

**OT – Optima Telekom d.d.
Annual Report and
Report for the 4th quarter
of the Group
for 2017.**

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Optima
TELEKOM

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I. **Management Report**

1.1 Introduction

In 2017 OT-OPTIMA TELEKOM d.d. (hereinafter: Optima or Company) successfully completed the process of merging H1 TELEKOM d.d., Split, Dračevac 2 / d, OIB: 88551335012 (hereinafter: H1 or Merged company). The merger procedure is continuation of activities that started during 2016, primarily of the Merger Agreement concluded on 29 July 2016 between Optima and H1 as well as of the request sent to Croatian Competition Agency (hereinafter: AZTN) for extension of the temporary management control over Optima by Hrvatski Telekom d.d., Zagreb, Roberta Frangeša Mihanovića 9, OIB: 81793146560 (hereinafter: HT).

In order to prepare the merger process of H1 with Optima, following the decision of AZTN on clearance of the concentration, the H1's Supervisory Board on 29 June 2017, appointed Optima's Management Board members, Mr. Zoran Kežman as the President of the Management Board of H1 and Mr. Tomislav Tadić as the Management Board member of H1.

Considering that the General Assemblies of both companies participating in the merger procedure approved the agreement on the merger of H1 to Optima on 25 January 2017 as well as that on 9 June 2017 AZTN has issued a conditional clearance of concentration related to merger of H1 to Optima, all the conditions have been fulfilled to register the merger with competent courts, in accordance with the provisions of the Companies Act.

In line with mentioned circumstances and based on the request for extension of the temporary management control filed on 29 July 2016, by HT, being the

company that gained management control over Optima by virtue of AZTN decision Class: UP/I 034-03/2013-02/007 of 19 March 2014, on 9 June 2017 AZTN also rendered a positive decision prolonging temporary management control of Optima for another three years, i.e. until 10 July 2021. The respective extension of HT's management control over Optima was one of the conditions for the Merger Agreement dated 29 July 2016 to enter into force and for earlier decisions of the General Assemblies of both companies to have legal effect.

Finally, following above mentioned activities, the court registry of the Commercial Court in Split on 5 July 2017 has issued the ruling number Tt-17 / 6536-2 for the status change in relation with H1's merger to Optima, with the record that the merger would be valid after the registration of the acquiring company at competent court, and after that on 1 August 2017 the court registry of the Commercial Court in Zagreb issued a decision No. Tt-17 / 26830-4 based on which the registration of merger was made in accordance with the above-mentioned decisions of the General Assemblies and AZTN.

With the implementation of the status change related to the merger, based on the decision of the Commercial Court in Zagreb, number Tt-17 / 26830-4, the share capital was increased from HRK 635,568,080.00 in the amount of HRK 58,864,560.00 up to the total amount of 694,432,640.00 HRK. This was all done in accordance with the provisions of Articles 519 and 520 of the Companies

Act to implement the merger process through issuance of 5,886,456 new ordinary shares in the nominal value of HRK 10.00.

The merger was implemented by transferring the entire assets, rights and obligations of H1 to Optima, without the need to liquidate the merged company. As a compensation for the transfer of entire assets, rights and obligations of H1, and in accordance with the obligation from Merger Agreement, Optima transferred the appropriate ratio of Optima shares to H1 shareholders. Share swap of the Optima's OPTE-R-C shares for the H1's HITE-R-A shares was conducted by exchange of one share of the HITE-R-A in the nominal value of HRK 10.00 for 0.75 Optima's OPTE-R-C shares in the nominal value of HRK 10.00 (1:0.75).

The purpose of the merger is to achieve positive synergies between the companies and to increase Optima's value for its current and new shareholders (former H1 shareholders). Optima has decided that connecting business-wise, organisationally, legally and financially is in the mutual interest of Optima and H1, considering that the merger and achieving the envisaged synergies will increase business efficiency and decrease costs, which could accordingly have a positive impact on the value of Optima as the third respectable operator in the fixed telephony market.

In the course of 2017 membership change occurred in Optima's Supervisory Board since the former Chairman of the Supervisory Board, Siniša Đuranović, withdrew from membership and from position of the Chairman of Optima's Supervisory Board on 31 May 2017, due to the taking over the position that is

procedurally incompatible with the membership in the Optima's Supervisory Board.

On the regular Optima's General Assembly meeting held on 11 July 2017, Mr. Igor Vavro was appointed as a Member of the Optima Supervisory Board, while Supervisory Board appointed Mr. Vavro as a Chairman of the Supervisory Board on its meeting dated 26 July 2017.

There were no other changes in Optima's Supervisory Board and current Board Members are: Igor Vavro, Chairman; Ariana Bazala-Mišetić, Deputy Chairman; Rozana Grgorinić, Member; Ana Hanžeković, Member; Marina Brajković – Member; Marko Makek, Member; Jasenka Anica Kreković, Member; Maša Serdinšek, Member; Ivica Hunjek, Member – Employee Representative.

During the observed period, on 7 March 2017, the Supervisory Board re-appointed Mrs. Irena Domjanović as the Member of the Management Board. According to the decision of the Supervisory Board the mandate lasts two years and starts with the day of previous mandate expiration.

Board of directors consists of: Zoran Kežman, President of the Board; Mirela Šešerko, Member of the Board; Irena Domjanović, Member of the Board; Tomislav Tadić, Member of the Board.

Just as in the period from the execution of the Settlement, Optima continues to duly perform all due obligations undertaken in the Pre-bankruptcy Settlement executed before the Commercial Court of Zagreb on 30 April 2014, case reference Stpn-354/13 and reports to the public regarding the said actions in accordance with the Financial

Operations and Pre-bankruptcy Settlement Act via FINA's website, www.fina.hr.

Due to the merger of H1, Optima became the universal legal successor of all H1 rights and obligations, including becoming the debtor according to the Pre-bankruptcy Settlement which was concluded before the Commercial Court in Split on 16 December 2014., number Stpn-74/2014. Optima regularly informs public regarding the said actions in

accordance with the Financial Operations and Pre-bankruptcy Settlement Act via FINA's website, www.fina.hr.

Apart from publications on Fina's website regarding the issues related to the implementation of the Pre-bankruptcy Settlement, Optima is informing the public on the fulfilment of obligations in a timely and transparent fashion in accordance with the relevant laws and regulations in the field of capital markets.

1.2 Statement of the Chairman of the Board

Behind us is a dynamic and challenging but very successful year marked by the formal merger of H1 Telekom with Optima Telekom. This friendly merger has enabled new perspective for Optima, it strengthened Optima's position in the market and opened new opportunities for revenue and profitability growth of the company. In 2017, we also achieved the first positive synergy effects in the technological, process and organizational field and that positively impacted our business results. We concluded the year with 9 percent revenue growth, resulting primarily from significant multimedia and Internet services revenue increase, while growth in EBITDA before one times items is 5 percent higher compared to 2016.

The merger of H1 Telecom has created new opportunities for investments, which will be primarily directed towards customers and their experience, through the development of high quality services and the infrastructure improvements. Being a telecom, in the middle of the digitalization trends and the growing



demand for broadband capacities, it is up to us to constantly upgrade infrastructure and improve our services and packages, thus meeting market demands and raising the satisfaction of our private and business customers.

Given all the achievements in 2017, I believe that 2018 will develop for us in the direction of business and market share growth as well as further improvement in satisfaction of our shareholders, employees and customers.

Zoran Kežman

1.3 Corporate Governance and General Information

SUPERVISORY BOARD

Igor Vavro – CHAIRMAN
Ariana Bazala-Mišetić – DEPUTY CHAIRMAN
Marina Brajković – MEMBER
Jasenka Anica Kreković – MEMBER
Marko Makek – MEMBER
Ana Hanžeković – MEMBER
Rozana Grgorinić – MEMBER
Maša Serdinšek – MEMBER
Ivica Hunjek – MEMBER – EMPLOYEE REPRESENTATIVE

BOARD OF DIRECTORS

Zoran Kežman – CHAIRMAN
Irena Domjanović – MEMBER
Mirela Šešerko – MEMBER
Tomislav Tadić – MEMBER

IBAN

HR3023600001101848050
Zagrebačka banka d.d. Zagreb
Commercial Court of Zagreb

OIB

36004425025

MBS

040035070

MB

0820431

SHARE CAPITAL AMOUNT

694,432,640.00 HRK

NUMBER OF SHARES

69,443,264, nominal value of HRK 10.00 each

I.4 Optima Telekom Group Members and Regional Centers

Headquarters – Company Management

OT-Optima Telekom d.d.
Bani 75a, Buzin
10 000 Zagreb, Hrvatska
TEL +385 1 54 92 699
FAX +385 1 54 92 019

Region West

OT-Optima Telekom d.d.
Andrije Kačića Miošića 13
51 000 Rijeka, Hrvatska
TEL +385 51 492 799
FAX +385 51 492 709
OT Centar
TEL +385 51 554 651

Region North

OT-Optima Telekom d.d.
Bani 75a, Buzin
10 000 Zagreb, Croatia
TEL +385 1 54 92 301
FAX +385 1 54 92 309

OT Centar

7. domobranske pukovnije 1/3, Zadar
TEL +385 23 492 860
Ivana Matijaševića 14, Dubrovnik
TEL +385 20 220 640

Members of the Optima Telekom Group

- Optima direct d.o.o, Trg Josipa Broza Tita 1, 52460 Buje
- OT-Optima Telekom d.o.o., Ulica 15. maja 21, 6 000 Koper, Republika Slovenija
- Optima telekom za upravljanje nekretninama i savjetovanje d.o.o., Bani 75/a, 10 000 Zagreb

Region East

OT-Optima Telekom d.d.
Vinkovačka 2
31 000 Osijek, Hrvatska
TEL +385 31 492 999
FAX +385 31 210 459

Region South

OT-Optima Telekom d.d.
Vinkovačka ulica 19
21 000 Split, Hrvatska
TEL +385 21 492 899
FAX +385 21 492 829

1.5 Market Overview

Fixed Telephony Market

In line with the long-standing, world-wide trends, the Croatian market in fixed telephony also has recorded negative trends. The total outbound traffic (in minutes) of all fixed public communications network operators in Croatia in the third quarter of 2017 decreased by 5.4% compared to the previous quarter while revenues declined by 2.2%.

Compared to the third quarter of 2016, the total outgoing traffic (in minutes) of all fixed public communications network operators in the third quarter of 2017 was 5.3% lower. Retail revenue has simultaneously dropped by 10.9%.

Broadband Access Market

The broadband Internet access via fixed networks market has recorded stable use of services and revenue in the third quarter of 2017. Compared to the second quarter of 2017, the number of connections for broadband Internet

access via fixed networks in the third quarter increased by 0.7%, while revenue recorded increase by 1.9% in the same period.

By comparing this year's third quarter with last year's, there is an increase of 6.0% in the number of connections for broadband access via fixed networks. The increase is also detectable in revenue, which is 5.7% higher.

It is predicted that this market will continue to grow.

IPTV Market

Compared to the second quarter of 2017, the total number of connections in the third quarter of 2017 is higher by 0.4%.

Comparison at annual level also indicates an increase in the number of connections, by as much as 4.5%.

Positive trends for Internet protocol based television (IPTV) market are predicted in the future as well.

1.6 Economic Environment

Available data concerning trends in certain indicators indicate continuing positive economic trends, especially when it comes to the export of goods. This is greatly aided by favorable trends in the global environment, especially the European Union, which is the most relevant market for goods originating from Croatia. The estimate for Croatia increased from the previous 2.9% to 3.2%, which means that it continues to grow

faster than the European Union, thus coming slightly closer to the average development level in the European Union.

In July, August and September of 2017, the unemployment trends according to HZZ records were somewhat atypical. Namely, in July and August of 2017 the unemployment rate went up, and in September it went down. Albeit atypical,

it should be noted that these are not major escalations which would mean a change in trends, but more of an accidental consequence of slower changes in unemployment records. Slightly slower changes are influenced by a reduced pressure on the labor market, connected with unfavorable demographic trends, emigration and stricter conditions for staying on the unemployment record, on the one hand, and a better and longer tourist season, as well as better general economic conditions, on the other. At the same time, interim employment statistics show that employment started to drop in August and continued in September, but with a lesser dynamic than in the same months in previous years. Due to these trends in employment and unemployment, the unemployment rate remained virtually stagnant for those three months. From 10.8% in July, it went up to 10.9% in August, only to go down again to 10.8% in September.

After the net salary surpassed the amount of six thousand, and the gross salary surpassed the amount of HRK 8,000.00 in March of 2017, it remained at the same level in August. Moreover, in 2017 highest increase of salaries at the annual level was recorded in August, and so the net salary increased by 6.1%, while at the same time the gross salary nominally increased by 4.6%. Due to the changes in income taxation which influenced the increase of the net salary's share in the gross salary, in 2017 the net salary is growing faster compared to the gross salary. As the year continues, we anticipate a dynamic increase of salaries supported by economic growth, pressure on increasing salaries caused by the lack of employees of certain professions and

skills, but also by the payment of the second part of the envisaged increase of salaries in public services. Thereby, the salary increase continues to contribute to the increase of available income and purchasing power of the population, thus increasing personal consumption, which supports overall economic growth.

Given that in September there was a normal decrease in foreign currency inflow, after the principal tourist season, a somewhat more conspicuous depreciation of the Croatian Kuna was recorded compared to other months of 2017. More precisely, the Croatian Kuna weakened by 1.2% compared to the common currency of the Eurozone. However, the very next month was characterized by a high stability of the exchange rate, and the Croatian Kuna went down by only 0.1% by the end of October. In 2017, the financial market is still showing a high Croatian Kuna liquidity and low interest rates (it should be noted that in September and October there was no demand or traffic at Tržište novca Zagreb d.d., and thus no record of average interest rates), so that the exchange rate trends are still primarily determined by the offer and demand for foreign currencies, which leads to only slight changes in exchange rates.

After the disruption caused by the blocking of Agrokor companies in March, the decreasing low-incline trend in outstanding payment titles stabilized again. Thus, between March and September, the value of outstanding payment titles decreased by HRK 2.3 billion, i.e. an average of HRK 387 million. The September level of HRK 15.05 billion was the lowest since 2006 (since when there are comparable information), and was at

a record low compared to the transaction money in the system. The decrease in the value of outstanding payment titles is accompanied by the decrease in the number of business entities with overdrawn bank accounts, which dropped at 26.2 thousand by the end of September. At the same time, personal debts are significantly higher. At the end of

September, there were 320,000 citizens with overdrawn bank accounts, with an overall debt of HRK 42.38 billion, which is almost three times higher compared to real economy. Compared to the value of deposited funds (giro and current accounts) of the household sector in commercial banks, this debt would be at a level of 60.7%.

1.7 Regulatory Environment

In this reporting period, the prices of certain wholesale services, used by Optima to provide its services to end customers, have entered into force in line with final decisions of the Croatian Regulatory Authority for Network Industries (hereinafter: HAKOM).

Thus, since 1 January 2017, the new wholesale prices are being applied as HAKOM calculated them based on its own cost model. Compared to the previous prices, the new prices for the unbundled access to the local loop service (hereinafter: ULL) and for the wholesale broadband access service when the end customer gains basic access to the network through the user operator (hereinafter: NBSA service) for speeds exceeding 30 Mbit/s are higher, while the price of the NBSA service for speeds up to 30 Mbit/s is lower. New monthly charge for the wholesale broadband access service and monthly charges for the wholesale high quality access service also apply, and these new prices are lower than the ones applied in 2016.

Starting from 1 July 2017, new, slightly higher prices apply to inter-connection

services in public fixed communications network.

Given the fact that the above changes had a significant impact on the distribution of wholesale costs, Optima has adapted its market strategy and approach, to optimize the impact of these HAKOM decisions on its financial operation.

Regardless of changes to wholesale prices, Optima continues to implement HAKOM's Margin Squeeze Test for every retail price for regulated service (network access services, Internet access services with the connected IPTV service), irrespective of whether this service is provided independently or as a part of a package including other electronic communications services. HAKOM has updated the model of Margin squeeze test with new wholesale prices, with the new retail costs and with the revised methodology of margin squeeze test which is in effect since 1 January 2017.

In the context of wholesale price regulation, in this reporting period HAKOM has modified HT's Standard Offer for ULL and HT's Standard Offer for the wholesale broadband Internet access for

the purpose of introducing FttB / FttDP type of access in HT network as well as for vectoring technology. Additionally, HAKOM has made the final decision to modify the Standard Offer for the Wholesale Line Rental service (herein-after: WLR), according to which announced increase of WLR price for 1 January 2018 had been withdrawn. Thus, the current WLR service prices remain in use while additional charges are charged only if WLR service is used in combination with bitstream service for access speeds greater than or equal to 30 Mbit/s.

In this reporting period, HAKOM imposed to mobile network operators the obligation to provide IP interconnection no later than 1 January 2018 at the request of other operators, all in accordance with the updated "IP Interconnection Terms" document. In the present case, it is a matter of harmonizing the regulation of fixed and mobile networks, since the obligation of IP interconnection has already been introduced to operators in the fixed network, and by introducing the obligation of IP interconnection of mobile networks (with fixed ones), it will not only technologically improve the interconnection of public communications networks, but Optima will achieve cost savings.

Following the change of regulations in the field of electronic communications, as of 1 January 2017, there is a new obligation for operators according to

which they have to provide the customer with a discount on the bill, without the need for customer to file an objection against the bill amount in cases where reported and ascertained malfunctions last longer than 24 hours. This obligation did not have any significant impact on Optima's business, since Optima has optimized its operations by improving fault repair procedures.

Among more important amendments to the regulations it should be mentioned the coming into force of the new Public Procurement Act as of 1 January 2017. Key novelties are the transparency and flexibility of public tendering procedures, the simpler and more effective public tendering rules for clients, but also for the providers where Optima plays the role. Costs of the guarantee and appeal costs are reduced too. From 1 July 2017, the principle of the most economically advantageous offering was introduced, as the only criterion for the offer selection, which should ensure the best value for money in the public procurement process. In public procurement procedures, this will enable Optima to demonstrate to existing and future customers who will be in a purchaser role, a higher level of quality in providing electronic communications services, which will have a positive impact on the Optima's business in the next reporting periods.

I.8 Business Indicators and Segments

Number of customers	31.12.2017 ¹	30.09.2017 ¹	31.12.2017/ 30.09.2017	31.12.2016	31.12.2017/ 31.12.2016
Business					
PVS ²	20,226	20,761	-2.6%	13,324	51.8%
IPTV	2,070	2,137	-3.1%	1,090	89.9%
Internet	17,571	17,925	-2.0%	11,653	50.8%
Data	1,674	1,479	13.2%	1,424	17.6%
Residential					
PVS	192,491	196,756	-2.2%	136,842	40.7%
IPTV	47,885	47,446	0.9%	30,112	59.0%
Internet	122,500	122,873	-0.3%	89,027	37.6%

¹ Includes customer base of merged H1 Telekom

² Methodology change: Within the number of business PVS customers, major business customers using only Internet and data services have been factored in. Previous periods have been updated to obtain comparable data

a. Residential Sales Segment

With the aim of attracting new customers, Optima has continued to invest in various marketing and sales activities in the fourth quarter of 2017.

In 2017, Optima introduced completely new service portfolio that is better suited to the market. Thanks to this and the accompanying advertising and sales activities, despite of the extremely competitive environment, Optima has been successful in the residential customer segment in 2017, while additional positive contribution is related to H1 merger.

In the residential customer segment of fixed network public voice service, Optima recorded 40.7% increase in the number of customers and 8.2% higher revenue in 2017 than in 2016, while the revenue for the fourth quarter was higher by 9.5% compared to the same period last year.

In the broadband Internet access segment, Optima achieved 24.7% revenue growth and 37.6% increase in number of customers, compared to previous year, while revenue increased by 58.4% in the fourth quarter compared to the same period last year.

Optima continually records growth of the number of customers and revenues in IPTV segment, which is above national market trends. This trend continues, regardless of the impact of H1 merger. This is a result of targeted marketing and sales activities that Optima is constantly undertaking.

At the annual level, Optima recorded 59.0% increase in the number of customers, with a revenue increase of 30.8% and also 38.9% revenue increase in fourth quarter compared to the same period last year.

b. Business Sales Segment

Whole 2017, as well as the fourth quarter of 2017, was marked by strong sales activities especially in cooperation with Croatian chambers and associations. In addition, the fourth quarter was marked by the intensive sale of ICT services, the launch of 3G backup services and the migration of H1 customers to Optima's services and packages. In the segment of small and medium-sized companies, changes were introduced in the portfolio and more intensive investments were made in marketing activities to increase competitiveness and sales.

At the annual level, in the segment of public voice services for business customers, Optima achieved 51.8% increase in number of customers, with a revenue increase of 0.2%, primarily due to the impact of H1 merger, where small businesses are more represented in the business customer base structure and in the revenues, among all those who use the public voice service. In the fourth quarter Optima achieved 1.4% revenue increase compared to the same period last year.

Similarly to the public voice services, in the segment of broadband Internet access,

Optima at the annual level recorded an increase in the number of connections by 50.8%, with 18.8% revenue increase, mainly due to the H1 merger, while in the fourth quarter revenues were higher by 42.4% over the same period last year.

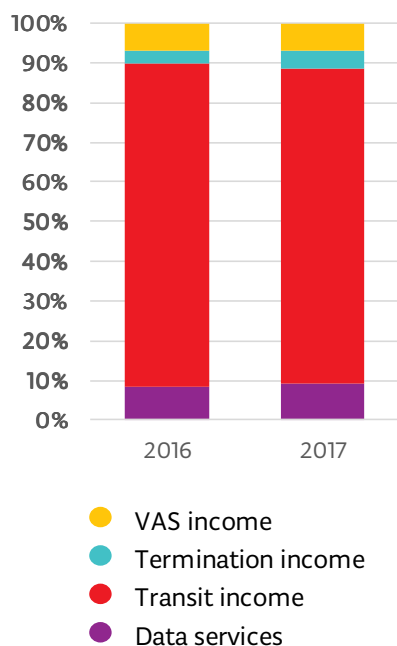
In the data services segment Optima recorded an increase in the number of connections by 17.6% at the end of 2017 compared to the end of 2016, with 1.0% decrease in revenues on the annual level, while in the fourth quarter revenue was lower by 4.0% compared to the same period last year. The decline in revenue in this segment is the result of the market trend marked with selling of lower-value data services on newer, broadband technologies. The impact of the H1 merger in this segment is not so pronounced, since this type of service is not represented widely due to the structure of the customers.

High growth in the sales of ICT solutions and services has been achieved in 2017, and significant shift in profitability was noted in relation to the previous year. The largest growth is seen in the field of standard solutions, which is the result of increased company orientation on this segment. In 2017, revenues of HRK 2.1 million were realized, which represents revenue increase of 122.4% compared to 2016.

In 2017, revenue from the sale of wholesale data services grew by 4.0% compared to the previous year. Excluding the one-off impact of the revenue increase at the beginning of 2016, which came from resolution of a regulatory dispute, data services revenue grew by 13.0% in 2017 compared to the previous year. This revenue increase in 2017 was largely influenced by H1 merger, and it is expected that this increase will be more pronounced in 2018. H1 merger has

neutralized the negative impact of the wholesale data services churn coming from major national customers, particularly in the second half of 2017, resulting from increased market consolidation (Vipnet's takeover of Metronet).

Interconnection Income Structure



Data Source: Company's business records

The revenue from termination into Optima's network in 2017, compared to the same period last year, shows a continuous growth and at the end of 2017 it is higher by 21.0% compared to 2016, which is mostly due to the H1 merger, since termination revenues are directly dependent on the customer base that has increased through the merger. Revenue from international transit is lower by 18.0% compared to the previous year, since in 2017, almost entirely, it was replaced by different, more profitable traffic routes. The impact of H1 on Optima's international transit revenues is insignificant given the fact that H1 has almost completely ceased its international transit business prior to the merger.

In 2017 sales of VAS services decreased by 12.5% compared to the previous year, mostly due to market conditions that have a negative impact on traffic.

c. Infrastructure, Optical Fiber Network and Internal Services Development

Voice Networks

At the beginning of 2017 a new SBC-ACC (Session Border Controller – Access) system has been acquired that is used to separate the core of the voice network, i.e. telephone switchboards within the core, from user equipment in the access voice network. The new SBC device supports the anticipated increase in the number of customers of the voice service through the VoIP technology and ensures full redundancy of the SBC system for the access voice network. By the end of 2017, the integration of the new SBC-ACC system into the core of Optima's voice network was completed and the voice traffic of residential customers and from certain portion of business customers was migrated to the new SBC-ACC system.

During 2017, voice traffic has been migrated from all Optima's telephone switchboards to an internally developed central system for intelligent call management while in parallel, internal LNP (Local Number Portability) system was upgraded.

Additionally, during 2017 voice traffic has been migrated for five international operators and three national operators, including the connection with three new international operators, using the IP/SIP IC connections to the SBC-IC (Session Border Controller – Interconnection) systems.

A new UC (Unified Communications) soft-switch system (a modern telephone switch-board) has been obtained and will be used to implement unified communications services for business users.

In mid-2017, a new UC ("Unified Communications") soft-switch system (modern telephone exchange) was acquired, which will serve to implement unified communications services for business customers. By the end of 2017, the basic functions of the new UC soft-switch system were integrated into the core of the Optima's voice network.

During the last quarter of 2017, Call Center systems of Optima and H1 were integrated with the aim of unifying the call center functionality. In the same period, interconnection of Optima's and H1's voice networks through IP technology was achieved. By the end of 2017, migration of voice traffic from H1 network towards all destinations was performed through Optima's voice network, and the aggregation of voice traffic into H1 network via the IP/SIP IC connections that Optima has with the four national operators.

Data Networks

As part of the VDSL access network upgrade, the number of VDSL interfaces on existing and new locations has continued to increase in 2017 and today Optima has 17,500 active VDSL interfaces at 245 locations.

In order to further upgrade the capacity of the IP/MPLS core network and raise the quality level, i.e. availability of the network, the upgrade of the central MPLS (Multiprotocol Label Switching) router in Zagreb was completed for the purpose of upgrading of the MPLS core network capacity, thereby ensuring the raising of the

quality of the network, i.e. network availability. Also, other cities (Sisak, Slavonski Brod, Kutina, Bjelovar, Našice and Donji Miholjac) have been connected by 10G capacity with larger centers while some cities have been connected by fiber optic cables such as Čepin, Bosnjaci, Ivankovo and Prelog, instead of radio access links.

New generation DWDM equipment was purchased. Following a successful upgrade of the system on the Zagreb-Sisak-Slavnoski Brod-Jarmina-Osijek route in 2016, the migration of telecommunication connections to a new system on the Zagreb-Ljubljana-Vienna and Ljubljana-Rijeka routes was completed in 2017.

In the second quarter of 2017, the integration of the Facebook cache server into Optima's network was accomplished, which ensures caching of multiple-downloaded FB content and its availability in the Optima's network and apart from the unload of capacity towards Internet network, this also has a direct impact on the faster reach of Facebook content in the Optima's network. By the end of 2017, connections to the new Internet access capacities were established - in total, connections to 4 Internet access service providers with higher interconnection capacity, further reduction of operating costs that all resulted in raise of the quality and availability of the public Internet network. The total access capacity to the public Internet network now amounts to 9x10Gbps.

Part of the capacity is also used for the existing H1 network, whose Internet traffic is also routed through the above-mentioned interconnection links. As a part of H1 merger, the IPv4 address space of H1 and Optima has been consolidated.

In 2017, the Ethernet aggregation switches were replaced by the new generation switches from Huawei, S5320-36C-EI-28S and S5320-32C-HI-24S-AC, at a total of 20 locations, enabling system scalability and higher levels of availability for end customers. The specified HI switch version also supports certain OSI-L3 functionality, making the Ethernet aggregation switches an integral part of the IP/MPLS network core.

Realization of 3G data backup service was realized in 2017 for business users via the 3G/4G HT mobile network.

Network Infrastructure and Optical Fiber Network

Optical infrastructure development, i.e. the construction of the own optical fiber network during 2017 consisted primarily of the construction of optical feeds to Optima's new wholesale and retail customers, but required works were performed in the optical fiber backbone as well.

76.6 km of new optical fiber access network were built, consisting of 252 new optical feeds. Most feeds have been built in Northern Croatia (101 feeds), followed by the West (65 feeds), South (58 feeds) and East with 28 optical feeds.

As it relates to works on Optima's optical fiber backbone, during 2017, the intercity optical route Ivankovo – Jarmina was completed and also the city optical route Zagrepčanka - CIX - Supranet was completed with the aim of achieving TC capacity redundancy up to the Optima's CIX node. During the last quarter, partial reconstructions and upgrades of the city optical backbone were required in Osijek, Split and Rijeka. The total additional

construction of the Optima's fiber optic backbone during 2017 amounts to 32.2 km.

As a result of the H1 merger, Optima expanded its own fiber optic capacities for additional 321 km of fiber optic routes and feeds during the third quarter and which, according to the estimated needs, were integrated into Optima's fiber optic network.

Supervision (NOC)

During 2017 the supervision of telecommunications systems and services has been expanded. For that purpose, new systems were added to the supervision: SBC (Session Border Controller – Access) system, Huawei MA5605, EATON SM45 DC, NetMan 204 UPS, ZTE 9806H mini-DSLAM, ZTE 9800 DSLAM, ZTE MSG 5200.

Network monitoring system Zabbix has been updated to comply with the requirement to keep measurement data for the period of 3 years. The “PHP networkweathermap” extension has been implemented into the Zabbix system which enables a visual overview of the key connections' status.

An application was developed for a more precise calculation of the number of customers affected by the failure, tailored to meet the obligation arising from the Ordinance on the manner and conditions for provision of electronic communications networks and services, that in the event of reported and ascertained failures going on for over 24 hours, operators always have to offer the customer a discount on the bill or another way of compensation without the need to object to the bill amount.

During the fourth quarter of 2017, the operational integration of H1's and Optima's

monitoring center was performed and one central organizational unit for both networks was established. Additional load monitoring for the existing interconnection links between H1 and HT networks was introduced in "Zabbix" monitoring system.

Internal Application Development

A new application has been implemented to accelerate the processing of customer complaints.

The SmartCare platform is implemented which enables better tracking of habits of IPTV customers, channel ratings and makes it easier to fix a failure of the IPTV service.

A new application for authorization and granting discounts on packages and additional services was introduced - one click to a new discount.

Activation of invoicing in electronic form (e-bill) is simplified which has resulted with 80% increase in the number of users using the e-bill. Automation of internal processes continued, leading to a reduction of manual back office actions for 10,000 activities per month.

"Master provisioning" is introduced, enabling

faster implementation of new services in systems.

New versions of systems for number portability and work orders were developed.

Infrastructure

During 2017, the project of replacing batteries in collocations continued, with the aim to secure the system's autonomy in the event of an electrical grid failure. During the year, 360 batteries have been replaced at 49 locations, and batteries were tested on 175 out of 317 locations on the territory of whole Croatia. Additionally, the worn-out system for uninterrupted power supply in Zagreb has been replaced by a system which improves the autonomy of the data center in the event of an electrical grid failure.

ICT Solutions

Through ICT solutions, a complete business solution has been offered to customers alongside Optima's standard services, which creates added value. Optima's partner base is expanding constantly, which has resulted in enhancing the Company's presence in the market, and the expansion of the ICT solutions portfolio.

I.9 Financial Results of the Group

Summary (in tsd HRK)	2016	2017	2017/ 2016	Q4 2016	Q4 2017	Q4 2017/ Q4 2016
Total income	454,287	495,091	9.0%	112,292	135,349	20.5%
Total expenses	348,969	389,684	11.7%	81,938	104,408	27.4%
EBITDA	105,319	105,407	0.1%	30,355	30,940	1.9%
One times items	891	6,290	605.8%	173	2,017	1,066.1%
EBITDA before one times items	106,210	111,697	5.2%	30,528	32,957	8.0%
EBITDA margin (before one times items)	23.4%	22.6%	(3.5%)	27.2%	24.3%	(10.4%)
Depreciation and impairment	68,970	150,343	118.0%	18,608	92,710	398.2%
Financial result (net)	(22,531)	(25,565)	13.5%	(7,253)	(6,604)	(9.0%)
Deferred taxes		11,613	100.0%		11,613	100.0%
Net profit/(loss) before income taxes	13,817	(58,888)		4,493	(56,760)	

a. Unconsolidated Results of the Company

Summary (in tsd HRK)	2016	2017	2017/ 2016	Q4 2016	Q4 2017	Q4 2017/ Q4 2016
Total income	454,183	482,173	6.2%	112,264	135,322	20.5%
Total expenses	350,383	376,988	7.6%	82,332	104,346	26.7%
EBITDA	103,799	105,185	1.3%	29,931	30,976	3.5%
One times items	891	4,057	355.2%	173	2,017	1,066.1%
EBITDA before one times items	10,469	10,924	4.3%	30,104	32,993	9.6%
EBITDA margin (before one times items)	23.1%	22.7%	(1.7%)	26.8%	24.4%	(9.1%)
Depreciation and impairment	67,457	146,116	116.6%	18,219	91,767	403.7%
Financial result (net)	(21,586)	(23,537)	9.0%	(7,501)	(6,701)	(10,7%)
Deferred taxes		11,613	100.0%		11,613	100.0%
Net profit/(loss) before income taxes	14,756	(52,855)		4,211	(55,879)	

The Company achieved 6.2% higher revenue, and 4.3% higher EBITDA before special items, compared to the previous year.

This is partly the result of the merging H1 Telekom, which took place on 1 August 2017.

b. Consolidated Revenue

Total telecommunications services revenue in 2017 is 9.0% higher compared to the previous year mainly due to contribution of H1 merger. The same trend is present at the quarterly level.

The increase in revenues in relation to the previous year was mostly due to higher revenues from multimedia by 30.7%, and higher revenues from the Internet by 23.7%, and these segments are the focus of Optima.

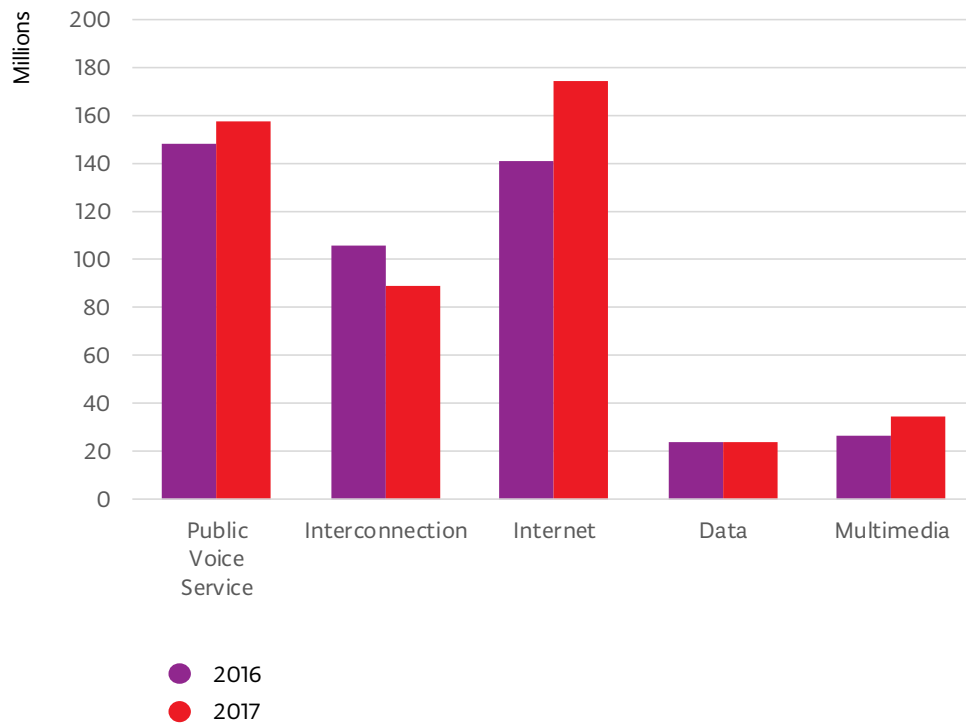
Revenues from public voice services increased by 6.3% compared to the previous year, due to contribution of H1. However, the declining trend of public voice revenues continues to be present, continuing the general trend of declining public voice services, following global trends.

Data revenue growth was at the level of the previous year with a slight increase of 0.2%, thanks to the contribution of H1 in the second half of 2017.

On the other hand, the afore-mentioned positive trends have been partially offset by the 15.7% lower interconnection revenue. The negative trend in interconnection

revenues are also present at the quarterly level, primarily due to the decline in revenues from voice service transit and as a result of low-profit international transit.

Telecommunication Services Revenue



Data Source: Company's business records

c. Earnings before Interest, Taxation and Depreciation – EBITDA

The consolidated EBITDA before special items amounts to HRK 111.7 million, thus being HRK 5.5 million higher compared to the previous year, primarily as a result of H1 merger contribution, both in revenue contribution and in the realized synergy

effects on costs, which significantly contributes to optimization of the entire business.

Positive effects are visible both at the yearly level and at the level of the fourth quarter.

d. Net Profit/(Loss)

Despite a positive contribution from operating results in 2017, the net result is lower by HRK 72.7m compared to the previous year, mostly as a result of the

impairment of goodwill and H1's trademark and higher amortization costs and financial results also resulting from the merged H1.

e. Capital Investments in 2017

Consolidated capital investments in 2017 amounted to HRK 59.1 million. Out of this, HRK 29.7 million has been invested in the development of access fibre optic network, expanding the collocations network, user equipment for providing the IPTV and Internet service for residential customers, as

well as the equipment to connect new business customers. HRK 9.5 million has been invested into the core network which was prevalently used for further expansion of the core network onto 10G technology, while HRK 18.6 million have been invested in expanding the range of customer services.

	2017 (in 000 kn)	share %
General Investments	1,344	2.3%
Capital Technical Investments	57,800	97.7%
ACCESS Network	29,682	50.2%
CORE Network	9,525	16.1%
Telecommunications Center	18,594	31.4%
TOTAL	59,144	100.0%

f. Risk Management

Currency Risk Management

The currency risk is the risk that the value of financial instruments will change due to exchange rate changes. The Group's and Company's highest exposure to currency risk arises out of long-term loans, denominated in foreign currencies and recalculated into

HRK applying the relevant exchange rates as per the balance sheet date. Any exchange rate divergences shall be attributed to operating costs or recorded in the profit and loss account, but do not influence the cash flow.

Interest Risk

The Group's and Company's exposure to interest risk is not significant, given that the Group's and Company's liabilities have not been agreed subject to variable interest rates.

The remaining assets and liabilities, including issued bonds, are not exposed to interest risk.

Credit Risk

The credit risk is the risk that the other party will fail to meet its contractual obligations arising out of potential financial losses of Group and Company. Group and Company do not have a significant credit risk concentration with contractual parties possessing similar characteristics and have adopted procedures that apply in buyer transactions. Group and Company receives sufficient collaterals, if necessary, as a means to mitigate the risk of financial loss due to unfulfilled obligations and offers no guarantees for third party liabilities. Group and Company sees maximum exposure of

third parties reflected in the amount of receivables from debtors, minus impairment recognized at the financial position report date.

Apart from this, Group and Company are exposed to the risk of money deposits in banks. Management of this risk is focused on dealing with the most reputable banks, both domestic and international, and in both the domestic and international markets, and based on daily contact with the banks.

Liquidity Risk Management

The Board of Directors has the responsibility for liquidity risk management and sets the appropriate framework for liquidity risk management, with a view to manage short-term, mid-term and long-term financing and liquidity requirements. Group and Company manage the liquidity risk by maintaining adequate reserves and credit lines, continuously comparing the planned and achieved cash flow and monitoring the receivables and liabilities due dates.

I.10 Own Shares

On 31 December 2017 Optima does not own treasury shares.

II. Statement Regarding the Application of the Code of Corporate Governance

In accordance with articles 250a and 250b of the Companies Act, the Company has compiled the Annual Management Report on the Status and Business of the Company and the Group for 2016, which contains the Statement Regarding the Application of the Code of Corporate Governance.

In the course of its business, the Company strives to adhere to the highest possible extent to the recommendations of the Code of Corporate Governance as published on the website of Zagrebačka Burza d.d., taking into account all the circumstances and specificities of its business organisation.

The Company adheres to the recommendations in the Code of Corporate Governance with the exception of those provisions that cannot be considered practicable under the present circumstances:

- For those shareholders who are not able to vote in the General Meeting for whatever reason, the Company has not provided proxies obligated to vote according to their instructions, with no extra costs. The shareholders unable to vote personally choose their own proxy who is obligated to vote according to their instructions.
- There is no decision on dividend payment or dividend advance, considering that the dividend has not been paid in 2017.
- During the General Meeting, the shareholders were not given the opportunity to vote using modern communications technology because this has not been provided in the Statute.
- The work of the Supervisory Board is not regulated by special internal rules. The provisions of the Companies Act apply to the work of the Supervisory Board. However, the Supervisory Board has a Committee in place for the supervision of synergy measures, in accordance with the terms of the cleared concentration between Hrvatski Telekom d.d. and the Company. The work of the abovementioned Committee is regulated by the terms set out in the Decision of the Croatian Competition Agency class: UP/I 034-03/2013-02/007, Cons. no. 580-06/41-14-096 of 19 March 2014. and Decision of the same Agency class: UP/I 034-03/2013-02/007; Cons. No.: 580-11/41-17-239 of 9 June 2017.
- The Supervisory Board does not have a majority of independent members, as defined in the Code's recommendations. All Supervisory Board members have been elected at the Company's General Meeting with adherence to the procedure of publishing candidacies.
- No long-term plan of succession was created in the Company because the Company invests in employee training taking into account business requirements.
- The Supervisory Board Members' right to remuneration for their work has been determined in a General Meeting decision, in a fixed monthly amount.

- There are no contracts or agreements between the Supervisory Board member and the Company itself, with the exception of the employment contract for one member of the Supervisory Board - the elected representative of the Company employees, therefore the work contract in question has not been previously approved by the Supervisory Board and the Annual Report contains information on the aggregate amount of payments made to the members of the Management Board and the Supervisory Board.
- The Audit Committee does not consist mostly of independent Supervisory Board members. The majority of the members of the Committee are Supervisory Board Members who have a business relationship with majority shareholders, and one of them is an employee of the majority shareholder.
- The Company does not have a statement regarding bonus policies for the Board of Directors and the Supervisory Board. The Company publishes information on all payments

to the members of the Board of Directors and the Supervisory Board. The said information is published in aggregate within the Company's annual report.

- The Company carries out internal control through internal procedures which include the supervision of proper fulfilment of obligations. Therefore, within the meaning of the Code of Corporate Governance, there is no special organisational unit dealing exclusively with internal control, apart from the abovementioned Audit Committee.

Special Note:

The Supervisory Board has in place the Committee for the supervision of synergy measures, the Committee for appointments and bonuses (founded 10 December 2015), and at the beginning of 2016 the Audit Committee was founded with the purpose of a detailed analysis of financial reports, providing support to the Company's accounting and setting up a good and quality internal control of the Company.

II.1 Internal Audit in the Company and Risk

Management in Correlation with Financial Reporting

Supervisory Board has set up an Audit Commission, with the task to analyze the financial reports in detail, support the Company's accounting and establish a good quality internal control of the Company.

The Company does not have a separate

organizational unit tasked solely with internal auditing, but the Company does have a corporate security organizational unit that works on minimizing all operating risks, among its regular activities.

II.2 Significant Shareholders in the Company as per 31.12.2017

As per 31 December 2017 the Company's majority shareholder is Zagrebačka banka

d.d. having a 36.9% share in the share capital.

II.3 Rules on Appointment and Recall of the members of the Board of Directors and the Supervisory Board and Their Powers

The Company's affairs are managed by a Board of Directors consisting of three to five members. One of the members is appointed as the Chairman of the Board. The Board of Directors and the Chairman of the Board are appointed and recalled by the Supervisory Board. The members of the Board of Directors are appointed for a term of 2 years and can be reappointed. Pursuant to the Companies Act and the Statute, the Board of Directors is solely responsible for conducting

the Company's business and has the power to undertake all actions and make such decisions as it deems necessary for successful management of the Company. The Board of Directors is obligated to observe the limitations set out in the Statute. Every member of the Board of Directors represents the Company jointly with another member of the Board of Directors.

The Supervisory Board consists of nine members, one of which is appointed by the employees. The General Meeting elects the Supervisory Board by an ordinary majority of votes, apart from the employee-appointed member. The mandate of Supervisory Board members is set at 4 years, and they can be re-elected. Supervisory Board members elect the Chairman and Deputy Chairman of the Supervisory Board amongst themselves. The Deputy Chair has the rights and obligations of the Chairman only when the Chairman is unable to carry out his/her function.

For specific transactions, or decisions of the Board of Directors, the Board of Directors is

obligated to obtain the previous consent of the Supervisory Board, according to the criteria provided in Art. 15 of the Statute. Within its scope of activities, the Supervisory Board handles the tasks laid down by Art. 18 of the Statute.

In line with Art. 8 of the Statute, within five years from the registration of Statute amendments with the Court Registry, the Board of Directors is authorized to increase the Company's share capital once or several times by a total sum of one hundred and eighty Croatian Kuna (authorized capital). Such a share capital increase requires the Supervisory Board's consent.

II.4 Changes in the Company's Governing Bodies

In the course of 2017 membership change occurred in Optima's Supervisory Board since the former Chairman of the Supervisory Board, Siniša Đuranović, withdrew from membership and from position of the Chairman of Optima's Supervisory Board on 31 May 2017, due to the taking over the position that is procedurally incompatible with the membership in the Optima's Supervisory Board.

On the regular Optima's General Assembly meeting held on 11 July 2017, Mr. Igor Vavro was appointed as a Member of the Optima Supervisory Board, while Supervisory Board appointed Mr. Vavro as a Chairman of the Supervisory Board on its meeting dated 26 July 2017. There were no other changes in Optima's Supervisory Board in the observed period and Board Members are: Igor Vavro, Chairman; Ariana Bazala-Mišetić, Deputy Chairman; Marina Brajković – Member; Jasenka Anica Kreković, Member; Marko

Makek, Member; Ana Hanžeković, Member; Rozana Grgorinić, Member; Maša Serdinšek, Member; Ivica Hunjek, Member – Employee Representative.

During the observed period, on 7 March 2017, the Supervisory Board re-appointed Mrs. Irena Domjanović as the Member of the Management Board. According to decision of the Supervisory Board the mandate lasts two years and starts with the day of previous mandate expiration.

Board of directors consists of: Zoran Kežman, President of the Board; Mirela Šešerko, Member of the Board; Irena Domjanović, Member of the Board; Tomislav Tadić, Member of the Board.

The Company does not have a written diversity policy.

III. Independent Auditor's Report on the Annual Report and Consolidated Financial Reports

IV. Financial Reports of the Group