

DALEKOVOD d.d.

**AUDITORS' REPORT AND
CONSOLIDATED FINANCIAL STATEMENTS
31 DECEMBER 2006**

FREE TRANSLATION FROM CROATIAN ORIGINAL

Independent auditor's report

To the Shareholders of DALEKOVOD d.d.

We have audited the accompanying consolidated financial statements of DALEKOVOD d.d. and its subsidiaries (the 'Group') which comprise the consolidated balance sheet as of 31 December 2006 and the consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.


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

Opinion

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2006, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.


PricewaterhouseCoopers d.o.o.
Zagreb, 26 April 2007


Tatjana Rukavina
President of the Management Board


Vladimir Topolnjak
Certified auditor

DALEKOVOD d.d.**CONSOLIDATED INCOME STATEMENTS****FOR THE YEAR ENDED 31 DECEMBER 2006**

<i>(all amounts are expressed in thousands of HRK)</i>	Note	2006	2005
Sales	5	1,452,723	1,315,867
Other income	6	7,229	9,728
		1,459,952	1,325,595
Operating expenses			
Change in work in progress and finished goods		(36,528)	(27,956)
Cost of materials and services	7	(843,022)	(822,124)
Staff costs	8	(305,192)	(248,720)
Depreciation and amortisation	15, 16	(35,833)	(30,680)
Other operating expenses	9	(124,049)	(98,954)
Other (losses)/gains – net	10	(2,909)	937
		112,419	98,098
Operating profit			
Finance income	11	1,022	6,185
Finance costs	11	(19,120)	(13,016)
		(18,098)	(6,831)
Profit before tax			
		94,321	91,267
Income tax expense	12	(23,083)	(20,419)
Net profit			
		71,238	70,848
Attributable to:			
Equity holders of the Company		72,324	71,879
Minority interest		(1,086)	(1,031)
Net profit			
		71,238	70,848
Earnings per share – basic and diluted (in HRK)			
	13	31.88	31.67

The financial statements set out on pages 2 to 38 were approved by the Management Board on 26 April 2007.

President of the Board/General Manager:

Luka Miličić, M. Sc. C. E.

The accompanying notes form an integral part of these consolidated financial statements.

DALEKOVOD d.d.**CONSOLIDATED BALANCE SHEET****AS AT 31 DECEMBER 2006**

<i>(all amounts are expressed in thousands of HRK)</i>	Note	As at 31 December	
		2006	2005
ASSETS			
Non-current assets			
Intangible assets	15	9,697	5,996
Property, plant and equipment	16	411,633	350,007
Prepayments for property, plant and equipment	16	1,273	908
Investment in subsidiaries	17	253	225
Available for sale financial asset	18	7,485	6,746
Loans and receivables	19	14,767	7,994
		<u>445,108</u>	<u>371,876</u>
Current assets			
Inventories	20	195,004	162,350
Trade and other receivables	21	557,023	438,395
Financial assets at fair value through profit or loss	22	6,687	-
Cash and cash equivalents	23	29,425	53,005
		<u>788,139</u>	<u>653,750</u>
Total assets		<u>1,233,247</u>	<u>1,025,626</u>
SHAREHOLDERS' EQUITY AND LIABILITIES			
Shareholders' equity			
Share capital	24	229,381	229,381
Legal reserves		11,487	11,487
Treasury shares		(1,244)	(1,244)
Statutory reserves		127,459	84,085
Other reserves		31,773	33,885
Retained earnings		73,057	71,879
		<u>471,913</u>	<u>429,473</u>
Minority interest		<u>13,754</u>	<u>14,605</u>
Total equity		<u>485,667</u>	<u>444,078</u>
Non-current liabilities			
Borrowings	25	182,899	169,669
Provisions	27	7,273	-
		<u>190,172</u>	<u>169,669</u>
Current liabilities			
Borrowings	25	219,324	118,780
Trade and other payables	26	332,615	286,739
Income tax payable		5,469	6,360
		<u>557,408</u>	<u>411,879</u>
Total liabilities		<u>747,580</u>	<u>581,548</u>
Total shareholders' equity and liabilities		<u>1,233,247</u>	<u>1,025,626</u>

The accompanying notes form an integral part of these consolidated financial statements.

DALEKOVOD d.d.

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

FOR THE YEAR ENDED 31 DECEMBER 2006

(all amounts are expressed in thousands of HRK)

	Note	Share capital	Legal reserves	Treasury shares	Statutory reserves	Other reserves	Retained earnings	Minority interest	Total
Year ended 31 December 2005									
Balance at 1 January 2005		229,381	11,487	(396)	41,452	33,355	71,650	3,395	390,324
Currency translation differences		-	-	-	-	530	-	(124)	406
Net income recognised directly in equity		-	-	-	-	530	-	(124)	406
Net profit for the year		-	-	-	-	-	71,879	(1,031)	70,848
Total income recognised for 2005		-	-	-	-	530	71,879	(1,155)	71,254
Dividend relating to 2004	14	-	-	-	-	-	(29,017)	-	(29,017)
Purchase of treasury shares		-	-	(848)	-	-	-	-	(848)
Increase in minority interest – Unidal d.o.o.	17	-	-	-	-	-	-	12,365	12,365
Statutory reserves		-	-	-	42,633	-	(42,633)	-	-
Balance at 31 December 2005	23	229,381	11,487	(1,244)	84,085	33,885	71,879	14,605	444,078
Year ended 31 December 2006									
Balance at 1 January 2006		229,381	11,487	(1,244)	84,085	33,885	71,879	14,605	444,078
Currency translation differences		-	-	-	-	(867)	-	235	(632)
Net income recognised directly in equity		-	-	-	-	(867)	-	235	(632)
Net profit for the year		-	-	-	-	-	72,324	(1,086)	71,238
Total income recognised for 2006		-	-	-	-	(867)	72,324	(851)	70,606
Transfer to statutory reserves		-	-	-	43,374	-	(43,374)	-	-
Dividend relating to 2005		-	-	-	-	-	(29,017)	-	(29,017)
Transfer from other reserves		-	-	-	-	(1,245)	1,245	-	-
Balance at 31 December 2006		229,381	11,487	(1,244)	127,459	31,773	73,057	13,754	485,667

The accompanying notes form an integral part of these consolidated financial statements.

DALEKOVOD d.d.**CONSOLIDATED CASH FLOW STATEMENT****FOR THE YEAR ENDED 31 DECEMBER 2006**

<i>(all amounts are expressed in thousands of HRK)</i>	Note	2006	2005
Cash flows from operating activities			
Cash generated from operations	28	24,093	84,718
Interest paid		(18,233)	(12,997)
Income tax paid		(23,974)	(14,554)
Net cash (outflow)/inflow from operating activities		(18,114)	57,167
Cash flows from investing activities			
Purchase of intangible assets	15	(4,707)	(4,168)
Purchase of property, plant and equipment		(97,498)	(86,787)
Proceeds from sale of property, plant and equipment	28	853	7,669
Loans granted		(17,459)	(4,734)
Loan repayments received		17,746	17,301
Investment in subsidiaries and associate	17	(28)	(200)
Investment in available-for-sale financial assets	18	(739)	(6,681)
Investment in financial assets	22	(6,350)	-
Interest received		3,037	3,197
Net cash used in investing activities		(105,145)	(74,403)
Cash flows from financing activities			
Proceeds from borrowings		327,550	255,713
Repayments of borrowings		(212,993)	(174,262)
Dividends paid		(14,878)	(42,455)
Net cash from financing activities		99,679	38,996
Net (decrease)/increase in cash and cash equivalents		(23,580)	21,760
Cash and cash equivalents, beginning of year		53,005	31,245
Cash and cash equivalents, end of year	23	29,425	53,005
Net (decrease)/increase in cash and cash equivalents		(23,580)	21,760

The accompanying notes form an integral part of these consolidated financial statements.

NOTE 1 – GENERAL INFORMATION

The Dalekovod Group (the Group) comprises the parent company Dalekovod d.d., Zagreb and seven subsidiaries (2005: seven) – Note 17.

Dalekovod d.d., Zagreb (the Company) is privately owned and was incorporated in compliance with the laws and regulations of the Republic of Croatia. The registered office of the Company is in Zagreb, Marijana Čavića 4. As at 31 December 2006, the Company's shares were listed on the public joint stock company listing on the Zagreb Stock Exchange.

The Company's principal activity is the engineering, production, construction and installation of electric power facilities, facilities for road, railroad and mass transit and telecommunication infrastructure.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated. All policies applicable to the Group are also applicable to the Group, unless otherwise stated.

2.1 Basis of preparation

The financial statements of the Group have been prepared in accordance with International Financial Reporting Standards (IFRS) under the historical cost convention, as modified by financial assets at fair value through profit or loss and available for sale financial assets.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in Note 4.

(a) Standards early adopted by the Group

No standards were early adopted by the Group.

(b) Standards, amendments and interpretations effective in 2006 but not relevant

The following standards, amendments and interpretations are mandatory for accounting periods beginning on or after 1 January 2006 but are not relevant to the Group's operations:

- IAS 19 (Amendment), Employee Benefits
- IAS 21 (Amendment) - Net Investment in a Foreign Operation
- IAS 39 (Amendment), The Fair Value Option
- IAS 39 (Amendment), Cash Flow Hedge Accounting of Forecast Intragroup Transactions
- IAS 39 and IFRS 4 (Amendment), Financial Guarantee Contracts
- IFRS 1 (Amendment), First-Time Adoption of International Financial Reporting Standards
- IFRS 6 and IFRS 6 (Amendment), Exploration for and Evaluation of Mineral Resources
- IFRIC 4, Determining whether an Arrangement contains a Lease
- IFRIC 5, Rights to interest arising from Decommissioning, Restoration and Environmental Rehabilitation Funds
- IFRIC 6, Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2006

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.1 Basis of preparation (continued)

(c) *Standards and interpretations to existing standards that are not yet effective and have not been early adopted by the Group*

The following standards, amendments and interpretations to existing standards are mandatory for the Group's accounting period beginning on or after the effective date, but have not been early adopted by the Group:

- *IFRS 7, Financial Instruments: Disclosures and the complementary Amendment to IAS 1, Presentation of Financial Statements – Capital Disclosures (effective from 1 January 2007)*. IFRS 7 introduces new disclosures to improve the information about financial instruments. It requires the disclosure of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk, including sensitivity analysis to market risk. It replaces disclosure requirements in IAS 32, Financial Instruments: Disclosure and Presentation. The amendment to IAS 1 introduces disclosures about the level of an entity's capital and how it manages capital. The Group will apply IFRS 7 and the amendment to IAS 1 beginning 1 January 2007, and is still assessing the relating impact.
- *IFRS 8, Business segments (effective from 1 January 2009)*. IFRS 8 replaces IAS 14 and adjusts segment reporting to internal reporting procedures of each entity. The Group assessed the impact of IFRS 8, and concluded that segment reporting will be summarised and focused on the income statement. The Group will apply IFRS 8 for annual periods after 1 January 2009.
- *IAS 23 (revised) - Borrowing costs - (effective from 1 January 2009)*. Standard removes the option of immediately recognising as an expense borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset. The Group is currently assessing what impact it will have on disclosures in its financial statements. The standard will be applied in annual periods after 1 January 2009.

d) *Interpretations to existing standards that are not yet effective and are not relevant to the Group's operations*

The following interpretations to existing standards are mandatory for the Group's accounting period beginning on or after the effective date, but are not relevant to the Group's operations:

- *IFRIC 7, Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies (effective from 1 March 2006)*. IFRIC 7 is not relevant as the Group does not operate in a hyperinflationary environment.
- *IFRIC 8, Scope of IFRS 2 (effective from 1 May 2006)*. IFRIC 8 is not relevant, since to date the Group only had restricted share-based payment transactions.
- *IFRIC 9, Reassessment of embedded derivatives (effective from 1 June 2006)*. IFRIC 9 is not relevant to the Group's operations because it does not have any embedded derivatives.
- *IFRIC 10, Interim Financial Reporting and Impairment (effective from 1 November 2006)*. IFRIC 10 is not relevant to the Group's operations because interim financial reports are not produced.
- *IFRIC 11, IFRS 2 – Group and Treasury share transactions (effective from 1 March 2007)*. IFRIC 11 is not relevant since the parent Group does not have payment arrangements involving its' own equity instruments granted to other Group companies.
- *IFRIC 12, Service Concession Arrangements (effective from 1 November 2008)*. IFRIC 12 is applicable to companies participating in service concession agreements, which is not relevant for the Group's activities.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.2 Consolidation

(a) Subsidiaries

Subsidiaries are all entities over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group (acquisition date). They are de-consolidated from the date that control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. The date of exchange is the acquisition date where a business combination is achieved in a single transaction, and is the date of each share purchase where a business combination is achieved in stages by successive share purchases.

Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement.

Inter-company transactions, balances and unrealised gains on transactions between Group companies are eliminated in consolidation. Unrealised losses are also eliminated but considered an impairment indicator of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

(b) Transactions and minority interests

The Group applies a policy of treating transactions with minority interests as transactions with parties external to the Group. Disposals to minority interests result in gains and losses for the Group that are recorded in the income statement. Purchases from minority interests result in goodwill, being the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary.

2.3 Segment reporting

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and returns that are different from those of segments operating in other economic environments.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.4 Foreign currencies

(a) Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The consolidated financial statements are presented in Croatian kuna (HRK), which is the Group's functional and presentation currency.

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

(c) Group companies

The results and financial position of all the Group entities that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- (i) assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;
- (ii) income and expenses for each income statement are translated at average exchange rates; and
- (iii) all resulting exchange differences are recognised as a separate component of equity.

On consolidation, exchange differences arising from the translation of the net investment in foreign operations are taken to 'Cumulative translation reserves' within shareholders' equity. When a foreign operation is partially disposed of or sold, exchange differences that were recorded in equity are recognised in the income statement as part of the gain or loss on sale.

2.5 Property, plant and equipment

Property, plant and equipment is included in the balance sheet at historical cost less accumulated depreciation and provision for impairment, where required. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognised. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2006

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.5 Property, plant and equipment (continued)

Land and work in progress 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, as follows:

	<u>Useful lives in years</u>
Buildings	20 – 40
Plant, machinery and equipment	8 – 10
Transportation vehicles	5 – 8
Leasehold improvements	Over the term of the underlying lease
Other	5 – 10

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

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (Note 2.8).

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the line item "other (losses)/gains - net" in the income statement.

2.6 Investment properties

Investment property, principally comprising office buildings and land, is held for long-term rental yields or appreciation and is not occupied by the Group. Investment property is treated as a long-term investment unless it is intended to be sold in the next year and a buyer has been identified in which case it is classified within current assets.

Investment property is carried at historical cost less accumulated depreciation and provision for impairment, where required. Depreciation for buildings is calculated using the straight-line method to allocate cost over estimated useful life (20 to 40 years).

Subsequent expenditure is capitalised only when it is probable that future economic benefits associated with it will flow to the Group and the cost can be measured reliably. All other repairs and maintenance costs are expensed when incurred. If an investment property becomes owner-occupied, it is reclassified to property, plant and equipment, and its carrying amount at the date of reclassification becomes its deemed cost to be subsequently depreciated.

2.7 Intangible assets

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised over their estimated useful lives (5 years).

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.8 Impairment of non-financial assets

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

2.9 Financial assets

The Group classifies its financial assets in the following categories: at fair value through profit or loss, available for sale financial assets and loans and receivables. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition.

(a) Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss are financial assets held for trading. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term. Assets in this category are classified as current assets.

Financial assets carried at fair value through profit or loss are initially recognised at fair value and transaction costs are expensed in the income statement.

Gains or losses arising, from changes in the fair value of the 'financial assets at fair value through profit or loss' category are presented in the income statement within the line item 'other (losses)/gains - net' in the period in which they arise.

(b) Available for sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the balance sheet date. Available-for-sale financial assets are carried at fair value.

Changes in the fair value of monetary securities and non-monetary securities classified as available-for-sale are recognised in equity.

In the case of equity securities classified as available for sale, a significant or prolonged decline in the fair value of the security below its cost is considered as an indicator that the securities are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in the income statement.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.9 Financial assets (continued)

When securities classified as available-for-sale are sold or impaired, the accumulated fair value adjustments recognised in equity are included in the income statement in line item 'other (losses)/gains - net'.

Interest on available-for-sale securities calculated using the effective interest rate method is recognised in the income statement. Dividends on available-for-sale securities are recognised in the income statement when the Group's right to receive payment is established.

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement.

(c) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the balance sheet date. These are classified as non-current assets.

Loans and receivables are carried at amortised cost using the effective interest method. Impairment testing of loans and receivables is described in Note 2.12.

2.10 Leases

The Group is a lessee

The Group leases certain property, plant and equipment. Leases of property, plant and equipment, where the Group has substantially all the risks and rewards of ownership, are classified as finance leases. Finance leases are capitalized at the lease's commencement at the lower of fair value of the leased property or the present value of minimum lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the balance outstanding. The interest element of the finance costs is charged to the income statement over the lease period. The property, plant and equipment acquired under finance leases are depreciated over the shorter of the useful life or the lease term.

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

The Group is the lessor

Assets under an operating lease are depreciated over their expected useful lives on a basis consistent with similar owned assets. Rental income is recognised on a straight-line basis over the lease term, even if the proceeds are not balanced, unless there is an alternative basis representing the time frame in which the benefits of the lease and the depreciation of the leased property are matched.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.11 Inventories

Inventories of raw materials and spare parts are stated at the lower of cost, determined using the weighted average method, or net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

The cost of work-in-process and finished goods comprise raw materials, direct labour, other direct costs and related production overheads (based on normal operating capacity).

Small inventory and tools are expensed when put into use.

2.12 Trade and loan receivables

Trade and loan receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy, and default or delinquency in payments are considered indicators that the receivable is impaired. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the effective interest rate. The amount of the provision is recognised in the income statement within "other operating expenses".

2.13 Construction contracts

Contract costs are recognised when incurred.

When the outcome of a construction contract cannot be estimated reliably, contract revenue is recognised only to the extent of contract costs incurred that are likely to be recoverable.

When the outcome of a construction contract can be estimated reliably and it is probable that the contract will be profitable, contract revenue is recognised over the period of the contract. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately.

The Group uses the 'percentage of completion method' to determine the appropriate amount to recognise in a given period. The stage of completion is measured by reference to the contract costs incurred up to the balance sheet date as a percentage of total estimated costs for each contract. Costs incurred in the year in connection with future activity on a contract are excluded from contract costs in determining the stage of completion. They are presented as inventories, prepayments or other assets, depending on their nature.

The Group presents as an asset the gross amount due from customers for contract work for all contracts in progress for which costs incurred plus recognised profits (less recognised losses) exceed progress billings. Progress billings not yet paid by customers and retention are included within 'trade and other receivables'.

The Group presents as a liability the gross amount due to customers for contract work for all contracts in progress for which progress billings exceed costs incurred plus recognised profits (less recognised losses).

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.14 Cash and cash equivalents

Cash and cash equivalents comprise cash in hand, deposits held at call with banks and other short-term highly liquid instruments with original maturities of three months or less.

2.15 Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

Where the Group purchases its equity share capital (treasury shares), the consideration paid, including any directly attributable incremental costs (net of income taxes) is deducted from equity attributable to the Group's equity holders until the shares are cancelled, reissued or disposed of. Where such shares are subsequently sold or reissued, any consideration received, net of any directly attributable incremental transaction costs and the related income tax effects, is included in equity attributable to the Group's equity holders.

2.16 Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method. The Group does not capitalise borrowing costs.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

2.17 Deferred income tax

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

2.18 Trade and other payables

Trade and other payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.19 Employee benefits

(a) Pension obligations and post-employment benefits

In the normal course of business through salary deductions, the Group makes payments to mandatory pension funds on behalf of its employees as required by law. All contributions made to the mandatory pension funds are recorded as salary expense when incurred.

Furthermore, according to Collective union agreement the Group has obligation to pay the employee severance at the time of employee's retirement. The liability recognised in the balance sheet is the present value of defined benefit obligation at the balance sheet date less past service costs with adjustments for unrecognised actuarial gains or losses. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of governmental bonds that are denominated in the currency in which the benefits will be paid and that have terms to maturity approximating to the terms of the related retirement severance payment.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions in excess of 10% of the defined benefit obligation are charged or credited to income over the employee's expected average remaining working lives.

Past-service costs are amortised on a straight-line basis over the employee's expected average remaining working life.

In addition, the Group is not obliged to provide any other post-employment benefits.

(b) Termination benefits

Termination benefits are payable when employment is terminated by the Group before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Group recognises termination benefits when it is demonstrably committed to either: terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal; or providing termination benefits as a result of an offer made to encourage voluntary redundancy. Benefits falling due more than 12 months after the balance sheet date are discounted to present value.

(c) Long-term employee benefits

The Group recognises a liability for long-term employee benefits evenly over the period the benefit is earned based on actual years of service. Long-term employee benefit liability is determined using assumptions regarding the likely number of staff to whom the benefit will be payable, estimated benefit cost and the discount rate.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.20 Provisions

Provisions are recognised when: the Group has a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

2.21 Revenue recognition

Revenue comprises the fair value of the consideration received or receivable for the sale of goods and services in the ordinary course of the Group's activities. Revenue is shown, net of value-added tax, estimated returns, rebates and discounts. The Group recognises revenue when the amount of revenue can be reliably measured, it is probable that future economic benefits will flow to the entity and specific criteria have been met for each of the Group's activities as described below.

(a) Revenue from construction contracts

When the outcome of a construction contract cannot be estimated reliably, contract revenue is recognised only to the extent of contract costs incurred that are likely to be recoverable. When the outcome of a construction contract can be estimated reliably and it is probable that the contract will be profitable, contract revenue is recognised over the period of the contract (Note 2.13)

(b) Sales of goods

Sales of goods are recognised when the Group has delivered products to the customer, the customer has accepted the products and collectibility of the related receivables is reasonably assured.

(c) Interest income

Interest income is recognised on a time-proportion basis using the effective interest method. When a receivable is impaired, the Group reduces the carrying amount to its recoverable amount, being the estimated future cash flow discounted at original effective interest rate of the instrument, and continues unwinding the discount as interest income. Interest income on impaired loans is recognised using the original effective interest rate.

(d) Dividend income

Dividend income is recognised when the right to receive payment is established.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.22 Dividend distribution

Dividend distribution to the Company's shareholders is recognised as a liability in the financial statements in the period in which the dividends are approved by the Company's shareholders.

2.23 Earnings per share

Earnings per share is determined by dividing the profit or loss attributable to equity holders of the Group by the weighted average number of participating shares outstanding during the reporting year.

2.24 Value added tax

The Tax Authorities require the settlement of VAT on a net basis. VAT related to sales and purchases is recognised and disclosed in the balance sheet on a net basis. Where provision has been made for impairment of receivables, impairment loss is recorded for the gross amount of the debtor, including VAT.

2.25 Comparatives

Where necessary, corresponding figures have been adjusted to conform with changes in the presentation of the current year. Management believes that this is better presentation and in compliance with disclosed accounting policies. Interest income from bank deposits relating to 2005 has been reclassified from other operating income to finance income in the total amount of HRK 37 thousand. VAT receivable of HRK 16,214 thousand as at 31 December 2005 is netted with VAT payable. Consequently, total asset as at 31 December 2005 decreased by the same amount.

NOTE 3 – FINANCIAL RISK MANAGEMENT

3.1 Financial risk factors

The Group's activities expose it to a variety of financial risks: foreign exchange risk, credit risk, liquidity risk and cash flow and fair value interest rate risk. The Group does not have a written risk management programme, but overall risk management in respect of these risks is carried out by the Group's finance department.

(a) Foreign exchange risk

The majority of the Group's foreign sales revenue is denominated in EUROS. The Group's domestic sales revenue is denominated in HRK. The majority of long-term and short-term loans were agreed with a currency clause, i.e. they are linked to the EURO. Any movement in exchange rates between the EURO and Croatian kuna will have an impact on the Group's operating results.

The Group's operating results are not directly influenced by movements in exchange rates, due to the Group's specific operating activities according to which it may set prices in order to neutralise the impact of movements in exchange rates. Simultaneously, income expected from work in progress is sufficiently high to neutralise the impact of movements in exchange rates. The Group does not use derivative instruments to actively hedge foreign exchange risk exposure.

NOTE 3 – FINANCIAL RISK MANAGEMENT (continued)

3.1 Financial risk factors (continued)

(b) Credit risk

The Group has no significant concentrations of credit risk. It has policies in place to ensure that sales of products are made to customers with an appropriate credit history. A favourable structure of buyers and the fact that, if necessary, collection from buyers is regulated by bank payment guarantees, bills of exchange, letters of credit and other types of security, almost completely diminishes the risk arising from the collection of trade receivables. The Group has no other significant concentrations of credit risk.

The Group has policies that limit the amount of credit exposure to any financial institution.

(c) Liquidity risk

Prudent liquidity risk management implies maintaining sufficient cash, the availability of funding through an adequate amount of committed credit facilities and the ability to meet all obligations. The Group aims to maintain flexibility in funding by keeping committed credit lines available. The finance department regularly monitors available cash resources.

(d) Cash flow and fair value interest rate risk

As the Group has no significant interest-bearing assets, the Group's income and operating cash flows are substantially independent of changes in market interest rates.

The Group's interest rate risk arises from long-term borrowings. Borrowings issued at variable rates expose the Group to cash flow interest rate risk. Borrowings issued at fixed rates expose the Group to fair value interest rate risk. Most borrowings are granted at variable interest rates.

The Group does not use derivative instruments to actively hedge cash flow and fair value interest rate risk exposure.

3.2 Fair value estimation

The fair value of financial instruments traded in active markets is based on quoted market prices at the balance sheet date. The quoted market price used for financial assets held by the Group is the current bid price. The fair value of financial instruments that are not traded in an active market is determined by using valuation techniques. The Group uses a variety of methods and makes assumptions that are based on market conditions existing at each balance sheet date.

The nominal value less impairment provision of trade receivables and payables are assumed to approximate their fair values.

The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate that is available to the Group for similar financial instruments.

NOTE 4 – CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, rarely equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are outlined below.

(a) Revenue recognition

The Group uses the percentage-of-completion method in accounting for its revenue from construction contracts to determine the appropriate amount to recognise in a given period. The stage of completion is measured by reference to the contract costs incurred up to the balance sheet date as a percentage of total estimated costs for each contract. If the estimated stage of completion would differ by 10% from management's estimates, the amount of revenue recognized in the year would be increased by HRK 4,820 thousand if the percentage of completion were increased, or would be decreased by HRK 4,191 thousand if the percentage of completion were decreased.

(b) Long-term employee benefits

In 2006, the Group recognised non-current liabilities to employees including liabilities for jubilee awards and retirement benefits in the amount of the estimated present value of future expenses. The present value estimation is based on the calculation performed by a certified actuary.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2006

NOTE 5 – SEGMENT INFORMATION

Primary reporting format – business segments

The Group separately monitors and presents business results of basic business segments, Production and Construction, whose operating activities are interrelated for the purpose of realising profit for the Group.

1. The segment of Production includes the forging works, the casting plant and the laboratory for quality control and the production of metal frames/structures.
2. The segment of Construction includes the construction of power and distribution facilities, transformer stations, laying submarine, subterranean and telecommunication cables, posting public lighting, installing antenna, television and telecommunication posts as well as work relating to the construction of motorways.
3. Other business segments includes separately Project design, zinc coating facility and other activities (subsidiary activities, restaurant and common services).

*Operating results by business segments**(In thousands of HRK)*

	<u>Construction</u>	<u>Production</u>	<u>Other</u>	<u>Total</u>
Year ended 31 December 2006				
Gross segment revenues	1,077,816	466,737	143,493	1,688,046
Inter-segment sales	(12,105)	(126,633)	(89,356)	(228,094)
Operating revenues	1,065,711	340,104	54,137	1,459,952
Operating profit	85,885	1,112	25,422	112,419
Finance cost				(18,098)
Profit before tax				94,321
Income tax expense				(23,083)
Net profit				71,238
Year ended 31 December 2005				
Gross segment revenues	1,090,021	343,147	160,990	1,594,158
Inter-segment sales	(52,574)	(97,701)	(118,288)	(268,563)
Operating revenues	1,037,447	245,446	42,702	1,325,595
Operating profit	92,031	1,329	4,738	98,098
Finance cost				(6,831)
Profit before tax				91,267
Income tax expense				(20,419)
Net profit				70,848

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2006

NOTE 5 – SEGMENT INFORMATION (continued)

Other segment information included in the income statement:

<i>(In thousands of HRK)</i>	<u>Construction</u>	<u>Production</u>	<u>Other</u>	<u>Total</u>
Year ended 31 December 2006				
Depreciation and amortisation (Notes 15,16)	8,868	11,330	15,635	35,833
Provision for inventories (Note 9)	551	-	-	551
Change in provision in trade receivables (Note 9)	(75)	-	(56)	(131)
Property, plant and equipment written off (Note 9)	165	23	32	220
Year ended 31 December 2005				
Depreciation and amortisation (Notes 15,16)	8,258	9,691	12,731	30,680
Provision for inventories (Note 9)	456	-	-	456
Change in provision in trade receivables (Note 9)	(2,174)	16	153	(2,005)
Property, plant and equipment written off (Note 9)	1,342	86	142	1,570

Balance sheet by business segments:

<i>(In thousands of HRK)</i>	<u>Construction</u>	<u>Production</u>	<u>Other</u>	<u>Unallocated</u>	<u>Total</u>
At 31 December 2006					
Assets					
Property, plant and equipment	66,495	126,371	218,767	-	411,633
Other assets	490,991	273,945	56,678	-	821,614
	557,486	400,316	275,445	-	1,233,247
Liabilities					
Long-term borrowings	-	-	-	182,899	182,899
Long-term provisions	-	-	-	7,273	7,273
Current liabilities	202,591	76,282	7,910	270,625	557,408
	202,591	76,282	7,910	460,797	747,580
Capital expenditure (Notes 15 and 16)	37,824	26,303	37,713	-	101,840
At 31 December 2005					
Assets					
Property, plant and equipment	75,079	62,900	212,028	-	350,007
Other assets	591,432	74,710	9,477	-	675,619
	666,511	137,610	221,505	-	1,025,626
Liabilities					
Long-term borrowings	-	-	-	169,669	169,669
Current liabilities	216,604	36,818	33,610	124,847	411,879
	216,604	36,818	33,610	294,516	581,548
Capital expenditure (Notes 15 and 16)	16,156	18,650	55,807	-	90,613

Non-current assets are comprised by land, buildings, equipment and intangible assets, whereas current assets of segments are primarily comprised by inventories, trade receivables and cash. Long-term loans of segments are not allocated. Current liabilities of segments are primarily comprised by trade payables and other operating liabilities.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2006

NOTE 5 – SEGMENT INFORMATION (continued)

Secondary reporting format – geographical segments

Sales among geographical segments are allocated based on the country in which the customer is located.

	2006		2005	
	<i>(In thousands of HRK)</i>	%	<i>(In thousands of HRK)</i>	%
Croatia	1,281,739	87.80	1,086,629	81.97
Bosnia and Herzegovina	71,960	4.92	205,053	15.47
Other	106,253	7.28	33,913	2.56
Total	1,459,952	100.00	1,325,595	100,00

NOTE 6 – OTHER INCOME

	2006	2005
	<i>(In thousands of HRK)</i>	
Interest income	3,255	3,260
Proceeds from insurance claims	255	412
Rental income	9	12
Other operating income	3,710	6,044
	7,229	9,728

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2006

NOTE 7 – COST OF MATERIALS AND SERVICES

	<u>2006</u>	<u>2005</u>
	<i>(In thousands of HRK)</i>	
Raw material and supplies		
Raw material and supplies	291,509	262,041
Energy	17,769	16,660
Spare parts and small inventory	7,525	7,524
	<u>316,803</u>	<u>286,225</u>
External services		
Subcontractor services	457,092	478,866
Transportation	24,592	13,679
Repairs and maintenance	10,596	10,403
Advertising and promotion	6,481	5,221
Rental expense	2,922	3,311
Other	24,536	24,419
	<u>526,219</u>	<u>535,899</u>
Total cost of materials and services	<u>843,022</u>	<u>822,124</u>

NOTE 8 – STAFF COSTS

	<u>2006</u>	<u>2005</u>
	<i>(In thousands of HRK)</i>	
Net salaries	163,691	137,048
Taxes and contributions on and from salaries	124,632	102,993
Severance costs	4,308	1,613
Other staff costs	12,304	6,704
Supervisory Board fees	257	362
	<u>305,192</u>	<u>248,720</u>

During 2006, the Group had an average of 2,038 employees (2005: 1,856).

Taxes and contributions include contributions paid into mandatory pension funds in the amount of HRK 47,577 thousand (2005: HRK 38,931 thousand). Contributions are calculated as a percentage of the employees' gross salaries.

Other staff costs include gifts, awards and other benefits.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2006

NOTE 9 – OTHER OPERATING EXPENSES

	<u>2006</u>	<u>2005</u>
	<i>(In thousands of HRK)</i>	
Consultancy services	36,240	28,081
Daily allowances and travel cost	32,200	33,348
Bank charges	10,973	6,558
Entertainment	9,208	7,625
Taxes and contributions	8,266	4,251
Insurance	5,024	3,460
Sponsorships, donations and other aids	5,289	5,554
Property, plant and equipment written off	220	1,570
Change in provision for trade receivables	131	(2,005)
Provision for inventories	551	456
Write off of loan receivables	2,441	-
Other operating expenses	13,506	10,056
	<u>124,049</u>	<u>98,954</u>

NOTE 10 – OTHER (LOSSES)/GAINS – NET

	<u>2006</u>	<u>2005</u>
	<i>(In thousands of HRK)</i>	
Net foreign exchange (losses)/gains – operating activities	(3,240)	840
Fair value gains (Note 22)	337	-
Net (loss)/gain on sale of tangible assets (Note 28)	(6)	97
	<u>(2,909)</u>	<u>937</u>

NOTE 11 – FINANCE INCOME AND COSTS

	<u>2006</u>	<u>2005</u>
	<i>(In thousands of HRK)</i>	
Interest income on bank deposits	170	37
Net foreign exchange differences (financing activities)	852	6,148
Finance income	1,022	6,185
Net foreign exchange difference on bank deposits	(36)	178
Interest expense	(19,084)	(13,194)
Finance cost	(19,120)	(13,016)
	<u>(18,098)</u>	<u>(6,831)</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2006

NOTE 12 – INCOME TAX EXPENSE

The reconciliation of accounting income and taxable income is detailed in the table below:

	<u>2006</u>	<u>2005</u>
	<i>(In thousands of HRK)</i>	
Net profit before tax	<u>94,321</u>	<u>91,267</u>
Tax calculated at a rate of 20%	18,864	18,253
Effect of income not subject to tax	(444)	(516)
Effect of non-deductible expenses	4,456	2,038
Effect of tax rates in other countries	<u>207</u>	<u>644</u>
Income tax charge	<u>23,083</u>	<u>20,419</u>
Effective tax rate	24.47%	22,37%

During 2006, the Tax Authority has performed an audit of the Company's income tax charged for 2005. In accordance with regulations in Republic of Croatia, the Tax Authority may at any time inspect the Company's books and records within 3 years following the year in which the tax liability is reported, may impose additional tax assessments and penalties. Similar regulations exist for other Group subsidiaries. The Group's management is not aware of any circumstances, which may give rise to a potential material liability in this respect.

NOTE 13 – BASIC AND DILUTED EARNINGS PER SHARE

Basic earnings per share in the amount of HRK 31.88 (2005: HRK 31.67) are calculated on the basis of the Group's net profit in the amount of HRK 72,324 thousand (2005: HRK 71,879 thousand) and the weighted average number of ordinary shares in issue which was 2,268,984 (2005: 2,269,491), excluding treasury shares.

There are no outstanding dilutive potential ordinary shares.

NOTE 14 – DIVIDENDS PER SHARE

During 2006, dividends were granted from retained earnings of previous years in the amount of HRK 29,017 thousand (2005: HRK 29,017 thousand), which amounts to HRK 12.65 per share (2005: HRK 12.65 per share). Dividend per share was calculated based on issued shares less treasury shares at the time the dividend was declared.

Unpaid dividends for 2006 in the amount of HRK 15,687 thousand (2005: HRK 1,548 thousand) are included as dividends payable in "trade and other payables" (Note 26).

According to a loan agreement concluded between the Company and one of its banks (Note 25), dividends are restricted to 50% of net profit for any year during the term of the loan agreement.

NOTE 15 – INTANGIBLE ASSETS

(In thousands of HRK)

	Computer software
At 31 December 2004	
Cost	4,955
Accumulated amortisation	(2,289)
Net book amount	2,666
Year ended 31 December 2005	
Opening net book amount	2,666
Additions	4,168
Amortisation	(838)
Closing net book amount	5,996
At 31 December 2005	
Cost	9,123
Accumulated amortisation	(3,127)
Net book amount	5,996
Year ended 31 December 2006	
Opening net book amount	5,996
Additions	4,707
Disposals	(28)
Amortisation	(978)
Closing net book amount	9,697
At 31 December 2006	
Cost	13,802
Accumulated amortisation	(4,105)
Net book amount	9,697

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2006

NOTE 16 – PROPERTY, PLANT AND EQUIPMENT

<i>(In thousands of HRK)</i>	Land	Buildings	Equipment	Work in progress	Total
At 31 December 2004					
Cost	23,146	297,171	332,133	12,356	664,806
Accumulated depreciation	-	(161,496)	(200,463)	-	(361,959)
Net book value	23,146	135,675	131,670	12,356	302,847
Year ended 31 December 2005					
At 1 January	23,146	135,675	131,670	12,356	302,847
Additions	-	-	-	86,445	86,445
Transfers	13,840	21,958	60,563	(96,361)	-
Disposals	-	(46)	(8,998)	-	(9,044)
Exchange differences	(115)	(206)	(78)	-	(399)
Depreciation	-	(6,396)	(23,446)	-	(29,842)
At 31 December	36,871	150,985	159,711	2,440	350,007
At 31 December 2005					
Cost	36,871	316,561	373,913	2,440	729,785
Accumulated depreciation	-	(165,576)	(214,202)	-	(379,778)
Net book value	36,871	150,985	159,711	2,440	350,007
Year ended 31 December 2006					
At 1 January	36,871	150,985	159,711	2,440	350,007
Additions	-	-	-	97,133	97,133
Transfers	8,992	28,944	55,805	(93,741)	-
Disposals	-	(21)	(845)	-	(866)
Exchange differences	(12)	111	115	-	214
Depreciation	-	(6,476)	(28,379)	-	(34,855)
At 31 December	45,851	173,543	186,407	5,832	411,633
At 31 December 2006					
Cost	45,851	345,574	423,266	5,832	820,523
Accumulated depreciation	-	(172,031)	(236,859)	-	(408,890)
Net book value	45,851	173,543	186,407	5,832	411,633

As at 31 December 2006, prepayments for property, plant and equipment equal to HRK 1,273 thousand (2005: HRK 908 thousand).

As at 31 December 2006, land, buildings and equipment with a net book value of HRK 98,804 thousand (2005: HRK 86,552 thousand) have been pledged as security for borrowings received (Note 25).

As at 31 December 2006, assets leased under finance leases where the Company is the lessee amounted to HRK 3,400 thousand (2005: HRK 5,384 thousand) - see Note 25.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2006

NOTE 17 – INVESTMENTS IN SUBSIDIARIES

	<u>2006</u>	<u>2005</u>
	<i>(In thousands of HRK)</i>	
At 1 January	225	3,260
Additions	28	200
Effect of consolidation - Unidal d.o.o.	-	(3,235)
At 31 December	<u>253</u>	<u>225</u>

Subsidiaries included in consolidation as at 31 December 2006 are as follows:

<u>Name</u>	<u>Country of incorporation</u>	<u>Holding in %</u>
Dalekovod d.o.o., Mostar	Bosnia and Herzegovina	100.00
Dalekovod d.o.o., Ljubljana	Slovenia	100.00
Dalekovod-Cinčaonica d.o.o., Dugo Selo	Croatia	100.00
Dalcom Engineering GmbH, Freilassing	Germany	100.00
Dalekovod-Polska S.A, Warsaw	Poland	95.00
Unidal d.o.o., Vinkovci	Croatia	50.54
Dalekovod TKS a.d., Dobož	Bosnia and Herzegovina	83.17

Subsidiaries not included in consolidation as at 31 December are as follows:

<u>Name</u>	<u>Country of incorporation</u>	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
		<i> Holding in % </i>		<i>(In thousands of HRK)</i>	
Dalekovod-projekt d.o.o., Zagreb	Croatia	100.00	100.00	25	25
Dalekovod ESOP d.o.o.	Croatia	100.00	100.00	200	200
Denacco Namibia (PTY) Ltd	Namibia	60.00	-	18	-
Zablaće d.o.o., Zagreb	Croatia	50.00	-	10	-
				<u>253</u>	<u>225</u>

Subsidiaries Dalekovod ESOP and Dalekovod-projekt do not perform any operating activities and therefore are not included in consolidation.

In January 2006, the Company established a subsidiary in Namibia with a founding capital of HRK 18 thousand (EUR 2.5 thousand). In November 2006, the Company and two other domestic companies established the subsidiary Zablaće d.o.o., Zagreb. The Company paid a founding capital of HRK 10 thousand, which represents a 50% share in the newly established company. As at 31 December 2006 Denacco Namibia (PTY) Ltd and Zablaće d.o.o. are inactive.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2006

NOTE 18 – AVAILABLE-FOR-SALE FINANCIAL ASSETS

	<u>2006</u>	<u>2005</u>
	<i>(In thousands of HRK)</i>	
At beginning of year	6,746	83
Additional investments	<u>739</u>	<u>6,663</u>
At end of year	<u>7,485</u>	<u>6,746</u>

The Company owns 8.57% of shares in a closed-ended investment fund. On behalf of the Company, this fund acquires shares in domestic companies, with the purpose of developing such companies and improving their long-term market position, as well as realising future benefits for the investors.

NOTE 19 – LOANS AND RECEIVABLES

	<u>2006</u>	<u>2005</u>
	<i>(In thousands of HRK)</i>	
Long-term deposits	135	768
Long-term loans receivable:		
- consumer goods loan	25,256	-
- housing loans	6,407	5,820
- ESOP (Employee Share Ownership Plan)	<u>1,784</u>	<u>6,466</u>
Total long-term loans and deposits	33,582	13,054
Current portion of long-term loans and deposits (Note 21)	<u>(18,815)</u>	<u>(5,060)</u>
Long-term loans and deposits	<u>14,767</u>	<u>7,994</u>

Consumer goods loan

Consumer goods loans represent trade receivables from Bosnia and Herzegovina based on the sale of equipment and provision of services, which were transformed into a loan repayable within a period of 2 years with an interest rate set at 4.5% p.a.

Housing loans receivable

Housing loans to employees carry an average effective interest rate of 6%, and are repayable over 2 to 25 years through deductions from employee salaries. Housing loans are denominated in HRK with currency clauses (EURO).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2006

NOTE 19 – LOANS AND RECEIVABLES (continued)**ESOP loans receivable**

Under the ESOP plan, in 2000 and 2001, employees received a certain amount of shares at market prices at that time. At the same time, loans were granted to employees for payment of these shares. The Company has first purchase right of shares when an employee leaves the Company for amounts not yet paid.

Loans to employees for the purchase of Company shares through the Employee Share Ownership Plan (ESOP) bear annual interest at 6% and are repayable over 6 years in equal annual instalments. During 2005, the Company reacquired 16,908 shares from employees who left the Company for an amount of HRK 848 thousand. ESOP loans are denominated in HRK. During 2006, ESOP loans from 2000 have been repaid.

As at 31 December 2006, loans to executive directors relating to the ESOP plan amounted to HRK 16 thousand (2005: HRK 526 thousand). Interest income realised in 2006 amounted to HRK 59 thousand (2005: HRK 110 thousand) – Note 29. The loans were granted at conditions equal to those granted to other employees.

The fair value of long-term loans approximates their carrying amount, since loan interest rates reflect market rates.

Deposits

Deposits are denominated in HRK with currency clauses (EURO).

NOTE 20 – INVENTORIES

	<u>2006</u>	<u>2005</u>
	<i>(In thousands of HRK)</i>	
Raw materials	119,159	92,101
Finished goods, semi-finished goods and work in progress	72,613	67,709
Spare parts and small inventories	2,835	1,847
Trade goods	397	693
	<u>195,004</u>	<u>162,350</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2006

NOTE 21 – TRADE AND OTHER RECEIVABLES

	<u>2006</u>	<u>2005</u>
	<i>(In thousands of HRK)</i>	
Domestic trade receivables	364,505	283,329
Foreign trade receivables	106,106	98,996
Provisions for impairment	<u>(10,033)</u>	<u>(11,959)</u>
	460,578	370,366
Amounts due from customers for contract work	30,500	41,906
Advances	19,816	8,130
Current portion of long-term loans (Note 19)	18,815	5,060
Short-term loans	13,216	5,322
Retentions	3,326	1,905
Receivable from employees	914	1,629
Other current assets	<u>9,858</u>	<u>4,077</u>
	<u>557,023</u>	<u>438,395</u>

Total construction costs incurred and recognised profits (less recognised losses to date) for all active construction contracts amounted to HRK 3,796,338 thousand (2005: HRK 3,293,139 thousand).

Other short-term loans and loans to subsidiaries represent primarily trade receivables converted to loans and loans given to sports organisations with annual interest rates from 3%-6%. The loans are generally granted for periods of 3 to 9 months and are secured by bills of exchange and promissory notes.

Advances were granted to suppliers for the purchase of material and equipment, as well as for project design services.

Movements on the provision for impairment of trade receivables are as follows:

	<u>2006</u>	<u>2005</u>
	<i>(in thousands of HRK)</i>	
At 1 January	11,959	13,964
Provision for receivables impairment (Note 9)	839	665
Collected amounts (Note 9)	(708)	(2,670)
Receivables written off during the year as uncollectible	<u>(2,057)</u>	<u>-</u>
At 31 December	<u>10,033</u>	<u>11,959</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2006

NOTE 22 – FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT AND LOSS

During 2006, the Group invested in domestic cash funds HRK 6,350 thousand. As at 31 December 2006, fair value of these assets amounted to HRK 6,687 thousand. The change in fair value of HRK 337 thousand is recognized in the income statements as a fair value gain (Note 10).

NOTE 23 – CASH AND CASH EQUIVALENTS

	<u>2006</u>	<u>2005</u>
	<i>(In thousands of HRK)</i>	
Domestic currency	5,476	9,012
Foreign currency	23,949	34,071
Short-term deposits at bank	<u>-</u>	<u>9,922</u>
	<u>29,425</u>	<u>53,005</u>

Depending on availability of cash, the Group places short-term deposits (with maturities of three months or less) with various banks for the purpose of realising additional interest income.

As at 31 December 2005, the average effective interest rate for short-term deposits with banks was 3.95%.

NOTE 24 – SHAREHOLDERS' EQUITY

Share capital

As at 31 December 2006, the share capital of the Company consisted of 2,293,812 ordinary shares, authorised and issued, with a nominal value of HRK 100 per share. All issued shares are fully paid.

As at 31 December 2006 and 2005 the Company owns 24,828 treasury shares.

Structure of shareholders as at 31 December:

	<u>2006</u>	<u>2005</u>
Natural persons	37.60%	44.31%
BMK i Partneri d.o.o.	18.24%	18.23%
KLT I Partneri d.o.o.	18.06%	18.06%
CTG d.o.o.	16.81%	16.81%
Treasury shares	1.08%	1.08%
Other	8.21%	1.51%
	<u>100.00%</u>	<u>100.00%</u>

Legal, statutory and other reserves

The legal reserve is required under Croatian law and must be built up at a minimum of 5% of the profit for the year until the total legal reserve reaches 5% of the Company's share capital. Legal reserves are not distributable.

During 2006, according to the decision of the Annual General Meeting statutory reserves were increased by HRK 43,374 thousand (2005: HRK 42,633 thousand). These reserves are distributable.

Other reserves consist of profits from previous periods set aside by decision of General Assembly (these reserves are distributable) and treasury shares reserves. As at 31 December 2006 and 2005, the balance of HRK 1,244 thousand within the other reserves represents the treasury shares reserves required by Croatian regulations.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2006

NOTE 25 – BORROWINGS

	Effective average interest rates	2006	2005
		<i>(In thousands of HRK)</i>	
Long-term			
Bank borrowings	5.28%	181,762	167,470
Finance lease	7.27%	1,137	2,199
		<u>182,899</u>	<u>169,669</u>
Short-term			
Bank borrowings	5.00%	143,270	116,904
Commercial papers	4.14%	75,000	-
Finance lease		1,054	1,876
		<u>219,324</u>	<u>118,780</u>
Total borrowings		<u>402,223</u>	<u>288,449</u>

Under the terms of a loan agreement concluded between the Company and one of its banks, the Company is obligated to maintain specific financial and non-financial restrictions (covenants). Covenants include conditions on the payment of dividends (Note 14), and the maintenance of financial covenants including: debt to equity, sale of assets, overdue payables and debt service coverage.

During 2006, the Company issued commercial papers in the amount of HRK 75 million in denominations of HRK 1.00 for a period of 364 days from the day of issuance with a nominal yield of 4.13% p.a.

Bank borrowings are secured with bills of exchange and by mortgage over property, plant and equipment and investment property (Notes 16).

As at 31 December 2006, interest payable on long-term and short-term borrowings amounted to HRK 4,152 thousand (2005: HRK 3,301 thousand), (Note 26).

The Group's borrowings in the amount of HRK 324,053 thousand (2005: HRK 284,080 thousand) are exposed to interest rate changes at the balance sheet date, since the contracted interest rate is variable. Other borrowings have fixed interest rates and are exposed to interest rate changes upon maturity of the principal.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2006

NOTE 25 – BORROWINGS (continued)

The exposure of the Group's borrowings to interest rate changes at the balance sheet date is as follows (other borrowings are stated at fixed rates):

	<u>2006</u>	<u>2005</u>
	<i>(In thousands of HRK)</i>	
3 months	170,945	53,373
6 months	40,575	18,159
12 months	10,000	71,027
5 years	105,355	141,521
	<u>326,875</u>	<u>284,080</u>

The carrying amount of the Group's long-term borrowings approximates their fair value, since the stated interest rates reflect current market interest rates.

Principal repayments on long-term borrowings and financial lease are as follows:

	<u>2006</u>	<u>2005</u>
	<i>(In thousands of HRK)</i>	
Loans in use	25,922	-
Between 1 and 2 years	27,430	38,168
Between 2 and 5 years	75,340	66,183
Over 5 years	54,207	65,318
	<u>182,899</u>	<u>169,669</u>

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

	<u>2006</u>	<u>2005</u>
	<i>(In thousands of HRK)</i>	
EUR	95,808	84,145
HRK	306,415	204,304
	<u>402,223</u>	<u>288,449</u>

Borrowings with currency clauses are included in HRK borrowings.

The Group has the following undrawn borrowing facilities:

	<u>2006</u>	<u>2005</u>
	<i>(In thousands of HRK)</i>	
Expiring within one year at:		
- floating rate	48,166	120,109
	<u>48,166</u>	<u>120,109</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2006

NOTE 26 – TRADE AND OTHER PAYABLES

	<u>2006</u>	<u>2005</u>
	<i>(In thousands of HRK)</i>	
Domestic suppliers	177,658	172,854
Foreign suppliers	54,500	52,391
	<u>232,158</u>	<u>225,245</u>
Advances received for construction work	16,180	21,797
VAT payable	15,557	3,838
Dividend payable	15,687	1,548
Salaries	12,678	10,161
Taxes and contributions on and from salaries	11,875	9,152
Interest payable	4,152	3,301
Advances	7,770	4,321
Other accruals and liabilities	16,558	7,376
	<u>332,615</u>	<u>286,739</u>

The dividend payable represents unpaid dividend declared in respect of prior periods.

NOTE 27 – PROVISIONS

As at 31 December 2006, long-term employee benefits include provisions for retirement severance payments in the amount of HRK 2,721 thousand and provisions for jubilee awards in the amount of HRK 4,552 thousand.

Retirement severance payment

According to Collective union agreement the Company has obligation to pay the employee severance at the time of employee's retirement. The liability is calculated by independent actuaries. Significant assumptions used by the actuary are as follows: an annual leaver's rate 0,98%, an annual discount rate of 4.5%; the age of retirement is determined for each individual employee taking into account their present age and the overall realised years of service (the average age of retirement used in the calculation is 62 years for men and 58 years for women).

Jubilee awards

This provision relates to estimated long-term employee benefits (jubilee awards) as defined in the Collective union agreement.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2006

NOTE 28 – CASH GENERATED FROM OPERATIONS

	<u>Note</u>	<u>2006</u>	<u>2005</u>
		<i>(In thousands of HRK)</i>	
Net profit before tax		94,321	91,267
Adjustments for:			
Depreciation and amortisation	15, 16	35,833	30,680
Unrealised foreign exchange differences		(1,620)	(5,514)
Provision for trade receivables	21	839	665
Provision for inventories	9	551	456
Impairment of loans receivable	9	2,441	-
Property, plant and equipment written off	9	220	1,570
Loss/(gain) on sale of property, plant and equipment	10	6	(97)
Effect of consolidation – Unidal d.o.o.	17	-	3,235
Increase in minority interest – Unidal d.o.o.		-	12,365
Fair value gain	10	(337)	-
Provision for long-term employee benefits		7,273	-
Interest expense	11	19,084	13,194
Interest income	6,11	(3,425)	(3,297)
		<u>60,865</u>	<u>53,257</u>
Changes in working capital:			
Increase in trade and other receivables		(128,773)	(137,799)
Increase in inventories		(33,205)	(37,551)
Increase in trade and other payables		30,885	115,544
		<u>24,093</u>	<u>84,718</u>
Net cash generated from operations		<u>24,093</u>	<u>84,718</u>

For the purposes of the cash flow statement, proceeds from sale of property, plant and equipment comprise the following:

	<u>2006</u>	<u>2005</u>
	<i>(In thousands of HRK)</i>	
Net book amount	859	7,572
Net (loss)/gain on sale of property, plant and equipment (Note 10)	(6)	97
	<u>853</u>	<u>7,669</u>
Proceeds from sale of property, plant and equipment	<u>853</u>	<u>7,669</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2006

NOTE 29 – RELATED PARTY TRANSACTIONS

In the ordinary course of business operations, the Group enters into transaction with related parties, which include the purchase of goods and services and loans. In addition to the subsidiaries which are not consolidated as set out in Note 17, the related parties of the Group are the Management and CEOs.

	<u>2006</u>	<u>2005</u>
	<i>(In thousands of HRK)</i>	
Revenues and expenses		
Net salaries	9,074	7,051
Contributions	<u>4,220</u>	<u>3,278</u>
	13,294	10,329
Interest income	94	110
Loans		
ESOP and housing loans	943	1,542

NOTE 30 – POST BALANCE SHEET EVENTS

The Group acquired 88.65% of the share capital of Tvornica istegnutih metala d.d., Topusko (TIM d.d., Topusko), a company specialising in expanded metal and fence production, for a cash consideration of HRK 25,997 thousand in February 2007.

The carrying amount of acquired net assets as at 31 December 2006 is as follows:

<i>(In thousands of HRK)</i>	<u>Carrying amount</u>
Tangible assets	11,686
Inventories	9,908
Trade and other receivables	10,520
Cash	2,220
Trade and other payables	(12,826)
Borrowings	<u>(8,571)</u>
Net assets	12,937

The Group is currently assessing the fair value of asset acquired. Consequently, it was not practicable to disclose goodwill and fair value of net assets acquired.

NOTE 31 – CONTINGENCIES AND COMMITMENTS

The Group has numerous contracts for provision of construction services which require future costs to be incurred. Costs to be incurred in the future related to these contracts are estimated in the amount of HRK 674,831 thousand as at 31 December 2006 (2005: HRK 478,575 thousand). The Group guarantees adhering to deadlines and ensures quality for all work performed.

In the ordinary course of operations, the Group was plaintiff and defendant in several legal disputes. Management and legal counsel believe that these legal disputes will not result in significant losses.