mapping of electromagnetic fields at Elering's 330 kV substations

This research, involving the measurement of electromagnetic fields and the mapping of areas with higher health risks, is being carried out at Elering's five 330 kV substations (Kiisa, Harku, Paide, Püssi and Balti) and beyond the perimeter fencing of these substations. The report must result in an assessment of whether these areas pose a health risk to people in the area. In 2014, the strength of low-frequency magnetic and electrical fields was measured at the Aruküla 330/110/20/10 kV substation, the Endla 110/35/6 kV substation and the Tartu 330/110/35/20/15/10 kV substation. Electric fields are relatively powerful in the 330 kV part of these substations (measured 10-30 kV at a height of 1.65 metres from ground level) and exceed the exposure limits established on working environments according to European directives. Therefore, it is recommended to adopt protective measures for the protection of employees within the 330 kV substation area, consisting of the use of specialised clothing or very short-term occupational exposure to this zone.

Social Responsibility

Elering as a supporter of energy awareness

As a company with a keen sense of corporate social responsibility, Elering provides grants that are aimed at promoting energy-related education, raising overall energy awareness and ensuring energy security of supply. In order to implement such objectives, Elering awards grants and makes donations in compliance with the State Assets Act and the company's internal regulations.

Elering's energy grant
In 2015, Elering awarded three grants for the study of energy-related subjects. The topics researched by the PhD and Master's students who were recipients of the Elering grant in 2015 were:

- Optimisation of the placement of FACTS equipment in light of Estonian power system stability requirements;
- Methodology for the determination of the useful lives of transmission network lines and substations;
- Organisation of the natural gas markets of Finland and the Baltic States and the collective natural gas network.

Grants awarded in 2015

- The Negavatt competition on resource and energy efficiency organised by the Environmental Investment Centre.

  The Negavatt competition is being organised for the second consecutive year and is aimed at raising awareness and developing green innovation in energy efficiency in universities. Negavatt is a contest that invites exciting ideas and projects from students that will help reduce resource consumption at or close to their university.

- The educational television programme Rakett 69 by Estonian Public Broadcasting.

  The objectives of this programme are to increase interest among young people in science, to guide them in learning and appreciating science and to discover the future scientists of Estonia. The competitors on the show develop solutions based on physics and engineering.

- The Lennart Meri Conference organised by the International Centre for Defence and Security

- The main topic of the Lennart Meri Conference in 2015 was "The Limits of Order". The energy part of the conference examined energy policy as an instrument as part of the topic of Russia and addressed the importance of energy security both as part of policy to restrain Russia and in the protection of more vulnerable Western countries.

- Supporting Tallinn University of Technology in publishing a textbook on electrical machines for the development of energy-related education and to support the future generation of specialists with degrees in energy.

- Supporting the creation of a website for the Estonian Energy Veterans Society for the purpose of distributing energy-related information.

Security of supply conference

Elering has been organising security of supply conferences for many years in order to raise awareness of energy-related issues. In addition to the presentation of a security of supply report each May, senior energy industry specialists from outside the company make presentations at the event. At the 2015 conference, Deputy Head of Cabinet of EU Climate Action Pierre Schellekens and Energy Commissioner Miguel Arias Cañete's team spoke about the energy union and its link to the Baltic States, while Stephen Woodhouse, the director of Pöyry Management Consulting in the United Kingdom, spoke about the future of energy markets.

Elering emergency reserve power plants

Elering owns two emergency reserve power plants near Kiisa in Harju County. They represent a major energy industry attraction in the Tallinn area, as they have been visited over the years by a large number of people from the energy industry and other sectors. In 2015 the power plants were visited by students from a number of schools in Tallinn and Harju County, by university students as part of Energy Week, by government officials and by representatives of Elering's business partners and customers.

Educational film on the functioning of the power system

In addition to its core business, Elering aims to raise awareness among the broader public of the role and importance of energy infrastructure, including the power system, which normally does not attract much attention in the public sphere. We also consider it important to promote engineering education among young people. At the end of 2015, Elering completed an educational film where an electrical engineer explains the functioning of the power system through questions asked by young people, and Elering's role within the system. We have attempted to establish links between young people's interests and the energy industry in order to gain better rapport with the younger generation.

Cooperation with the Estonian Fund for Nature

Elering values nature and the environment and uses the principles of increasing the well-being of our society and the development of the living environment as a whole as a foundation for its activities. As such, the employees of Elering make an effort every year to conserve and improve our natural environment.

In 2015, Elering continued its tradition of partnering the Estonian Fund for Nature in organising a joint clean-up effort, in the course of which Elering employees cleared brush in the Vatla pit in Lääne County in order to improve the living conditions of the natterjack toad. The toad's numbers have seen a drastic decrease in the last 50 years and the restoration of habitats suitable for them requires a lot of manual labour, making the assistance of clean-up crews highly necessary.

Corporate Governance Report

In 2015, the Management Board of Elering approved the updated Corporate Governance Code. This code is a set of recommendations meant to be followed mainly by stock exchange companies.

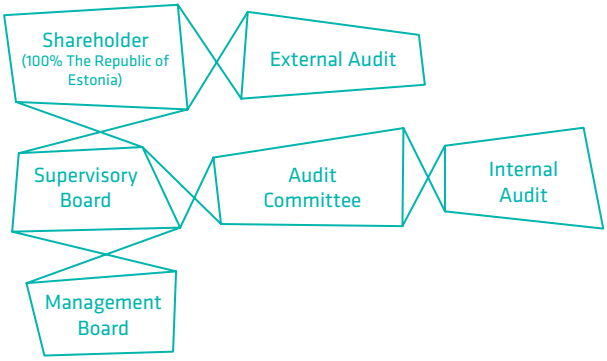
Elering is dedicated to following the Corporate Governance Code and wishes to grow further in this area. We consider this a prerequisite for achieving our strategic goals and shaping our organisational culture.

We can confirm that:

- the company's risk management and control systems are fully functional and efficient; and
- the company's financial reporting and annual report are based on a functioning system of risk management and internal control.

Elering publishes the Corporate Governance Code and its Corporate Governance Report on its website www.elering.ee.

Shareholder rights



Elering is a fully state-owned company. It is the majority shareholder in AS Võrguteenus Valdus, which, in turn, is the sole owner of AS Elering Gaas.

The shareholder is represented at the general meeting by the Minister of Economic Affairs and Infrastructure. The general meeting of shareholders is the highest governing body of Elering. The general meeting was held on 20 April 2015. No extraordinary general meetings were convened by the Management Board. The general meeting was attended by Minister of Economic Affairs and Infrastructure Kristen Michal; Supervisory Board chairman Kajar Lember; Management Board members Taavi Veskimägi, Peep Soone and Kalle Kilk; and Ministry of Economic Affairs and Communications officials Timo Tatar and Regina Raukas.

At the general meeting decisions were made with regard to approving the annual report for 2014, paying out dividends and distributing retained profits.

The competence of the company's owner includes: amending 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 allocating profits; and deciding upon the merger, division, restructuring and/or dissolution of the company. The general meeting must base its actions (convening, disclosure of information, etc.) on the State Assets Act as well as the Commercial Code.

Management Board

The Management Board is Elering's governing body. It represents and governs the company's daily activities in accordance with the law and the requirements of the organisation's articles of association, and organises the company's accounting. Elering's Management Board has complete freedom of decision: everyday management choices are made independently, without interference from the owner or the Supervisory Board. The Management Board needs the consent of the Supervisory Board for transactions and operations that are beyond the daily economic activities of the company. The Management Board ensures that the members of the Supervisory Board have sufficient information regarding the company's economic condition, as well as important circumstances related to economic activities, and informs the Supervisory Board of the important circumstances of economic activities as necessary.

Composition and remuneration of the Management Board

According to the articles of association, the Management Board can consist of up to three members. The Supervisory Board elects Members of the Management Board for a term of up to five years.

The company's articles of association state that two members jointly or the Chairman of the Management Board separately can represent the company in all legal transactions.

The person authorised by the Supervisory Board concludes contracts with the members of the Management Board, which determine the rights and obligations of the Management Board member regarding the company and their remuneration.

Throughout 2015, the Management Board of Elering comprised three members:

- Taavi Veskimägi: in his role as the chairman of the Management Board his responsibilities include the day-to-day duties of the Chief Executive Officer of Elering, i.e. management and representation of the company, ensuring compliance with contracts and legislation, organising the work of the Management Board, coordination of the development of the company's strategy and performance of a leadership role in the implementation of this strategy;

- Peep Soone: in his role as a member of the Management Board his responsibilities include the position of Chief Financial Officer, managing the accounting and finance as well as administrative and IT functions of Elering; and

- Kalle Kilk: in his role as a member of the Management Board his responsibilities include day-to-day duties as the Head of Asset Management.

Based on the articles of association, a member of the Management Board may only be paid a fee under the contract concluded with them. A member of the Management Board may also be paid an additional fee based on their performance in the amount of up to four months' fee. Bonuses may be paid based on the annual results or any other grounds based on a resolution of the Supervisory Board. Fees of the members of the Management Board are fixed and stipulated in the Management Board member's contract. Elering has not established any long-term bonus systems. A member of the Management Board may only be paid severance benefits upon their removal at the initiative of the Supervisory Board before the term of their authority has expired in the amount of up to three months' fees.

The Management Board of Elering also acts as the representative of the shareholder in Võrguteenus Valdus AS. The Management Board of Võrguteenus Valdus AS acts as the representative of the shareholder in Elering Gaas AS. The duties of the Management Board members of both Võrguteenus Valdus AS and Elering Gaas AS were fulfilled by Mart Landsberg and Taavi Vospert from 19 January 2015 (having previously been fulfilled by Sergei Jefimov and Eerika Pentel).

Elering does not disclose the pay of members of the Management Board individually due to the confidentiality provisions contained in contracts. Instead it discloses the total remuneration of governing bodies (including taxes) in the company's annual report. The remuneration paid to the members of the Management Boards of Elering AS, Võrguteenus Valdus AS and Elering Gaas AS in 2015, including bonuses and severance benefits, was 612 187 euros (incl. social taxes).

Conflicts of interest
Members of the Management Board do not make decisions based on their own interests, nor do they use commercial offers made to Elering to their own gain. A member of the Management Board must declare any conflict of interest to the Supervisory Board and other members of the Management Board before concluding their contract of service, or immediately after such a conflict arises. A member of the Management Board must promptly notify other members of the Management Board and the chairman of the Supervisory Board about any commercial offers related to the company's economic activities made to them, their family members or anyone else associated with them.

The principles preventing conflicts of interest of members of the Management Board are established in the contracts concluded with members of the Management Board.

A member of the Management Board avoids conflicts between their own interests and the interests of the company. He or she declares any direct or indirect interest in the transactions made by the company to Elering's Supervisory Board, and informs the Supervisory Board of any conflict as soon as it arises or of any situation that could lead to such a conflict. The Supervisory Board decides upon executing transactions with members of the Management Board or any transactions that could involve the personal interests of members of the Management Board. They also decide upon the terms and conditions of the transaction.

In order to ensure independence, transactions concluded with related parties are declared upon the approval of the annual report and in the audit.

Elering did not enter into any transactions with members of the Management Board or related parties in 2015.

Supervisory board

The owner's interests in the company are guaranteed by members of the Supervisory Board (representatives of the Ministry of Finance and the Ministry of Economic Affairs and Communications). The Supervisory Board gives the Management Board instructions on organising the management of the company and exercises supervision over the activities of the company's Management Board. The Supervisory Board regularly reviews and assesses the company's strategy, general actions, risk assessments, annual report and annual budget.

According to the company's articles of association, regular meetings of the Supervisory Board are held as needed, but no less frequently than once every three months. The notification of a Supervisory Board meeting and any related materials are sent to the board members at least three working days before the meeting takes place.

Composition and remuneration of the Supervisory Board
The supervisory Board comprises three to five members. The number of members of the Supervisory Board is decided and the members are elected and removed by the representative of the owner, i.e. the Minister of Economic Affairs and Infrastructure. The work of the Supervisory Board is run by the chairman of the Supervisory Board. The chairman sets the agenda for Supervisory Board meetings, runs the meetings, observes the effectiveness of the Supervisory Board's actions, arranges operational data transfers to Supervisory Board members, provides enough time for the Supervisory Board members to draft decisions and familiarise themselves with the data and represents the Supervisory Board in interactions with Elering's Management Board. To coordinate the Supervisory Board's work, the general meeting has established the Supervisory Board's working procedures.

In 2015 the Supervisory Board held four regular meetings:

- 8 April: Approval of annual report, overview of performance of core activities, transactions involving registered assets, overview of activities involving AS Võrguteenus Valdus;
- 3 June: Overview of activities of Elering Gaas AS, overview of four-month financial results, transactions involving registered assets;

- 23 September: Overview of six-month financial results, approval of Elering strategy and risk assessments, overview of holding of shares in AS Võrguteenus Valdus, transactions involving registered assets;

- 16 December: Approval of operating budget and capital expenditure budget, overview of nine-month financial results, overview of Estfeed energy smart grid platform, overview of holding of shares in AS Võrguteenus Valdus, transactions involving registered assets.

Throughout 2015 the Supervisory Board of Elering comprised of five members:

- Kajar Lember, Chairman of the Supervisory Board (Deputy Mayor of Tartu): attended all four meetings;

- Timo Tatar (Head of the Energy Department, Ministry of Economic Affairs and Infrastructure): attended all four meetings;

- Heiki Tammoja (Professor Emeritus of Tallinn University of Technology): attended all four meetings;

- Thomas Auväärt (Head of the Financial Markets Department, Ministry of Finance): attended all four meetings;

- Tarmo Mänd (politician): attended all four meetings.

Chairman of the Management Board of Nortal AS Priit Alamäe replaced Heiki Tammoja as a member of the Supervisory Board on 17 December 2015.

As of 14 January 2015, the members of the Supervisory Boards of Võrguteenus Valdus AS and Elering Gaas AS were Taavi Veskimägi, Peep Soone, Kalle Kilk and Kalle Kukk.

The remuneration paid to the members of the Supervisory Boards of Elering AS, Võrguteenus Valdus AS and Elering Gaas AS in 2015 was 77 770 euros (incl. social taxes). The remuneration paid to the members of the Supervisory Board of Elering includes payment for participation in the work of the audit committee. There is no provision for the payment of severance benefits or other benefits to members of the Supervisory Board.

Members of the Supervisory Board must meet the requirements set for Supervisory Board members in the Commercial Code, as well as in the State Assets Act, and they must follow all of their obligations.

Audit committee

The Supervisory Board elects the Audit Committee, comprising up to five members. The committee is responsible for exercising supervision over risk management, internal control and financial reporting. The Audit Committee advises the Supervisory Board in the area of accounting, checking the independence of the statutory auditor, risk management, internal control and audit, exercising supervision and preparation of the budget as well as the legality of activities.

Members of the Audit Committee are elected for a term of three years. They elect from among themselves a chairman to organise the activities of the Audit Committee. The chairman cannot also hold the position of chairman of the Supervisory Board. The members of the Audit Committee are paid a fee for participating in the committee's activities.

Throughout 2015 the composition of the Audit Committee of Elering was the following: Chairman Thomas Auväärt and members Timo Tatar, Heiki Tammoja, Kajar Lember, Tarmo Mänd and, replacing Heiki Tammoja as of 17 December 2015, Priit Alamäe.

In 2015 the Audit Committee met four times: on 8 April, 3 June, 23 September and 16 December. The committee addressed the following internal audits that were carried out: an occupational health and safety audit; an audit on the organisation of information security; a tariffs audit; and an audit on ensuring the security of supply of electricity.

Cooperation between the Management and Supervisory BoardS

The Management Board and the Supervisory Board cooperate closely to best protect Elering's interests. They work together to develop the company's strategy. The Management Board bases its management decisions on the strategic guidelines issued by the Supervisory Board.

The Management Board regularly informs the Supervisory Board of any important matters that have a bearing on the planning and business activities of the

company and draws particular attention to important changes in Elering's business activities. The Management Board forwards data to the Supervisory Board, including financial reports, in sufficient time prior to Supervisory Board meetings. If the Supervisory Board requires more information about the operations of the Management Board or the company, a member of the Management Board gives the necessary data either verbally or in writing. They also ensure the Supervisory Board's access to any data relevant to the actions of the Management Board and the company.

The company's management principles are based on legislation, the articles of association and decisions made and objectives set at general meetings and Supervisory Board meetings.

Disclosure of information

Elering's website (www.elering.ee) presents a separate list of data that is subject to disclosure by law. The website presents annual reports, financial results, operating information, an overview of main activities, Elering's structure, a summary of its strategy, news and notices as well as other information needed by investors and the public at large. The website is also available in English. The information on the website is constantly updated.

Financial reporting and auditing

The Management Board of Elering publishes an annual report once a year and mid-term reviews during the financial year. The annual report is compiled in accordance with the International Financial Reporting Standards (IFRS) and audited according to International Standards on Auditing (ISA). At the invitation of the Supervisory Board, the auditor of the company also participates in the meeting of the Supervisory Board to review the annual report. The annual report signed by the Management Board members is submitted to the general meeting for approval. Along with the annual report, the Supervisory Board's opinion on the annual report is submitted to the general meeting.

Elering elects an external auditor following procurement procedures and ensures the best possible value for money for the auditing services. Only internationally recognised, high-quality service providers are asked to submit a tender. Elering follows the requirements of the Auditors Activities Act by rotating auditors every seven years.

An external auditor is appointed on the resolution of the general meeting, while the contract for auditing services is concluded by the Management Board. In the contract concluded with the auditor, his or her tasks, timeframe and fees are settled. This contract can in no way hamper auditors' work in assessing the company's activities.

From 2012-2016 Elering's external auditor is AS PricewaterhouseCoopers. The company is guided by the legislation of the Republic of Estonia, the ISA and auditor risk management regulations in performing external audits.

The Audit Committee monitors the external auditor's progress in accordance with the Auditors Activities Act.

Risk management and internal control system

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

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

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

- the culture, processes and structure of the company encourage the fulfilment of the company's strategic objectives and at the same time also the identification, management, monitoring and, if possible, hedging of risks;
- the monitoring and management of the company's risks and the internal control system are based on the internationally recognised Enterprise Risk Management (ERM) Model developed by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), a voluntary organisation that promotes good corporate governance;

- all relevant legislation, standards, regulations and contractual obligations, as well as requirements and expectations arising from society, are taken into account in the management of the company's risks; and;

- we are continuously improving the risk management activities in the company.

The Management Board is responsible for the functioning of the internal control system of the company. To ensure the functioning of the internal control system, the internal auditor service is outsourced to an audit company. The internal auditor reports to the Audit Committee.

From 2014-2016, internal audit services are being provided to the company by KPMG Baltics OÜ. The company is guided by the legislation of the Republic of Estonia and guidance issued by the Institute of Internal Auditors (IIA) in performing the internal audit function.

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

Equal treatment

As a system operator, Elering bears system responsibility in accordance with the Electricity Market Act. This means the obligation to ensure, at all times, the security of supply and the balance of the electrical system. The system operator exercises these rights and performs these obligations in compliance with the principles of equal treatment.

In order to ensure equal treatment, Elering has established internal procedures and, based on legislation, has compiled standard terms and conditions that have been published on the company's website and approved by the Estonian Competition Authority:

- Conditions for connecting to the grid;

- Standard Terms and Conditions for Network Services;

- Standard Terms and Conditions for Balance Agreement.

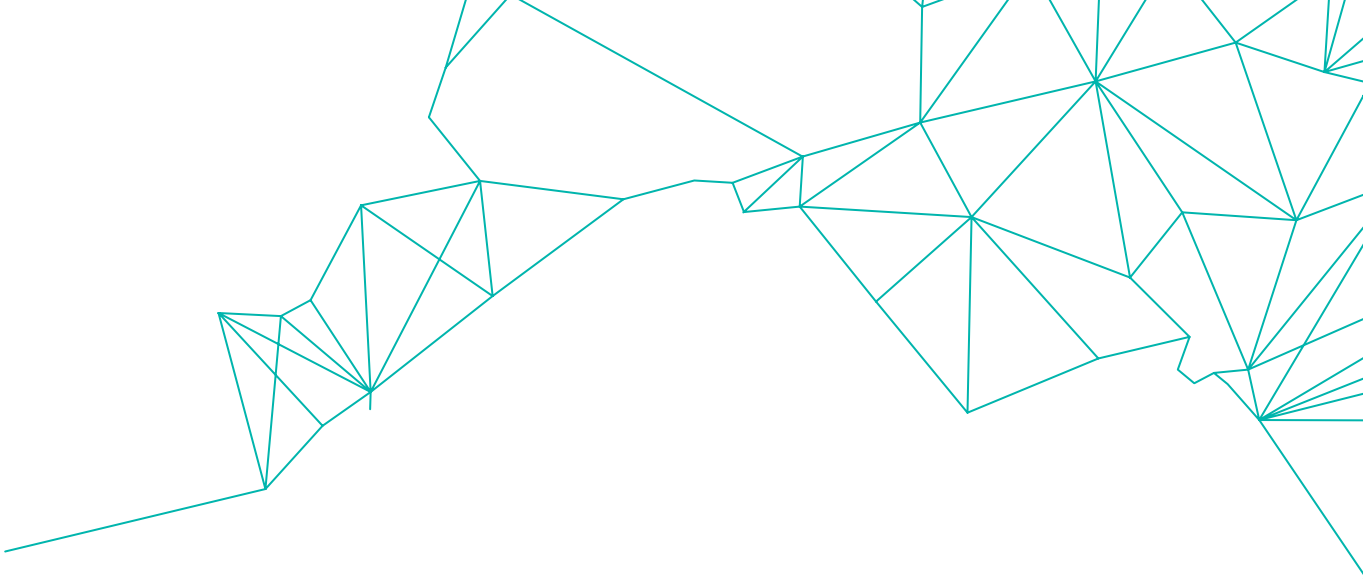
Complying with the conditions of the Natural Gas Act, the equal treatment action plan for AS EG Võrguteenus (currently called Elering Gaas AS) was approved on 5 September 2014.

Elering and the Environment

Elering is one of the largest infrastructure companies in Estonia. We acknowledge our responsibility to operate in a manner that ensures the sustainable and prudent use of Estonian nature and existing resources, as well to serve as a role model to others in this respect. We consider it important to not only comply with legislation in effect in Estonia related to the environment in an exemplary manner, but also to take into consideration environmental impact in broader and more comprehensive terms. Therefore, we are continuously developing and enhancing our operations in order to minimise our environmental impact and the potential disruption to people arising from our activities.

We are guided by the following principles of environmental responsibility in our business:

- We inform our employees and suppliers of legislative and other environmental requirements and obligate them to meet them;
- We avoid environmental pollution and reduce waste generation, implementing the best possible technology to this end;
- We consume resources sustainably;
- We require in our procurement documentation that suppliers act in an environmentally sound manner and use environmentally sound technologies;
- The company's environmental policy and environmental aspects are public information – any employee can distribute them freely outside of the company.



New power lines

Construction of new high-voltage power lines is necessary to increase national security of supply and to reduce transmission losses, as well as to create connection possibilities to the transmission network for new electricity generators. New lines are planned in close cooperation with the Environmental Board of Estonia, local authorities and landowners to ensure that neither construction nor the lines themselves affect people or the environment as a whole. An integral and important part of new power system developments for Elering is the (strategic) environmental impact assessment of plans and projects and the notification and inclusion of various stakeholders. Environmental impact assessment is a process whereby the estimated environmental impact of planned actions are determined, assessed and described, the measures for the prevention or mitigation of negative impact are analysed and the most suitable alternative is identified. The involvement of the population at large through public hearings is the best way for stakeholders to participate in the planning of new lines and in the assessment of environmental impact and enables a common basis to be found at an early stage of a project.

In 2015, work continued on planning for two major high-voltage power lines: Harku–Lihula–Sindi 330/110 kV and Kilingi-Nõmme–Riia TEC2 330 kV.

In 2015, we continued to develop the planning solution for the planning of the Harku–Lihula–Sindi 330/110 kV power line. This process included a strategic environmental impact assessment. County governments accepted the plans and public displays, and public hearings took place regarding the plans and the environmental impact assessment report. At the end of 2015, the environmental impact assessment report was submitted to the Environmental Board of Estonia for approval.

During 2015, thematic plans in Viljandi and Pärnu counties were completed for the planning of the 13.8-kilometre Kilingi-Nõmme–Riia TEC2 330 kV overhead power line up to the Estonian-Latvian border. The Environmental Board of Estonia approved the environmental impact assessment report in April and Viljandi and Pärnu counties adopted the plan in November. All of the parties involved in the planning and strategic environmental impact assessment process demonstrated expeditious and constructive collaboration throughout the planning process.

High-voltage power lines are planned in consideration of their potential impact on human health, well-being and property. The locations of route corridors were determined in the aforementioned planning processes with the important criterion that residential buildings remain at a distance of at least 100 metres from the planned overhead line in order to prevent the potential impact of electromagnetic radiation. Locating route corridors on state forest land is preferable and, where possible, next to another engineering structure (such

as a highway). Another important consideration is to effect as little damage to the existing landscape as possible. Therefore, one of the objectives of the planning process was to accomplish a route corridor that was as straight as possible, because the masts used in straight lines are smaller than corner masts. Overhead line masts are planned so that they are not in the direct line of sight, i.e. in front of windows. New grey-white or silver masts and conductors fit the surrounding landscape better by being less visible.

Line maintenance work

In addition to building new lines, maintenance of existing lines is also important. This includes the regular clearing of brush to prevent potential flashovers, the felling of large trees and the widening of line corridors. The objective of line maintenance is to prevent high brush growth in the protection zone because this could cause power interruptions, electrical injuries to people and animals, brush fires and forest fires. In clearing a protection zone of transmission lines, the environmental requirement is to leave junipers, rose hip and cultivated plants in place. Transmission line maintenance work is performed on an annual basis. In 2015, logging was carried out over an area of 218 hectares and brush clearing was carried out over an area of 2,286 hectares of route corridors, which is similar in magnitude to the work performed in 2014.

In order to prevent the tripping of lines, insulation was replaced on 110 kV lines over a total length of 244 kilometres and the old insulation was recycled. Perimeters were maintained on 330 kV lines measuring 226 kilometres in length and on 110 kV lines measuring 14 kilometres in length. The aforementioned work also served to reduce the hazard of forest fires. In addition to the above activities, we have replaced old reinforced concrete and steel lattice-type masts and cleaned and recycled old mast foundations made from reinforced concrete. This work will increase the operational reliability and safety of the power lines and clean up the land under the overhead line.

From an environmental standpoint, it is important to replace old and obsolete oil-filled underground cables with dry cables. For this purpose, the Ranna–Ida 110 kV oil-filled cable (3.7 km in length) in Tallinn was replaced with a non-oil based cable in 2015. The replacement of overhead lines with underground cables continues. The next overhead line to be replaced by Elering with a cable is the Veskimetsa-Järve overhead line, and in the next couple of years we are planning to replace several other overhead lines in the Mustamäe and Põhja-Tallinn areas.

Equipping overhead lines with bird barriers is an annual activity whose objective is to reduce the negative impact of overhead lines on birds, but also to avoid the soiling of electric equipment with bird excrement. In 2015, bird barriers (mast gear) were installed on 110 kV overhead lines over a total length of 272 km in order to prevent tripping and to save birds' lives.

Environmental impact related to substations

The biggest environmental hazards where Elering's substations are concerned are oil that can leak from transformers, chemicals and hazardous waste (mainly batteries). Therefore, it is particularly important that risks are analysed, assessed and controlled. Waste handling and disposal of materials is the responsibility of licensed subcontractors. One possible environmental risk at substations is the release of a small quantity of a hazardous substance into the environment when taking samples of oil from transformers and electrolytes from batteries. To avoid possible leaks, Elering has drawn up guidelines on how to neutralise polluted earth and how to make electrolytes safe for the environment. Everyone who works at substations undergoes specific training and is competent to respond in the event of environmental hazards.

SF6
SF6 is used mainly in switches of electrical gear as it helps to extinguish electrical arches. SF6 contains Freon, which damages the ozone layer and therefore has a major impact on the environment. Two years ago Elering acquired a measuring camera that helps detect any leaks of this environmentally hazardous gas. SF6 levels are continuously measured at substations according to the orders of operations and maintenance coordinators. This is done in the course of high-voltage circuit breaker inspections if the SF6 pressure in them drops. The most recent measurements took place in September and October last year at the Paide and Puhja substations, respectively. No SF6 leaks were detected during the measurement efforts.

Oil traps
In 2015, oil traps were installed in the substations at Sindi, Paide and Imavere.

Noise
In 2015, two old power transformers at the Sindi and Tsirguliina substations were replaced with new ones that emit lower levels of noise. No noise measurements were carried out at the substations.

Electric and magnetic field
In 2015, electric and magnetic fields were measured at the Harku 330/110/20 kV, Kiisa 330/110/35/10 kV, Paide 330/110/35/20/10 kV and Rakvere 330/110/35/10 kV substations. The objective of the measurements was to identify and map the areas on their territory where time restrictions are imposed on the presence of people. According to the data of the World Health Organization (WHO), electrical and magnetic fields do not affect human health if the indicators remain within the permitted limits.

Enhancement of corporate environmental awareness

To prevent potential environmental impact on our sites, at the end of 2014 we signed a contract for the procurement of environmental organisation advisory services from the consulting company Skepast&Puhkim AS (formerly known as Ramboll Eesti AS). At the start of 2015, the company's environmental audit was conducted as part of this contract at six 330 kV and 110 kV substations, the Estlink 2 converter station, the emergency reserve power plant in Kiisa and the diagnostics centre and headquarters. The environmental audit was conducted as a compliance audit aimed at analysing and evaluating the compliance of the company's activities with objectives that have been established, approved procedures, rules and instructions, as well as applicable laws and other legislation. The results of the audit will enable the assessment of Elering's environmental impact and the implementation of measures for the reduction or prevention of potential environmental impact. The audit concluded that significant environmental impact on Elering sites are controlled and that activities are in compliance with applicable laws, as well as with the instructions established by the company itself.

The audit nevertheless made some recommendations as to actions that would help prevent any environmental impact in the future: organising environmental training for operations and maintenance coordinators at substations in order to improve their ability to respond in case an environmental hazard arises (e.g. in the event of an oil spill); developing an action plan for responding to any environmental hazards; obtaining safety data sheets for all hazardous substances used at substations; considering the establishment of a register of chemicals at the diagnostics centre; and improving the collection of waste, including the separate collection of hazardous waste.

Work included under the advisory contract specified above that was carried out in 2015 consisted of consulting services with regard to the greenhouse gas report and safety data sheets of liquids and gases.

Elering Gaas

In 2015, we entered into a merger agreement with our subsidiary AS Võrguteenus Valdus and its fully owned subsidiary Elering Gaas AS. As a result of this transaction, Elering owns all of the shares in AS Võrguteenus Valdus. As part of preparatory activities for the establishment of a combined system operator of electricity and natural gas, we developed a new strategy that provides a framework for the development of both industries. The strategy includes six important lines of action and objectives: initiative in the region's energy industry; continued development of the regional electricity and natural gas markets; the region's most efficient network; strong financial results; being highly rated by customers and society; and attractiveness as an employer.

In 2015, several investments were made in the natural gas network owned by Elering Gaas AS, increasing the safety of the gas network and improved the overall condition of the environment. As part of the work, a total of 126 metres of corroded gas pipelines were replaced, a gas pipeline bushing was replaced under the Kunda River (198 metres), repair fittings were installed to strengthen pipelines, a node was reconstructed at the Värska gas metering station and insulation work was carried out on 793 metres of gas pipelines, rendering the gas pipeline more resistant to corrosion and safer for the environment. In addition, internal diagnostics were performed on 74 kilometres of pipelines, as part of which approximately 1.5 tonnes of polymer waste was removed from the pipelines and recycled. Logging and brush clearing was carried out on a total of 161 hectares of land along route corridors, resulting in a decreased risk of the spread of forest fires in the event of a potential accident.

Organisation and People

Our stable, highly educated and experienced staff are the foundation of Elering`s sustainable economic growth.

At the end of 2015 Elering employed 148 people, while Elering's subsidiary Elering Gaas employed 81. The average length of employment in both companies exceeds 15 years and the average age is 45. Men account for more than three-quarters of all employees in both Elering and Elering Gaas.

Elering is characterised by low employee turnover: the two companies combined saw turnover last year of just 6.6%. Low employee turnover is a strategically important indicator for Elering due to the high level of competence required for its core business. The majority of our employees have higher education, and approximately half of all Elering and Elering Gaas employees have a Master's degree or PhD.

2015 marked an important milestone in the history of Elering, as it became a combined electricity and natural gas transmission system operator. Elering and Elering Gaas hired 20 new specialists last year, several of whom were recruited for the purpose of developing new lines of business (development of the natural gas market, long-term planning of the gas network, development of the renewable energy industry and coordination of the Balticconnector project).

An important aspect in the development of employee competence is the sharing of knowledge from the natural gas and electricity industries. For this purpose we organised various in-house training sessions and fact-finding trips during the year and worked with experts from Tallinn University of Technology. In addition, an outside expert conducted a seminar in spring to discuss subjects related to the international natural gas market.

To promote energy education and assist young people in entering the labour market, Elering works closely with universities. The annual traineeship that the company organises for students from Tallinn University of Technology consists of eight weeks of studies in different departments of Elering, plus field work. In 2015, five students participated in the traineeship programme, and we are planning to increase the number of student trainees in the coming years. As well as guiding trainees, several Elering employees are also visiting lecturers at Estonian universities and have discovered that teaching others is also the best way to learn, test one's knowledge and highlight the value of one's specialisation and day-to-day work.

In order to shape a common culture for the organisation upon the merger of two companies, we focused on joint events and team-building in a relaxed atmosphere in addition to work-related meetings. In spring Elering continued its tradition of partnering with the Estonian Fund for Nature by holding a joint clean-up effort; a joint summer retreat held in southern Estonia helped with team-building efforts; and in autumn we organised a sports and bicycle day tour in Lahemaa National Park. The annual reception held in January to celebrate Elering becoming an independent company has become a firm tradition. This event includes recognition of the best employees and a summary of the most important projects and events from the previous year.

Looking ahead to 2016, areas of high priority in the development of our people and organisation continue to be raising the level of professional skills in the natural gas and electricity industries, developing a common management culture and management principles, and designing a common culture for the organisation that is based on Elering's corporate values.

Consolidated annual report

Consolidated Statement of Financial Position

In thousands of euros	*Note*	*31.12.2015*	*31.12.2014*
ASSETS			
Current assets			
Cash and cash equivalents	7	60,489	31,869
Trade and other receivables	8	27,499	39,773
Inventories	9	3,361	2,631
Total current assets		**91,349**	**74,272**
Non-current assets			
Available-for-sale financial assets	2	1,946	1,946
Property, plant and equipment	10	764,726	710,457
Intangible assets	11	3,905	3,374
Total non-current assets		**770,577**	**715,777**
TOTAL ASSETS		**861,926**	**790,050**
LIABILITIES			
Current liabilities			
Borrowings	12	2,381	1,191
Trade and other payables	13	26,735	29,094
Total current liabilities		**29,117**	**30,285**
Non-current liabilities			
Borrowings	12	376,796	346,666
Deferred income	14	126,655	98,280
Total non-current liabilities		**503,450**	**444,945**
TOTAL LIABILITIES		**532,567**	**475,230**
EQUITY			
Share capital	15	149,890	149,890
Unregistered share capital	15	8,000	0
Statutory reserve capital	15	10,743	8,706
Retained earnings	15	160,726	156,223
TOTAL EQUITY		**329,359**	**314,820**
TOTAL LIABILITIES AND EQUITY		**861,926**	**790 050**

The notes on pages 74 to 113 are an integral part of these financial statements.

Consolidated Statement of Comprehensive Income

in thousands of euros	*Note*	*2015*	*2014*
Revenue	16	127,001	129,229
Other income	17	5,444	1,609
Goods, raw materials and services	18	-40,682	-39,703
Other operating expenses	19	-5,390	-4,006
Staff costs	20	-7,807	-5,090
Depreciation and amortization	10;11	-37,007	-31,273
Operating profit		**41,560**	**50 766**
Financial income	21	30	4
Financial costs	21	-11,478	-10,037
Profit before income tax		**30,111**	**40,732**
Income tax expense	15	-5,000	0
Profit for the year		**25,111**	**40,732**
Total comprehensive income for the year		**25,111**	**40,732**
Profit attributable to:			
Equity holder of the parent company		24,381	40,732
Non-controlling interest		730	0

The notes on pages 74 to 113 are an integral part of these financial statements.

Consolidated Cash Flow Statement

in thousands of euros	*Note*	*1.01.2015-31.12.2015*	*1.01.2014-31.12.2014*
Cash flows from operating activities			
Profit before income tax		30,111	40,732
Adjustments for:			
· Profit from sale of property, plant and equipment	17	-360	-18
· Depreciation, amortisation and impairment	10, 11	37,007	31,273
· Dividends received from long-term financial investments	17	-58	-35
· Government grants expended and amortised	17	-1,186	-1,086
· Interest expenses	21	11,470	10,034
· Interest income	21	-30	-4
· Negative goodwill	24	-1,509	0
· Changes in inventories	9	-325	-2,284
· Changes in receivables and prepayments related to operating activities	8	-1,051	177
· Changes in liabilities and prepayments related to operating activities	13	-2,177	-7,680
Changes in deferred income from connection and other service fees	14	648	739
Cash generated from operations		**72,539**	**71,849**
Income tax paid	15	-5,000	0
Interest paid	13, 21	-11,458	-11,426
Interest received	21	28	4
Net cash from operating activities		**56,108**	**60,427**
Cash flows from investing activities			
Purchases of property, plant and equipment and intangible assets	10, 11, 13	-39,797	-105,694
Foreign grants to acquire non-current assets	8, 14	15,280	19,995
Proceeds from sale of property, plant and equipment	10, 17	1,817	31
Payments for acquisition of subsidiary, net of cash acquired	6, 24	-26,584	0
Dividends received from long-term financial investments	17	58	35
Congestion fees received	14	29,048	20,974
Net cash used in investing activities		**-20,179**	**-64,658**
Cash flows from financing activities			
Long-term bank loans received	12	31,968	34,955
Repayments of bank loans	12	-1,190	0
Transactions with non-controlling interest	24	-26,087	0
Proceeds from contributions to equity	15	8,000	0
Dividends paid to parent company´s shareholders	15	-20,000	0
Net cash used in financing activities		**-7,309**	**34,955**
Net increase/decrease in cash and cash equivalents		**28,620**	**30,724**
Cash and cash equivalents at the beginning of the year	**7**	**31,869**	**1,145**
Cash and cash equivalents at the end of the year	**7**	**60,489**	**31,869**

The notes 74 to 113 are an integral part of these financial statements.

Consolidated Statement of Changes in Equity

	Attributable to equity holder of the parent company						
in thousands of euros	*Share capital*	*Unregistered share capital*	*Statutory reserve capital*	*Retained earnings*	*Total*	*Non-controlling interest*	*Total equity*
	(Note 15)	(Note 15)	(Note 15)	(Note 15)			
Balance as of 1.01.2014	**149,890**	**0**	**6,259**	**117,939**	**274,087**	**0**	**274,087**
Comprehensive income for financial year	0	0	0	40,732	40,732	0	40,732
Transfers to statutory reserve capital	0	0	2,448	-2,448	0	0	0
Balance as of 31.12.2014	**149,890**	**0**	**8,706**	**156,223**	**314,820**	**0**	**314,820**
Contributions of equity	0	8,000	0	0	8 000	0	8,000
Comprehensive income for financial year	0	0	0	24,381	24,381	730	25,111
Transactions with non-controlling interest (Note 24)	0	0	0	0	0	27,515	27,515
Acquisition of non-controlling interest (Note 24)	0	0	0	2,158	2,158	-28,245	-26,087
Transfers to statutory reserve capital	0	0	2,037	-2,037	0	0	0
Dividends paid	0	0	0	-20,000	-20,000	0	-20,000
Balance as of 31.12.2015	**149,890**	**8,000**	**10,743**	**160,726**	**329,359**	**0**	**329,359**

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

The notes on pages 74 to 113 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 (the "Group") for the year ended 31 December 2015 have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union.

The Group is comprised of the parent company Elering AS, hereinafter "Parent company," its subsidiary AS Võrguteenus Valdus and its subsidiary Elering Gaas AS (up to 10/04/2015: AS EG Võrguteenus).

The parent company Elering AS is incorporated in the Republic of Estonia and its registered address is Kadaka tee 42, 12915 Tallinn, Estonia. The parent company is engaged in electricity transmission in the Republic of Estonia. The parent company acquired on 2 January 2015 a majority stake in AS Võrguteenus Valdus and in the course of the year it also acquired the remaining shares in the subsidiary as a result of multiple transactions.

AS Võrguteenus Valdus is a holding company solely engaged in the holding of the 100% ownership interest in its subsidiary Elering Gaas AS.

Elering Gaas AS is a subsidiary of AS Võrguteenus Valdus that is engaged in natural gas transmission in the Republic of Estonia.

The Group's business is subject to laws of the Republic of Estonia and European Union. The Group's transmission business and balance 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 the Company is the Republic of Estonia.

The Management Board approved these consolidated financial statements on 16 March 2016. Pursuant to the Commercial Code of the Republic of Estonia, the annual report shall be presented for approval to the parent company'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.

Principles of consolidation

Subsidiaries
A subsidiary is an entity controlled by the Group. Control is presumed to exist when the Group owns, directly or indirectly through subsidiaries, more than 50% of the voting power of a subsidiary or otherwise has power to govern its financial and operating policies. Subsidiaries are consolidated from the date of their acquisition (obtaining of control) until the date of sale (loss of control).

The Group applies the acquisition method to account for business combinations. The cost of acquisition is measured as the fair value of consideration paid upon acquisition (i.e. assets transferred, liabilities incurred and equity instruments issued by the acquirer for the purpose of acquisition) plus fair value of assets and liabilities of contingent consideration. Acquisition-related costs are expensed as incurred. Acquired and separately identifiable assets, liabilities and contingent liabilities assumed in a business combination are initially measured at their fair values on the date of acquisition. The Group chooses for each business combination whether to account for non-controlling interest at fair value or proportionally to net assets.

The excess of the cost of acquisition over the fair value of the Group´s share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement.

In preparation of consolidated financial statements the financial statements of the parent company and its subsidiaries are consolidated on a line-by-line basis. In preparation of consolidated financial statements, inter-company transactions, balances and unrealised gains on transactions between Group companies are eliminated. Unrealised losses are also eliminated. When necessary, amounts reported by subsidiaries have been adjusted to conform with the Group's accounting policies.

Changes in ownership interests in subsidiaries without change of control
Transactions with non-controlling interests that do not result in loss of control are accounted for as equity transactions – that is, as transactions with the owners in their capacity as owners. The difference between fair value of any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary is recorded in equity. Gains and losses on disposals to non-controlling interests are also recorded in equity.

Segment reporting
Business segment disclosures are provided in a manner that operating results are regularly reviewed by the Group'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 the Parent company's management board.

Functional and presentation currency
The financial statements of the Group are presented in thousands of euros which is the parent company´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 the income statement.

Financial assets
The purchases and sales of financial assets are recognised on the trade date – the date on which the Group 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 the Group 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;
- held-to-maturity investments;
- available-for-sale financial assets.

As at 31 December 2015, the Group had no other classes of financial assets than those classified under the category of 'loans and receivables' and 'available-for-sale financial assets' (as at 31 December 2014, 'loans and receivables' and 'available-for-sale financial assets'). As of balance sheet date the Group had no derivative instruments.

Loans and receivables
Loans and receivables are unquoted non-derivative financial assets with fixed or determinable payments other than those that the Group intends to sell in the near term. Financial assets that are not recognised at fair value through profit or loss are initially recognised at fair value to which transaction costs are added. After initial recognition, loans and receivables are accounted for at amortised cost using the effective interest rate method.

The Group 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 the Group 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 the income statement.

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

The Group recognises the following financial assets in the category of 'loans and receivables': "Cash and cash equivalents" and "Trade and other receivables".

Available-for-sale financial assets
Available-for-sale financial assets are non-derivative financial assets that the Group intends to sell immediately or in the short term 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 the Group 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 considered reliable, 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 Spot AS. The principal business activity of Nord Pool Spot 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, the Group does not have any current financial information on AS Nord Pool Spot; 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. The Management of the Group decided to subsequently recognise those shares at their cost.

Cash and cash equivalents
Cash and cash equivalents include cash in hand, deposits held at call with banks, and other short-term highly liquid investments with original maturities of three months or less. Cash and cash equivalents are carried at amortised cost using the effective interest method.

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 the Group has obtained control of the asset and it is probable that future economic benefits associated with the asset will flow to the Group. 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 recognised in the statement of financial position at the carrying amount which constitutes 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.

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 the income statement 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
Other facilities	10-30
Machinery and equipment – electricity and natural gas transmission equipment	7-25
Other property, plant and equipment	3-20

The residual value of an asset is the estimated amount that the Group 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.

On each reporting date management assesses whether there is any indication of impairment of property, plant and equipment. If any such indication exists, management estimates the recoverable amount, which is determined as the higher of an asset's fair value less costs to sell and its value in use. The carrying amount is reduced to the recoverable amount and the

impairment loss is recognised in the income statement. An impairment loss recognised for an asset in prior years is reversed where appropriate if there has been a change in the estimates used to determine the asset's value in use or fair value less costs to sell.

Gains and losses on disposals and write-offs determined by comparing proceeds with the carrying amount are recognised in profit or loss.

Intangible assets
Intangible assets are recognised in the statement of financial position only if the following conditions are met:

- the asset is controlled by the Group;
- it is probable that the future economic benefits that are attributable to the asset will flow to the Group;
- 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 to sell.

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 to sell 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 the income statement 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. The Group 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 the income statement over the period of the borrowings using the effective interest rate method. The borrowing costs associated with the assets meeting respective requirements are capitalised as cost of the assets.

Fees paid on the establishment of loan facilities are recognised as transaction costs of the loan to the extent that it is probable that some or all of the facility will be drawn down. In this case, the fee is deferred and treated as a transaction cost when the draw-down occurs.

A financial liability is classified as current when it is due within 12 months after the balance sheet date or the Group 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 the Group 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.

Provisions for greenhouse gas emissions
Provision for greenhouse gas emissions arises from the Group's obligation to deliver emission allowance that equals greenhouse gases emitted by its emergency reserve power plant during the accounting period. According to law, the greenhouse gas emission allowance must be delivered after the end of the calendar year in April. Calculation of the greenhouse gas emission allowance is based on the pollution emitted during the accounting period and the price of the greenhouse gas emission allowance effective on the NASDAQ OMX stock exchange on the balance sheet day. See also Note 13.

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
The Group 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 recognition
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
The Group 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
The Group 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
The Group prepares on an hourly basis the energy balance in kilowatt-hours of the Estonian electricity system that consists of the energy balances of the Group itself and balance providers that have entered into a balance agreement with the Group. Energy balances are prepared by comparing the measurement data of the Group 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, the Group sells the balance providers the shortage of energy. In a trading period when the situation is opposite, the Group buys from the balance providers the surplus of energy. The sale and purchase prices are calculated by the Group for each trading period on a cost basis.

Gas balancing service
The Group prepares on a daily basis the gas balance in cubic meters of the Estonian gas system that consists of the gas balances of the Group itself and balance providers that have entered into a balance agreement with the Group. Gas balances are prepared by comparing the measurement data of the Group 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, the Group sells the balance providers the shortage of gas. In a trading period when the situation is opposite, the Group buys from the balance providers the surplus of gas. The sale and purchase prices are calculated by the Group for each trading period on a cost basis.

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. Under the principle used in these auctions, 50% of auction income belongs to the transmission system operator of either country. Types of the auctions:

1. Hourly auctions. Revenue gained on the hourly auctions is essentially a price difference between Estonian and neighbouring countries electricity every hour, and it is allocated to counterparties through the Nord Pool Spot (hereinafter NPS) power exchange. The auctions are organized by NPS and the latter shall transfer 50% to the relevant transmission system operators.

2. Physical Transmission Right auctions (hereinafter PTR auctions). The market participant that buys transmission capacity at PTR auction acquires the right for the hourly auction revenue in the same amount. The Group distributes to the market participants hourly action revenue that was received from the power exchange, proportionate to the PTR transmission capacity.

Net income from hourly and PTR auctions is recognised in compliance with the Article 16 of European Parliament and Council Regulation (EC) No 714/2009, according to which congestion income should be utilized for the construction of new interconnection capacities. If congestion income cannot be used for this purpose, then it is used for reduction of current period network tariffs.

If congestion revenue is used for the construction of new interconnection capacities, then it is recognized in the financial statements similarly to the government grants. Initially, it is recognized as deferred income, and then is credited to income over the estimated useful life of the asset. If congestion revenue is used for the reduction of tariffs, then revenue is recognized on an accrual basis in the period, when the Group established the right for net income from hourly and PTR auctions. See also Note 3.

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 when it is probable that the interest will be received and the amount of revenue can be measured reliably. Interest income is recognized on an accrual basis using the effective interest method.

Recognition of government grants
Government grants are recognised at fair value when there is a reasonable assurance that the Group 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 the Group 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 it 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. The Group recognises the net amounts in the statement of comprehensive income depending whether it is net income or net expense under "Revenue" or under "Goods, raw materials and services" respectively.

Subsidies to electricity producers
The law obliges the Group to participate in supporting mechanism for eligible electricity producers (first and foremost power plants using renewable sources of energy). The Group 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, the Group 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. The Group uses these estimates to determine the charge of subsidy for the following calendar year per kWh (kilowatt-hour) of network services, taking into account any difference between estimated and actual amounts of subsidies paid during the previous period (from November to October), interest earned on over collected amounts or interest paid on under collected amounts and justified expenses incurred for management of subsidies.

The customers are charged according to the estimated charge per kWh. For different reasons the actual amounts paid out and received as subsidies always differ from the estimated amounts. Over or under collected subsidies are shown in the statement of financial position as either Trade and other payables (in case of surplus) or Trade and other receivables (in case of deficit). These balances are taken into account when determining the charge for the next period as described above. Collecting and paying of subsidies has no material impact on the comprehensive income of the Group. 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 the income statement in the year in which the associated services are rendered by the employees of the Group. 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, the Group 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 in 2015 (2014: 21/79). 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 paid or the actual payment date. An income tax liability is due on the 10th day of the month following the payment of dividends.

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

Other taxes in Estonia
The following taxes had an effect on the Group´s expenses:

Tax	*Tax rate*
Social security tax	33% of the paid payroll to employees and fringe benefits
Unemployment insurance tax	0,8% of the payroll paid to employees
Fringe benefit income tax	20/80 of fringe benefits paid to employees
Land tax	1-2,5% on taxable value of land per annum
Excise tax on electricity	4,47 euros per MWh of electricity
Excise tax on gas	28,14 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

The Group 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. In the reporting period,

depreciation amounted to EUR 36,185 thousand (2014: EUR 30,553 thousand). If depreciation rates were increased/decreased by 10%, the depreciation charge for the year would increase/decrease by EUR 3,619 thousand (2014: EUR 3,055 thousand).

Congestion revenue
According to the accounting principles described in Note 2, congestion revenue depends on the purposes for which the revenue 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 the Group has been using congestion revenue for constructions of new interconnection capacities (until 30 June 2014, the Group used congestion revenue to decrease current network tariffs, and hence, recognized revenue in the same reporting period as incurred). In 2015 the Group recognised deferred congestion revenue EUR 28,635 thousand (2014: EUR 20,892 thousands), see also Note 14.

Note 4

NEW ACCOUNTING PRONOUNCEMENTS

Adoption of new or revised standards and interpretations
The new standards, amendments to published standards and interpretations that became effective for the Group from 1 January 2015 had no effect on the financial statements and have no importance with respect to the Group's business activity.

New or revised standards and interpretations
Certain new or revised standards and interpretations have been issued that are mandatory for the Group's annual periods beginning on or after 1 January 2016, and which the Group has not early adopted.

Disclosure Initiative – Amendments to IAS 1
(effective for annual periods beginning on or after 1 January 2016). The amendments clarify guidance in IAS 1 on materiality and aggregation, the presentation of subtotals, the structure of financial statements and the disclosure of accounting policies. The Group is currently assessing the impact of the amendments on its financial statements.

IFRS 15, Revenue from Contracts with Customers
(effective for annual periods beginning on or after 1 January 2018; not yet adopted by the EU). 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. The Group is currently assessing the impact of the amendments on its financial statements.

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 the Group.

Note 5

FINANCIAL RISK MANAGEMENT

The risk management function is performed at the Group 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). The Group's risks are assessed in four categories: strategic, operational, financial and external risks. Financial risk comprises market risk (including electricity 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. The Group's financial risks are managed at the Group's Finance Department.

The following table provides reconciliation of classes of financial assets and financial liabilities of the Group in accordance with the measurement categories of IAS 39:

Financial assets

in thousands of euros	*31.12.2015*	*31.12.2014*
Loans and receivable		
Cash and cash equivalents (Note 7)	60,489	31,869
Trade and other receivables (Note 8)	27,189	39,577
Total loans and receivables	**87,678**	**71,446**
Available-for-sale financial assets	1,946	1,946
Total financial assets	**89,624**	**73,392**

Financial liabilities

in thousands of euros	*31.12.2015*	*31.12.2014*
Trade and other payables (Note 13)	24,232	26,591
Borrowings (Note 12)	379,177	347,857
Total financial liabilities	**403,409**	**374,448**

Credit risk

The Group 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 the Group's sales on credit terms and other transactions with counterparties giving rise to financial assets. In accordance with the Group's risk management principles, the Group's short-term available cash resources can be deposited in the following domestic financial instruments: overnight deposits at acceptable credit institutions or term deposits at credit institutions. The following principles are followed when depositing short-term available cash resources: ensuring of liquidity, capital preservation, revenue generation.

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

in thousands of euros	*31.12.2015*	*31.12.2014*
Cash and cash equivalents (Note 7)	60,489	31,869
Trade and other receivables (Note 8)	27,189	39,577
Total exposure of assets to credit risk in the consolidated statement of financial position	**87,678**	**71,446**

The Group 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. The Group 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 a biannual review.

The Group'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 the Group. The Group 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.

Credit risk concentration
The Group 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 the Group's equity. On 31.12.2015, the Group had one counterparty (31.12.2014: one counterparty) with an aggregated receivables balance of EUR 17,137 thousand (31.12.2014: EUR 16,802 thousand) or 68% of the total amount of accounts receivable (31.12.2014: 68%).

In 2015 as well as in 2014 the major part of receivables was to the wholly state owned company. The Group acts as a natural monopolist in distribution network field. Therefore Management believes that the credit risk arising from the concentration of receivables is not significant.

Market risk
The Group 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 offsetting network losses, the Group primarily buys electricity 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 offset in the next tariff period. As a result the Group may earn

profit or sustain loss on the purchased electricity in the short-term. The Group does not expect the risk of potential loss to be high and therefore it does not employ any financial instruments to mitigate this risk.

Price risk of natural gas
The Group 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 the Group may generate a profit or sustain a loss on the purchased gas in the short-term as the price of gas changes. The Group 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 most of the Group's transactions and balances are denominated in euros, the Group is not exposed to significant currency risk. The Group 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 31.12.2015 and 31.12.2014.

Interest rate risk
The financial instruments with floating interest rate expose the Group to cash flow interest rate risk, i.e. the risk that an increase in market interest rates will cause an increase in the Group's interest expense. At the same time, in case of short-term deposits, a change in market interest rates has effect on the Group's interest income arising from investment of available resources into new deposits. The Group established the minimum limit for fixed interest-bearing liabilities at 50% of all liabilities. To some extent, the Group 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. Fixed interest financial instruments create fair value interest rate risk. Since the Group does not recognise 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 31.12.2015 borrowings with fixed interest rate constituted 59% (as of 31.12.2014 64%) of all borrowings carried at amortised cost; the remaining 41% (as of 31.12.2014 36%) of the abovementioned liabilities were long-term bank loans with a floating interest rate carried at amortised cost. Long-term bonds were issued on 12.07.2011 with the maturity of seven years and the nominal value of EUR 225 million. The bonds' coupon is fixed at 4.625% p.a. and interest payments are made once a year. The floating interest rate of bank loans is based on the 6-month Euribor and it is fixed twice a year.

The Group'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.

The table below summarises the Group's exposure to interest rate risks in 2015 and 2014. The table presents the aggregated amounts of the Group's financial assets and liabilities at carrying amounts, categorised by the earlier of contractual interest repricing and maturity dates.

in thousands of euros	*On demand and less than 1 month*	*From 1 to 12 months*	*From 12 months to 5 years*	*Total*
31.12.2015				
Cash and cash equivalents (Note 7)	60,489	0	0	60,489
Current portion of long-term borrowings (Note 12)	0	-2,381	0	-2,381
Long-term borrowings (Note 12)	0	-153,227	-223,569	-376,796
Net interest sensitivity gap on 31.12.2015	**60,489**	**-155,608**	**-223,569**	**-318,688**

in thousands of euros	*On demand and less than 1 month*	*From 1 to 12 months*	*Over 5 years*	*Total*
31.12.2014				
Cash and cash equivalents (Note 7)	31,869	0	0	31,869
Current portion of long-term borrowings (Note 12)	0	-1,191	0	-1,191
Long-term borrowings (Note 12)	0	-123,615	-223,051	-346,666
Net interest sensitivity gap on 31.12.2014	**31,869**	**-124,806**	**-223,051**	**-315,988**

The Group 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. The Group is exposed to daily calls on its available cash resources. Liquidity risk is managed by the Finance Department of the Group. The Group'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 31.12.2015 and 31.12.2014 by their remaining contractual maturity. The amounts disclosed in the maturity table are contractual undiscounted cash flows. When the amount payable is not fixed, the amount disclosed is determined by reference to the conditions existing on the reporting date. Foreign currency payments are translated using exchange rate at the balance sheet date. The cash flows of subsequent periods are calculated on the basis of loan interest rates effective at balance sheet date.

The maturity analysis of financial liabilities on 31.12.2015 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)	16,222	2,814	0	0	19,037
Borrowings (Note 12)	0	13,930	285,436	120,806	420,172
Total future payments	**16,222**	**16,745**	**285,436**	**120,806**	**439,209**

* including interest expenses

The maturity analysis of financial liabilities on 31.12.2014 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)	17,640	3,741	0	0	21,380
Borrowings (Note 12)	0	12,966	280,894	108,923	402,783
Total future payments	**17,640**	**16,707**	**280,894**	**108,923**	**424,164**

* including interest expenses

The Group holds its money in liquid bank deposits. As of 31.12.2015, the Group's total available cash resources (cash and cash equivalents) amounted to EUR 60,489 thousand (as of 31.12.2014: EUR 31,869 thousand). See further information in Note 7. For ensuring liquidity and better management of cash flows, the Group had an overdraft contract amounting to EUR 20,000 thousand until 31 August 2015.

As of 31.12.2015 the Group did not have undrawn borrowing facilities (as of 31.12.2014 the Group had undrawn borrowing facilities amounting to EUR 32,000 thousand). As of 31.12.2014 the Group had uncollected irrecoverable financial help amounting to EUR 15,000 thousand from the European Union for building of Estlink 2 electricity interconnector between Estonia and Finland. The subsidy was collected by the Group in 2015 (see also Note 8).

Capital Management

The Group's main goal in capital risk management is to ensure the Group'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, the Group 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, the Group uses the equity to asset ratio for monitoring the Group's capital structure, arrived at by dividing total equity by total assets as of the balance sheet date. The Group'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	*31.12.2015*	*31.12.2014*
Equity	329,359	314,820
Total assets	861,926	790,050
Equity to asset ratio	**38%**	**40%**

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 the Group 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 non-current borrowings with a fixed interest 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 for new instruments with similar credit risk and remaining maturity.

The Group had the following borrowings as of 31.12.2015: bonds, the market value of which without accrued interest was EUR 248,738 thousand (nominal value EUR 225,000 thousand) and bank loans, the market value of which without accrued interest was EUR 151,977 thousand (nominal value EUR 157,000 thousand). The liabilities as of 31.12.2014 consisted of bonds the market value of which without accrued interest was EUR 249,278 thousand (nominal value EUR 225,000 thousand) and bank loans, the market value of which without accrued interest was EUR 120,522 thousand (nominal value EUR 125,000 thousand).

Note 6

SEGMENT REPORTING

The Management Board is the chief operating decision maker. The Management Board considers the business from the business activity perspective and has distinguished two operating segments: electricity and natural gas transmission.

In 2014, the Group had one operating segment, i.e. electricity transmission which activity is operating the electricity transmission system network belonging to the parent company of the Group; the majority of revenues is earned for providing network services and balancing service.

In 2015, the natural gas transmission segment was added to the operating segments of the Group when the Group acquired controlling interest in the share capital of AS Võrguteenus Valdus, a parent company of AS Elering Gaas which is a company operating the gas transmission system network in Estonia. The segment´s activity is providing the natural gas transmission services by means of gas network belonging to Group´s subsidiary AS Elering Gaas.

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 Management Board assesses the performance of the operating segments based on revenue, EBITDA (which is defined as total segment revenue, other income less operating expenses before depreciation and amortization) and net profit.

The Group is domiciled in Estonia. Non-current assets of the Group are located in Estonia. The result of the Group´s revenue from external customers in Estonia is EUR 105,541 thousand, and the total of revenue from external customers from other countries is EUR 21,460 thousand (2014: EUR 28,216 thousand). In the reporting period, the Group had one counterparty with an aggregated revenue more than 10% of the Group´s consolidated revenue totalling EUR 78,108 thousand (2014: EUR 81,074 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

in thousands of euros	1.01.2015 – 31.12 2015 Electricity transmission	Natural gas transmission	Elimination between segments	Total	1.01 2014-31.12 2014 Electricity transmission
Revenue from external customers	118,013	8,988	0	**127,001**	129,229
Revenue between segments	0	80	-80	**0**	0
Total revenue	**118,013**	**9,068**	**-80**	**127,001**	**129,229**
Other income	3,908	26	0	**3,934**	1,609
Total income	**121,921**	**9,094**	**-80**	**130,935**	**130,838**
Goods, raw materials and services	-39,739	-1,024	80	**-40,683**	-39,703
Other operating expenses	-10,166	-3,030	0	**-13,196**	-9,097
EBITDA	**72,016**	**5,040**	**0**	**77,056**	**82,038**
Depreciation and amortization (Note 10,11)	-33,633	-3,374	0	**-37,007**	-31,273
Net financial income (costs) (Note 21)	-11,448	0	0	**-11,448**	-10,033
Income tax (Note 15)	-5,000	0	0	**-5,000**	0
Net profit	**21,935**	**1,666**	**0**	**23,601**	**40,732**
Total assets	**802,720**	**59,206**	**0**	**861,926**	**790,050**
Total liabilities	**531,636**	**941**	**-10**	**532,567**	**475,230**
Additions to property, plant and equipment (Note 10)	35,639	1,908	0	**37,547**	100,099
Additions to intangible assets (Note 11)	1,013	216	0	**1,229**	381

Revenue by geographical location of customers

in thousands of euros	1.01.2015 – 31.12 2015 Electricity transmission	Natural gas transmission	Total	1.01 2014-31.12 2014 Electricity transmission
Estonia	96,553	8,988	105,541	101,013
Norway	418	0	418	18,013
Latvia	2,860	0	2,860	2,835
Finland	3,875	0	3,875	3,340
Lithuania	7,338	0	7,338	700
Russia	215	0	215	114
Other	6,755	0	6,755	3,214
Total revenue	**118,013**	**8,988**	**127,001**	**129,229**

Note 7

CASH AND CASH EQUIVALENTS

in thousands of euros	*31.12.2015*	*31.12.2014*
Bank accounts	60,489	31,869
Total cash and cash equivalents	**60,489**	**31,869**

Bank accounts and deposits with maturities of up to 3 months

in thousands of euros	*31.12.2015*	*31.12.2014*
Bank accounts and short-term deposits at banks		
with Moody's credit rating of Aa3	10,047	35
with Moody's credit rating of A2	24,035	664
with Moody's credit rating of A1*	26,407	31,170
Total bank accounts and short-term deposits at banks	**60,489**	**31,869**

*Two banks without credit rating at which the Group holds its money are Estonia-based subsidiaries of international banks with Moody's credit ratings of A1.

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Note 8

TRADE AND OTHER RECEIVABLES

in thousands of euros	*31.12.2015*	*31.12.2014*
Trade receivables		
Accounts receivable	24,960	24,577
· PRT-Limited auction receivables	2,011	2,092
Other receivables	**2,229**	**15,000**
· Subsidies due from electricity producers (Note 2, 13)	2,227	0
· Government grant to be collected (Note 5)	0	15,000
· Interest receivables	2	0
Total financial assets within trade and other receivables in the consolidated statement of financial position	**27,189**	**39,577**
Tax receivables	7	47
Prepayments	303	148
Total trade and other receivables	**27,499**	**39,773**

Analysis by credit quality of trade receivables is as follows:

in thousands of euros	*31.12.2015*	*31.12.2014*
Accounts receivable not yet due		
· Distribution networks	19,512	18,179
· Other clients	5,203	5,131
Total accounts receivable not yet due	**24,715**	**23,310**
Accounts receivable past due but not classified as doubtful (IAS 39)		
· 1 to 90 days overdue	245	1,267
Total accounts receivable past due but not classified as doubtful	**245**	**1,267**
Total accounts receivable past due	**245**	**1,267**
Total trade receivables	**24,960**	**24,577**

In the reporting period, the Group did not write off any uncollectible receivables (in 2014 the respective amount was EUR 22 thousand).

Further information on receivables from related parties is disclosed in Note 23.

Note 9

INVENTORIES

in thousands of euros	*31.12.2015*	*31.12.2014*
Fuel oil	2,442	2,631
Natural gas reserves	187	0
Other materials at warehouses	732	0
Total inventories	**3,361**	**2,631**

The Group maintains fuel reserves for the purposes of emergency reserve power plants, natural gas reserves for providing gas-related services 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 on 1.01.2014							
Cost at 01.01.2014	5,215	30,687	354,542	361,072	54	0	751,570
Accumulated depreciation	0	-4,345	-93,399	-82,912	-52	0	-180,708
Carrying amount on 01.01.2014	**5,215**	**26,342**	**261,143**	**278,160**	**2**	**0**	**570,862**
Construction in progress	0	0	0	0	0	70,063	70,063
Total property, plant and equipment on 01.01.2014	**5,215**	**26,342**	**261,143**	**278,160**	**2**	**70,063**	**640,925**
Movements 01.01.2014-31.12.2014							
Additions	103	0	0	73	11	97,916	98,103
Reclassified from construction in progress	0	12,903	53,325	88,760	8	-154,996	0
Capitalised borrowing costs (Note 21)	0	0	0	0	0	1,996	1,996
Disposals and write-offs at carrying amount	-12	0	-2	0	0	0	-14
Depreciation charge	0	-1,186	-12,182	-17,180	-5	0	-30,553
Total movements 1.01.2014-31.12.2014	**91**	**11,717**	**41,141**	**71,653**	**14**	**-55,084**	**69,532**
Cost at 31.12.2014	5,306	43,488	406,909	448,408	73	0	904,184
Accumulated depreciation	0	-5,429	-104,625	-98,595	-57	0	-208,706
Carrying amount on 31.12.2014	**5,306**	**38,059**	**302,284**	**349,813**	**16**	**0**	**695,478**
Construction in progress	0	0	0	0	0	14,979	14,979
Total property, plant and equipment on 31.12.2014	**5,306**	**38,059**	**302,284**	**349,813**	**16**	**14,979**	**710,457**
Movements 01.01.2015-31.12.2015							
Additions	561	0	0	135	103	36,246	37,045
Acquisition of subsidiary (Note 24)	197	318	51,483	1,385	20	963	54,364
Reclassified from construction in progress	0	447	23,130	12,120	15	-35,711	0
Capitalised borrowing costs (Note 21)	0	0	0	0	0	487	487
Disposals and write-offs at carrying amount	-95	-1,099	0	-264	0	0	-1,458
Prepayments	15	0	0	0	0	0	15
Depreciation charge	0	-1,343	-16,539	-18,263	-40	0	-36,185
Transfers	0	0	200	-242	42	0	0
Total movements 01.01.2015-31.12.2015	**677**	**-1,679**	**58,276**	**-5,128**	**139**	**1,984**	**54,268**
Property, plant and equipment on 31.12.2015							
Cost on 31.12.2015	5,968	43,259	512,297	461,974	341	0	1,023,839
Accumulated depreciation	0	-6,879	-151,737	-117,289	-186	0	-276,091
Carrying amount on 31.12.2015	**5,968**	**36,380**	**360,560**	**344,685**	**155**	**0**	**747,748**
Construction in progress	0	0	0	0	0	16,963	16,963
Prepayments	15	0	0	0	0	0	15
Total property, plant and equipment on 31.12.2015	**5,983**	**36,380**	**360,560**	**344,685**	**155**	**16,963**	**764,726**

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 487 thousand (2014: EUR 1,996 thousand). The capitalisation rate was 3.3% (2014: 3.7%).

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

Note 11

INTANGIBLE ASSETS

in thousands of euros	*Acquired software and licenses*	*Right of use of land*	*Total*
Intangible assets on 01.01.2014			
Cost at 01.01.2014	3,265	1,587	4,852
Accumulated amortisation	-1,276	-85	-1,361
Carrying amount on 01.01.2014	**1,989**	**1,502**	**3,491**
Intangible assets not yet available for use	222	0	222
Total intangible assets on 1.01.2014	**2,211**	**1,502**	**3,713**
Movements 1.01.2014-31.12.2014:			
Additions	365	15	380
Capitalised borrowing costs (Note 21)	1	0	1
Amortisation charge	-703	-17	-720
Total movements 1.01.2014-31.12.2014	**-337**	**-2**	**-339**
Intangible assets on 31.12.2014			
Cost at 31.12.2014	3,800	1,602	5,402
Accumulated amortisation	-1,980	-102	-2,082
Carrying amount on 31.12.2014	**1,820**	**1,500**	**3,320**
Intangible assets not yet available for use	54	0	54
Total intangible assets on 31.12.2014	**1,874**	**1,500**	**3,374**
Movements 1.01.2015-31.12.2015			
Acquisition of subsidiary (Note 24)	124	0	124
Additions	1,229	0	1,229
Amortisation charge	-806	-16	-822
Total movements 1.01.2015-31.12.2015	**547**	**-16**	**531**
Intangible assets on 31.12.2015			
Cost at 31.12.2015	4,404	1,602	6,006
Accumulated amortisation	-2,939	-118	-3,057
Carrying amount on 31.12.2015	**1,465**	**1,484**	**2,949**
Intangible assets not yet available for use	956	0	956
Total intangible assets on 31.12.2015	**2,421**	**1,484**	**3,905**

Note 12

BORROWINGS

in thousands of euros	*31.12.2015*	*31.12.2014*
Short-term borrowings		
Current portion of long-term bank loans	2,381	1,191
Total short-term borrowings	**2,381**	**1,191**

in thousands of euros	*31.12.2015*	*31.12.2014*
Long-term borrowings		
Long-term bank loan	153,227	123,615
Bonds issued	223,569	223,051
Total long-term borrowings	**376,796**	**346,666**

The Group's borrowings are denominated in the following currencies:

	31.12.2015	*31.12.2014*
Borrowings denominated in euros	379,177	347,857
Total borrowings (Note 5)	**379,177**	**347,857**

The average effective interest on borrowings was 3.3% in 2015 (2014: 3.7%).

The Group has used the following types of facilities for financing purposes:

- Loans from the European Investment Bank
  The Group has two loans in the total amount of EUR 107,000 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. The repayments of the loan will start in 2017.

- Loans from the Nordic Investment Bank
  The Group has three loans in the total amount of EUR 50,000 thousand. The repayments will start in 2015-2018 and will end in 2025-2033. Interest rate is floating which is the sum of 6-month Euribor and margin.

- Eurobonds
  In 2011, the parent company issued Eurobonds with the maturity of seven years and the nominal value of EUR 225 million and these bonds are listed on London stock exchange. Bonds' coupon is fixed at 4.625% p.a. and interest payments are made once a year.

- Overdraft
  The Group had an overdraft contract in the amount of EUR 20,000 thousand. The contract was terminated on 31 August 2015. The interest payable on the used portion was floating. As of 31.12.2015 and 31.12.2014, the Group did not use overdraft.

As of 31.12.2015 the Group did not have undrawn borrowing facilities (as of 31.12.2014 the Group had undrawn borrowing facilities amounting to EUR 32,000 thousand). Under its loan agreements, the Group has undertaken to comply with certain financial covenants. The Group's financial indicators complied with all contractual covenants.

Note 13

TRADE AND OTHER PAYABLES

in thousands of euros	*31.12.2015*	*31.12.2014*
Trade payables	15,040	15,298
· Including payables for PRT-Limited auction	2,506	2,175
Payables for purchased property, plant and equipment and intangible assets	1,210	2,342
Subsidies due to electricity producers	0	3,447
Other payables	2,814	294
Total financial liabilities within trade and other payables without accrued interests	**19,065**	**21,380**
Accrued interests	5,167	5,211
Total financial liabilities within trade and other payables in the consolidated statement of financial position	**24,232**	**26,591**
Taxes payable		
VAT	784	1,275
Social security tax	310	207
Personal income tax	166	112
Unemployment insurance tax	18	14
Contributions to mandatory funded pension	16	10
Corporate income tax and income tax on fringe benefits	11	10
Excise tax	182	174
Pollution tax	3	1
Total taxes payable	**1,490**	**1,803**
Accrued expenses - employee benefits		
Wages and salaries	249	226
Bonuses	430	240
Holiday pay	106	89
Social security and unemployment insurance tax	181	111
Total accrued expenses - employee benefits	**965**	**666**
Other payables	**49**	**33**
· Including Provisions for greenhouse gas emissions (Note 2)	44	29
Total trade and other payables	**26,735**	**29,094**

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	*2015*	*2014*
Deferred income from connection and other service fees at the beginning of the period	**28,915**	**28,176**
Connection and other service fees received	2,687	1,997
Connection and other service fees recognised as revenue (Note 16)	-2,035	-1,258
Deferred income from connection and other service fees at the end of the period	**29,567**	**28,915**

Income from government grants

in thousands of euros	*2015*	*2014*
Prepayments related to government grants at the beginning of the period	**48,473**	**14,564**
Subsidies received (Note 5 and 8)	331	35,136
Subsidies used for operating expenses (Note 17)	-51	-141
Government grants recognised as revenue (Note 17)	-1,186	-1,086
Prepayments related to government grants at the end of the period	**47,567**	**48 473**

Congestion revenue

in thousands of euros	*2015*	*2014*
Congestion revenue at the beginning of the period	**20,892**	**0**
Congestion revenue received during the period	28,635	20,892
Congestion revenue recognised as revenue (Note 17)	-6	0
Congestion revenue at the end of the period	**49,521**	**20,892**

Note 15

EQUITY

The Group's share capital consists of 157,890 shares with the nominal value of EUR 1,000 (31.12.2014: 149,890 shares with the nominal value of EUR 1,000). The shares have been paid for in full.

In 2015, share capital was increased by EUR 8 million by resolution of the sole shareholder and it was paid for in cash. The share capital was registered on 20 January 2016.

Dividends totalling EUR 20 million were paid out in 2015 (no dividends were paid out in 2014).

Income tax of EUR 5 million was incurred upon distribution of dividends.

As of 31.12.2015, the Group's statutory reserve capital totalled EUR 10,743 thousand (31.12.2014: EUR 8,706 thousand). As at 31.12.2015, the Group has the obligation to additionally transfer EUR 1,219 thousand (31.12.2014: EUR 2,037 thousand) to reserve capital.

The retained earnings of the Group as of 31.12.2015 amounted to EUR 158,568 thousand (31.12.2014: EUR 156,223 thousand). The income tax applicable to the net profit distributable as dividends is 20/80 (2014: 21/79). As of 31.12.2015, it would be possible to distribute EUR 125,879 thousand as net dividends (31.12.2014: EUR 123,349 thousand) and the corresponding income tax would amount to EUR 31,470 thousand (31.12.2014: EUR 30,837 thousand).

Note 16

REVENUE

Analysis of revenue by activity

in thousands of euros	*2015*	*2014*
Sales of balancing electricity and regulation services		
Balancing electricity	17,016	13,360
Regulation services	1,875	1,638
Balancing gas	98	0
Total sales of balancing electricity and regulation services	**18,990**	**14,998**
Sales of network services		
Electricity transmission fees	85,784	88,432
Natural gas transmission fees	7,942	0
Other network services	8,909	21,020
· Including congestion revenue (Note 2)	0	15,792
Revenue from connection fees (Note 14)	2,035	1,258
Total sales of network services	**104,670**	**110,711**
Sales of other goods and services		
Lease of transmission equipment (Note 22)	908	855
Sales of scrap metal	21	114
Sales of other services	2,407	2,547
Other goods	5	3
Total sales of other goods and services	**3,341**	**3,520**
Total revenue	**127,001**	**129,229**

Analysis of revenue by geographical location of customers

in thousands of euros	*2015*	*2014*
Estonia	105,541	101,012
Norway	418	18,013
Latvia	2,860	2,835
Finland	3,875	3,340
Lithuania	7,338	700
Russia	215	114
Other	6,755	3,214
Total revenue	**127,001**	**129,229**

Note 17

OTHER INCOME

in thousands of euros	*2015*	*2014*
Fines, penalties and compensations received	2,137	235
Negative goodwill (Note 24)	1,186	1,086
Government grants related to acquisition of property, plant and equipment (Note 14)	1,509	0
Gain on disposal of property, plant and equipment	380	18
Income related to administration of renewable energy	100	91
Dividends from long-term financial investments	58	35
Foreign grants for operating expenses (Note 14)	51	141
Congestion revenue (Note 14)	5	0
Other income	18	2
Total other income	**5,444**	**1,609**

Note 18

GOODS, RAW MATERIALS AND SERVICES

in thousands of euros	*2015*	*2014*
Electricity and gas purchased to provide the balancing service		
Purchase of balancing electricity	15,703	12,289
Purchase of power regulation service	2,354	2,098
Operating expenses of emergency reserve power plant	0	110
Purchase of balancing gas	93	0
Total electricity purchased to provide the balancing service	**18,150**	**14,497**
System services		
Purchased electricity reserves	12	15
Reactive energy	347	409
Countertrade	0	343
Operating expenses of emergency reserve power plant	195	257
Total system services expenses	**553**	**1,024**
Electricity and gas to compensate for network losses		
Electricity network losses	13,156	15,024
Gas network losses	523	0
Total electricity and gas to compensate for network losses	**13,680**	**15,024**
Maintenance and repair works		
On facilities and equipment related to core activities	5,066	5,209
On production buildings and sites	515	341
Disassembly works and waste processing	117	140
Other	285	202
Total maintenance and repair works	**5,982**	**5,892**
Other costs		
Operative switching and dispatching management expenses	661	665
Other costs	1,657	2,600
Total other costs	**2,317**	**3,265**
Total goods, raw materials and services	**40,682**	**39,703**

Note 19

OTHER OPERATING EXPENSES

in thousands of euros	*2015*	*2014*
Telecommunication	1,101	1,022
Research and consulting	895	537
Training and other miscellaneous operating expenses	788	857
Research and development costs (R&D)	725	386
Information technology	691	445
Office expenses	584	300
Security, insurance and occupational safety	192	170
Transportation and tools	149	131
Other expenses	265	158
Total other operating expenses	**5,390**	**4,006**

Note 20

STAFF COSTS

in thousands of euros	*2015*	*2014*
Base salaries, additional remuneration, bonuses, vacation pay	5,573	3,650
Termination benefits	68	7
Other remuneration	182	117
Total remuneration to employees	**5,823**	**3,775**
Social security tax	1,943	1,284
Unemployment insurance tax	41	32
Total staff costs	**7,807**	**5,090**

· Including compensations to the members of the Management and Supervisory Board		
Salaries, additional remuneration bonuses, vacation pay	495	269
Fringe benefits	29	26
Termination benefits	43	0
Social security tax	187	97
Total compensations to the members of the Management and Supervisory Boards	**754**	**392**

Remuneration of the members of governing bodies in 2015 included the remuneration of the governing bodies of the three Group entities, including termination benefits related to the premature termination of previous management's contracts. For 2014, only the remuneration of the members of the parent company's governing bodies are provided.

The average monthly pay was EUR 2,019 (2014: EUR 2,084).

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

Note 21

FINANCIAL INCOME AND COSTS

in thousands of euros	*2015*	*2014*
Financial income		
Interest income	30	4
Total financial income	**30**	**4**
Financial costs		
Interest expenses	-11,957	-12,031
Foreign exchange losses	-2	-1
Other financial costs	-7	-2
Total financial costs	**-11,965**	**-12,034**
Capitalised borrowings costs (Notes 10 and 11)	487	1,997
Total financial costs recognised in the consolidated statement of comprehensive income	**-11,478**	**-10,037**
Net financial income (costs)	**-11,448**	**-10,033**

Note 22

OPERATING LEASE

Group as a lessor

Operating lease revenue

in thousands of euros	*2015*	*2014*
Buildings	192	197
Transmission equipment	908	855
Total operating lease revenue	**1,100**	**1,052**

Transmission equipment
The Group 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 the Group for its technical communication. The free fibres have been leased out to Televõrgu AS. The lease contract contains a restriction under which the Group 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	*31.12.2015*	*31.12.2014*
Cost	6,266	6,112
Accumulated depreciation at the end of period	-4,140	-3,725
Carrying amount	**2,126**	**2,387**

Depreciation charge

in thousands of euros	*2015*	*2014*
Depreciation charge	407	399

Estimated future lease payments under operating leases

in thousands of euros	*31.12.2015*	*31.12.2014*
Not later than 1 year	958	908
Later than 1 year and not later than 5 years	3,832	3,632
Later than 5 years	4,072	4,767
Total future minimum lease payments	**8,862**	**9,307**

Group as a lessee

Operating lease expenses

in thousands of euros	*2015*	*2014*
Buildings	213	36
Transport equipment	83	85
Other machinery and equipment	85	21
Total operating lease expenses	**381**	**142**

All operating leases where the Group 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 the Group, 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 Group and Subsidiaries;

III Close relatives of the persons described above and the entities under their control or significant influence;

IV Minority shareholders that have significant influence over the subsidiaries and the entities under their control or significant influence.

The outstanding balances with related parties were as follows:

in thousands of euros	*31.12.2015*	*31.12.2014*
Trade receivables		
Companies controlled or significantly influenced by the State	18,717	18,340
Total trade receivables	**18,717**	**18,340**
· incl. from network operators	17,315	16,989
Trade payables and other liabilities		
Companies controlled or significantly influenced by the State	3,782	3,976
Total trade payables and other liabilities	**3,782**	**3,976**

Income and expense items with related parties were as follows

in thousands of euros	*Related party*	*2015*	*2014*
Revenue from sale of goods	Companies controlled or significantly influenced by the State	6,719	8,223
Revenue from sale of services	Companies controlled or significantly influenced by the State	79,155	80,316
Revenue from sale of goods and services		**85,874**	**88,539**
Purchase of goods	Companies controlled or significantly influenced by the State	4,972	6,073
Purchase of services	Companies controlled or significantly influenced by the State	4,043	3,351
Purchase of goods and services		**9,015**	**9,424**
Expenditures on non-current assets	Companies controlled or significantly influenced by the State	319	1,844

- Revenue from sale of goods is incurred by the sale of reactive power, 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, reactive 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	*2015*	*2014*
Sales of services	0	47
Purchase of services	13	13

Key management personnel compensations are disclosed in Note 20.

The receivables from related parties were written off neither in 2015 nor 2014.

Note 24

BUSINESS COMBINATION

On 13 January 2015, the Group acquired 51.38% of the share capital of AS Võrguteenus Valdus, a parent company of AS EG Võrguteenus which is a company operating the gas transmission system network in Estonia. The purpose of the acquisition was diversification of the risks by adding new operating activity and expanding the customer base, cost savings on overheads

and better access to the international capital markets due to the Group´s growth.

The cash consideration amounted to EUR 27,573 thousand, paid in January 2015.

The direct costs of acquisition, which were charged to the income statement, were EUR 242 thousand.

The assets and liabilities arising from the acquisition, provisionally determined, are as follows:

in thousands of euros	*Fair value*
Cash and cash equivalents	989
Trade and other receivables	1,642
Inventory	405
Property, plant and equipment (Note 10)	54,364
Intangible assets (Note 11)	124
Trade and other payables	-692
Long-term provisions	-234
Net assets acquired	**56,598**

Purchase consideration	
· Cash paid	27,573
Fair value of net assets acquired (see above)	-56,598
Non-controlling interest 48.62%	**27,515**
Negative goodwill	**-1,509**

The revenue included in the consolidated statement of comprehensive income since 1 January 2015 contributed by Võrguteenus Valdus AS and Elering Gaas AS was EUR 9,094 thousand and profit EUR 1,668 thousand.

Non-controlling interest was measured at the non-controlling interest's proportionate share in the identifiable net assets.

Pursuant to stipulations of the Estonian Natural Gas Act, effective from 01/01/2015, the gas transmission network was no longer permitted to be controlled by entities that concurrently held a stake in a gas production or sales business. As a result of the legislative change, the previous owners had a stronger pressure to sell than the parent company's incentive to buy. In a situation where the transmission volumes in Estonia are very low, international investors showed no interest in the acquisition of a company with relatively low market value. The parent company, however, had existing financial capability and capacity for infrastructure maintenance and development and therefore the parent company emerged as the sole serious buyer. In addition, risks related to acquired assets were mitigated for the company due to expected synergies as a result of cost savings arising from common support services and financing. For the described reasons, Elering AS was able to negotiate a lower price for the acquired natural gas network compared to the fair value of the acquired assets.

The negative goodwill of EUR 1,509 thousand has been recognised as other income (Note 17).

During 2015, additional stakes of 48.62% were acquired .Consideration paid for the additional shares amounted to EUR 26,087 thousand.

The difference resulting from the adjustment of non-controlling interest of EUR 2,158 thousand has been recognised in retained earnings

Note 25

CONTINGENT LIABILITIES AND BINDING COMMITMENTS

Network development obligations
Under the Electricity Market Act, 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.

Obligation to tolerate utility networks
On the basis of a ruling of the Supreme Court, current amounts of fees paid for tolerating utility networks and structures have been annulled in 2012 and lawmakers have not yet adopted new regulation. This means that the situation remains unclear and while landowners are still entitled to claim payment for tolerating utility networks and structures, the method for determining justified fees is unclear and unregulated. The time of introduction of new regulation is also unknown and it is unclear whether the regulation will be effective since introduction or it will be applied retrospectively. Although at present Elering has only one pending court dispute related to tolerating utility networks, the above situation creates a major ambiguity with regard to contingent financial claims for tolerating utility networks. According to the tariff regulation, the aforementioned costs are included in the calculation of network service fees, but there may be a time lag between the payment of compensations and receiving compensations via network tariffs. Therefore the Group may temporarily need to finance these costs from other sources of income.

Capital expenditure commitments
On 31.12.2015, the Group has contractual capital expenditure commitments in respect of property, plant and equipment totalling EUR 16,423 thousand (31.12.2014: EUR 26,322 thousand).

Tax legislation
The tax authorities have the right to verify the Group'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. The Group's management estimates that there are not any circumstances which may lead the tax authorities to impose additional significant taxes on the Group.

Note 26

FINANCIAL INFORMATION ON THE PARENT COMPANY

Financial information disclosed on the parent company includes the primary separate financial statements of the parent company, the disclosure of which is required by the Accounting Act of Estonia. The primary financial statements of the parent company have been prepared using the same accounting policies that have been used in the preparation of the consolidated financial statements except for investments in subsidiaries that are reported at cost in the separate financial statements of the parent company (less impairment).

Statement of Financial Position

in thousands of euros	*31.12.2015*	*31.12.2014*
ASSETS		
Current assets		
Cash and cash equivalents	56,476	31,869
Trade and other receivables	26,350	39,773
Inventories	2,442	2,631
Total current assets	**85,267**	**74,272**
Non-current assets		
Available-for-sale financial assets	1,946	1,946
Investments in subsidiaries	53,660	0
Property, plant and equipment	711,911	710,457
Intangible assets	3,606	3,374
Total non-current assets	**771,123**	**715,777**
TOTAL ASSETS	**856,390**	**790,050**
LIABILITIES		
Current liabilities		
Borrowings	2,381	1,191
Trade and other payables	26,034	29,094
Total current liabilities	**28,415**	**30,285**
Non-current liabilities		
Borrowings	376,796	346,666
Deferred income	126,425	98,280
Total non-current liabilities	**503,221**	**444,945**
TOTAL LIABILITIES	**531,636**	**475,230**
EQUITY		
Share capital	149,890	149,890
Unregistered share capital	8,000	0
Statutory reserve capital	10,743	8,706
Retained earnings	156,121	156,223
TOTAL EQUITY	**324,754**	**314,820**
TOTAL LIABILITIES AND EQUITY	**856,390**	**790,050**

Statement of Comprehensive Income

in thousands of euros	*2015*	*2014*
Revenue	118,013	129,229
Other income	3,909	1,609
Goods, raw materials and services	-39,739	-39,703
Other operating expenses	-4,559	-4,006
Staff costs	-5,607	-5,090
Depreciation and amortization	-33,633	-31,273
Operating profit	38,384	50,766
Financial income	30	4
Financial costs	-11,478	-10,037
Profit before income tax	**26,935**	**40,732**
Income tax	5,000	0
Profit for the year	**21,935**	**40,732**
Total comprehensive income for the year	**21,935**	**40,732**

Cash Flow Statement

in thousands of euros	*1.01.2015-31.12.2015*	*1.01.2014-31.12.2014*
Cash flows from operating activities		
Profit before income tax	26,935	40,732
Adjustments for:		
· Profit from sale of property, plant and equipment	-369	-18
· Depreciation, amortisation and impairment	33,633	31,273
· Dividends received from long-term financial investments	-58	-35
· Government grants expended and amortised	-1,186	-1,086
· Interest expenses	11,470	10,034
· Interest income	-30	-4
· Changes in inventories	189	-2,284
· Changes in receivables and prepayments related to operating activities	-1,656	177
· Changes in liabilities and prepayments related to operating activities	-2,184	-7,680
· Changes in deferred income from connection and other service fees	648	739
Cash generated from operations	**67,392**	**71,849**
Income tax paid	-5,000	0
Interest paid	-11,458	-11,426
Interest received	28	4
Net cash from operating activities	**50,961**	**60,427**

Cash flows from investing activities		
Purchases of property, plant and equipment and intangible assets	-37,330	-105,694
Foreign grants to acquire non-current assets	15,050	19,995
Proceeds from sale of property, plant and equipment	1,703	31
Payments for acquisition of subsidiary, net of cash acquired	-53,660	0
Dividends received from long-term financial investments	58	35
Congestion fees received	29,048	20,974
Net cash used in investing activities	**-45,131**	**-64,658**
Cash flows from financing activities		
Long-term bank loans received	31,968	34,955
Repayments of bank loans	-1,190	0
Contributions to equity	8,000	0
Dividends paid	-20,000	0
Net cash from financing activities	**18,778**	**34,955**
Net increase/decrease in cash and cash equivalents	**24,607**	**30,724**
Cash and cash equivalents at the beginning of the year	**31,869**	**1,145**
Cash and cash equivalents at the end of the year	**56,476**	**31,869**

Statement of Changes in Equity

in thousands of euros	*Share capital*	*Unregistered share capital*	*Statutory reserve capital*	*Retained earnings*	*Total*
Balance as of 1.01.2014	**149,890**	**0**	**6,259**	**117,939**	**274,087**
Comprehensive income for financial year	0	0	0	40,732	40,732
Transfers to statutory reserve capital	0	0	2,448	-2,448	0
Dividends paid	0	0	0	0	0
Balance as of 31.12.2014	**149,890**	**0**	**8,706**	**156,223**	**314,820**
Contributions of equity	0	8,000	0	0	8,000
Comprehensive income for financial year	0	0	0	21,935	21,935
Transfers to statutory reserve capital	0	0	2,037	-2,037	0
Dividends paid	0	0	0	-20,000	-20,000
Balance as of 31.12.2015	**149,890**	**8,000**	**10,743**	**156,121**	**324,754**
Carrying amount of holdings under controlling and significant influence				-53,660	-53,660
Carrying amount of holdings under controlling and significant influence using equity method				56,106	56,106
Adjusted unconsolidated equity as at 31 December 2015				**158,568**	**327,200**

INDEPENDENT AUDITOR'S REPORT

(Translation of the Estonian original)*

To the Shareholder of Elering AS

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Elering AS and its subsidiaries (the Group), which comprise the consolidated statement of financial position as of 31 December 2015 and the consolidated statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and notes comprising a summary of significant accounting policies and other explanatory information.

Management Board's Responsibility for the Consolidated Financial Statements

Management Board is responsible for the preparation and fair presentation of these consolidated 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 the consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2015, 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.

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Report on Other Legal and Regulatory Requirements

During the audit we have not noted any material inconsistencies between the accompanying consolidated financial statements, the regulatory requirements as set out in Electricity Market Act and Natural Gas Act and legislation established on the basis thereof.

AS PricewaterhouseCoopers

Stan Nahkor
Auditor's Certificate No. 508

16 March 2016

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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 the Group as of 31.12.2015 were EUR 160,726 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 31,000 thousand
To transfer to the statutory reserve capital	EUR 1,219 thousand
Not to distribute the remaining retained earnings	EUR 128,507 thousand

SIGNATURES OF THE MANAGEMENT TO THE 2015 ANNUAL REPORT

The signing of Elering AS 2015 Annual Report on 16.03.2016.

Taavi Veskimägi
Chairman of the Management Board

Peep Soone
Member of the Management Board

Kalle Kilk
Member of the Management Board

THE REVENUE OF ELERING AS ACCORDING TO EMTAK 2008

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

EMTAK area of activity*		*01.01.2015 - 31.12.2015*	*01.01.2014 - 31.12.2014*
35121	Transmission of electricity – transmission through the transmission network	97,969	113,060
35221	Natural gas transmission	7,942	0
35141	Trade of electricity (balancing electricity)	18,892	14,998
35231	Trade of gas (balancing gas)	98	0
77399	Renting and leasing of other machinery, equipment and tangible goods	908	855
49501	Pipeline transport	890	0
47770	Retail sale of other second-hand goods	27	118
68201	Renting and operating of own or leased real estate	192	197
46699	Other sales	84	0

* *EMTAK – classification of Estonian economic activities.*

Photos: Ain Köster, Annika Haas, Estfilm, Ken Oja

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