

DALEKOVOD d.d.

**AUDITOR'S REPORT AND
FINANCIAL STATEMENTS
31 DECEMBER 2008**

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

Independent auditor's report

To the shareholders of DALEKOVOD d.d.

We have audited the accompanying financial statements of Parent Company DALEKOVOD d.d. (the 'Company') which comprise the balance sheet as of 31 December 2008 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 consolidated and non-consolidated financial statements present fairly, in all material respects, the financial position of the Company as of 31 December 2008, 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 May 2009

DALEKOVOD d.d.**INCOME STATEMENT****FOR THE YEAR ENDED 31 DECEMBER 2008**

<i>(all amounts are expressed in thousands of HRK)</i>	Note	2008	2007
Sales	5	2,217,649	1,739,227
Other income	6	40,349	27,351
Change in work in progress and finished goods		349,798	17,102
Cost of goods sold		(250,318)	(127,918)
Cost of materials and services	7	(1,668,217)	(1,055,843)
Staff costs	8	(325,305)	(308,049)
Depreciation and amortisation	15,16,17	(44,028)	(37,197)
Other operating expenses	9	(152,094)	(132,337)
Other gains/(losses) – net	10	(17,433)	(2,938)
Operating profit		150,401	119,398
Finance income	11	1,712	3,640
Finance costs	11	(47,129)	(22,276)
		(45,417)	(18,636)
Profit before tax		104,984	100,762
Income tax expense	12	(22,470)	(21,564)
Net profit		82,514	79,198
Attributable to:			
Equity holders of the Company		82,514	79,198
Minority interest		-	-
Net profit		82,514	79,198
Earnings per share – basic an diluted (in HRK)	13	36.30	34.91

The financial statements set out on pages 2 to 53 were approved by the Management Board on 19 May 2009.

President of the Board/General Manager:

mr. sc. Luka Miličić, dipl. ing.

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

DALEKOVOD d.d.**BALANCE SHEET****AS AT 31 DECEMBER 2008***(all amounts are expressed in thousands of HRK)*

	<u>Note</u>	<u>2008</u>	<u>2007</u>
ASSETS			
Non-current assets			
Intangible assets	15	18,156	19,379
Property, plant and equipment	16	380,836	281,505
Prepayments for property, plant and equipment	16	25	46
Investment property	17	110,846	122,003
Investments in subsidiaries	18	72,648	60,643
Available-for-sale financial assets	19	45,186	27,435
Loans and receivables	21	25,481	21,373
		<u>653,178</u>	<u>532,384</u>
Current assets			
Inventories	22	691,662	229,023
Trade and other receivables	23	1,137,418	837,264
Financial assets at fair value through profit or loss	24	24	894
Cash and cash equivalents	25	104,720	177,495
		<u>1,933,824</u>	<u>1,244,676</u>
Total assets		<u>2,587,002</u>	<u>1,777,060</u>
SHAREHOLDERS' EQUITY AND LIABILITIES			
Shareholders' equity			
	26		
Share capital		229,381	229,381
Legal reserves		11,487	11,487
Treasury shares		(5,374)	(1,244)
Statutory reserves		219,999	173,309
Revaluation reserves		3,591	5,064
Other reserves		36,422	32,292
Retained earnings		82,514	79,198
		<u>578,020</u>	<u>529,487</u>
Minority interest		-	-
Total equity		<u>578,020</u>	<u>529,487</u>
Non-current liabilities			
Borrowings	27	183,957	174,174
Provisions	30	7,189	6,540
Deferred income	28	77,388	-
		<u>268,534</u>	<u>180,714</u>
Current liabilities			
Borrowings	27	714,322	327,073
Trade and other payables	29	1,023,687	738,751
Income tax payable	12	2,439	1,035
		<u>1,740,448</u>	<u>1,066,859</u>
Total liabilities		<u>2,008,982</u>	<u>1,247,573</u>
Total shareholders' equity and liabilities		<u>2,587,002</u>	<u>1,777,060</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 2008

(all amounts are expressed in thousands of HRK)

	Note	Share capital	Legal reserves	Treasury shares	Revaluation reserves	Statutory reserves	Other reserves	Retained earnings	Total
Year ended 31 December 2007									
At 1 January 2007		229,381	11,487	(1,244)	-	127,459	32,291	74,867	474,241
Dividend relating to 2006	14	-	-	-	-	-	-	(29,016)	(29,016)
Financial assets – fair value	26	-	-	-	5,064	-	-	-	5,064
Statutory reserves	26	-	-	-	-	45,850	1	(45,851)	-
Net profit		-	-	-	-	-	-	79,198	79,198
At 31 December 2007		229,381	11,487	(1,244)	5,064	173,309	32,292	79,198	529,487
Year ended 31 December 2008									
At 1 January 2008		229,381	11,487	(1,244)	5,064	173,309	32,292	79,198	529,487
Dividend relating to 2007	14	-	-	-	-	-	-	(32,508)	(32,508)
Financial assets – fair value	26	-	-	-	(1,473)	-	-	-	(1,473)
Purchase of treasury shares	26	-	-	(4,130)	-	-	4,130	-	-
Statutory reserves	26	-	-	-	-	46,690	-	(46,690)	-
Net profit		-	-	-	-	-	-	82,514	82,514
At 31 December 2008		229,381	11,487	(5,374)	3,591	219,999	36,422	82,514	578,020

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

DALEKOVOD d.d.**CASH FLOW STATEMENT****FOR THE YEAR ENDED 31 DECEMBER 2008***(all amounts are expressed in thousands of HRK)*

	Note	2008	2007
Cash flows from operating activities			
Cash generated from operations	32	(240,888)	336,087
Interest paid		(43,738)	(21,886)
Income tax paid		(21,066)	(25,988)
Net cash (outflow)/inflow from operating activities		(305,692)	288,213
Cash flows from investing activities			
Purchase of intangible assets	15	(3,050)	(10,823)
Purchase of property, plant and equipment		(128,558)	(93,406)
Proceeds from sale of property, plant and equipment	32	178	2,699
Loans granted		24,144	(74,134)
Loan repayments received		4,255	12,209
Investment in subsidiaries and associate		(12,005)	(29,577)
Investment in available-for-sale financial assets	19	(19,224)	(14,876)
Sale of/investment in financial assets		870	5,916
Interest received		5,615	6,180
Net cash used in investing activities		(127,775)	(195,812)
Cash flows from financing activities			
Proceeds from borrowings		538,097	384,380
Issue of commercial papers - net	27	118,000	32,000
Purchase of treasury shares	26	(4,130)	-
Repayments of borrowings		(258,767)	(305,291)
Dividends paid		(32,508)	(43,392)
Net cash from financing activities		360,692	67,697
Net increase/(decrease) in cash and cash equivalents		(72,775)	160,098
Cash and cash equivalents at beginning of year		177,495	17,397
Cash and cash equivalents at end of year	25	104,720	177,495
Net increase/(decrease) in cash and cash equivalents		(72,775)	160,098

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

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2008

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. As at 31 December 2008, 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.

2.1 Basis of preparation

The financial statements of the Company 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 Company's accounting policies. The 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 (the Group), which were approved by the Management Board on 19 May 2009. 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 2008 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) Interpretations to existing standards effective in 2008 but not relevant to the Company's operations

The following interpretations to published standards are mandatory for accounting periods beginning on or after 1 January 2008 but are not relevant to the Company's operations:

- *IFRIC 14, IAS 19 – The limit on a defined benefit asset, minimum funding requirements and their interaction (effective from 1 January 2008).* IFRIC 14 is not relevant since the Company does not have defined benefit plans.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.1 Basis of preparation (continued)

(a) *Interpretations to existing standards effective in 2008 but not relevant to the Company's operations (continued)*

- *IFRIC 11, IFRS 2 – Group and treasury share transactions*, provides guidance on whether share-based transactions involving treasury shares or involving group entities (for example, options over a parent's shares) should be accounted for as equity-settled or cash-settled share-based payment transactions in the stand-alone accounts of the parent and group companies. This interpretation does not have an impact on the Company's financial statements.
- *Amendment to IAS 39 Financial instruments: Recognition and measurement and IFRS 7 Financial instruments: Disclosures*. An amendment to the standards, issued in October 2008, permits the company to reclassify non-derivative financial assets (other than those designated at fair value through profit or loss by the entity upon initial recognition) out of the fair value through profit or loss category in particular circumstances. The amendment also permits the Company to transfer from the "available-for-sale" category to the loans and receivables category a financial asset that would have met the definition of loans and receivables (if the financial assets had not been designated as available for sale), if the Company has the intention and ability to hold that financial asset for the foreseeable future. The Company did not use the option to reclassify its financial assets.
- *IFRIC 16, 'Hedges of a net investment in a foreign operation' (effective from 1 October 2008)*. IFRIC 16 clarifies the accounting treatment in respect of net investment hedging. This includes the fact that net investment hedging relates to differences in functional currency not presentation currency, and hedging instruments may be held anywhere in the Company. The requirements of IAS 21, 'The effects of changes in foreign exchange rates', do apply to the hedged item. The Company will apply IFRIC 16 from 1 January 2009. It is not expected to have a material impact on the Company's financial statements.

(b) *Standards and amendments to existing standards effective on or after 1 January 2009, and not early adopted by the Company*

The following standards and amendments to existing standards are mandatory for the Company's accounting periods beginning on or after the effective date, but the Company has not early adopted them:

- *IAS 1 (Revised), 'Presentation of financial statements' (effective from 1 January 2009)*. The revised standard will prohibit the presentation of items of income and expenses (that is, 'non-owner changes in equity') in the statement of changes in equity, requiring 'non-owner changes in equity' to be presented separately from owner changes in equity. All non-owner changes in equity will be required to be shown in a performance statement, but entities can choose whether to present one performance statement (the statement of comprehensive income) or two statements (the income statement and statement of comprehensive income). Where entities restate or reclassify comparative information, they will be required to present a restated balance sheet as at the beginning of comparative period. The Company will apply IAS 1 (Revised) from 1 January 2009. It is likely that the Company will present one performance statement.
- *IAS 19 (Amendment), 'Employee benefits' (effective from 1 January 2009)*. The amendment clarifies the effects of certain changes to defined benefit plans, amends the definition of the return on plan assets, clarifies distinction between short-term and long-term employee benefits and requires contingent liabilities to be disclosed, not recorded, in line with IAS 19. The Company does not expect the amendment to IAS 19 to have a significant impact on the financial statements.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.1 Basis of preparation (continued)

(b) *Standards and amendments to existing standards effective on or after 1 January 2009, and not early adopted by the Company (continued)*

- *IAS 23 (Amendment), Borrowing costs (effective from 1 January 2009)*. The amendment requires an entity to capitalise borrowing costs directly attributable to the acquisition, construction or production of qualifying assets. Management is currently assessing the impact of this standard. The Company will apply IAS 23 (Amendment) from 1 January 2009.
- *IAS 23 (Amendment), 'Borrowing costs' (effective from 1 January 2009)*. The amendment is part of the IASB's annual improvements project published in May 2008. The definition of borrowing costs has been amended so that interest expense is calculated using the effective interest method defined in IAS 39 'Financial instruments: Recognition and measurement'. This eliminates the inconsistency of terms between IAS 39 and IAS 23. The Company will apply IAS 23 (Amendment) prospectively to the capitalisation of borrowing costs on qualifying assets from 1 January 2009.
- *IAS 1 (Amendment), 'Presentation of financial statements' (effective from 1 January 2009)*. The amendment clarifies that some rather than all financial assets and liabilities classified as held for trading in accordance with IAS 39, 'Financial instruments: Recognition and measurement' are examples of current assets and liabilities respectively. The Company will apply the IAS 1 (Amendment) from 1 January 2009. It is not expected to have an impact on the Company's financial statements.
- *IAS 36 (Amendment), 'Impairment of assets' (effective from 1 January 2009)*. The amendment is part of the IASB's annual improvements project published in May 2008. Where fair value less costs to sell is calculated on the basis of discounted cash flows, disclosures equivalent to those for value-in-use calculation should be made. The Company will apply the IAS 36 (Amendment) and provide the required disclosure where applicable for impairment tests from 1 January 2009.
- *IAS 38 (Amendment), 'Intangible assets' (effective from 1 January 2009)*. The amendment is part of the IASB's annual improvements project published in May 2008.
 - A prepayment may only be recognised in the event that payment has been made in advance of obtaining right of access to goods or receipt of services. Management does not expect it will have a material impact on the Company's financial statements.
 - The amendment deletes the wording that states that there is 'rarely, if ever' support for use of a method that results in a lower rate of amortisation than the straight line method. The amendment will not currently have an impact on the Company's operations as all intangible assets are amortised using the straight line method.
- *IFRS 2 (Amendment), 'Share-based payment' (effective from 1 January 2009)*. The amended standard deals with vesting conditions and cancellations. It clarifies that vesting conditions are service conditions and performance conditions only. Other features of a share-based payment are not vesting conditions. As such these features would need to be included in the grant date fair value for transactions with employees and others providing similar services, that is, these features would not impact the number of awards expected to vest or valuation thereof subsequent to grant date. All cancellations, whether by the entity or by other parties, should receive the same accounting treatment. The Company will apply IFRS 2 (Amendment) from 1 January 2009. It is not expected to have a material impact on the Company's financial statements.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.1 Basis of preparation (continued)

(b) *Standards and amendments to existing standards effective on or after 1 January 2009, and not early adopted by the Company (continued)*

- *IAS 32 (Amendment), 'Financial instruments: Presentation', and IAS 1 (Amendment), 'Presentation of financial statements' – 'Puttable financial instruments and obligations arising on liquidation' (effective from 1 January 2009).* The amended standards require entities to classify puttable financial instruments and instruments or components of instruments that impose on the entity an obligation to deliver to another party a pro rata share of net assets of the entity only on liquidation as equity, provided the financial instruments have particular features and meet specific conditions. The Company will apply the IAS 32 and IAS 1 (Amendment) from 1 January 2009. It is not expected to have any impact on the Company's financial statements.
- *IAS 27 (Revised), 'Consolidated and separate financial statements' (effective from 1 July 2009).* The revised standard requires the effects of all transactions with non-controlling interests to be recorded in equity if there is no change in control and these transactions will no longer result in goodwill or gains and losses. The standard also specifies the accounting when control is lost. Any remaining interest in the entity is re-measured to fair value and a gain or loss is recognised in profit or loss. The Company will apply IAS 27 (Revised) prospectively to transactions with non-controlling interests from 1 January 2010.
- *IAS 39 (Amendment), 'Financial instruments: Recognition and measurement' (effective from 1 January 2009).* The amendment is part of the IASB's annual improvements project published in May 2008.
 - This amendment clarifies that it is possible for there to be movements into and out of the fair value through profit or loss category where a derivative commences or ceases to qualify as a hedging instrument in cash flow or net investment hedge.
 - The definition of financial asset or financial liability at fair value through profit or loss as it relates to items that are held for trading is also amended. This clarifies that a financial asset or liability that is part of a portfolio of financial instruments managed together with evidence of an actual recent pattern of short-term profit-taking is included in such a portfolio on initial recognition.
 - The current guidance on designating and documenting hedges states that a hedging instrument needs to involve a party external to the reporting entity and cites a segment as an example of a reporting entity. This means that in order for hedge accounting to be applied at segment level, the requirements for hedge accounting are currently required to be met by the applicable segment. The amendment removes this requirement so that IAS 39 is consistent with IFRS 8, 'Operating segments' which requires disclosure for segments to be based on information used by Management.
 - When remeasuring the carrying amount of a debt instrument on cessation of fair value hedge accounting, the amendment clarifies that a revised effective interest rate (calculated at the date fair value hedge accounting ceases) are used. The Company will apply the IAS 39 (Amendment) from 1 January 2009.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2008

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.1 Basis of preparation (continued)

(b) Standards and amendments to existing standards effective on or after 1 January 2009, and not early adopted by the Company (continued)

- *IFRS 5 (Amendment), 'Non-current assets held for sale and discontinued operations' (and consequential amendment to IFRS 1, 'First-time adoption') (effective from 1 July 2009).* The amendment is part of the IASB's annual improvements project published in May 2008. The amendment clarifies that all of a subsidiary's assets and liabilities are classified as held for sale if a partial disposal sale plan results in loss of control, and relevant disclosure should be made for this subsidiary if the definition of a discontinued operation is met. A consequential amendment to IFRS 1 states that these amendments are applied prospectively from the date of transition to IFRSs. The Company will apply IFRS 5 (Amendment) prospectively to all partial disposals of subsidiaries from 1 January 2010.
- *IFRS 3 (Revised), 'Business combinations' (effective from 1 July 2009).* The revised standard continues to apply the acquisition method to business combinations, with some significant changes. For example, all payments to purchase a business are to be recorded at fair value at the acquisition date, with contingent payments classified as debt subsequently re-measured through the income statement. There is a choice on an acquisition-by-acquisition basis to measure the non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's net assets. All acquisition-related costs should be expensed. The Company will apply IFRS 3 (Revised) prospectively to all business combinations from 1 January 2010.
- There are a number of minor amendments to *IFRS 7, 'Financial instruments: Disclosures', IAS 8, 'Accounting policies, changes in accounting estimates and errors', IAS 10, 'Events after the reporting period', IAS 18, 'Revenue' and IAS 34, 'Interim financial reporting'*, which are part of the IASB's annual improvements project published in May 2008. These amendments are unlikely to have an impact on the Company's accounts and have therefore not been analysed in detail.
- *IFRS 1 (Amendment) 'First time adoption of IFRS' and IAS 27 'Consolidated and separate financial statements'(effective from 1 January 2009).* The amendment is not relevant since the Company applied IAS in earlier periods.
- *IAS 27 (Amendment), 'Consolidated and separate financial statements' (effective from 1 January 2009).* The amendment is part of the IASB's annual improvements project published in May 2008. Where an investment in a subsidiary that is accounted for under IAS 39, 'Financial instruments: recognition and measurement' is classified as held for sale under IFRS 5, 'Non-current assets held for sale and discontinued operations', IAS 39 would continue to be applied. The amendment will not have an impact on the Company's operations because it is the Company's policy for an investment in subsidiary to be recorded at cost in the standalone accounts of each entity.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.1 Basis of preparation (continued)

(b) *Standards and amendments to existing standards effective on or after 1 January 2009, and not early adopted by the Company (continued)*

- *IAS 19 (Amendment), 'Employee benefits' (effective from 1 January 2009)*. The amendment is part of the IASB's annual improvements project published in May 2008.
 - The amendment clarifies the effects of defined benefit plan amendments on expected gains arising from future salary increases or past service.
 - The definition of return on plan assets has been amended to state that plan administration costs are deducted in the calculation of return on plan assets only to the extent that such costs have been excluded from measurement of the defined benefit obligation.
 - The distinction between short term and long term employee benefits will be based on whether benefits are due to be settled within or after 12 months of employee service being rendered.
 - IAS 37, 'Provisions, contingent liabilities and contingent assets', requires contingent liabilities to be disclosed, not recognised. IAS 19 has been amended to be consistent.
 - *IAS 16 (Amendment), 'Property, plant and equipment' (and consequential amendment to IAS 7, 'Statement of cash flows') (effective from 1 January 2009)*. The amendment is part of the IASB's annual improvements project published in May 2008. Entities whose ordinary activities comprise renting and subsequently selling assets present proceeds from the sale of those assets as revenue and should transfer the carrying amount of the asset to inventories when the asset becomes held for sale. A consequential amendment to IAS 7 states that cash flows arising from purchase, rental and sale of those assets are classified as cash flows from operating activities. The amendment will not have an impact on the Company's operations because none of the Company's companies ordinary activities comprise renting and subsequently selling assets.
- *IAS 28 (Amendment), 'Investments in associates' (and consequential amendments to IAS 32, 'Financial Instruments: Presentation' and IFRS 7, 'Financial instruments: Disclosures') (effective from 1 January 2009)*. The amendment is part of the IASB's annual improvements project published in May 2008. An investment in associate is treated as a single asset for the purposes of impairment testing and any impairment loss is not allocated to specific assets included within the investment, for example, goodwill. Reversals of impairment are recorded as an adjustment to the investment balance to the extent that the recoverable amount of the associate increases. It is not expected to have a material impact on the Company's financial statements.
- *IAS 28 (Amendment), 'Investments in associates' (and consequential amendments to IAS 32, 'Financial Instruments: Presentation' and IFRS 7, 'Financial instruments: Disclosures') (effective from 1 January 2009)*. The amendment is part of the IASB's annual improvements project published in May 2008. Where an investment in associate is accounted for in accordance with IAS 39 'Financial instruments: recognition and measurement' only certain, rather than all disclosure requirements in IAS 28 need to be made in addition to disclosures required by IAS 32, 'Financial Instruments: Presentation' and IFRS 7 'Financial Instruments: Disclosures'. It is not expected to have a material impact on the Company's financial statements.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2008

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.1 Basis of preparation (continued)

(b) *Standards and amendments to existing standards effective on or after 1 January 2009, and not early adopted by the Company (continued)*

- *IAS 31 (Amendment), 'Interests in joint ventures (and consequential amendments to IAS 32 and IFRS 7) (effective from 1 January 2009)*. The amendment is part of the IASB's annual improvements project published in May 2008. Where an investment in joint venture is accounted for in accordance with IAS 39, only certain rather than all disclosure requirements in IAS 31 need to be made in addition to disclosures required by IAS 32, 'Financial instruments: Presentation' and IFRS 7 'Financial instruments: Disclosures'. The amendment will not have an impact on the Company's operations because it is the Company's policy for an interests in joint ventures to be equity accounted in the Company's consolidated accounts.
- *IAS 29 (Amendment), 'Financial reporting in hyperinflationary economies' (effective from 1 January 2009)*. The amendment is part of the IASB's annual improvements project published in May 2008. The guidance has been amended to reflect the fact that a number of assets and liabilities are measured at fair value rather than historical cost. The amendment will not have an impact on the Company's operations, as the Company's does not operate in hyperinflationary economies.
- *IAS 40 (Amendment), 'Investment property' (and consequential amendments to IAS 16) (effective from 1 January 2009)*. The amendment is part of the IASB's annual improvements project published in May 2008. Property that is under construction or development for future use as investment property is within the scope of IAS 40. Where the fair value model is applied, such property is, therefore, measured at fair value. However, where fair value of investment property under construction is not reliably measurable, the property is measured at cost until the earlier of the date construction is completed and the date at which fair value becomes reliably measurable. The amendment will not have an impact on the Company's operations.
- *IAS 41 (Amendment), 'Agriculture' (effective from 1 January 2009)*. The amendment is part of the IASB's annual improvements project published in May 2008. It requires the use of a market-based discount rate where fair value calculations are based on discounted cash flows and the removal of the prohibition on taking into account biological transformation when calculating fair value. The amendment will not have an impact on the Company's operations as no agricultural activities are undertaken.
- *IAS 20 (Amendment), 'Accounting for government grants and disclosure of government assistance' (effective from 1 January 2009)*. The benefit of a below-market rate government loan is measured as the difference between the carrying amount in accordance with IAS 39, 'Financial instruments: Recognition and measurement', and the proceeds received with the benefit accounted for in accordance with IAS 20. The amendment will not have an impact on the Company's operations.
- There are minor amendments to *IAS 20 'Accounting for government grants and disclosure of government assistance'* and *IAS 29, 'Financial reporting in hyperinflationary economies'*, *IAS 40, 'Investment property'* and *IAS 41, 'Agriculture'*, which are part of the IASB's which are part of the IASB's annual improvements project published in May 2008. These amendments will not have an impact on the Company's operations.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.1 Basis of preparation (continued)

(b) Standards and amendments to existing standards effective on or after 1 January 2009, and not early adopted by the Company (continued)

- *IFRIC 15, 'Agreements for construction of real estates' (effective from 1 January 2009). The interpretation clarifies whether IAS 18, 'Revenue', or IAS 11, 'Construction contracts' should be applied to particular transactions. It is not expected to have a material impact on the Company's financial statements.*
- *IFRIC 17, Distribution of Non-Cash Assets to Owners (effective for annual periods beginning on or after 1 July 2009). The interpretation clarifies when and how distribution of non-cash assets as dividends to the owners should be recognised. An entity should measure a liability to distribute non-cash assets as a dividend to its owners at the fair value of the assets to be distributed. A gain or loss on disposal of the distributed non-cash assets will be recognised in profit or loss when the entity settles the dividend payable.*
- *IFRIC 18, Transfers of Assets from Customers (effective for annual periods beginning on or after 1 July 2009). The interpretation clarifies the accounting for transfers of assets from customers, namely, the circumstances in which the definition of an asset is met; the recognition of the asset and the measurement of its cost on initial recognition; the identification of the separately identifiable services (one or more services in exchange for the transferred asset); the recognition of revenue, and the accounting for transfers of cash from customers.*

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 of sale or the date that control ceases.

In the non-consolidated financial statements, the Company carries investments in subsidiaries at acquisition cost.

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 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 are charged to the income statement during the financial period in which they are incurred.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2008

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.5 Property, plant and equipment (continued)

Land and work in progress are not depreciated. Depreciation of other assets 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.

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).

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.8 Impairment of non-financial assets

Assets that have an indefinite useful life (such as land or goodwill) 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.

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 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.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2008

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.9 Financial assets (continued)

(b) Available-for-sale 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 right to receive payment is established.

The Company assess 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 Company is the lessee

The Company lease 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. 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.

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 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".

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 use 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).

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 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.

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.

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 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.

Furthermore, according to Collective bargaining agreement the Company has an obligation to make severance payments to employees at the time of the employees' 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 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. The 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 General Assembly of 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.

NOTE 3 – FINANCIAL RISK MANAGEMENT

3.1 Financial risk factors

The Company's activities exposes them to a variety of financial risks: market risk (including currency risk and cash flow interest rate risk), credit risk and liquidity 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) Market risk

(i) *Foreign exchange risk*

The majority of foreign sales revenue is denominated in EUROS and USD. 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 USD against the Croatian kuna will have an impact on the Company's operating results.

At 31 December 2008, if the EURO had weakened/strengthened by 0.5% against the HRK, with all other variables held constant, the net profit for the reporting period after tax would have been HRK 1,355 thousand (2007: HRK 6,905 thousand) higher/(lower), mainly as a result of foreign exchange gains/(losses) on translation of EURO-denominated trade receivables, borrowings and foreign cash funds.

At 31 December 2007, if the USD had weakened/strengthened by 5% against the HRK, with all other variables held constant, the net profit for the reporting period after tax would have been HRK 5,449 thousand (2007: HRK 8,097 thousand) higher/(lower), mainly as a result of foreign exchange gains/(losses) on translation of USD-denominated trade receivables, prepayments and foreign cash funds.

(ii) *Equity securities risk*

The Company is exposed to equity securities fair value and price risk because of investments held by the Company classified on the consolidated balance sheet either as available for sale or at fair value through profit or loss. Equity investments classified as available for sale are not listed, while those classified as fair value through profit or loss are publicly traded. To manage its fair value and price risk arising from investments in equity securities, the Company monitors market transactions and performance of investment entities.

NOTE 3 – FINANCIAL RISK MANAGEMENT (continued)

3.1 Financial risk factors (continued)

(iii) 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 and commercial papers. Borrowings and commercial papers issued at variable rates expose the Company to cash flow interest rate risk. Borrowings and commercial papers issued at fixed rates expose the Company to fair value interest rate risk (Note 27).

The Company analyses their interest rate changes on a regular basis. Various scenarios are simulated taking into consideration refinancing, renewal of existing positions and alternative financing. Based on these scenarios, the Company calculate the impact on profit and loss of a defined interest rate shift. As at 31 December 2008, if the effective interest rate on borrowings had increased/decreased by 1% on an annual level (2007: 1%), the profit after tax would be lower/higher by HRK 1,735 thousand (2007: HRK 4,938 thousand).

(b) Credit risk

The Company's assets, which potentially subject the Company to concentrations of credit risk, primarily include cash, trade and other receivables. The Company has policies in place to ensure that sales of products are made to customers with an appropriate credit history, within previously defined credit limits. 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. A detailed analysis and maximum exposure to credit risk are shown in Note 23.

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.

Trade and other payables as well as short-term borrowings are due within 12 months after the balance sheet date, while the maturity of long-term borrowings is disclosed in Note 27.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2008

NOTE 3 – FINANCIAL RISK MANAGEMENT (continued)

3.1 Financial risk factors (continued)

(c) Liquidity risk (continued)

The table below analyses financial liabilities of the Company according to contracted maturities. The amounts stated below represent undiscounted cash flows.

<i>(in thousands of HRK)</i>	Less than 1 year	Between 1-5 years	Over 5 years	Total
31 December 2008				
Trade payables	870,991	-	-	870,991
Other payables	12,749	-	-	12,749
Borrowings	720,685	134,626	49,311	904,622
 <i>(in thousands of HRK)</i>				
31 December 2007				
Trade payables	436,514	-	-	436,514
Other payables	16,453	-	-	16,453
Borrowings	372,138	89,466	39,643	501,247

Financial liabilities do not include amounts due to employees, liabilities for contributions, taxes, advances received and deferred income.

3.2 Capital risk management

The Company monitors capital on the basis of laws and regulations of the countries in which they operate. Croatian laws and regulations require minimum paid in capital of HRK 200 thousand for joint stock companies. There are no specific objectives required by the owners in managing capital. The Company is not subject to externally imposed capital requirements. In addition, there are no internally monitored capital objectives.

3.3 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.

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 16,300 thousand if the percentage of completion were increased, or would be decreased by HRK 14,100 thousand if the percentage of completion were decreased.

(b) Long-term employee benefits

The Company recognises non-current liabilities to employees including liabilities for jubilee awards and retirement benefits in the amount of the estimated present value of future expenses. Each year a certified actuary revalues the present value of these liabilities based on new information.

(c) Impairment test for goodwill

Provisionally determined goodwill resulting from the business combinations during the year 2007 has been restated upon completion of the valuation of acquired net assets (Notes 15 and 31).

Goodwill is tested annually for impairment as stated in Note 2.8.

The recoverable amount of cash generating units is determined based on value-in-use calculations. These calculations use cash flow projections from financial budgets approved by the management covering a five-year period. The terminal growth rate used to extrapolate the cash flows beyond the five-year period is 5%, and present value of future cash flows is calculated using a discount rate of 10%. Growth rate assumption was based on the historical data and the management's expectations for market development. Discount rate used is based on the Company's weighted average cost of capital.

At the balance sheet date the recoverable amount of cash generating units was higher than carrying value and there were no impairment losses.

NOTE 4 – CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS (continued)

(d) Recent volatility in global and Croatian financial markets

The ongoing global liquidity crisis which commenced in the middle of 2007 has resulted in, among other things, a lower level of capital market funding, lower liquidity levels across the banking sector, and, at times, higher interbank lending rates and very high volatility in stock markets. The uncertainties in the global financial markets have also led to bank failures and bank rescues in the United States of America, Western Europe, Russia and elsewhere. Indeed the full extent of the impact of the ongoing financial crisis is proving to be impossible to anticipate or completely guard against.

It is impossible to reliably estimate the effects on the Company's financial position of any further deterioration in the liquidity of the financial markets and the increased volatility in the currency and equity markets. Management believes it is taking all the necessary measures to support the sustainability and growth of the Company's business in the current circumstances.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2008

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 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 2008				
Gross segment revenues	1,926,163	431,338	73,921	2,431,422
Inter-segment sales	<u>(18,548)</u>	<u>(140,269)</u>	<u>(14,607)</u>	<u>(173,424)</u>
Operating revenues	1,907,615	291,069	59,314	2,257,998
Operating profit	129,388	8,611	12,402	150,401
Finance costs				<u>(45,417)</u>
Profit before tax				104,984
Income tax expense				<u>(22,470)</u>
Net profit				82,514
Year ended 31 December 2007				
Gross segment revenues	1,210,219	244,472	471,327	1,926,018
Inter-segment sales	<u>(10,660)</u>	<u>(36,448)</u>	<u>(112,332)</u>	<u>(159,440)</u>
Operating revenues	1,199,559	208,024	358,995	1,766,578
Operating profit	98,438	765	20,195	119,398
Finance costs				<u>(18,636)</u>
Profit before tax				100,762
Income tax expense				<u>(21,564)</u>
Net profit				79,198

NOTE 5 – SEGMENT INFORMATION (continued)

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2008

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 2008				
Depreciation and amortisation (Notes 15,16)	12,755	21,315	9,958	44,028
Impairment of inventories (Note 9)	295	-	-	295
Change in provision for receivables (Note 9)	1,995	-	-	1,995
Property, plant and equipment written off (Note 9)	325	-	-	325
Year ended 31 December 2007				
Depreciation and amortisation (Notes 15,16)	12,112	11,305	13,780	37,197
Impairment of inventories (Note 9)	160	-	-	160
Change in provision for receivables (Note 9)	588	-	-	588
Property, plant and equipment written off (Note 9)	141	2,023	11	2,175

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 2008					
Assets					
Property, plant and equipment	118,224	156,053	106,559	-	380,836
Other assets	1,279,525	424,846	501,795	-	2,206,166
	1,397,749	580,899	608,354	-	2,587,002
Liabilities					
Long-term borrowings	-	-	-	183,957	183,957
Non-current provisions	-	-	-	7,189	7,189
Current liabilities	671,091	68,305	183,021	895,419	1,817,836
	671,091	68,305	183,021	1,086,565	2,008,982
Capital expenditure (Notes 15 and 16)	23,470	105,475	2,359	-	131,304
At 31 December 2007					
Assets					
Property, plant and equipment	72,869	66,894	141,742	-	281,505
Other assets	780,335	401,126	314,094	-	1,495,555
	853,204	468,020	455,836	-	1,777,060
Liabilities					
Long-term borrowings	-	-	-	174,174	174,174
Non-current provisions	-	-	-	6,540	6,540
Current liabilities	320,497	90,748	86,455	569,159	1,066,859
	320,497	90,748	86,455	749,873	1,247,573
Capital expenditure (Notes 15 and 16)	45,919	44,845	12,517	-	103,281

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

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2008

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.

	2008		2007	
	<i>(in thousands of HRK)</i>	%	<i>(in thousands of HRK)</i>	%
Croatia	1,555,393	70.14	1,341,961	77.16
Bosnia and Herzegovina	133,953	6.04	139,146	8.00
Norway	113,599	5.12	31,576	1.82
Albania	125,787	5.67	-	-
Slovenia	69,812	3.15	61,192	3.52
Kazakhstan	48,217	2.17	72,330	4.16
Other	170,888	7.71	93,022	5.34
Total	2,217,649	100.00	1,739,227	100.00

NOTE 6 – OTHER INCOME

<i>(in thousands of HRK)</i>	2008	2007
Interest income	6,635	4,545
Proceeds from insurance claims	373	867
Rental income	26,535	15,548
Income from reversal of provisions (Note 27)	33	733
Other operating income	6,773	5,658
	40,349	27,351

Rental income mainly relates to the lease of property to the subsidiary Dalekovod-Cinčaonica d.o.o. which reimburses the depreciation charge, 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 2008

NOTE 7 – COST OF MATERIALS AND SERVICES

<i>(in thousands of HRK)</i>	<u>2008</u>	<u>2007</u>
Raw materials and supplies		
Raw materials and supplies	493,554	299,791
Energy	13,631	13,008
Spare parts and small inventory	9,997	8,536
	<u>517,182</u>	<u>321,335</u>
External services		
Subcontractor services	1,072,749	683,071
Transportation	23,952	23,086
Repairs and maintenance	9,002	8,321
Advertising and promotion	20,351	12,842
Rental expense	2,412	1,109
Other	22,569	6,079
	<u>1,151,035</u>	<u>734,508</u>
Total cost of materials and services	<u>1,668,217</u>	<u>1,055,843</u>

Rental expenses relate to the lease of vehicles and office premises based on one-year agreements.

NOTE 8 – STAFF COSTS

<i>(in thousands of HRK)</i>	<u>2008</u>	<u>2007</u>
Net salaries	181,914	161,470
Taxes and contributions on and from salaries	132,555	134,014
Severance costs	2,564	5,077
Other staff costs	7,166	7,119
Supervisory Board compensation	1,106	369
	<u>325,305</u>	<u>308,049</u>

Taxes and contributions include contributions paid into mandatory pension funds in the amount of HRK 47,220 thousand for the Company (2007: HRK 49,644 thousand). Contributions are calculated as a percentage of the employees' gross salaries.

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

As at 31 December 2008, the Company had 1,537 employees (2007.: 1,558).

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2008

NOTE 9 – OTHER OPERATING EXPENSES

<i>(in thousands of HRK)</i>	<u>2008</u>	<u>2007</u>
Intellectual services	67,640	54,982
Daily allowances and travel cost	26,804	27,255
Bank charges	14,461	8,436
Entertainment	9,365	9,219
Taxes and contributions	8,056	7,015
Insurance	9,195	6,288
Sponsorships, donations and other aids	6,468	8,610
Write-off of property, plant and equipment	325	2,175
Change in provision for impairment of trade receivables	1,995	588
Write-off of inventories	295	160
Interest from suppliers	18,277	1,274
Other operating expenses	4,056	6,335
	<u>166,937</u>	<u>132,337</u>

NOTE 10 – OTHER (LOSSES)/GAINS – NET

<i>(in thousands of HRK)</i>	<u>2008</u>	<u>2007</u>
Net foreign exchange (loss)/gain from operating activities	(2,443)	(3,585)
Fair value (losses)/gains (Note 24)	-	123
Net (loss)/gain on sale of tangible assets (Note 32)	(147)	524
	<u>(2,590)</u>	<u>(2,938)</u>

NOTE 11 – FINANCE INCOME AND COSTS

<i>(in thousands of HRK)</i>	<u>2008</u>	<u>2007</u>
Interest income on bank deposits	-	1,162
Net foreign exchange differences (financing activities)	1,712	2,478
Finance income	1,712	3,640
Interest expense	(47,129)	(22,276)
Finance costs	(47,129)	(22,276)
	<u>(45,417)</u>	<u>(18,636)</u>

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2008

NOTE 12 – INCOME TAX

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

<i>(in thousands of HRK)</i>	<u>2008</u>	<u>2007</u>
Profit before tax	104,984	100,762
Tax calculated at a rate of 20%	20,997	20,153
Effect of income not subject to tax	(1,064)	(341)
Effect of expenses not deductible for tax purposes	2,537	1,752
Effect of tax rates in other countries	-	-
Income tax charge	22,470	21,564
Effective tax rate	21.36%	21.40%
Income tax payable as at 31 December	2,439	1,035

In accordance with the regulations of 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 are calculated on the basis of the Company's net profit and the weighted average number of ordinary shares in issue, excluding treasury shares. There are no dilutable potential ordinary shares.

	<u>2008</u>	<u>2007</u>
Net profit <i>(in thousands of HRK)</i>	82,514	79,198
Weighted average number of shares	2,272,973	2,268,573
Earnings per share <i>(in HRK)</i>	36.30	34.91

NOTE 14 – DIVIDENDS PER SHARE

During 2008, dividends were granted from retained earnings of previous years in the amount of HRK 32,508 thousand (2007: HRK 29,017 thousand), which amounts to HRK 14.30 per share (2007: 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 2007 in the amount of HRK 1,947 thousand (2007: HRK 1,312 thousand) are included as dividends payable in "trade and other payables" (Note 29).

NOTE 15 – INTANGIBLE ASSETS

(in thousands of HRK)

	<u>Software</u>
At 1 January 2007	
Cost	13,802
Accumulated amortisation	(4,105)
Net book amount	9,697
Year ended 31 December 2007	
Opening net book amount	9,697
Additions	10,823
Amortisation	(1,141)
Closing net book amount	19,379
At 31 December 2007	
Cost	24,625
Accumulated amortisation	(5,246)
Net book amount	19,379
Year ended 31 December 2008	
Opening net book amount	19,379
Additions	3,050
Amortisation	(4,273)
Closing net book amount	18,156
At 31 December 2008	
Cost	27,675
Accumulated amortisation	(9,519)
Net book amount	18,156

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2008

NOTE 16 – PROPERTY, PLANT AND EQUIPMENT

<i>(in thousands of HRK)</i>	Land	Buildings	Equipment	Work in progress	Total
At 1 January 2007					
Cost	16,288	190,366	343,874	4,119	554,647
Accumulated depreciation	-	(121,380)	(182,327)	-	(303,707)
Net book amount	16,288	68,986	161,547	4,119	250,940
Year ended 31 December 2007					
At 1 January	16,288	68,986	161,547	4,119	250,940
Transfer to investment property (Note 17)	(2,901)	-	-	-	(2,901)
Additions	134	13,860	41,787	13,715	69,496
Disposals	-	-	(2,175)	-	(2,175)
Depreciation	-	(4,491)	(29,364)	-	(33,855)
At 31 December	13,521	78,355	171,795	17,834	281,505
At 31 December 2007					
Cost	13,521	204,226	375,476	17,834	611,057
Accumulated depreciation	-	(125,871)	(203,681)	-	(329,552)
Net book amount	13,521	78,355	171,795	17,834	281,505
Year ended 31 December 2008					
At 1 January	13,521	78,355	171,795	17,834	281,505
Transfer to investment property (Note 17)	-	14,695	-	-	14,695
Additions	-	21,547	91,833	10,247	123,627
Disposals	-	-	(325)	-	(325)
Depreciation	-	(6,863)	(31,803)	-	(38,666)
At 31 December	13,521	107,734	231,500	28,081	380,836
At 31 December 2008					
Cost	13,521	239,272	442,366	28,081	723,240
Accumulated depreciation	-	(131,538)	(210,866)	-	(342,404)
Net book amount	13,521	107,734	231,500	28,081	380,836

As at 31 December 2008, the Company's advances for property, plant and equipment amounted to HRK 25 thousand (2007: HRK 46 thousand).

As at 31 December 2008, land, buildings and equipment of the Company with a net book value of HRK 150,338 thousand (2007: HRK 102,989 thousand) were pledged as security for borrowings received (Note 27).

As at 31 December 2008, assets leased under finance leases where the Company is the lessee amounted to HRK 206,147 thousand (2007: HRK 1,431 thousand) – see Note 27.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2008

NOTE 17 – INVESTMENT PROPERTY

(in thousands of HRK)

	<u>Land</u>	<u>Buildings</u>	<u>Total</u>
At 1 January 2007			
Cost	21,713	82,628	104,341
Accumulated depreciation	-	(6,000)	(6,000)
Net book amount	21,713	76,628	98,341
Year ended 31 December 2007			
As at 1 January	21,713	76,628	98,341
Transfer from property, plant and equipment (Note 16)	2,901	-	2,901
Additions	-	22,962	22,962
Depreciation	-	(2,201)	(2,201)
As at 31 December	24,614	97,389	122,003
As at 31 December 2007			
Cost	24,614	105,590	130,204
Accumulated depreciation	-	(8,201)	(8,201)
Net book amount	24,614	97,389	122,003
Year ended 31 December 2008			
As at 1 January	24,614	97,389	122,003
Transfer to property, plant and equipment (Note 16)	-	(14,695)	(14,695)
Additions	4,627	-	4,627
Depreciation	-	(1,089)	(1,089)
As at 31 December	29,241	81,605	110,846
As at 31 December 2008			
Cost	29,241	90,895	120,136
Accumulated depreciation	-	(9,290)	(9,290)
Net book amount	29,241	81,605	110,846

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

All land and buildings have been pledged as security for borrowings received (Note 27).

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2008

NOTE 18 – INVESTMENTS IN SUBSIDIARIES

	<u>2008</u>	<u>2007</u>
At 1 January	60,643	31,076
Decrease	-	-
Additions	12,005	29,567
At 31 December	<u>72,648</u>	<u>60,643</u>

The principal subsidiary undertakings at 31 December are as follows:

<u>Name</u>	<u>Country of incorporation</u>	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
		<i>Holding in %</i>		<i>(in thousands of HRK)</i>	
Dalekovod 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	87.18	95.00	2,597	2,597
Dalekovod TKS a.d., Doboj	Bosnia and Herzegovina	88.83	83.17	18,564	11,934
Unidal d.o.o., Vinkovci	Croatia	50.54	50.54	16,185	16,185
Dalekovod ESOP d.o.o., Zagreb	Croatia	100.00	100.00	200	200
Denacco Namibia (PTY) Ltd	Namibia	60.00	60.00	18	18
Dalekovod TIM Topusko d.d.	Croatia	89.28	88.83	26,181	25,997
Dalekovod – ulaganje d.o.o. Zagreb	Croatia	100.00	100.00	20	20
Dalekovod EKO d.o.o. Zagreb	Croatia	50.00	50.00	10	10
Cindal d.o.o. Doboj	Bosnia and Herzegovina	95.01	-	5,191	-
				<u>72,648</u>	<u>60,643</u>

In 2008, the Company performed a capital contribution to its subsidiary in Doboj in the amount of HRK 6,630 thousand following the Decision of the General Assembly. During 2008, it also purchased additionally 0.37% shares of Dalekovod TIM Topusko from small shareholders in the amount of HRK 184 thousand.

At the end of 2008, the Company and its subsidiary Dalekovod TKS a.d. Doboj founded a new company in Bosnia and Herzegovina, Cindal d.o.o. The Company owns 95% of the new company, whereas the subsidiary owns 5%. The newly established company was not active during 2008.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2008

NOTE 19 – AVAILABLE-FOR-SALE FINANCIAL ASSETS

<i>(in thousands of HRK)</i>	<u>2008</u>	<u>2007</u>
At beginning of year	27,435	7,485
Transfer from investments	-	10
Additional investments	19,224	14,876
Fair value adjustment	<u>(1,473)</u>	<u>5,064</u>
At end of year	<u>45,186</u>	<u>27,435</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. During the year, the Company invested an additional amount of HRK 3,224 thousand in the fund (2007: HRK 7,666 thousand).

In November 2008, the Company paid in HRK 10,000 thousand of the founding capital in a sport joint company, which represented 12% of interest in the newly established company. Also, during 2008, the Company transformed its deposit in the amount of HRK 6,303 thousand in a Croatian bank into the additional capital of this bank. Total ownership of the bank does not exceed 5% of capital.

As at 31 December 2008, the Company performed a valuation of its available-for-sale financial assets and adjusted them to fair value. The decrease of HRK 1,473 thousand (2007: an increase of 5,064 thousand) is recognised within revaluation reserves (Note 26).

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2008

NOTE 20A – FINANCIAL INSTRUMENTS BY CATEGORY

The accounting policies for financial instruments have been applied to the line items below:

<i>(in thousands of HRK)</i>	Note	Loans and receivables	Financial assets at fair value through profit or loss	Available- for-sale financial assets	Total
31 December 2008					
Financial assets					
Trade and other receivables	23	990,590	-	-	990,590
Loans and deposits given	21,23	112,723	-	-	112,723
Available-for-sale financial assets (changes through capital)	19	-	-	45,186	45,186
Financial assets at fair value through profit or loss	24	-	24	-	24
Cash and cash equivalents	25	104,720	-	-	104,720
Total		1,208,033	24	45,186	1,253,243

<i>(in thousands of HRK)</i>	Note	Other financial liabilities
31 December 2008		
Financial liabilities		
Borrowings	27	898,279
Trade payables	29	870,991
Other payables	29	12,749
Total		1,782,019

Financial instruments do not include business transactions with employees, receivables/payables for contributions, taxes and receivables/payables for advances received.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2008

NOTE 20a – FINANCIAL INSTRUMENTS BY CATEGORY (continued)

<i>(in thousands of HRK)</i>	Note	Loans and receivables	Financial assets at fair value through profit or loss	Available- for-sale financial assets	Total
31 December 2007					
Financial assets					
Trade and other receivables	23	688,016	-	-	688,016
Loans and deposits given	21,23	123,642	-	-	123,642
Available-for-sale financial assets (changes through capital)	19	-	-	27,435	27,435
Financial assets at fair value through profit or loss	24	-	894	-	894
Cash and cash equivalents	25	177,495	-	-	177,495
Total		989,153	894	27,435	1,017,482

<i>(in thousands of HRK)</i>	Note	Other financial liabilities
31 December 2007		
Financial liabilities		
Borrowings	27	501,247
Trade payables	29	436,514
Other payables	29	16,183
Total		953,944

NOTE 20b – CREDIT QUALITY OF FINANCIAL ASSETS

The credit quality of financial assets that are neither past due nor impaired can be assessed by reference to historical information about counterparty default rates.

	<u>2008</u>	<u>2007</u>
	<i>(in thousands of HRK)</i>	
Trade receivables – neither past due nor impaired		
Existing customers – payments within maturity period	128,672	146,144
Existing customers – with some defaults in the past	266,220	183,604
	394,892	329,748

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2008

NOTE 20b – CREDIT QUALITY OF FINANCIAL ASSETS (continued)

The Company mainly deposits its cash with local banks without credit ratings, whose majority ownership is held by large foreign banking groups, while during 2007, the majority of cash was deposited with a local bank with a BBB - credit rating.

Cash at bank and deposits	2008	2007
	<i>(in thousands of HRK)</i>	
BBB -	13,215	163,633
Without rating	91,505	13,862
	104,720	177,495

NOTE 21 – LOANS AND RECEIVABLES*(in thousands of HRK)*

	2008	2007
Long-term deposits	34	6,034
Long-term loans receivable:		
- loans to subsidiaries	5,355	-
- consumer goods loans	15,188	17,952
- housing loans and other loans to employees	4,348	5,666
- loans to other companies	8,626	-
- ESOP (Employee Share Ownership Plan)	8	84
Total long-term loans and deposits	33,559	29,736
Current portion of long-term loans and deposits (Note 23)	(8,078)	(8,363)
Long-term loans and deposits	25,481	21,373

Deposits

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

Consumer goods loans

Consumer goods loans represent trade receivables from customers in Bosnia and Herzegovina based on the sale of equipment and the 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

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 2008

NOTE 21 – LOANS AND RECEIVABLES (continued)

Loans to subsidiaries and related parties

Of the total amount of loans given, the majority relates to a loan granted to Dalekovod TIM Topusko in October 2008 in the total amount of HRK 4,222 thousand, which is repayable over 5 years and bears an interest rate of 1-month EURIBOR + 2.5% annually. The amount of HRK 211 thousand was repaid until the end of 2008.

The other long-term loan was granted to a subsidiary in Poland in the total amount of HRK 1,344 thousand with the currency clause (EUR 183,500), which matures in 2010 and bears an interest rate of 3-month EURIBOR + 0.5 annually.

Loans to other companies

During 2008, the Company concluded a Loan Agreement with TPN Sportski grad from Split, according to which a revolving loan facility was agreed in the total amount of HRK 9,000 thousand. Until 31 December 2008, the debtor drew down HRK 8,551 thousand on this facility. The loan was granted with a discount rate which was 9% annually at the date of Agreement. The loan matures in one instalment in 2028, while interest is calculated over the entire period and will be repaid from 31 October 2010.

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

NOTE 22 – INVENTORIES

(in thousands of HRK)

	<u>2008</u>	<u>2007</u>
Raw materials	220,053	108,236
Finished goods, semi-finished goods and work in progress	465,164	112,177
Spare parts and small inventories	6,089	4,922
Trade goods	<u>356</u>	<u>3,688</u>
	<u>691,662</u>	<u>229,023</u>

Total construction costs incurred and recognised profits (less recognised losses to date) for all active construction contracts amounted to HRK 4,121,027 thousand (2007: HRK 3,144,582 thousand).

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2008

NOTE 23 – TRADE AND OTHER RECEIVABLES

<i>(in thousands of HRK)</i>	<u>2008</u>	<u>2007</u>
Domestic trade receivables	590,493	409,914
Foreign trade receivables	231,526	226,987
Provisions for impairment	(9,915)	(9,866)
	812,104	627,035
Receivable from customers for contract work	163,563	48,926
Retentions	40,709	72,068
Current portion of long-term loans (Note 21)	8,078	8,363
Loans to subsidiary (Note 33)	3,340	9,402
Other short-term loans	35,115	21,838
Advances	14,230	36,283
Receivable from employees	1,154	1,294
VAT receivable	33,259	-
Prepaid expenses	10,943	-
Other current assets	14,923	12,055
	1,137,418	837,264

Other short-term loans and a loan to subsidiary 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.

As at 31 December 2008, the Company recognised trade receivables in the amount of HRK 380,416 thousand (2007: HRK 278,105 thousand) that were past due, but not impaired. They mainly compose of receivables from customers owned by the state. The ageing of these receivables is based on the number of days outstanding after the maturity date:

	<u>2008</u>	<u>2007</u>
	<i>(in thousands of HRK)</i>	
Up to 90 days	183,919	199,049
From 91 to 180 days	63,352	25,498
Over 180 days	133,145	53,558
	380,416	278,105

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2008

NOTE 23 – TRADE AND OTHER RECEIVABLES (continued)

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

<i>(in thousands of HRK)</i>	<u>2008</u>	<u>2007</u>
At 1 January	9,866	9,411
Provision for receivables impairment (Note 9)	1,955	588
Collected amounts	-	(50)
Receivables eliminated during the year as uncollectible	(1,869)	(83)
At 31 December	<u>9,952</u>	<u>9,866</u>

The carrying amounts of the Company's trade and other receivables are denominated in the following currencies:

<i>(in thousands of HRK)</i>	<u>2008</u>	<u>2007</u>
EUR	175,576	94,362
USD	88,431	124,990
HRK	<u>873,411</u>	<u>617,912</u>
Total	1,137,418	837,264

The maximum exposure to credit risk at the reporting date is the carrying value of each class of receivable mentioned above. The Company hold collaterals as security.

The fair value of trade receivables approximates their carrying amount.

NOTE 24 – FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

During 2008, the Company invested in domestic cash funds. As at 31 December 2008, fair value of these assets in the Company amounted to HRK 24 thousand (2007: HRK 894 thousand). The change in fair value of HRK 1 thousand is recognized in the income statement as a fair value loss (2007: gain - HRK 123 thousand – Note 10).

NOTE 25 – CASH AND CASH EQUIVALENTS

<i>(in thousands of HRK)</i>	<u>2008</u>	<u>2007</u>
Domestic currency	2,964	10,568
Foreign currency	101,756	22,326
Short-term deposits at bank	-	144,601
	<u>104,720</u>	<u>177,495</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 2008, the average effective interest rate for short-term deposits with banks was 7.6% (2007: 7.6%).

NOTE 26 – SHAREHOLDERS' EQUITY

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2008

Share capital

As at 31 December 2008, 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 2008 the Company owns 34,208 treasury shares (2007: 24,828).

The structure of shareholders as at 31 December:

	<u>2008</u>	<u>2007</u>
Natural persons	38.93%	28.55%
BMK i Partneri d.o.o.	13.11%	17.92%
KLT i Partneri d.o.o.	12.79%	17.86%
CTG d.o.o.	15.64%	16.83%
Treasury shares	1.49%	1.08%
Other	18.04%	17.76%
	<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 2008, according to the decision of the Annual General Meeting statutory reserves were increased by HRK 46,690 thousand (2007: HRK 45,850 thousand). These reserves are distributable.

Other reserves consist of profits from previous periods set aside by the decision of the General Meeting (these reserves are distributable) and treasury shares reserves. At the end of 2008, the Company purchased on the stock exchange 9,380 treasury shares in the total amount of HRK 4,130 thousand for which, according to Croatian regulations, reserves were formed (in earlier years HRK 1,244 thousand).

Revaluation reserves

As at 31 December 2008, the Company performed a valuation of fair value of available-for-sale financial assets (shares and interests in the investment fund – Note 19) and, in accordance with the applicable accounting policy, a decrease was performed in revaluation reserves in the amount of HRK 1,473 thousand (2007: an increase of HRK 5,064 thousand).

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2008

NOTE 27 – BORROWINGS

<i>(in thousands of HRK)</i>	<u>Average interest rates</u>	<u>2008</u>	<u>2007</u>
Long-term			
Bank borrowings	6.11%	2,498	173,796
Finance lease	7.27%	181,459	378
		<u>183,957</u>	<u>174,174</u>
Short-term			
Bank borrowings	6.29%	467,532	219,318
Commercial papers	8.4%	225,000	107,000
Finance lease	6.5%	21,790	755
		<u>714,322</u>	<u>327,073</u>
Total borrowings		<u>898,279</u>	<u>501,247</u>

During 2008, the Company concluded an agreement on the sale of assets (the plant in Dugo Selo) and on the lease-back of the same assets under a finance lease where the Company is the lessee. The total amount of this lease is HRK 215,774 thousand. The lease matures in 2016. The interest rate is 3-month Euribor + 1.6%. All assets have been pledged as collateral.

Gross liabilities under the finance lease – minimum lease payments:

	<u>2008</u>	<u>2007</u>
	<i>(in thousands of HRK)</i>	
Up to 1 year	35,366	755
1 to 5 years	141,465	1,265
Over 5 years	131,107	-
	<u>307,938</u>	<u>2,020</u>
Future finance costs under finance lease	<u>(105,075)</u>	<u>(128)</u>
Present value of liabilities under finance lease	<u>202,683</u>	<u>1,892</u>

During 2008, the Company issued commercial papers in the amount of HRK 225 million in denominations of HRK 1.00 for a period of 364 days from the day of issuance with a nominal yield of 8.4% (2007: 4.13%) p.a.

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

As at 31 December 2008, interest payable on long-term and short-term borrowings amounted to HRK 8,367 thousand (2007: HRK 4,843 thousand), (Note 29).

The Company 's borrowings in the amount of HRK 388,803 thousand (2007: HRK 403,562 thousand) are exposed to interest rate changes, 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.

NOTE 27 – BORROWINGS (continued)

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2008

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

<i>(in thousands of HRK)</i>	<u>2008</u>	<u>2007</u>
1 month	205,022	-
3 months	103,286	241,303
6 months	62,330	21,426
12 months	10,000	10,000
5 years	-	97,305
	<u>380,638</u>	<u>370,034</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.

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

<i>(in thousands of HRK)</i>	<u>2008</u>	<u>2007</u>
Loans in use	-	45,065
Between 1 and 2 years	49,146	37,978
Between 2 and 5 years	85,480	51,488
Over 5 years	49,331	39,643
	<u>183,957</u>	<u>174,174</u>

The borrowings are denominated in the following currencies:

	<u>2008</u>	<u>2007</u>
EUR	364,713	232,912
CHF	-	-
USD	99,501	-
HRK	434,065	268,335
	<u>898,279</u>	<u>501,247</u>

Borrowings with currency clauses are included in HRK borrowings.

NOTE 28 – DEFERRED INCOME

Deferred income arose during 2008 at finance lease (Note 27) in which the Company sold its assets in the present carrying amount of HRK 126,440 thousand for the amount of HRK 215,774 thousand and realised profit of HRK 89,334 thousand, which is decreased over the lease period by the depreciation charge for these assets. As at 31 December 2008, the total amount of HRK 83,599 thousand was recorded, of which HRK 6,211 thousand relates to the current portion of deferred income.

NOTE 29 – TRADE AND OTHER PAYABLES

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2008

<i>(in thousands of HRK)</i>	<u>2008</u>	<u>2007</u>
Domestic suppliers	626,959	299,861
Foreign suppliers	<u>244,032</u>	<u>136,653</u>
	870,991	436,514
Advances received for construction work	50,624	176,158
Advances	21,342	53,065
Salaries	11,120	14,125
Taxes and contributions	10,967	10,551
Dividend payable (Note 14)	1,947	1,312
Interest payable	7,881	4,490
VAT payable	-	30,843
Bills of exchange (i)	37,736	-
Deferred income (Note 28)	6,211	-
Other accruals and liabilities	<u>4,868</u>	<u>11,693</u>
	<u>1,023,687</u>	<u>738,751</u>

- (i) Bills of exchange relate to financing with a discount of 4.31% with maturity in January 2009 when the liability was settled.

NOTE 30 – PROVISIONS

<i>(in thousands of HRK)</i>	<u>Jubilee awards</u>	<u>Retirement severance payment</u>	<u>Other</u>	<u>Total</u>
At 1 January 2008	4,090	2,450	-	6,540
Additional provisions	829	121	287	1,237
Reversal of provision	-	(33)	-	(33)
Used during the period	<u>(461)</u>	<u>(94)</u>	<u>-</u>	<u>(555)</u>
At 31 December 2008	<u>4,458</u>	<u>2,444</u>	<u>287</u>	<u>7,189</u>

Retirement severance payment

According to the Collective bargaining agreement, the Company has an obligation to make severance payments to employees at the time of the employees' retirement. The liability is calculated by independent actuaries. Significant assumptions used by the actuary are as follows: an annual leaver's rate of 0.89% (2007: 0.88%), an annual discount rate of 6.4% (2007: 5.4%); 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).

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2008

NOTE 30 – PROVISIONS (continued)*Jubilee awards*

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

Other provisions

These provisions relate to potential liabilities for guarantees given for the quality of works performed in Montenegro.

NOTE 31 – ACQUISITION

In February 2007, the Company acquired an 88.83% interest in the company Tvornica istegnutih metala d.d., Topusko (TIM d.d., Topusko), specialised for production of expanded metals and fences. The acquired company contributed revenues of HRK 30,616 thousand and net profit of HRK 513 thousand to the consolidated result for the year ended 31 December 2007. If the acquisition had occurred on 1 January 2007, the consolidated revenues for the year ended 31 December 2007 would have been HRK 2,271 thousand higher, while the profit before tax would have been HRK 1,040 thousand lower than the one realised.

Details of net assets and goodwill are as follows:

Purchase consideration	25,997
Fair value of net assets acquired	<u>(22,651)</u>
Goodwill	3,346

The assets and liabilities as at 31 December 2006 arising from the acquisition are as follows:

<i>(in thousands of HRK)</i>	<u>Carrying amount</u>	<u>Fair value</u>
Cash	2,220	2,220
Tangible assets	11,686	25,468
Inventories	9,537	9,537
Trade and other receivables	9,621	9,530
Trade and other payables	(8,318)	(8,318)
Borrowings	<u>(12,938)</u>	<u>(12,938)</u>
Net assets	11,808	25,499
Minority interests (11.17%)		<u>(2,848)</u>
Net assets acquired		22,651

Purchase consideration settled in cash	25,997
Cash and cash equivalents acquired	<u>(2,220)</u>
Cash outflow on acquisition	23,777

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2008

NOTE 32 – CASH GENERATED FROM OPERATIONS

<i>(in thousands of HRK)</i>	<u>Note</u>	<u>2008</u>	<u>2007</u>
Profit before tax		104,984	100,762
Adjustments for:			
Depreciation and amortisation	15,16, 17	44,028	37,197
Unrealised foreign exchange differences		(298)	(7,394)
Property, plant and equipment written off	9	325	2,175
Impairment of trade receivables	9	1,995	588
Impairment of inventories	9	295	160
Provision for long-term employee benefits		649	(733)
Loss/(gain) on sale of property, plant and equipment		147	(524)
Minority interest		-	-
Fair value gains	10	-	(123)
Interest income		(6,635)	(5,705)
Interest expense	11	47,129	22,276
Other		-	-
		<u>87,635</u>	<u>47,917</u>
Changes in working capital:			
Trade and other receivables		(329,506)	(147,318)
Inventories		(462,934)	(68,053)
Trade and other payables		<u>358,933</u>	<u>402,779</u>
Net cash (used in) /generated from operations		<u>(240,888)</u>	<u>336,087</u>

In the cash flow statement, proceeds from the sale of property, plant and equipment comprises:

<i>(in thousands of HRK)</i>	<u>2008</u>	<u>2007</u>
Net book amount	325	2,175
Net (loss)/gain on sale of property, plant and equipment (Note 10)	<u>(147)</u>	<u>524</u>
Proceeds from sale of property, plant and equipment	<u>178</u>	<u>2,699</u>

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2008

NOTE 33 – RELATED PARTY TRANSACTIONS

In the ordinary course of business operations, the Company enters into related party transactions, 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>2008</u>	<u>2007</u>
	<i>(in thousands of HRK)</i>	
Sales	300,581	143,753
Rental income	26,548	15,540
Sale of properties	4,685	-
	<u>331,814</u>	<u>159,293</u>
Cost of materials and services	154,575	31,456
Subcontractor services	93,001	103,451
Other operating expenses	20,007	1,808
	<u>267,583</u>	<u>136,715</u>

Receivables, payables and loans

	<u>2008</u>	<u>2007</u>
	<i>(in thousands of HRK)</i>	
Trade receivables	130,171	76,793
Other receivables	28	1,105
Short-term loans given	3,340	9,402
	<u>133,539</u>	<u>87,300</u>
Trade payables	130,219	76,599
	<u>130,219</u>	<u>76,599</u>

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

	<u>2008</u>	<u>2007</u>
	<i>(in thousands of HRK)</i>	
Revenues and expenses		
Net salaries	8,565	7,189
Contributions	3,981	3,342
	<u>12,546</u>	<u>10,531</u>
Interest income	32	36
Loans		
ESOP and housing loans	828	1,045

NOTE 34 – CONTINGENCIES AND COMMITMENTS

As at 31 December 2008, the Company has numerous contracts for the provision of construction services which have commenced, but have not been completed. Costs to be incurred in the future arising from these contracts are estimated in the amount of HRK 3,883,680 thousand (2007: HRK 2,231,398 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.