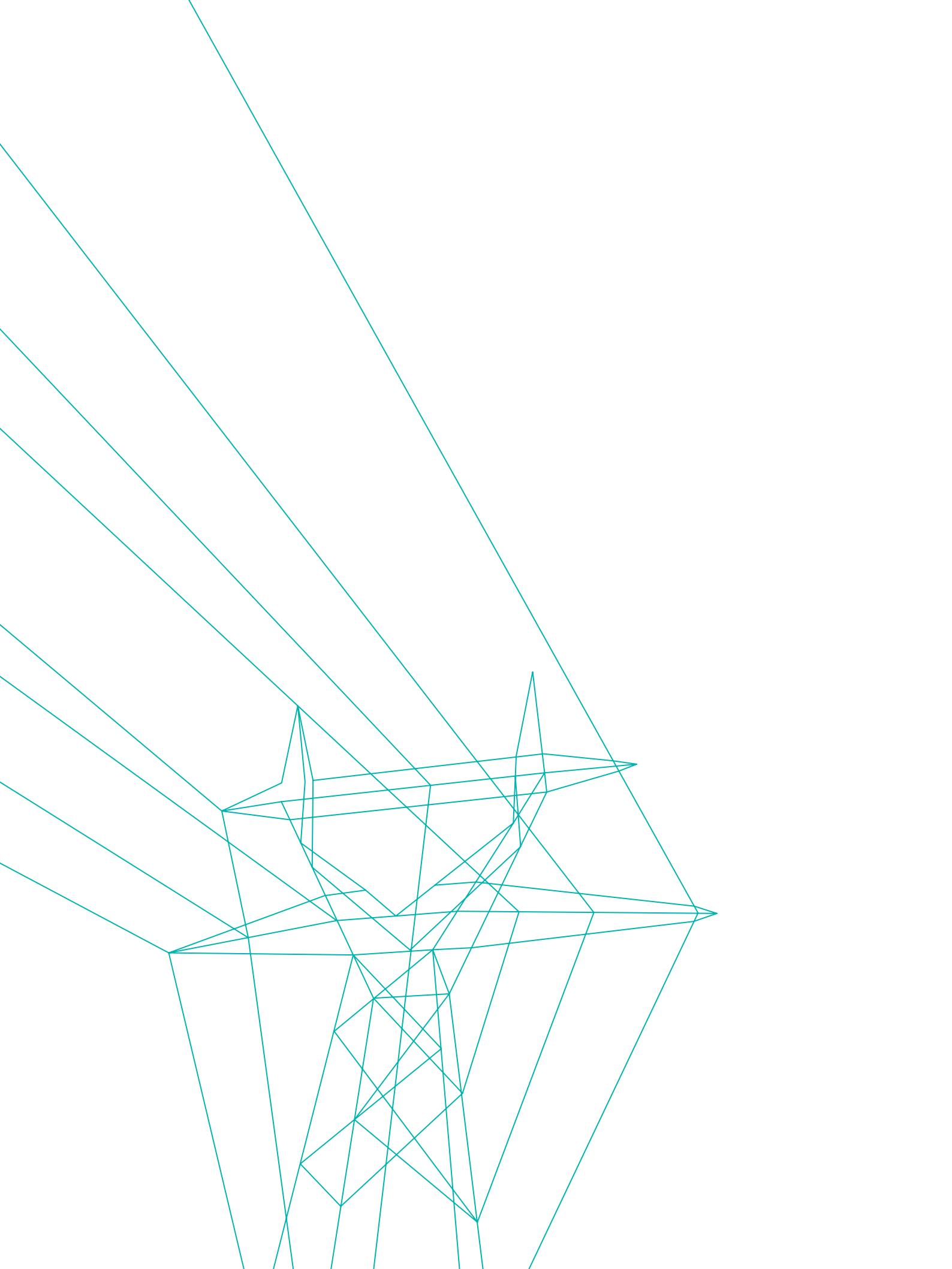




elering
GENERATING OPPORTUNITIES

2016

Annual Report



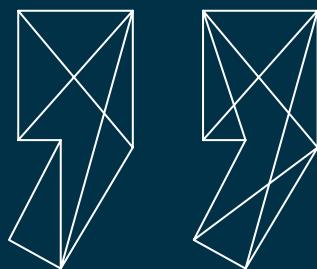
Management Report – Elering

Statement by the Chairman of the Management Board	5
Overview of Elering	9
Key indicators of the Estonian Energy System	13
Summary of the Financial Year	19
Development of the Energy Networks	23
Development of Energy Markets	29
Operation of the Estonian Energy System	37
Research and Development	43
Social Responsibility	51
Corporate Governance Report	57
Balance with the Natural and Living Environments	65
Organisation and People	71





Statement by the Chairman of the Management Board



The digitalisation of energy networks will give rise to a vision for the development of the energy sector in the Baltic Sea region.



TAAVI VESKIMÄGI
Chairman of the Management Board

Elering's smart grid creates value for the customer

Philosopher Eric Hoffer has written that in times of change learners inherit the earth; while the learned find themselves beautifully equipped to deal with a world that no longer exists.

In the energy industry, learning is now more important than it has ever been in order to do the right thing in the right way. In times of great change, it is easy to make errors in principle, to continue as before without recognising the existence of new needs and challenges. At Elering we have tried to constantly learn, learn more and relearn to organise the Estonian electricity and gas market in a way that creates the most value for the market participants.

In the energy industry, a digital revolution is taking place. The importance of information and communication technology for the functioning of energy systems is growing on a large scale. At Elering, we constantly ask ourselves what jobs can/should we hand over to digitalisation when it comes to energy. If we can answer that, we can create platforms and applications that can be scaled globally for large scale energy systems. This can be the basis for truly attractive value offers that solve many issues in the

energy sector, starting from large-scale integration of renewable energy into the network, developing storage technologies and implementing consumer flexibility up to remote control of home automatics on the basis of price signals. All this requires availability of data as close to real time as possible, the capability of moving massive data volumes, high requirements of cyber security and the protection of personal data.

Considering these trends, Elering is developing the smart grid platform Estfeed, which enables to obtain energy consumption data efficiently and securely, understanding the needs related to the location of consumption, and altering actions accordingly. Estfeed will integrate different data sources and applications that use the data. The data may include information like production and consumption of electricity, gas, heat or market prices of energy, and weather forecasts. The creators of the applications can use databases interfaced to the platform of the smart grid to offer useful information technology solutions for the smart usage of energy both in business and production processes and also for private households.

Estfeed is integrated to the Estonian state data exchange layer X-tee, which ensures high security of the processes. Elering's position as the system operator ensures the reliability and independence of the data exchange service.

Elering's vision is that the digitalisation of energy networks will give rise to a vision for the development of the energy sector in the Baltic Sea region, a global leader across companies and governments in the digitalisation of the energy sector.

Global energy trends

In addition to the massive digitalisation of energy systems, energy is moving from being local towards it being global. The liberalisation of markets, new technologies and fuels used have freed energy sector's development from the restriction of state borders. And this is something working in our favour. In the new circumstances, energy can grow much larger than the Baltic Sea region. For example in electricity trading, there is no longer a Nordic-Baltic electricity market, but a common, better connected and more closely integrated market from Gibraltar to the North Cape.

Our common level of ambition has to be to move from regional towards global, not viewing the energy sector in the Baltic Sea region as a secondary, only local energy supplier, but as an export sector that is capable of providing all the services and goods created here to much larger markets. The energy sector has to break out of the limits of the Baltic Sea region.

As always, the world is antagonistic and asymmetrical. Simultaneously with moving from local, state-based energy organisation towards the global market, a weakening of central systems and a rise of local solutions can be noticed. Local small production is stepping on the heels of central networks and production more and more. While the earlier model of thought was figuratively based on central power stations, such as Olkiluoto, Forsmark or Narva, and the total consumption of states, now it is necessary to view each household and company separately to find an unique solution that satisfies the needs of the specific consumer in the best way.

Cross-border energy infrastructure

In 2014, the second electricity connection between Estonia and Finland, EstLink 2, was completed. It increased the electricity connection between the countries to 1000 megawatts and made a combined Estonian-Finnish electricity market possible. In the coming years we will make efforts to be able to discuss a similar success story in the gas economy. We have begun building a gas connection between Estonia and Finland—Balticconnector—to fully open and operate the gas market and so it has become a reality. Without Balticconnector it would not be possible to create a Baltic-Finnish gas market.

Two years of cooperation has been fruitful. In 2016, Elering signed a cooperation agreement with the Finnish Balticconnector developer to build an underwater tube and a financing contract of more than 200 million euros with the European Commission with the purpose of completing the Estonian-Finnish gas connection costing more than 300 million euros by 2020. Balticconnector will join the natural gas networks of Estonia and Finland with a 150 km gas transmission pipeline, 80 of which are located at the bottom of the sea, with compressor stations enabling gas flow on both sides of the Gulf of Finland.

In electricity economy, the project developing the third electrical connection between Estonia and Latvia is as important. There is a public procurement to build the first section from Harku to Sindi going through Lihula, after which a new line will be built from Kilingi-Nõmme to the Estonian-Latvian border. Building the new

Estonian-Latvian connection costs 172 million euros, of which a co-funding from the European Union covers 112 million euros. In the upcoming four years we will invest, together with our Finnish and Latvian partners, approximately half a billion euros into a cross-border energy infrastructure.

Where to next? Synchronising the Baltic electricity systems with those of the Nordic countries

The Estonian and Baltic energy system is irrevocably moving towards separation from the sphere of influence of the Russian energy system. In order to ensure energy security of the region, it is necessary to turn our energy system from east to west and exit isolation—be free from Russia and join Europe. Integrating the electricity system of the Baltic states with those of the Nordic countries is the next step in a row of steps that includes the Baltic states joining the European Union, NATO, OECD, Eurozone and other networks ensuring that the interests of the region are considered in the best possible way.

The meaning of also this step is much wider, in the same way as joining the Eurozone was, which was not only related to economic and financial politics, but has a wider meaning in security politics, participating in European politics, and sharing common values. Desynchronisation from the Russian electricity network is not a unique step. In 1995, this was done by Hungary, Czech Republic, Slovakia, and Poland. In 2002, Romania and Bulgaria left the Russian synchronous area.

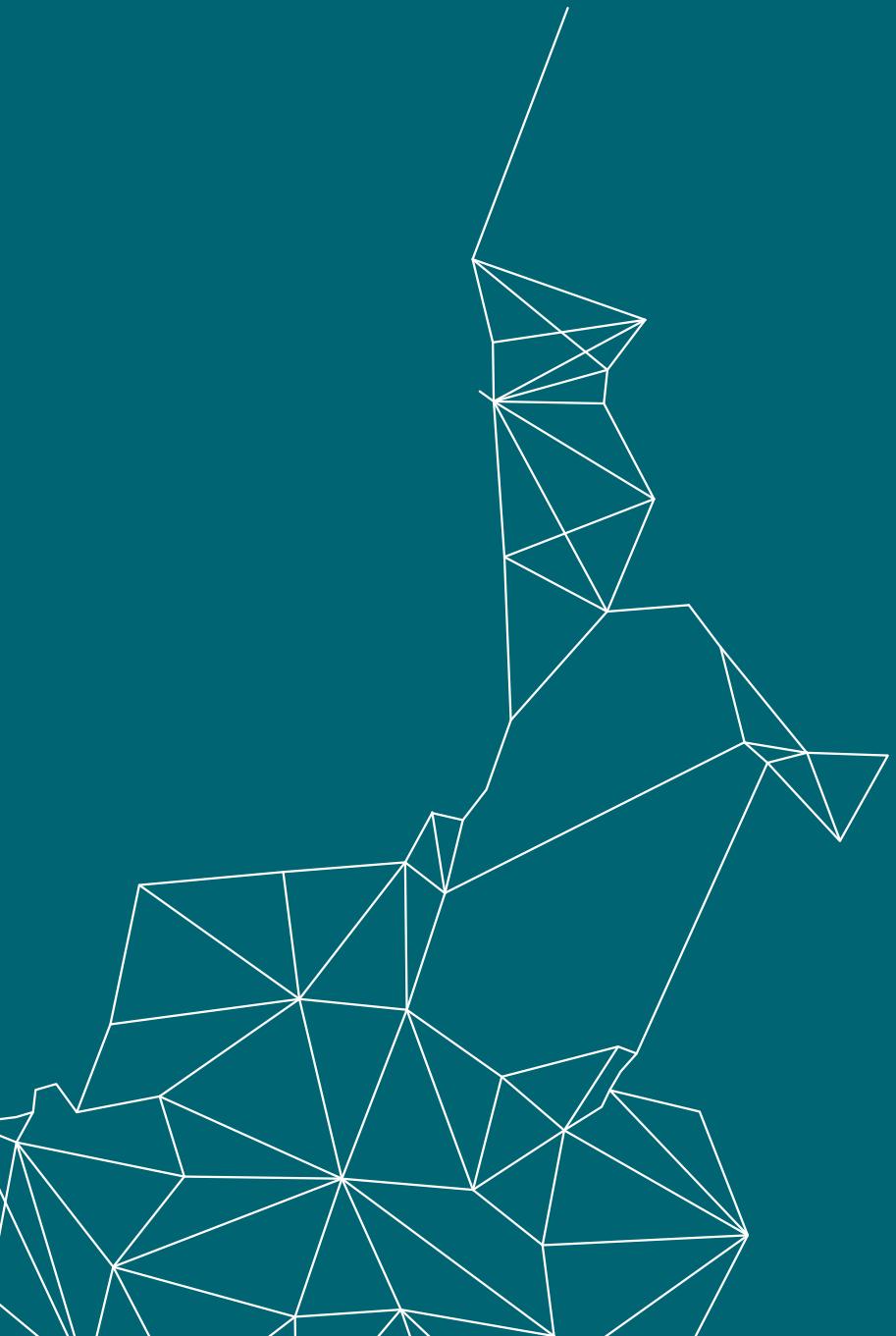
At the moment, the Baltic electricity system is operating in a common synchronous area with the electrical systems of Latvia, Lithuania, Belarus, and Russia. This constitutes to a single circulation, one organic whole. For the past seven years we have worked very intensely to disconnect the Estonian energy system from the east and to connect it to the west. This is necessary in order to reduce systemic risks to the region's energy security.

We have worked with different options to make this idea happen. The first option is to synchronise the Baltic electricity system with that of Central Europe, but Poland is dragging its feet here. Now we have begun to look towards the Nordic countries with whom we have a common electricity market and common electricity cables. And, what is most important, a common understanding of the development of the electricity market and network. Synchronised operation with the Nordic countries is technically possible, but certainly not usual as it presents a great technical challenge. But we are capable of accepting this challenge.



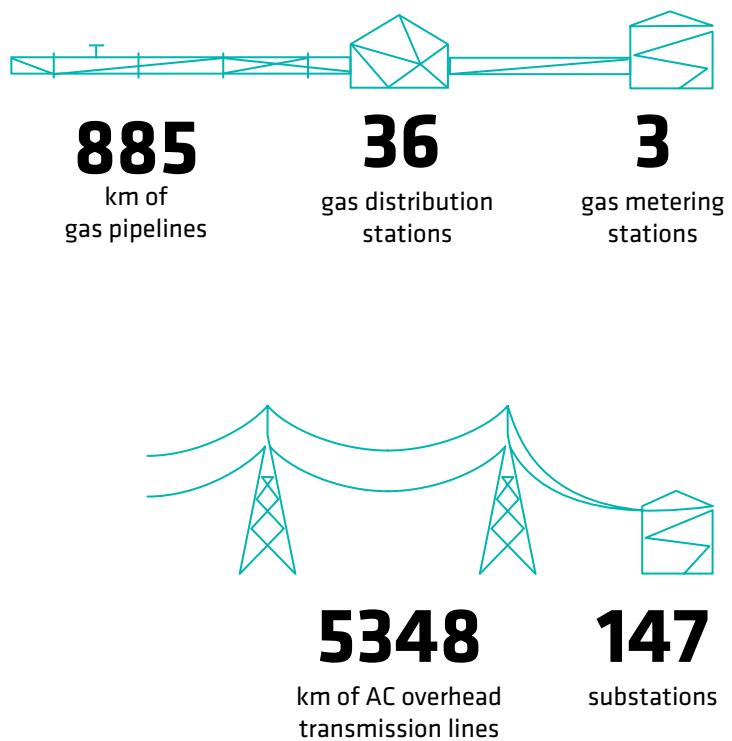


Overview of Elering

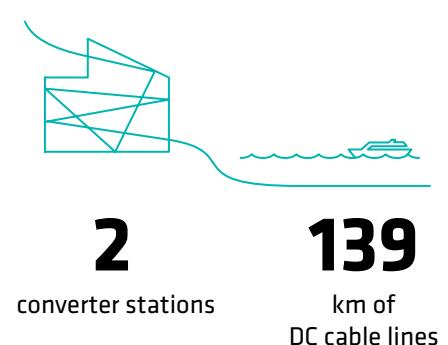
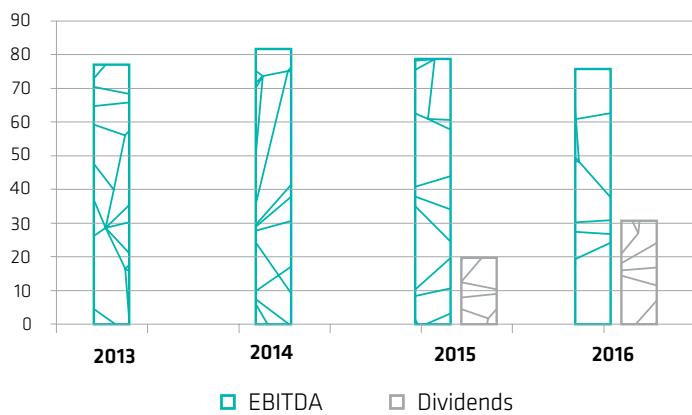


Major projects in 2016

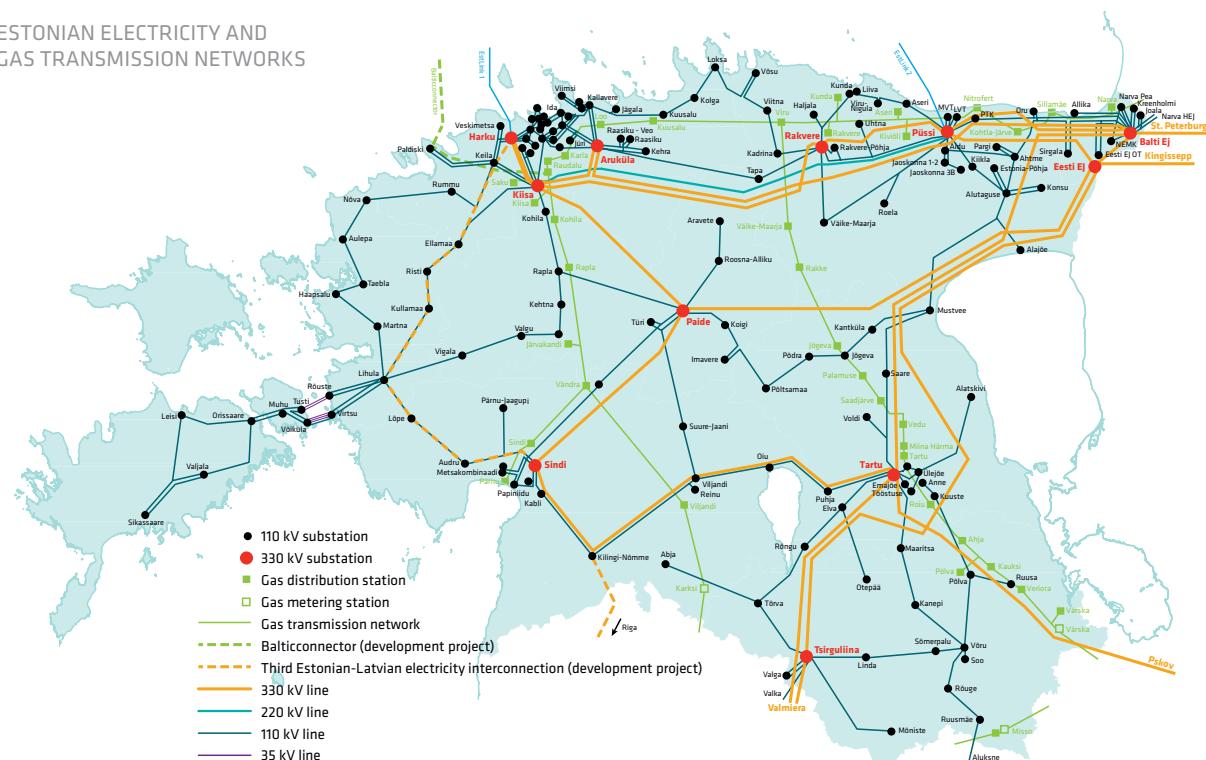
- Merger of natural gas transmission system operator (Elering Gaas) with Elering AS
- Approval of EU funding in the amount of EUR 206 million for construction of Balticconnector and improving cross-border capacities of natural gas transmission network between Estonia and Latvia
- Lowest number of failures of electricity network devices in recent years (100)
- Reconstruction works at the Sõmerpalu, Paljassaare and Leisi substations completed



EBITDA and dividends



ESTONIAN ELECTRICITY AND GAS TRANSMISSION NETWORKS



Financial figures (MEUR)

	2013	2014	2015	2016
Revenue	134,4	130,8	132,4	135,9
Operating expenses	81,1	80,0	90,9	98,1
Operating profit	53,3	50,8	41,6	37,8
Financial expenses	4,4	10,0	11,4	11,4
Income tax	0,0	0,0	5,0	7,8
Net profit	49,0	40,7	25,1	18,7
Borrowings	312,4	347,9	379,2	367,4
Equity	274,1	314,8	329,4	349,1
Assets	670,9	790,0	861,9	903,7
EBITDA	77,0	82,0	78,6	76,0
Investments	203,3	100,5	93,1	26,7
Dividends	0,0	0,0	20,0	31,0

Financial ratios

ROE	19,6%	13,8%	7,8%	5,5%
Equity/Assets	41%	40%	38%	39%
Net Borrowings/EBITDA	4,0	3,9	4,1	4,1

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

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

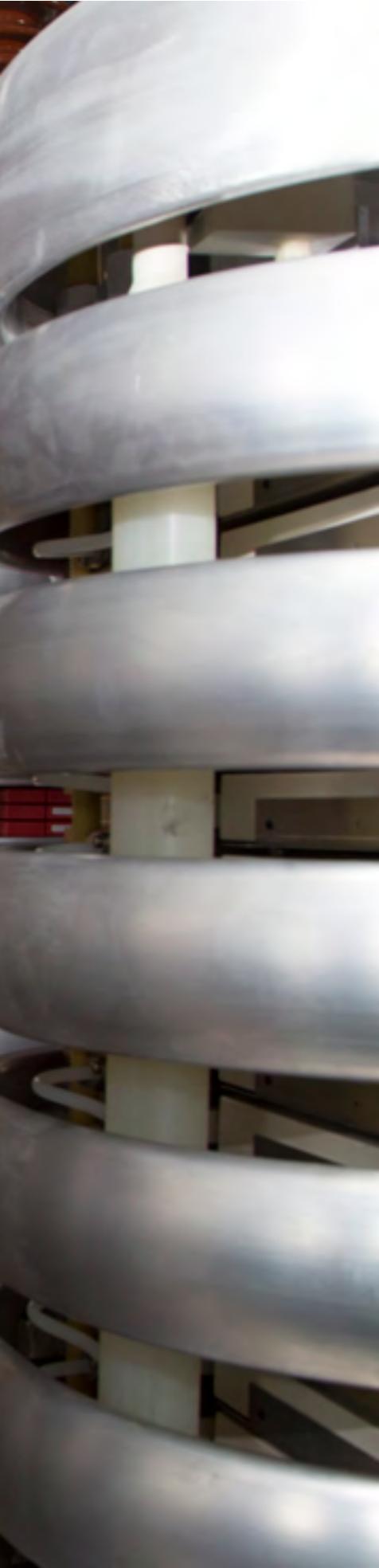
Average age **44**
Average length of employment **15**
Voluntary turnover **4,4%**



231

with women
representing 25%
of the workforce





Key Indicators of the Estonian Energy System

10 422 GWh

ELECTRICITY PRODUCTION

335 GWh

ELECTRICITY CONSUMPTION

Estonian electricity system balance

In 2016, Estonia's domestic electricity consumption (including network losses) amounted to 8.38 TWh, which means a 3% increase compared to 2015.

Electricity production increased by 15% year-on-year, to 10.42 TWh. This increase was attributable to higher prices on the power exchange and a decrease in the production cost of oil shale. On the other hand, production from renewable sources of energy decreased by 6%, including a 15% decrease in electricity production from wind power and a 30% increase from hydropower, while the amount of electricity produced from biomass, biogas and waste remained the same as in the previous year. The proportion of energy produced from renewable sources in overall production in 2016 was 13.6%.

For the year, electricity production in Estonia exceeded electricity consumption by 24%, resulting in net exports of 2.04 TWh.

<i>Electricity balance, GWh</i>	<i>2016</i>	<i>2015</i>	<i>Change %</i>
Electricity production in Estonia	10,422	9,062	15%
Domestic electricity production provided to Elering network	10,118	8,771	15%
Production of renewable energy in Estonia	1,412	1,507	-6%
Electricity imports from cross-border power lines	3,572	5,344	-33%
· incl. physical transmission from Finland	3,052	5,018	-39%
· incl. physical transmission from Latvia and Russia	520	326	60%
Total electricity provided to network	13,994	14,406	-3%
 Electricity consumption in Estonia	 8,385	 8,137	 3%
Elering's domestic transmission service for consumption	7,672	7,443	3%
Elering network losses	408	402	2%
Electricity exports through cross-border power lines	5,609	6,269	-11%
· incl. physical transmission to Finland	685	39	1,642%
· incl. physical transmission to Latvia and Russia	4,924	6,230	-21%
Total electricity taken from network	13,994	14,406	-3%
 Balance	 2,038	 925	 120%

Electricity trade balance

According to the electricity trade balance of 2016, electricity exports decreased by 12% and imports decreased by 35% compared to the previous year. 86% of total exports were to Latvia and 14% to Finland. 93% of total imports were from Finland and 7% from Latvia.

Cross-border electricity trade, GWh	2016	2015	Change %
Total exports	5,318	6,026	-12%
Exports on Estonian-Latvian border	4,552	5,925	-23%
Exports to Finland	766	101	658%
· incl. exports through Elspot power exchange	5,123	5,917	-13%
· incl. exports through Elbas power exchange	194	109	79%
Total imports	3,404	5,273	-35%
Imports on Estonian-Latvian border	231	60	287%
Imports from Finland	3,173	5,213	-39%
· incl. imports through Elspot power exchange	3,137	5,100	-38%
· incl. imports through Elbas power exchange	267	173	54%
Electricity trade balance*	1,914	753	154%
· incl. net exports on Estonian-Latvian border	4,321	5,865	-26%
· incl. net exports on Estonian-Finnish border	-2,407	-5,112	-53%

* The cross-border trade balance consists of trade supplies planned and executed by market participants. 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 production grew by 17% year-on-year in Latvia and amounted to 6.22 TWh. The total production of the co-generation hydroelectric power plants in Daugava increased by 36% compared to the previous year, which was attributable to the better availability of hydropower resources – the average inflow into the Daugava River in 2016 was 460 m³/s compared to an average of 348 m³/s in 2015. Consumption in Latvia increased by 2% and the annual deficit amounted to 1.01 TWh.

Electricity production in Lithuania decreased by 19% to 2.66 TWh and consumption increased by 6% to 10.11 TWh. The balance deficit in Lithuania decreased by 19% to 745 TWh and the percentage of local production plants covering domestic consumption was 26%.

The combined electricity production in the Baltic States increased year-on-year by 9% to 19.30 TWh. Combined consumption amounted to 25.72 TWh, an increase of 4% compared to 2015. The combined electricity balance deficit in the Baltic States amounted to 6.42 TWh, a decrease of 10% compared to the previous year. An estimated 55% of the electricity balance deficit of the Baltic States was covered by imports from the Nordic countries and 45% by imports from third countries.

The electricity balance of the Nordic countries posted a net surplus of 5.12 TWh – a two-thirds decrease compared to the previous year. The surplus in Norway was 16.46 TWh, while Sweden's surplus amounted to 12.23 TWh. Finland and Denmark imported 18.63 TWh and 4.94 TWh, respectively, to cover domestic consumption.

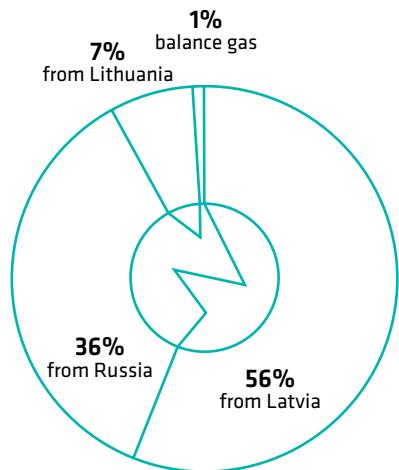
Gas balance

In 2016, the volume of the gas transmission service provided by Elering increased by 9% to 523 million cubic metres compared to the previous year. Network losses (uncertainty of measurements, leaks and self-consumption) decreased year-on-year by 22% and constituted 0.27% of the volume of the service in 2016, amounting to 1.41 million cubic metres. Transit from Latvia to Russia via the natural gas pipeline in south-eastern Estonia decreased year-on-year by 25% to 1.799 billion cubic metres.

<i>Gas balance</i>	<i>1000 m³ 2016</i>	<i>GWh 2016</i>	<i>1000 m³ 2015</i>	<i>2016/2015 change %</i>
Transit flows (Misso)	1,798,507	18,939	2,397,023	-25%
Total gas provided to the transmission pipeline	525,640	5,530	479,473	10%
· Domestic generation provided to the transmission pipeline	0	0	0	0%
Domestic transmission service for onsumption	522,705	5,499	478,349	9%
Network losses incl. self-consumption	1,414	15	1,809	-22%
Change in the transmission pipeline reserve capacity	1,521	16	-685	-322%

Commercial imports of gas in 2016 amounted to 528 million cubic metres. 56% of total imports came from the Latvian natural gas storage facility, 36% from Russia and 7% from Lithuania. Balance gas constituted 1% of total imports. In order to balance the Estonian gas system, the system operator purchased a total of 4.02 million cubic metres of balance gas from balance providers and sold them 1.20 million cubic metres of gas in 2016.

Commercial imports of gas by countries in 2016







Summary of the Financial Year

116,65

MILLION EUROS EU SUBSIDIES
FOR GAS INFRASTRUCTURE



PEEP SOONE
Member of the Management Board

A year of preparations for large investments in the future

2016 was characterised by an unusually low amount of investments in fixed assets. Whereas from 2013-2015 the average amount of investments in energy networks was over 100 million euros per annum, in 2016 it was just 26.7 million euros. At the same time, we were making active preparations for large investments in the coming years, including:

Investment	Amount, m €	Year of construction	EU assistance
Cross-border gas projects	154	2017-2019	65-70%
Cross-border electricity projects	179	2017-2020	60-65%

Cross-border gas projects include the Balticconnector gas pipeline between Estonia and Finland and increasing the gas transmission capacity between Estonia and Latvia. The cross-border electricity project includes a third transmission line between Estonia and Latvia.

To avoid a significant increase in domestic network tariffs due to these large projects, we entered into INEA contracts for EU assistance that will allow us to receive non-refundable financial assistance for financing the cross-border gas projects. A financing contract for the electricity transmission line between Estonia and Latvia had already been entered into in 2015. The second financing source for the cross-border electricity projects is revenue from overload that we have collected over the years, in the amount of 62 million euros. This means that, for example, the third electricity transmission line between Estonia and Latvia does not require financing from network tariffs – it is completely covered by the EU assistance and revenue from overload.

Revenue

Total revenue amounted to 135.9 million euros (2015: 132.4 million euros). The most important source of revenue was the sale of network services, which amounted to 106.5 million euros (2015: 104.7 million euros). This consisted of electricity network services (91%) and gas network services (9%). However, 92% of network service revenue came from network tariffs, i.e. regulated areas of activity. The company has 28 electricity network service clients and 11 gas network service clients. Most network service revenue (84%) comes from clients, who are regulated distribution network operators acting as natural monopolies. By far the largest client is Elektilevi OÜ (74% of network service revenue), a distribution network operator belonging to the Eesti Energia AS group, which is owned by the Republic of Estonia.

Sales of balancing and regulation services amounted to 23.4 million euros (2015: 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, most of whom purchase their electricity balancing service from balance providers. Elering itself provides these eight providers with the service of balancing their energy balance.

The principles of balancing the gas system are generally the same. The only difference is that the gas system does not have to be balanced at all times. If 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 six 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 the generated revenue covers the cost of providing the service.

Expenses

Operating expenses totalled 98.1 million euros (2015: 90.9 million euros) and financial expenses amounted to 11.4 million euros (2015: 11.5 million euros).

The main reason for the increase in operating expenses was the rise in balance energy purchase costs with regard to the changed electricity balance management system of the Baltic States.

Financing

Cash flow from operating activities amounted to 56.6 million euros (2015: 56.1 million euros).

Cash flow from investments amounted to 52.7 million euros (2015: 20.2 million euros). Purchases of fixed assets totalled 25.9 million euros (2015: 39.8 million euros). Proceeds from cross-border transmission capacity auctions were 12.6 million euros (2015: 29.0 million euros) and EU assistance for financing future cross-border gas investments was received in the amount of 21.7 million euros (2015: 15.3 million euros). 40 million euros was deposited in long-term bank deposits. EU assistance for financing the future cross-border gas investments is restricted cash, and therefore it does not have impact on the cash flow statement. Under the agreement, these deposits are not allowed to be used for purposes other than specified in the agreement to finance the investments. The deposits will be not used to pay for the investments at least for three months after the balance sheet day.

Cash flow from financing amounted to 11.4 million euros (2015: 7.3 million euros). The owner expanded the share capital by 32.0 million euros in connection with the purchase of the gas transmission network last year and Elering paid dividends amounting to 31.0 million euros. Amortising loans were repaid in the amount of 2.4 million euros, and a bank loan of 10.0 million euros was repaid ahead of schedule.

Summary

2016 was economically successful for Elering. Net profit was 18.7 million euros (2015: 25.1 million euros), EBITDA 76.0 million euros (2015: 78.6 million euros) and this strong financial position enables the company to pay dividends to its owner in 2017 in the amount of 20 million euros (2016: 31.0 million euros). The requirements stated in the loan contracts have been fulfilled with a surplus and the company is ready for future investments.





Development of the Energy Networks



TIMES

LESS OUTAGES COMPARED TO
THE AVERAGE OF RECENT YEARS



KALLE KILK
Member of the Management Board

The synchronization project

One of the most important strategic goals for Elering regarding energy network development is stronger integration of our networks into other networks in the Nordic-Baltic region and increasing energy security by reducing dependence on Russia. In order to achieve these strategic goals, Elering is building additional energy connections to the Finnish and Latvian networks and preparing the desynchronisation of the Baltic electricity system from Russia's United Energy System in cooperation with Latvian and Lithuanian colleagues.

Synchronisation is a long-term project involving many different activities. In 2016, significant steps were taken in proceeding with the project.

Two synchronisation studies have been completed. The first study was conducted by the Joint Research Centre operating at the European Commission and is called "Integration of the Baltic States into the EU electricity system: A cost-benefit and geo-political energy security analysis". It focuses on a comparison of three alternatives for the separation of the Baltic States from Russia's electricity system: 1) a separate synchronisation area for the Baltic States; 2) connecting the Baltic States to the synchronisation area of the Nordic countries; and 3) connecting the Baltic States to the synchronisation area of Central Europe. The study concludes that all three options are feasible and that sufficient security of supply would be ensured by synchronised operating with both Central Europe and the Nordic countries. The second study was conducted by the electricity transmission system operators of the Nordic countries and is called "Impact of Baltic Synchronisation on Nordic Power System Stability". It focuses on the synchronised operating of the Baltic States with the Nordic countries and explores changes and effects in terms of the electricity system stability of the Nordic countries. The study concludes that the synchronised operating of the Baltic States with the electricity system of the Nordic countries is possible in terms of technical stability and would require no significant additional investments for the compensation of potential negative effects.

Many activities for reducing dependence on Russia, improving energy security and creating the technical prerequisites for synchronisation were undertaken years ago, but 2016 also represented a major step towards achieving these goals. For example, the capabilities required for independent operation have already been developed at the control centre of the Estonian electricity system, including the construction of a fully functional back-up control centre. In addition, we have started building a new, more secure main control centre utilising the new SCADA information system, which is scheduled for completion by the

end of 2017. At the level of Baltic control centres the principles of controlling the electricity system in real time in normal as well as emergency situations have been agreed, which is also an important prerequisite for ensuring the ability to keep the Baltic electricity system operational even in the event of separation from the Russian electricity system. As at the end of 2016 our network is now technically much better prepared for unexpected situations – all of the major 330 kV substations that ensure electrical independence have been reconstructed, including the Eesti Power Plant substation, which was energised at the end of 2016 and which allows us to keep the electricity system operational without the Narva Power Plants.

New energy connections

In terms of building new energy connections, 2016 was an active year for two projects: the Balticconnector gas network; and the third connection in the Estonian-Latvian electricity network.

The main developments in the Balticconnector project were related to making investment decisions. Namely, Elering and its Finnish counterpart Balticconnector OY requested co-financing for the project from the Connecting Europe Facility of the European Union. As such, the Estonian and Finnish energy market regulators made a decision on sharing the cross-border expenses related to the project on April 22, on the basis of which Elering and Balticconnector OY, as the project developers, submitted financing applications to the European Commission on April 27. On July 15 the Member States of the European Union approved the European Commission's proposal on co-financing 75% of the investment cost of the Balticconnector project and 50% of the investment cost of the Estonian-Latvian gas network improvement project. The developers of the Balticconnector project signed a cooperation agreement on October 17 and the co-financing agreement for the project was signed by the project developers and the Connecting Europe Facility on October 21. The joint investment decision for the project was made by the project developers on October 26. The Estonian-Latvian gas network co-financing agreement was signed on December 19, thus confirming the financing of both the Balticconnector project and the Estonian-Latvian gas network improvement project.

In order to ensure the successful execution of the project, preparations have been ongoing for many years. In 2016 the environmental impact assessment of the undersea pipe was completed and approved,

the detailed plans of the Puiatu compression station were implemented and procurement documentation for different parts of the project was prepared, forming the basis of upcoming construction procurements. Seabed assessments of the undersea pipeline route also commenced in 2016, being completed in early 2017.

For the development of the Estonian-Latvian third electricity connection the preparation period was successfully completed, which included securing the line route and proceeding with plans. In February, the Environment Agency approved the report on the strategic assessment of environmental impact and during July and August the plans were implemented in all three counties (Harju, Lääne and Pärnu). At the end of the year a procurement was launched in order to find a designer and constructor for the section of the line running from Harku through Lihula to the Sindi substation. The procurement will be carried out using the turnkey method – the contractor will establish the line project, prepare the agreements on personal right of use, disassemble the old line, organise deforestation works and build the new 330/110 kV line.

For the connection section from Kilingi-Nõmme to the Estonian-Latvian border, a contract for services was entered into with Empower AS for the preparation of a work project and the organisation of agreements on personal right of use.

The scope of the Estonian-Latvian third connection project also includes reinforcing the substations at the ends of the line and at the intermediate points. In 2016 the following works were performed:

- detailed plans of the Kilingi-Nõmme 330 kV distribution point were implemented, with construction planned for 2018-2020;
- a procurement for the Kullamaa 110 kV substation was launched, with completion of the substation planned for May 2018;
- preparation of the detailed plans for the Riisipere 110 kV substation continued in Elektrilevi OÜ;
- a procurement for the Sindi 110 kV substation was carried out, with completion of the substation planned by the end of 2018;
- procurement documentation for the Harku 110 kV substation was prepared.

According to the plan, the Estonian-Latvian third electricity connection will be completed by the end of 2020.

Domestic investment projects

Besides the development of large projects, 2016 was also productive in terms of completing many other investment projects that are important for the system. One of the largest ongoing electricity network construction projects – reconstruction of the Eesti Power Plant substation – finally reached a level of completion by the end of 2016, with all of the new devices having been commissioned and the disassembly works of the old switchyard having commenced. The renewal of the Eesti Power Plant substation significantly improves the reliability of the electricity network in potential emergency situations, because as a result of these works it is now possible to keep the entire Estonian electricity network operational even when there is no electricity production in the Narva Power Plants. Final completion and acceptance of the substation reconstruction works is scheduled in the first half of 2017.

In 2016 the reconstruction works at the Sõmerpalu, Paljassaare and Leisi substations were completed. New supply points for clients were completed at the Imavere, Kehra and Iru substations. In addition, shunt reactors for electricity network voltage regulation were installed at the Balti and Virtsu substations. Partial renovation works of more than 400 km of power lines were performed and bird diverters were also installed on approx. 300 km of power lines.

For the gas network, renovations were performed on 1165 metres of gas pipelines, which included complete replacement of 305 metres of pipes, insulation of 798 metres and installation of 14 composite repair sockets together with the replacement of the insulation in 62 metres of pipes. In addition, the Loobu and Ahja pipeline intersections were completely renovated.

Reliability of the networks

Based on all of the works performed, it is important to point out the reliability indicators of the networks, which indicate whether the activities performed so far have proven effective. The availability and reliability of the networks in 2016 was at a very high level. The number of failures of electricity network devices over the last year has more than halved, totalling 100 failures compared to previous years. For consumers these failures caused only 24 outages. The failures with the most significant effect on consumers were caused by old devices that had exceeded their technical lifetime. The high reliability indicators of the electricity network are based on continuous improvements in the reliability of lines and substations. In 2016 the implementation of the network reliability improvement programme continued, which included clearing the protection zones of lines from dangerous brushwood and forests over an area of approx. 2600 hectares. The positive trend in operational reliability is also the result of many years of making significant investments, which has been the reason for the decrease in failures caused by devices that have exceeded their designed lifetimes.

There were no major failures in the gas network that would have caused disturbances for gas consumers or restrictions on cross-border connections. Elering continues to contribute to maintaining the good technical condition of gas network devices. An important aspect that can be highlighted is clearing the protection zones of the gas pipeline of trees and brushwood to prevent damage caused by roots.

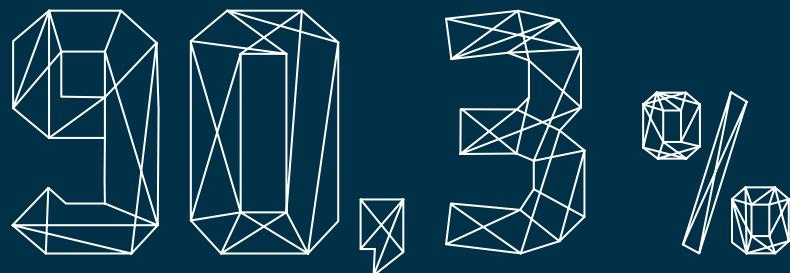
The reliability of cross-border electricity connections has also continuously improved. In 2016, EstLink 2 was in operation for almost 96% of all hours, while for EstLink 1 the same indicator was over 98%. The connections directed to Finland experienced restrictions caused by failures affecting the electricity trade at the exchange for just 23.5 hours total – 719 hours less than in 2015.







Development of Energy Markets



OF TIME ELECTRICITY PRICE ON
EQUAL LEVEL WITH FINLAND



ELIS PAAS
Head of the Energy Markets Department

Regional development

The regional electricity market was impacted in 2016 by new direct-current cables that went into operation at the start of the year, LitPol between Poland and Lithuania and NordBalt between Lithuania and Sweden. The new links have pushed Baltic electricity prices to the level of the Nordic countries and substantially reduced overloading on the Estonia-Latvia border.

The implementation of the new network codes of the European Union energy package continues to be an important factor in the regional development and cooperation of the electricity market. In October 2016, the second network code addressing the electricity market entered into force: European Commission Regulation No 2016/1719 establishing a guideline on forward capacity allocation across Europe. As part of the implementation of EC Regulation No 2015/1222 establishing a guideline on capacity allocation and congestion management (CACM) across Europe in November 2016, the Agency for the Cooperation of Energy Regulators (ACER) approved the joint proposal of European transmission system operators for determining the capacity calculation regions. On the basis of this proposal, Estonia is part of the Baltic capacity calculation region together with Latvia, Lithuania and, to the extent of direct current lines, also Finland (EstLinks),

Sweden (NordBalt) and Poland (LitPol). Future regional efforts in the implementation of network codes will largely be based on this newly assigned region.

As part of the CACM implementation process, Baltic transmission system operators launched a study at the start of 2016 to evaluate the adoption of the flow-based capacity calculation methodology in the Baltic capacity calculation region. The study aims to assess the technical feasibility and socio-economic rationality of the methodology. Its estimated completion date is in 2017.

Another important topic with regard to CACM was the development of the European Cross-Border Intraday trading platform (XBID). Transmission system operators belonging to the Baltic capacity calculation region, working with currently the only Baltic power market, Nord Pool (NP), initiated a so-called local implementation project in early 2016 that aims to agree upon data transmission rules and procedures to join the first phase of the XBID project launch at the end of 2017.

In November 2016, the Baltic States adopted single standard-based manually activated frequency restoration reserves products. In the Baltic States these products will be used to control power balancing in normal and emergency situations. Effective from November, all of the bids of the products will be available for activation by each of the Baltic transmission system operators from a single Baltic common merit order list. This constitutes the first step toward a single Baltic regulated market.

The natural gas industry was also subject to important developments in 2016. In the first half of the year, the Regional Gas Market Coordination Group (RGMCG) representing the ministries, regulators and transmission system operators connected to the natural gas industry in the Baltic region agreed to establish a regional Baltic-Finnish natural gas market or single entry-exit zone by 2020. A joint declaration was signed by the ministers in charge of the gas industry in all three Baltic States on 9 December 2016. Finland will hopefully join the plan in 2017.

Domestic developments

The separation of the natural gas transmission system operator that occurred in 2015, followed by the establishment of a combined electricity and natural gas transmission network operator in 2016, laid the foundations for an actual competitive natural gas market to emerge in Estonia.

In April 2016, new standard terms and conditions for the balance agreement became effective, establishing the balancing policies, rights and obligations of market participants who have entered into balance agreements with the transmission system operator, etc. The most significant change arising from the adoption of new standard terms and conditions was the change in the balancing period. Whereas the balance was previously determined on a monthly basis, this has been changed to 24 hours under the new standard terms and conditions.

Natural gas supplies made from October 2016 are subject to natural gas transmission capacity allocation and congestion management methodology and conditions for access to cross-border infrastructure in Estonia. According to the methodology, all market participants engaging in cross-border supply or from the transmission system to the end consumer and/or distribution network must enter into a natural gas transmission capacity allocation agreement with Elering and pre-reserve capacity for each supply under the procedure set by the Estonian Competition Authority.

Another important step was the establishment of a natural gas data warehouse, which went into operation in December 2016. The warehouse will simplify the functioning of the open market in a similar way to the electricity data warehouse, providing transparent management of customer agreements, an efficient supplier switching process and exchange of measurement data. The electricity data warehouse received an important update at the end of 2016: effective from 2017, electricity sellers have the option to issue a single invoice for the sale of electricity and network services.

Transparency of market data

Elering considers the equal access of market participants to data and data transparency to be one of the pillars of the market. Effective from January 2016, Elering transmits to the ENTSOG Transparency Platform the flows, nominations and gas quality data of the Estonian gas system. In October, additional data on gas transmission capacities and service interruptions were added.

Elering has been disclosing data on the Estonian electricity system and market pursuant to European Commission Regulation No 543/2013 on the European ENTSO-E Transparency Platform since 5 January 2015.

In addition, Elering launched a project in 2016 to update its website in a manner that will disclose more data on the Estonian electricity and natural gas system and market in Estonian and English. The new website enables the use of an API, allowing for automated downloading and use of data. The updated website is scheduled for completion in the first quarter of 2017.

Elering submits comprehensive data on electricity and gas market transactions to ACER pursuant to EC Regulation No 1227/2011 on wholesale energy market integrity and transparency and its implementing acts. As a transmission system operator, Elering submits data on cross-border transmission capacity transactions (transmission capacity purchase/sale, incl. PTR-Limited and nominations). Such data are not subject to disclosure and are collected by regulators to monitor the functioning of the market and identify any violations of competition rules.

Forward capacity allocation instruments on the electricity market

<i>PTR-Limited auction results for 2016</i>	<i>Sold capacity</i>	<i>Auction price</i>	<i>Actual price difference NPS EE-LV</i>	<i>System operators income/expense</i>
<i>Product name</i>	<i>(MW)</i>	<i>(EUR/MWh)</i>	<i>(EUR/MWh)</i>	<i>(EUR)</i>
PTR-L Y-2016	300	4.55	3.02	3,934,017.00
PTR-L Q1-2016	100	2.42	4.81	-523,037.00
PTR-L Q2-2016	50	4.54	3.25	140,974.50
PTR-L Q3-2016	50	3.74	3.81	-7,945.50
PTR-L Q4-2016	100	2.18	0.25	398,774.00
PTR-L Jan-2016	100	3.4	12.38	-668,387.00
PTR-L Feb-2016	150	3.03	1.38	172,570.50
PTR-L Mar-2016	150	2.11	0.46	183,957.00
PTR-L Apr-2016	150	0.59	0.98	-42,525.00
PTR-L May-2016	100	1.16	4.42	-242,314.00
PTR-L Jun-2016	150	3.22	4.31	-117,448.50
PTR-L Jul-2016	150	3.1	7.35	-474,139.50
PTR-L Aug-2016	150	3.66	2.39	142,218.00
PTR-L Sept-2016	150	1.89	1.63	27,933.00
PTR-L Oct-2016	150	2.03	0.93	122,625.00
PTR-L Nov-2016	150	2.7	-0.39*	291,600.00
PTR-L Dec-2016	150	0.36	0.17	20,221.50

* The price in the NP LV price area was lower than in the NP EE price area. As PTR-Limited constitutes an option from Estonia to Latvia, the deemed price difference is 0.00 EUR/MWh

In 2016, PTR-Limited auctions on the Estonia-Latvia border were organised by the transmission system operators of Estonia and Latvia (Elering and Augstspriguma tikls (AST), respectively) in accordance with the European Harmonised Allocation Rules (EU HAR). 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 the 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. Transmission system operators continue to provide PTR-Limited in 2017, increasing the annual auction volume to 300 MW for each hour.

PTR-Limited's total net expense(-)/income(+) for Elering in 2016 amounted to +1.68 million euros (2015: -5.73 million euros).

Summary of 2016 in NP Estonian price area

- The average price in the NP Estonian price area in 2016 was 33.06 EUR/MWh, which was 6.4% higher than the average price in 2015.
- The average NPS system price was 26.91 EUR/MWh, which was 28.3% higher than the average price in 2015.
- To cover domestic consumption in 2016, Estonian market participants purchased a total of 7.65 TWh of electricity from the day-ahead and intraday market, representing 93.7% of total domestic consumption.
- Of the 10.25 TWh of electricity produced in Estonia in 2016, 93.3% or 9.56 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 70.8% of hours (2015: 33.9%).
- The NP Estonian and NP Finnish price areas converged on the day-ahead market for 90.3% of hours (2015: 88%).

NP Estonian price area	2014	2015	2016
Openness of electricity market	100%	100%	100%
Eligible consumers	all	all	all
Volume of electricity bought on NP EE day-ahead market (TWh)	7.14	7.09	7.50
Volume of electricity sold on NP EE day-ahead market (TWh)	9.82	7.85	9.49
Congestion income from implicit auction between Estonia and Finland (MEUR)	2.39	4.18	2.37
Congestion income from implicit auction between Estonia and Latvia (MEUR)	38.91	31.93	9.35

* Since The NP ELE price area was opened on 18 June 2012

** Since 3 June 2013 total capacity has been allocated through an implicit auction

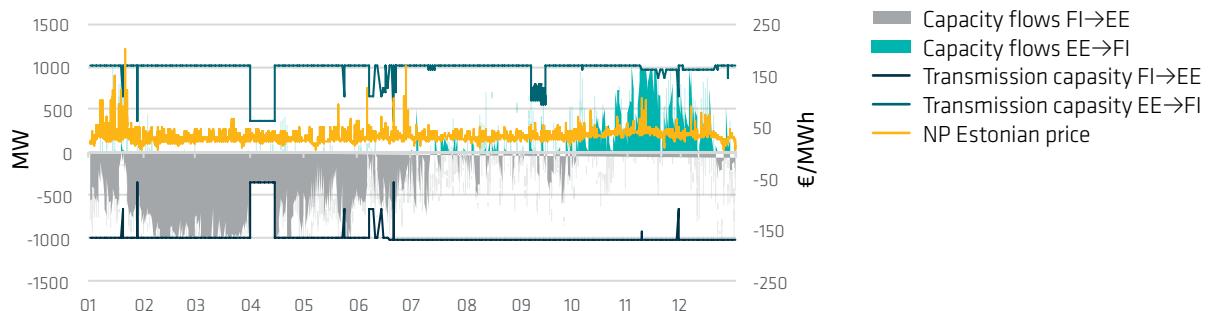
Volumes purchased from the Elbas (intraday) market totalled 144.7 GWh in 2016, accounting for 1.9% of the total volume purchased in the Estonian price area. The volumes sold during the year amounted to 70.4 GWh, accounting for 0.7% of the total in the NP Elspot and Elbas price area.

Compared to 2015, annual average electricity prices increased in all price areas except Latvia and Lithuania. The price increase compared to 2015 was mainly attributable to unfavourable conditions for hydro-power generation in the Nordic countries (low rainfall). Prices in the Lithuanian and Latvian price areas were impacted by lower-priced generation capacity entering the market as a result of the deployment of the new Lithuania-Poland and Lithuania-Sweden power lines at the beginning of 2016.

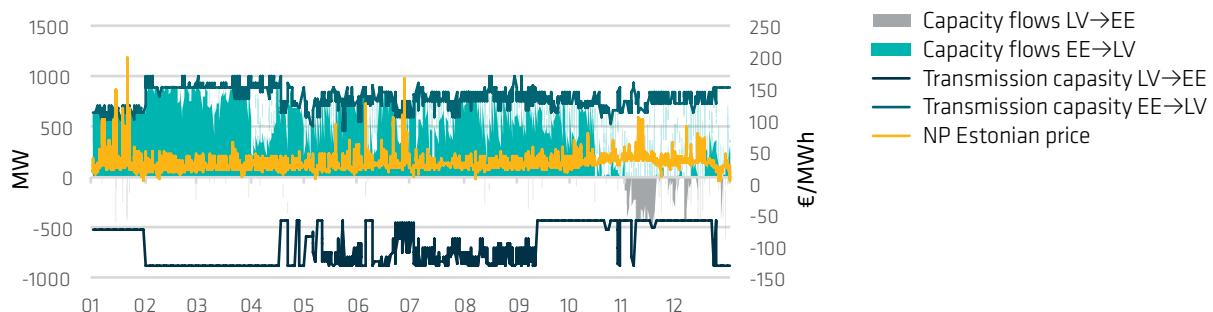
€/MWh	Price 2016			Price 2015
	Average	Max	Min	Average
NP System	26.91	199.97	7.45	20.98
NP Finland	32.45	214.25	4.02	29.66
NP Estonia	33.06	200.06	4.02	31.08
NP Latvia	36.09	202.04	4.02	41.85
NP Lithuania	36.54	202.04	4.02	41.92

The average price difference in 2016 between Estonia and Finland was just 0.62 euros and prices differed only 9.7% of the time. In comparison, prices in Estonia and Finland differed 12% of the time in 2015 and the average price difference was 1.43 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 3.02 euros higher than that in the Estonian price area (2015: 10.76 euros). In 2016, prices in the NP Estonian and NP Latvian price areas differed during 29.2% of hours, while in 2015 prices differed 66.1% of the time.

In the first half of 2016, capacity flows were predominantly from Finland to Estonia; whereas in the final months of the year it was mostly the other way round. For the year as a whole, flows from Finland to Estonia amounted to 69.5% of hours and from Estonia to Finland 24.2% of hours. On the basis of day-ahead trading data, the EstLink interconnections between NP Estonia and NP Finland were divided from Finland to Estonia at maximum capacity for 10.4% of hours (2015: 11.7%) and from Estonia to Finland for 0.3% of hours (2015: they did not operate at maximum capacity at any time).

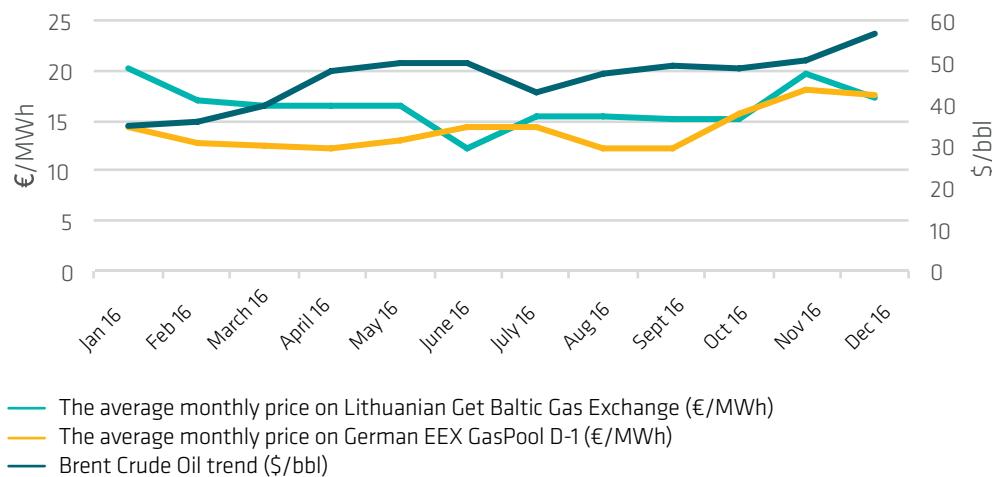


Cross-border trade between Estonia and Latvia for 2016 as a whole mainly flowed from Estonia to Latvia: flows in this direction represented 92.3% of hours, with electricity supplied from Latvia to Estonia in just 5.3% of hours. On the basis of day-ahead trading data, the NP Estonian and NP Latvian interconnections flowed at maximum capacity from Estonia to Latvia for 30.4% of hours (2015: 66.1% of hours) and after intraday trading for 21.4% of hours (2015: 54.8% of hours). In normal mode (i.e. during the time transmission capacity was not limited because of maintenance) there was a transmission capacity bottleneck during 0.5% of hours (2015: 5%).



Market prices of natural gas

The decline in natural gas prices that resulted from the global oil price decline in 2015 had been somewhat alleviated by the end of 2016. Although there is no natural gas exchange in Estonia, market participants are able to trade on the Lithuanian gas exchange GET Baltic, where the price declined from €20.15/MWh at the beginning of the year to €17.30/MWh (-14%) by December. For the purposes of comparison, the figure below also indicates average monthly German EEX GasPool gas exchange day-ahead transaction prices and Brent oil prices (\$/bbl).



Renewable energy in 2016

Total renewable energy generation in 2016 amounted to 1,412 GWh and accounted for 15.1% of total consumption of electricity. Biomass accounted for 785 GWh and wind power contributed 590 GWh. The total generation of solar energy is insignificant but the number of producers almost doubled year-on-year, reaching close to 700.

Renewable energy, GWh	2016	2015	Change %
Total renewables	1,412.3	1,506.9	-6%
Wind energy	590.0	694.4	-15%
Hydroelectric power	34.6	26.6	30%
Waste, biomass	784.9	784.4	0%
Solar	2.8	1.6	76%

The generation of 1,203 GWh of renewable energy was subsidised, resulting in a total payout of 69 million euros. Elering is further simplifying and automating the process of registering generation equipment and applying for subsidies for small producers and other producers of renewable energy. An electronic registry of subsidies and production will be added to the existing certificates of origin registry. The objective is to record and communicate to consumers on an ongoing basis what technology and fuel were used to generate and consume electricity.

The Estonian registry of certificates of origin administered by Elering was used to issue certificates of origin for approx. 90% of the renewable energy generated for the purpose of being able to prove the origin of electricity generated. The trading of certificates of origin domestically and between countries is also active: more than 2.8 TWh in transfers of certificates of origin occurred in 2016.





Operation of the Estonian Energy System

61 GWh

IMPORTS OF THE ELECTRICITY SYSTEM
IMBALANCE ENERGY

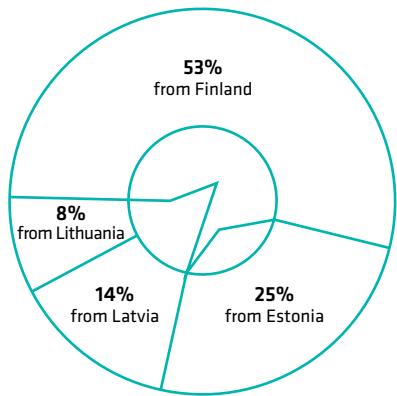
153 GWh

EXPORTS OF THE ELECTRICITY SYSTEM
IMBALANCE ENERGY

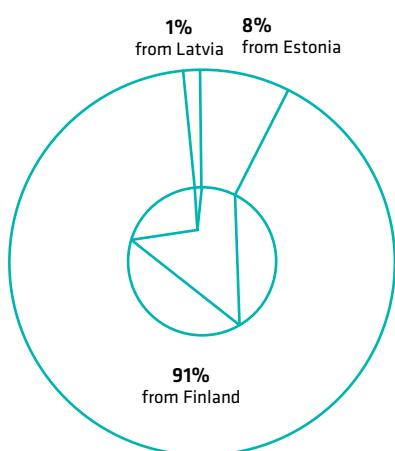


MÄRT ALLIKA
Head of the Energy System Control Centre

Distribution of upward regulation deliveries to maintain balance of Estonian electricity system (incl. activated emergency reserves) by country in 2016



Distribution of downward regulation deliveries sold to maintain balance of Estonian electricity system by country in 2016



Operation of the Estonian Electricity System

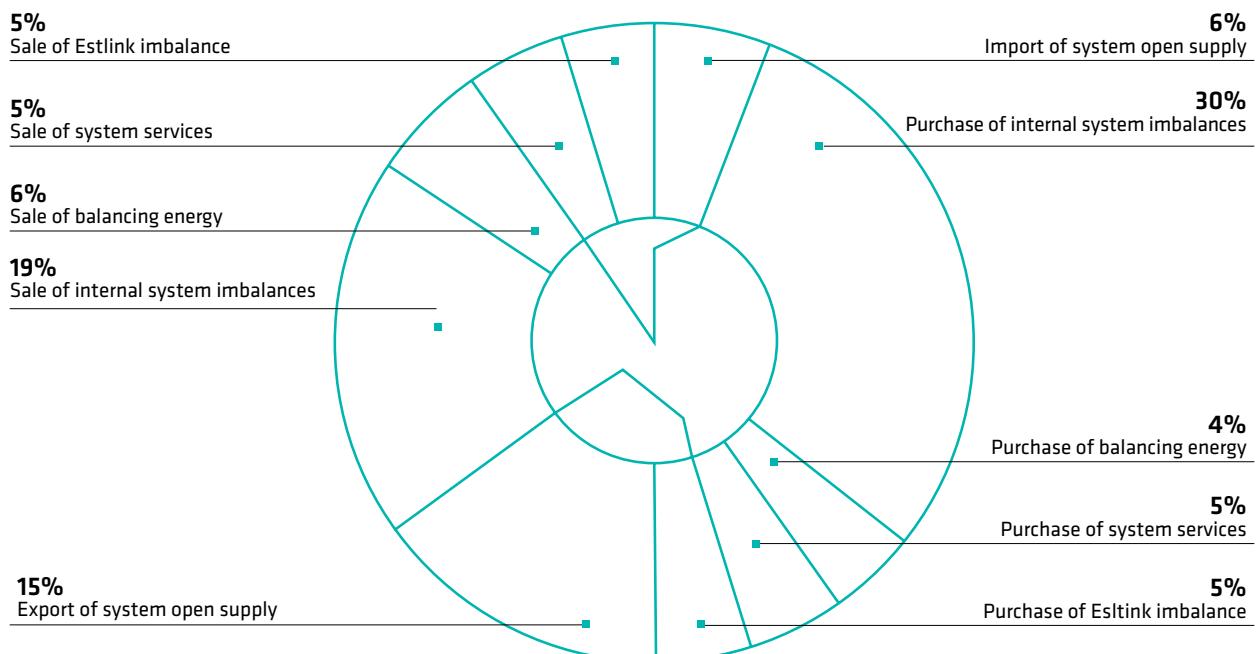
Balancing deliveries

Purchases by the transmission system operator from balance providers decreased by 5% compared to the previous year, whereas the volume of imbalance energy sold to cover the balance providers' deficit increased by 11%. Overall in 2016, cross-border imports of imbalance energy by the Estonian electricity system amounted to 61 GWh, increasing by 6% compared to the year before. Cross-border exports of system imbalance energy also grew by 6%, to 158 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 to a total volume of 47 GWh. Approximately 53% of activated upward regulation deliveries were purchased from Finland through the EstLink interconnections. Upward regulation deliveries purchased domestically accounted for 25%, followed by 14% and 8% for purchases of regulation energy offered by the transmission system operators of Latvia and Lithuania, respectively. During 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 to a total volume of 62 GWh. 91% of such deliveries were sold to the Finnish electricity system.

In 2016, the volume of system service sales declined by 28% and purchases of system services declined by 30%. The declines in these transactions were primarily attributable to the decrease in countertrade deliveries. Total countertrade deliveries for 2016 amounted to 10.99 GWh, of which 1.29 GWh were carried out to compensate for emergency trippings occurring in the EstLink interconnectors between Estonia and Finland, and 9.70 GWh was transacted to mitigate overloading on cross-border transmission lines between Estonia and Latvia. The balance of system service deliveries constituted regulation services resold mainly to the Lithuanian transmission system operator.

Balance settlement deliveries in 2016



Prices of imbalance energy

The highest sale price of imbalance energy was EUR 200.56/MWh, recorded on January 21 between the hours of 9.00 a.m. and 10.00 a.m. During that hour, the price was set by the average Baltic Elspot price (the same price in all Baltic price areas during this hour), which is used as a reference for the offsetting of Baltic system imbalances.

The lowest purchase price of imbalance energy in 2016 was EUR -2.00/MWh, which was registered on December 24 between 7.00 a.m. and 8.00 a.m. and which was due to the price of downward regulation deliveries to balance the Estonian electricity balance during that hour.

The total Estonian electricity system imbalance was 218.93 GWh, of which 36% was traded within the single coordinated balance area on the basis of the arithmetic average of Baltic Elspot prices.

Imbalance energy prices 2016, EUR/MWh

	Average price	Max. price	Min. price
Sale price of imbalance energy	34.92	200.56	1.54
Purchase price of imbalance energy	32.01	199.55	-2.00

Imbalance energy prices 2015, EUR/MWh

	Average price	Max. price	Min. price
Sale price of imbalance energy	32.40	216.20	0.54
Purchase price of imbalance energy	28.85	215.20	-6.00

Operation of the Estonian Natural Gas System

Cross-border natural gas flows and peak consumption

The Estonian natural gas transmission network has three border points that enable cross-border trade: Karksi, Värska and Narva. Below we provide an overview of the maximum physical natural gas flows by month and the transmission capacities available in border points during the occurrence of peak gas flows.

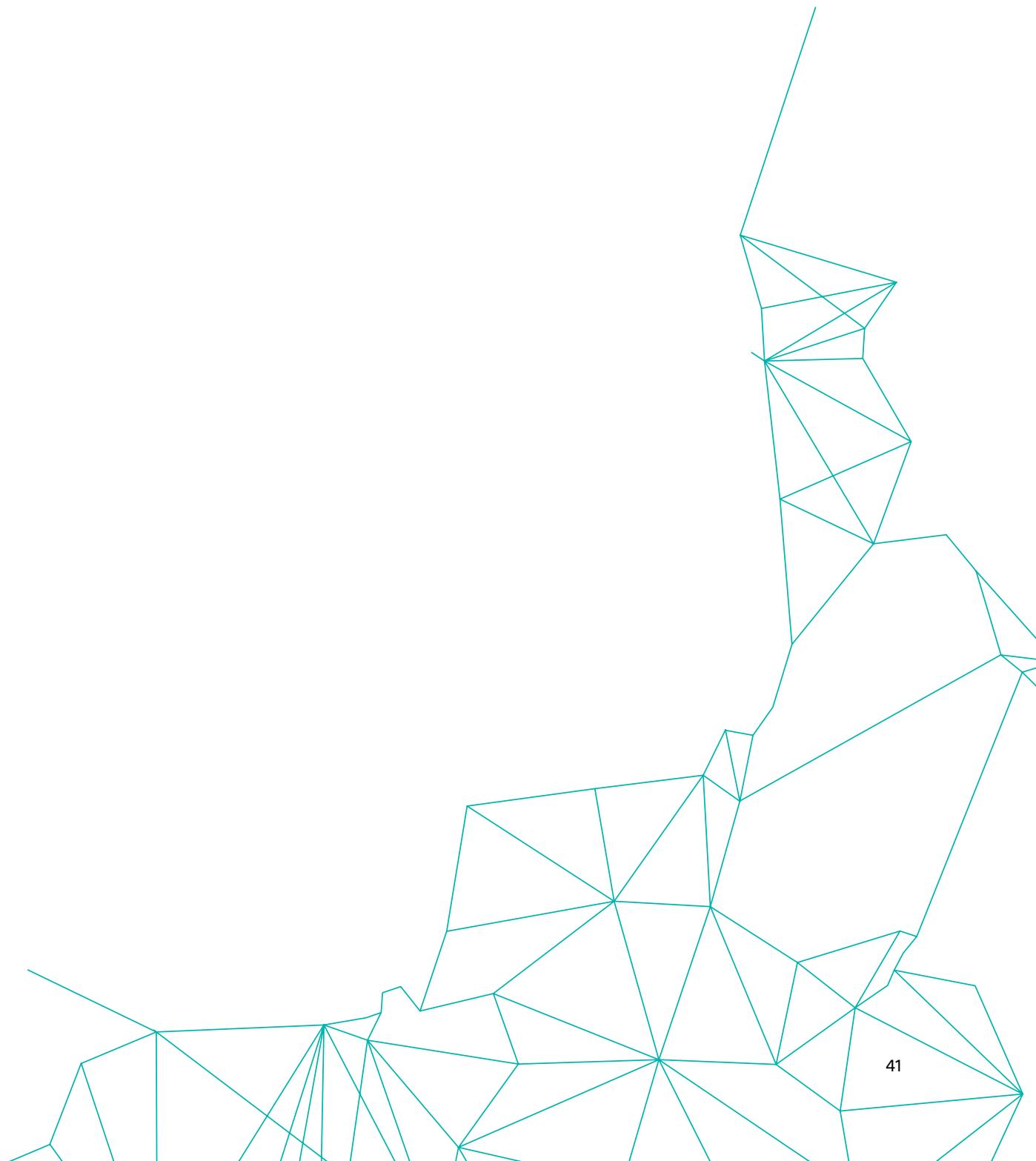
Maximum natural gas flows and transmission capacity of the Estonian natural gas transmission network in 2016

Month	Karksi gas metering station			Värska gas metering station			Narva pipeline		
	Peak gas flow per day MWh	Transmission capacity MWh	Capacity utilisation %	Peak gas flow per day MWh	Transmission capacity MWh	Capacity utilisation %	Peak gas flow per day MWh	Transmission capacity MWh	Capacity utilisation %
January	52,190	68,570	48.9	0	29,190	0	0	10,710	0
February	26,850	73,500	30.5	0	29,610	0	0	11,870	0
March	29,510	73,500	27.6	0	30,660	0	0	11,970	0
April	18,300	73,500	19.6	0	30,350	0	0	12,710	0
May	10,780	73,500	10.2	0	28,350	0	0	13,440	0
June	6,460	72,660	1.6	6,610	30,140	17.2	0	4,200	0
July	8,350	73,500	5.6	8,860	15,440	10.0	0	13,230	0
August	9,650	73,500	2.8	7,540	34,180	11.3	0	12,500	0
September	7,800	73,900	1.9	8,860	42,200	12.8	0	12,900	0
October	18,500	57,120	4.8	19,670	30,765	42.6	0	14,385	0
November	15,460	56,217	4.3	24,070	25,515	72.4	0	12,747	0
December	12,600	57,593	2.6	27,640	29,295	66.8	0	12,999	0

The cross-border transmission capacity allocated for trading was below the maximum theoretical transmission capacity due to the lower actual pressure levels in the Estonian, Latvian and Northwest Russian natural gas pipelines.

The peak day with maximum natural gas throughput was recorded at 52,740 MWh (average capacity of 2,196 MW) on 8 January and minimum daily natural gas consumption was recorded on 6 August when only 4,284 MWh was consumed. As the winter of 2016 only had colder temperatures briefly at the start of the year, the peak of consumption was also modest, nevertheless accounting for 77% of the operational Karksi gas metering station capacity and 49% of the overall Estonian capacity. The Värska gas metering station was closed at the time. The peak day recorded by the Värska gas metering station was on 11 December at 27,556 MWh per day, accounting for 90% of its capacity on that day.

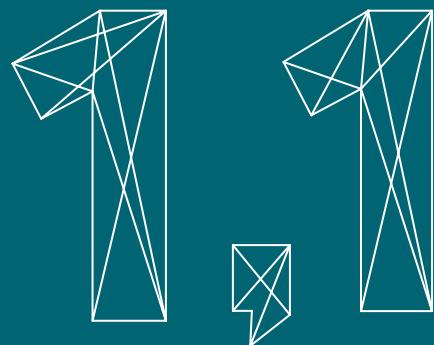
In 2016, natural gas was additionally imported through Lithuania, including gas from Gazprom in Belarus, to the extent of 7.6%. Furthermore, balance providers used natural gas that they stored in the Latvian Inčukalns natural gas storage facility for 0.6% of the total imported natural gas volume. A further 0.2% of natural gas was purchased from the Latvian transmission system operator.







Research and Development



MILLION EUROS CONTRIBUTION
TO R&D



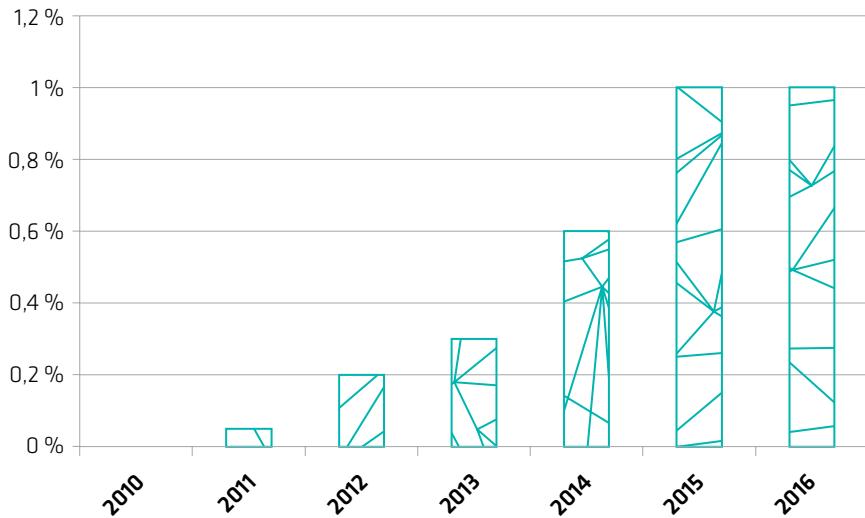
KALLE KUKK
Strategy Manager

Elering has prepared an annual research and development (R&D) plan and a corresponding budget since 2012. The company is also a member of the R&D committee of ENTSO-E and is involved 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, which was the level that was reached in 2015.

In its strategy, Elering has defined smart grid development 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 most likely 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 standpoint of transmission system development but in fact serve the interests of society more broadly. 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

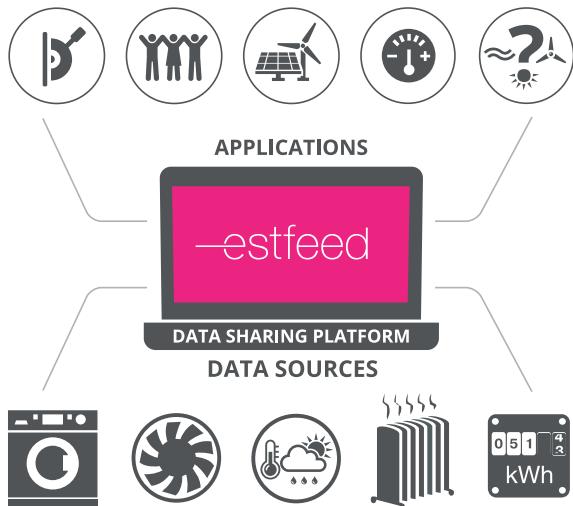


R&D and technical research expenditure by functionality, 2013-2017

	2013 actual	2014 actual	2015 actual	2016 actual	2017 budget
Development	11,472	5,003	131,394	540,360	489,000
Base and applied research	284,482	380,799	593,132	530,699	603,003
Total research & development	295,954	385,802	724,526	1,071,059	1,092,003
Technical studies	404,901	88,793	32,173	28,239	210,500
TOTAL	700,855	474,595	756,699	1,099,298	1,302,503

R&D and technical studies expenditure by field of study, 2013-2017

	2013 actual	2014 actual	2015 actual	2016 actual	2017 budget
Smart grid	187,916	356,803	570,526	661,359	519,000
Desynchronisation	363,025	0	0	0	48,003
Security of supply	12,400	28,999	140,000	258,600	531,000
Market arrangement	94,500	0	14,000	0	50,000
Natural gas	21,065	65,644	0	80,000	100,000
Other	21,950	23,149	32,173	99,339	54,500
TOTAL	700,855	474,595	756,699	1,099,298	1,302,503



Elering's smart grid platform Estfeed

The energy system is undergoing transformational change in Europe and globally. Among other trends, it is worth highlighting 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), 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 exponential growth in information flows in the energy system. Energy network operators must adapt to the new conditions

and 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 those market participants who are intent on providing such efficiency. The cheapest, most environmentally friendly and 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 energy system transformation, Elering has established a network of companies that it intends to leverage to develop the Estfeed smart energy network platform. This 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 through 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 platform will be opened to all interested parties, including consumers and application developers, in spring 2017.

Flexibility services platform prototype

The final objective of the study is to create a flexibility services platform prototype through the use of actual data from a specific pilot area for the purposes of network limit management. There must be good prospects for the further development of the platform and its implementation nationwide in Estonia, as well as regionally. In the best case scenario, the platform will be capable of meeting other energy system flexibility needs (on the wholesale, intraday, regulated, capacity and reserves markets) and opportunities provided by DSR.

Expected benefits of study:

- Bottlenecks have been determined related to the connection of additional consumption and generation to the grid together with the resulting need for DSR.
- More detailed potential for DSR has been determined on the basis of the sample pilot area.
- Benefits from the implementation of DSR have been estimated, which will be achievable from the implementation of network limit management through deferral or withdrawal of network capital expenditure.
- The scope, specifications and requirements necessary for the launch of Phase Two of the project that are essential for the procurement of the software solution for the platform prototype have been developed.
- The flexibility services platform prototype has been developed – as detailed a description as possible of the platform architecture, software suites used, models and databases and the link and rules between them.
- The extent of the investments that need to be made in the establishment and maintenance of the technical capabilities necessary for consumption management has been estimated.
- Proposals have been drafted for reaching an agreement on information sharing, reports and standards between parties.
- A preliminary analysis has been completed on the identification of problem areas involving the existing regulation and proposals have been made for the amendment of the regulation

MIGRATE – Massive InteGRATion of large power Electronic devices

In 2015, a joint project of European transmission network operators and other partners was approved for funding. It will be funded from the Horizon2020 programme of the European Union and 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 long-term time horizon. The short-term perspective will address today's electricity system and the technical solutions 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 would make this possible.

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

The objective of this project is to evaluate the socio-economic impact of transitioning to electricity- and natural gas-powered transport on Estonian society. Transitioning to such transport 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 the development scenarios of the Estonian transport sector, an 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.

Impact of electric transport on power quality

The objective of this project is to continue the study of electric transport that was carried out from 2012-2014. Said study only focused on cases involving the normal configuration, with potential impact analysed within such a framework. As part of the planned project, cases involving failures will be addressed, including various N-1 cases whereby the resistance of the network changes and causes changes to the transmission of harmonics and unbalance in the power grid. The dynamics of the power quality indicators will be addressed and the transmission of unbalances within dynamic applications will be evaluated. The objective is to achieve an understanding of dynamic mutual impact between dielectric strength, power quality and various types of consumers within the transmission network. The project will provide additional models and principles that must be taken into consideration in electric railroad connections. Knowledge of the mutual impact of various types of loads and the power grid and, in particular, dynamic processes is essential from the point of view of network management and analysis. The suitability of the dynamic process analysis methodologies that have been used to date in unbalanced process conditions will also be clarified. Therefore, the impact of the electric railway and the requirements defined in the future connection process will be able to be evaluated with improved accuracy on the basis of the knowledge gained. In addition, supplementary information will be gathered on the analysis of the dynamic operation of various types of consumers in the management and planning of the transmission network.

Static and dynamic characteristics of the Estonian power system load

This project aims to define 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 operation. Performing the calculations will enable the capacity of lines, the dynamic limits of the power system and other issues related to stability to be defined more accurately. 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 from quality analysis tools, fault counters and the wide-area monitoring system will also be used in the definition of the dynamic characteristics of loads. The load characteristics will be analysed using the measurement data and the static and dynamic load characteristics of Estonian power system substations will be defined, taking into consideration the technical requirements of the calculation software PSCAD and PSS/E. The project will make use of scientific methods to define 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 will be assessed based on the 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 transmission 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 that the stability reserve of the system is analysed.

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, 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. Should the study produce positive results, Elering AS will be able to use the methodology under development 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.

Natural gas consumption study

Elering, in its role as a combined transmission system operator of electricity and natural gas, is responsible for the markets and transmission network of both energy sources. A long-term forecast of natural gas consumption represents much-needed input for the effective and optimal management of the natural gas transmission network and for the planning of capital expenditure. The forecast is used for the assessment of Estonia's security of supply, the planning of capital expenditure involving existing infrastructure and the planning of supplementary natural gas network connections. The objective of the completed study was to prepare a long-term natural gas consumption forecast that would meet the requirements of the aforementioned uses. The study prepared a natural gas consumption forecast until 2025 and analysed both optimistic and pessimistic developments in natural gas consumption so as to reflect the factors having the greatest impact on natural gas consumption. The base case forecast of natural gas consumption does not call for any significant changes to natural gas consumption in the short term.

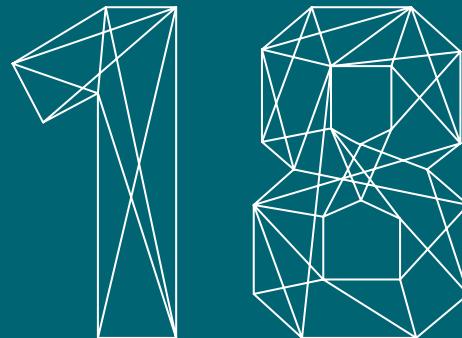
Impact of biomethane on steel transmission pipelines

The large-scale introduction of biomethane into the natural gas transmission network (steel pipeline) has only become particularly relevant in Europe in the last decade, which is why greater attention has only recently been turned to the problems involved. In general, the approach to the adding of biomethane has been limited to the assumption that the concentration of corrosive compounds created upon mixing it with natural gas will remain below the danger threshold. Another important factor for Estonia is the low level of natural gas consumption, which in turn means that no mixing of gases occurs and the concentration of biomethane in certain pipeline sections (the Pärnu pipeline) is up to 100% of total capacity. However, no study has been completed to date that could be used as a basis for the claim that biomethane is either safe or dangerous for the pipeline or how higher concentrations of corrosive compounds impact the useful lives of equipment. The study determined that biomethane meeting the quality specifications applicable in Estonia does not have a significant damaging effect on the transmission pipeline. It is important to emphasise that the added gas must meet the applicable quality specifications and that the occurrence of moisture in the pipeline must be avoided at all costs. This study addressed the impact of biomethane on the transmission network, but the impact on consumers' installations may differ.





Social Responsibility



CONTEST ENTRIES WERE SUBMITTED
TO THE DESIGN PYLON IDEA CONTEST

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 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.

Grants awarded in 2016

- Negavatt competition on resource and energy efficiency organised by the Environmental Investment Centre: Students were encouraged to submit clever project ideas to the contest, which was being held for the third time, with the aim of helping to reduce the consumption of resources and energy at or close to their university. Negavatt aims to improve the awareness of energy efficiency among university students and faculty members, to encourage green innovation at universities (including social innovation) and to generate environmentally responsible discussion.
- Publishing of textbooks of Tallinn University of Technology titled "Energiatarbimise juhtimine ja säästlik korraldamine" and "Energia ringkäiklooduses"; organising an international conference titled "Electric Power Quality and Supply Reliability Conference"; purchasing "Clean Energy Trainer" study materials/billboards; organising Energy Week, professional and information days and open days.
- Creation of an exhibit for Väätsa municipal government's Renewable Energy training centre that simulates the operation of power networks (a miniature model of Elering's day-to-day activities).
- Lennart Meri Conference organised by the International Centre for Defence and Security. The main topic of the 2016 conference was "Shaping the New Normal". Energy was discussed as part of topics titled "Oil, War and Politics: Trends in the Global Economy" and "Climate, Security and Supply: How sustainable is the EU's energy security strategy?".
- Supporting the prize pool and organisation of the Ajugaht 2015-2018 competition. Elering's participation in the project is in line with its strategy of promoting research, development and education in the field of energy.

Elering's energy grant

In 2016, Elering awarded two grants for the study of energy-related subjects. Grants were awarded to doctoral students from Tallinn University of Technology and the University of Tartu whose topics of research were the following:

- Opportunities and limitations of relay protection and automation equipment in power system automation
- Overview of complex hydride-carbon composite materials for hydrogen storage

Design pylon idea contest

In 2016, Elering partnered with the Estonian Association of Architects to organise a contest for ideas aimed at finding the best architectural solution for the design pylon of the third power transmission line between Estonia and Latvia.

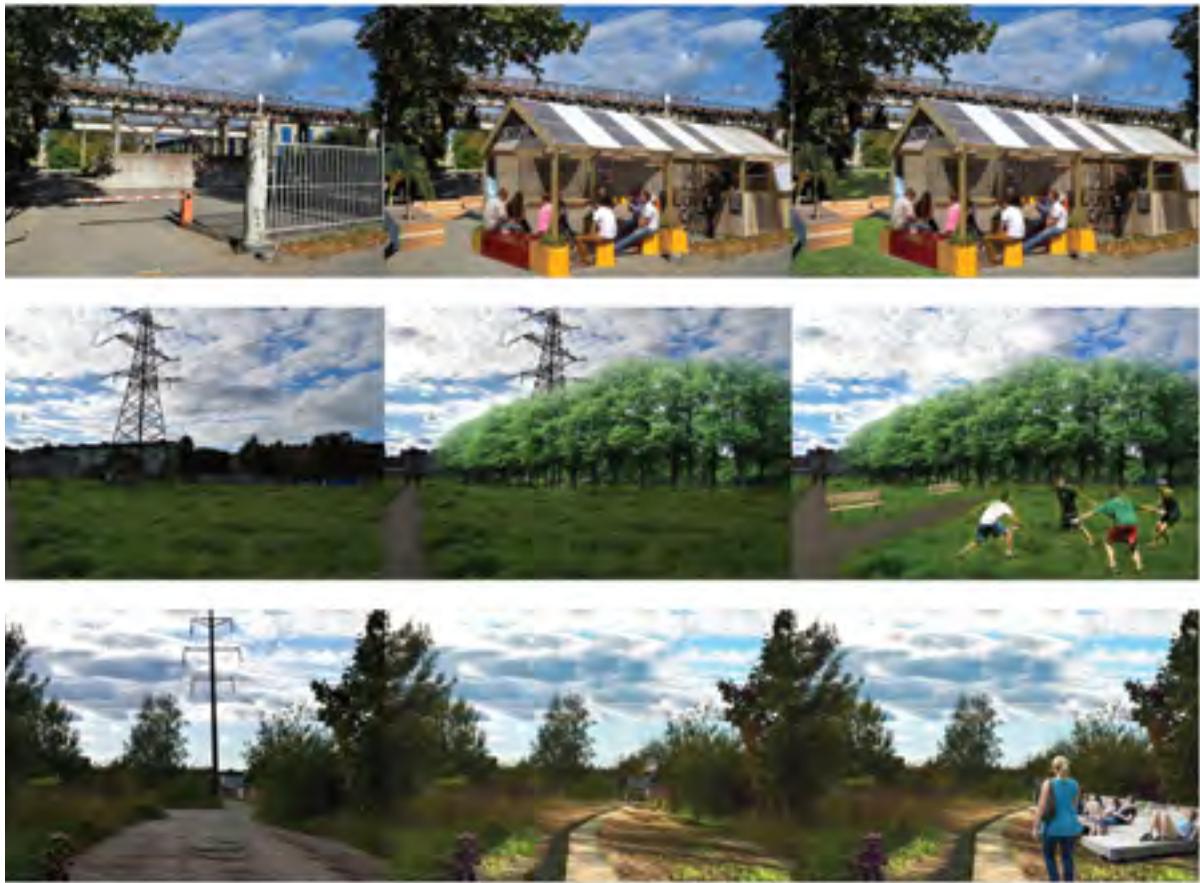
The planned pylon is the corner pylon of the Harku-Lihula-Sindi 330/110 kilovolt high-voltage power transmission line near Risti in Lääne County. As the pylon will be located in the area between the protected Kuistlema wetlands and the high-traffic Ääsmäe-Haapsalu and Risti-Virtsu roads, the objective of the contest was to develop the most architecturally and functionally appropriate solution for the location, one that would naturally blend into the surrounding environment.

Among the 18 proposals submitted by 15 participants, a concept titled Soorebane by architects Sille Pihlak and Siim Tuksam from OÜ Part was named the winner. The contest also received entries from Austria, Denmark and the United Kingdom.

Elering partnered with Viru Keskus shopping centre to organise an exhibition in the second half of August in the centre to exhibit the contest entries. The contest was named the Purchase of the Year at the Estonian Design Awards 2016.

Sille Pihlak and Siim Tuksam "Saarebane", OÜ Part 2016





Kaspars Lucinskas "Future Visions", Estonian Academy of Arts 2016

Converting urban overhead power lines to underground cable

Elering has launched a project in Tallinn for converting old urban overhead power lines to underground cable with the aim of increasing safety and improving aesthetics due to less clutter. Elering is concerned about the living environment and would like those areas newly cleared of overhead power lines to be repurposed in a comprehensive way that benefits city residents. The Estonian Academy of Arts has joined Elering in its quest by using the subject of overhead power line route corridors in its studies. Students of Urban Studies at the academy proposed ideas for the development of areas newly cleared of overhead power lines in the autumn semester in 2016.

Conference on security of supply

Elering has been organising conferences on security of supply 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 of the company make presenta-

tions at the event. There were several international presenters at the 2016 conference, including Stefan Moser, Head of Unit - Security of Supply, European Commission DG Energy (with a presentation titled "Improvement of European Security of Supply") and Jussi Jyrinsalo, Senior Vice President at the Finnish national electricity transmission grid operator Fingrid (with a presentation titled "Synchronisation of Baltic States with Nordic Countries - a Realistic Possibility?").

Promotion of energy education

Elering aims to promote education in the field of energy and raise overall awareness related to energy. It organises paid one- to two-month traineeship programmes annually for university students obtaining energy-related degrees. Students from schools and universities also have the opportunity to explore various facilities at Elering (emergency reserve power plants and substations) and the Energy System Control Centre. During 2016, Elering employees also visited schools to explain the functioning of the Estonian electricity system to students. Tabivere Lower Secondary School and Rakvere High School of Sciences were among the schools visited.





A photograph of a woman with blonde hair, wearing a pink blazer and black pants, walking away from the camera down a carpeted hallway with wooden doors.

Corporate Governance Report



In 2016, the Management Board of Elering approved the updated Corporate Governance Code¹. This code is a set of recommendations that are meant to be followed mainly by stock exchange companies.

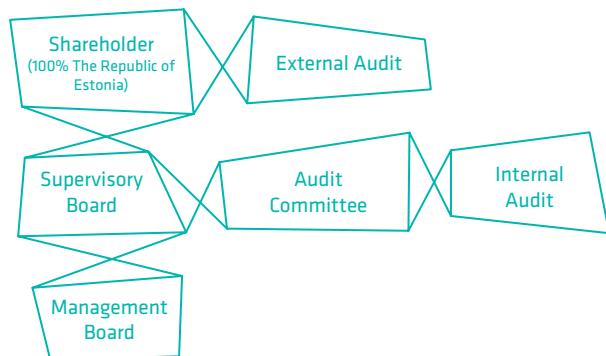
Elering is dedicated to following the Corporate Governance Code and wishes to grow further in this area. We consider this a prerequisite for achieving our strategic goals and shaping our organisational culture.

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



100% of the shares in Elering are owned by the Republic of Estonia.

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 for 2016 was held on April 26. 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 Ando Leppiman, Timo Tatar, Priit Tinit, Kätlin Atonen and Regina Raukas.

At the meeting, decisions were made with regard to approving the annual report for 2015, paying out dividends and distributing retained profits.

¹ The Corporate Governance Code initiated by Tallinn Stock Exchange and the Financial Supervision Authority was released in 2015.

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 and 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 situation, as well as important circumstances related to economic activities, and informs the Supervisory Board of important circumstances related to 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 enters into 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 2016, the Management Board of Elering comprised three members:

- Taavi Veskimägi – 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 – Member of the Management Board. His responsibilities include the position of Chief Financial Officer, managing the accounting and finance of Elering.
- Kalle Kilk – 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 entered into 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 on the basis of a resolution of the Supervisory Board. The 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.

Elering does not disclose the pay of members of the Management Board individually due to the confidentiality provisions contained in their 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 in 2016 was EUR 485 thousand (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 entering into their contract of service, or as soon as 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 entered into with them.

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, informing it 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 entered into 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 2016.

Supervisory Board

The owner's interests in the company are guaranteed by the 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 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 a chairman, who 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 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 2016 the Supervisory Board held four regular meetings:

- April 6: Approval of annual report, approval of Supervisory Board report, overview of performance of core activities, transactions involving registered assets, change in members of Audit Committee
- June 8: Overview of four-month financial results, overview of general meetings, transactions involving registered assets, election of Chairman of Supervisory Board, change in members of Audit Committee
- September 28: Overview of eight-month financial results, approval of Elering strategy and risk assessments, transactions involving registered assets, change in members of Audit Committee
- December 19: Approval of operating budget and capital expenditure budget, overview of ten-month financial results, transactions involving registered assets, changes in members of Audit Committee

In 2016, the following persons were members of the Supervisory Board of Elering:

- Kajar Lember (politician) – Chairman of the Supervisory Board until May 30: attended one meeting;
- Timo Tatar (Head of the Energy Department, Ministry of Economic Affairs and Infrastructure) – Chairman of the Supervisory Board from June 8: attended four meetings;
- Priit Alamäe (entrepreneur), until February 17: attended no meetings;
- Thomas Auväär (Head of the Financial Markets Department, Ministry of Finance): attended four meetings;
- Indrek Kasela (entrepreneur), from August 21: attended 2 meetings;
- Tarmo Mänd (politician), until December 15: attended 3 meetings;
- Ando Leppiman (Deputy Secretary General for Energy and Construction, Ministry of Economic Affairs and Infrastructure), from December 15: attended 1 meeting.

The remuneration paid to the members of the Supervisory Board of Elering AS in 2016 was EUR 28 thousand (incl. social taxes). This remuneration 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 meet 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 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 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. The members of the committee are the members of the Supervisory Board of Elering.

In 2016 the Audit Committee met four times: on April 6, June 8, September 28 and December 19. The committee addressed the following internal audits that were carried out: electricity balance management audit; financial risk management audit; audit of employees workload engaged in administration of natural gas transmission network; and risk management audit.

Cooperation between 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 provides 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. 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 is 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.

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

From 2012-2016 Elering's external auditor was AS PricewaterhouseCoopers. A new tender for the appointment of an auditor shall be held in spring 2017. The company is guided by the legislation of the Republic of Estonia, the ISA and auditor risk management regulations in performing external audits, including the Directive of the European Commission related to the field of audit that came into force in 2016.

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 the 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 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, equal treatment 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 continuously improve 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 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 were provided to the company by KPMG Baltics OÜ. As a result of a tender held in 2016, KPMG Baltics OÜ, the bidder who offered the lowest price, will provide the service of internal audit to Elering for the next three years. 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, including the Directive of the European Commission related to the field of audit that came into force in 2016.

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

Equal treatment

As a system operator, Elering bears responsibility for the system 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 the legislation of the Republic of Estonia and of the European Union (including network codes), has compiled various standards, conditions, methodologies and other rules that have been published on the company's website and approved by the Estonian Competition Authority.

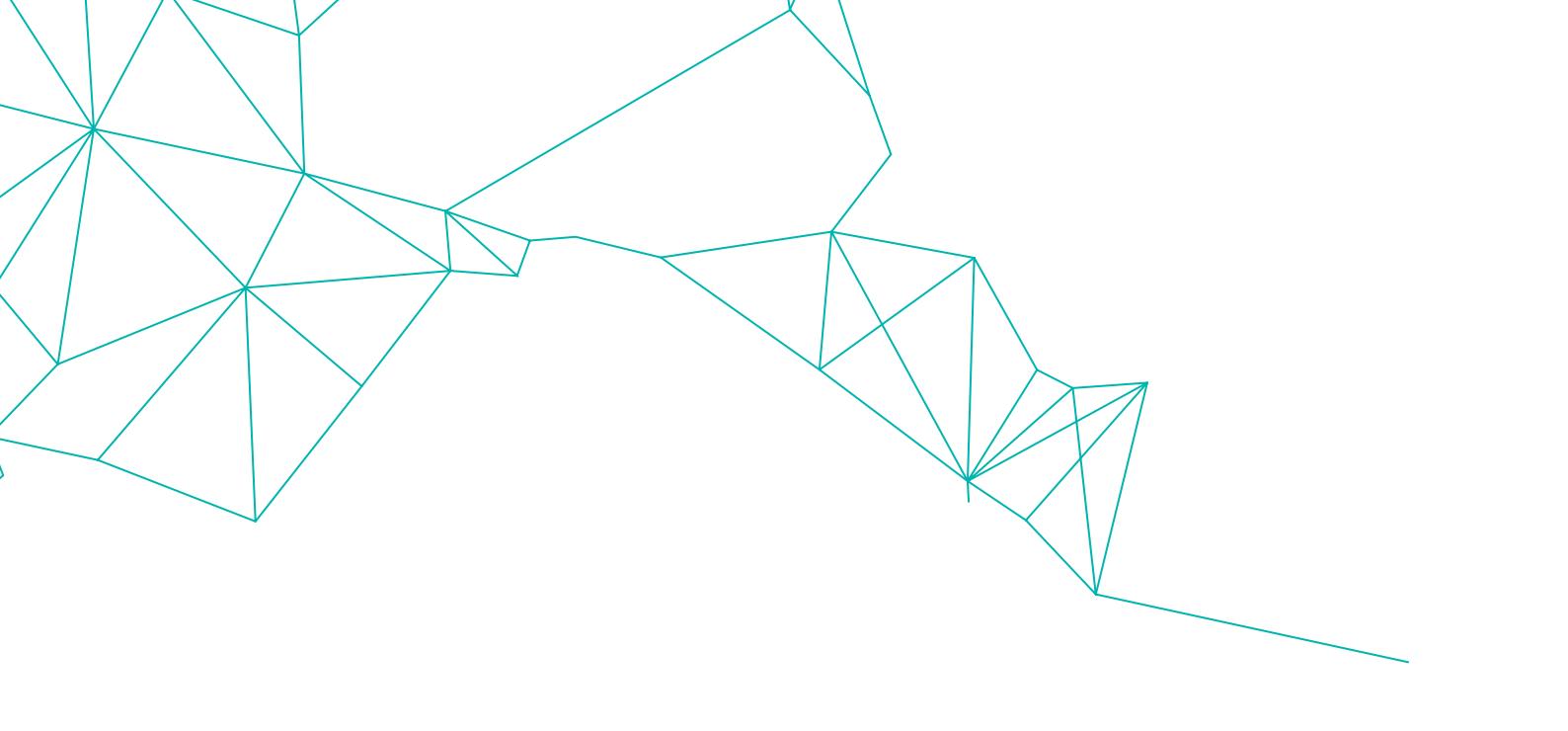




Balance with the Natural and Living Environments



OPREY NESTS HAVE BEEN FOUND
FROM ELERING'S 330KV LINE TOWERS



Elering is one of the largest infrastructure companies in Estonia. We acknowledge our responsibility to operate in a way that ensures the conservation of Estonia's natural environment and sustainable and prudent use of existing resources. We therefore wish to set a good example to others. In addition to strict compliance with applicable requirements relating to the environment, we consider it important to take a broader and more comprehensive approach to environmental impact. As such, we constantly develop and improve our activities to minimise impact on the surrounding natural and human environments. In 2016, no major environmental incidents took place involving Elering equipment.

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;
- we consume resources sustainably;
- we demand in our procurement documentation that our suppliers act in an environmentally sound manner and use environmental technologies; and
- the company's environmental policy and environmental aspects are public – any employee can distribute them freely outside the company.

Operations on power lines, gas pipelines and the protection zones thereof

In electricity transmission network management the maintenance of power lines is of great importance, involving technical maintenance, the regular clearing of brush and the felling of trees. The objective of line maintenance is to keep power lines in good condition so as to prevent breakdowns of equipment as well as high brush and tree growth, which create the risk of a short circuit between the ground and the line. Such a short circuit may cause forest fires, electrical injuries to people and animals and power interruptions. Maintenance of transmission networks is an ongoing process. Based on periodic inspection Elering decides on the maintenance needs of a particular line. A protection zone cleared of dangerous trees and high brush growth is paramount to prevent extensive environmental damage resulting from possible fires. Furthermore, thoroughly cleared protection zones help to limit the propagation of fire. In 2016, the company salvaged timber in the protection zones of overhead lines over a total surface of 155 hectares and cut brush over a total surface of 2,403 hectares.

Equipping overhead lines with bird barriers (mast gear) is an annual activity whose objective is to reduce the negative impact of overhead lines on birds on the one hand, and on the other hand to avoid the soiling of electrical equipment by birds, which may cut power lines off. In 2016, bird barriers were installed on 110 kV overhead lines over a distance of 314 kilometres.

There is another aspect related to bird activity: the 330 kV line towers of Elering are known to be home to seven osprey nests. In one case an osprey caused a short circuit on an overhead line, putting its life in danger and creating a fire risk. To prevent such dangers Elering worked with the Eagle Club to analyse the positioning of the osprey nests and considered the locations of two nests hazardous to the birds. Observing the conditions laid down by the Environmental Board, we have installed an artificial nest for the ospreys and removed one unused nest in close cooperation with the Eagle Club.

Upgrading and maintenance of the gas transmission network also play an important role in avoiding environmental damage. The greatest potential danger in gas pipes in the case of incidents is natural gas released into the air, and the resulting fire risk in particular. In the course of the work carried out in 2016, 305 metres of corroded gas pipes were replaced, including 154 metres in places where the pipeline is crossed by the Tallinn-Narva highway. 798 metres of

gas pipeline insulation was replaced. As a result the pipeline is more resistant to corrosion and safer for the environment. During the year, a total of 188,642 cubic metres of tail gas was released into the atmosphere to drain the pipeline in the course of replacing pipes and reconstructing tap nodes.

Deforestation and brush cutting in the protection zones of gas pipelines affected a total of 148 hectares of land. They were carried out to prevent the risk of injuries to gas installations caused by root systems and to ensure access to pipelines in the case of potential incidents. As with overhead lines, a clear protection zone of a gas pipeline helps to limit the propagation of fire in the event that one occurs.

Elering also contributes to safety by odourising gas to be placed on the market. At gas distribution stations, an odourant is added to gas to be supplied to the distribution pipeline system, which results in the characteristic odour and reduces the risk of accidents caused by gas leaks. Tetrahydrothiophene C4H8S is generally used as the odourant.

Substations and DC converter stations

The biggest environmental hazards where Elering substations are concerned are the oil that can leak from transformers, chemicals and hazardous waste (mainly batteries). Therefore it is extremely important that risks are mapped, 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 risks materialising. Any larger oil-filled containers belonging to Elering are equipped with oil traps or collectors to minimise the possibility of oil being released into the environment.

The electrical equipment of the transmission network uses over 13 tonnes of sulphur hexafluoride (SF6). SF6 is used mainly in electrical gear switches as it helps to extinguish electrical arches. However, SF6 contains Freon, which damages the ozone layer and therefore has a major impact on the environment. SF6 is constantly measured at substations, including during the inspection of high-voltage circuit breakers.

Elering's emergency reserve power plants

Importantly, the infrastructure administered by Elering also comprises the emergency reserve power plants near Kiisa. In 2016, the plants produced a total of 17.5 GWh of electricity per 207 working hours. The emergency reserves were activated 53 times. The quantity of carbon dioxide released into the air from the power plants totalled 8,200 tonnes during the year.

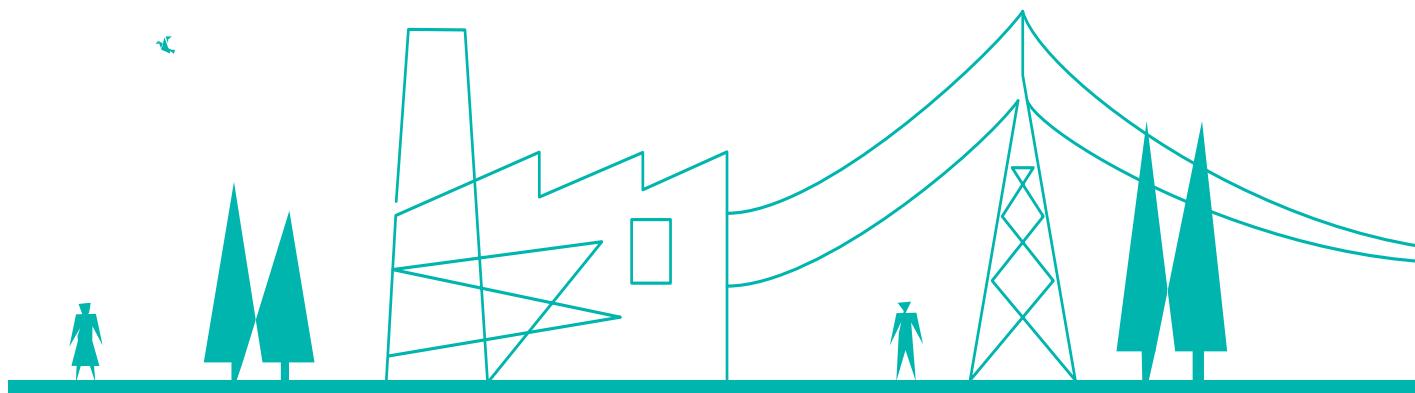
The emergency reserve power plants can produce electricity from both gaseous and diesel fuel. Gas is the primary fuel used in the plants, with the reserves of diesel fuel kept on the premises mostly being used as pilot fuel. In the event of emergencies where gas supplies are suspended, the power plant must be able to operate at full capacity for at least 60 hours using diesel fuel.

The emergency power plants are equipped with devices used for constant environmental monitoring. We periodically take water samples from nearby Soo Creek, carry out annual air pollution monitoring and periodically inspect the oil traps, the area of the fuel tanks and the piping. The drainage pipes of the power transformer area, the engine compartment and the area of diesel fuel containers are directed to an oil trap operating automatically, which must eliminate environmental pollution in the event of a possible breakdown in the technological equipment.

Electrical and magnetic field

In 2016, electrical and magnetic fields were measured at several of Elering's electrical installations at substations. The results of the measurements helped to identify and map the areas on the territory of the substations where time restrictions are imposed on the presence of people. The results reveal that outside the territory of Elering's electrical installations, electromagnetic field do not exceed the permitted limits. These limits are stipulated in regulations titled "Limits and measuring of non-ionising radiation levels in living and leisure areas, dwellings, classrooms and building in shared use" and "Occupational health and safety requirements on working environments impacted by electromagnetic fields, exposure limits, action values and measurement procedure for electromagnetic fields". In accordance with these regulations, the permitted limit of electromagnetic field in the human environment is 5 kV/m.

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.



Design pylon for Harku-Lihula-Sindi overhead line

In 2016, in cooperation with the Estonian Association of Architects, Elering organised a competition to find the best architectural solution for the design pylon of the Harku-Lihula-Sindi overhead line located near the village of Risti. In this location the future overhead line will cross the boundary of Kuistlema bog. The goal was to find a solution that would fit into the surrounding natural landscape so as to soften the visual impact of the power line and help acknowledge the growing dependence on electricity. The competition attracted 15 participants (several from abroad), who submitted a total of 18 entries. The jury – consisting of architects and designers and Elering's own representatives – declared the winner to be Soorebane (Marsh Fox) designed by young Estonian architects.

Replacing Tallinn's overhead lines with underground cables

A lot of overhead lines in the Tallinn transmission network are approaching the end of their useful life. These power lines were built decades ago when their suitability for and impact on the urban environment did not attract a great deal of attention. Today, the construction of new overhead lines in the densely populated areas of Tallinn is out of the question. Thus, Elering has launched a programme to replace overhead lines in Tallinn with underground cables, which are safer, entail considerably less stringent constraints and, unlike overhead lines, do not create visual pollution in public space. In 2016, preparations for establishing several new cable lines continued. Due to be opened in 2017, the cable line between the Veskimetsa and Järve substations will enable the dismantling of the 110 kV line connecting the same substations, which also passes across the Siili district in the suburb of Mustamäe. Several overhead lines passing through the suburbs of Õismäe, Mustamäe, Kristiine and Põhja-Tallinn are waiting to be replaced by underground cables.







Organisation and People

231

EMPLOYERS

15

AVERAGE LENGTH
OF EMPLOYMENT

44

AVERAGE AGE

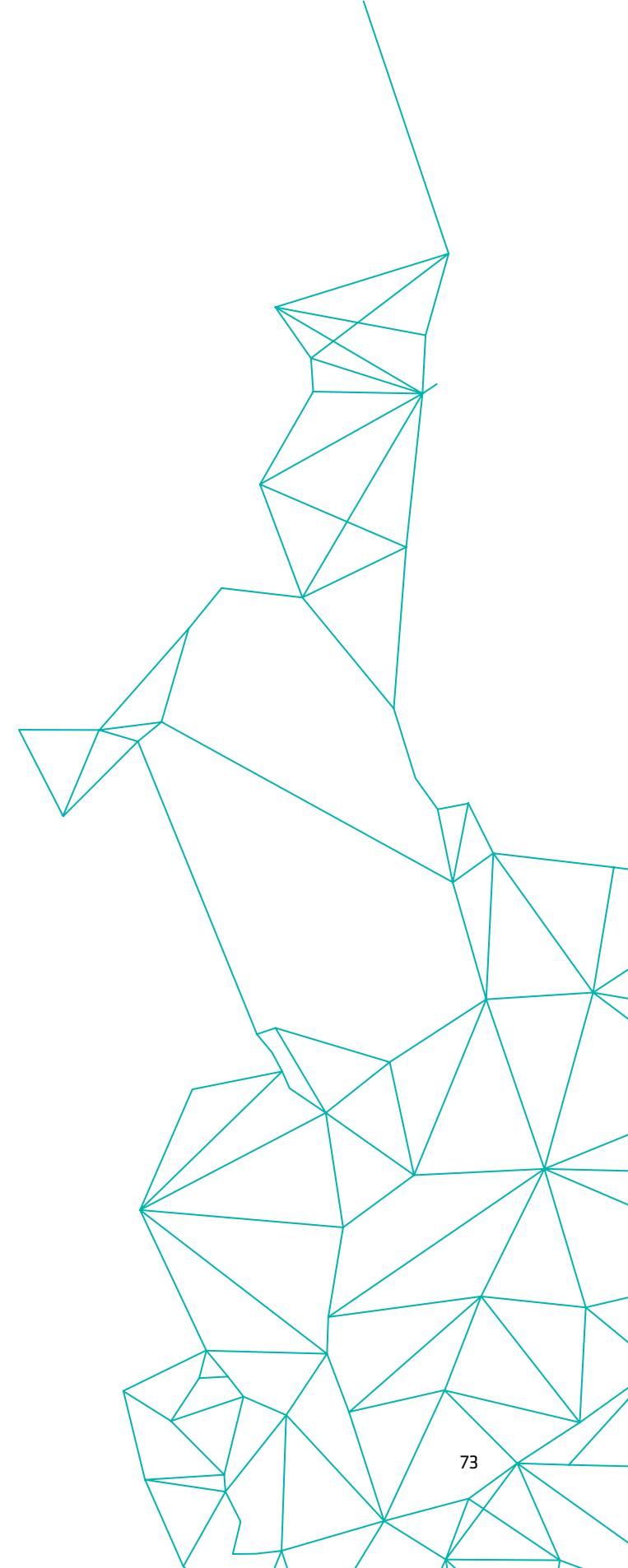
Our stable, highly educated and experienced staff form the foundation of Elering's sustainable economic growth.

At the end of 2016 Elering employed 231 people. The average length of employment is a little over 15 years and the average age of employees is 44. Over three-quarters of the workforce are men.

Elering is characterised by low employee turnover, being just 4.4% (voluntary turnover) in 2016. This is a strategically important indicator for the company due to the high level of competence required for its core business. The majority of our employees have higher education, and almost half have a Master's degree or PhD.

In early 2016, Elering and Elering Gaas merged to become one company. A new structure for a joint transmission system operator for electricity and gas was created and work organisation was reviewed in order to find synergies by joining similar strands of action in the fields of electricity and gas. Together with the company's managers, personnel management principles were laid down. This meant mapping the current situation in various fields of personnel management, describing the bottlenecks and trends related to workforce both within and outside of the company and laying down the strategic focus and development efforts for the following four years.

Contributing to the establishment of joint objectives and a shared view of the company, a yearly workshop was held early in the year, assembling all of the employees of the company for the first time. The previous year was summarised, the best employees were recognised and objectives for the new year were reviewed. To enhance cooperation and internal communication we organised various events and activities, from visits to major gas and electricity infrastructure, teamwork development events and training days to celebrating Elering becoming an independent company and Joint System Administrator Day as a new tradition. Besides work, Elering's employees in the gas and electricity sector are also active in sports, meaning we also got together at the company's joint sports day and honed our cooperation skills at a sporty summer event in August.

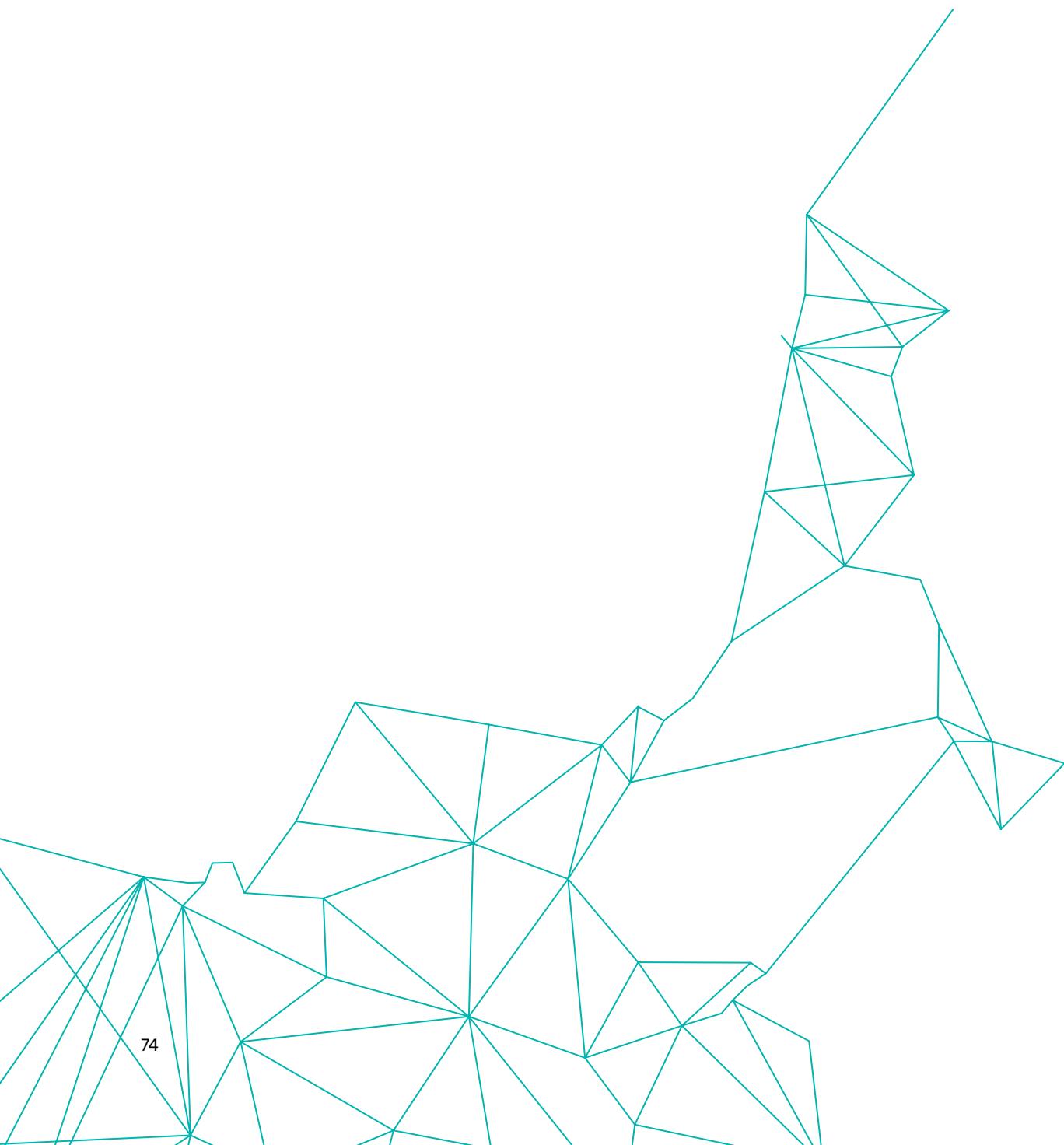
A large, abstract graphic element consisting of a complex network of teal-colored lines forming a three-dimensional, star-like or fractal-like geometric shape, centered on the right side of the page.

Within the next five years ca 20% of Elering's current employees will reach pensionable age, while fewer students are being accepted into specialities in the field of energy. To promote energy education and assist young people in entering the labour market, Elering works closely with universities. The annual traineeship programme in the field of energy consists of eight weeks of studies in different departments of Elering, plus field work. In 2016, seven trainees participated in the programme and three students were shown Elering's activities and processes in other areas. Elering has six employees with a Doctoral degree in the field of energy, and many of our employees also work as supervisors or lecturers at universities. Each year Elering also awards grants for education in the field of energy as well as for research work.

In 2016, we made preparations for the implementation of Elering's management system for results and development. The management process in this area provides for negotiations over objectives and indicators related to the company's work schedule in cooperation interviews, mid-term reviews during the year and evaluation of the results thereof at the end of the year. To introduce the company's strategic objectives we have involved more managers from different levels and specialists in discussions over strategies. A series of strategy seminars for Elering's young employees has received very positive feedback. In 2016, 13 managers participated in the development programme for Elering's managers so as to enhance management culture and implement shared management principles. This programme is continuing in 2017.

Development cooperation and management culture promoting the image of Elering as an employer and the description and execution of an action plan for talent management will continue as priorities into 2017.

Consolidated annual report



Consolidated statement of financial position	76
Consolidated statement of comprehensive income	77
Consolidated cash flow statement	78
Consolidated statement of changes in equity	79
Notes to the consolidated Financial Statements	81
Note 1 Elering AS and its operations	82
Note 2 Summary of significant accounting policies	83
Note 3 Critical accounting estimates and judgements in applying accounting policies	92
Note 4 New accounting pronouncements	93
Note 5 Financial risk management	95
Note 6 Segment reporting	100
Note 7 Bank accounts and deposits	101
Note 8 Trade and other receivables	102
Note 9 Inventories	103
Note 10 Property, plant and equipment	104
Note 11 Intangible assets	105
Note 12 Borrowings	106
Note 13 Trade and other payables	107
Note 14 Deferred income	108
Note 15 Equity	108
Note 16 Revenue	109
Note 17 Other income	110
Note 18 Goods, raw materials and services	110
Note 19 Other operating expenses	111
Note 20 Staff costs	111
Note 21 Financial income and costs	112
Note 22 Operating lease	112
Note 23 Balances and transactions with related parties	114
Note 24 Business combination	116
Note 25 Contingent liabilities and binding commitments	117
Note 26 Financial information on the parent company	118
Independent Auditor's Report	122
Profit allocation proposal	128
Signatures of the Management to the 2016 Annual Report	129
The revenue of Elering AS according to EMTAK 2008	130

Consolidated statement of financial position

In thousands of euros

Note 31.12.2016 31.12.2015

ASSETS

Current assets

Cash and cash equivalents	7	52,997	60,489
Restricted cash	7	21,778	0
Trade and other receivables	8	26,682	27,499
Inventories	9	3,543	3,361
Total current assets		105,001	91,349

Non-current assets

Available-for-sale financial assets	2	1,946	1,946
Long term deposits	7	40,000	0
Property, plant and equipment	10	751,621	764,726
Intangible assets	11	5,153	3,905
Total non-current assets		798,721	770,577

TOTAL ASSETS

903,722 **861,926**

LIABILITIES

Current liabilities

Borrowings	12	5,704	2,381
Trade and other payables	13	27,963	26,735
Total current liabilities		33,667	29,117

Non-current liabilities

Borrowings	12	361,685	376,796
Deferred income	14	159,296	126,655
Total non-current liabilities		520,982	503,450

TOTAL LIABILITIES

554,649 **532,567**

EQUITY

Share capital	15	189,890	149,890
Unregistered share capital	15	0	8,000
Statutory reserve capital	15	11,962	10,743
Retained earnings	15	147,220	160,726
TOTAL EQUITY		349,072	329,359

TOTAL LIABILITIES AND EQUITY

903,722 **861,926**

The notes on pages 82 to 121 are an integral part of these financial statements.

Consolidated statement of comprehensive income

in thousands of euros

	Note	2016	2015
Revenue	16	134,012	127,001
Other income	17	1,879	5,444
Goods, raw materials and services	18	-46,662	-40,682
Other operating expenses	19	-5,457	-5,390
Staff costs	20	-7,807	-7,807
Depreciation and amortization	10;11	-38,128	-37,007
Operating profit		37,841	41,560
Financial income	21	18	30
Financial costs	21	-11,395	-11,478
Profit before income tax		26,463	30,111
Income tax expense	15	-7,750	-5,000
Profit for the year		18,713	25,111
Total comprehensive income for the year		18,713	25,111
Profit attributable to:			
Equity holder of the parent company		18,713	24,381
Non-controlling interest		0	730

The notes on pages 82 to 121 are an integral part of these financial statements.

Consolidated cash flow statement

in thousands of euros

Note 2016 2015

Cash flows from operating activities

Profit before income tax		26,463	30,111
Adjustments for:			
▪ Profit from sale of property, plant and equipment	17	-32	-360
▪ Depreciation, amortisation and impairment	10,11	38,128	37,007
▪ Dividends received from long-term financial investments	17	-59	-58
▪ Government grants expended and amortised	17	-1,174	-1,186
▪ Interest expenses	21	11,390	11,470
▪ Interest income	21	-17	-30
▪ Negative goodwill	24	0	-1,509
▪ Changes in inventories	9	-182	-325
▪ Changes in receivables and prepayments related to operating activities	8	-70	-1,051
▪ Changes in liabilities and prepayments related to operating activities	13	1,972	-2,177
▪ Changes in deferred income from connection and other service fees	14	-895	648
Cash generated from operations		75,525	72,539
Income tax paid	15	-7,750	-5,000
Interest paid	13,21	-11,200	-11,458
Interest received	21	18	28
Net cash from operating activities		56,593	56,108

Cash flows from investing activities

Purchases of property, plant and equipment and intangible assets	10,11,13	-25,872	-39,797
Grants to acquire non-current assets	7, 14	0	15,280
Proceeds from sale of property, plant and equipment	10,17	510	1,817
Payments for acquisition of subsidiary, net of cash acquired	24	0	-26,584
Placing long term deposits	7	-40,000	0
Dividends received from long-term financial investments	17	59	58
Congestion fees received	8,13,14	12,600	29,048
Net cash used in investing activities		-52,703	-20,179

Cash flows from financing activities

Long-term bank loans received	12	0	31,968
Repayments of bank loans	12	-12,381	-1,190
Transactions with non-controlling interest	24	0	-26,087
Proceeds from contributions to equity	15	32,000	8,000
Dividends paid to company's shareholders	15	-31,000	-20,000
Net cash used in financing activities		-11,381	-7,309

Net increase/decrease in cash and cash equivalents		-7,491	28,620
Cash and cash equivalents at the beginning of the year	7	60,489	31,869
Cash and cash equivalents at the end of the year	7	52,997	60,489

The notes 82 to 121 are an integral part of these financial statements.

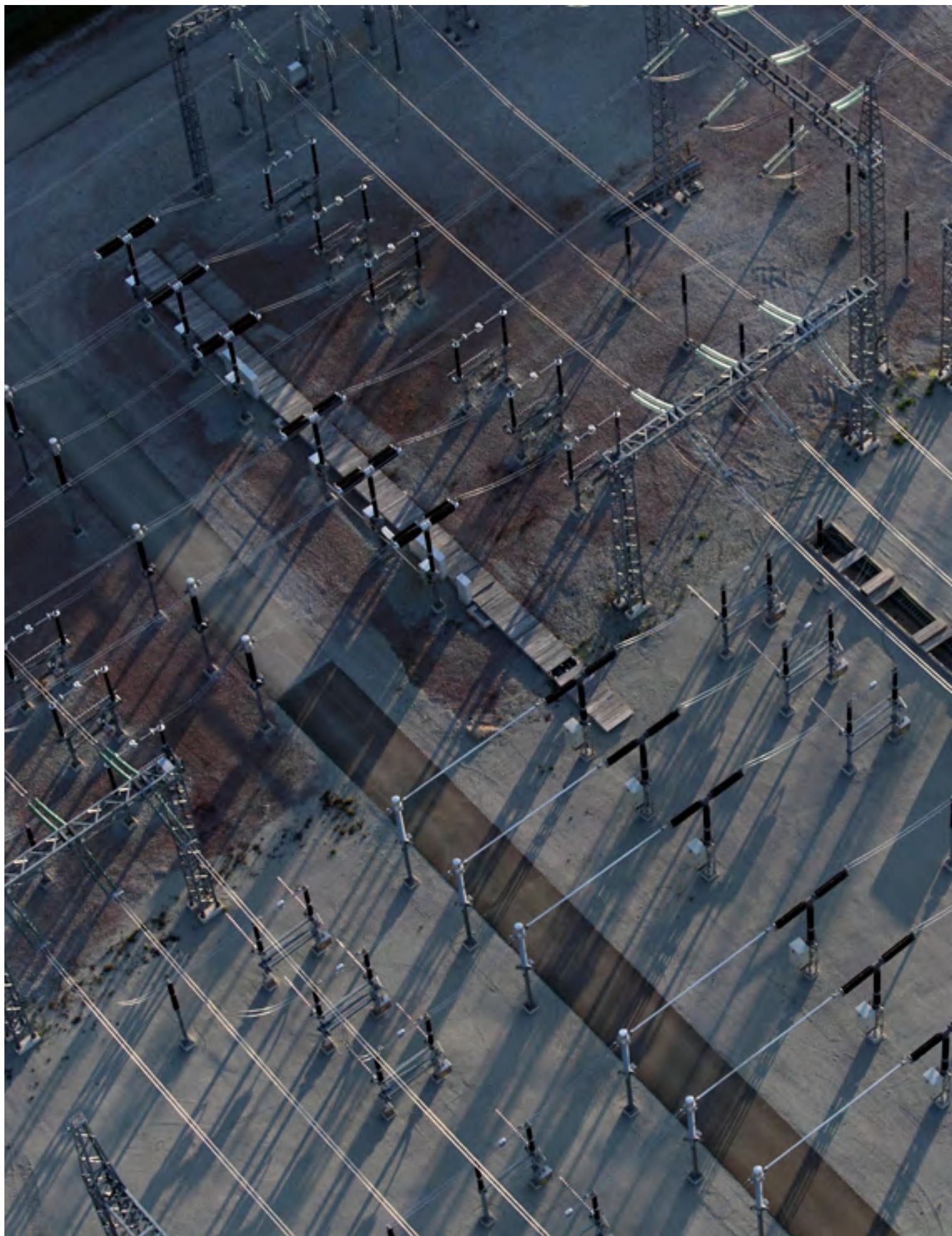
Consolidated statement of changes in equity

Attributable to equity holder of the 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 1.01.2015	149,890	0	8,706	156,223	314,820	0	314,820
Comprehensive income for financial year	0	0	0	24,381	24,381	730	25,111
Total comprehensive income for the period	0	0	0	24,381	24,381	730	25,111
Transactions with owners:							
Non-controlling interest arising on business combination (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
Contributions to equity	0	8,000	0	0	8,000	0	8,000
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
Total transactions with owners	0	8,000	2,037	-19,879	-9,842	-730	-10,572
Balance as of 31.12.2015	149,890	8,000	10,743	160,726	329,359	0	329,359
Comprehensive income for financial year	0	0	0	18,713	18,713	0	18,713
Total comprehensive income for the period	0	0	0	18,713	18,713	0	18,713
Transactions with owners:							
Contributions of equity	40,000	-8,000	0	0	32,000	0	32,000
Transfers to statutory reserve capital	0	0	1,219	-1,219	0	0	0
Dividends paid	0	0	0	-31,000	-31,000	0	-31,000
Total transactions with owners	40,000	-8,000	1,219	-32,219	1,000	0	1,000
Balance as of 31.12.2016	189,890	0	11,962	147,220	349,072	0	349,072

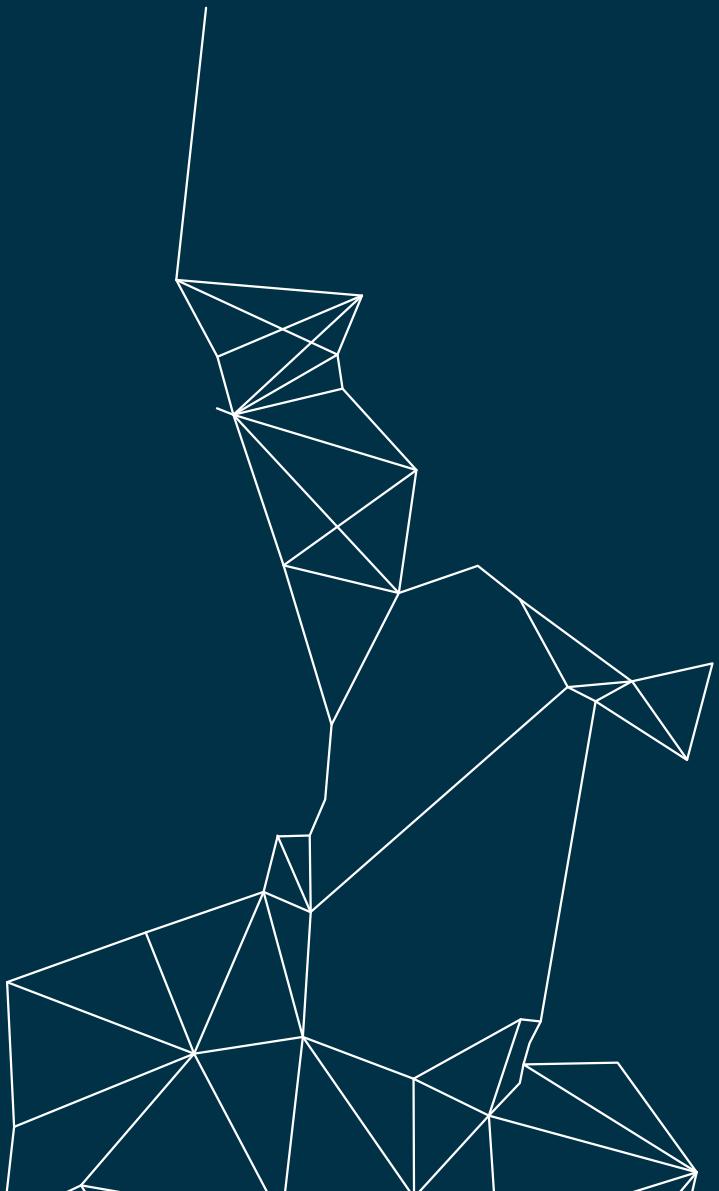
More detailed information on share capital and other equity items is set out in Note 15.

The notes on pages 82 to 121 are an integral part of these financial statements.





Notes to the Consolidated Financial Statements



Note 1.

ELERING AS AND ITS OPERATIONS

The financial statements of Elering AS (“Elering”) for the year ended 31 December 2016 have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union. Elering is incorporated in the Republic of Estonia and its registered address is Kadaka tee 42, 12915 Tallinn, Estonia. Elering is engaged in electricity and natural gas transmission in the Republic of Estonia.

In the period 1 January 2015 – 28 February 2016 Elering was a group that comprised the parent company Elering AS, hereinafter “parent company,” its subsidiary AS Võrguteenus Valdus and its subsidiary Elering Gaas AS (up to 10 April 2015: AS EG Võrguteenus). On 1 March 2016 Võrguteenus Valdus AS and Elering Gaas AS were merged with the parent company and from then Elering AS has been acting as one transmission system operator of electricity and natural gas. Throughout the annual report “Elering” has been used to identify the reporting entity, i.e. the Group for 01.01.2015-01.03.2016, and the parent company thereafter.

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

Elering Gaas AS was a subsidiary of Võrguteenus Valdus AS that was engaged in natural gas transmission in the Republic of Estonia. The merger had no impact to the consolidated numbers of Elering.

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

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

The Management Board approved these consolidated financial statements on 15 March 2017. Pursuant to the Commercial Code of the Republic of Estonia, the annual report shall be presented for approval to Elering’s Supervisory Board and the General Meeting of Shareholders.

Note 2.**SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Bases of preparation

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

Principles of consolidation**Subsidiaries**

A subsidiary is an entity controlled by Elering. Control is presumed to exist when Elering 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).

Elering applies the acquisition method to account for business combinations. The consideration transferred 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 the fair value of any asset or liability resulting from a contingent consideration arrangement. 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. Elering recognises any non-controlling interest in the acquiree on an acquisition-by-acquisition basis, either at fair value or at the non-controlling interest's proportionate share of the recognised amounts of acquiree's identifiable net assets.

The excess of the cost of acquisition over the fair value of acquirer'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 profit or loss.

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 Elering'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 Elering's chief operating decision maker. The chief operating decision maker responsible for the allocation of resources for business segments and the results of their operations is Elering's management board.

Functional and presentation currency

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

Foreign currency translation

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

Financial assets

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

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

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

As at 31 December 2016, Elering 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 2015, 'loans and receivables' and 'available-for-sale financial assets').

Loans and receivables

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

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

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

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

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

Available-for-sale financial assets

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

Available-for-sale financial assets entirely comprise of shares of Nord Pool AS (until 2016 AS Nord Pool Spot). The principal business activity of Nord Pool AS Group, registered in Norway, is the organisation of electricity exchanges in the Nordic countries, Great Britain and the Baltic States. The investment was made with a long-term strategic goal of taking part in the decision-making process concerning the development of electricity market in the Nordic-Baltic region.

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

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 Elering has obtained control of the asset and it is probable that future economic benefits associated with the asset will flow to Elering. Other prepayments are written off to profit or loss when the goods or services relating to the prepayments are received. If there is an indication that the assets, goods or services relating to a prepayment will not be received, the carrying amount of the prepayment is written down accordingly and a corresponding impairment loss is recognised in profit or loss.

Inventories

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

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

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

Property, plant and equipment

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

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

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

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

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

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

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

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

Intangible assets

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

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

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

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

Personal right of use

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

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

	<i>Useful lives in years</i>
Software licences	3-5 years
Personal rights of use	50-100 years

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

Impairment of non-financial assets

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

Leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made or received under operating leases are charged to profit or loss on a straight-line basis over the period of the lease.

Financial liabilities

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

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

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

Provisions and contingent liabilities

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

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

Development costs

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

Share capital

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

Dividends

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

Statutory reserve capital

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

Revenue 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

Elering measures the quantity of electricity transmission by remotely read metres in customers' connection points. The transmission service fees are calculated on the basis of the volumes of electricity transmitted in these points and regulated transmission tariffs.

Natural gas transmission service

Elering measures the quantity of natural gas transmission by remotely read metres in customers' connection points. The transmission service fees are calculated on the basis of the volumes of natural gas transmitted in these points and regulated transmission tariffs.

Electricity balancing service

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

Gas balancing service

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

Congestion income

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

1. Hourly auctions. Proceeds from the hourly auctions are essentially a price difference between Estonian and neighbouring countries electricity every hour, and they are allocated to counterparties through the Nord Pool power exchange.
2. Physical Transmission Right auctions (hereinafter PTR auctions). The market participant that buys transmission capacity at PTR auction held by Elering acquires the right for the hourly auction proceeds in the same amount. Elering distributes to the market participants hourly auction proceeds that was received from the power exchange, proportionate to the PTR transmission capacity that was acquired by the market participant.

Net proceeds 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 network tariffs.

If congestion proceeds are used for the construction of new interconnection capacities, then they are recognized in the financial statements similarly to the government grants. Initially, they are recognized as deferred income, and then are credited to income over the estimated useful life of the asset. If congestionproceeds are used for the reduction of tariffs, then proceeds are recognised in profit or loss during the period when Elering's right to receive proceeds from hourly and PTR auctions is established.. 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.

Accounting for government grants

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

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

Electricity inter-transmission system operator compensation mechanism (ITC).

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

Subsidies to electricity producers

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

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

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

Employee benefits

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

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

Income tax

According to the Income Tax Act, the annual profit earned by entities is not taxed in Estonia. Income tax is paid on dividends, fringe benefits, gifts, donations, costs of entertaining guests, non-business related disbursements and adjustments of the transfer price. The tax rate on the net dividends paid out of retained earnings is 20/80. 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.

Other taxes in Estonia

The following taxes had an effect on Elering's expenses in 2016:

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	1.1-2.5% on taxable value of land per annum
Excise tax on electricity	4.47 euros per MWh of electricity
Excise tax on gas	33.77 per thousand cubic meters
Corporate income tax on non-business related expenses	20/80 on non-business related expenses

Note 3.

CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

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

Useful lives of property, plant and equipment

The estimated useful lives of items of property, plant and equipment (Note 10) are based on management's estimates regarding the period during which the asset will be used. The estimation of useful lives is based on historical experience and takes into consideration production capacity and physical condition of the assets. Previous experience has shown that the actual useful lives have sometimes been longer than the estimates. In the reporting period, depreciation amounted to EUR 37,327 thousand (2015: EUR 36,185 thousand). If depreciation rates were increased/decreased by 10%, the depreciation charge for the year would increase/decrease by EUR 3,733 thousand (2015: EUR 3,619 thousand).

Congestion income

According to the accounting principles described in Note 2, timing of recognition of congestion income depends on the purposes for which the proceeds is used – for constructions of new interconnection capacities or reduction of current network tariffs. The purposes are outlined in the Article 16 of European Parliament and Council Regulation (EC) No 714/2009. Since 1 July 2014 Elering has determined that congestion income will be used for constructions of new interconnection capacities and thus has been deferring the income since that date. In 2016 Elering recognised deferred congestion income in the amount EUR 12,933 thousand (2015: EUR 28,635 thousands); see also Note 14. Amounts accrued since 1 July 2014 are used to finance investments in network that will increase the cross border interconnection capacity, i.e. the construction of the third electricity transmission line between Estonia and Latvia.

Note 4.

NEW ACCOUNTING PRONOUNCEMENTS

Adoption of new or revised standards and interpretations

The new standards, amendments to published standards and interpretations that became effective for Elering from 1 January 2016 had no effect on the financial statements and were not relevant with respect to Elering's business activity.

New or revised standards and interpretations

Certain new or revised standards and interpretations have been issued that are mandatory for Elering's annual periods beginning on or after 1 January 2017, and which Elering has not early adopted.

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

- Financial assets are required to be classified into three measurement categories: those to be measured subsequently at amortised cost, those to be measured subsequently at fair value through other comprehensive income (FVOCI) and those to be measured subsequently at fair value through profit or loss (FVPL).
- Classification for debt instruments is driven by the entity's business model for managing the financial assets and whether the contractual cash flows represent solely payments of principal and interest (SPPI). If a debt instrument is held to collect, it may be carried at amortised cost if it also meets the SPPI requirement. Debt instruments that meet the SPPI requirement that are held in a portfolio where an entity both holds to collect assets' cash flows and sells assets may be classified as FVOCI. Financial assets that do not contain cash flows that are SPPI must be measured at FVPL (for example, derivatives). Embedded derivatives are no longer separated from financial assets but will be included in assessing the SPPI condition.
- Investments in equity instruments are always measured at fair value. However, management can make an irrevocable election to present changes in fair value in other comprehensive income, provided the instrument is not held for trading. If the equity instrument is held for trading, changes in fair value are presented in profit or loss..

- Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The key change is that an entity will be required to present the effects of changes in own credit risk of financial liabilities designated at fair value through profit or loss in other comprehensive income.
- IFRS 9 introduces a new model for the recognition of impairment losses – the expected credit losses (ECL) model. There is a 'three stage' approach which is based on the change in credit quality of financial assets since initial recognition. In practice, the new rules mean that entities will have to record an immediate loss equal to the 12-month ECL on initial recognition of financial assets that are not credit impaired (or lifetime ECL for trade receivables). Where there has been a significant increase in credit risk, impairment is measured using lifetime ECL rather than 12-month ECL. The model includes operational simplifications for lease and trade receivables.
- Hedge accounting requirements were amended to align accounting more closely with risk management. The standard provides entities with an accounting policy choice between applying the hedge accounting requirements of IFRS 9 and continuing to apply IAS 39 to all hedges because the standard currently does not address accounting for macro hedging.

Elering is assessing if the new standard could impact the accounting for assets available for sale.

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

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

Elering is assessing if the new standard could impact the accounting for connection fees, balancing service revenues and congestion income.

IFRS 16, Leases (effective for annual periods beginning on or after 1 January 2019; not yet adopted by the EU). The new standard sets out the principles for the recognition, measurement, presentation and disclosure of leases. All leases result in the lessee obtaining the right to use an asset at the start of the lease and, if lease payments are made over time, also obtaining financing. Accordingly, IFRS 16 eliminates the classification of leases as either operating leases or finance leases as is required by IAS 17 and, instead, introduces a single lessee accounting model. Lessees will be required to recognise: (a) assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value; and (b) depreciation of lease assets separately from interest on lease liabilities in profit or loss. IFRS 16 substantially carries forward

the lessor accounting requirements in IAS 17. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently.

Elering is assessing if the new standard could impact the accounting for right-of-use assets.

Disclosure Initiative - Amendments to IAS 7 (effective for annual periods beginning on or after 1 January 2017; not yet adopted by the EU). The amended IAS 7 will require disclosure of a reconciliation of movements in liabilities arising from financing activities.

Elering is assessing if the new standard could impact the disclosure of borrowings in the 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 Elering.

Note 5.

FINANCIAL RISK MANAGEMENT

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

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

Financial assets

<i>in thousands of euros</i>	31.12.2016	31.12.2015
Cash and cash equivalents (Note 7)	52,997	60,489
Restricted cash (Note 7)	21,778	0
Long term deposits (Note 7)	40,000	0
Trade and other receivables (Note 8)	26,438	27,189
Available-for-sale financial assets	1,946	1,946
Financial assets	143,160	89,624

Financial liabilities

<i>in thousands of euros</i>	31.12.2016	31.12.2015
Trade and other payables (Note 13)	24,127	24,232
Borrowings (Note 12)	367,389	379,177
Total financial liabilities	391,516	403,409

Credit risk

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

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

<i>in thousands of euros</i>	31.12.2016	31.12.2015
Cash and cash equivalents (Note 7)	52,997	60,489
Restricted cash (Note 7)	21,778	0
Longterm deposits (Note 7)	40,000	0
Trade and other receivables (Note 8)	26,438	27,189
Total exposure of assets to credit risk in the consolidated statement of financial position	141,214	87,678

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

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

Credit risk concentration

Elering is exposed to concentrations of credit risk. Management monitors and discloses concentrations of credit risk by reports, which list exposures to counterparty with aggregated balances in excess of 5% of Elering's equity. On 31.12.2016, Elering had one counterparty (31.12.2015: one counterparty) with an aggregated receivables balance of EUR 18,942 thousand (31.12.2015: EUR 17,137 thousand) or 79% of the total amount of accounts receivable (31.12.2015: 68%).

In 2016 as well as in 2015 the major part of receivables was to the wholly state owned company who is monopolist in distribution network. Therefore Management believes that the credit risk arising from the concentration of receivables is not significant.

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

Market risk

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

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

Electricity price risk

For compensating network losses, Elering buys electricity primarily in the electricity exchange. The average electricity exchange price of the last period is used for calculation of network tariffs. In a situation where the exchange price differs from the one used for calculation of tariffs, the difference is not compensated in the next tariff period.

Elering does not expect the risk of potential loss to be high and therefore it does not use any financial instruments to mitigate this risk.

Price risk of natural gas

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

Currency risk

Currency risk is the risk that in the future fair value of financial instruments of cash flow will fluctuate due to changes in currency rates. As virtually all of Elering's transactions and balances are denominated in euros, Elering is not exposed to significant currency risk. Elering established separate limits for open currency positions depending on the currency and duration. Transactions in other currencies are insignificant; there were no financial instruments denominated in other currencies as of 31.12.2016 and 31.12.2015.

Interest rate risk

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

As of 31.12.2016 borrowings with fixed interest rate constituted 62% (as of 31.12.2015 59%) of all borrowings carried at amortised cost; the remaining 38% (as of 31.12.2015 41%) 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.

As at 31.12.2016 borrowings with a floating interest rate totalled EUR 143,274 thousand (as at 31.12.2015: EUR 155,606 thousand).

As of 31.12. 2016, if the interest rates of Elering's borrowings, that are exposed to the cash flow interest rate risk, had been 50 basis points (31.12.2015: 50 basis points) higher with all other variables held constant, profit for the year would have been EUR 716 thousand (2015: EUR 778 thousand) lower.

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

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

Liquidity risk

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

The table below shows liabilities on 31.12.2016 and 31.12.2015 by their remaining contractual maturity. The amounts disclosed in the maturity table are contractual undiscounted cash flows. The cash flows for borrowings subsequent periods are calculated on the basis of loan interest rates effective at balance sheet date.

The maturity analysis of financial liabilities on 31.12.2016 is as follows:

in thousands of euros	<i>On demand and less than 1 month</i>	<i>From 1 to 12 months</i>	<i>From 12 months to 5 years</i>	<i>Over 5 years</i>	<i>Total</i>
Liabilities*					
Trade and other payables (Note 13)	15,869	3,157	0	0	19,026
Borrowings (Note 12)	0	16,754	276,896	99,906	393,569
Total future payments	15,869	19,921	276,896	99,909	412,595

* including interest expenses

The maturity analysis of financial liabilities on 31.12.2015 is as follows:

in thousands of euros	<i>On demand and less than 1 month</i>	<i>From 1 to 12 months</i>	<i>From 12 months to 5 years</i>	<i>Over 5 years</i>	<i>Total</i>
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

Elering holds its money in bank deposits. As of 31.12.2016, Elering's total available cash and cash equivalents amounted to EUR 52,997 thousand (as of 31.12.2015: EUR 60,489 thousand) and other bank deposits EUR 21,778 thousand (Restricted cash) and EUR 40,000 thousand (Long-term deposits) (as of 31.12.2015 both: EUR 0). See further information in Note 7.

As of 31.12.2016 and 31.12.2015 Elering did not have undrawn borrowing facilities.

Capital Management

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

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

<i>in thousands of euros</i>	31.12.2016	31.12.2015
Equity	349,072	329,359
Total assets	903,722	861,926
Equity to asset ratio	39%	38%

Fair Value of Financial Instruments

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

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

Level 1. Quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2. Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly or indirectly;

Level 3. Inputs for the asset or liability that are not based on observable market data.

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

Financial assets carried at amortised cost

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

Liabilities carried at amortised cost

Carrying amounts of trade and other payables approximate their fair values (level 3).

The estimated fair value of bonds rate is determined using their quoted price (level 1). The estimated fair value of non-current borrowings with a floating interest rate (level 3) is determined using valuation techniques, based on expected cash flows discounted at current interest rates (0.35%) for new instruments with similar credit risk and remaining maturity.

Elering had the following borrowings as of 31.12.2016: bonds, the market value was EUR 241,290 thousand (nominal value EUR 225,000 thousand) and bank loans, the market value of which was EUR 143,429 thousand (nominal value EUR 143,429 thousand). The following borrowings as of 31.12.2015 consisted of bonds the market value of which was EUR 248,738 thousand (nominal value EUR 225,000 thousand) and bank loans, the market value of which was EUR 151,977 thousand (nominal value EUR 157,977 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. The majority of revenue is earned from provision of network and balancing services in the field of electricity and natural gas from the Elering-owned electricity and natural gas networks. The income taxes are allocated to electricity segment only.

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 (net profit plus income taxes, net finance cost, and depreciation and amortization) and net profit.

Elering is domiciled in Estonia. Non-current assets of Elering are located in Estonia. The result of Elering's revenue from external customers in Estonia is EUR 109,644 thousand (2015: EUR 105,541 thousand), and the total of revenue from external customers from other countries is EUR 24,368 thousand (2015: EUR 21,460 thousand). In the reporting period, Elering had one counterparty with an aggregated revenue more than 10% of Elering's consolidated revenue totalling EUR 81,180 thousand (2015: EUR 78,108 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	2016			2015			Total
	Electricity	Natural gas	Elimination between segments	Total	Electricity	Natural gas	
Revenue from external customers	124,148	9,864	0	134,012	118,013	8,988	0 127,001
Revenue between segments	0	70	-70	0	0	80	-80 0
Total revenue	124,148	9,934	-70	134,012	118,013	9,068	-80 127,001
Other income	1,848	30	0	1,879	3,908	26	0 3,934
Total income	125,996	9,965	-70	135,891	121,921	9,094	-80 130,935
Goods, raw materials and services	-45,257	-1,473	70	-46,661	-39,739	-1,024	80 -40,683
Other operating expenses including payroll expenses	-9,823	-3,438	0	-13,262	-10,166	-3,030	0 -13,196
EBITDA	70,916	5,053	0	75,968	72,016	5,040	0 77,056
Depreciation and amortization (Note 10, 11)	-34,906	-3,222	0	-38,128	-33,633	-3,374	0 -37,007
Net financial income (costs) (Note 21)	-10,493	-884	0	-11,377	-11,448	0	0 -11,448
Income tax (Note 15)	-7,750	0	0	-7,750	-5,000	0	0 -5,000
Net profit	17,767	946	0	18,713	21,935	1,666	0 23,601
Total assets	822,125	81,597	0	903,722	856,390	59,206	-53,670 861,926
Total liabilities	508,420	46,229	0	554,649	531,636	941	-10 532,567
Additions to property, plant and equipment (Note 10)	22,992	1,709	0	24,701	35,639	1,908	0 37,547
Additions to intangible assets (Note 11)	1,818	231	0	2,049	1,013	216	0 1,229

Revenue by geographical location of customers

in thousands of euros	2016			2015		
	Electricity	Natural gas	Total	Electricity	Natural gas	Total
Estonia	100,448	9,196	109,644	96,553	8 988	105,541
Norway	168	0	168	418	0	418
Latvia	2,971	0	2,971	2,860	0	2,860
Finland	3,898	0	3,898	3,875	0	3,875
Lithuania	10,982	0	10,982	7,338	0	7,338
Russia	0	668	668	215	0	215
Other	5,682	0	5,682	6,755	0	6,755
Total revenue	124,148	9,864	134,012	118,013	8,988	127,001

Note 7.

BANK ACCOUNTS AND DEPOSITS

in thousands of euros	31.12.2016	31.12.2015
Cash and cash equivalents	52,997	60,489
Restricted cash*	21,778	0
Long-term deposits**	40,000	0

* Financial aid allocated by the European Union to Elering for construction of cross-border gas transmission capacities is recorded in the financial statement under "Restricted cash". Under the agreement, these deposits are not allowed to be used for purposes other than specified in the agreement to finance the investments. The deposits will be not used to pay for the investments at least for three months after the balance sheet day.

** Long-term deposits at banks are recorded in the financial statement under "Long-term financial deposits". Three contracts in the amount of EUR 30,000 thousand have been concluded with Nordea Bank AB Estonia branch. Maturity date of these deposits is 19.01.2018 and the interest rate is 0.19%. One contract in the amount of EUR 10,000 thousand has been signed with Swedbank. The maturity date of the deposit is 20.01.2018.a and the interest rate is 0.1%. All contracts are denominated in euros.

Bank accounts and deposits

in thousands of euros	31.12.2016	31.12.2015
Bank accounts and deposits at banks		
with Moody's credit rating of Aa3	86,336	10,047
with Moody's credit rating of A2	1,004	24,035
with Moody's credit rating of A1*	27,436	26,407
Total bank accounts and deposits at banks	114,776	60,489

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

Note 8.

TRADE AND OTHER RECEIVABLES

in thousands of euros

31.12.2016 31.12. 2015

Trade receivables

Accounts receivable	26,437	24,960
· incl. PTR-Limited auction receivables	1,186	2,011
Other receivables	1	2,229
· Subsidies due from electricity producers (Note 2, 13)	0	2,227
· Interest receivables	1	2
Total financial assets within trade and other receivables in the consolidated statement of financial position	26,438	27,189
Tax receivables	4	7
Prepayments	240	303
Total trade and other receivables	26,682	27,499

Analysis by credit quality of trade receivables is as follows:

in thousands of euros

31.12.2016 31.12.2015

Accounts receivable not yet due

Distribution networks	21,658	19,512
Other clients	4,525	5,203
Total accounts receivable not yet due	26,183	24,715

Accounts receivable past due but not classified as doubtful (IAS 39)

-1 to 90 days overdue	254	245
Total accounts receivable past due but not classified as doubtful	254	245
Total accounts receivable past due	254	245
Total trade receivables	26,437	24,960

In the reporting period and in 2015, Elering did not write down any receivables. Further information on receivables from related parties is disclosed in Note 23.

Note 9.

INVENTORIES

in thousands of euros

	31.12.2016	31.12.2015
Fuel oil	2,351	2,442
Natural gas reserves	268	187
Natural gas balance	154	0
Other materials at warehouses	770	732
Total inventories	3,543	3,361

Elering 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	<i>Land</i>	<i>Buildings</i>	<i>Facilities</i>	<i>Machinery and equipment</i>	<i>Other</i>	<i>Construction in progress</i>	<i>Total</i>
Property, plant and equipment on 1.01.2015							
Cost at 01.01.2015	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 01.01.2015	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 01.01.2015	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 1.01.2015-31.12.2015	677	-1,679	58,276	-5,128	139	1,984	54,268
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
Movements 01.01.2016-31.12.2016							
Additions	117	0	0	10	0	24,236	24,363
Reclassified from construction in progress	0	537	11,943	11,899	6	-24,384	0
Capitalised borrowing costs (Note 21)	0	0	0	0	0	338	338
Disposals and write-offs at carrying amount	-13	0	0	-465	0	0	-478
Depreciation charge	0	-2,925	-15,531	-18,798	-73	0	-37,327
Transfers	0	0	-8,179	8,179	0	0	0
Total movements 01.01.2016-31.12.2016	104	-2,388	-11,767	825	-67	190	-13,105
Property, plant and equipment on 31.12.2016							
Cost on 31.12.2016	6,071	41,570	502,098	491,453	182	0	1,041,375
Accumulated depreciation	0	-7,578	-153,305	-145,944	-95	0	-306,922
Carrying amount on 31.12.2016	6,071	33,992	348,793	345,510	88	0	734,453
Construction in progress	0	0	0	0	0	17,153	17,153
Prepayments	15	0	0	0	0	0	15
Total property, plant and equipment on 31.12.2016	6,086	33,992	348,793	345,510	88	17,153	751,621

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 338 thousand (2015: EUR 487 thousand). The capitalisation rate was 3.2% (2015: 3.3%).

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

Note 11.

INTANGIBLE ASSETS

<i>in thousands of euros</i>	<i>Acquired software and licenses</i>	<i>Right of use of land</i>	<i>Total</i>
Intangible assets on 01.01.2015			
Cost at 01.01.2015	3,800	1,605	5,402
Accumulated amortisation	-1,980	-102	-2,082
Carrying amount on 01.01.2015	1,820	1,500	3,320
Intangible assets not yet available for use	54	0	54
Total intangible assets on 1.01.2015	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

Movements 1.01.2016-31.12.2016

Additions	2,039	10	2,049
Amortisation charge	-784	-17	-801
Total movements 1.01.2016-31.12.2016	1,255	-7	1,248

Intangible assets on 31.12.2016

Cost at 31.12.2016	5,828	1,612	7,440
Accumulated amortisation	-3,675	-135	-3,810
Carrying amount on 31.12.2016	2,153	1,477	3,630
Intangible assets not yet available for use	1,523	0	1,523
Total intangible assets on 31.12.2016	3,676	1,477	5,153

Note 12.**BORROWINGS**

<i>in thousands of euros</i>	<i>31.12.2016</i>	<i>31.12.2015</i>
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Short-term borrowings

Current portion of long-term bank loans	5,704	2,381
Total short-term borrowings	5,704	2,381

<i>in thousands of euros</i>	<i>31.12.2016</i>	<i>31.12.2015</i>
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Long-term borrowings

Long-term bank loan	137,570	153,227
Bonds issued	224,115	223,569
Total long-term borrowings	361,685	376,796

Borrowings are denominated in the following currencies:

<i>in thousands of euros</i>	<i>31.12.2016</i>	<i>31.12.2015</i>
Borrowings denominated in euros	367,389	379,177
Total borrowings (Note 5)	367,389	379,177

The average effective interest rate on borrowings was 3.2% in 2016 (2015: 3.3%).

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

- **Loans from the European Investment Bank.**

Elering has two loans with outstanding balance of EUR 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.**

Elering has two loans with outstanding balance of EUR 36,429 thousand. The repayments started in 2015 and will end in 2025-2033. Interest rate is floating which is the sum of 6-month Euribor and margin. During 2016 Elering repaid loan in the amount of EUR 10,000 thousand before due date in August 2016 and EUR 2,381 thousand according the loan payment schedule.

- **Eurobonds.**

In 2011, Elering 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.**

As at 31.12.2016 Elering did not use overdraft. In 2015, Elering had an overdraft contract in the amount of EUR 20,000 thousand that was terminated on 31 August 2015. The interest payable on the used portion was floating.

As of 31.12.2016 Elering did not have undrawn borrowing facilities (as of 31.12.2015 Elering did not have undrawn borrowing facilities). Under its loan agreements, Elering has undertaken to comply with certain financial covenants (shareholder's equity to total assets ratio and net debt to EBITDA ratio). Elering's financial indicators complied with all contractual covenants.

Note 13.**TRADE AND OTHER PAYABLES**

<i>in thousands of euros</i>	31.12.2016	31.12.2015
Trade payables	14,119	15,040
▪ Including payables for PTR-Limited auction	1,288	2,506
Payables for purchased property, plant and equipment and intangible assets	1,750	1,210
Subsidies due to electricity producers	2,850	0
Other payables	307	2,814
Total financial liabilities within trade and other payables without accrued interests	19,026	19,065
Accrued interests from borrowings carried at amortised cost (Note 12)	5,101	5,167
Total financial liabilities within trade and other payables in the consolidated statement of financial position	24,127	24,232
 Taxes payable		
VAT	1,712	784
Social security tax	298	310
Personal income tax	156	166
Unemployment insurance tax	18	18
Contributions to mandatory funded pension	15	16
Corporate income tax and income tax on fringe benefits	7	11
Excise tax	314	182
Pollution tax	1	3
Total taxes payable	2,521	1,490
 Accrued expenses - employee benefits		
Wages and salaries	350	249
Bonuses	450	430
Holiday pay	127	106
Social security and unemployment insurance tax	201	181
Termination benefits	18	0
Total accrued expenses - employee benefits	1,145	965
 Other payables	170	49
Total trade and other payables	27,963	26,735

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

Note 14.**DEFERRED INCOME****Income from connection and other service fees**

<i>In thousands of euros</i>	2016	2015
Deferred income from connection and other service fees at the beginning of the period	29,567	28,915
Connection and other service fees received	947	2,687
Connection and other service fees recognised as revenue (Note 16)	-1,807	-2,035
Deferred income from connection and other service fees at the end of the period	28,707	29,567

Deferred income from government grants

<i>in thousands of euros</i>	2016	2015
Deferred income from government grants at the beginning of the period	47,567	48,473
Grants received (Note 7)	21,866	331
Grants used for operating expenses (Note 17)	-149	-51
Grants recognised as revenue (Note 17)	-1,174	-1,186
Deferred income from government grants at the end of the period	68,110	47,567

Deferred income from congestion fees

<i>in thousands of euros</i>	2016	2015
Deferred congestion income at the beginning of the period	49,521	20,892
Congestion fees received during the period	12,993	28,635
Recognised as income (Note 17)	-35	-6
Deferred congestion income at the end of the period	62,479	49,521
Total deferred income	159,296	126,655

* Grants in amount of EUR 21,778 thousand were received on restricted account (see Note 7).

Note 15.**EQUITY**

Elering's share capital consists of 189,890 shares with the nominal value of EUR 1,000 (31.12.2015: 157,890 shares with the nominal value of EUR 1,000). The shares have been paid for in full.

In 2016, share capital was increased by EUR 32 million by resolution of the sole shareholder and it was paid for in cash. The share capital was registered on 05 July 2016. 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 31 million were paid out in 2016 (in 2015 dividends were paid in amount of EUR 20 million). Dividends per share totalled EUR 163 (2015: EUR 127).

Income tax of EUR 7.75 million was incurred upon distribution of dividends (in 2015 of EUR 5 million)

As of 31.12.2016, Elering's statutory reserve capital totalled EUR 11,962 thousand (31.12.2015: EUR 10,743 thousand). As at 31.12.2016, Elering has the obligation to additionally transfer EUR 936 thousand (31.12.2015: EUR 1,219 thousand) to reserve capital. In 2016 Elering transferred to statutory reserve in amount of EUR 1,219 thousand (in 2015 EUR 2,037 thousand).

The distributable retained earnings of Elering as of 31.12.2016 amounted to EUR 147,220 thousand (31.12.2015: EUR 158,568 thousand which is calculated based on adjusted unconsolidated equity as at 31.12.2015, see Note 26). The income tax applicable to the net profit distributable as dividends is 20/80 (2015: 20/80). As of 31.12.2016, it would be possible to distribute EUR 117,027 thousand as net dividends (31.12.2015: EUR 125,879 thousand) and the corresponding income tax would amount to EUR 29,257 thousand (31.12.2015: EUR 31,470 thousand). These numbers are calculated taking into account the obligation to transfer certain amount of retained earnings to statutory reserve.

Note 16.

REVENUE

Analysis of revenue by activity

<i>in thousands of euros</i>	2016	2015
Sales of balancing and regulation services		
Balancing electricity	21,373	17,016
Regulation services	1,519	1,875
Balancing gas	489	98
Total sales of balancing and regulation services	23,381	18,990
Sales of electricity and natural gas network services		
Electricity transmission fees	89,147	85,784
Natural gas transmission fees	8,698	7,942
Other network services	6,816	8,909
Revenue from connection fees (Note 14)	1,807	2,035
Total sales of network services	106,469	104,670
Sales of other goods and services		
Lease of transmission equipment (Note 22)	915	908
Sales of scrap metal	28	21
Sales of other services	3,214	2,407
Other goods	6	5
Total sales of other goods and services	4,163	3,341
Total revenue	134,012	127,001

Note 17.**OTHER INCOME**

<i>in thousands of euros</i>	2016	2015
Government grants related to acquisition of property, plant and equipment (Note 14)	1,174	1,186
Negative goodwill (Note 24)	0	1,509
Fines, penalties and compensations received	296	2,137
Grants for operating expenses (Note 14)	149	51
Income related to administration of renewable energy	127	100
Dividends from long-term financial investments	59	58
Gain on disposal of property, plant and equipment	40	380
Congestion income (Note 14)	35	5
Other income	0	18
Total other income	1,879	5,444

Note 18.**GOODS, RAW MATERIALS AND SERVICES**

<i>in thousands of euros</i>	2016	2015
Electricity and gas purchased to provide the balancing service		
Purchase of balancing energy	19,254	15,703
Purchase of power regulation service	2,409	2,354
Purchase of balancing gas	473	93
Expenses of emergency reserve power plant to provide balancing services	281	0
Total electricity purchased to provide the balancing service	22,417	18,150
System services		
Reactive energy	366	347
Operating expenses of emergency reserve power plant	262	195
Purchased electricity reserves	0	12
Total system services expenses	628	553
Losses in electricity and gas network		
Electricity network losses	14,409	13,156
Gas network losses	307	523
Total electricity and gas to compensate for network losses	14,716	13,680
Maintenance and repair works		
On facilities and equipment related to core activities	4,923	5,066
On production buildings and sites	460	515
Other	319	285
Disassembly works and waste processing	99	117
Total maintenance and repair works	5,800	5,982

Other costs		
Other costs	2,420	1,657
Operative switching and dispatching management expenses	680	661
Total other costs	3,100	2,317
Total goods, raw materials and services	46,662	40,682

Note 19.

OTHER OPERATING EXPENSES

<i>in thousands of euros</i>	2016	2015
Research and development costs (R&D)	1,082	725
Telecommunication	1,036	1,101
Research and consulting	911	895
Training and other miscellaneous operating expenses	707	788
Office expenses	657	584
Information technology	532	691
Security, insurance and occupational safety	242	192
Transportation and tools	157	149
Other expenses	135	265
Total other operating expenses	5,457	5,390

Note 20.

STAFF COSTS

<i>in thousands of euros</i>	2016	2015
Base salaries, additional remuneration, bonuses, vacation pay	5,600	5,573
Termination benefits	44	68
Other remuneration	182	182
Total remuneration to employees	5,826	5,823
Social security tax	1,936	1,943
Unemployment insurance tax	42	41
Total staff costs	7,804	7,807

- Including compensations to the members of the Management and Supervisory Board

Salaries, additional remuneration bonuses, vacation pay	351	495
Social security tax	127	187
Fringe benefits	28	23
Income tax on fringe benefits	7	6
Termination benefits	0	43
Total compensations to the members of the Management and Supervisory Boards	513	754

Remuneration of the members of the management in 2015 included termination benefits related to the premature termination of previous management's contracts.

The average monthly pay of all employees was EUR 2,074 (2015: EUR 2,019).

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

<i>in thousands of euros</i>	2016	2015
Financial income		
Interest income	17	30
Other financial income	1	0
Total financial income	18	30
Financial costs		
Interest expenses	-11,728	-11,957
Foreign exchange losses	-2	-2
Other financial costs	-4	-7
Total financial costs	-11,733	-11,965
Less: capitalised borrowings costs (Notes 10 and 11)	338	487
Total financial costs recognised in the consolidated statement of comprehensive income	-11,395	-11,478
Net financial income (costs)	- 11,377	- 11,448

Note 22.

OPERATING LEASE

Elering as a lessor

Operating lease revenue

<i>in thousands of euros</i>	2016	2015
Buildings	85	192
Transmission equipment	915	908
Total operating lease revenue	1,000	1,100

Transmission equipment

Elering has an operating lease contract under which the free fibres of the fibre-optic cable fixed to the line masts are leased out. This cable also acts as a lightning protection cord for the lines and the fibres are used by Elering for its technical communication. The free fibres have been leased out to Tele2 Eesti AS. The lease contract contains a restriction under which Elering cannot give its transmission equipment out for use by other companies operating in the telecommunications field. The contract is effective until 31.03.2025. Annual lease payments vary depending on the length of fibres leased out during the year.

Information about assets (facilities) leased out under operating leases

<i>in thousands of euros</i>	31.12.2016	31.12.2015
Cost	5,633	6,266
Accumulated depreciation at the end of period	-4,388	-4,140
Carrying amount	1,245	2,126

Depreciation charge

<i>in thousands of euros</i>	2016	2015
Depreciation charge	354	407

Estimated future lease payments under operating leases

<i>in thousands of euros</i>	31.12.2016	31.12.2015
Not later than 1 year	916	958
Later than 1 year and not later than 5 years	3,664	3,832
Later than 5 years	3,893	4,072
Total future minimum lease payments	8,473	8,862

Elering as a lessee

Operating lease expenses

<i>in thousands of euros</i>	2016	2015
Buildings	480	213
Transport equipment	110	83
Other machinery and equipment	20	85
Total operating lease expenses	610	381

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

Note 23.**BALANCES AND TRANSACTIONS WITH RELATED PARTIES**

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

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

- I Republic of Estonia and the entities under its control or significant influence;
- II Management and Supervisory Boards of Elering and Subsidiaries;
- III Close family members of the persons described above and the entities under their control or significant influence;
- IV Non-controlling shareholders that have significant influence over the subsidiaries and the entities under their control.

The outstanding balances with related parties were as follows

<i>in thousands of euros</i>	31.12.2016	31.12.2015
Trade receivables		
Companies controlled or significantly influenced by the State	20,144	18,717
Total trade receivables	20,144	18,717
• incl. from network operators	19,130	17,315
Trade payables and other liabilities		
Companies controlled or significantly influenced by the State	3,280	3,782
Total trade payables and other liabilities	3,280	3,782

Income and expense items with related parties were as follows

<i>in thousands of euros</i>	<i>Related party</i>	<i>2016</i>	<i>2015</i>
Revenue from sale of goods	Companies controlled or significantly influenced by the State	6,428	6,719
Revenue from sale of services	Companies controlled or significantly influenced by the State	82,413	79,042
	Non-controlling shareholders that have significant influence over the subsidiaries and the entities under their control.	0	113
Revenue from sale of goods and services		88,841	85,874
Purchase of goods	Companies controlled or significantly influenced by the State	3,901	4,922
	Non-controlling shareholders that have significant influence over the subsidiaries and the entities under their control.	0	50
Purchase of services	Companies controlled or significantly influenced by the State	3,649	4,022
	Non-controlling shareholders that have significant influence over the subsidiaries and the entities under their control.	0	21
Purchase of goods and services		7,550	9,015
Expenditures on non-current assets	Companies controlled or significantly influenced by the State	256	319

- 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

<i>in thousands of euros</i>	<i>2016</i>	<i>2015</i>
Purchase of services	6	13

Key management personnel compensations are disclosed in Note 20.

The receivables from related parties were written down neither in 2016 nor 2015.

Note 24.**BUSINESS COMBINATION**

On 13 January 2015, Elering 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 Elering's growth.

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

The direct costs of acquisition, which were charged to profit or loss, were EUR 242 thousand.

In 2015 financial statements of Elering the acquisition accounting was provisional. The accounting was finalised in 2016 and there were no adjustments to the provisionally determined fair values.

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

<i>in thousands of euros</i>	<i>Fair value</i>
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 (Note 17)	-1,509

On 1.03.2016 Elering AS, Võrguteenus Valdus AS and Elering Gaas AS were merged.

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 Elering had an incentive to buy. In a situation where the transmission volumes in Estonia are relatively low, international investors showed no interest in the acquisition of a company with relatively low market value. Elering however, had existing financial capability and capacity for infrastructure maintenance and development and therefore Elering emerged as the sole serious buyer. In addition, risks related to acquired assets were mitigated for Elering 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, the remaining stake of 48.62% was acquired. Consideration paid for the additional shares amounted to EUR 26,087 thousand.

The difference between cash paid and carrying value of non-controlling interest derecognised was recognised in retained earnings in the amount of EUR 2,158 thousand.

Note 25.

CONTINGENT LIABILITIES AND BINDING COMMITMENTS

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 uncertainty 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 to landowners and receiving additional revenue due to increased network tariffs . Therefore the Group may temporarily need to finance these costs from other sources of income.

Capital expenditure commitments

The network operator must develop the network within its service area in a way that ensures the continued provision of network services in accordance with the set requirements. At 31.12.2016, Elering has contractual capital expenditure commitments in respect of property, plant and equipment totalling EUR 21,860 thousand (31.12.2015: EUR 16,423 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). The merger with subsidiary was accounted prospectively from the date of the merger, i.e. 01.01.2016.

Statement of Financial Position

	31.12.2016	31.12.2015
ASSETS		
Current assets		
Cash and cash equivalents	52,997	56,476
Restricted cash	21,778	0
Trade and other receivables	26,682	26,350
Inventories	3,543	2,442
Total current assets	105,001	85,267
Non-current assets		
Available-for-sale financial assets	1,946	1,946
Long term deposits	40,000	0
Investments in subsidiaries	0	53,660
Property, plant and equipment	751,621	711,911
Intangible assets	5,153	3,606
Total non-current assets	798,721	771,123
TOTAL ASSETS	903,722	856,390

LIABILITIES

Current liabilities

Borrowings	5,704	2,381
Trade and other payables	27,963	26,034
Total current liabilities	33,667	28,415

Non-current liabilities

Borrowings	361,685	376,796
Deferred income	159,297	126,425
Total non-current liabilities	520,982	503,221

TOTAL LIABILITIES	554,649	531,636
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EQUITY

Share capital	189,890	149,890
Unregistered share capital	0	8,000
Statutory reserve capital	11,962	10,743
Retained earnings	147,220	156,121
TOTAL EQUITY	349,072	324,754

TOTAL LIABILITIES AND EQUITY	903,722	856,390
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Statement of Comprehensive Income

<i>in thousands of euros</i>	2016	2015
Revenue	134,012	118,013
Other income	1,879	3,909
Goods, raw materials and services	-46,662	-39,739
Other operating expenses	-5,458	-4,559
Staff costs	-7,804	-5,607
Depreciation and amortization	-38,128	-33,633
Operating profit	37,841	38,384
Financial income	18	30
Financial costs	-11,395	-11,478
Profit before income tax	26,463	26,935
Income tax	-7,750	-5,000
Profit for the year	18,713	21,935
Total comprehensive income for the year	18,713	21,935

Cash Flow Statement

in thousands of euros

2016 2015

Cash flows from operating activities

Profit before income tax	26,463	26,935
Adjustments for:		
▪ Profit from sale of property, plant and equipment	-32	-369
▪ Depreciation, amortisation and impairment	38,128	33,633
▪ Dividends received from long-term financial investments	-59	-58
▪ Government grants expended and amortised	-1,174	-1,186
▪ Interest expenses	11,390	11,470
▪ Interest income	-17	-30
▪ Changes in inventories	-182	189
▪ Changes in receivables and prepayments related to operating activities	-70	-1,656
▪ Changes in liabilities and prepayments related to operating activities	1,972	-2,184
▪ Changes in deferred income from connection and other service fees	-895	648
Cash generated from operations	75,525	67,392
Income tax paid	-7,750	-5,000
Interest paid	-11,200	-11,458
Interest received	18	28
Net cash from operating activities	56,593	50,961

Cash flows from investing activities

Purchases of property, plant and equipment and intangible assets	-25,872	-37,330
Grants to acquire non-current assets	0	15,050
Proceeds from sale of property, plant and equipment	510	1,703
Payments for acquisition of subsidiary, net of cash acquired	0	-53,660
Placing deposits	-40,000	0
Dividends received from long-term financial investments	59	58
Congestion fees received	12,600	29,048
Cash received from subsidiaries as a result of the merge	4,013	0
Net cash used in investing activities	-48,690	-45,131

Cash flows from financing activities

Long-term bank loans received	0	31,968
Repayments of bank loans	-12,381	-1,190
Contributions to equity	32,000	8,000
Dividends paid	-31,000	-20,000
Net cash from financing activities	-11,381	18,778

Net increase/decrease in cash and cash equivalents	-3,478	24,607
Cash and cash equivalents at the beginning of the year	56,476	31,869
Cash and cash equivalents at the end of the year	52,997	56,476

Statement of Changes in Equity

<i>in thousands of euros</i>	<i>Share capital</i>	<i>Un-registered share capital</i>	<i>Statutory reserve capital</i>	<i>Retained earnings</i>	<i>Total</i>
Balance as of 1.01.2015	149,890	0	8,706	156,223	314,820
Comprehensive income for financial year	0	0	0	21,935	21,935
Total comprehensive income for the period	0	0	0	21,935	21,935
Transactions with owners:					
Contributions to equity	0	8,000	0	0	8,000
Transfers to statutory reserve capital	0	0	2,037	-2,037	0
Dividends paid	0	0	0	-20,000	-20,000
Total transactions with owners	0	8,000	2,037	-22,037	-12,000
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 31.12.2015				158,568	327,200
Comprehensive income for financial year	0	0	0	18,713	18,713
Total comprehensive income for the period	0	0	0	18,713	18,713
Transactions with owners:					
Contributions of equity	40,000	-8,000	0	0	32,000
Transfers to statutory reserve capital	0	0	1,219	-1,219	0
Merger with subsidiary	0	0	0	2,158	2,158
Dividends paid	0	0	0	-31,000	-31,000
Total transactions with owners	40,000	-8,000	1,219	-30,061	3,158
Balance as of 31.12.2016	189,890	0	11,962	147,220	349,072

Independent auditor's report

To the Shareholder of Elering AS

(Translation of the Estonian original)*

Our opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Elering AS and its subsidiaries (together the Group) as at 31 December 2016, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

What we have audited

The Group's consolidated financial statements comprise:

- the consolidated statement of financial position as at 31 December 2016;
- the consolidated statement of comprehensive income for the year then ended;
- the consolidated cash flow statement for the year then ended;
- the consolidated statement of changes in equity for the year then ended; and
- the notes to the consolidated financial statements, which include a summary of significant accounting policies and other explanatory information.

Basis for opinion

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

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

Independence

We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) and the ethical requirements of the Auditors Activities Act of the Republic of Estonia. We have fulfilled our other ethical responsibilities in accordance with the IESBA Code and the ethical requirements of the Auditors Activities Act of the Republic of Estonia.

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Our audit approach

Overview



Materiality

Overall Group materiality is EUR 1.9 million which represents 2.5% of profit before interest, tax, depreciation and amortization (EBITDA).

Audit scope

During 2015 Elering AS acquired two subsidiaries that were merged with Elering AS as of 1 March 2016. After merger, the Group comprises of one legal entity only that is fully audited by the Group audit team.

Key audit matters

- Estimates involved in capitalisation of capital expenditures and determining their useful lives
- Accounting for congestion income

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

Materiality

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

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

Overall group materiality	EUR 1.9 million
How we determined it	2.5% of profit before interest, tax, depreciation and amortization (EBITDA), as disclosed in Note 6.
Rationale for the materiality benchmark applied	We have applied EBITDA because, as described in Note 6, it is one of the key measures the management uses to assess the Group's performance.

Key audit matters

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

Key audit matters	How our audit addressed the key audit matters
<p>Estimates involved in capitalisation of capital expenditures, and determining their useful lives (refer to Note 2 'Summary of significant accounting policies', Note 3 'Critical accounting estimates and judgments in applying accounting policies' and Note 10 'Property, plant and equipment' for further details).</p> <p>In 2016, the Group capitalised additions to property, plant and equipment (PPE), mainly related to the construction of electricity and gas transmission network, in the amount of EUR 24.4million.</p> <p>Expenditures are capitalised, if they create new or enhance the existing assets, and expensed, if they relate to repair or maintenance of the assets.</p> <p>Classification of the expenditures involves judgment.</p> <p>The useful lives of PPE items are based on management's estimates regarding the period during which the asset or its significant components will be used. The estimates are based on historical experience and market practice and take into consideration the physical condition of the assets.</p> <p>Capital expenditure is not considered to be an area of significant risk for our audit but as it requires considerable time and resource to audit due to its magnitude, it is considered to be a key audit matter.</p>	<p>We assessed whether the Group's accounting policies in relation to the capitalisation of expenditures are in compliance with IFRS.</p> <p>We obtained a listing of capital expenditures incurred during the year and, on a sample basis, inspected contracts and underlying invoices to ensure the classification between capital and operating expenditure was appropriate.</p> <p>We evaluated whether the useful lives determined and applied by the management were in line with historical experience and the market practice.</p> <p>We checked whether the depreciation of self-constructed PPE items was commenced timely, by comparing the date of the reclassification from construction in progress to finished projects, with the date of the act of completion of the work.</p> <p>As a result of our work, we noted no material exceptions.</p>
<p>Accounting for congestion income (refer to Note 2 'Summary of significant accounting policies – Congestion income', Note 3 'Critical accounting estimates and judgments in applying accounting policies' and Note 14 'Deferred income' for further details).</p> <p>In 2016 the Group has received congestion fees of EUR 13.0 million and the deferred congestion revenue as of 31 December 2016 amounted to EUR</p>	<p>We assessed whether the Group's accounting policy in relation to accounting for the congestions revenue is in compliance with IFRS.</p> <p>We evaluated the management's assessment on whether and when the congestion fees will be used for constructions of new interconnection capacities. We corroborated the information received with the Management and Supervisory Board minutes of meetings describing future investments and with the</p>

62.5 million.

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

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

capital expenditures budget.

We reconciled the balances of deferred congestion income to the respective invoices and subsequent cash receipts.

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

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

How we tailored our audit scope

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

After the merger of two recently acquired subsidiaries with Elering AS that took place on 1 March 2016, the Group consists of one legal entity only that is fully audited by us.

Other information

The Management Board is responsible for the other information contained in the Annual Report in addition to the consolidated financial statements and our auditor's report thereon.

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

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

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

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

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

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

Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

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

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



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

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

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

AS PricewaterhouseCoopers

A handwritten signature in blue ink, appearing to read "Ago Vilu".

Ago Vilu
Certified auditor in charge, auditor's certificate No.325

A handwritten signature in blue ink, appearing to read "Doris Egel".

Doris Egel
Auditor's certificate No.587

16 March 2017

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

PROFIT ALLOCATION PROPOSAL

The retained earnings of Elering AS as of 31.12.2016 were EUR 147,220 thousand.

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

To pay as dividends to the shareholder EUR 20,000 thousand

To transfer to the statutory reserve capital EUR 936 thousand

Not to distribute the remaining retained earnings EUR 126,284 thousand

SIGNATURES OF THE MANAGEMENT TO THE 2016 ANNUAL REPORT

The signing of Elering AS 2016 Annual Report on 15 March 2017.



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

<i>EMTAK* area of activity</i>	<i>01.01.2016 - 31.12.2016</i>	<i>01.01.2015 - 31.12.2015</i>
35121 Transmission of electricity – transmission through the transmission network:	100,185	97,969
35221 Natural gas transmission	8,698	7,942
35141 Trade of electricity (balancing electricity)	22,892	18,892
35231 Trade of gas (balancing gas)	489	98
77399 Renting and leasing of other machinery, equipment and tangible goods	915	908
49501 Pipeline transport	668	890
47770 Retail sale of other second-hand goods	34	27
68201 Renting and operating of own or leased real estate	85	192
46699 Other sales	47	84

* EMTAK – classification of Estonian economic activities.



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