

DALEKOVOD d.d.

**AUDITOR'S REPORT AND
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 parent Company financial statements of DALEKOVOD d.d. (the 'Company') which comprise the balance sheet as of 31 December 2006 and the income statement, statement of changes in equity and 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 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 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 financial statements present fairly, in all material respects, the financial position of the parent Company 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.**INCOME STATEMENT****FOR THE YEAR ENDED 31 DECEMBER 2006**

<i>(all amounts are expressed in thousands of HRK)</i>	Note	2006	2005
Sales	5	1,439,249	1,280,995
Other income	6	21,555	20,496
		<u>1,460,804</u>	<u>1,301,491</u>
Change in work in progress and finished goods		(38,221)	(29,307)
Cost of materials and services	7	(885,747)	(833,617)
Staff costs	8	(267,890)	(215,523)
Depreciation and amortisation	15, 16, 17	(32,586)	(29,167)
Other operating expenses	9	(118,075)	(95,998)
Other (losses)/gains – net	10	(2,621)	1,581
Operating profit		115,664	99,460
Finance income	11	685	6,185
Finance costs	11	(18,607)	(13,016)
		<u>(17,922)</u>	<u>(6,831)</u>
Profit before tax		97,742	92,629
Income tax expense	12	(22,875)	(20,238)
Net profit		74,867	72,391
Basic and diluted earnings per share (in HRK)	13	32.96	31.90

The financial statements set out on pages 2 to 39 were approved by the Management Board on 19 April 2007.

President of the Board/General Manager:

Luka Miličić, M. Sc. C. E.

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

DALEKOVOD d.d.**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	5,968
Property, plant and equipment	16	250,940	209,777
Prepayments for property, plant and equipment	16	1,273	909
Investment property	17	98,341	91,128
Investments in subsidiaries	18	31,076	28,228
Available-for-sale financial assets	19	7,485	6,746
Loans and receivables	20	14,767	7,881
		<u>413,579</u>	<u>350,637</u>
Current assets			
Inventories	21	161,130	148,331
Trade and other receivables	22	617,412	466,978
Financial assets at fair value through profit or loss	23	6,687	-
Cash and cash equivalents	24	17,397	46,939
		<u>802,626</u>	<u>662,248</u>
Total assets		<u>1,216,205</u>	<u>1,012,885</u>
SHAREHOLDERS' EQUITY AND LIABILITIES			
Shareholders' equity			
Share capital	25	229,381	229,381
Legal reserves	25	11,487	11,487
Treasury shares	25	(1,244)	(1,244)
Statutory reserves	25	127,459	84,085
Other reserves	25	32,291	32,291
Retained earnings	25	74,867	72,391
		<u>474,241</u>	<u>428,391</u>
Non-current liabilities			
Borrowings	26	173,242	169,669
Provisions	28	7,273	-
		<u>180,515</u>	<u>169,669</u>
Current liabilities			
Borrowings	26	218,344	118,486
Trade and other payables	27	337,647	289,979
Income tax payable	12	5,458	6,360
		<u>561,449</u>	<u>414,825</u>
Total liabilities		<u>741,964</u>	<u>584,494</u>
Total shareholders' equity and liabilities		<u>1,216,205</u>	<u>1,012,885</u>

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

DALEKOVOD d.d.**STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY****FOR THE YEAR ENDED 31 DECEMBER 2006**

(all amounts in thousands of HRK)

	<u>Note</u>	<u>Share capital</u>	<u>Legal reserves</u>	<u>Treasury shares</u>	<u>Statutory reserves</u>	<u>Other reserves</u>	<u>Retained earnings</u>	<u>Total</u>
Year ended 31 December 2005								
Balance at 1 January 2005		229,381	11,487	(396)	41,452	32,312	71,629	385,865
Dividend relating to 2004	14	-	-	-	-	-	(29,017)	(29,017)
Purchase of treasury shares	20	-	-	(848)	-	-	-	(848)
Statutory reserves		-	-	-	42,633	(21)	(42,612)	-
Net profit		-	-	-	-	-	72,391	72,391
Balance at 31 December 2005	25	229,381	11,487	(1,244)	84,085	32,291	72,391	428,391
Year ended 31 December 2006								
Balance at 1 January 2006		229,381	11,487	(1,244)	84,085	32,291	72,391	428,391
Dividend relating to 2005	14	-	-	-	-	-	(29,017)	(29,017)
Statutory reserves		-	-	-	43,374	-	(43,374)	-
Net profit		-	-	-	-	-	74,867	74,867
Balance at 31 December 2006	25	229,381	11,487	(1,244)	127,459	32,291	74,867	474,241

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

DALEKOVOD d.d.**CASH FLOW STATEMENT****FOR THE YEAR ENDED 31 DECEMBER 2006***(all amounts are expressed in thousands of HRK)*

	<u>Note</u>	<u>2006</u>	<u>2005</u>
Cash flows from operating activities			
Cash generated from operations	29	18,368	58,295
Income tax paid		(23,777)	(14,343)
Interest paid		(17,774)	(12,997)
Net cash (outflow)/inflow from operating activities		(23,183)	30,955
Cash flows from investing activities			
Purchase of intangible assets	15	(4,707)	(4,140)
Purchase of property, plant and equipment		(81,183)	(47,011)
Proceeds from sale of property, plant and equipment	29	852	8,235
Loans granted		(21,336)	(5,083)
Loan repayments received		17,468	18,894
Investment in subsidiaries	18	(2,848)	(17,894)
Purchase of available-for-sale financial assets	19	(739)	(6,663)
Purchase of financial assets at fair value through profit or loss	23	(6,350)	-
Interest received		3,081	3,065
Net cash used in investing activities		(95,762)	(50,597)
Cash flows from financing activities			
Proceeds from borrowings		312,942	255,420
Repayments of borrowings		(208,661)	(174,264)
Dividends paid		(14,878)	(42,455)
Net cash from financing activities		89,403	38,701
Net (decrease)/increase in cash and cash equivalents		(29,542)	19,059
Cash and cash equivalents			
Beginning of year		46,939	27,880
End of year	24	17,397	46,939
Net (decrease)/increase		(29,542)	19,059

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

NOTE 1 – GENERAL INFORMATION

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.

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.

The Company has subsidiaries in Bosnia and Herzegovina, Slovenia, Poland, Germany and Croatia. A list of subsidiaries is presented in Note 18. The Parent Company separately prepares consolidated financial statements for the Dalekovod Group.

As at 31 December 2006, the Company's shares were listed on the public joint stock company listing on the Zagreb Stock Exchange.

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.

2.1 Basis of preparation

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

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 Company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in Note 4.

The Company has issued these non-consolidated financial statements in accordance with Croatian regulations. The Company has also prepared consolidated financial statements in accordance with IFRS for the Company and its subsidiaries (Group), which were approved by the Management Board on 19 April 2007. In the consolidated financial statements, subsidiary undertakings (listed in Note 18) – which are those companies in which the Group, directly or indirectly, has an interest of more than half of the voting rights or otherwise has power to exercise control over the operations – have been fully consolidated. Users of these non-consolidated financial statements should read them together with the Group's consolidated financial statements as at and for the year ended 31 December 2006 in order to obtain full information on the financial position, results of operations and changes in financial position of the Group as a whole.

(a) Standards early adopted by the Company

No standards were early adopted by the Company.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2006

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.1 Basis of preparation (continued)

(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 Company'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 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

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

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

- *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 Company will apply IFRS 7 beginning 1 January 2007. The amendment to IAS 1 introduces disclosures about the level of an entity's capital and how it manages capital. The Company is currently assessing what impact the new IFRS and the amendment to IAS 1 will have on disclosures in its financial statements.
- *IFRS 8, Operating Segments (effective from 1 January 2009).* IFRS 8 replaces IAS 14 and adjust segment reporting to internal reporting procedures of each entity. The Company assessed the impact of IFRS 8, and concluded that segment reporting will be summarised and focused on the income statement. The Company will apply IFRS 8 for annual periods after 1 January 2009.
- *IAS 23 (revised), Borrowing costs (effective from 1 January 2009).* The 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 Company 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.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2006

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.1 Basis of preparation (continued)

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

The following interpretations to existing standards are mandatory for the Company's accounting period beginning on or after the effective date, but are not relevant to the Company'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 Company does not operate in a hyperinflationary environment.
- *IFRIC 8, Scope of IFRS 2 (effective from 1 May 2006)*. IFRIC 8 is not relevant since the Company does not have share-based payments.
- *IFRIC 9, Reassessment of embedded derivatives (effective from 1 June 2006)*. IFRIC 9 is not relevant to the Company'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 Company'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 Company does not have payment arrangements involving its own equity instruments.
- *IFRIC 12, Service Concession Arrangements (effective for annual periods beginning on or after 1 January 2008)*. IFRIC 12 is not relevant since the Company is not an operator of a public-to-private service concession arrangement.

2.2 Investments in subsidiaries

Subsidiaries are all entities (including special purpose entities) over which the Company 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 Company controls another entity. Investments in subsidiaries are carried at cost, less impairment losses, if any.

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.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2006

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.4 Foreign currencies

(a) Functional and presentation currency

Items included in the financial statements of the Company are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The financial statements are presented in Croatian kuna (HRK), which is the Company'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.

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 Company and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognised. All other repairs and maintenance costs are charged to the income statement during the financial period in which they are incurred.

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 Company 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 Company 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.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 Company. 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 Company 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).

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 Company 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.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.9 Financial assets (continued)

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.

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 Company's right to receive payment is established.

The Company 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.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.10 Leases

The Company is a lessee

The Company leases certain property, plant and equipment. Leases of property, plant and equipment, where the Company 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 so as to produce a constant periodic rate of interest on the remaining balance of the liability for each 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 Company 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.

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 Company 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".

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 Company 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 Company 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 Company 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).

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 Company 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 Company'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 Company's equity holders.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 Company does not capitalise borrowing costs.

Borrowings are classified as current liabilities unless the Company 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.

2.19 Employee benefits

(a) Pension obligations and post-employment benefits

In the normal course of business through salary deductions, the Company 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. The Company does not have any other pension scheme and consequently, has no other obligations in respect of employee pensions. In addition, the Company is not obliged to provide any other post-employment benefits.

(b) Termination benefits

Termination benefits are payable when employment is terminated by the Company before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Company 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 Company 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 Company 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 Company's activities. Revenue is shown, net of value-added tax, estimated returns, rebates and discounts. The Company 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 Company'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 Company 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 Company 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 Company 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

In accordance with changes in presentation of the current year, 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.

The VAT receivable of HRK 11,016 thousand as at 31 December 2005 is netted with the VAT payable. Consequently, total assets as at 31 December 2005 decreased by the same amount.

NOTE 3 – FINANCIAL RISK MANAGEMENT

3.1 Financial risk factors

The Company'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 Company does not have a written risk management programme, but overall risk management in respect of these risks is carried out by the Company's finance department.

(a) Foreign exchange risk

The majority of the Company's foreign sales revenue is denominated in EUROS. The Company'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 Company's operating results.

The Company's operating results are not directly influenced by movements in exchange rates, due to the Company'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 Company does not use derivative instruments to actively hedge foreign exchange risk exposure.

NOTE 3 – FINANCIAL RISK MANAGEMENT (continued)

(b) Credit risk

The Company 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 Company has no other significant concentrations of credit risk.

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

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

The Company 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 Company 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 Company 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 Company for similar financial instruments.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2006

NOTE 4 – CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

The Company 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 Company 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 Company 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 FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2006

NOTE 5 – SEGMENT INFORMATION

Primary reporting format – business segments

The Company 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 Company.

1. The segment of Production includes the casting plant, tool-room, the laboratory for quality control and the production of metal structures and suspension and jointing materials.
2. The segment of Construction includes the construction of power and distribution facilities, transformer stations, laying submarine, subterranean energy 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 include separately Project design and other 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	452,026	229,552	1,759,394
Inter-segment sales	(12,105)	(127,129)	(159,356)	(298,590)
Operating revenues	1,065,711	324,897	70,196	1,460,804
Operating profit	85,885	4,491	25,288	115,664
Finance cost				(17,992)
Profit before tax				97,742
Income tax				(22,875)
Net profit				74,867
Year ended 31 December 2005				
Gross segment revenues	1,090,021	327,594	152,439	1,570,054
Inter-segment sales	(52,574)	(97,701)	(118,288)	(268,563)
Operating revenues	1,037,447	229,893	34,151	1,301,491
Operating profit	92,031	1,258	6,171	99,460
Finance cost				(6,831)
Profit before tax				92,629
Income tax				(20,238)
Net profit				72,391

NOTES TO THE 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 15,16,17)	8,868	10,383	13,335	32,586
Provision for inventories (Note 9)	551	-	-	551
Change in provision for trade receivables (Note 9)	(75)	159	(583)	(499)
Property, plant and equipment written off (Note 9)	165	23	33	221
Year ended 31 December 2005				
Depreciation and amortisation (Note 15,16,17)	8,258	9,124	11,785	29,167
Provision for inventories (Note 9)	456	-	-	456
Change in provision for trade receivables (Note 9)	(2,174)	16	153	(2,005)
Property, plant and equipment written off (Note 9)	1,342	86	-	1,428

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	111,187	73,258	-	250,940
Other assets	490,991	261,239	213,035	-	965,265
	557,486	372,426	286,293	-	1,216,205
Liabilities					
Long-term borrowings	-	-	-	173,242	173,242
Long-term provisions	-	-	-	7,273	7,273
Current liabilities	202,591	68,023	7,910	282,925	561,449
	202,591	68,023	7,910	463,440	741,964
Capital expenditure (Notes 15, 16 and 17)	37,824	26,303	21,398	-	85,525
At 31 December 2005					
Assets					
Property, plant and equipment	75,079	50,746	83,952	-	209,777
Other assets	638,809	74,710	89,589	-	803,108
	713,888	125,456	173,541	-	1,012,885
Liabilities					
Long-term borrowings	-	-	-	169,669	169,669
Current liabilities	232,818	36,818	20,343	124,846	414,825
	232,818	36,818	20,343	294,515	584,494
Capital expenditure (Notes 15, 16 and 17)	16,156	16,610	18,141	-	50,907

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 borrowings of segments are not allocated. Current liabilities of segments are primarily comprised by trade payables and other operating liabilities.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2006

NOTE 5 – SEGMENT INFORMATION (continued)

Secondary reporting format – geographical segments

Sales are allocated by geographical segments 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	1,327,097	90.85	1,082,642	83.18
Bosnia and Herzegovina	50,611	3.46	192,894	14.82
Other	83,096	5.69	25,955	2.00
Total	1,460,804	100.00	1,301,491	100.00

All Company assets and capital expenditures are located in Croatia.

NOTE 6 – OTHER INCOME

	2006	2005
	<i>(In thousands of HRK)</i>	
Rental income	14,691	12,270
Interest income from operating activities	3,307	3,128
Proceeds from insurance claims	255	411
Other operating revenues	3,302	4,687
	21,555	20,496

Rental income mainly relates to the lease of property to the subsidiary Dalekovod-Cinčaonica d.o.o. which reimburses the depreciation charge of leased assets, the interest expense of long-term borrowings used to finance the construction of leased assets and the expense of common departments (accounting, legal affairs, etc.) providing services to the subsidiary.

NOTES TO THE 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	308,168	267,509
Energy	11,616	11,789
Spare parts and small inventory	10,780	8,272
	<u>330,564</u>	<u>287,570</u>
External services		
Subcontractor services	505,335	502,481
Transportation	24,087	13,600
Repairs and maintenance	10,376	10,292
Other external services	8,093	11,785
Advertising and promotion	5,334	4,420
Rental expense	1,958	3,469
	<u>555,183</u>	<u>546,047</u>
Total cost of materials and services	<u>885,747</u>	<u>833,617</u>

Rental expense relates to vehicles and office premises.

NOTE 8 – STAFF COSTS

	<u>2006</u>	<u>2005</u>
	<i>(In thousands of HRK)</i>	
Net salaries	138,461	116,210
Taxes and contributions on and from salaries /i/	114,233	91,842
Other staff costs /ii/	10,631	5,496
Severance costs	4,308	1,613
Supervisory Board fees	257	362
	<u>267,890</u>	<u>215,523</u>

/i/ Taxes and contributions include contributions paid into mandatory pension funds calculated as a percentage of the employees' gross salaries.

/ii/ Other staff costs include gifts, jubilee awards and other benefits.

The number of staff employed by the Company as at 31 December 2006 was 1,566 (2005: 1,467).

NOTES TO THE 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 and intellectual services	34,286	29,834
Daily allowances and travel cost	30,325	27,551
Bank charges	10,892	6,485
Entertainment	9,854	8,018
Sponsorships, donations and other aids	5,462	5,792
Insurance	4,897	3,347
Taxes and contributions	7,810	8,246
Write-off of property, plant and equipment	221	1,428
Change in provision for impairment of trade receivables (Note 22)	(499)	(2,005)
Write-off of inventories	551	456
Write-off of loan receivables	2,441	-
Other operating expenses	11,835	6,846
	<u>118,075</u>	<u>95,998</u>

NOTE 10 – OTHER (LOSSES)/GAINS – NET

	<u>2006</u>	<u>2005</u>
	<i>(In thousands of HRK)</i>	
Net gain on sale of tangible assets	239	761
Fair value gains (Note 23)	337	-
Net foreign exchange (loss)/gain from operating activities	(3,197)	820
	<u>(2,621)</u>	<u>1,581</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)	515	6,148
Finance income	685	6,185
Net foreign exchange difference on bank deposits	(36)	178
Interest expense	(18,571)	(13,194)
Finance cost	(18,607)	(13,016)
	<u>(17,922)</u>	<u>(6,831)</u>

NOTES TO THE 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	97,742	92,629
Tax calculated at a rate of 20%	19,548	18,526
Effect of income not subject to tax	(444)	(286)
Effect of non-deductible expenses	3,771	1,998
Income tax charge	22,875	20,238
Effective tax rate	23.4%	21.9%
Income tax payable as at 31 December	5,458	6,360

During 2006, the Tax Authority performed an audit of the Company's income tax charged for 2005. In accordance with regulations in the 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, and may impose additional tax assessments and penalties. The Company'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 32.96 (2005: HRK 31.90) are calculated on the basis of the Company's net profit in the amount of HRK 74,867 thousand (2005: HRK 72,391 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 27).

According to a loan agreement concluded between the Company and one of its banks (Note 26), 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 amortization	(2,289)
Net book amount	2,666
Year ended 31 December 2005	
Opening net book amount	2,666
Additions	4,140
Amortisation	(838)
Closing net book amount	5,968
At 31 December 2005	
Cost	9,095
Accumulated amortisation	(3,127)
Net book amount	5,968
Year ended 31 December 2006	
Opening net book amount	5,968
Additions	4,707
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 FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2006

NOTE 16 – PROPERTY, PLANT AND EQUIPMENT

<i>(In thousands of HRK)</i>	Land	Buildings	Equipmen t	Work in progress	Total
At 31 December 2004					
Cost	16,058	168,981	279,412	12,345	476,796
Accumulated depreciation	-	(116,522)	(149,956)	-	(266,478)
Net book value	16,058	52,459	129,456	12,345	210,318
Year ended 31 December 2005					
At 1 January	16,058	52,459	129,456	12,345	210,318
Additions	-	-	-	34,505	34,505
Transfers	258	1,010	45,285	(46,553)	-
Disposals	-	(46)	(8,856)	-	(8,902)
Depreciation	-	(3,753)	(22,391)	-	(26,144)
At 31 December	16,316	49,670	143,494	297	209,777
At 31 December 2005					
Cost	16,316	167,879	308,293	297	492,785
Accumulated depreciation	-	(118,209)	(164,799)	-	(283,008)
Net book value	16,316	49,670	143,494	297	209,777
Year ended 31 December 2006					
At 1 January	16,316	49,670	143,494	297	209,777
Transfer to investment property (Note 17)	(28)	-	-	-	(28)
Additions	-	23,193	44,434	3,822	71,449
Disposals	-	(21)	(813)	-	(834)
Depreciation	-	(3,856)	(25,568)	-	(29,424)
At 31 December	16,288	68,986	161,547	4,119	250,940
At 31 December 2006					
Cost	16,288	190,366	343,874	4,119	554,647
Accumulated depreciation	-	(121,380)	(182,327)	-	(303,707)
Net book value	16,288	68,986	161,547	4,119	250,940

As at 31 December 2006, prepayments for property, plant and equipment amounted to HRK 1,273 thousand (2005: HRK 909 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) were pledged as security for borrowings received (Note 26).

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 26.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2006

NOTE 17 – INVESTMENT PROPERTY

(In thousands of HRK)

	<u>Land</u>	<u>Buildings</u>	<u>Total</u>
As at 31 December 2004			
Cost	4,089	78,607	82,696
Accumulated depreciation	-	(1,645)	(1,645)
Net book value	<u>4,089</u>	<u>76,962</u>	<u>81,051</u>
Year ended 31 December 2005			
As at 1 January	4,089	76,962	81,051
Additions	8,780	3,482	12,262
Depreciation	-	(2,185)	(2,185)
As at 31 December	<u>12,869</u>	<u>78,259</u>	<u>91,128</u>
As at 31 December 2005			
Cost	12,869	82,089	94,958
Accumulated depreciation	-	(3,830)	(3,830)
Net book value	<u>12,869</u>	<u>78,259</u>	<u>91,128</u>
Year ended 31 December 2006			
As at 1 January	12,869	78,259	91,128
Transfer from property, plant and equipment (Note 16)	28	-	28
Additions	8,816	553	9,369
Depreciation	-	(2,184)	(2,184)
As at 31 December	<u>21,713</u>	<u>76,628</u>	<u>98,341</u>
As at 31 December 2006			
Cost	21,713	82,628	104,341
Accumulated depreciation	-	(6,000)	(6,000)
Net book value	<u>21,713</u>	<u>76,628</u>	<u>98,341</u>

Based on the current market prices and location of the property, Management determined that the fair value of investment property approximates its carrying amount.

All land and buildings have been pledged as security for borrowings received (Note 26).

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2006

NOTE 18 – INVESTMENTS IN SUBSIDIARIES

	<u>2006</u>	<u>2005</u>
	<i>(In thousands of HRK)</i>	
At 1 January	28,228	10,334
Additions	<u>2,848</u>	<u>17,894</u>
At 31 December	<u>31,076</u>	<u>28,228</u>

The principal subsidiary undertakings 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>	
Dalen d.o.o., Ljubljana	Slovenia	100.00	100.00	2,075	2,075
Dalekovod d.o.o., Mostar	Bosnia and Herzegovina	100.00	100.00	210	210
Dalekovod-Cinčaonica d.o.o., Dugo Selo	Croatia	100.00	100.00	1,000	1,000
Dalekovod-projekt d.o.o., Zagreb	Croatia	100.00	100.00	25	25
Dalcom Engineering GmbH, Freilassing	Germany	100.00	100.00	372	372
Dalekovod-Polska S.A., Warsaw	Poland	95.00	60.00	2,597	509
Dalekovod TKS a.d., Doboj	Bosnia and Herzegovina	83.17	78.60	11,934	11,202
Unidal d.o.o., Vinkovci	Croatia	50.54	50.54	12,635	12,635
Dalekovod ESOP d.o.o., Zagreb	Croatia	100.00	100.00	200	200
Zablaće d.o.o., Zagreb	Croatia	50.00	-	10	-
Denacco Namibia (PTY) Ltd	Namibia	60.00	-	18	-
				<u>31,076</u>	<u>28,228</u>

During 2005, the capital of the companies Dalen d.o.o. and Dalekovod TKS a.d. was increased by an amount of HRK 1,564 thousand and HRK 6,730 thousand (KM 1,775 thousand), respectively. The remaining amount of the registered founding capital of the company Unidal d.o.o. was paid in the amount of HRK 9,400 thousand and the company Dalekovod ESOP d.o.o. was established with a founding capital in the amount of HRK 200 thousand.

During 2006, a capital increase in Dalekovod-Polska S.A., Warsaw was performed in the amount of HRK 2,088 thousand. The Company acquired 4.57% of the registered capital of Dalekovod TKS a.d., Doboj for an amount of HRK 732 thousand.

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 FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2006

NOTE 19 – 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 20 – 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	5,707
- ESOP (Employee Share Ownership Plan)	<u>1,784</u>	<u>6,466</u>
Total long-term loans and deposits	33,582	12,941
Current portion of long-term loans and deposits (Note 22)	<u>(18,815)</u>	<u>(5,060)</u>
Long-term loans and deposits	<u>14,767</u>	<u>7,881</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 FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2006

NOTE 20 – 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 30. 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 21 – INVENTORIES

	<u>2006</u>	<u>2005</u>
	<i>(In thousands of HRK)</i>	
Raw materials	89,742	81,138
Finished goods, semi-finished goods and work in progress	68,552	65,346
Spare parts and small inventories	2,836	1,847
	<u>161,130</u>	<u>148,331</u>

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2006

NOTE 22 – TRADE AND OTHER RECEIVABLES

	<u>2006</u>	<u>2005</u>
	<i>(In thousands of HRK)</i>	
Domestic trade receivables	415,895	309,007
Foreign trade receivables	108,343	98,094
Provisions for impairment	<u>(9,411)</u>	<u>(11,959)</u>
	514,827	395,142
Receivable from customers for contract work	30,500	41,906
Retentions	3,326	1,905
Current portion of long-term loans (Note 20)	18,815	5,060
Loans to subsidiaries (Note 30)	8,127	3,458
Other short-term loans	13,551	5,237
Advances	19,800	8,130
Receivable from employees	868	959
Other current assets	<u>7,598</u>	<u>5,181</u>
	<u>617,412</u>	<u>466,978</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)	209	665
Collected amounts (Note 9)	(708)	(2,670)
Receivables written off during the year as uncollectible	<u>(2,049)</u>	<u>-</u>
At 31 December	<u>9,411</u>	<u>11,959</u>

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2006

NOTE 23 – FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT AND LOSS

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

NOTE 24 – CASH AND CASH EQUIVALENTS

	<u>2006</u>	<u>2005</u>
	<i>(In thousands of HRK)</i>	
Domestic currency	4,095	8,871
Foreign currency	13,302	28,147
Short-term deposits at bank	<u>-</u>	<u>9,921</u>
	<u>17,397</u>	<u>46,939</u>

Depending on the availability of cash, the Company 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 25 – 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 the decision of the 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 other reserves represents the treasury shares reserves required by Croatian regulations.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2006

NOTE 26 – BORROWINGS

	Effective average interest rates	2006	2005
		<i>(In thousands of HRK)</i>	
Long-term			
Bank borrowings	5.28%	215,359	204,150
Finance lease	7.27%	2,191	4,075
		<u>217,550</u>	<u>208,225</u>
Current portion of long-term debt		(43,254)	(36,680)
Current portion of finance lease		(1,054)	(1,876)
		<u>(44,308)</u>	<u>(38,556)</u>
Long-term portion		173,242	169,669
Short-term			
Bank borrowings	5.00%	99,036	79,930
Commercial papers	4.13%	75,000	-
		<u>174,036</u>	<u>79,930</u>
Total short-term borrowings		218,344	118,486

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.

The bank borrowings are secured with bills of exchange and by mortgage over property, plant and equipment and investment property (Notes 16 and 17).

As at 31 December 2006, interest payable on long-term and short-term borrowings amounted to HRK 4,098 thousand (2005: HRK 3,301 thousand), (Note 27).

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2006

NOTE 26 – BORROWINGS (continued)

The Company's borrowings in the amount of HRK 314,395 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.

Principal repayments of 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	24,492	38,168
Between 2 and 5 years	68,621	66,183
Over 5 years	54,207	65,318
	<u>173,242</u>	<u>169,669</u>

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

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

	<u>2006</u>	<u>2005</u>
	<i>(In thousands of HRK)</i>	
EUR	86,309	83,851
HRK	305,277	204,304
	<u>391,586</u>	<u>288,155</u>

Borrowings with currency clauses are included in HRK borrowings.

The Company 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 FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2006

NOTE 27 – TRADE AND OTHER PAYABLES

	<u>2006</u>	<u>2005</u>
	<i>(In thousands of HRK)</i>	
Domestic suppliers	209,723	197,088
Foreign suppliers	<u>33,879</u>	<u>30,075</u>
	<u>243,602</u>	<u>227,163</u>
Advances received for construction work	16,180	21,797
Advances	4,041	4,276
Salaries	10,427	8,351
Taxes and contributions on and from salaries	10,403	7,687
Dividend payable (Note 14)	15,687	1,548
Interest payable (Note 26)	4,098	3,301
VAT payable – net	17,782	8,821
Other accruals and liabilities	<u>15,427</u>	<u>7,035</u>
	<u>337,647</u>	<u>289,979</u>

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

NOTE 28 – PROVISIONS

In 2006, the Company recognised non-current liabilities to employees including liabilities for jubilee awards and retirement benefits in the amount HRK 7,273 thousand. The amount represents the estimated present value of future expenses calculated by a certified actuary.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2006

NOTE 29 – CASH GENERATED FROM OPERATIONS

	<u>Note</u>	<u>2006</u>	<u>2005</u>
		<i>(In thousands of HRK)</i>	
Net profit before tax		97,742	92,629
Adjustments for:			
Depreciation and amortisation	15,16,17	32,586	29,167
Unrealised foreign exchange differences		(773)	(6,318)
Property, plant and equipment written off	16, 9	221	1,428
Provision for trade receivables	22	209	665
Provision for inventories	9	551	456
Provision for long-term employee benefits	28	7,273	-
Impairment of short-term loans	9	2,441	-
Gain on sale of property, plant and equipment	10	(239)	(761)
Fair value gains	10	(337)	-
Interest income	6, 11	(3,477)	(3,165)
Interest expense	11	18,571	13,194
Other		(707)	-
		<u>56,319</u>	<u>34,666</u>
Changes in working capital:			
Increase in trade and other receivables		(156,369)	(164,860)
Increase in inventories		(13,350)	(29,119)
Increase in trade and other payables		<u>34,026</u>	<u>124,979</u>
Net cash generated from operations		<u>18,368</u>	<u>58,295</u>

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

	<u>2006</u>	<u>2005</u>
	<i>(In thousands of HRK)</i>	
Net book amount (Note 16)	613	7,474
Gains on sale of property, plant and equipment (Note 10)	<u>239</u>	<u>761</u>
Proceeds from sale of property, plant and equipment	<u>852</u>	<u>8,235</u>

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2006

NOTE 30 – RELATED PARTY TRANSACTIONS

In the ordinary course of business operations, the Company enters into transactions with related parties, which include the purchase of goods and services and loans. In addition to the subsidiaries presented in Note 18, the Company's related parties include its Management Board and executive directors.

Year-end balances resulting from transactions with subsidiaries are as follows:

Revenues and expenses

	<u>2006</u>	<u>2005</u>
	<i>(In thousands of HRK)</i>	
Sales	61,687	37,355
Rental income	14,681	12,672
Sale of properties	673	8,181
Foreign exchange gains	-	122
	<u>77,041</u>	<u>58,330</u>
Cost of materials and services	25,076	1,550
Subcontractor services	48,620	29,653
Other operating expenses	2,259	10,729
	<u>75,955</u>	<u>41,932</u>

Receivables, payables and loans

	<u>2006</u>	<u>2005</u>
	<i>(In thousands of HRK)</i>	
Trade receivables	65,614	45,150
Other receivables	-	2,000
Short-term loans given	8,127	3,458
	<u>73,741</u>	<u>50,608</u>
Trade payables	24,652	12,325
	<u>24,652</u>	<u>12,325</u>

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2006

NOTE 30 – RELATED PARTY TRANSACTIONS (continued)

Year-end balances resulting from transactions with key management are as follows:

In 2006, a total amount of HRK 11,380 thousand (2005: HRK 9,854 thousand) was paid as salaries to the Supervisory Board, Management Board and executive directors.

As at 31 December 2006, ESOP and housing loans given to directors amounted to HRK 943 thousand (2005: HRK 1,541 thousand). Interest income in 2006 on these loans amounted to HRK 94 thousand (2005: HRK 110 thousand).

NOTE 31 – CONTINGENCIES AND COMMITMENTS

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

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

NOTE 32 – POST BALANCE SHEET EVENTS

The Company acquired 100% of the share capital of Tvornica istegnutih metala d.d., Topusko (TIM d.o.o., 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>	Carrying amount
Tangible assets	11,686
Inventories	9,908
Trade and other receivables	10,520
Cash	2,220
Trade and other payables	(12,826)
Borrowings	(8,571)
Net assets	(12,937)

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