



Annual Report 2008





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HEP Group 2008		Change (2008/2007)
Electricity sales	17.7 TWh	5.6 %
Electricity production	14.3 TWh	3.0 %
Heat sales	2.2 TWh	5.8 %
Gas sales	166 mn. m ³	8.5 %
Operating income	HRK 11,889.4 mn	9.9 %
EBITDA	HRK 1,922.9 mn	2.6%
Group net profit	HRK 31.1 mn	19.6 %
Total assets	HRK 32,635.4 mn	5.0 %
Number of employees	14,375	0.6 %

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CHAIRMAN'S REPORT



The energy sector in the Republic of Croatia in 2008 was strongly exposed to unfavorable movements in the world's economy and uncertainties in the fuel market. The year began unexpectedly, with a sharp rise in oil price – from the initial 90 dollars a barrel it hit its all-time high of 147 dollars a barrel on July 11, 2008. This was followed by a sharp drop in oil prices of 20 percent by the end of July. Since oil is the foundation of the world's economy, the consequences of these oscillations reflected on the global economy. The world entered an unprecedented recession which caused a further drop in oil prices, to below 40 dollars a barrel at the end of the year.

In addition to the global movements, the Croatian electricity system, in which 35 percent of total electricity is produced by hydro power plants, was exposed to exceptionally poor hydrological conditions during 2008. In such an unfavorable environment HEP Group was able to maintain liquidity and provide citizens and industry in Croatia with a competitive, quality and uninterrupted supply, primarily of electricity but also of heat and gas. Given the circumstances, not all planned investments in renewal and modernization of existing facilities could be made. In this segment the indispensable works were carried out, and construction of new facilities which had began earlier continued at undiminished pace. All thermal power plants operated reliably and Krško Nuclear Power plant delivered the highest annual production in its history. The transmission and distribution systems also functioned reliably.

In 2008, the activities in the Ministry of Economy, Labor and Entrepreneurship went in two directions:

creation of preconditions for the fulfillment of the requirements of Chapter 15 Energy as part of the EU accession negotiations, and the preparation of a new Energy Development Strategy of the Republic of Croatia. A number of primary and subordinate legislative acts were passed which govern the energy sector and harmonize it with the EU legislation. Some of the implementing documents elaborated on the basis of these acts are within the authority of public service providers which include HEP Group members such as HEP Operator prijenosnog sustava and HEP Operator distribucijskog sustava. Through the activities of the Energy Community, a single regulatory and market framework was established which is a precondition for attracting sound investments and reliable energy supply in both Croatia and the region. Thus, the conditions for the energy sector and its participants have become, even before the entry into the European Union, the same as in the member states.

The new environment required a new strategic approach. Being aware of the significance of HEP as an exceptional and integral economic entity for which we must open prospects and allow competitiveness in the region while ensuring adequate energy supply for the Croatian citizens, in the new energy strategy we paid special attention to the development of the electricity system. Electricity is particularly demanding considering the fact that it must be generated at precisely the moment of its consumption. Therefore, the construction of new base-load power plants is of primary significance for future security of supply.

Today, Croatia imports more than 20 percent of electricity. The strategic goal is to meet domestic needs

with domestic production by 2020. By 2020, due to old age and uneconomical production, 1,100 MW in thermal power plants will be retired. To compensate this and to meet increasing electricity consumption, new power plants must be built. Since domestic potential for large hydro power plants have been practically used up, and some of potential sites are bound by intergovernmental agreements, the Government of the Republic of Croatia opted in the new strategy for base-load power plants which use gas or coal but also for undertaking analyses and preliminary work needed to make a decision by 2012 on whether to build a nuclear power plant. Considering the modest domestic energy resources and in order to diversify the sources, achieve competitiveness of base-load production and greenhouse emission control, no energy option can be ruled out in advance.

Regarding the fulfillment of goals in the limiting of greenhouse gases emission, a significant contribution is expected from renewable sources. It a national target to maintain the share of 35 percent of electricity production from renewable sources. We support HEP in the use of renewable sources and we are sure that it will be more successful if it becomes competitive in electricity production from base-load plants.

It is necessary for HEP to continue to participate in interstate projects for interconnection of electricity transmission systems, and in other energy projects of interest to the Republic of Croatia. Only as such, strong and integral, HEP can go into the common market and become the leader in the region, and support the Government of the Republic of Croatia in its efforts to provide the citizens with affordable, adequate and reliable energy supply.



Leo Begović
Chairman of Supervisory Board

PRESIDENTS'S REPORT



In 2008, HEP Group operated in extremely unfavorable conditions, especially during the first half of the year. Oil, coal and electricity prices in the international market continued to grow. Gas purchase price, contractually agreed to gradually reach market price, increased by 65 percent, and due to lower water inflow hydroelectric production decreased by 10 percent compared to the plan. As a result, operating costs rose sharply, affecting HEP Group liquidity.

On July 1 the Government approved higher electricity prices based on new tariff systems, separately for each of the regulated electricity businesses. With the increased electricity prices, income in the second half of the year grew and the liquidity downward trend was stopped (thanks also to receiving a 125 million euro loan).

In 2008 HEP Group achieved the highest operating income ever – 11.9 billion kuna and an operating profit of 31.1 million kuna. The positive business result was achieved thanks to the implemented measures for consolidation of the financial situation, which resulted in a decrease in operating costs of 291 million kuna compared to the business plan, while the investment plan was curtailed by 880 million kuna.

Early in the year we adopted decisions to implement plant maintenance plans by introducing an event-based maintenance system. The investment priority was to complete capital production projects and other capital projects and programs in our

core businesses. I will mention the most important ones. Construction continued of the high-efficiency combined-cycle cogeneration unit L at TE-TO Zagreb (100 MW electrical and 80 MW thermal power) which will be put into operation in 2009. Before the end of 2009, Lešće hydro power plant (42 MW) will go into service, the first hydro power plant built by HEP since Croatia became independent. Preparatory works were also carried out for the construction of Unit C at Sisak TPP (230 MW electrical and 80 MW thermal power). In the transmission business the most important event was the start of construction of a 2x400 kV interconnecting double circuit line Ernestinovo – Pecs (Hungary).

Together with savings measures, the continued opening of the Croatian electricity market also had a favorable effect on HEP's business result. Specifically, in the situation where the electricity price for tariff customers did not keep up with costs of fuel and imported electricity, bilateral contracts were concluded between HEP and eligible customers which provide not only for payment security but also for price change to reflect movements in world market fuel prices. In 2008, we had contracts with large customers who account for about 30 percent of annual electricity consumption, and we began to conclude supply contracts with medium enterprises bound by the Public Procurement Act. At the end of 2008, amendments were passed to the Energy Act and Electricity Market Act which require about 110 thousand small customers – enterprises to conclude

contracts with an electricity supplier by June 30, 2009. Given that electricity prices in the Croatian market are still not enticing for our competitors, we expect to keep the existing customers and to achieve favorable effects from selling electricity under the newly concluded contracts.

Even in the aggravated business circumstances in 2008, HEP, as a socially responsible company, did not neglect the important areas of environmental protection and energy efficiency. Compared to 2007, expenses to protect the environment and nature increased, amounting to about 142 million kuna.

Our company HEP ESCO d.o.o., the implementing entity for Energy Efficiency Program Croatia, had 50 energy efficiency projects in 2008 in various phases of preparation or implementation across Croatia.

We believe that it is especially important to develop production from renewable energy sources, which will experience a strong growth in Croatia over the next years. Our aim is to attain a 30 percent share in this market. Charged with this task our company for renewable energy sources HEP Obnovljivi izvori energije d.o.o. has been developing several projects in cooperation with domestic and foreign partners.

The good cooperation with foreign partners in the development of joint projects, both in engineering and financial areas, is, in our view, a confirmation of the transparency of our business restructuring in line with EU directives, based on legal, accounting and management separation of businesses within

HEP Group. We expect that by fulfilling our restructuring obligations we will contribute to the upcoming successful closing of Energy Chapter of Croatia's accession negotiations with the European Union, that we will continue to contribute to the development of the Croatian economy and to encourage the functioning of the electricity market.



Ivan Mravak
President of the Management Board



HEP makes the day longer



Company profile

Mission and vision

HEP Group companies

Legal framework

Development and planned investments

Membership in international organizations

Short historical overview



Company profile

- HEP Group is a 100% state-owned energy company with a tradition longer than one century. The Group consists of the parent company HEP d.d. and limited liability companies (d.o.o.) in the core businesses of electricity production, transmission, distribution and supply, in the district heating and gas distribution, and other businesses (environmental services, energy efficiency).

HEP Group has carried out the unbundling with respect to legal form, accounts, organization and decision-making of the regulated companies («natural monopoly») – HEP - Operator prijenosnog sustava d.o.o. (Transmission System Operator) and HEP - Operator distribucijskog sustava d.o.o. (Distribution system Operator) – from other activities of HEP Group which are or will be exposed to competition.

MISSION

Secure and reliable electricity supply to customers at minimum costs

VISION

An integral corporation which is becoming a regional market player, a Croatian energy cluster – a group of related businesses, with a multiutility approach, one of the main driving forces of Croatia's economic development

HEP Group companies

HEP d.d. (Hrvatska elektroprivreda d.d.) is the parent company of HEP Group, the founder and the sole (100%) owner of the companies that have been founded; it consolidates management of HEP Group subsidiary companies and is the owner of the assets which are contractually transferred to subsidiary or daughter companies for management.

HEP-Proizvodnja d.o.o. (HEP Production) carries out the activity of electricity production, and heat production for district heating systems in the cities of Zagreb, Osijek and Sisak. C.S. Buško Blato d.o.o., a daughter-company of HEP Proizvodnja d.o.o., is located in Bosnia-Herzegovina.

HEP - Operator prijenosnog sustava d.o.o. (HEP Transmission System Operator) is responsible for the transmission of electricity produced in Croatian power plants or imported from other countries for Croatian customers, at minimum costs and maximum possible standards of electricity quality and system security. The company is also responsible for transmission of Croatia-produced electricity for export purposes, and it manages electricity transit through the Croatian system.

HEP – Operator distribucijskog sustava d.o.o. (HEP Distribution System Operator) is responsible for secure supply to tariff customers. The company distributes the electricity taken from the transmission network, and performs selling, metering, billing and payment collection for the electricity supplied. It is also responsible for the maintenance and operation of distribution network and plants.

HEP-Opskrba d.o.o. (HEP Supply) supplies electricity to eligible customers in Croatia.

HEP-Trgovina d.o.o. (HEP Trade) carries out the activities of purchase and sale of electricity, optimization of power plants' operation and trading intermediation in the domestic and international market.

TE Plomin d.o.o., co-owned by HEP d.d. and RWE Power (50%;50%), operates a 210 MW power plant.



HEP-Toplinarstvo d.o.o. (HEP Heating) is active in heat production, distribution and supply in the the cities of Zagreb, Osijek and Sisak and in a part of the Zagreb County.

HEP-Plin d.o.o. (HEP Gas) headquartered in Osijek, supplies natural gas to customers in the areas of Osijek-Baranja County, Požeška-Slavonia County and Virovitica-Podravina County.

HEP-ESCO d.o.o. a company providing energy services, develops, implements and finances market-based energy efficiency projects.

APO d.o.o. usluge zaštite okoliša (APO Environmental Services) is a consulting and engineering company specializing in environmental protection, especially hazardous and radioactive waste and radioactive material.

HEP – Obnovljivi izvori energije d.o.o. (HEP Renewable Energy Sources) deals with preparation, construction and use of renewable energy sources (wind, small waterways, geothermal water, etc.)

HEP – Odmor i rekreacija d.o.o. (HEP Leisure and Recreation) provides tourist and hospitality services and organizes sporting recreation.

Plomin Holding d.o.o. develops local infrastructure and entrepreneurial projects in the vicinity of the Plomin power plant.

Ustanova HEP - Nastavno-obrazovni centar, Velika, (HEP Training and Education Center) is an educational institution which, in addition to providing training in live work, conducts secondary school programs for adults and organizes professional gatherings, seminars and courses.

NE Krško d.o.o. (Nuklearna elektrana Krško), Republic of Slovenia, is a company outside HEP Group, co-owned by HEP d.d. and GEN Energija (50%:50%).

■ Legal framework

Energy legislation of the Republic of Croatia has been harmonized with that of the European Union. The following are some of the basic provisions of the legal framework applicable to HEP:

- permission to build new generating capacity can be obtained under either authorization or tendering procedure;
- network access is based on Regulated Third Party Access, and producers and customers are obligated to obtain consent from the transmission or distribution system operator for a new connection to the network or for increase in connected load;
- electricity production and electricity supply are separate from the activities of transmission and distribution;
- regulated energy businesses are carried out as public services, namely: electricity production for tariff customers, electricity transmission, electricity distribution, electricity supply for tariff customers and organization of the electricity market;

Opening of the electricity market

Under the Electricity Market Act, eligible customers can freely choose their electricity supplier. Since July 1, 2008 all customers in Croatia, including residential, have been granted the status of eligible customer, whereby the Croatian electricity market is fully open. In December 2008, the Croatian Parliament passed acts amending the Energy Act and Electricity Market Act (NN 152/2008.), which require about 110 thousand small customers- enterprises to conclude contracts with an electricity supplier by June 30, 2009.

Privatization Act

Under the Hrvatska Elektroprivreda Privatization Act (NN 32/2002), at least 51% of HEP shares will remain in government ownership up until the Republic of Croatia joins the European Union. Croatian Homeland War veterans and their families will receive, without compensation, up to seven percent of the shares, and up to seven percent will be sold to current and former HEP employees under special privileges. At least 15 percent of the shares will be offered to Croatian nationals through a public offering with pre-emptive rights and privileges yet to be determined, while the remaining shares will be offered on the capital market.

Energy strategy

The Energy Development Strategy is a fundamental document that sets out the energy policy and plans for the energy development of the Republic of Croatia. Pursuant to the Energy Act, the Strategy is adopted for a period of 10 years. The current Strategy was adopted in 2002. Crucial changes have occurred since then which have impacted the Croatian energy sector – Croatia has become a candidate for the EU membership, accepted the Energy Community Treaty, signed and ratified the Kyoto Protocol, all in the circumstances of pronounced instability of the world's energy market. Therefore, before the expiry of the ten year period the adjustment and expansion of the energy strategy was initiated. After almost a two-year procedure, which was conducted in line with the practice of EU countries, on June 19, 2009, the Government adopted the Proposal for Energy Development Strategy of the Republic of Croatia to 2020 and submitted it to the Croatian Parliament for adoption.

The objective of the Strategy is to build in the Republic of Croatia a secure, competitive and sustainable energy sector whose development will be based on the use of all energy options to meet national energy needs and to create additional benefits for the citizens, in accordance with the principles of environmental, economic and social responsibility.

The proposed Strategy expects that total electricity needs in 2020 will be 28 TWh and that the system peak load will be 4,600 MW. The following base load power plants are planned to be built: large hydro power plants with the total capacity of up to 300 MW, natural gas power plants up to 1,200 MW and coal power plants up to 1,200 MW. It is also planned to launch a nuclear energy program so that on the basis of preliminary actions and investigations a decision on the construction of a nuclear power plant can be made by 2012 studies.

The proposed Strategy provides for intensive construction of renewable sources aimed at maintaining the present share of 35 percent of electricity production in 2020 (which includes production from large hydro power plants). The targets for individual renewable sources are:

- Wind power plants – up to 1,200 MW of installed capacity,
- Biomass power plants – up to 85 MW of installed capacity,
- Small hydro power plants – up to 100 MW of installed capacity
- Bio-gas power plants – up to 40 MW of installed capacity,
- Geothermal power plants – up to 20 MW of installed capacity,
- Solar power plants – up to 45 MW of installed capacity.

The proposed Strategy points to the needs for development and renewal of transmission and distribution networks, which should be in aligned with new production plants coming in service, especially larger units and distributed units of renewable energy sources.

■ Development and planned investments

Electricity production

In the period to 2015, it is planned to build about 1400 MW of new installed capacity. By the end of 2009, Lešće hydro power plant (42 MW) will be built and put into operation as well as a cogeneration gas-fueled unit (100 MWe, 80 MWt) in the existing location at TE-TO Zagreb, and by the end of 2012 a combined-cycle unit (230 MWe, 50 MWt) in the location at Sisak TPP and a wind power plant, Krš Pađene (100 MW).

Electricity transmission and distribution

By 2010, a double circuit line toward Hungary, a 2x400 kV line Ernestinovo – Pecs, will be built. The introduction of newly standardized voltages continued, in compliance with the European voltage quality standard EN 50 160, as well as restoration of voltage conditions in critical areas. Reconstruction of war-damaged plant and network is nearing completion.

District heating

The refurbishment project of the heating networks of Zagreb and Osijek continued. It is planned to expand the district heating business in Sisak by building a new unit at Sisak TPP.

Gas

Based on a concession right to build a gas network and to supply customers with gas in a period of 30 years, a gas network will be built in the area of Baranja and the municipalities of Ernestinovo, Podgorač and Sopje by the end of 2010.

HEP will participate in the development and construction of the first LNG terminal in Croatia. It is planned to develop natural gas distribution and supply to customers in Croatia but also in neighboring countries.

■ Membership in international organizations

- HEP is a full member of Eurelectric
 - HEP OPS is a full member of the Union for the Coordination of Transmission of Electricity (UCTE) and an associate member of ETSO (European Transmission System Operators)
 - HEP Trgovina d.o.o. is an associate member of the Federation of European Energy Traders (EFET)
- HEP, HEP Group companies or HEP's individual experts are members of other international organizations such as: CIGRE, CIRED, UNICHAL, ICOLD, IHA, IAEA, IEEE, ENS and others

LWA (Live Work Association)

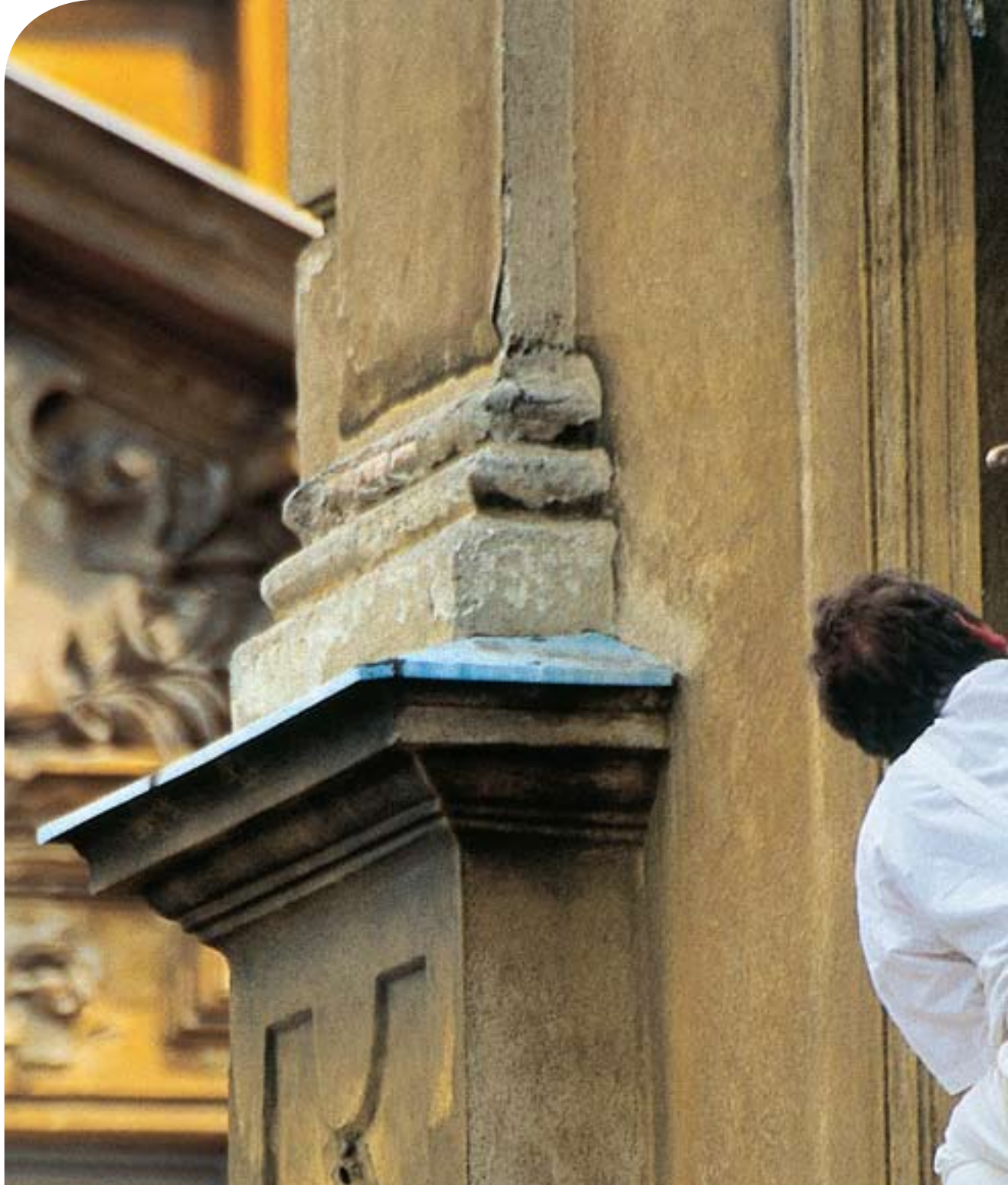
At the ICOLIM 2008 Conference in Poland, HEP was elected host for the next conference in 2011.

■ Short historical overview

1895 First alternating current electricity system in Croatia, Krka HPP - Šibenik

- 1912 Kraljevac HPP, among the largest hydro power plants at the time, is built
- 1925 "Ante Šupuk i sin" (Ante Šupuk & Son), Šibenik, among UNIPEDE founders
- 1937 Vice Roy's Electrica Company is founded
- 1941 State electrical company is founded
- 1943 110 kV line Rakitje (Zagreb) - Brestanica (Slovenia) is built
- 1945 Electrical company of Croatia is founded
- 1954 Union of electricity companies of Croatia is founded
Beginning of district heating: hot water pipeline for Končar factory from EL-TO Zagreb plant
- 1957 110kV Zagreb – Jajce (BiH) line goes into service; synchronous operation of western and central system
- 1961 Business association of electricity distribution companies of Croatia is founded
- 1962 First line of 220 kV network Zakučac HPP (Split) - Brinje – Mraclin (Zagreb)
- 1965 United electricity industry of Croatia is founded
- 1974 Union of electricity organizations of Croatia is founded
Gas distribution and supply begins within Elektroslavonija Osijek

- 1977 First 400 kV transformer station, Ernestinovo (Osijek), and first 400 kV line, Ernestinovo – Mladost, are built
- 1981 Krško nuclear power plant goes into service
- 1990 Public enterprise Hrvatska elektroprivreda (HEP) is founded**
- 1991 Heavy war destruction to power plants and facilities
- 1992 400 kV line TS Meline (Rijeka) – TS Tumbri (Zagreb) is put into operation
- 1993 About 120 MW emergency diesel and gas power plants are installed in Dalmatia
- 1994 Island interconnection 110 kV TS Melina (Rijeka) – Krk – Rab - Pag – Zadar is built
- 1995 Reconstruction and refurbishment of Peruća dam is completed (blasted in 1993)
- 1997 Eastern Slavonia reintegrated into the Croatian electricity system
- 1998 Gas-fired power plant (2x26 MW) is put into operation at EL-TO Zagreb location
- 1999 Double circuit line 400 kV Žerjavinec/Tumbri (Zagreb) – Heviz, Hungary is put into service
- 2000 Plomin 2 TPP (210 MW) begins commercial operation
- 2001 HEP becomes a member of UCTE
- 2002 Hrvatska Elektroprivreda d.d. is restructured into HEP Group
- 2003 Combined-cycle cogeneration unit K (200 MWe/150 MWt) at TE-TO Zagreb is put into operation
- 2004 TS 400/220/110 kV Žerjavinec and the reconstructed TS 400/110 kV Ernestinovo are put into operation
Reconnection of UCTE zones 1 and 2 is coordinated from HEP's headquarters
- 2005 Construction work on Lešće HPP (42 MW) begins
- 2006 HEP issues corporate bonds worth 500 million kuna
Construction begins of a combined-cycle cogeneration unit (230 MWe, 50 MWt at TE-TO Zagreb)
- 2007 Contracts are signed for construction of a combined-cycle unit (230 MWe, 50 MWt) at Sisak TPP
HEP issues corporate bonds worth 700 million kuna
- 2008 Construction begins of a 2x400 kV line Ernestinovo – Pecs (Hungary)



Creating and keeping true values



Corporate governance

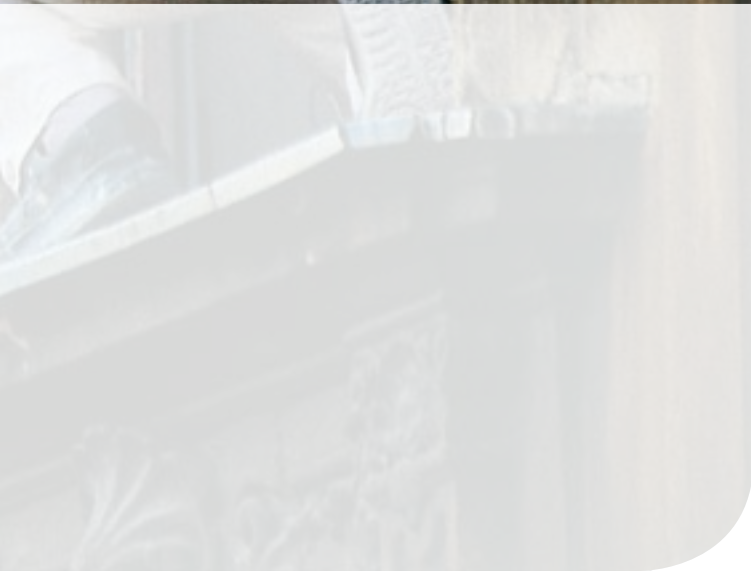
Governing bodies of HEP d.d.

Organizational structure of HEP d.d.

Members of governing bodies

Audit

Certificates



■ Governing bodies of HEP d.d. *(from HEP d.d. Articles of Association)*

The Management Board of the Company

The Management Board of the Company consists of 6 members, one of which is appointed president of the Management Board. The president is appointed and removed by the Supervisory Board. The term of office of the president and members of the Management Board is 4 years.

For the realization of its managerial tasks and powers the Management Board performs the following work:

1. manages the business affairs of the Company,
2. establishes and implements the business policy, medium-term and long-term plans,
3. carries out the decisions made by the Supervisory Board and the Shareholders' Assembly, and takes measures and issues instructions for their implementation,
4. passes internal rules and regulations of the Company and organizational rules,
5. represents and acts for the Company, and signs contracts within the framework of the law and these Articles of Association,
6. proposes decisions on matters falling in the scope of work of the Supervisory Board and Shareholders' Assembly of the Company,
7. appoints members to shareholders' assemblies and to supervisory boards of the companies in which HEP has controlling interests or significant influence,
8. appoints and revokes the Company's officers,
9. decides whether new employees are needed,
10. proposes and takes necessary measures and issues direct orders to ensure operations of the Company, especially the safety and functioning of the power system.

The Management Board of the Company may, subject to approval by the Supervisory Board, decide on:

1. Formation of companies in this country and abroad ,
2. Sale and purchase of shares and stakes held by the Company in other companies, and sale of real property,
3. Sale and purchase of and charges on real property exceeding HRK 20,000,000.00
4. Borrowing and issuance of securities exceeding HRK 100,000,000.00
5. Giving of power of attorney and waiving of rights without compensation above HRK 5,000,000.00

The Supervisory Board

The Supervisory Board consists of 7 members. Six members are appointed and revoked by the Shareholders' Assembly of the Company and one member is elected and revoked by workers pursuant to provisions of the Labor Act. The term of office of the members of the Supervisory Board is four years and after the expiry of their term the members of the Supervisory Board may be reelected. The members of the Supervisory Board elect the chairperson and an alternate chairperson from among themselves. The Supervisory Board supervises the management of the Company's business affairs.

The Supervisory Board:

1. appoints and revokes the Management Board of the Company;
2. examines and reviews business records, documentation, cash records, securities and other documents related to the operations of the Company;
3. gives prior approval on the decisions of the Management Board where required by these Articles of Association;
4. submits reports to the Shareholders' Assembly of the Company on the supervision carried out, especially with respect to financial operations and their consistency with business records.

General Shareholders Assembly

The Shareholders' Assembly is composed of shareholders and/or their proxies. The Shareholders' Assembly decides on matters determined by the law and these Articles of Association, in particular:

1. passes the Articles of Association and their amendments;
2. appoints and revokes the members of the Supervisory Board;
3. makes decisions on annual financial statements and use of profit;
4. appoints the auditor of the Company;
5. decides on increase or decrease in the capital stock of the Company;
6. decides on status changes and dissolution of the Company;
7. carries out other work in accordance with the law and these Articles of Association.

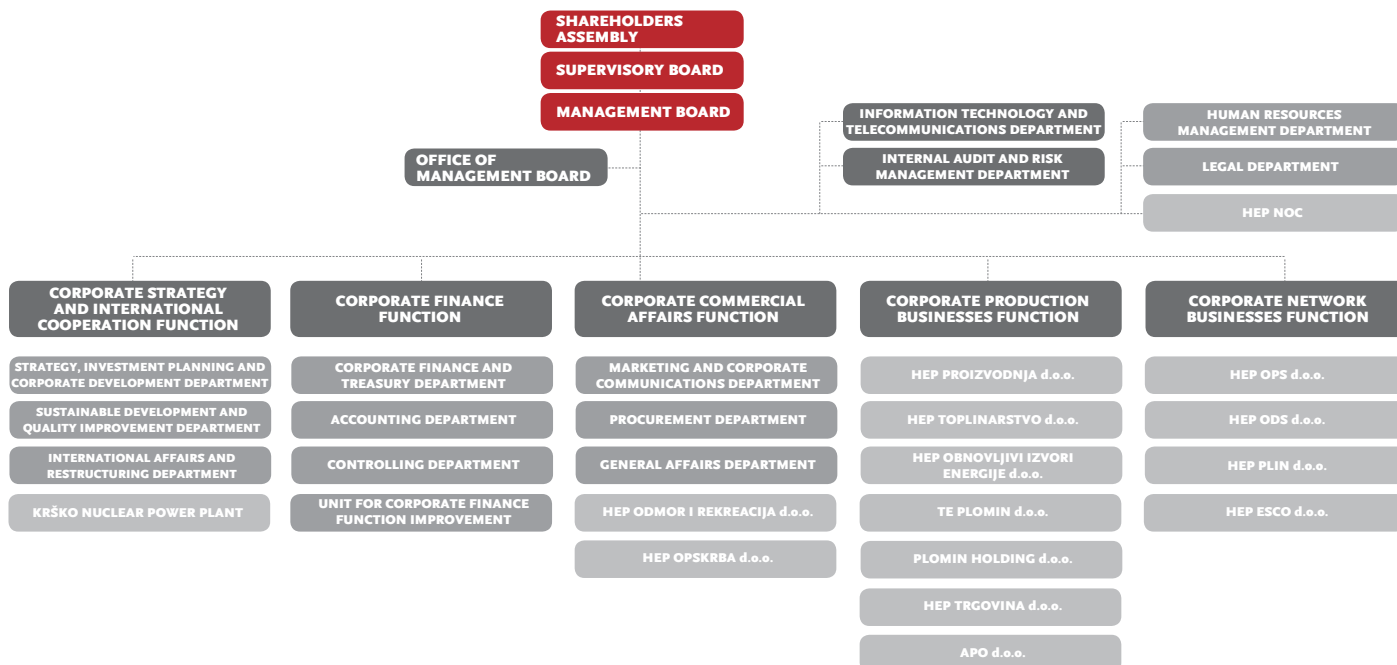
The meeting of the Shareholders' Assembly of the Company is convened by the Management Board of the Company. The Management Board of the Company is obligated to convene the Shareholders' Assembly when requested by the Supervisory Board or shareholders who hold at least 20% of the capital stock of the Company. The Management Board and the chairperson of the Supervisory Board participate in the work of the Shareholders' Assembly.

Organizational structure of HEP d.d.

Since January 1, 2009, a new model of corporate governance has been applied by HEP Group. The parent company HEP d.d. executes or manages the following corporate functions: business strategy and international affairs; commercial affairs; finance; human resources management; legal affairs; information technology and telecommunications; internal audit; defense and security; risk management; optimization of production facilities and energy trading; and optimization of network systems operation.

The organizational units called divisions (for development, economic affairs, human resources management, legal and general affairs) do not exist any more and their functional and organizational roles have been taken by members of the Management Board who are now in charge of particular functions.

HEP d.d., as well as through corporate functions, directs, coordinates and monitors production and network and other businesses of all subsidiary companies.



Members of governing bodies

Shareholders Assembly



Miljenko Pavlaković,
Chairman of Shareholders Assembly
State Secretary at the Ministry of Economy,
Labor and Entrepreneurship

Supervisory Board



Leo Begović
Chairman of Supervisory Board
State Secretary for the Economy at the Ministry of
Economy, Labor and Entrepreneurship



Krešimir Ćosić
Deputy Chairman of Supervisory Board
Member of the Croatian Parliament



Dasenko Baldasari
Member of Supervisory Board



Jadranko Berlengi
Member of Supervisory Board
Workers' representative



Luciano Delbianco
Member of Supervisory Board



Zdenko Juričić
Member of Supervisory Board



Slavko Konfic
Member of Supervisory Board

Management Board



Ivan Mravak,
President of Management Board

Born in 1954. Graduate electrical engineer, MSc degree in 1994. First employment as maintenance engineer at the sugar factory in Bač, 1980. From 1982 worked in the company Borovo, first as a senior electrical design engineer in Engineering, then as a technical director in Energy. In 1988 joined HEP as head of technical affairs in Vukovar operative area. During the Homeland War (1991), organized an autonomous electricity supply system for Vukovar. In HEP Distribution Division, he was coordinator for construction and a team member for Project 35 kV Adriatic Islands (1992-1995), coordinator of reconstruction of electric facilities damaged in the war (1995-1997) and leader of reintegration of Eastern Slavonia electricity system into HEP system (1997). From 1997 to 2004, director of Technical department in HEP Distribucija d.o.o., and since 2004 president of HEP d.d. Management Board.



Darko Dvornik,
Member of Management Board for Finance

Born in 1973. MSc degree in 1998 and DSc in 2006. First employment (1998) at the company AIPK as a marketing manager. Joined Siemens d.d. Zagreb in late 1998, first as head of GSM Sales, then as Key Account manager (2000-2001) and head of Business Strategy and Development Department (2001-2004). At the same time he was a member of Telecommunications Council (independent regulator). From 2004 to 2008 Assistant Minister of Sea, tourism, Transport and Development in Telecommunications and Postal Service Directorate. He is a member of the National Council for Information Society, a member of Council for Establishment of Computer Communication Network in Government Bodies and a member of Working Group for negotiations with the EU for Chapter 10 Information society and media.



Željko Kljaković Gašpić
Member of Management Board for Production

Born in 1955. Graduate electrical engineer. First employment as a teacher at the secondary school Sinj (1980-1982). From 1982 to 1984 worked in the company Končar Elektrouredaji, Split, then in Engineering of the Shipbuilding Industry Split (1984-1988), in Safety Institute, Split (1988-1993) and in the Communal Fund of the city of Solin (1993-1996). Joined HEP in 1996, first as head of Safety and Fire Protection in Elektrodalmacija and then as a director of Hydro Production Area South, Split, HEP Proizvodnja d.o.o. (2004-2008).



Nikola Rukavina
Member of Management Board for Commercial Affairs

Born in 1970. Graduate mechanical engineer. From 1998 to 2008 worked in the company T-Mobile Hrvatska d.d., Zagreb, with responsibilities in planning and investment of radio GSM and UMTS networks, implementation of SAP system, legalization and planning and investment in infrastructure. Work positions: technical leader of Production Group (1998-2000), specialist for construction of mobile networks (2000-2002), head of Investment and Infrastructure (2002-2005) and manager for construction and quality assurance.



Željko Tomšić,
Member of Management Board for Business Strategy and International Affairs

Born in 1957. Graduate electrical engineer, MSc (1990) and DSc degree (2001). First employment at the factory TEP Zagreb, first as development and construction engineer in Section for Research and Development of Electrical Distribution Equipment (1981-1987), then as head of the Section. (1987-1991). In 1991 joined the Faculty of Electrical Engineering and Computing in Zagreb, High Voltage Department. In 2002 he was energy-economic planner in the Nuclear Energy Department of the IAEA in Vienna. From 2004 to 2008 Assistant Minister for Energy and Mining in the Ministry of Economy, Labor and Entrepreneurship. From 2006 to March 2008, he was chairman of HEP d.d. Supervisory Board. He is the leader of the working group for negotiations with the EU for chapter 15 Energy, a member of the Croatian Academy of Engineering and a member of IEEE and European Nuclear Society.



Stjepan Tvrdinić,
Member of Management Board for Network Businesses

Born in 1959. Graduate safety engineer. Has worked in HEP since 1981, first at Elektra Karlovac until 2004 except during the Homeland War (1991-1995) when he was a commander and officer in the Croatian Armed Forces. From 2004 to 2008, worked in HEP d.d. as a coordinator of corporate security and safety for HEP Group. He is captain first class of the Croatian Armed Forces, recipient of a high decoration of the President of the Republic for participation in the Homeland War. He was president of Association of Homeland War Veterans of HEP and president of Federation of Homeland War Veterans of Croatian Public Enterprises

Management

Marija Modrić	Head of the Office of the Management Board
Frane Barbarić	Assistant to the President of the Management Board for Human Resources Management and legal Affairs
Davor Sokač	Assistant to the Member of Management Board for Network Businesses
Tihomir Saić	Director of Information Technology and Telecommunications Department
Stanko Tokić	Director of Internal Audit and Risk Management Department
Bernarda Pejić	Director of Human Resources Management Department
Anica Bobetić	Director of Legal Department
Ante Ćurković	Director of Department for Strategy, Investment Planning and Corporate Development
Kažimir Vrankić	Director of Department for Sustainable Development and Quality Improvement
Ljubica Cvenić	Director of Department for International Affairs and Restructuring
Nikola Mlinarić	Director of Department for Corporate Finance and Treasury
Vera Knez	Director of Accounting Department
Snježana Pauk	Director of Controlling Department
Mihovil-Bogoslav Matković	Director of Department for Marketing and Corporate Communications
Zvonimir Divić	Director of Procurement Department
Jerko Doko	Director of Department for General Affairs

Directors of HEP Group companies

HEP–Proizvodnja d.o.o.	Petar Ćubelić
HEP – Operator prijenosnog sustava d.o.o.	Dubravko Sabolić
HEP – Operator distribucijskog sustava d.o.o.	Mišo Jurković
HEP-Opskrba d.o.o.	Ivan Mrljak
HEP-Trgovina d.o.o.	Žarko Mudrovčić
HEP-Toplinarstvo d.o.o.	Robert Krklec
HEP-Plin d.o.o.	Nikola Liović
HEP ESCO d.o.o.	Gordana Lučić
APO Usluge zaštite okoliša d.o.o	Damir Subašić
HEP – Obnovljivi izvori energije d.o.o.	Goran Slipac
HEP - Odmor i rekreacija d.o.o.	Edo Virgini
Plomin Holding d.o.o.	Marino Roce
HEP – Nastavno-obrazovni centar	Zdenko Miletić, Head of the Institution

■ General Shareholders Assembly 2008

The annual meeting of the General Shareholders Assembly was held on June 19, 2008. The Assembly considered annual business and financial reports and adopted the Decision on the use of the operating profit achieved in 2007. The Assembly gave a statement of release to the president and members of the Management Board and to the chairman and members of the Supervisory Board of HEP d.d. for the business year 2007.

Audit

Independent auditor

At a meeting held on October 22, 2008, the Shareholders Assembly appointed the auditing firm Deloitte d.o.o. Zagreb as the auditor of HEP d.d., related companies and consolidated financial statements for HEP Group for the year ended December 31, 2008.

Internal audit and risk management

Internal Audit and Risk Management Department is responsible for the corporate function of internal audit which is part of the internal supervision of HEP Group, and since January 1, 2009 the Department has been also responsible for the corporate function of risk management.

Internal supervision consists of internal controls and an internal control system, internal audit, controlling, treasury, risk management and other forms of internal controls. The management is responsible for the establishment, organization, functioning and supervision of internal controls and the internal control system, and the internal audit is responsible for verifying how they work. The corporate function of risk management is set up in a Risk Management Unit.

The task of the internal audit is to conduct internal audits and to submit reports on audit results. The reports give HEP d.d. Management Board and lower-level management an objective assessment of the state of affairs and operations, business processes, compliance with laws and internal rules of HEP Group in the area of internal audit. In the assessment, the internal audit indicates in particular its findings concerning adequacy, efficiency and effectiveness of the internal control system, business processes and risk management. The purpose and objective of internal audits and reports is to provide a reasonable guarantee of security, efficiency and effectiveness of the business system and processes, reliability and accuracy of information, compliance of business operations with laws, regulations and HEP internal rules, plans, programs and business policy.

In 2008, the Department carried out internal audits of procurement, work safety and fire protection, information system, ICT security, legal, personnel and property-law related affairs, cash transactions and inventories of supplies. Based on these audits, it was assessed that the internal control system in HEP Group was reliable and that the main business risks had been identified and well managed. The Department submitted semi-annual and annual reports on its work to HEP d.d. Management Board.

Certificates



ISO 14001 Certificate for environmental management within HEP Proizvodnja d.o.o. issued to TE-TO Zagreb (by BVQI), EL-TO Zagreb, Sisak TPP, CCPP Jertovec and hydro production areas North and West (by Det Norske Veritas) with all hydro power plants included, within HEP ODS to Elektra Zagreb, and within HEP OPS to Zagreb Transmission Area (by Bureau Veritas)



ISO 9001 Certificate for quality management issued to TE-TO Zagreb (by Bureau Veritas), EL-TO Zagreb and CCPP Jertovec and hydro production areas North and West (by Det Norske Veritas) with all hydro power plants included



All HEP's hydro power plants have since 2003 certificates of a hundred percent production from renewable sources, or green energy (issued by TÜV)



Leader in Croatia, partner in Europe

A photograph of a man and a woman standing on a sandy beach, looking out at the ocean. The woman is on the left, wearing a red top and dark pants, with a dark bag slung over her shoulder. The man is on the right, wearing a dark blue t-shirt and dark pants. They are both looking towards the ocean where waves are breaking. The sky is not visible, and the water is a vibrant blue. The image has rounded corners at the top and bottom.

HEP's business operations in 2008

Macroeconomic environment

Business conditions

Financial results achieved

Results by activity

Financial position

Investments

Credit rating

■ Macroeconomic environment

Croatia – basic macroeconomic indicators

		2006	2007	2008
GDP	in EUR mn, current prices	39,102	42,833	47,370
GDP per capita	in EUR	8,807	9,656	10,682
GDP annual growth rate	constant prices	4.7%	5.5%	2.4%
Average annual inflation rate		3.2%	2.9%	6.1%
Foreign debt	in EUR mn, at year end	29,274	32,929	39,125
Unemployment rate	using ILO definition	11.2%	9.6%	8.4%
Population (estimate 2005)	in mn	4.44	4.44	4.44
Average exchange rate	HRK : 1 EUR	7.3228	7.3360	7.2232
Average exchange rate	HRK : 1 USD	5.8392	5.3660	4.9344

■ Business conditions

In 2008, HEP Group operated in extremely aggravated conditions, especially during the first half of the year. Oil, coal and electricity prices continued to grow and lower production by hydro power plants, due to less water inflows, necessitated greater electricity imports and/or change in the planned production structure. This caused a high rise in operating costs and a significant burden on the Group's liquidity.

Since it was estimated that electricity price increase would be approved in the second half of the year, appropriate decisions were taken to implement the plans on an event-based plant maintenance system and to reduce general costs by postponing those activities that would not adversely affect the business.

Also reduced was the planned scope of investments into construction, replacement and reconstruction of energy facilities, plants and networks as well as other investments. The investment priority was given to the completion of construction projects in progress – three important production plants with which the Group would increase its electrical and heat production capacity (a new unit at TE-TO Zagreb, Lešće HPP and a new unit at Sisak TPP) – and investments necessary for safe and reliable operation of the Group's energy systems.

Electricity price increase for domestic customers was approved on July 1, 2008 when the Government approved the prices according to new tariff systems, separately for each regulated business. With this increase income in the second half of the year grew significantly and the worsening liquidity trend of the Group was stopped.

After the outbreak of the world financial crisis, in the last quarter prices of oil and coal fell first and then electricity and gas prices followed. This fall, however, will have a more significant impact on the Group's costs only in 2009.

For 2008 the Group planned to enter into a new long-term loan arrangement of 300 million euro, of which 200 million euro for the financing of the planned investments and 100 million euro for trade payables. The process of receiving offers from banks for this financial arrangement had begun just before the outbreak of the financial crisis which led to the collapse of the money market and curtailed lending, so that eventually a 125 million euro loan was realized, a part of which was funneled to meet trade payables. Therefore, liquidity recovery has continued into 2009.

Total electricity turnover in 2008 was 19.5 TWh, of which 14.3 TWh was produced by power plants owned or partly owned by the Group, and 5.2 TWh was procured from the regional market. The amount needed for domestic customers and coverage of network losses was 18 TWh, and 1.5 was sold in the regional market. Due to the economic downturn in the last quarter, total domestic electricity consumption in 2008 grew by only 2.1 percent compared to 2007, with consumption in the first two quarters being significantly higher, 5.2 percent.

The availability of power plants, transmission and distribution networks was very good without any serious disturbances in electricity, heat or gas supply.

In the second half of 2008, HEP Opskrba d.o.o. began to negotiate electricity sale with a number of customers who had under the Electricity Market Act been granted the status of eligible customer and the right to choose electricity supplier. These customers entered into contracts with HEP OPS or HEP ODS for the use of transmission or distribution networks. Electricity price in the Croatian market is not enticing yet for competitors so that the Group retained supply to all customers in Croatia.

■ Financial results achieved

Basic indicators

	unit	2006	2007	2008	2008/2007
Electricity sales	TWh	17.4	16.7	17.7	5.6%
Electricity production	TWh	14.2	13.9	14.3	3.0%
Heat sales	TWh	2.2	2.1	2.2	5.8%
Gas sales	mn m ³	157	153	166	8.5%
Operating income	HRK mn	10,247.3	10,815.5	11,889.4	9.9%
EBITDA	HRK mn	2,259.3	1,872.9	1,922.9	2.6%
Group net profit	HRK mn	241.9	26.0	31.1	19.6%
Total assets	HRK mn	29,335.6	31,070.2	32,635.4	5.0%
Investments	HRK mn	2,761.9	3,077.0	2,644.2	-14.1%
Number of employees		14,356	14,290	14,375	0.6%

Business operations in 2008 were characterized by extremely unfavorable conditions. Due to rising prices of energy input and unfavorable hydrological circumstances, operating expenses increased significantly. Electricity prices did not increase until July, but the increased income from electricity sales covered cost growth so that operating profit increased to 289.3 million kuna (in 2007 it was 204.8 million kuna). Group net profit was 31.1 million kuna, of which 11.7 million kuna was attributable to equity holders of the parent.

Consolidated profit and loss account (abridged)

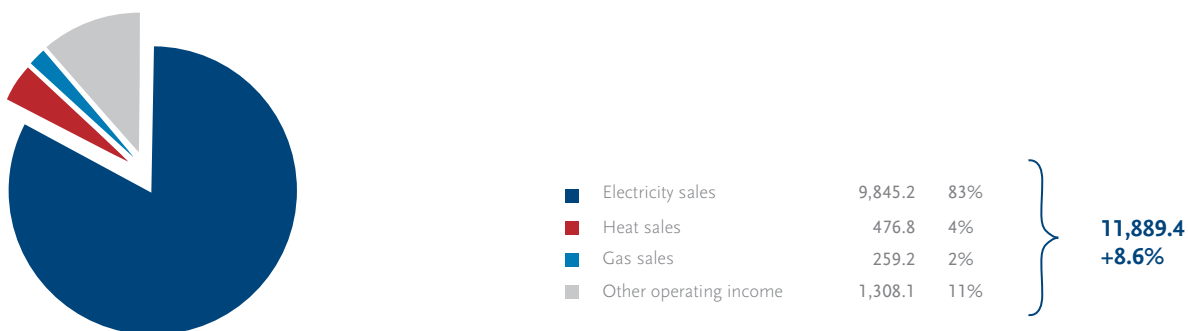
HRK mn

	2006	2007	07/06	2008	08/07
Operating income	10,247.3	10,815.5	5.5%	11,889.4	9.9%
Operating expenses	9,846.6	10,610.7	7.8%	11,600.1	9.3%
Operating profit	400.7	204.8	-48.9%	289.3	41.3%
Group net profit	241.9	26.0	-89.2%	31.1	19.6%
Net profit attributable to equity holders of the parent	216.9	3.8	-98.2%	11.7	207.9%

Operating income

In 2008 Group achieved the highest operating income ever – 11,889.4 million kuna. This is an increase of 1,073.9 million kuna over 2007. The growth in operating income is the result of increased income from electricity, heat and gas sales.

Operating income (HRK mn)



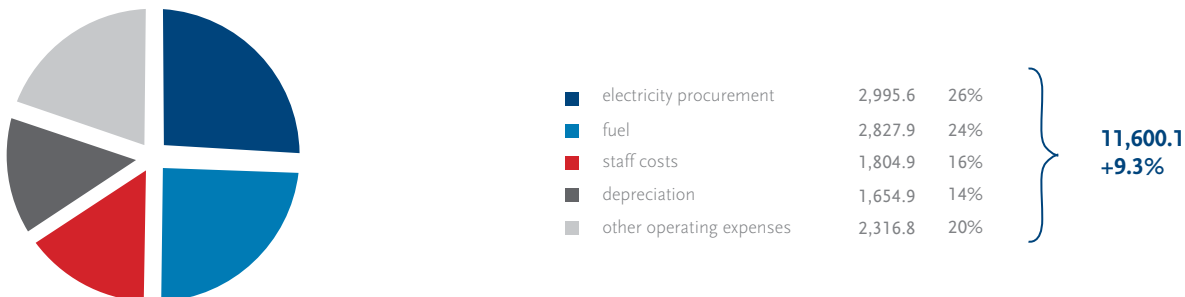
Income from electricity sales, which increased 13 percent compared to the year before, account for 83 percent of the Group's operating income. Income from heat and gas sales grew by 7 percent and account for 6 percent of operating income. The Group's income growth was largely due to the increase in electricity selling price. Other operating income decreased by 16 percent compared to 2007.

Operating expenses

The Group's operating expenses in 2008 increased by 989.4 million kuna to 11,600.1 million kuna, a growth which is by 84.5 million kuna lower than the growth in operating income. More than 80 percent of the increase is related to electricity production and procurement costs which grew by 16 percent due to the following factors:

- rise in purchase price of oil (32%), gas (65%) and coal (45%),
- rise in imported electricity price (28%),
- greater electricity procurement (5%),
- greater heat production (3%).

Operating expenses (HRK mn)



Staff costs are determined in the Collective Agreement and growth in salaries is linked to the growth in gross domestic product in the previous year.

Other operating expenses decreased by 2 percent due to the implementation of measures for the consolidation of the Group's financial situation. Measures were taken to mitigate the negative impact of the high rise in fuel prices and electricity procurement on the Group's liquidity. These were related to the reduction of maintenance of energy facilities and reduction in manageable general costs which do not adversely affect the operations.

■ Results by activity

<i>Business result</i>	HRK mn								
	electricity			heat			gas distribution		
	2007	2008	08/07	2007	2008	08/07	2007	2008	08/07
Operating income	10,057.1	11,082.9	10.2%	502.1	523.4	4.2%	256.3	283.1	10%
Operating profit	308.1	460.7	49.5%	-101.9	-181.5	78%	-1.5	10.1	

The greatest portion of the operating income (93 percent) as well as the total operating profit were achieved in the electricity business. The share of district heating in the income was only 4 percent, but an operating loss of 181.5 million kuna was made which halved the operating profit achieved in electricity and gas distribution businesses. Gas distribution business has the smallest share in operating income (2 percent) and an operating profit of 10.1 million kuna.

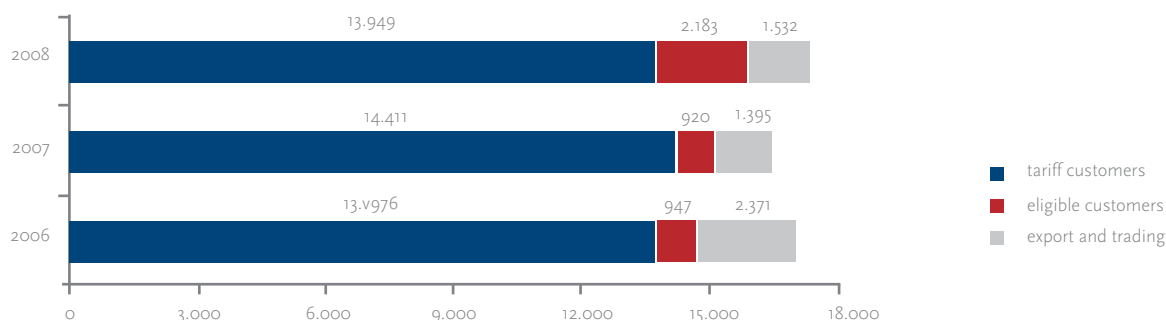
Electricity (production, transmission, distribution and supply)

An operating profit of 460.7 million kuna was achieved in 2008, which is by 153 million kuna a better business result compared to 2007. Income from electricity sales amounted to 9,845.2 million kuna, in which 95 percent was realized from supply to domestic customers and 5 percent from sales in the regional market.

Power plants owned or partly owned by the Group generated 14.3 TWh of electricity, which is 73 percent of total electricity turnover realized by the Group in 2008 or 80 percent of consumption in Croatia.

<i>Electricity production and procurement</i>	GWh			
	2006	2007	2008	08/07
hydro power plants	6,070	4,357	5,277	21%
thermal power plants	5,436	6,845	6,075	-11%
Krško nuclear power plant	2,645	2,714	2,986	10%
electricity procurement	5,513	5,133	5,229	2%

Sales to domestic customers amounted to 16.1 TWh of electricity, and with a further opening of the market in 2008 the share of sales to eligible customers increased to 14% of total sales in Croatia.

Electricity sales (GWh)**District heating**

District heating business made an operating loss in 2008 of 181.5 million kuna and compared to 2007 the loss increased by 80 million kuna due to large increase in fuel prices. The Government of the Republic of Croatia did not approve the request for increase in heat price which has not changed since 2004, although in the meantime production costs have significantly increased due to fuel price growth.

Sales of heat and process steam were 2.21 TWh, which is 6 percent higher compared to 2007, mainly due to low external temperatures during the heating season.

Gas

In 2008 the gas business made an operating profit of 10.1 million kuna and an increase in gas sales of 8.6 percent, also largely due to low external temperatures during the heating season.

■ Financial position

Consolidated balance sheet (abridged)

	December 31 2007		December 31 2008		08/07
	HRK mn	share	HRK mn	share	
Long-term assets	28,040.2	90%	29,285.9	90%	4%
Short-term assets	3,030.0	10%	3,349.5	10%	11%
Total assets	31,070.2	100%	32,635.4	100%	5%
Capital and reserves	18,135.2	59%	18,130.2	56%	0%
Long-term liabilities	8,495.3	27%	9,149.7	28%	8%
Short-term liabilities	4,439.7	14%	5,355.5	16%	21%
Total liabilities and capital	31,070.2	100%	32,635.4	100%	5%

Assets

The value of total assets of HEP Group in 2008 increased by 1.56 billion kuna to 32.6 billion kuna. The greatest increase is in long-term assets where significant investments into construction, replacement and reconstruction of energy plants, facilities and networks increased the value of the assets by 1.1 billion kuna. Long-term assets account for 90 percent of the value of the Group's assets.

The value of short-term assets is 3.3 billion kuna. The greatest increase in the value is in inventories of fuels due to larger amounts of oil and coal and higher purchase prices. Accounts receivable also increased as a result of electricity price increase in the second half of the year. Provisions for doubtful and disputed debts decreased as a result of collection of some older receivables.

Capital and liabilities

Capital and reserves at the end of 2008 amounted to 18.13 billion kuna with a share of 56 percent in the Group's total assets.

The structure of liabilities did not change significantly, short-term liabilities grew the most and increased their share from 14 to 16 percent. Short-term loans increased as well as current portion of long-term liabilities.

Long-term liabilities for loans increased due to the use of earlier agreed loans and a new loan arrangement in 2008. Other long-term liabilities significantly increased, which is related to connection of new customers and increase in connected load of existing customers.

Because interest-bearing debt was higher than the increase in capital and reserves, debt to equity ratio increased from 30 to 34 percent.

Investments

In 2008 the value of the investments that were made was 2,644.2 million kuna, of which the greatest part is related to new construction and to replacement and reconstruction of existing energy facilities, plants and networks. The remaining part is related to information technology and telecommunications infrastructure, remote control systems, measuring devices and instruments, business premises and transport vehicles.

<i>Investments</i>	HRK mn			
	2006	2007	2008	08/07
Investments in property, plant and equipment	2,761.9	3,077.0	2,644.2	-14%

Construction of transmission and distribution networks makes it possible to meet continuous growth in electricity consumption in Croatia, while replacement and reconstruction remove inefficiencies of existing plants and facilities with the aim of improving the security and quality of electricity supply and reducing network losses. Construction of new high-efficiency generating plants will reduce the gap between generating capability of existing plants and growing needs for electricity. It will also allow closure of old, inefficient and therefore expensive, plants.

An overview of major investments 2008 per company is given in the section Reports by HEP Group companies.

Credit rating

Standard&Poor's lowered BBB rating outlook of HEP d.d. from stable to negative on October 28, 2008, as a result of the same lowering for the Republic of Croatia.

Due to worsening liquidity during 2008, on February 23, 2009, rating was lowered to BBB- with negative outlook and on April 23, 2009, to BB+ with negative outlook.

Credit rating history

	Local currency	Foreign currency
November 13, 1998	BBB	BBB-
July 19, 2005	BBB	BBB
October 28, 2008	BBB /Negative/	
February 3, 2009	BBB- /Watch Neg/	
April 23, 2009	BB+ /Watch Neg/	



Light on the journey together

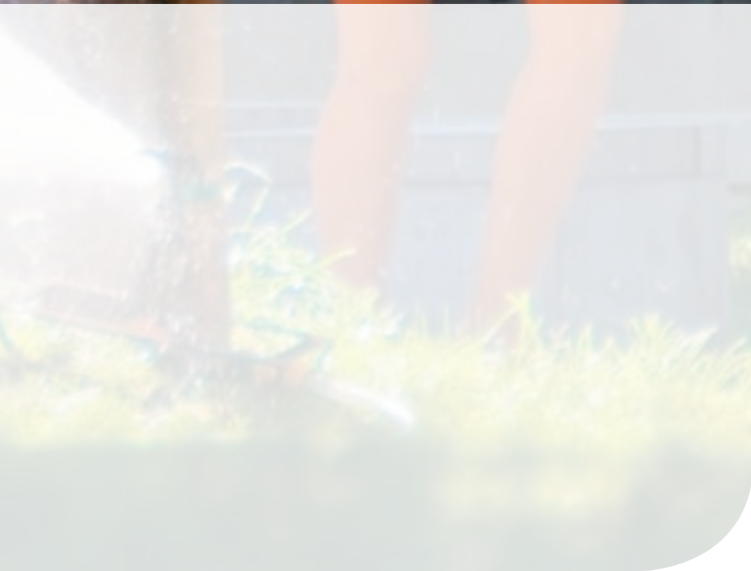


Report on impact on HEP Group stakeholders

Employees

Customers

Other stakeholders



Social responsibility

HEP conducts its business in compliance with the law and ethical standards, on the principles of sustainable development and social responsibility, based on the following documents:

- Code of Ethics – Principles of Business Conduct Within HEP, 2002
- Code of Ethics of the Croatian Chamber of Economy, 2005
- Code of Corporate Governance (Zagreb Stock Exchange and HANFA);

and membership in social responsibility organizations and initiatives:

- Global Compact (a network of organizations for socially responsible business operations),
- Community for Corporate Social Responsibility of the Croatian Chamber of Economy (members include HEP Group companies - HEP-Toplinarstvo d.o.o., HEP ESCO d.o.o. and APO d.o.o. Environmental Services)
- Croatian Business Council for Sustainable Development (co-founded by APO Environmental Services)

■ Employees

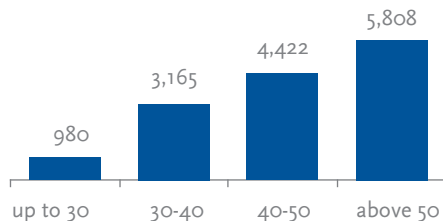
Number of employees

On December 31, 2008 of the total of 14,375 employees, 14,292 were employed on a permanent basis and 81 on a temporary basis (of which 65 probationary employees), and two employees were on unpaid leave.

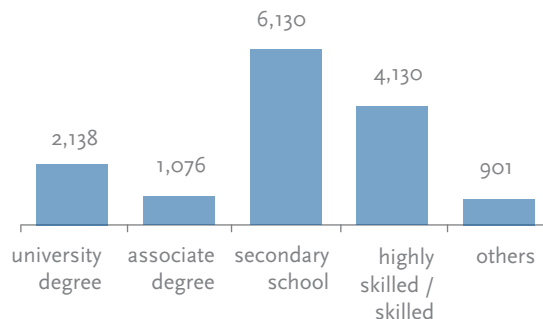
Number of employees by HEP Group company (December 31)

Company	2007	2008	Change
HEP - Operator distribucijskog sustava d.o.o.	9,622	9,603	-19
HEP-Proizvodnja d.o.o.	2,344	2,362	18
HEP - Operator prijenosnog sustava d.o.o.	1,243	1,248	5
HEP d.d.	411	444	33
HEP-Toplinarstvo d.o.o.	386	392	6
HEP-Plin d.o.o.	136	139	3
HEP-Opskrba d.o.o.	23	50	27
C.S. Buško blato d.o.o.	43	42	-1
APO d.o.o., usluge zaštite okoliša	21	27	6
HEP-ESCO d.o.o.	18	20	2
HEP - Trgovina d.o.o.	14	15	1
HEP - Odmor i rekreacija d.o.o.	12	15	3
Ustanova HEP - Nastavno-obrazovni centar	11	11	0
HEP - Obnovljivi izvori energije d.o.o.	6	7	1
Total	14,290	14,375	85

Age structure



Qualification structure



Employment and trade union relations and workers' councils

Four trade unions are active in HEP Group. Employment and rights of HEP Group employees are regulated in work rules of the companies and Collective Agreement. The employers fully and timely fulfilled all prescribed or contractual obligations toward the registered unions and employees.

The Collective Agreement for HEP Group (concluded on December 30, 2005) was applied until June 30, 2008. Negotiations with a negotiating board of all trade unions began in April and ended on July 1, 2008 by concluding a new Collective Agreement for HEP Group among all employers of HEP Group and three of the four registered unions. The Agreement was concluded for a period from July 1, 2008 to June 30, 2010. In accordance with Article 147 of the Agreement, the parties have set up a joint commission for interpretation of the provisions of the Agreement.

In HEP Group companies in which workers' councils were elected, the employers fulfilled their obligations toward workers' councils, in compliance with the sections of the Labor Act relating to obligations to inform, consult and allow participation in decision-making of workers' councils on matters important for employees.

Human resources management

An increasing attention has been paid to the development and implementation of modern HR management practices in order to prepare the company and its employees for doing business in an open market.

After the establishment of a standardized selection procedure for new employees and scholarship recipients (high school and university students), in 2008 the system for monitoring probationary employees was further developed so that they can sooner become capable of working independently, adapt to the work environment and start their personal development from the very beginning in the company. For the purposes of employee professional and personal development, preparations began for introduction of a performance monitoring system which will include annual interviews and defining of individual professional and personal goals of each employee for a pre-set future period and an assessment of their achievement.

HEP d.d. conducted an examination in HEP Group companies of the organizational climate and employee satisfaction in order to determine the degree of satisfaction with particular aspects of the work environment and to make improvements accordingly over a reasonable period.

Education and training

HEP allocates significant financial resources for postgraduate studies (15 students at HEP Group level), additional training, professional improvement, and scholarship of high school and university students. In 2008, HEP invested 11.2 million kuna in employee education and 7.3 million kuna in scholarship and student practical work. In addition to investing in employee professional competencies, special attention is paid to improvement of their computer literacy and foreign language skills.

Education and professional improvement activities in 2008 included in particular:

- In mid-September a one-year education project intended for desk employees of HEP ODS was completed, covering the area of efficient client communication and encompassing 217 participants from all distribution areas.
- The establishment began of an internal training system for probationary employees (45 participants) in the area of communication skills and business etiquette.
- Internal education was provided to new reception desk employees in the area of business communication.
- HEP Group managers attended the program Corporate Governance for Members of Supervisory and Management Boards, organized by the Faculty of Economics in Zagreb, Faculty of Economics in Split and CROMA Zagreb.
- A large number of employees of technical, economic, legal and other background attended professional conferences, topical seminars and courses.
- The development of the Education Register application continued.

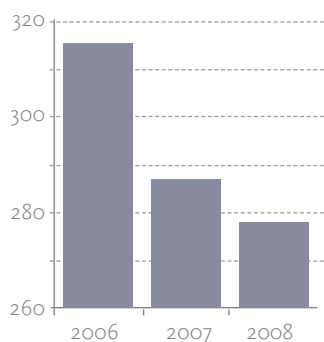
Health and safety at work

At the 4th Safety and Fire Protection Congress, in 2007 in Zagreb, HEP received Annual Award for “exceptional contribution in promoting protection of human working and living environment”.

The number of injuries has continued to decrease, by about three percent a year, the goal being to reduce the number of injuries by at least ten percent a year. The credit for this goes to safety specialists, to the right approach taken by the employer's authorized persons and to the support given by the Management Board.

Safety specialists participate in the work of Safety Commission, cooperate with workers' safety representatives, perform internal supervision, take care of medical examination of employees who work in special working conditions, oversee and keep records of regular testing of potentially dangerous machines and equipment as well as of training, in accordance with legal requirements and internal rules.

Number of injuries in HEP Group 2006-2008



In 2008, there were 278 injuries at work or nine injuries less than the year before. There were no fatalities.

Number of injuries in 2008 by HEP Group company*

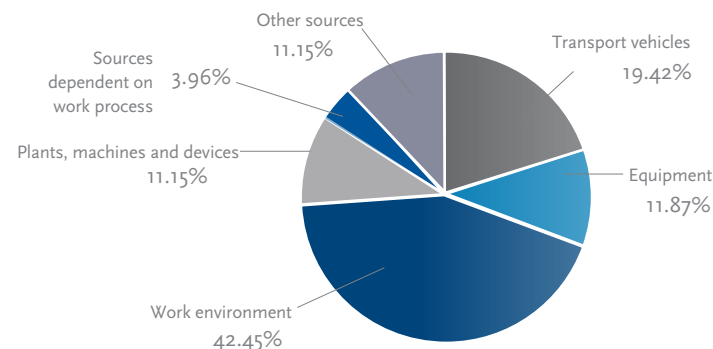
Name of organizational unit	Aver.no. employees	Injuries at work	To/from work	Business trip	Other	Fatal injury	TOTAL	Hours lost	Days lost
HRVATSKA ELEKTROPRIVREDA d.d.	303	4	0	5	0	0	9	3,632	454
HEP - PROIZVODNJA d.o.o.	2,312	20	4	0	0	0	24	10,376	1,297
HEP - OPERATOR PRIJENOSNOG SUSTAVA d.o.o.	1,220	11	0	5	1	0	17	5,848	731
HEP - OPERATOR DISTRIBUCIJSKOG SUSTAVA d.o.o.	9,487	176	34	0	13	0	223	109,780	13,724
HEP - TOPLINARSTVO d.o.o.	388	1	2	0	2	0	5	1,504	188
TOTAL HEP GROUP:	14,375	212	40	10	16	0	278	131,140	16,394

*Only companies in which there were injuries

In 2008, as many as 40 injuries occurred on the way to/from work, which is close to 15 percent of the total number of injuries. These injuries occur outside HEP system and it is difficult to influence them.

Most injuries occurred in the work environment – 118 or 42.45 percent of the total number of injuries. These are followed by injuries whose source is transport vehicles or traffic (54 injuries or 19.42 percent), less however than in 2007. Very few injuries occur at the place of work.

Share of injury sources



Other

- All HEP Group companies have Rules on the procedure and measures for protection of employee dignity.
- As well as covering the costs of additional health insurance, HEP organizes periodic general medical checkups for its employees.
- Based on contest, employees and their families have the right to spend summer vacation in HEP's vacation homes and winter vacation abroad on privileged terms. HEP organizes active summer vacation program for employees' children and summer vacation for the children of HEP's dead and missing employees in the Homeland War.
- HEP Group companies organize sporting recreation, sports meetings and contests for their employees.
- HEP supports programs for excursions and sporting activities of associations related to HEP such as the Association of Homeland War Veterans and Retirees Association.

Customers

Number of customers

The number and structure of electricity, district heating, process steam and natural gas customers are shown in reports by HEP Group companies: HEP ODS, HEP-Toplinarstvo and HEP-Plin.

Relations with electricity customers - HEP ODS

In line with HEP Group customer relations strategy, HEP Operator distribucijskog sustava d.o.o. (HEP ODS) places electricity customers in the center of its business interests. Through customer management HEP ODS, besides supplying quality electricity and providing quality service, wants to recognize and fulfill other needs and requirements of its customers.

In addition to usual payment methods (cash, credit cards, standing orders), customers can pay their bills without extra charge at all FINA and Croatian Postal Service offices.

In order to make the practice in the entire Company uniform, the implementation of Billing application was completed which, besides uniform appearance of electricity bills, fulfilled conditions for establishing a single contact center for the whole of Croatia. For now, customers have at their disposal call centers 9820 in ten local organizational units, which provide services free of charge, for submission of meter readings or complaints or for information of interest to customers.

On HEP ODS website (www.hep.hr/ods) customers can ask their questions using e-mail, get information about how a particular HEP ODS distribution area does its business, submit meter reading, learn about laws and regulations and news pertaining to electricity distribution and supply, see or print the necessary application or contract forms, etc.

Each distribution area has organized receiving and processing of customer queries, information and complaints, and customers in the distribution areas of Zagreb and Pula can additionally use the services of Info Center. Info Center provides all information of interest for current or future customers: information regarding electricity supply, technical information about savings and efficient use of electricity, about electricity production, conditions for connection to the distribution network, environmental protection measures, etc.

Supply Sections at each Elektra systematically take care, monitor and record services, information and complaints and provide or resolve them as soon as possible. The Department for Tariff Customers' Supply coordinates the work of all Supply Sections and continuously monitors and oversees relevant indicators in order to ensure that customers receive appropriate quality of service, in accordance with European standards.



Relations with electricity customers- HEP Opkrba

From the initial 19 customers at the end of 2007, in December 2008 HEP Opkrba had 2,095 active customers. All customers receive their bills via postal mail, but also by email, including billing statements for each metering point, on the very day bills are prepared and issued. Customers have welcomed this novelty, and any complaints are made much sooner. Also, the appearance of the bills has been changed to make them look different than bills for tariff customers.

Customer communication in 2008 was also improved and intensified through all means available – upgraded website, email and telephone communication, and direct written correspondence. Additional training was delivered to Call Center employees.

Yet another important step forward was made in negotiating electricity supply contracts. Exceptionally good contacts have been established with entities that are subject to Public Procurement Act. The Company's staff have provided all professional and technical assistance in order for such entities to comply with legal requirements and procedure. We have thus earned customer trust and strengthened HEP's reputation.

Relations with natural gas customers

Relations with natural gas customers were at a satisfactory level. Individual and occasional complaints, mostly related to meter reading and gas consumption billing, were resolved to mutual satisfaction. The global crisis aggravated customers' financial position so that in 2008 outstanding debt for natural gas sold increased compared to the year before.

Because in 2008 residential customers were also granted the status of eligible customer, preparations were made during the year for a new type of contractual relation – supply to eligible customers based on open market principles. Therefore, HEP Plin d.o.o. has been making adjustments for a gradual transition from regulated to competitive market conditions, aware of the need to further improve its relations with customers.

Complaint commissions

As required by the Consumer Protection Act, commissions have been set up for customer complaints in 21 distribution areas of HEP ODS, in HEP-Toplinarstvo d.o.o. and HEP-Plin d.o.o. The commissions are composed of representatives of individual HEP companies or areas and representatives of consumer associations. Regionally organized complaint commissions allow a speedier complaint filing and processing procedure.

Number of complaints considered by commissions of HEP ODS - 2008

Reason for complaint													Meetings held	Total complaints	Total accepted	Total rejected		
Billing			Inaccurate meter			Connection/disconnection			Voltage conditions			Other						
total	accepted	rejected	total	accepted	rejected	total	accepted	rejected	total	accepted	rejected	total	accepted	rejected				
145	45	100	4	1	3	6	1	5	2	0	2	35	7	28	71	192	54	138

Number of complaints considered by commissions of HEP ODS - 2008

Reason for complaint																				
Quality of supply services (regarding meter reading, billing, collection)			Quality of heat energy (temperature in customer premises, temperature of hot water, steam parameters)			Change in connected load			Change at metering point (separation, linking, relocation of installations, etc.)			Redistribution of quantity of heat supplied			Other reasons			UKUPNO		
total	accepted	rejected	total	accepted	rejected	total	accepted	rejected	total	accepted	rejected	total	accepted	rejected	total	accepted	rejected			
10	7	3	5	5	0	3	2	1	4	3	1	1	1	0	10	7	3	33	25	8

Other stakeholders

Local communities

- The programs to improve communal infrastructure and economic/entrepreneurial environment in the local communities are implemented in the vicinity of HEP's plants.
- HEP's staff participate in professional forums in order to provide information to representatives of local communities, environmental organizations, members of the public and the media about relevant HEP's activities.
- Elektra Karlovac (HEP ODS) and Ozalj hydro power plant (HEP-Proizvodnja) marked during 2008 the 100th anniversary of public electrification of Karlovac. The events marking the anniversary included in particular a series of local radio shows, presenting gifts to loyal electricity customers in an appropriate public program and staging a theatrical performance, A Century of Munjara Power Plant – A Century of Light.

Recognition for external communication

At the award ceremony of the Croatian Public Relations Association - grand PRix 2008, HEP's project of marking the 100th anniversary of public electrification of Zagreb entitled A Century of Light in Zagreb was declared one of the three best projects carried out in 2007, in the category Public relations in the business sector - external communication for large companies. The anniversary was marked under the high auspices of the Government of the Republic of Croatia.

Education system

- Since 1998, HEP has been participating in the Eco School Project which has been implemented by the Foundation for Environmental Education of the Council of Europe. HEP is the sponsor of the following ECO Schools: Electromechanical Vocational School Varaždin, secondary school Antun Matijašević Karameo Vis, and Konjščina, Stanovi Zadar, Ivo Lola Ribar Labin, Vladimir Nazor Pazin, Kostrena elementary schools and a kindergarten, Tribalj
- Since 1995, HEP has been giving prizes to students who achieve best results in national mathematics and physics contests and since 2005 to the best students of vocational electrical schools.
- In 2008, the cooperation with the Technical Museum Zagreb continued concerning organization of educational visits of secondary school students to Krško Nuclear Power Plant.

Media

- On the occasion of Earth Day, April 22, Degenia Velebitica, an annual award for the best piece of environmental journalism, was presented. The founders of the award (1999) are Environmental Journalists Section of the Croatian Journalists Society and APO d.o.o., a member of HEP Group.

We borrow from nature





Sustainable development

Policy and organization of nature and environmental protection function

Basic indicators

Major achievements in 2008 (by HEP Group companies)

Policy and organization of nature and environmental protection function

HEP continuously monitors and analyzes the impact of its business processes on the environment. The company reports on all environmental components timely and objectively to relevant institutions, units of local self-government and the interested public. Employees working in nature and environmental protection function attend seminars and workshops to get informed about duties and activities arising from environmental and nature protection legislation. Technical support to these employees that are active in individual HEP Group companies is provided by the members of HEP's Team for Environmental Protection Coordination and Standardization. During the year, HEP's representatives participated in seminars, workshops and conferences relating to the implementation of the Kyoto Protocol, waste management, hazardous substances management, and water protection.

Harmonization with the EU legislation

In 2008, the thermal power plants Sisak and Plomin participated in the EU project CARDS 2004: „Support for the Further Approximation of Croatian Legislation with the Environmental Acquis – preparation of IPPC/ environmental pilot permit, whose endorser was the Ministry of Environmental Protection, Physical Planning and Construction. The purpose of the project was to gain, through the environmental pilot permit, an insight into and experience with the process of obtaining integrated environmental requirements which all HEP's thermal power plants exceeding a gross thermal capacity of 50 MW would have to obtain for further operation. All new plants and those that will undergo major reconstruction will also have to obtain integrated environmental requirements.

Basic indicators

According to water quality analyses carried out during 2008 by authorized laboratories as required by water laws and regulations, all HEP's plants operated in accordance with permits and legal requirements. In 2008 HEP continued to monitor air emissions of pollutants -sulfur dioxide (SO₂), nitrogen oxide (NO_x), carbon dioxide (CO₂) and particulates as required by air quality legislation, as well as the quantities of hazardous and non-hazardous waste generated by HEP.

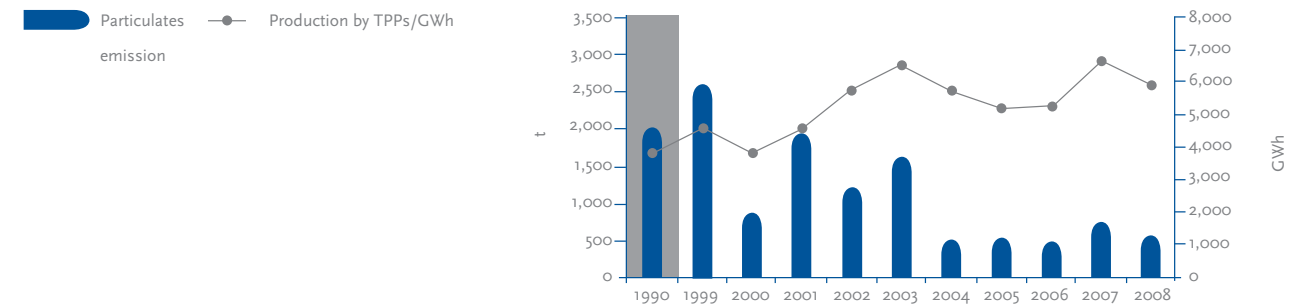
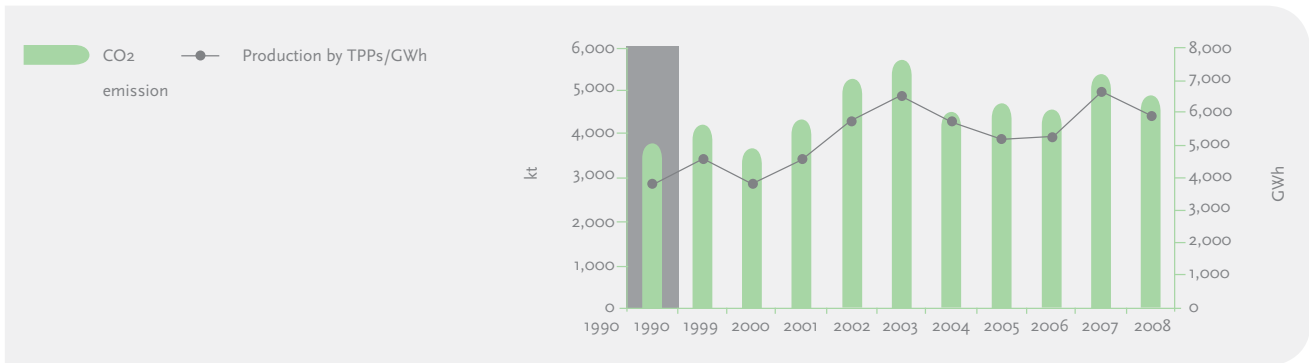
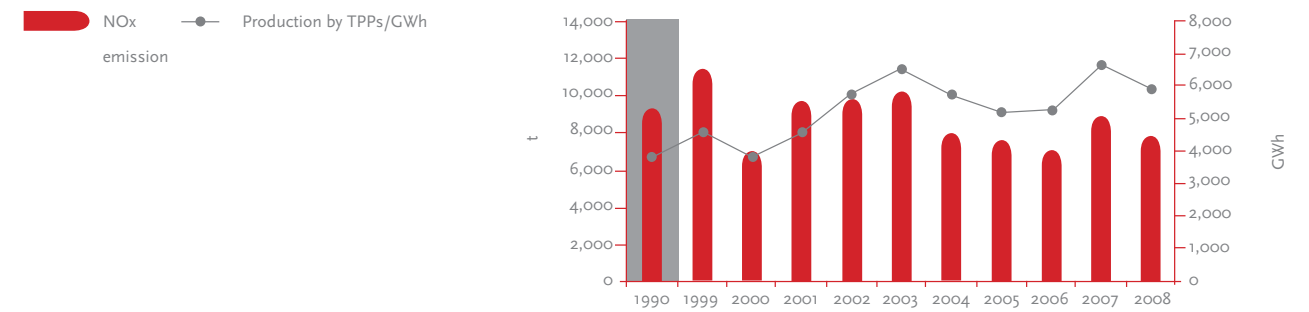
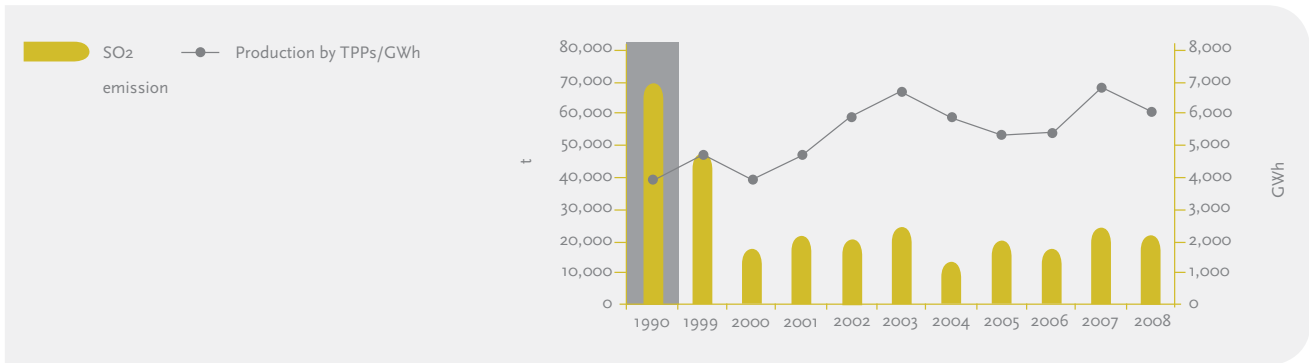
Air emissions

In 2008 HEP's thermal power plants produced less electricity than in 2007. As a result, emissions of all air pollutants decreased.

Air pollutant emissions from HEP's thermal power plants (1990) 1998-2008

year	SO ₂ (t)	NO _x (t)	CO ₂ (kt)	particulates (t)	Production by TPPs (GWh)
1990	69,402	9,248	3,750	2,031	4,030
1999	47,092	11,506	4,195	2,610	4,768
2000	17,343	7,067	3,654	885	3,958
2001	21,807	9,733	4,347	1,939	4,713
2002	20,147	9,780	5,259	1,215	5,899
2003	24,635	10,303	5,679	1,634	6,703
2004	13,723	7,900	4,503	518	5,899
2005	20,167	7,564	4,694	548	5,387
2006	17,664	7,044	4,544	504	5,436
2007	24,376	8,879	5,383	756	6,845
2008	22,165	7,834	4,862	566	6,075
2008/2007 (%)	-9.07	-11.78	-9.69	-25.08	-11.26

Trend of pollutant emissions from HEP's thermal power plants (1990-1998-2008)



Waste

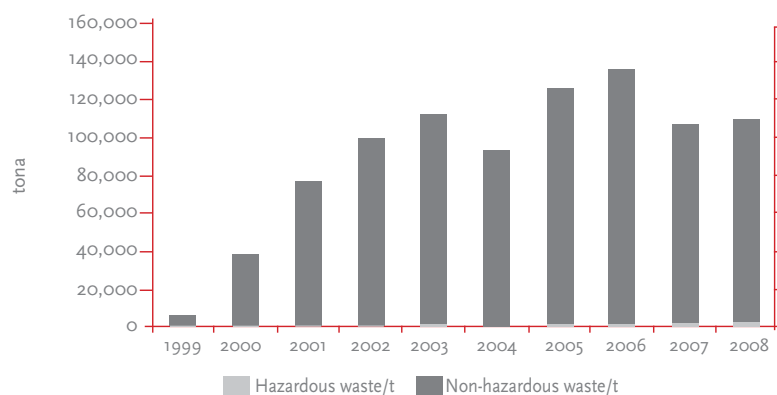
Over the last four years HEP's waste management system has significantly improved. Most plants have either completed or begun construction of temporary disposal facilities for waste and secondary raw material and equipped them with tanks for separate waste collection.

In 2008 HEP's plants generated 1,243 tons of hazardous and 107,623 tons of non-hazardous waste. The waste was delivered to authorized collectors and processors for further processing.

Total waste quantity 1999-2008

Year	Hazardous waste (t)	Non-hazardous waste (t)
1999	479	5,670
2000	490	37,531
2001	518	76,717
2002	577	98,492
2003	1,148	111,292
2004	940	92,067
2005	1,209	124,820
2006	1,112	134,336
2007	1,269	105,569
2008	1,243	107,623
Change 2008/ 2007 (%)	-2	+2

Total waste quantity 1999-2008



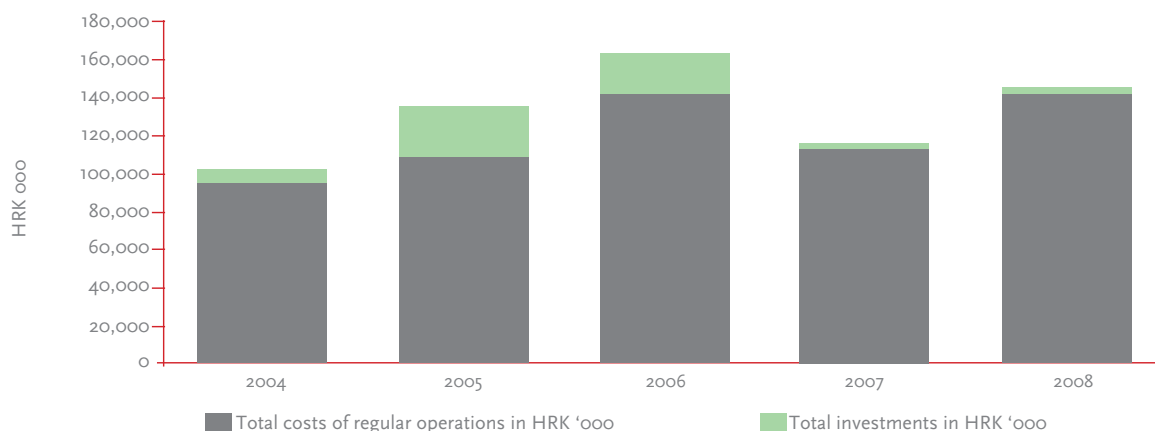
Expenses for nature and environmental protection

Since the beginning of the implementation of Accounting for Nature and Environmental Protection Expenses project (RETZOK) in 2004 until early 2008, HEP Group invested 56.25 million kuna in total in the protection of nature and the environment while total costs of regular activities to protect nature and the environment were 599.06 million kuna. Total expenses for nature and environmental protection in 2008 were 144.05 million kuna. The most significant investments in 2008 were made to improve the waste management system in HEP's plants, protection of nature and the environment and radiation protection.

Expenses for nature and environmental protection in 2008

Environmental area	Costs of regular operations (HRK'000)	Investments (HRK'000)
air and climate	3,237	580
waste water	3,461	0
waste	14,928	469
soil and groundwater protection	613	92
noise and vibrations	35	0
nature and landscape protection	25,727	939
radiation protection	71	107
research and development	667	2
other (mostly fees)	93,113	4
TOTAL	141,853	2,195

Total expenses for nature and environmental protection 2004-2008



■ Major achievements in 2008 (by HEP Group companies)

There are as many as three companies within HEP Group whose primary activities are in the areas of environmental protection and sustainable development: HEP-ESCO d.o.o., a company which develops energy efficiency projects, HEP-Obnovljivi izvori energije d.o.o. which deals with preparation, construction and use of renewable energy sources, and APO d.o.o. a company specializing in environmental protection services, especially management of hazardous and radioactive waste. The achievements of these companies in 2008 are described in the section Reports by other HEP Group companies. This section gives an overview of achievements in companies which carry out core electricity activities.

Achievements by HEP Proizvodnja d.o.o.

Thermal power plants

- All thermal power plants during 2006 began to implement the modernization of the air pollutant emission monitoring system and to adapt the system for continuous emission measurement (CEM) in order to link it with the information system of the Environmental Protection Agency.
- In TE-TO Zagreb, a device for control of oil of the heating condensate of fuel oil heater was put into operation. The pure condensate is used as makeup for the hot water system for district heating, and in case condensate is oiled, it is transferred to the oily waste water treatment system. In one of the two columns of the pumping station of cooling water from the Sava river, the screen was replaced with a sieve, and the screen in the other column is planned to be replaced as well. During the year the temporary storage facility for hazardous and non-hazardous waste was rehabilitated as well as chemicals storage facility.
- U EL-TO Zagreb the sewage system was rehabilitated, an additional separator was installed for separation of oily waters, and the open-cycle cooling water system was changed to the close-cycle system. A new water treatment plant was built thanks to which consumption of chemicals and quantity of hazardous waste will be reduced. With the aim of reducing air pollutant emissions, burners on high-pressure boilers were replaced and preparations were carried out for installation of burners in the new hot water boiler.
- In Sisak TPP, video cameras were installed and put in operation shooting smoke of the chimney of Units A and B, a reserve device for measurement of NO_x, SO₂ and CO was procured, and procurement of a spare device for measurement of particulates is currently underway as well as a device for measurement of mass flow of flue gases for all boilers. Sisak TPP as a member of the Forum of the city of Sisak and Sisak-Moslavina County, participated in the adoption of the environmental protection program of the City and the County.
- In TE-TO Osijek, a device for continuous measurement of flue gases flow was installed as part CEM system of a 45 MW unit.



Hydro power plants

- In Dubrava HPP, the system of waste water drainage was improved by installing new oil separators for receiving of process water. An oil detector was installed at points where seepage water accumulates and currently underway is the preparation of design documentation for the construction of protective floating dams at the end of the tailrace channel.
- In Varaždin HPP, a temporary sediment storage area was improved, and a new trash rack rake was procured.
- In order to solve the problem of eutrophication of the Varaždin HPP storage lake caused by accumulation of nutrients and relatively low depth of the lake which results in excessive growth of water plants which hinder water flow and thus jeopardize nearby populated areas and the structures of the hydro power plant, a project is being developed to remove sediments from the lake and dispose of and manage the sediments on-site.
- In Senj and Sklope hydro power plants, a temporary hazardous waste storage was arranged and equipped with tanks for separate waste collection. For Grabovu operation, devices for biological treatment of sanitary waste water were procured as well as oil and grease separator.
- In order to prevent oil to leak from the pipe of the hydraulic crane that is used to remove sediments on the Bukovnik dam, a spill containment was placed.

Achievements by HEP OPS

- An Environmental Protection Working Group was set up, allowing Company-wide improvements in this business area.
- The Commission for handling of the gas sulfur-hexafluoride (SF₆) continued its activities relating to the obligations under the Regulation on Greenhouse Gases Emission Monitoring and Establishment of a National Greenhouse Emission Register.
- In the Zagreb Transmission Area, the environmental management system ISO 14001:2004 was introduced.
- In the Osijek Transmission Area, in the location of TS 400/110 kV Ernestinovo, oil drainage and oil sewage were rehabilitated.

Achievements by HEP ODS

- In Elektra Sisak, a temporary non-hazardous waste storage was built.
- In Elektroprimorje Rijeka, temporary storages of hazardous and non-hazardous waste in the location of the car repair shop were built. In Skrad, Elektroprimorje Rijeka, the system for waste water drainage was reconstructed.





Financial statements

HEP group - Consolidated financial statements

Hrvatska elektroprivreda d.d. (HEP d.d.)

HEP group

- Consolidated financial statements
For the year ended 31 December 2008 Together with Independent Auditor's Report

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Notes to the consolidated financial statements - HEP Group

Responsibility for the financial statements

Pursuant to the Croatian Accounting Law, the Management Board is responsible for ensuring that financial statements are prepared for each financial year in accordance with International Financial Reporting Standards ("IFRS") as published by the International Accounting Standards Board ("IASB") which give a true and fair view of the state of affairs and results of the Group for that period.

After making enquiries, the Management Board has a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. For this reason, the Management Board continues to adopt the going concern basis in preparing the financial statements.

In preparing those financial statements, the responsibilities of the Management Board include ensuring that:

- suitable accounting policies are selected and then applied consistently;
- judgments and estimates are reasonable and prudent;
- applicable accounting standards are followed, subject to any material departures disclosed and explained in the financial statements; and
- the financial statements are prepared on the going concern basis unless it is inappropriate to presume that the Group will continue in business.

The Management Board is responsible for keeping proper accounting records, which disclose with reasonable accuracy at any time the financial position of the Group and must also ensure that the financial statements comply with the Croatian Accounting Law. The Management Board is also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.



Signed on behalf of the Management Board:
Ivan Mravak
President of the Board

HEP d.d.
Ulica grada Vukovara 37
10000 Zagreb
Republic of Croatia

08 May 2009

■ Independent Auditor's Report

To the Owner of HEP d.d.:

We have audited the accompanying consolidated financial statements of the HEP Group (the 'Group'), which comprise the consolidated balance sheet as at 31 December 2008 and the related consolidated statement of income, consolidated statements of changes in equity and of cash flows 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 entities' 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.

Matters affecting the opinion

a) Measurement of investment properties at fair value

As described in Note 5 to the financial statements, the Group changed its accounting policy during 2008 in respect of the valuation of its investment property from the cost model to the fair value model. In accordance with International Accounting Standard 40 Investment Property, investment properties are initially carried at cost and subsequently measured either at cost or fair value. The Group remeasured its investment property at fair value and the resulting fair value gains in the amount of HRK 133 million have been entirely included in the 2008 income statement rather than in the earliest period presented in accordance with International Accounting Standard 8, which requires that the effects of changes in accounting policies are recognised retrospectively in the financial statements of the Group.

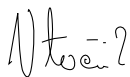
Since the Group has not applied the change in the accounting policy retrospectively, the effect of the changes in the fair value for the year 2008 has not been assessed. Therefore, we were not able to apply audit procedures that would enable us to quantify the effect of the changed accounting policy on the net profit for the year ended 31 December 2008 or on the equity in the periods presented in the accompanying financial statements.

Opinion

In our opinion, except for the effect of the matters discussed in paragraph a), the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2008, and their financial performance and their cash flows for the year then ended in accordance with International Financial Reporting Standards.

Emphasis of matter

Without further qualifying our opinion, we draw attention to Note 2 to the financial statements, discussing the revenue recognition policy. In June 2008, the Government of the Republic of Croatia promulgated a „Decision on the The Electricity Generation Tariff Model, with the exemption of eligible customers, with no tariff item amounts; The Electricity Transmission Tariff Model, with no tariff item amounts; The Electricity Distribution Tariff Model, with no tariff amounts; and the Electricity Supply Tariff Model, with the exemption of eligible customers, with no tariff amounts“. The Group has been applying the tariff models since 1 July 2008.



Deloitte d.o.o.
Branislav Vrtačnik, certified auditor
Zagreb, 08 May 2009

Consolidated Income Statement - HEP Group
For the year ended 31 December 2008

	Notes	2008	2007
		HRK'000	HRK'000
Revenue from electricity sales		9,845,219	8,739,188
Revenue from thermal power sales		476,796	450,941
Revenue from gas sales		259,228	235,534
Other operating income	5	1,308,109	1,389,835
TOTAL OPERATING INCOME		11,889,352	10,815,498
Electricity purchase cost		(2,995,645)	(2,504,385)
Fuel costs		(2,827,850)	(2,504,597)
Staff cost	6	(1,804,925)	(1,645,229)
Depreciation and amortization expense		(1,654,886)	(1,592,366)
Other operating expenses	7	(2,316,767)	(2,364,116)
TOTAL OPERATING EXPENSES		(11,600,073)	(10,610,693)
PROFIT FROM OPERATIONS		289,279	204,805
Finance revenue	8	114,402	97,930
Finance costs	8	(355,872)	(195,744)
NET FINANCIAL LOSS		(241,470)	(97,814)
PROFIT BEFORE TAX		47,809	106,991
Income tax expense	9	(16,712)	(80,985)
PROFIT FROM OPERATIONS		31,097	26,006
ATTRIBUTABLE TO:			
Equity holder		11,655	3,814
Minority interest		19,442	22,192
		31,097	26,006

The accompanying notes form an integral part of these consolidated financial statements.
Signed on behalf of the Company on 08 May 2009 by:



Ivan Mravak
President of the Board



Darko Dvornik
Member of the Board

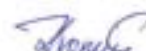
Consolidated Balance Sheet – HEP Group
As at 31 December 2008

ASSETS	Notes	31 DECEMBER 2008	31 DECEMBER 2007
		HRK'000	HRK'000
NON-CURRENT ASSETS			
Property, plant and equipment	10	23,227,513	22,587,104
Capital work in progress	10	3,370,610	3,021,148
Intangible assets	11	78,650	85,715
Investment property	12	211,074	73,462
Prepayments for tangible assets	13	448,642	490,609
Investment in NPP Krško	14	1,609,598	1,609,752
Long-term loan receivables and deposits	16	2,416	2,449
Other non-current assets	17	270,875	107,519
Deferred tax assets	9	66,568	62,477
		29,285,946	28,040,235
CURRENT ASSETS			
Inventories	18	1,369,704	1,079,826
Trade receivables	19	1,419,114	1,227,288
Other short-term receivables	20	366,462	556,322
Cash and cash equivalents	21	194,213	166,512
		3,349,493	3,029,948
TOTAL ASSETS		32,635,439	31,070,183

The accompanying notes form an integral part of these consolidated financial statements.
Signed on behalf of the Company on 08 May 2009 by:



Ivan Mravak
President of the Board



Darko Dvornik
Member of the Board

Consolidated Balance Sheet
As at 31 December 2008

CAPITAL AND LIABILITIES	Notes	31 DECEMBER 2008	31 DECEMBER 2007
		HRK'000	HRK'000
Share capital	22	19,792,159	19,792,159
Capital reserves	22	(2,035,890)	(2,035,736)
Retained earnings	22	267,155	256,690
EQUITY ATTRIBUTABLE TO EQUITY HOLDER		18,023,424	18,013,113
Minority interest	15	106,821	122,064
TOTAL EQUITY		18,130,245	18,135,177
Long-term borrowings	23	3,098,473	2,928,740
Long-term liabilities to the state	24	62,710	66,061
Long-term provisions	26	422,000	511,317
Liabilities under securities	27	1,197,070	1,196,590
Other long-term liabilities	28	4,369,412	3,792,602
TOTAL NON-CURRENT LIABILITIES		9,149,665	8,495,310
Trade payables		2,609,773	2,579,830
Current portion of long-term borrowings	23	943,099	612,485
Short-term borrowings	29	1,122,054	905,449
Taxes payable		130,327	123,987
Interest payable		48,465	42,646
Liabilities to employees	30	129,831	108,843
Other payables	31	371,980	66,456
TOTAL CURRENT LIABILITIES		5,355,529	4,439,696
TOTAL CAPITAL AND LIABILITIES		32,635,439	31,070,183

The accompanying notes form an integral part of these consolidated financial statements.
Signed on behalf of the Company on 08 May 2009 by:



Ivan Mravak
President of the Board



Darko Dvornik
Member of the Board

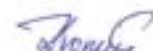
Consolidated Statement of Changes in Equity - HEP Group
For the year ended 31 December 2008

	SHARE CAPITAL	CAPITAL RESERVES	RETAINED EARNINGS/ (ACCUMULATED LOSSES)	EQUITY ATTRIBUTABLE TO THE EQUITY HOLDER OF THE PARENT	MINORITY INTEREST	TOTAL EQUITY
	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000
BALANCE AT 31 DECEMBER 2007	19,792,159	(2,031,587)	252,876	18,013,448	137,670	18,151,118
Minority interest	-	-	-	-	(25,008)	(25,008)
Distribution of dividend to RWE	-	-	-	-	(12,540)	(12,540)
Profit for the year	-	-	3,814	3,814	22,192	26,006
Exchange differences	-	(4,149)	-	(4,149)	(250)	(4,399)
BALANCE AT 31 DECEMBER 2007	19,792,159	(2,035,736)	256,690	18,013,113	122,064	18,135,177
Refit for HROTE	-	-	(768)	(768)	-	(768)
Deffered asset	-	-	(422)	(422)	-	(422)
Minority interest	-	-	-	-	(22,192)	(22,192)
Distribution of dividend to RWE	-	-	-	-	(12,416)	(12,416)
Profit for the year	-	-	11,655	11,655	19,442	31,097
Exchange differences	-	(154)	-	(154)	(77)	(231)
BALANCE AT 31 DECEMBER 2008	19,792,159	(2,035,890)	267,155	18,023,424	106,821	18,130,245

The accompanying notes form an integral part of these consolidated financial statements.
Signed on behalf of the Company on 08 May 2009 by:



Ivan Mravak
President of the Board



Darko Dvornik
Member of the Board

Consolidated Cash Flow Statement – HEP Group
For the year ended 31 December 2008

	2008	2007
	HRK'000	HRK'000
CASH FLOWS FROM OPERATING ACTIVITIES		
Profit for the year	31,097	26,006
Income tax expense recognised in profit	16,712	80,985
Net financial loss	241,470	97,814
Deferred tax (assets)/liabilities	4,514	(66,563)
(Gains) / losses on derivatives	(2,953)	591
Depreciation and amortization	1,654,886	1,592,366
Losses from decrease in inventory and equipment	14,391	35,744
Inventory surpluses	(11,933)	-
Increase in investment property	(133,533)	-
Increase in provisions for doubtful receivables	(78,024)	(17,878)
Increase in provisions	(89,317)	(456,515)
Operating cash flows before movements in working capital	1,647,310	1,292,550
(Increase) / decrease in trade receivables	(113,802)	113,902
Increase in inventories	(289,878)	(124,376)
(Increase)/decrease in other current assets	189,860	(240,636)
Increase in trade payables	29,943	868,822
Increase / (decrease) in other liabilities	277,134	(122,352)
Increase / (decrease) in liabilities to employees	20,988	(76,717)
Increase / (decrease) in tax liabilities	40,549	(56,974)
Increase in long-term liabilities	584,887	615,737
CASH GENERATED FROM OPERATIONS	2,386,991	2,269,956
Income taxes paid	(21,226)	(14,423)
NET CASH FROM OPERATING ACTIVITIES	2,365,765	2,255,533
INVESTING ACTIVITIES		
Interest received	8,053	4,150
Profit distributions from subsidiaries	12,039	49,366
Increase in property, plant and equipment	(2,644,229)	(3,077,040)
Decrease/(increase) in other non-current assets	(125,293)	14,003
Change in minority interest	(15,243)	(15,606)
NET CASH USED IN INVESTING ACTIVITIES	(2,764,673)	(3,025,127)

■ Consolidated Cash Flow Statement – HEP Group
For the year ended 31 December 2008

	2008	2007
	HRK'000	HRK'000
FINANCING ACTIVITIES		
Repayments of borrowings	(1,785,511)	(1,921,194)
Interest paid	(223,842)	(173,955)
New bank loans raised	2,458,690	2,943,647
NET CASH FROM FINANCING ACTIVITIES	449,337	848,498
NET INCREASE IN CASH AND CASH EQUIVALENTS	50,429	78,904
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	166,512	159,599
Effect of changes in exchange rates	(22,728)	(71,991)
CASH AND CASH EQUIVALENTS AT END OF YEAR	194,213	166,512

The accompanying notes form an integral part of these consolidated financial statements.
Signed on behalf of the Company on 08 May 2009 by:



Ivan Mravak
President of the Board



Darko Dvornik
Member of the Board

Notes to the financial statements of the HEP Group For the year ended 31 December 2008

1. GENERAL

Hrvatska elektroprivreda Group (the 'Group') consists of the parent company Hrvatska elektroprivreda d.d., Zagreb ('HEP', the 'Parent Company' or the 'Company') and the subsidiaries listed in Note 35.

HEP d.d. is registered in Zagreb, Ulica grada Vukovara 37. The principal activities of HEP Group are the generation, transmission and distribution of electricity, and the control of the electric power systems. In addition to these main activities, HEP Group deals with the production and distribution of thermal power through the district heating systems in Zagreb and Osijek, and the distribution of gas in Osijek and Đakovo.

All the Group's activities are governed by applicable laws, regulations and decisions issued by the Croatian Government.

At 31 December 2008, the number of staff employed by the Group was 14,348 (31 December 2007: 14,269).

These financial statements are presented in Croatian Kuna (HRK) since that is the currency in which the majority of the Group's transactions are denominated.

ENERGY LAWS

On 3 December 2004, the Croatian Parliament ratified the amendments to the following laws: The Energy Law, the Law on Electricity Market and the Law on the Regulation of Energy Activities.

The subsidiaries and HEP d.d. continue their regulated activities as public services companies for tariff-based customers: production of electricity, transmission of electricity, distribution of electricity, organizing electricity market and supplying of electricity to tariff-based customers.

Production and supply of electricity to eligible buyers and trading on the energy market are done as market activities.

Supply of electricity for eligible customers (corporate customers) is performed according to rules governing market relations, which allow these customers to purchase electricity in a free market. Tariff-based customers are supplied with electricity in the system of obligatory public services in accordance with prices from the tariff system for electricity.

According to the Law on the Amendments to the Energy Law from December 2004, the Croatian Energy Regulatory Agency ("CERA") was to prepare a methodology for determining the tariff systems for different customers within two years.

In December 2006, the CERA published the tariff models for regulated electricity activities: The Electricity Generation Tariff Model, with the exemption of eligible customers, with no tariff item amounts; The Electricity Transmission Tariff Model, with no tariff item amounts. The Electricity Distribution Tariff Model, with no tariff amounts; and the Electricity Supply Tariff Model, with the exemption of eligible customers, with no tariff amounts. The Group applied the model in the preparation of the financial statements for the year ended 31 December 2007 and for the period January – June 2008.

In June 2008, the Government of the Republic of Croatia promulgated a Decision on the The Electricity Generation Tariff Model, with the exemption of eligible customers, with no tariff item amounts; The Electricity Transmission Tariff Model, with no tariff item amounts; The Electricity Distribution Tariff Model, with no tariff amounts; and the Electricity Supply Tariff Model, with the exemption of eligible customers, with no tariff amounts. The Company has been applying the tariff models since 1 July 2008.

According to the new laws, HEP restructured its operations, by forming separate companies, for electricity generation, transmission, distribution, power supply management, and electricity market management, all of which commenced their respective business activities on 1 July 2002. HEP is obligated to adjust the organization of the Group in accordance with these amended laws.

LAW ON THE PRIVATISATION OF HEP D.D.

The Law on the Privatisation of Hrvatska Elektroprivreda d.d. was passed on 25 March 2002. According to the Law, the privatisation of HEP is to be carried out as follows: 7% of its shares are to be transferred to Croatian war veterans without consideration, 7% of the shares will be sold to the Company's present and former employees, minimum 15% of the shares will be sold by way of public offering first to the Croatian citizens and then to domestic and foreign legal entities. The remaining shares will be sold in the capital markets. The Republic of Croatia will retain direct ownership over 51% of HEP's shares until the admission of the Republic of Croatia to the European Union. After the admission, separate laws may be passed to further privatise the shares held by the state. To date, HEP remains fully owned by the Republic of Croatia and the privatisation process has still not yet begun.

Notes to the financial statements of the HEP Group
For the year ended 31 December 2008

GOVERNANCE AND MANAGEMENT

ASSEMBLY OF HEP D.D

The Assembly consists of the members representing the interests of the HEP d.d:

MILJENKO PAVLAKOVIĆ, B.Sc.ECON.

PRESIDENT

Member since Februar 14, 2008

VLADIMIR VRANKOVIĆ, B.E.E.

PRESIDENT

Member since 2004 until February 14, 2008

SUPERVISORY BOARD OF HEP D.D.

Members of Supervisory Board:

LEO BEGOVIĆ, B.E.E.

PRESIDENT

Member since 28 April 2008

PROFESSOR KREŠIMIR ČOSIĆ, D. SC.

MEMBER

Member since 28 April 2008

DASENKO BALDASARI, B.E.E.

MEMBER

Member since 28 April 2008

LUCIANO DELBIANCO, D. SC.

MEMBER

Member since 28 April 2008

ZDENKO JURIČIĆ, B.L.L.

MEMBER

Member since 28 April 2008

SLAVKO KONFIC

MEMBER

Member since 28 April 2008

JADRANKO BERLENGI, B.L.L.

MEMBER

Member since 03 June 2008

Notes to the financial statements of the HEP Group
For the year ended 31 December 2008

Members of Supervisory Board in 2007:

<p>ŽELJKO TOMŠIĆ, D. SC. PRESIDENT Member since 2006 until March 2008</p>	<p>PROFESSOR KREŠIMIR ČOSIĆ, D. SC. MEMBER Member since 2004 until March 2008</p>	<p>ZDENKO JURČIĆ, B.L.L. MEMBER Member since 2004 until March 2008</p>
<p>DASENKO BALDASARI, B.E.E. MEMBER Member since 2004 until March 2008</p>	<p>LUCIANO DELBIANCO, D. SC. MEMBER Member since 2004 until March 2008</p>	<p>FRANC FERENČAK, ENG. MEMBER Member since 2004 until March 2008</p>

Management Board:

<p>M. SC. IVAN MRAVAK PRESIDENT Member since 2004</p>	<p>ŽELJKO KLJAKOVIĆ-GAŠPIĆ, B.E.E. MEMBER Member since 1 March 2008</p>	<p>DARKO DVORNIK, D. SC. MEMBER Member since 1 March 2008</p>
<p>STJEPAN TVRDI NIĆ, B.E.E. MEMBER Member since 18 March 2008</p>	<p>ŽELJKO TOMŠIĆ, D. SC. MEMBER Member since 29 April 2008</p>	<p>NIKOLA RUKAVINA, B.E.E. MEMBER Member since 29 April 2008</p>

Management Board 2007:

<p>ANTE DESPOT, B.E.E. MEMBER Member from 2004 until 29 February 2008</p>	<p>M. SC. IVICA TOLJAN MEMBER Member from 2004 until 29 February 2008</p>	<p>IVO ČOVIĆ, B.E.E. MEMBER Member from 2004 until 29 February 2008</p>
<p>M. SC. KAŽIMIR VRANKIĆ MEMBER Member from 2004 until 29 February 2008</p>	<p>M. SC. VELIMIR LOVRIĆ MEMBER Member from 2004 until 29 February 2008</p>	

Notes to the financial statements of the HEP Group
For the year ended 31 December 2008

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A summary of the Groups's principal accounting policies which have been applied consistently in the current year and with the prior year, is set out below.

PRESENTATION OF THE FINANCIAL STATEMENTS

The financial statements have been prepared in accordance with International Financial Reporting Standards as published by the International Accounting Standards Board. The financial statements have been prepared on the historical cost basis, except for certain financial instruments that are presented at revalued amounts. The financial statements are presented in thousands of Croatian Kuna (HRK'000), since that is the currency in which the majority of the Company's transactions are denominated.

The financial statements have been prepared under the going-concern assumption.

BASIS OF ACCOUNTING

The Group maintains its accounting records in the Croatian language, in Croatian kuna and in accordance with Croatian law and the accounting principles and practices observed by enterprises in Croatia. The accounting records of the Company's subsidiaries in Croatia and abroad are maintained in accordance with the requirements of the respective local jurisdictions.

ADOPTION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS

STANDARDS AND INTERPRETATIONS EFFECTIVE IN THE CURRENT PERIOD

In 2007, the Company has adopted IFRS 7 "Financial Instruments: Disclosures" which is effective for annual reporting periods beginning on or after 1 January 2007, and the consequential amendments to IAS 1 "Presentation of Financial Statements".

The impact of the adoption of IFRS 7 and the changes to IAS 1 has been to expand the disclosures provided in these financial statements regarding the Company's financial instruments and management of capital.

The eight interpretations issued by the International Accounting Standards Board (the IASB) are effective for the current period and they are as follows: IFRIC 7 "Applying the Restatement Approach under IAS 29, Financial Reporting in Hyperinflationary Economies"; IFRIC 8 "Scope of IFRS 2"; IFRIC 9 "Reassessment of Embedded Derivatives"; IFRIC 10 "Interim Financial Reporting and Impairment"; IFRIC 11 "IFRS 2: Group and Treasury Share Transactions" – effective for annual reporting periods beginning on or after 1 March 2007; IFRIC 12 "Service Concession Arrangements" - effective for annual reporting periods beginning on 1 January 2008; IFRIC 14 "IAS 19: The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction" - effective for annual reporting periods beginning on or after 1 January 2008 and IFRIC 13 "Customer Loyalty Programs" - effective for annual reporting periods beginning on or after 1 July 2008.

Adoption of those interpretations did not cause changes in Accounting policies of the Company.

Notes to the financial statements of the HEP Group
For the year ended 31 December 2008

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

ADOPTION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS

STANDARDS AND INTERPRETATIONS IN ISSUE NOT YET ADOPTED

At the date of authorization of these financial statements, the following Standards and Interpretations were in issue but not yet effective:

IFRS 2	SHARE-BASED PAYMENT	Annual periods beginning
	— Amendment relating to vesting conditions and cancellations	on or after 1 January 2009
IFRS 3	BUSINESS COMBINATIONS	Annual periods beginning
	— Comprehensive revision on applying the acquisition method	on or after 1 January 2009
IFRS 5	NON-CURRENT ASSETS HELD FOR SALE AND DISCONTINUED OPERATIONS	Annual periods beginning
	— Amendments resulting from May 2008 Annual Improvements to IFRSs	on or after 1 January 2009
IFRS 8	OPERATING SEGMENTS	Annual periods beginning
		on or after 1 January 2009
IAS 1	PRESENTATION OF FINANCIAL STATEMENTS	Annual periods beginning
	— Comprehensive revision including requiring a statement of comprehensive income	on or after 1 January 2009
IAS 1	PRESENTATION OF FINANCIAL STATEMENTS	Annual periods beginning
	— Amendments relating to disclosure of puttable instruments and obligations arising on liquidation	on or after 1 January 2009
IAS 1	PRESENTATION OF FINANCIAL STATEMENTS	Annual periods beginning
	— Amendments resulting from May 2008 Annual Improvements to IFRSs	on or after 1 January 2009
IAS 16	PROPERTY, PLANT AND EQUIPMENT	Annual periods beginning
	— Amendments resulting from May 2008 Annual Improvements to IFRSs	on or after 1 January 2009
IAS 19	EMPLOYEE BENEFITS	Annual periods beginning
	— Amendments resulting from May 2008 Annual Improvements to IFRSs	on or after 1 January 2009
IAS 20	GOVERNMENT GRANTS AND DISCLOSURE OF GOVERNMENT ASSISTANCE	Annual periods beginning
	— Amendments resulting from May 2008 Annual Improvements to IFRSs	on or after 1 January 2009
IAS 23	BORROWING COSTS	Annual periods beginning
	— Comprehensive revision to prohibit immediate expensing	on or after 1 January 2009
IAS 23	BORROWING COSTS	Annual periods beginning
	— Amendments resulting from May 2008 Annual Improvements to IFRSs	on or after 1 January 2009
IAS 27	CONSOLIDATED AND SEPARATE FINANCIAL STATEMENTS	Annual periods beginning
	— Amendment relating to cost of an investment on first-time adoption	on or after 1 January 2009
IAS 27	CONSOLIDATED AND SEPARATE FINANCIAL STATEMENTS	Annual periods beginning
	— Amendments resulting from May 2008 Annual Improvements to IFRSs	on or after 1 January 2009
IAS 28	INVESTMENTS IN ASSOCIATES	Annual periods beginning
	— Consequential amendments arising from amendments to IFRS 3	on or after 1 January 2009
IAS 28	INVESTMENTS IN ASSOCIATES	Annual periods beginning
	— Amendments resulting from May 2008 Annual Improvements to IFRSs	on or after 1 January 2009
IAS 29	FINANCIAL REPORTING IN HYPERINFLATIONARY ECONOMIES	Annual periods beginning
	— Amendments resulting from May 2008 Annual Improvements to IFRSs	on or after 1 January 2009

Notes to the financial statements of the HEP Group
For the year ended 31 December 2008

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

ADOPTION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS (CONTINUED)

STANDARDS AND INTERPRETATIONS IN ISSUE NOT YET ADOPTED (CONTINUED)

At the date of authorization of these financial statements, the following Standards and Interpretations were in issue but not yet effective:

IAS 31	INTERESTS IN JOINT VENTURES	Annual periods beginning
	— Consequential amendments arising from amendments to IFRS 3	on or after 1 January 2009
IAS 31	INTERESTS IN JOINT VENTURES	Annual periods beginning
	— Amendments resulting from May 2008 Annual Improvements to IFRSs	on or after 1 January 2009
IAS 32	FINANCIAL INSTRUMENTS: PRESENTATION	Annual periods beginning
	— Amendments relating to puttable instruments and obligations arising on liquidation	on or after 1 January 2009
IAS 36	IMPAIRMENT OF ASSETS	Annual periods beginning
	— Amendments resulting from May 2008 Annual Improvements to IFRSs	on or after 1 January 2009
IAS 38	INTANGIBLE ASSETS	Annual periods beginning
	— Amendments resulting from May 2008 Annual Improvements to IFRSs	on or after 1 January 2009
IAS 39	FINANCIAL INSTRUMENTS: RECOGNITION AND MEASUREMENT	Annual periods beginning
	— Amendments resulting from May 2008 Annual Improvements to IFRSs	on or after 1 January 2009
IAS 39	FINANCIAL INSTRUMENTS: RECOGNITION AND MEASUREMENT	Annual periods beginning
	— Amendments for eligible hedged items	on or after 1 January 2009
IAS 40	INVESTMENT PROPERTY	Annual periods beginning
	— Amendments resulting from May 2008 Annual Improvements to IFRSs	on or after 1 January 2009
IAS 41	AGRICULTURE	Annual periods beginning
	— Amendments resulting from May 2008 Annual Improvements to IFRSs	on or after 1 January 2009
IFRIC 15	AGREEMENTS FOR THE CONSTRUCTION OF REAL ESTATE	Annual periods beginning
		on or after 1 January 2009

The Management anticipates that all of the above Standards and Interpretations will be adopted in the Company's financial statements for the period commencing 1 January 2009, and after, and that the adoption of those Standards and Interpretations will have no material impact on the financial statements of the Company in the future periods except for IAS 31 which relates to interests in joint ventures.

Management Board has adopted alternative method of IAS 23 in previous periods and will continue to capitalize borrowing costs.

Notes to the financial statements of the HEP Group
For the year ended 31 December 2008

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

BASIS OF THE PREPARATION OF THE GROUP FINANCIAL STATEMENTS

The financial statements of the Group represent aggregate amounts of the Company's assets, liabilities, capital and reserves at 31 December 2008, and the results of its operations for the year then ended. All internal balances and transactions have been eliminated.

PRINCIPLES AND METHODS OF CONSOLIDATION

The consolidated financial statements incorporate the financial statements of HEP d.d. and entities controlled by HEP d.d. (its subsidiaries). A listing of the Group's subsidiaries is provided in Note 35. Control is achieved where HEP d.d. has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with those used by other members of the Group.

All intra-group transactions, balances, income and expenses are eliminated on consolidation.

Minority interests in the net assets of consolidated subsidiaries are identified separately from the Group's equity therein. Minority interests consist of the amount of those interests at the date of the original business combination and the minority's share of changes in equity since the date of the combination. Losses applicable to the minority in excess of the minority's interest in the subsidiary's equity are allocated against the interests of the Group except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses.

INVESTMENTS IN ASSOCIATES

An associate is an entity over which the Group is in a position to exercise significant influence, but not control or joint control, through participation in the financial and operating policy decisions of the investee.

The results and assets and liabilities of associates are incorporated in these consolidated financial statements using the equity method of accounting except when classified as held for sale in accordance with IFRS 5 Non-current Assets Held For Sale and Discontinued Operations. Investments in associates are carried in the consolidated balance sheet at cost as adjusted by post-acquisition changes in the Group's share of the net assets of the associate, less any impairment in the value of individual investments. Losses of an associate in excess of the Group's interest in that associate (which includes any long-term interests that, in substance, form part of the Group's net investment in the associate) are not recognised, unless the Group has incurred legal or constructive obligations or made payments on behalf of the associate.

Any excess of the cost of acquisition over the Group's share of the fair values of the identifiable net assets of the associate at the date of acquisition is recognised as goodwill. Goodwill is included in net book value of investments and is tested for impairment as part of investment. Any deficiency of the cost of acquisition below the Group's share of the fair values of the identifiable net assets of the associate at the date of acquisition is credited to profit and loss in the period of acquisition.

Where the Group transacts with its associate, profits and losses are eliminated to the extent of the Group's interest in the relevant associate.

Notes to the financial statements of the HEP Group
For the year ended 31 December 2008

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

INVESTMENTS IN JOINTLY CONTROLLED ENTITIES

Jointly controlled entities are entities where control is shared with other parties through contractual arrangements and are included in the Group accounts using the method of proportionate consolidation.

Where a group entity undertakes its activities under joint venture arrangements directly, the Group's share of jointly controlled assets and any liabilities incurred jointly with other venturers are recognised in the financial statements of the relevant entity and classified according to their nature. Liabilities and expenses incurred directly in respect of interests in jointly controlled assets are accounted for on an accrual basis. Income from the sale or use of the Company's share of the output of jointly controlled assets, and its share of joint venture expenses, are recognised when it is probable that the economic benefits associated with the transactions will flow to/from the Company and their amount can be measured reliably.

Joint venture arrangements that involve the establishment of a separate entity in which each venturer has an interest are referred to as jointly controlled entities. The Group reports its interests in jointly controlled entities using proportionate consolidation. The Group's share of the assets, liabilities, income and expenses of jointly controlled entities are combined with the equivalent items in the consolidated financial statements on a line-by-line basis. Where the Group transacts with its jointly controlled entities, unrealised profits and losses are eliminated to the extent of the Group's interest in the joint venture.

REPORTING CURRENCY

The Company's and the Group's financial statements are prepared in Croatian kuna (HRK). As at 31 December 2008, the official exchange rates for EUR 1 and USD 1 were HRK 7,32 and HRK 5,16, respectively (at 31 December 2007: EUR 1 = HRK 7,33 and USD 1 = HRK 4,99). Average middle exchange rate of CNB in year 2008 was EUR 1 = 7,23 and USD 1 = 4,91. (In year 2007 EUR 1 = 7,34 and USD 1 = 5,37).

RETIREMENT AND OTHER EMPLOYEE BENEFIT COSTS

The Group has no defined post-retirement benefit plans for its employees or management in Croatia or abroad. Accordingly, no provision for these costs has been included.

Legal pension and health insurance contributions are paid on behalf of the Group's employees in the Republic of Croatia. This obligation applies to all staff hired on the basis of employment contract. The contributions are paid at a certain percentage determined on the basis of gross salary.

	2008
Pension insurance contributions	20%
Health insurance contributions	15%
Employment Fund contribution	1.7%
Occupational injury	0.5%

The Group companies have the obligation to withhold the pension insurance contributions from the employees' gross salaries.

Contributions on behalf of the employer and the employees are recognised as cost in the period in which they are incurred (see Note 7).

The Group provides employees with jubilee and one off retirement awards. The obligation and costs of these benefits are determined using a projected unit credit method. The Projected Unit Credit Method considers each period of service as giving rise to an additional unit of benefit entitlement and measures each unit separately to build up the final obligation. The pension obligation is measured at the present value of estimated future cash flows using a discount rate that is similar to the interest rate on high-quality corporate bonds quoted in the Republic of Croatia where the currency and terms of the government bonds are consistent with the currency and estimated terms of the benefit obligation.

Notes to the financial statements of the HEP Group
For the year ended 31 December 2008

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are carried at cost less accumulated depreciation and any impairment losses, except for land, which is carried at cost.

The estimated useful lives, residual values and depreciation methods are reviewed at each year end, with the effect of any changes in estimate.

Fixed assets in use are depreciated using the straight-line method on the following bases:

	2008
BUILDINGS	
Hydroelectric power plants (Dams, embankments, buildings and other structures and facilities)	20 – 50 years
Thermal power plants (Buildings and other structures)	33 – 50 years
Electricity transmission and distribution plants and facilities (Transmission lines and buildings of transformer stations, switch-yard and dispatch centers)	20 – 40 years
Water and steam pipelines and other thermal power generation and transmission plants and facilities	33 years
Gas pipelines	20 - 25 years
Administrative buildings	50 years
PLANT AND EQUIPMENT	
Hydroelectric power plants	10 – 33 years
Thermal power plants	6 – 25 years
Electricity transmission plants and facilities (electric parts of transformer stations and transformers; and electric parts of transmission lines)	15 – 40 years
Electricity distribution plants and facilities (electric parts of transformer stations and transformers, electric parts of distribution lines, measuring instruments, meters and other equipment)	8 – 40 years
Thermal power stations, hot-water pipelines and other equipments	15 – 30 years
Gas meters and other gas network equipment	5 – 20 years
OTHER EQUIPMENT AND VEHICLES	
IT equipment	5-20 years
Software licences	5 years
Telecommunications equipment	5 – 20 years
Motor vehicles	5 – 8 years
Office furniture	10 years

Notes to the financial statements of the HEP Group
For the year ended 31 December 2008

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

PROPERTY, PLANT AND EQUIPMENT (CONTINUED)

In 2008, the Company reviewed the useful lives of its non-current assets as provided in IAS 16. During 2007, considering the development of new technologies, as well as the global practice in estimating the useful lives of power plants and structures, the Company established that the useful lives of the canals, hydro power plants, production equipment at the power plants, transformer stations and grids should be extended. A decrease in the useful life of office furniture from 15 to 10 years was suggested.

The initial cost of property, plant and equipment contain the purchase price, including all customs duties and non-refundable taxes and all costs directly attributable to bringing an asset to the condition and location for its intended use. Expenditures incurred after the property, plant and equipment have been put into use are charged to expense the period in which they are incurred.

In situations where it can be clearly demonstrated that the expenditures have resulted in an increase in the future economic benefits expected to be obtained from the use of an item of property, plant and equipment beyond its originally assessed standard performance, the expenditures are capitalised as an additional cost of property, plant and equipment. Costs eligible for capitalization include costs of periodic, planned significant inspections and overhauls necessary for further operation.

The gain or loss arising from disposal or withdrawal of property, plant and equipment is determined as the difference between the gains on sale and the carrying amount of the asset and are credited and charged, respectively, to the income statement.

IMPAIRMENT OF TANGIBLE AND INTANGIBLE ASSETS

Items of tangible and intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Whenever the carrying amount of an asset exceeds its recoverable amount, an impairment loss is charged to the income statement.

At each balance sheet date, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Intangible assets with indefinite useful lives and intangible assets not yet available for use are tested for impairment annually, and whenever there is an indication that the asset may be impaired.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

The net selling price is the amount obtainable from the sale of an asset in an arm's length transaction less the cost of disposal, while value in use is the present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life. Recoverable amounts are estimated for individual assets or, if it is not possible, for the relevant cash-generating unit.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised immediately in profit or loss, unless the relevant asset is land or a building other than an investment property carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (cash-generating unit) in prior years. A reversal of an impairment loss is recognised immediately in profit or loss, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

Notes to the financial statements of the HEP Group
For the year ended 31 December 2008

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

INTANGIBLE ASSETS

Intangible fixed assets include patents, trade marks and licences and are carried at cost less accumulated amortisation. Amortisation is provided on a straight-line basis over a period from 5 to 20 years.

INVESTMENT PROPERTY

Investment properties, which is property held to earn rentals and/or for capital appreciation, are stated at fair value according best estimate of management. Fair value is assessed based on estimated market prices as of balance sheet date. Gains and losses arising from the changes in the fair value of investment properties are included in the income statement for the period in which they arise. During 2008, Group has changed its accounting policy in relation to investment property from cost model to fair value mode.

FINANCE AND OPERATING LEASES

The Group has no finance lease arrangements and no significant operating lease agreements were entered into during 2008 and 2007. Amounts payable under operating leases are recognised as expense on a straight-line basis over the term of the relevant lease, unless there is another systematic basis that would be more representative of the time pattern of the user's benefit.

TRADE DEBTORS AND PREPAYMENTS

Trade receivables are carried at invoiced amounts. Since 1 July 2002, the subsidiary HEP Distribucija d.o.o. has been providing electricity distribution services, keeping record and collecting the related receivables from tariff-based customers, and HEP Opskrba d.o.o. has been providing electricity distribution services to eligible customers for the account of HEP d.d. since 26 February 2003.

The risk of collectability of receivables from the sale of electricity is borne by HEP d.d., and an allowance for bad and doubtful receivables is made based on the estimate of HEP's management. All trade debtors in bankruptcy and receivables claimed through court are fully written off.

Management provides for doubtful receivables based on a review of the overall ageing of all receivables and a specific review of significant individual amounts receivable.

As the collectability of certain receivables over a longer term is not certain, the Company makes an allowance for unrecoverable amounts, based on a reasonable estimate and past experience, in order to write down or write off those amounts as follows:

AGEING OF PAST DUE	WRITE DOWN IN PERCENTAGE
61 – 90 days	5%
91-120 days	10%
121-365 days	20%
Over one year	100%

Outstanding receivables claimed through court and those not included in bankruptcy estate (the principal debt and interest) are fully written off, regardless of the number of past due days. Such write-offs are charged to value adjustment of assets and credited to the allowance account on short-term receivables.

Notes to the financial statements of the HEP Group
For the year ended 31 December 2008

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

INVENTORIES

Inventories consist mainly of material and small inventory, and are carried at the lower of weighted average cost less value adjustment for obsolete and excessive inventories and net realisable value. Management provides for doubtful receivables based on a review of the overall ageing of all receivables and a specific review of significant individual amounts receivable.

Cost includes invoiced price and other costs directly attributable to bringing inventories to their present location and condition.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents comprise cash on hand and demand deposits with banks and other short-term highly liquid investments that are readily convertible to a known amount of cash and are subject to an insignificant risk of changes in value.

BORROWING COSTS

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale. Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalisation.

All other borrowing costs are recognised in the statement of income in the period in which they are incurred. Short-term borrowings and supplier loans are recorded at original amount granted less repayment. Interest expense is charged to income statement on an accrual basis.

FOREIGN CURRENCIES

The individual financial statements of each Company and the Group entity are presented in the currency of the primary economic environment in which the entity operates (its functional currency). For the purpose of the consolidated financial statements, the results and financial position of each Group entity are expressed in Croatian kunas (HRK), which is the functional currency of the Company and the presentation currency for the consolidated financial statements.

In preparing the financial statements of the individual Group entities, transactions in currencies other than the entity's functional currency (foreign currencies) are translated to the functional currency of the entity at the rates of exchange prevailing on the dates of the transactions. At each balance sheet date, monetary items denominated in foreign currencies are retranslated to the functional currency of the entity at the year-end rates. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing on the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences arising on the settlement of monetary items, and on the retranslation of monetary items, are included in profit or loss for the period. Exchange differences arising on the retranslation of non-monetary items carried at fair value are included in profit or loss for the period as finance cost except for differences arising on the retranslation of non-monetary assets available for sale, in respect of which gains and losses are recognised directly in equity. For such non-monetary items, any exchange component of that gain or loss is also recognised directly in equity.

For the purpose of presenting consolidated financial statements, the assets and liabilities of the Group's foreign operations are expressed in Croatian kuna using exchange rates prevailing at the balance sheet date. Income and expense items (together with the corresponding figures) are translated at the average exchange rates for the period, unless exchange rates fluctuated significantly during that period, in which case the exchange rates at the dates of the transactions are used. Exchange differences arising on the year-end translation, if any, are classified as equity and recognised in the Group's foreign currency translation reserve. Such exchange differences are recognised in profit or loss in the period in which the foreign operation is disposed of.

Notes to the financial statements of the HEP Group
For the year ended 31 December 2008

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

TAXATION

The tax expense represents the sum of the tax currently payable and deferred tax.

CURRENT TAX

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Company's and the Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

DEFERRED TAX

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences, and deferred tax assets are generally recognised for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised on the basis of taxable temporary differences on investments in subsidiaries and associates and joint ventures, unless the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset realised, based on tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date. The measurement of deferred tax liabilities and assets reflects the amount in which the Group expects, at the reporting date, to recover or settle the carrying amount of its assets and liabilities.

CURRENT AND DEFERRED TAX FOR THE PERIOD

Current and deferred tax are recognised as an expense or income in profit or loss, except when they relate to items credited or debited directly to equity, in which case the tax is also recognised directly in equity, or where they arise from the initial accounting for a business combination.

In the case of a business combination, the tax effect is taken into account in calculating goodwill or in determining the excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over cost.

Notes to the financial statements of the HEP Group
For the year ended 31 December 2008

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

FINANCIAL ASSETS

Investments are recognised and derecognised on a trade date where the purchase or sale of an investment is under a contract whose terms require delivery of the investment within the timeframe established by the market concerned, and are initially measured at fair value, net of transaction costs, except for those financial assets classified as at fair value through profit or loss, which are initially measured at fair value.

Financial assets are classified into as “assets available for sale“ and “loans and receivables“. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

EFFECTIVE INTEREST METHOD

The effective interest method is a method of calculating the amortised cost of a financial asset and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset, or, where appropriate, a shorter period.

Income is recognised on an effective interest basis for debt instruments.

FINANCIAL ASSETS AVAILABLE FOR SALE

Unlisted shares held by the Company and the Group that are traded in an active market are classified as being AFS and are stated at fair value. Fair value is determined in the manner described in Note 24. Gains and losses arising from changes in fair value are recognised directly in equity in the investments revaluation reserve with the exception of impairment losses, interest calculated using the effective interest method and foreign exchange gains and losses on monetary assets, which are recognised directly in profit or loss. Where the investment is disposed of or is determined to be impaired, the cumulative gain or loss previously recognised in the investments revaluation reserve is included in profit or loss for the period.

Dividends on AFS equity instruments are recognised in profit or loss when the Group’s right to receive the dividends has been established.

The fair value of AFS financial assets denominated in a foreign currency is determined in that foreign currency and translated at the spot rate at the balance sheet date. The change in fair value attributable to translation differences that result from a change in amortised cost of the asset is recognised in profit or loss, and other changes are recognised in equity. As of 31 December 2008, the Company remeasured the Jadranski Naftovod shares at fair value. The fair value of the share has been determined in the amount of HRK 2,800, which is the amount at which the shares have been booked in the Company’s accounts. The fair value has been determined using discounted cash flow projections in accordance with the adopted 2009 Business Plan of Jadranski naftovod and by reference to the trends derived from the historical data about the operations of Jadranski naftovod.

Notes to the financial statements of the HEP Group
For the year ended 31 December 2008

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

FINANCIAL ASSETS (CONTINUED)

LOANS AND RECEIVABLES

Trade receivables, loans, and other receivables with fixed or regular payments that are not quoted in an active market are classified as loans and receivables. Loans and receivables are measured at amortised cost using the effective interest method, less any impairment. Interest income is recognised by applying the effective interest rate, except for short-term receivables when the recognition of interest would be immaterial.

IMPAIRMENT OF FINANCIAL ASSETS

Financial assets are assessed for indicators of impairment at each balance sheet date. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been impacted. For financial assets carried at amortised cost, the amount of the impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate. The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables, where the carrying amount is reduced through the use of an allowance account. When a trade receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognised in profit or loss. With the exception of AFS equity instruments, if, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

In respect of AFS equity securities, any increase in fair value subsequent to an impairment loss is recognised directly in equity.

INVESTMENTS

Investments in immaterial non-consolidated companies are generally recorded at cost less provisions for any impairment.

FINANCIAL LIABILITIES

Financial liabilities are classified as other financial liabilities.

Other financial liabilities, including borrowings, are initially measured at fair value, net of transaction costs.

Other financial liabilities are subsequently measured at amortised cost using the effective interest method, with interest expense recognised on an effective yield basis.

The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or, where appropriate, a shorter period.

The Group derecognises financial liabilities when, and only when, the Group's obligations are discharged, cancelled or have expired.

DERIVATIVE FINANCIAL INSTRUMENTS

During 2008 and 2007, the Company had no derivative financial instruments.

Notes to the financial statements of the HEP Group
For the year ended 31 December 2008

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

PROVISIONS

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event and it is probable (i.e. more likely than not) that an outflow of resources will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. Provisions are reviewed at each balance sheet date and adjusted to reflect the current best estimate. Where the effect of discounting is material, the amount of the provision is the present value of the expenditures expected to be required to settle the obligation. Where discounting is used, the increase in provisions that reflects the passage of time is recognized as interest expense.

USE OF ESTIMATES IN THE PREPARATION OF THE FINANCIAL STATEMENTS

The preparation of financial statements in conformity with International Reporting Financial Standards, as published by the International Accounting Standards Board requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, income and expenses and disclosure of contingencies. The significant areas of estimation used in the preparation of the accompanying financial statements relate to employee benefits, useful lives of property, plant and equipment, impairment of assets and determination of fair values of assets and liabilities, and estimated decommissioning costs. Future events may occur which will cause the assumptions used in arriving at the estimates to change. The effect of any changes in estimates will be recorded in the financial statements, when determinable.

REVENUE RECOGNITION

Revenue is earned primarily from the sale of electricity to households, industrial and other users within Croatia.

These sales constitute the main source of the Group's operating income.

The revenue for the period July - December 2008 was recognised on the basis of the Decision of the Croatian Government on the tariffs from June 2008.

Electricity sales are recognised based on the management's best estimate of the actual consumption of the energy delivered to customers.

Interest income is recognised on an accrual basis, by reference to the principal settled and at the effective interest rate applied.

SEGMENTAL DISCLOSURES

The Group has adopted not to present all required segmental information, since the equity instruments of the Group are not traded on public markets.

Notes to the financial statements of the HEP Group
For the year ended 31 December 2008

3. CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES

CRITICAL JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

In the application of the accounting policies, which are described in Note 2, the management made certain judgements that had a significant impact on the amounts reported in the financial statements (irrespective of the underlying estimates referred to below).

These judgements are provided in detail in the accompanying notes. However, the critical judgements relate to the following areas:

USEFUL LIVES OF PROPERTY, PLANT AND EQUIPMENT

As described in Note 2, the Company reviews the estimated useful lives of property, plant and equipment at the end of each annual reporting period.

FAIR VALUE OF FINANCIAL ASSETS AND INTEREST-RATE SWAP

As described in Note 19, the management uses judgement to estimate whether trade and other receivables have suffered an impairment loss. The management believes that the carrying amount of the interest-rate swap approximates its fair value as disclosed in Note 25.

PROVISIONS FOR ENVIRONMENTAL PROTECTION

The exact scope of activities or technologies to be applied has not been specified by the applicable laws or regulations. In determining the level of provisions for environmental protection and decommissioning, the management relies on the prior experience and its own interpretation of the current laws and regulations. Pursuant to Article 4.1 of the Law on Acknowledging the Contract between the Government of the Republic of Croatia and the Government of the Republic of Slovenia on Regulating the Status and other Legal Relations in Respect of Investments in, Exploitation and Decommissioning of, the Nuclear Power Plant Krško (Official Gazette No. 9/2002), the Croatian Government issued on 28 April 2006 a decree on the payment of the funds for the decommissioning and disposal of radioactive waste and consumed nuclear fuel of the NPP Krško.

The decommissioning costs of thermal power plants represent the discounted value of the estimated decommissioning costs of the Group's thermal power plants.

IMPAIRMENT OF NON-CURRENT ASSETS

The impairment calculation requires the estimate of the value in use of the cash generating units. Value in use is measured using the discounted cash flow projections. The most significant variables in determining cash flows are discount rates, time values, the period of cash flow projections, as well as assumptions and judgements used in determining cash receipts and expenditure. There were no impairments of assets of the Company that would result from the projections described above.

The Company engaged an independent firm to appraise the fair value of NPP Krško d.o.o. as of 31 December 2007. In determining the fair value, all technical and technological, as well as economic and market characteristics of the power plant were taken into account. Accordingly, the fair value represents the discounted free cash flow as a free net category (the difference between income and expenses) attributable to the investors. The appraised fair value of the NPP Krško was significantly higher than its carrying amount and, as a result, the provision of HRK 263,181 thousand, included in the balance sheet as at 31 December 2006, was reversed and credited to income in the current year.

AVAILABILITY OF TAXABLE PROFITS AGAINST WHICH THE DEFERRED TAX ASSETS COULD BE RECOGNISED

A deferred tax asset is recognized only to the extent that it is probable that the related tax benefit will be realized. In determining the amount of deferred taxes that can be recognised are required, which are based on the probable quantification of time and level of future taxable profits, together with the future tax planning strategy. The carrying amounts of deferred tax assets at 31 December 2008 and 31 December 2007 amounted to HRK 4,514 thousand and HRK (66,563) thousand, respectively (see Note 9).

Notes to the financial statements of the HEP Group
For the year ended 31 December 2008

3. CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES (CONTINUED)

ACTUARIAL ESTIMATES USED IN DETERMINING THE RETIREMENT BONUSES (CONTINUED)

The cost of defined benefits is determined using actuarial estimates. Actuarial estimates involve assumptions about discount rates, future salary increases and the mortality or fluctuation rates. Because of the long-term nature of those plans, there is uncertainty surrounding those estimates. Provisions for jubilee awards and retirement bonuses amounted to HRK 245,247 thousand and HRK 230,161 thousand at 31 December 2008 and 31 December 2007, respectively (see Note 26).

CONSEQUENCES OF CERTAIN LEGAL ACTIONS

There is a number of legal actions involving the Group, which have arisen from the regular course of their operations. The management makes estimates when the probable outcome of the legal action has been estimated, and the provisions are recognised on a consistent basis (see Note 26).

The principal accounting policies applied in the preparation of the financial statements for the year 2008 are consistent with those applied in the prior year, unless stated otherwise.

REMEASUREMENT OF THE JANAF SHARES AND INVESTMENT PROPERTY AT FAIR VALUE

During 2008, the Company remeasured the Jadranski naftovod shares and the investment properties at fair value.

Gains resulting from the fair valuation of the investment property amount to HRK 133,533 thousand.

The fair value of the share has been determined in the amount of HRK 2,800, which is the amount at which the shares have been booked in the Company's accounts. The fair value has been determined using discounted cash flow projections in accordance with the adopted 2009 Business Plan of Jadranski naftovod and by reference to the trends derived from the historical data about the operations of Jadranski naftovod.

Notes to the financial statements of the HEP Group
For the year ended 31 December 2008

4. SEGMENT INFORMATION

The Group generates income from its operations in a single geographical area – the Republic of Croatia.

The Group's reportable segments are separated as follows: electricity (generation, distribution and sale of electricity), heating (distribution and sale of thermal power), and gas (distribution and sale of gas).

Each segment's operating profit or loss includes all revenue and expenses directly attributable to the reporting business segments. Information about segment financial income/expense and income tax is not provided on a segment level, as the segments are disclosed based on operating profit.

	ELECTRICITY		HEATING		GAS		GROUP	
	2008	2007	2008	2007	2008	2007	2008	2007
	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000
Revenue	11,082,854	10,057,069	523,387	502,094	283,111	256,335	11,889,352	10,815,498
RESULT FROM OPERATIONS	460,655	308,142	(181,464)	(101,858)	10,088	(1,479)	289,279	204,805
Finance cost							(241,470)	(97,814)
Income tax							(16,712)	(80,985)
NET PROFIT							31,097	26,006

Segment assets consist primarily of property, plant and equipment, receivables, cash and inventories. Segment liabilities consist of trade and other payables. Non-segment assets and liabilities consist of assets and liabilities that cannot be reasonably attributed to the reporting business segments.

Total unallocated assets include investments in NPP Krško, a part of property, plant and equipment, and unallocated financial assets. Total unallocated liabilities include long-term loans, short-term loans and various other liabilities.

	TOTAL SEGMENT ASSETS		TOTAL SEGMENT LIABILITIES	
	2008	2007	2008	2007
	HRK'000	HRK'000	HRK'000	HRK'000
Electricity	26,972,901	25,865,750	7,420,066	7,047,886
Heating	989,017	1,005,080	286,571	278,341
Gas	266,045	272,134	135,871	154,305
Unallocated	4,407,476	3,927,219	6,662,686	5,454,474
GROUP	32,635,439	31,070,183	14,505,194	12,935,006

Notes to the financial statements of the HEP Group
For the year ended 31 December 2008

5. OTHER OPERATING INCOME

	2008	2007
	HRK'000	HRK'000
Services rendered	237,689	234,979
Capitalised assets	182,605	186,125
Income from assets received free of charge	178,208	137,662
Subsequent collection of receivables previously provided against	167,488	62,636
Gains on remeasurement of investment properties at fair value	133,533	-
Late-payment interest	81,787	54,787
Income from sale of materials	67,395	42,343
Rental income – electricity sales facilities	45,955	61,793
Income from electricity in transit – foreign	39,837	51,266
Recovery of receivables previously written off	19,334	15,954
Income in respect of the electricity bill reminders	14,073	12,004
Income from reversal of long-term provisions for retirement benefits and jubilee awards	14,038	61,498
Income from reversal of long-term provisions – court costs	12,321	55,838
Inventory surplus – fixed assets	11,933	2,314
Income from sale of tangible assets	7,931	29,719
Income in respect of court costs on claims	6,948	6,243
Income from reversal of long-term decommissioning provision	3,020	43,014
Income from reversal of long-term provisions for benefits under Collective Agreement	1,467	15,549
Income in respect on the settlement to write-off debt	1,355	12,764
Income from reversal of long-term provisions for the value adjustment of NPPK	-	263,181
Other	81,192	40,166
	1,308,109	1,389,835

Included in Subsequent collection of receivables previously provided against is the amount of HRK 151,147 thousand in respect of the initial recognition of the Jadranski Naftovod shares at fair value, which the Group received for the purpose of settlement of certain past due receivables (see Note 17).

In 2008, the Group changed its accounting policy in respect of the valuation of its investment property from the cost model to the fair value model. The Company has not applied the change in the accounting policy retrospectively because of the lack of information about the fair value of the properties in previous periods.

The gains on remeasurement of the investment properties at fair value amount to HRK 133,533 thousand.

Notes to the financial statements of the HEP Group
For the year ended 31 December 2008

6. STAFF COSTS

	2008	2007
	HRK'000	HRK'000
Net salaries	1,074,508	984,349
Taxes and contributions	730,417	660,880
	1,804,925	1,645,229

TOTAL STAFF COSTS	2008	2007
	HRK'000	HRK'000
Gross salaries	1,804,925	1,645,229
Reimbursement of costs to employees (Note 7)	153,393	145,851
Employee benefits (Note 7)	65,962	112,758
	2,024,280	1,903,838

DIRECTORS' AND EXECUTIVES REMUNERATION:	2008	2007
	HRK'000	HRK'000
Gross salaries	6,416	7,792
Pension contributions	1,400	1,478
Benefits in kind	1,082	1,095
	8,898	10,365

Reimbursement of costs to employees includes commutation allowances in the amount of HRK 90,009 thousand (2007: HRK 80,477), daily allowances and travelling expenses in the amount of HRK 26,191 thousand (2007: HRK 29,619 thousand), additional health insurance amounting to HRK 14,807 thousand (2007: HRK 14,974 thousand) and other similar expenses.

Employee benefit costs include benefits under Collective Agreement and consists primarily of Christmas and Easter allowance, solidarity support, jubilee awards, family separation allowances and fieldwork bonuses, holiday bonuses, child benefits and other in the total amount of HRK 52,807 thousand (2007: HRK 56,895 thousand).

Notes to the financial statements of the HEP Group
For the year ended 31 December 2008

7. OPERATING EXPENSES

	2008	2007
	HRK'000	HRK'000
Maintenance costs (service and material)	504,310	536,803
General and administrative expenses	464,016	470,800
Gas costs	216,051	199,069
Cost of material	157,154	160,851
Other employee benefits (Note 6)	153,393	145,851
Provisions for doubtful receivables	110,148	119,896
Contributions to the State	109,106	100,712
NPP Krško – valuation of investment	103,882	104,448
Other material employee's rights (Note 6)	65,962	112,758
Distributions and concession for water	60,764	54,989
Fee for enviromental protection	57,933	26,316
Purchase value of sold materials	56,057	37,029
Fee for the usage of power plant facilities	43,306	43,417
Write-off of non claimed receivables	32,876	23,355
Calculation and collection costs	31,823	29,577
Provisions for retirement bonuses and jubilee awards	29,124	884
Insurance premiums	26,027	26,207
Development costs	15,612	20,056
Write-off of tangible assets	14,391	38,997
Information costs	8,735	10,762
Damages and indemnities	8,197	10,138
Litigation provisions	8,132	15,968
Fees and subscriptons	4,229	4,074
Disposal of equity investment	-	6,220
Other	35,539	64,939
	2,316,767	2,364,116

Notes to the financial statements of the HEP Group
For the year ended 31 December 2008

8. FINANCE REVENUE AND COSTS

	2008	2007
	HRK'000	HRK'000
FINANCIAL INCOME		
Foreign exchange gains	106,349	93,189
Interest expense	8,053	4,150
Fair value of interest rate swap	-	591
TOTAL FINANCIAL INCOME	114,402	97,930
FINANCE COSTS		
Interest expense	(220,208)	(170,276)
Foreign exchange losses	(129,077)	(21,789)
Amortization of deferred interest	(3,634)	(3,679)
Fair value of interest swap	(2,953)	-
Total financial expenses	(355,872)	(195,744)
NET FINANCE LOSS	(241,470)	(97,814)

Notes to the financial statements of the HEP Group
For the year ended 31 December 2008

9. INCOME TAX

	2008	2007
	HRK'000	HRK'000
Current taxes	21,226	14,422
Deferred tax expense/(income) relating to the origination and reversal of temporary differences	(4,514)	66,563
INCOME TAX EXPENSE	16,712	80,985

Adjustments to deferred tax assets were as follows:

	2008	2007
	HRK'000	HRK'000
Balance at 1 January	62,477	129,071
Restatement - HROTE	-	(32)
Reversal of deferred tax assets	(2,703)	(70,033)
Deferred tax assets recognised	6,794	3,471
BALANCE AT 31 DECEMBER	66,568	62,477

Deferred tax assets have arisen on provisions for jubilee awards and regular retirement benefits not recognised for tax purposes, provisions for trade debtors – households, provisions for the NPP Krško and provisions for legal actions.

9. INCOME TAX HRK 000

The reconciliation between income tax and profit reported in the income statement is set out below:

	2008	2007
	HRK'000	HRK'000
Profit before taxation	47,809	106,991
INCOME TAX AT THE APPLICABLE RATE OF 20%	9,562	21,398
Tax disallowable expense/(income)	2,524	(25,479)
Tax effect	4,514	(66,563)
Tax effect of losses brought forward	(194,026)	(1,362)
Tax effect of Group entities operating with loss	194,138	152,991
TAX EXPENSE FOR THE YEAR	16,712	80,985

The Group and its subsidiaries are subject to income tax separately, according to the tax laws and regulations of the Republic of Croatia. Other subsidiaries in the Group reported total tax losses of HRK 536,269 thousand (2007: HRK 587,003 thousand), while the Group recorded a total income tax expense of HRK 21,226 thousand (2007: HRK 14,422 thousand) and reported deferred tax assets in the amount of HRK 4,514 thousand for the current year and HRK 66,563 thousand for prior years.

Tax losses are available for carry forward and offsetting against the tax base in future taxation periods until their expiration as prescribed by law, which is 5 years following the year in which the tax losses were incurred.

Tax losses reported by the Group and their expiry are presented below:

YEAR OF LOSS ORIGINATION	TOTAL TAX LOSS REPORTED BY THE GROUP	YEAR OF EXPIRY
HRK'000		
2004	23,233	2009
2005	62,449	2010
2006	60,664	2011
2007	195,865	2012
2008	194,058	2013
	536,269	

Notes to the financial statements of the HEP Group
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9. INCOME TAX (CONTINUED)

As of 31 December 2008 and 2007 the Group did not recognise deferred tax assets arising from tax losses carried forward at certain subsidiaries because the availability of future taxable profit against which the unused tax losses can be utilized is not certain.

The Croatian Tax Authorities have not performed a review of the income tax returns of the Company and its subsidiaries. In accordance with local regulations, the Tax Authority may at any time inspect the books and records of any Group company within 3 years following the year in which the tax liability is reported and may impose additional tax assessments and penalties. The Group management is not aware of any circumstances that may give rise to a potential material liability in this respect.

The following table summarizes the movement in deferred tax assets during the year:

HRK'000	UNBILLED REVENUE	PROVISIONS FOR JUBILEE AND RETIREMENT BENEFITS	VALUE ADJUSTMENT – NPP KRŠKO	LITIGATION PROVISION	DEPRECIATION AT RATES ABOVE STATUTORY RATES	OTHER	TOTAL
At 1 January 2007	24,864	56,120	34,168	11,103	1,190	1,626	129,071
Restatement - HROTE	-	(31)	-	-	-	-	(31)
Credited to profit and loss for the year	(24,864)	(5,318)	(34,168)	(2,841)	581	47	(66,563)
At 31 December 2007	-	50,771	-	8,262	1,771	1,673	62,477
Credited to profit and loss for the year	-	5,093	-	(554)	663	(1,111)	4,091
At 31 December 2008	-	55,864	-	7,708	2,434	562	66,568

Notes to the financial statements of the HEP Group
For the year ended 31 December 2008

10. PROPERTY, PLANT AND EQUIPMENT

HRK'000	LAND AND BUILDINGS	FIXTURES AND EQUIPMENT	ASSETS UNDER CONSTRUCTION	TOTAL
COST				
AT 1 JANUARY 2007	31,411,575	27,688,280	2,600,388	61,700,243
Restatement – HROTE	-	(1,473)	-	(1,473)
Transfers	(44,470)	11,535	4,699	(28,236)
Additions	-	-	3,037,226	3,037,226
Transfers from assets under construction	1,037,966	1,655,033	(2,692,999)	-
Capitalized interests	-	-	74,833	74,833
Disposals	(89,265)	(225,186)	(2,999)	(317,450)
AT 31 DECEMBER 2007	32,315,806	29,128,189	3,021,148	64,465,143
Restatement 01 January 2008	(5,154)	(54)	-	(5,208)
Transfers	(140,858)	140,013	894	49
Additions	8,509	83,773	2,405,184	2,497,466
Transfers from assets under construction	870,275	1,313,360	(2,202,731)	(19,096)
Capitalized interests	-	-	146,763	146,763
Inventory surplus	8,461	8,724	-	17,185
Disposals	(65,088)	(207,016)	(648)	(272,752)
AT 31 DECEMBER 2008	32,991,951	30,466,989	3,370,610	66,829,550

Notes to the financial statements of the HEP Group
For the year ended 31 December 2008

10. PROPERTY, PLANT AND EQUIPMENT (CONTINUED)

	LAND AND BUILDINGS	FIXTURES AND EQUIPMENT	ASSETS UNDER CONSTRUCTION	TOTAL
HRK'000				
ACCUMULATED DEPRECIATION				
AT 1 JANUARY 2007	19,402,744	18,163,488	-	37,566,232
Restatement - HROTE	-	(791)	-	(791)
Transfers	(32,284)	33,471	-	1,187
Charge for the year	671,107	895,189	-	1,566,296
Value adjustment of additions	2,776	9,759	-	12,535
Eliminated on disposal	(71,543)	(217,025)	-	(288,568)
AT 31 DECEMBER 2007	19,972,800	18,884,091	-	38,856,891
Restatement at 01 January 2008	(550)	-	-	(550)
Transfers	(84,700)	84,178	-	(522)
Charge for the year	685,294	941,926	-	1,627,220
Impairment losses	1,315	1,168	-	2,483
Value adjustment of additions	146	212	-	358
Eliminated on disposal	(61,283)	(198,369)	-	(259,652)
Inventory surplus	126	5,073	-	5,199
AT 31 DECEMBER 2008	20,513,148	19,718,279	-	40,231,427
CARRYING AMOUNT				
AT 31 DECEMBER 2008	12,478,803	10,748,710	3,370,610	26,598,123
AT 31 DECEMBER 2007	12,343,006	10,244,098	3,021,148	25,608,252

Disposals from capital work in progress during 2008 in the amount of HRK 12,647 thousand (2007: HRK 2,999 thousand) represent write-offs based on the estimate of management that no future economic benefits will be derived from those assets.

Due to political developments in Croatia since 1990, certain local municipal land registers have not been fully established. The company is in the process of registering, through the local courts in Croatia, its title to land and buildings. To date, no claims have been made against the company concerning its title to these assets.

The Group has pledged property, plant and equipment having a carrying amount of approximately HRK 942,360 thousand (2007: HRK 959,361 thousand) to secure the banking facilities provided to TE Plomin d.o.o.

Notes to the financial statements of the HEP Group
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11. INTANGIBLE ASSETS

	HRK'000
COST	
At 1 January 2007	522,612
Transfers	(7,800)
Additions	38,600
Disposals	(7,663)
At 1 January 2008	545,749
Transfers	(49)
Additions	19,096
Disposals	(371)
At 31 December 2008	564,425
ACCUMULATED AMORTISATION	
At 1 January 2007	448,923
Transfers	(4,480)
Charge for the year	23,254
Disposals	(7,663)
At 1 January 2008	460,034
Transfers	-
Charge for the year	26,081
Disposals	(340)
At 31 December 2008	485,775
CARRYING AMOUNT	
At 31 December 2008	78,650
At 31 December 2007	85,715

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12. INVESTMENT PROPERTY

	RESIDENTIAL BUILDINGS	RECREATIONAL FACILITIES	TOTAL
	HRK'000	HRK'000	HRK'000
COST			
At 1 January 2007	87,341	40,566	127,907
Transfers	-	810	810
Additions	1,026	188	1,214
Disposals	(8,541)	-	(8,541)
At 31 December 2007	79,826	41,564	121,390
Reconstruct at 1 January 2008.	-	(15,271)	(15,271)
Other additions	-	2,001	2,001
Disposals	(1,218)	-	(1,218)
At 31 December 2008	78,608	28,294	106,902
ACCUMULATED DEPRECIATION			
At 1 January 2007	26,470	20,117	46,587
Transfers	-	397	397
Charge for the year	1,620	1,004	2,624
Disposals	(1,680)	-	(1,680)
At 31 December 2007	26,410	21,518	47,928
Reconstruct at 01 January 2008	-	(20,200)	(20,200)
Transfers	53	-	53
Charge for the year	1,514	66	1,580
At 31 December 2008	27,977	1,384	29,361
CARRYING AMOUNT			
At 31 December 2008	50,631	26,910	77,541
At 31 December 2007	53,416	20,046	73,462

Notes to the financial statements of the HEP Group
For the year ended 31 December 2008

12. INVESTMENT PROPERTY (CONTINUED)

As of 31 December 2008, investment properties comprise properties held for the purpose of generating earnings from rental and or capital appreciation, and are carried at the management's best estimate of fair value. The fair value comprises the estimated market price at the balance sheet date. All the investment properties are owned by the Company.

AT FAIR VALUE	31 DECEMBER 2008	31 DECEMBER 2007
	HRK'000	HRK'000
Opening balance at cost	73,462	81,320
Increase on subsequent capital investments	1,948	1,627
Disposals	3,711	(6,861)
Depreciation charge for the year	(1,580)	(2,624)
Net book value at 31 December 2008	77,541	73,462
Net gains on remeasurement at fair value	133,533	-
Closing balance at fair value	211,074	73,462

Notes to the financial statements of the HEP Group
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13. PREPAYMENTS FOR FIXED ASSETS

	31 DECEMBER 2008	31 DECEMBER 2007
	HRK'000	HRK'000
Electricity facilities on the Croatian highways - Hrvatske autoceste	300,000	300,000
JSC Tehnopromexport –TE Sisak	59,976	57,998
Litostroj Slovenija	11,333	11,500
Končar Inženjering d.d. – HE Lešće	20,672	37,859
TPK-EPO Proizvodnja d.o.o.	10,768	-
Ingra d.d. – HE Lešće	6,493	14,645
Konstruktor Inženjering	3,919	14,851
Others	35,481	53,756
	448,642	490,609

In December 2006, the Company advanced a payment to Hrvatske ceste for the purpose of acquisition of electricity facilities on the Croatian highways within 2 years from the advance payment.

As of the date of these financial statements, the facilities were not transferred to the Company, and an agreement was concluded with Hrvatske autoceste in November 2008, under which the deadline for the takeover of the electricity facilities by the Company has been prolonged for another year.

The Company's management are confident that the electricity facilities will be transferred to the Company by 31 December 2009.

Notes to the financial statements of the HEP Group
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14. INVESTMENT IN THE NUCLEAR POWER PLANT KRŠKO

	31 DECEMBER 2008	31 DECEMBER 2007
	HRK'000	HRK'000
Opening balance	1,609,752	1,613,901
Negative exchange difference (charged to capital reserves)	(154)	(4,149)
	1,609,598	1,609,752

INVESTMENT BACKGROUND

The legal status of the Nuclear Power Plant Krško ("NPP Krško") was regulated by inter-republic agreement dating back to 1970 and various agreements between the founders from 1974 and 1982. Pursuant to the stated agreements, the Company had a 50% interest in the NPP Krško in Slovenia, the other 50% was held by ELES GEN d.o.o., Ljubljana, the legal successor of the Slovenian power utility.

In 1998, the Slovene government passed a decree transforming the Nuclear Power Plant Krško into a public company, NPPK d.o.o. ("NPPK"), and nationalizing the nuclear power plant. Additionally, due to operational disputes, which include disagreements on energy prices to be charged and approval of annual budgets, the supply of power to HEP from NPPK was cut on 31 July 1998 and was not restored until 19 April 2003. The absence of power from NPPK has been compensated by increased generation from other HEP generation facilities and increased imports.

In late 2001, the Governments of the Republic of Croatia and the Republic of Slovenia signed an agreement governing the status and other legal relations in connection with their respective investment in NPPK, usage and decommissioning, as well as a partnership agreement between HEP and ELES GEN. This agreement was ratified by the Croatian parliament during 2002, and it came into effect as at 11 March 2003, following the ratification by the Slovene parliament on 25 February 2003.

The agreement acknowledges the ownership rights of HEP in the newly formed company, Nuklearna elektrana Krško d.o.o. ("NPPK") in respect to its 50% holding in NPPK, which were previously denied. Both parties have agreed to extend the useful life of the power plant at least to the year 2023. The agreement also regulates that the produced electricity is supplied 50:50 to both contracting parties, and that the price of the electricity supplied is determined based on total production cost.

HEP started to receive electricity from NPPK on 19 April 2003, and expects to receive 2,550 GWh annually up to 2023, representing 16% of electricity consumption in Croatia.

By the end of 2003, the provisions of the agreement have been implemented according to which HEP and NPPK waive mutual receivables for damages and withdraw all claims arising there from up to 30 June 2002, including the disputed liabilities for electricity purchase and amounts due with respect to the previously calculated contribution for financing the decommissioning of the power plant and funds to cover the losses from previous years. After implementing the changes, the capital of NPPK as at 31 December 2003 amounted to SIT 84.7 billion (approximately: HRK 2.8 billion). Still there are some outstanding off-balance receivables from HEP to NPPK and Slovenia from the past, which do not have any influence on the current business relations.

CURRENT STATUS

According to the above stated agreement, the decommissioning of NPP will be a joint obligation of both parties. Each party will provide half of the funds necessary to prepare the decommissioning plan and to cover the cost of implementation of the plan. In addition, each party will form a separate fund to allocate the funds for this purpose in the amounts estimated by the decommissioning plans. When the Croatian parliament accepts the decommissioning programme (including radioactive waste disposal), it is expected that a Croatian fund for gathering decommissioning funds and for nuclear waste management will be incorporated. The amount of annual payments to be made to the Fund will be determined taking into account the decommissioning programme. From 2004 to 2008, the Company disclosed radioactive waste disposal and decommissioning provisions in the amount of HRK 521,295 thousand, and paid HRK 358,838 thousand on a separate account in the period from 2006 to 2008. Thus, the balance at 31 December 2008 amounts to HRK 162,457 thousand, of which HRK 47,647 thousand are long-term, HRK 62,624 are current and HRK 52,186 thousand represent a short-term liability for the year 2008 (Notes 26 and 31).

Notes to the financial statements of the HEP Group
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14. INVESTMENT IN THE NUCLEAR POWER PLANT KRŠKO (CONTINUED)

The investment in NPPKis accounted for using the equity method and amounts to HRK 1,609,598 thousand. The negative foreign exchange difference arising on recalculating the capital from the company's investment amounting to HRK 154 thousand was charged to capital reserves.

EXTRACTED FINANCIAL INFORMATION

The following table presents the financial information extracted from the financial statements of NPPK as at 31 December 2008 and 2007:

	31 DECEMBER 2008	31 DECEMBER 2007
	HRK'000	HRK'000
Property, plant and equipment	3,103,205	3,188,505
Capital and reserves	3,219,196	3,219,505
Gross sales	1,029,480	945,820
Net profit	-	490
Cash flows from operating activities	224,498	133,442

Until 2007, the Company valued its investment in NE Krško d.o.o. by comparing the difference between the price of electricity supplied from the NE Krško d.o.o., plus decommissioning costs and loan expense in respect of the NPP Krško, and the electricity imported, on one hand, and 1/19 of the investment value, on the other hand and charging the lower of the two prices to expense. In 2007, the Company engaged an independent firm that appraised the fair value of the investment in NE Krško d.o.o. In determining the fair value, all technical and technological, as well as economic and market characteristics of the power plant were taken into account. Accordingly, the fair value represents the discounted free cash flow as a free net category (the difference between income and expenses) attributable to the investors.

Notes to the financial statements of the HEP Group
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15. INVESTMENT IN PLOMIN

In November 1996, HEP entered into a Joint Venture Agreement with RWE Energie Aktiengesellschaft, Germany ('RWE') regarding the completion and operation of TPP Plomin II. Consequently, a joint venture, TE Plomin d.o.o. ('Plomin') was formed in December 1996, with each partner holding 50 % of the equity of the new entity. A number of agreements were entered into, which regulate the relationship between the joint venture partners and their respective relationships with the new groups.

In accordance with the 1996 Asset Contribution Agreement, HEP contributed property, plant and equipment previously acquired for the project valued (by Croatian valuation experts) at DEM 50,000 thousand (HRK 179,138 thousand) as a contribution in kind to Plomin. Of this amount, HRK 50 thousand was allocated as share capital, while HRK 179,088 thousand was allocated to reserves. In accordance with the Joint Venture Agreement, RWE contributed an equal amount of cash over the period of construction. The initial cash contribution of HRK 50 thousand was allocated as share capital and the remainder to reserves. The RWE capital contributed is distributed back to RWE over the term of the joint venture of 15 years, starting from the date of operation of the power plant at 30 April 2000.

In 2008 the distribution of RWE invested equity amounted to HRK 12,416 thousand (2007: HRK 12,540 thousand). The remaining undistributed RWE invested capital amounted to HRK 87 million at 31 December 2008 (2007: HRK 100 million).

Under the Statute of Plomin, RWE is entitled to an annual return during the term of the joint venture of 14% to 17% on invested capital (based on the actual number of hours of peak exploitation during the year). The invested capital includes RWE undistributed equity contribution as the unpaid portion of the accrued cumulative interest earned on investment during construction.

During the period of construction, the accrued cumulative interest on the RWE capital amounted to HRK 54,717 thousand (EUR 7,536 thousand) and is payable on a straight-line basis during the period of exploitation. At 31 December 2008, accrued undistributed interest amounted to HRK 23,306 thousand (2007: HRK 26,988 thousand).

The RWE annual return on invested capital, effectively a preferred dividend, is paid out from net profit of Plomin. The rate in 2007 and 2006 was 17%. The amount paid out in 2007 in respect of 2006 profits was HRK 25,008 thousand and in 2006 HRK 27,879 thousand in respect of 2005 profits. In 2005, HRK 37,499 thousand was paid in respect of 2004 profits.

These distributions have priority to HEP's interest in the results of the joint venture and any other payments to HEP. Since HEP's share has been used to pay RWE interest on capital since 2000, HEP has not realized any portion of profits earned by Plomin.

The joint venture partners entered into a number of agreements necessary for power plant operations, including: operation and maintenance agreements, a joint use and supply agreement and a power purchase agreement ('PPA'). The PPA agreement regulates the sale of electric energy to the Company by Plomin d.o.o. HEP is obliged to purchase all energy produced by TE Plomin d.o.o. at prices calculated in accordance with specified formulas in the PPA, which are designed to cover all costs of operations of Plomin, and ensure the guaranteed return on capital to RWE.

In these financial statements, the Group has presented its interest in TE Plomin using the method of full consolidation.

Notes to the financial statements of the HEP Group
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16. LONG-TERM LOAN RECEIVABLES AND DEPOSITS

	31 DECEMBER 2008	31 DECEMBER 2007
	HRK'000	HRK'000
Loans given	2,552	3,107
Current portion of loans given	(136)	(658)
LONG-TERM PORTION	2,416	2,449

Loans given to third parties:

	YEAR LOAN APPROVED	REPAYMENT PERIOD	LOAN AMOUNT	31 DECEMBER 2008	31 DECEMBER 2007
				HRK'000	HRK'000
Town of Sisak	2005	3 years	4,810	-	134
Town of Pregrada	2006	10 years	1,358	1,358	1,358
Vrni d.o.o.	2007	3 years	247	164	247
Did d.o.o.	2007	4 years	1,010	715	968
Others				315	400
TOTAL				2,552	3,107
Current portion				(136)	(658)
NON CURRENT PORTION				2,416	2,449

Notes to the financial statements of the HEP Group
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17. OTHER NON-CURRENT ASSETS

	31 DECEMBER 2008	31 DECEMBER 2007
	HRK'000	HRK'000
Investments available for sale	151,374	2
Housing loan receivables	57,852	63,761
Calculated intercalary interest – RWE	23,306	26,988
Other non-current assets	38,343	16,768
	270,875	107,519

In December 2008, HEP acquired 53,981 shares of Jadranski Naftovod d.d. under a decision of the Croatian Government, with a nominal value of HRK 2,700 per share i.e. the total nominal value of HRK 145,748,700. According to the Management Decision, the Jadranski Naftovod shares were designated as available for sale. The shares were subscribed at the Central Depository Agency on 19 March 2009.

According to International Accounting Standard 29, financial assets available for sale are initially recognised at fair value and any subsequent changes in the fair value are included within equity. The Company made an independent fair value appraisal of the Jadranski Naftovod shares because of the disturbances on the capital market and discontinued trading with the Jadranski Naftovod shares in December 2008, which is allowed in accordance with the Interpretations of the International Financial Reporting Standards Interpretations Committee published in October 2008 in case of inactive markets and disturbances on capital markets.

At 31 December 2008, the fair value per Janaf Naftovod share was determined at HRK 2,800, which is the value at which the share has been included in the Company's accounts. The fair value was determined using the discounted cash flow projections in accordance with the 2009 Jadranski Naftovod Business Plan and by reference to the historical trends applicable to the performance of Jadranski Naftovod.

Prior to 1996, the Group had sold apartments it owned to its employees, the sale of which were governed by the laws of the Republic of Croatia. This property was generally sold on credit, and the related housing receivables, which are secured and bear interest at rates below market, are repayable on a monthly basis over periods of 20-35 years. Receivables for sold flats were transferred to new subsidiaries as of 1 July 2002. The housing receivables are shown in the financial statements at their discounted net present values, determined using an interest rate of 6.3 %. The state payable which represents 65% of the value of sold apartments is recorded in non-current liabilities to the state (Note 24). The receivables are secured by mortgages over the sold apartments.

Calculated intercalary interest towards RWE represents deferred interest on the funds invested by RWE in the period between the initial capital contribution and the start of operation of TPP Plomin. This amount is depreciated over 15 years.

18. INVENTORIES

	31 DECEMBER 2008	31 DECEMBER 2007
	HRK'000	HRK'000
Inventories of fuel and other material	874,495	592,713
Electric materials	182,682	205,083
Spare parts	206,342	175,599
Construction material	80,424	91,915
Other inventories	25,761	14,516
	1,369,704	1,079,826

Notes to the financial statements of the HEP Group
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19. TRADE RECEIVABLES

	31 DECEMBER 2008	31 DECEMBER 2007
	HRK'000	HRK'000
Electricity – Corporate customers	915,259	790,954
Electricity – Households	295,100	296,155
Heating, gas and services	368,757	392,167
Foreign sales	51,726	52,244
Other	28,261	13,781
	1,659,103	1,545,301
ALLOWANCE FOR BAD AND DOUBTFUL RECEIVABLES	(239,989)	(318,013)
	1,419,114	1,227,288

Ageing analysis of receivables not impaired

	31 DECEMBER 2008	31 DECEMBER 2007
	HRK'000	HRK'000
Not yet due	851,656	636,755
0-60 days	444,776	502,423
61-90 days	70,123	40,998
91-120 days	15,725	16,339
121-365 days	36,834	30,773
	1,419,114	1,227,288

Notes to the financial statements of the HEP Group
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19. TRADE RECEIVABLES (CONTINUED)

Movements in impairment allowance were as follows:

	31 DECEMBER 2008	31 DECEMBER 2007
	HRK'000	HRK'000
AT 1 JANUARY	318,013	335,891
Restated	-	10,401
AT 1 JANUARY	318,013	346,292
Provisions for potential losses (Note 7)	110,148	119,896
Reversal of prior-year provisions	(27,599)	(95,754)
Amounts collected (Note 5)	(160,573)	(52,421)
AT 31 DECEMBER	239,989	318,013

20. OTHER SHORT-TERM RECEIVABLES

	31 DECEMBER 2008	31 DECEMBER 2007
	HRK'000	HRK'000
Demand and time deposits	124,762	96,053
VAT receivable	71,725	145,275
Income tax prepayments	28,409	75,996
Receivables for Government bonds	22,639	22,563
Accrued electricity sales – households	20,157	91,059
Receivables from the State in respect of employees	12,374	10,452
Interest receivable	2,724	2,996
Other short-term receivables	83,672	111,928
	366,462	556,322

Accrued electricity sales at 31 December 2008 amounted to HRK 20,157 thousand (2007: HRK 91,059 thousand, see Note 28). In 2008, HRK 70,902 thousand were credited to income based on the underestimated electricity sales to households. The estimate is based on the calculation of losses determined using a logarithmic regression on the distribution level (HEP ODS) and the average electricity price for households without a permanent monthly fee.

Notes to the financial statements of the HEP Group
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21. CASH AND CASH EQUIVALENTS

	31 DECEMBER 2008	31 DECEMBER 2007
	HRK'000	HRK'000
Giro accounts - Kunas	142,986	130,627
Giro accounts – Foreign	44,269	29,823
Special purposes giro accounts	6,382	5,416
Petty cash registers – Kunas	566	590
Special purposes giro accounts – postal payments	10	56
	194,213	166,512

22. CAPITAL AND RESERVES

The original registration of share capital on 12 December 1994 was made in German Marks (DEM 5,784,832 thousand). On 19 July 1995, the share capital was reregistered in Croatian Kuna in the value of HRK 19,792,159 thousand. The share capital consists of 10,995,644 ordinary shares, with a nominal value of HRK 1,800 each.

In 2005 the value adjustment of the investment in NPP Krško in respect of exchange differences in the amount of HRK 63,556 thousand, HRK 7,028 thousand and HRK 4,148 thousand, respectively, was charged to equity.

At 31 December 2008, the exchange differences on NPP Krško amounted to HRK 144,821 thousand.

Retained earnings in the amount of HRK 267,155 thousand comprise prior year profits in the amount of HRK 108,130 thousand, legal reserves in the amount of HRK 147,370 thousand, profit for the year in the amount of HRK 11,655 thousand. The minority interest attributable to RWE amounts to HRK 106,821 thousand of which HRK 19,442 thousand represent dividends attributable to the foreign equity holder.

Notes to the financial statements of the HEP Group
For the year ended 31 December 2008

23. NON-CURRENT BORROWINGS

	INTEREST RATES	31 DECEMBER 2008 HRK'000	31 DECEMBER 2007 HRK'000
Domestic bank borrowings	EURIBOR+ (1,00%-2,0%)	925,036	1,029,153
Foreign bank borrowings	EURIBOR+ (0,50%-2,75%)	2,912,361	2,190,377
Liabilities to domestic companies	EURIBOR+ 1,95%	23,116	32,365
Liabilities to foreign companies (taken up via domestic banks)	EURIBOR+ 1,5%	-	-
Loan from RWE		23,306	26,988
Rescheduled debt		157,753	262,342
TOTAL LONG-TERM BORROWINGS		4,041,572	3,541,225
Current portion		(943,099)	(612,485)
LONG-TERM PORTION		3,098,473	2,928,740

Loans from domestic banks are secured by bills of exchange and promissory notes. Loans from foreign banks are partly secured by state guarantees (loan for the project of special state care, and IBRD loan) and total assets of Plomin.

During the year, around EUR 63.9 million out of a long-term loan of EUR 200 million, based on the underlying agreement concluded in 2005, was used for the financing of the L Block at Thermal Power and District Heating Plant Zagreb and Hyrdoelectric Power Plant Lešće.

Under the loan agreement, concluded with the International Bank for Reconstruction and Development, for a loan of EUR 24 million to finance the Toplinarstvo Project, EUR 3.7 million were utilised in 2008. The undrawn loan balance at 31 December 2008 amounted to EUR 12.7 million. The loan expires on 30 June 2010.

The loan agreement, concluded with the International Bank for Reconstruction and Development, for a loan of EUR 4.4 million to finance the implementation of the Energy Efficiency Project via HEP – ESCO, was concluded in 2003. The undrawn balance at 31 December 2008 was EUR 0.7 million. For the second phase of the implementation of the Energy Efficiency Project, a long-term loan agreement was concluded with OTP Bank for a loan of EUR 3 million. The undrawn balance at 31 December 2008 was EUR 1,5 million.

In December 2008, a new club loan of EUR 125 million was concluded, earmarked for the execution of the 2008 investment plan. The arrangers comprise the following banks acting as creditors: Banca Infrastrutture Inovazione e Sviluppo S.P.A. (Milan), Erstebank Group AG (Vienna), Privredna banka Zagreb d.d. and Societe Generale Group (Paris). The loan term is 5 years, and two-thirds of the principal amount are repayable in quarterly instalments, whereas the remaining third is repayable on the fifth anniversary of the date of signing the agreement, with an option to prolong the payment for another two years. The interest is determined on the basis of the reference rate of 3-month EURIBOR, plus a margin of 2.75 percent.

Notes to the financial statements of the HEP Group
For the year ended 31 December 2008

23. NON-CURRENT BORROWINGS (CONTINUED)

During 2008, negotiations with the German Development Bank continued, which presented the option to utilise a special Fund of the German Government under the International Climate Protection Initiative.

The projects nominated by HEP-ESCO d.o.o. and HEP-obnovljivi izvori energije d.o.o. received support by the competent Croatian ministries, and the Loan Agreement with KfW was concluded in December 2008 for a loan of EUR 50 million. The principal loan terms and conditions comprise: a loan utilisation period of 5 years; principal repayment on a quarterly basis over a period of 10 years upon the expiry of the utilisation period; and a fixed rate of interest equal to 6-month EURIBOR.

Liabilities to domestic and foreign companies represent mainly extended payment terms for the purchases of tangible assets. If no repayment deadline has been specified in the underlying agreement any such liability is included within long-term liabilities.

The annual principal repayment schedule for the following five years is as follows:

	AMOUNT
	HRK'000
2009	943,099
2010	817,702
2011	740,347
2012	610,406
2013	367,845
After 2013	562,173
Total	4,041,572

The covenants, as defined in the applicable loan agreements, specifically require the Company to meet certain prescribed levels of the following ratios: operating ratio, debt service coverage, internal cash generation, tangible net worth, and net borrowing.

The analysis of long-term borrowings in various foreign currencies is provided below (in '000):

CURRENCY	31 DECEMBER 2008	31 DECEMBER 2007
USD	24,559	40,845
EURO	531,325	453,486

Notes to the financial statements of the HEP Group
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23. NON-CURRENT BORROWINGS (CONTINUED)

RESCHEDULED DEBT

The status of rescheduled debt is presented below:

	AMOUNT
	HRK'000
Rescheduled Paris Club debt	84,719
Rescheduled London Club debt	73,034
TOTAL RESCHEDULED DEBT	157,753

PARIS CLUB DEBT

The rescheduling of the majority of the Paris Club debt was finalized in 1998.

For the purpose of rescheduling of the remaining Paris Club Debt, the Croatian Government signed on 16 December 2005 a bilateral agreement with the Italian Government in connection with the debt consolidation according to the Law on the Methods and Conditions for the Settlement of Loan and Other Debts with the Paris Club Member Governments (Official Gazette No. 34/1996). Following the ratification in the Parliament and the publication of the Agreement in the Official Gazette No. 01/06, the Company concluded an agreement with Erste & Steiermärkische Bank d.d., Rijeka on 31 January 2006. Under the loan agreement, 51.78 % of the total loan debt principal (EUR 999,719.99) was paid on 15 February 2006, together with all accrued interest, in order to align the terms and conditions applicable to this debt with other Paris Club Loans. The remaining portion of 48.22 % of the loan principal, or EUR 925,399.35, will be repaid by the Group in seven semi-annual instalments, with a regular interest equal to 6-month EURIBOR + 0.50%.

The last instalment under the rescheduled Paris Club Debt is due on 31 July 2009.

During 2008, interest was charged at fixed or variable rates, determined by reference to interest rates on short-term loans in the respective country of the lender, and ranged from 5.10-7.84 % at 31 December 2008 (2007: 5.23% to 7.90%).

LONDON CLUB DEBT

The rescheduling agreements for the London Club debt, which comprised 29 loans in a variety of currencies, resulted in all principal and interest being translated into US dollars at 30 June 1997 using the Croatian National Bank official rate as at that date. These rescheduled loans have a variable interest rate (six-month LIBOR + 13/16%), and the principal is repayable as follows:

Loan repayments originally due from 1 August 1996 onwards are repayable in 20 semi-annual installments, commencing 31 January 2000, with a final maturity at 31 July 2010.

Notes to the financial statements of the HEP Group
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24. LONG-TERM LIABILITIES TO THE GOVERNMENT

The long-term debt to the Government in the amount of HRK 62,710 thousand relates to the obligation arising on the sale of housing units to employees under the Government program, which was discontinued in 1996. According to the law regulating housing sales, 65% of the proceeds from the sale of apartments to employees were payable to the state at such time as the proceeds were collected. According to the law, HEP has no liability to remit the funds, unless and until they are collected from the employee.

25. DERIVATIVE FINANCIAL INSTRUMENTS

INTEREST RATE SWAP

The Group has one interest rate swap contract which hedges the Group's exposure to variable interest rate debt. Under the contract, the six-month interest rate payable by the Company is fixed at 5.39%, while the swapped interest rate is equal to the six-month EURIBOR rate, approximately 4.9931% at 31 December 2008 (2007: approximately 4.709 %).

Contract settlements are payable every six months. The contract matures on 25 October 2012. The notional principal amount of the interest rate swap contract at 31 December 2008 was EUR 20,452 thousand (2007: EUR 25,565 thousand). The fair value of the interest rate swap contract, representing a future obligation, at 31 December 2008 amounted to HRK 6,909 thousand (2007: HRK 4,702 thousand). The related deferred tax asset at 31 December 2008 amounted to HRK 1,382 thousand (2007: HRK 940 thousand).

The non-current and the current portions of the obligation are presented below:

	31 DECEMBER 2008	31 DECEMBER 2007
	HRK'000	HRK'000
Long-term portion (Note 28)	5,721	1,384
Current portion (Note 31)	1,188	3,318
	6,909	4,702

Notes to the financial statements of the HEP Group
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26. LONG-TERM PROVISIONS

	31 DECEMBER 2008	31 DECEMBER 2007
	HRK'000	HRK'000
Litigation provision	53,458	57,647
Provision for retirement bonuses	185,207	179,169
Provision for jubilee awards	60,040	50,992
Thermal power plant decommissioning provision	75,648	73,719
Other provisions	-	7,685
Provision for NPP Krško – decommissioning (note 31.)	47,647	142,105
	422,000	511,317

The thermal power plant decommissioning provision in the amount of HRK 75,648 thousand represents a discounted value of the estimated decommissioning costs of the Group's thermal power plants.

Movements in the present value of defined benefit obligations in the current period were as follows:

	LEGAL ACTIONS	RETIREMENT BONUSES	JUBILEE AWARDS	NPPK VALUATION	DECOMMISSION- ING - NPPK	DECOMMISSION ING OF TPPS	OTHER	TOTAL
HRK'000								
AT 1 JANUARY 2008	57,647	179,169	50,992	-	142,105	73,719	7,685	511,317
Current maturity	-	-	-	-	(62,624)	-	-	(62,624)
New provisions made	8,133	12,049	16,195	-	-	4,949	-	41,326
Decrease in provisions (amounts paid)	(1,455)	(6,011)	(7,140)	-	(21,862)	-	-	(36,468)
Decrease in provision on valuation	(10,867)	-	(7)	-	(9,972)	(3,020)	(7,685)	(31,551)
AT 31 DECEMBER 2008	53,458	185,207	60,040	-	47,647	75,648	-	422,000

Notes to the financial statements of the HEP Group
For the year ended 31 December 2008

26. LONG TERM PROVISIONS (CONTINUED)

Movements in the present value of defined benefit obligations in respect of employee benefits during the current period were as follows:

	RETIREMENT BENEFITS HRK'000	JUBILEE AWARDS HRK'000	TOTAL HRK'000
At 1 JANUARY 2008	179,169	50,992	230,161
Cost of services	(6,010)	(7,160)	(13,170)
Interest expenses	11,642	3,721	15,363
Benefits paid	7,249	3,147	10,396
Actuarial gains/(losses)	(6,843)	9,340	2,497
At 31 DECEMBER 2008	185,207	60,040	245,247

The following assumptions were used in preparing the calculations:

- The termination rate is 1.93 percent and is based on the statistical fluctuation rates for the Company in the period from 2005 to 2008.
- The probability of death by age and sex is based on Croatian Mortality Tables 2004 published by the Croatian Statistical Bureau. It is assumed that the population of employees of the Company represents average with respect to mortality and health status.
- We assumed the annual salary growth of 1.8 % in 2009; 1 % in 2010; and 3 % in other years.
- The average tax rate applied in calculating the termination benefits was 25%.
- The present value of the obligation was determined using a 7 % discount rate.

27. LIABILITIES UNDER CORPORATE BONDS

In prior years, HEP d.d. issued two corporate bonds in the total amount of HRK 1,200,000 thousand. The funds were used to execute the 2006 and 2007 investment plans.

The key reasons for the HEP's appearance on the domestic capital market comprise the following: reducing the level of external debt; diversifying the sources of funding; reducing the currency risk; eliminating the risk pertaining to the EURIBOR fluctuation in the next medium term; and approaching investors that will definitely play a significant role in the future activities involving the privatisation of HEP. The sponsors and arrangers were: Privredna banka Zagreb d.d., Raiffeisenbank Austria d.d. and Zagrebačka banka d.d. Zagreb.

Bonds in the amount of HRK 500,000 thousand, issued in 2006, are due in 2013, and bear interest at a fixed rate of 5.00 percent. Bonds in the amount of HRK 700,000, issued at the end of 2007, are repayable in 15 semi-annual installments, commencing three years from the date of issue, and bear interest at a fixed rate of 6.50 percent. The HEP d.d. bonds are included in the Official Quotation of the Zagreb Stock Exchange and are traded on a secondary market.

	31 DECEMBER 2008 HRK'000	31 DECEMBER 2007 HRK'000
Nominal value of bonds	1,200,000	1,200,000
Discount value	(2,930)	(3,410)
	1,197,070	1,196,590

Notes to the financial statements of the HEP Group
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28. OTHER NON-CURRENT LIABILITIES

	31 DECEMBER 2008	31 DECEMBER 2007
	HRK'000	HRK'000
Deferred income	4,312,136	3,740,429
Deffered recognition of income – clearing debt	51,555	50,789
Long-term debt under interest rate swap (Note 25)	5,721	1,384
	4,369,412	3,792,602

Deferred revenue is related to fixed assets contributed by customers and others without charge. The revenue is recognized into income over the same periods as the related assets are amortized.

29. SHORT-TERM BORROWINGS

	31 DECEMBER 2008	31 DECEMBER 2007
	HRK'000	HRK'000
Borrowings from domestic banks and branch offices of foreign banks, denominated in various currencies on the following terms:	1,115,536	898,873
Interest rates ranging from EURIBOR + (0.245 – 3.55%)	-	-
Interest rates on Ministry of Finance Treasury Bills + (1.90 – 2.80%)	-	-
Secured by bills of exchange	-	-
Borrowings from domestic companies on the following terms:	2,838	2,896
Interest rate 7.25%	-	-
Secured by bills of exchange	-	-
Current portion of RWE loan	3,680	3,680
	1,122,054	905,449

During 2008, the Group used short-term loans from domestic banks for working capital purposes and for the settlement of trade payables.

Notes to the financial statements of the HEP Group
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30. LIABILITIES TO EMPLOYEES

	31 DECEMBER 2008	31 DECEMBER 2007
	HRK'000	HRK'000
Provisions for obligations under Collective Agreement	287	5,305
Net salaries	78,337	62,478
Contributions	50,636	36,834
Termination bonuses	571	4,226
	129,831	108,843

31. OTHER PAYABLES

	31 DECEMBER 2008	31 DECEMBER 2007
	HRK'000	HRK'000
Liabilities for renewable sources	198,951	34,209
Decommissioning NEK accrued expenses	114,810	-
Deferred income and received advances	12,081	12,222
Accrued expenses	6,779	7,448
Current portion of the liability under interest rate swap (Note 25.)	1,188	3,318
Other payables	38,171	9,259
	371,980	66,456

Notes to the financial statements of the HEP Group
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32. RELATED PARTY TRANSACTIONS

The Group has a 50% interest in the capital of the joint venture NE Krško d.o.o.

The produced electric energy at NPP Krško is delivered to HEP at 50% of total produced quantities at a price which is determined in accordance with the total production costs of NE Krško d.o.o.

Receivables and payables, and income and expenditure arisen from related party transactions are presented in the table below:

NE KRŠKO d.o.o.	31 DECEMBER 2008	31 DECEMBER 2007
	HRK'000	HRK'000
Liabilities for purchased electricity	36,382	40,077
Cost of purchased electricity	502,903	469,029

Notes to the financial statements of the HEP Group
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32. RELATED PARTY TRANSACTIONS (CONTINUED)

	SALES REVENUE		PURCHASES	
	2008	2007	2008	2007
	HRK'000			
ENTERPRISES CONTROLLED BY THE GOVERNMENT				
Hrvatske Željeznice	86,128	80,357	16,257	14,261
INA-Industrija nafte	132,071	119,744	2,288,077	2,202,838
Hrvatske telekomunikacija	51,535	46,480	26,011	25,957
Croatia osiguranje	4,052	3,691	18,050	17,769
Hrvatska pošta	15,237	14,014	38,330	31,629
Hrvatske šume	5,076	4,876	7,585	7,715
Jadrolinija	1,099	977	572	473
Narodne novine	1,846	1,513	4,835	6,122
Croatian Radio & Television	15,408	15,561	1,702	1,590
Plovput	424	357	144	157
Croatia Airlines	768	580	475	244
Petrokemija Kutina	18,707	13,879	-	-
Ministry of Foreign Affairs	1,180	639	-	-
Ministry of Defence	29,012	26,039	1,949	-
Ministry of Interior	20,511	17,388	43	20
Elementary and secondary schools	73,074	62,318	168	141
Judicial institutions	10,663	22,842	97	243
Colleges and universities	34,731	36,503	13,932	13,128
Legislative, executive and other bodies of the Republic of Croatia	65,562	62,986	7,679	9,256
Health institutions and organisations	116,898	98,784	6,051	7,544
Other users	106,399	97,673	60,762	30,743
TOTAL	790,381	727,201	2,492,719	2,369,830

Notes to the financial statements of the HEP Group
For the year ended 31 December 2008

32. RELATED PARTY TRANSACTIONS (CONTINUED)

HRK'000	RECEIVABLES		PAYABLES	
	31 DECEMBER 2008	31 DECEMBER 2007	31 DECEMBER 2008	31 DECEMBER 2007
ENTERPRISES CONTROLLED BY THE GOVERNMENT				
Hrvatske Željeznice	2,689	12,024	2,531	5,959
INA-Industrija nafte	5,142	3,743	463,112	436,725
Hrvatske telekomunikacija	3,637	5,473	7,558	4,972
Croatia osiguranje	184	297	3,873	2,195
Hrvatska pošta	1,069	1,737	4,095	3,265
Hrvatske šume	479	476	2,196	2,367
Jadrolinija	115	161	602	550
Narodne novine	184	189	1,330	2,690
Croatian Radio & Television	792	1,528	452	256
Ploput	26	42	96	96
Croatia Airlines	37	50	312	375
Petrokemija Kutina	520	690	-	-
Ministry of Foreign Affairs	5,263	5,672	-	-
Ministry of Defence	4,314	4,376	-	-
Ministry of Interior	9,715	9,441	-	-
Elementary and secondary schools	1,387	1,321	-	-
Judicial institutions	5,152	4,482	-	-
Colleges and universities	5,802	5,040	-	-
Legislative, executive and other bodies of the Republic of Croatia	41,652	37,010	-	-
Health institutions and organisations	19,079	12,799	40,573	26,485
Other users				
TOTAL	107,238	106,551	526,730	485,935

Under the Croatian energy laws, the Company is an eligible gas buyer, for whom gas prices differ from the market ones.

Notes to the financial statements of the HEP Group
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33. CONTINGENT LIABILITIES AND COMMITMENTS

LEGAL ACTIONS

In 2008, the Group established a provision for legal actions estimated to be ruled against HEP.

The Group has long-term financial investments in the territory of Bosnia and Herzegovina, and Serbia which in 1994 had a historical cost of HRK 1,243,970 thousand. At the time of the transformation of the Company into a joint stock company in 1994, this amount was excluded from the net asset value.

OPERATING COMMITMENTS

As at 31 December 2008, as part of its investing activities, the Group has concluded contracts under which the construction of a number of significant facilities and other investments has commenced but has not been completed. The unrealised contract value for most significant projects amounts to approximately HRK 348,821 thousand (2007: HRK 557,568 thousand).

ENVIRONMENTAL MATTERS

The principal activities of the Group are generation, transmission and distribution of electricity, and the control of the electric power systems.

In addition to these main activities, the HEP Group deals with the production and distribution of thermal power through the district heating systems in Zagreb in Osijek, and the distribution of gas in Osijek and Đakovo. These principal business activities can have inherent effects on the environment in terms of emissions into soil, water and air. The environmental effects of the Company's and Group's activities are monitored by local management and environmental authorities.

Croatia requested membership to the European Union. As part of the succession process environmental regulations similar to those at other EU countries might be introduced in Croatia. Such environmental regulations might have an impact on environmental liabilities for the Group.

Notes to the financial statements of the HEP Group
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34. SUBSIDIARIES

As at 31 December 2008, the Group had the following subsidiaries:

SUBSIDIARY	ZEMLJA	INTEREST IN (%)	MAIN ACTIVITY
HEP-Proizvodnja d.o.o.	Croatia	100	Electricity generation and heating
HEP-Operator prijenosnog sustava d.o.o.	Croatia	100	Electricity transmission
HEP-Operator distribucijskog sustava d.o.o.	Croatia	100	Electricity distribution
HEP Opskrba d.o.o.	Croatia	100	Electricity supply
HEP-Toplinarstvo d.o.o.	Croatia	100	Thermal power generation and distribution
HEP-Trgovina d.o.o.	Croatia	100	Electrical energy trading and optimization of power plants production
HEP-Plin d.o.o.	Croatia	100	Gas distribution
TE Plomin d.o.o.	Croatia	50	Electricity generation
Agencija za posebni otpad d.o.o.	Croatia	100	Special waste management
HEP ESCO d.o.o.	Croatia	100	Financing of energy efficiency projects
Plomin Holding d.o.o.	Croatia	100	Development of infrastructure in area around Plomin
Teppo d.o.o.	Croatia	75	In liquidation
Buško Blato d.o.o.	BiH	100	Maintenance of hydro power plants
HEP-Telecom d.o.o.	Croatia	100	Telecommunications
HEP-Odmor i rekreacija d.o.o.	Croatia	100	Accommodation and recreation services
HEP-NOC Velika	Croatia	100	Accommodation and training
HEP-Obnovljivi izvori energije d.o.o.	Croatia	100	Electricity generation

The majority of these subsidiaries were created for the purpose of reorganization and re-structuring the core business activities driven by the new energy legislation, which came into effect as of 1 January 2002, as indicated in Note 1.

Notes to the financial statements of the HEP Group
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35. FINANCIAL INSTRUMENTS

CAPITAL RISK MANAGEMENT

The Company manages its capital to ensure that it will be able to continue as a going concern while maximising the return to stakeholders through the optimisation of the debt and equity balance.

The capital structure of the Company consists of debt, which includes the borrowings and issued bonds disclosed in Note 23 and 27, cash and cash equivalents and equity attributable to equity holders of the parent, comprising issued capital, legal and other reserves and retained earnings.

GEARING RATIO

The Group's risk management committee reviews the capital structure on a semi-annual basis. As part of this review, the committee considers the cost of capital and the risks associated with each class of sources of funding. The gearing ratio at the year end can be presented as follows:

	31 DECEMBER 2008	31 DECEMBER 2007
	HRK'000	HRK'000
Debt	6,360,696	5,643,264
Cash and cash equivalents	(194,213)	(166,512)
Net debt	6,166,483	5,476,752
Equity	18,130,245	18,013,113
Net debt to equity ratio	34%	30%

SIGNIFICANT ACCOUNTING POLICIES

Details of the significant accounting policies and methods adopted, including the criteria for recognition, the basis of measurement and the basis on which income and expenses are recognised, in respect of each class of financial asset, financial liability and equity instrument are disclosed in Note 2 to the financial statements.

CATEGORIES OF FINANCIAL INSTRUMENTS

	2008	2007
	HRK'000	HRK'000
FINANCIAL ASSETS		
Loans and receivables (including cash and cash equivalents)	2,430,847	2,442,413
Other non-current assets	270,875	107,519
FINANCIAL LIABILITIES		
Non-current liabilities	5,301,352	4,803,876
Current liabilities	4,412,430	3,827,211

Notes to the financial statements of the HEP Group
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35. FINANCIAL INSTRUMENTS (CONTINUED)

FINANCIAL RISK MANAGEMENT OBJECTIVES

The Group's Treasury function provides services to the business, co-ordinates access to domestic and international financial markets, monitors and manages the financial risks relating to the operations of the Group through internal risk reports which analyse exposures by degree and magnitude of risks. These risks include market risk (including currency risk, fair value interest rate risk and price risk), credit risk, liquidity risk and cash flow interest rate risk.

MARKET RISK

The Group's activities expose it primarily to the financial risks of changes in foreign currency exchange rates and interest rates (see below). Market risk exposures are supplemented by sensitivity analysis. There has been no change to the Group's exposure to market risks or the manner in which it manages and measures the risk.

FOREIGN CURRENCY RISK MANAGEMENT

The Group undertakes certain transactions denominated in foreign currencies. Hence, exposures to exchange rate fluctuations arise. Exchange rate exposures are managed within approved policy parameters utilising forward foreign exchange contracts. The carrying amounts of the Group's foreign currency denominated monetary assets and monetary liabilities at the reporting date are as follows:

	ASSETS		LIABILITIES	
	31 DECEMBER 2008 in'000	31 DECEMBER 2007 in'000	31 DECEMBER 2008 in'000	31 DECEMBER 2007 in'000
European Union (EUR)	7,955	7,222	602,510	541,277
USD		-	124,155	72,747
CHF			22,403	-

FOREIGN CURRENCY SENSITIVITY ANALYSIS

The Group is mainly exposed to the changes of euro (EUR), US dollar (USD), Swiss franc (CHF). The following table details the Group's sensitivity to a 10% increase and decrease in the HRK against EUR, USD and CHF. 10% is the sensitivity rate used when reporting foreign currency risk internally to key management personnel and represents Management's assessment of the reasonably possible change in foreign exchange rates. The sensitivity analysis includes only outstanding foreign currency denominated receivables and liabilities and adjusts their translation at the period end for a 10% change in foreign currency rates. The sensitivity analysis includes external loans where the denomination of the loan is in a currency other than the currency of the lender or the borrower. A positive/negative number below indicates an increase in profit and other equity where HRK strengthens 10% against the relevant currency. For a 10% weakening of the HRK against the relevant currency, there would be an equal effect, but the balance would be negative.

	2008 HRK'000	2007 HRK'000
EUR CHANGE IMPACT		
Profit or loss	436,137	391,202
USD CHANGE IMPACT		
Profit or loss	64,008	36,267
CHF CHANGE IMPACT		
Profit or loss	11,002	-

Notes to the financial statements of the HEP Group
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35. FINANCIAL INSTRUMENTS (CONTINUED)

INTEREST RATE RISK MANAGEMENT

The Group is exposed to interest rate risk as it borrow funds at floating interest rates.

The Group's exposures to interest rates on financial assets and financial liabilities are detailed in Note 36, the liquidity risk management. The Group manages this risk by maintaining an appropriate mix between fixed and floating rate borrowings, by the use of interest rate swap contracts.

INTEREST RATE SENSITIVITY ANALYSIS

The sensitivity analysis has been determined based on the interest rate exposure of the Group to financial instruments at the balance sheet date. For floating rates, the analysis is prepared assuming the amount of liability outstanding at the balance sheet date was outstanding for the whole year. A 50 basis point increase or decrease is used when reporting interest rate risk internally to key management personnel and represents Management's assessment of the reasonably possible change in interest rates.

If interest rates had been 50 basis points higher/lower and all other variables were held constant, the Group's:

- Profit for the year ended 31 December 2008 would decrease/increase by HRK 23,116 thousand (2007: HRK 19,628 thousand), based on exposure to interest rate risk. This is mainly attributable to the Group's exposure to interest rates on its variable rate borrowings, which accounted for 75% % in 2008 (2007: 71%); and
- The Group's sensitivity to interest rates has decreased during the current period mainly due to the reduction in variable rate of debt instruments.

CREDIT RISK MANAGEMENT

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the Group. The Group is the sole provider of electric energy in the Republic of Croatia. As such, it has a public responsibility to provide services to all users, and locations within the country, irrespective of credit risk associated with particular customers. Trade receivables, net, consist of a large number of customers, spread across diverse industries and geographical areas.

The Group does not have any significant credit risk exposure to any single counterparty or any group of counterparties having similar characteristics. The Group defines counterparties as having similar characteristics if they are related entities. Credit risk with respect to trade receivables is primarily related to domestic corporate receivables, specifically where services are provided to economic concerns, which are in a difficult financial position. Overdue receivables from households are limited due to Group's ability to disconnect such customers from the power supply network.

Except as detailed in the following table, the carrying amount of financial assets recorded in the financial statements, which is net of impairment losses, represents the Group's maximum exposure to credit risk without taking account of the value of any collateral obtained.

LIQUIDITY RISK MANAGEMENT

Ultimate responsibility for liquidity risk management rests with the Management Board, which has built an appropriate liquidity risk management framework for the management of the Group's short, medium and long-term funding and liquidity management requirements. The Company manages liquidity risk by maintaining adequate reserves, banking facilities and other sources of financing, by continuously monitoring forecast and actual cash flows and matching the maturity profiles of financial assets and liabilities.

Notes to the financial statements of the HEP Group
For the year ended 31 December 2008

35. FINANCIAL INSTRUMENTS (CONTINUED)

LIQUIDITY AND INTEREST RATE RISK TABLES

The following table details the remaining period to contractual maturity for the Group's non-derivative financial assets. The tables below have been drawn up based on the undiscounted cash flows of the financial assets including interest that will be earned on those assets except where the Group anticipates that the cash flow will occur in a different period.

MATURITY OF NON-DERIVATIVE FINANCIAL ASSETS

	WEIGHTED AVER- AGE EFFECTIVE INTEREST RATE	LESS THAN 1 MONTH HRK'000	1 - 3 MONTHS HRK'000	3 -12 MONTHS HRK'000	1 - 5 YEARS HRK'000	OVER 5 YEARS HRK'000	TOTAL HRK'000
2008							
Non-interest bearing		1,362,601	615,352	105,629	443,451	28,103	2,555,136
Variable interest rate instruments	5.47%	39	80	337	427	418	1,301
Fixed interest rate instruments	4.00%	-	-	136	680	406	1,222
TOTAL		1,362,640	615,432	106,102	444,558	28,927	2,557,659
2007							
Non-interest bearing		1,116,058	683,741	256,809	444,342	45,875	2,546,825
Variable interest rate instruments	5.29%	60	141	451	1,020	-	1,672
Fixed interest rate instruments	4.01%	140	-	199	731	764	1,834
TOTAL		1,116,258	683,882	257,459	446,093	46,639	2,550,331

Notes to the financial statements of the HEP Group
For the year ended 31 December 2008

35. FINANCIAL INSTRUMENTS (CONTINUED)

The following tables detail the Group's remaining contractual maturity for its non-derivative financial liabilities. The tables have been drawn up based on the undiscounted cash flows of financial liabilities based on the earliest date on which the Group can be required to pay.

MATURITY OF NON-DERIVATIVE FINANCIAL LIABILITIES

	WEIGHTED AVER- AGE EFFECTIVE INTEREST RATE	LESS THAN 1 MONTH HRK'000	1 - 3 MONTHS HRK'000	3 -12 MONTHS HRK'000	1 - 5 YEARS HRK'000	OVER 5 YEARS HRK'000	TOTAL HRK'000
2008							
Non-interest bearing		1,323,924	1,378,879	704,353	14,698	7,327	3,429,181
Variable interest rate instruments	5.51%	144,065	482,707	1,123,143	2,831,554	595,700	5,177,169
Fixed interest rate instruments	5.34%	5,162	-	442,385	1,076,964	427,706	1,952,217
TOTAL		1,473,151	1,861,586	2,269,881	3,923,216	1,030,733	10,558,567
2007							
Non-interest bearing	-	963,284	1,616,729	320,750	9,418	11,581	2,921,762
Variable interest rate instruments	5.46%	223,130	399,808	1,048,753	2,199,651	710,561	4,581,903
Fixed interest rate instruments	5.37%	13,627	216	93,162	889,622	1,045,809	2,042,436
TOTAL		1,200,041	2,016,753	1,462,665	3,098,691	1,767,951	9,546,101

The Group has access to financing facilities, the total unused amount which is HRK 444,106 thousand at the balance sheet date. The Group expects to meet its other obligations from operating cash flows and proceeds of maturing financial assets.

Notes to the financial statements of the HEP Group
For the year ended 31 December 2008

35. FINANCIAL INSTRUMENTS (CONTINUED)

MATURITY OF DERIVATIVE FINANCIAL LIABILITIES

The Group has an interest rate swap, which it uses to hedge its exposure to variable rate debt. Based on the underlying agreement, the six-month interest rate payable by the Company is fixed at 5.39 %, whereas the swap rate is equal to six-month EURIBOR, or approximated at 4.9931 % at 31 December 2008 (2007: 4.709 %), as disclosed in detail in Note 25.

	WEIGHTED AVER- AGE EFFECTIVE INTEREST RATE	LESS THAN 1 MONTH HRK'000	1 - 3 MONTHS HRK'000	3 -12 MONTHS HRK'000	1 - 5 YEARS HRK'000	OVER 5 YEARS HRK'000	TOTAL HRK'000
31 DECEMBER 2008							
Variable interest rate instruments	4.9931%	-	5,205	4,580	13,703	-	23,488
Fixed interest rate instruments	5.39%	-	(5,619)	(4,943)	(14,793)	-	(25,355)
TOTAL		-	(414)	(363)	(1,090)	-	(1,867)
31 DECEMBER 2007							
Variable interest rate instruments	4.709%	-	6,170	5,553	22,154	-	33,878
Fixed interest rate instruments	5.39%	-	(7,063)	(6,357)	(25,358)	-	(38,778)
TOTAL		-	(893)	(804)	(3,204)	-	(4,901)

FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair values of financial assets and financial liabilities are determined as follows:

The fair value of financial assets and financial liabilities with standard terms and conditions and traded on active liquid markets is determined with reference to quoted market prices.

The fair value of other financial assets and financial liabilities is determined in accordance with generally accepted pricing models based on discounted cash flow analysis using prices from observable current market transactions.

Notes to the financial statements of the HEP Group
For the year ended 31 December 2008

36. APPROVAL OF THE FINANCIAL STATEMENTS

These financial statements were approved by the Board and authorised for issue on 08 May 2009.

Signed on behalf of the Management Board on 08 May 2009:



Ivan Mravak
President of the Board



Darko Dvornik
Member of the Board



Hrvatska elektroprivreda d.d. (HEP d.d.)

■ Independent Auditor's Report

To the Owners of Hrvatska elektroprivreda d.d.:

We have audited the unconsolidated accompanying financial statements of Hrvatska elektroprivreda d.d. (the 'Company'), which comprise the unconsolidated balance sheet as at 31 December 2008 and the related unconsolidated statement of income, unconsolidated statements of changes in equity and of cash flows 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 entities' 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.

Matters affecting the opinion

a) Measurement of investment properties at fair value

As described in Note 4 to the financial statements, the Company changed its accounting policy during 2008 in respect of the valuation of investment property from the cost model to the fair value model. In accordance with International Accounting Standard 40 Investment Property, investment properties are initially carried at cost and subsequently measured either at cost or fair value. The Company remeasured the group's investment property portfolio to fair value as at 31 December 2008. The Company booked the entire resultant gain of HRK 133 million, which relates to the entire Group's investment property portfolio, in its income statement. HRK 128 million of this gain relate to the investment properties reported in the financial statements of subsidiaries which, therefore, should not have been presented in the HEP d.d. income statement as of 31 December 2008. Accordingly, long-term receivables from related parties at 31 December 2008 and net income for the year then ended are overstated by HRK 128 million.

Opinion

In our opinion, except for the effect of the matters discussed in paragraph a) and the effect, if any, of the matter referred to in paragraph b) above, the unconsolidated financial statements present fairly, in all material respects, the financial position of the Company at 31 December 2008, the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Emphasis of matter

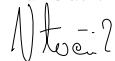
Without qualifying our opinion, we draw attention to Note 2 to the unconsolidated financial statements, discussing the accounting policies for revenue recognition. The Company recognizes revenue based on the invoicing of its subsidiary HEP Operator distribucijskog sustava d.o.o. to the final customers of the Group. However, the receivables from the final customers remain with the subsidiary. This policy is in accordance with the Croatian law.

The current regulatory framework does not provide details of allocation of the rewards pertaining to the electricity generation activity. In June 2008, the Government of the Republic of Croatia promulgated a Decision on the The Electricity Generation Tariff Model, with the exemption of eligible customers, with no tariff item amounts; The Electricity Transmission Tariff Model, with no tariff item amounts; The Electricity Distribution Tariff Model, with no tariff amounts; and the Electricity Supply Tariff Model, with the exemption of eligible customers, with no tariff amounts. The Group has been applying the tariff models since 1 July 2008.

We also draw attention to Note 2 to the accompanying unconsolidated financial statements discussing the accounting policy for leases. The Company has leased out fixed assets to its subsidiaries based on financial lease agreements. Furthermore, the Company has receivables from finance lease agreements with its other subsidiaries. These leases bear interest only to the extent that the Company has acquired external financ-

ing to construct the corresponding asset. These receivables are carried at nominal amounts because of the special organizational framework of the HEP Group. Therefore, for a better understanding of the operations of the Company, the accompanying financial statements should be read in conjunction with the consolidated financial statements of the HEP Group.

Deloitte d.o.o.
Branislav Vrtačnik, Certified Auditor



Zagreb, 8 May 2009

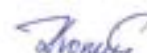
**Unconsolidated Income Statement - Hrvatska elektroprivreda d.d.
For the year ended 31 December 2008**

	2008	2007
	HRK'000	HRK'000
Electricity sales	9,681,877	8,558,652
Service revenues – related companies	1,074,900	1,005,707
Other operating income	462,280	502,284
TOTAL OPERATING INCOME	11,219,057	10,066,643
Purchase of electricity	(3,468,510)	(2,857,537)
Staff costs	(75,931)	(69,675)
Depreciation and amortisation	(62,293)	(54,889)
Fee expense in respect of electricity generation, transmission and distribution – related companies	(7,148,427)	(6,232,395)
Other operating expenses	(379,576)	(450,275)
TOTAL OPERATING EXPENSES	(11,134,737)	(9,664,771)
PROFIT FROM OPERATIONS	84,320	401,872
Finance revenue	205,993	214,255
Finance costs	(286,797)	(164,348)
NET FINANCIAL (LOSS) / GAINS FROM FINANCIAL ACTIVITIES	(80,804)	49,907
PROFIT BEFORE TAX	3,516	451,779
Income tax expense	-	(66,192)
PROFIT FOR THE YEAR	3,516	385,587

Signed on behalf of the Company on 08 May 2009 by:



Ivan Mravak
President of the Board



Darko Dvornik
Member of the Board

■ Unconsolidated Balance Sheet - Hrvatska elektroprivreda d.d.
As at 31 December 2008

ASSETS	31 December 2008	31 December 2007
	HRK'000	HRK'000
Property, plant and equipment	312,482	304,661
Capital work in progress	185,422	95,374
Intangible assets	28,493	27,461
Investment property	10,832	6,715
Prepayments for tangible assets	376,285	381,453
Investment in NPP Krško	1,609,598	1,609,753
Investment in, and receivables from TPP Plomin	702,292	766,058
Investments in subsidiaries	6,548	6,548
Investments available for sale	151,374	2
Long-term loan receivables and deposits	1,537	1,235
Long-term lease receivables from related companies	17,465,813	17,061,389
Long-term loan receivables from related companies	159,033	159,214
Other non-current assets	126,285	69,475
Deferred tax assets	2,704	3,127
TOTAL NON-CURRENT ASSETS	21,138,698	20,492,465
Inventories	11,045	8,044
Trade receivables	65,570	30,827
Current portion of long-term loan receivables from related companies	1,296,050	1,401,773
Current portion of long-term receivables	-	658
Other short-term receivables	245,282	189,430
Receivables from related companies	4,134,577	3,410,148
Cash and cash equivalents	72,376	30,452
TOTAL CURRENT ASSETS	5,824,900	5,071,332
TOTAL ASSETS	26,963,598	25,563,797

Signed on behalf of the Company on 08 May 2009 by:



Ivan Mravak
President of the Board



Darko Dvornik
Member of the Board

EQUITY AND LIABILITIES	31 December 2008	31 December 2007
	HRK'000	HRK'000
Share capital	19,792,159	19,792,159
Capital reserves	(2,035,890)	(2,035,735)
Retained earnings	905,336	902,243
TOTAL EQUITY	18,661,605	18,658,667
Liabilities under issued bonds	1,197,070	1,196,590
Long-term borrowings	2,963,030	2,722,041
Long-term liabilities to the state	24,257	24,307
Other long-term liabilities	66,266	61,367
Liabilities to related companies	68,627	43,907
Long-term provisions	63,623	116,747
TOTAL NON-CURRENT LIABILITIES	4,382,873	4,164,959
Trade payables	733,410	614,704
Current portion of long-term borrowings	875,619	544,999
Short-term borrowings	1,118,344	901,825
Taxes payable	37,518	144,657
Interest payable	45,680	41,954
Liabilities to related companies	975,772	423,317
Liabilities to employees	5,554	10,155
Other payables	127,223	58,560
TOTAL CURRENT LIABILITIES	3,919,120	2,740,171
TOTAL EQUITY AND LIABILITIES	26,963,598	25,563,797

Signed on behalf of the Company on 08 May 2009 by:



Ivan Mravak
President of the Board



Darko Dvornik
Member of the Board





Reports by HEP Group companies

HEP - Proizvodnja d.o.o.

HEP - Operator prijenosnog sustava d.o.o.

HEP - Operator distribucijskog sustava d.o.o.

HEP - Toplinarstvo d.o.o.

HEP - Plin d.o.o.

■ HEP - Proizvodnja d.o.o.



In 2008, business conditions for HEP Group, HEP Proizvodnja d.o.o. (HEP Production) included, were determined by changes in the Croatian energy market. Besides regularly performing its core businesses of production and delivery of electricity and heat, HEP Proizvodnja d.o.o., in cooperation with other HEP Group companies, was making adjustments to meet new requirements, providing other services too, primarily for the needs of the electricity system. Thus, auxiliary services (services our generators provide to the electricity system through primary, secondary and tertiary control), which had been our product since before but without a recognizable commercial market aspect, became in 2008 under the contract with HEP OPS a new commercial product which brings revenue to the Company.

In addition to continued reorganization, the Company continuously worked on technological improvements in availability of power plants and their capability to respond quickly to market demands. Therefore, as part of regular maintenance and in addition to modernization and refurbishment, the activities continued to improve hydro power management system and to modernize the control system to make it capable of handling rapid load changes.

Especially important are the activities carried out by HEP Proizvodnja d.o.o. for and on behalf of HEP d.o.o. to build new power plants. Verification of the progress of projects was carried out and in order to meet time-limits works continued on Lešće HPP and Unit L at TE-TO Zagreb. Preparatory works on the construction of a cogeneration unit, Unit C at Sisak TPP (including the activities to secure gas for the power plant) are in full swing and some on-site works have already begun.

Special attention is paid to the implementation of environmental legislation. Emissions from all thermal power plants are regularly monitored, emission monitoring systems have been upgraded and CISEM project provides in a single place access to information on current emissions from all thermal

power plants and allows appropriate reporting to relevant state and local authorities. A program to reduce emissions of CO₂ has been prepared, in accordance with Croatia's obligations under the Kyoto Protocol and other international documents, and has been submitted to the ministry in charge. As part of the regular verification, all hydro power plants were again certified for energy production from renewable sources as well as for ISO series 9000 and 14000. Preparations for obtaining certificates for the remaining power plants have continued.

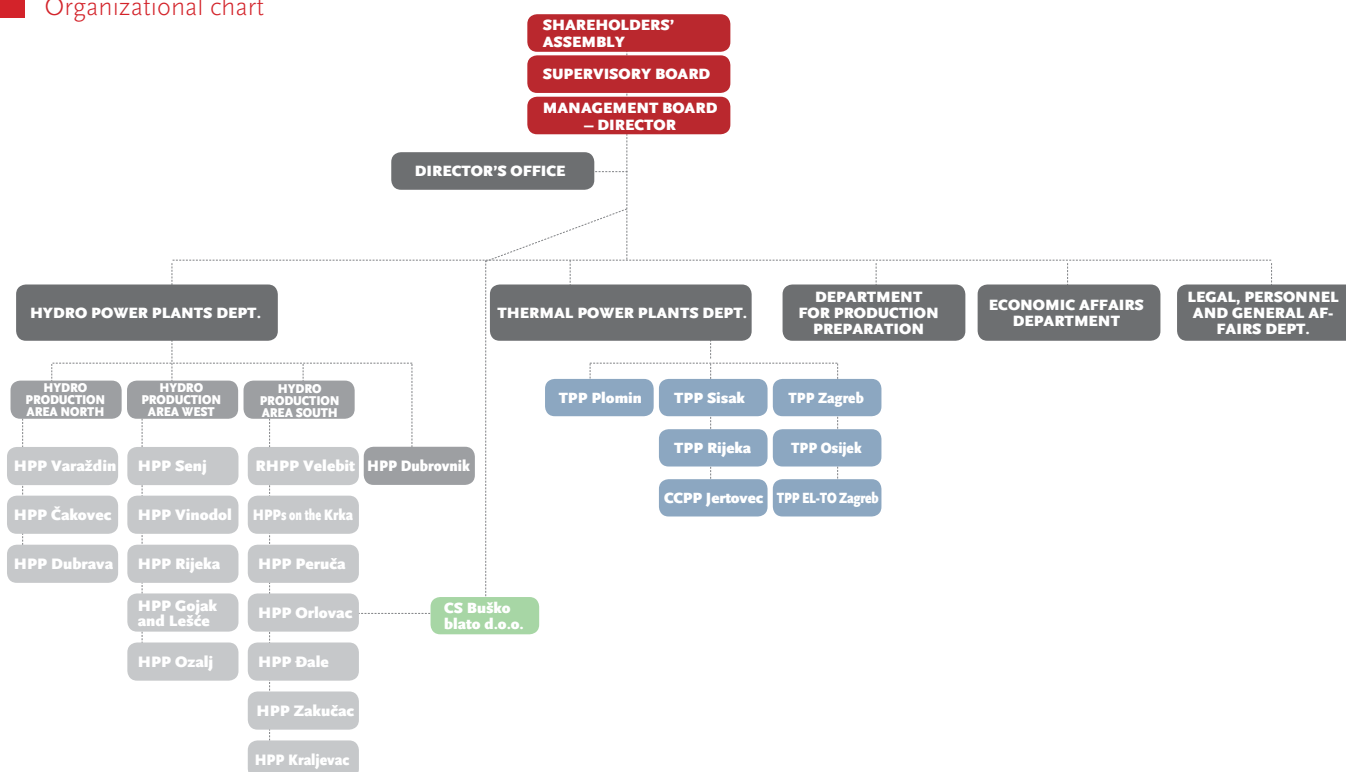
HEP Proizvodnja gives an important place to safety at work and fire protection. As part of the reorganization of the company from 2007, safety and fire protection function is a vertically organized department which apart from regular activities takes particular care that there is constant education and constant increase in the degree of work safety.

Business operations in 2008 were burdened with unexpectedly high rise in prices of all fuels. Hydrological circumstances were unfavorable for most of the year, until the end of November when their sudden improvement allowed hydro power plants to run at full capacity, and thereby significant savings in costs of fuel for thermal power plants, which had a favorable impact on the overall business of the Company in 2008. In the second half of the year, the increase in production component of the tariff for electricity customers had a favorable effect on the business.

During the year internal controls were performed, all manageable internal costs were reduced, and internal reserves were efficiently used, without jeopardizing the operational readiness of plants. The measures that were implemented have made it possible to achieve a favorable business result, even above expectations given the worse business conditions.

Petar Čubelić
Director

Organizational chart



Generating plants

HYDRO POWER PLANTS	AVAILABLE CAPACITY (MW)	HYDRO POWER PLANTS	AVAILABLE CAPACITY (MW)
STORAGE		NATURAL FLOW	
HPP Zakučac	486	HPP Varaždin	86.5
RHPP Velebit	276 (-240)	HPP Dubrava	77.8
HPP Orlovac	237	HPP Čakovec	77.4
HPP Senj	216	HPP Gojak	55.5
HPP Dubrovnik	2x108*	HPP Rijeka	36
HPP Vinodol	90	HPP Miljacka	24
HPP Peruća	60	HPP Jaruga	7.2
HPP Kraljevac	46.4	HPP Golubić	6.5
HPP Đale	40.8	HPP Ozalj	5.5
HPP Sklope	22.5	HPP Krčić	0.3
CS Buško blato	7.5/4.2 (-10.2/-4.8)		
CHPP Fužine	4.6 (-5.7)		
HPP Zavrelje	2		
CHPP Lepenica	0.8 (-1.2)		
HPP Zeleni vir	1.7		

CS: pumping station CHPP: pumped storage RHPP: reversible pump turbine

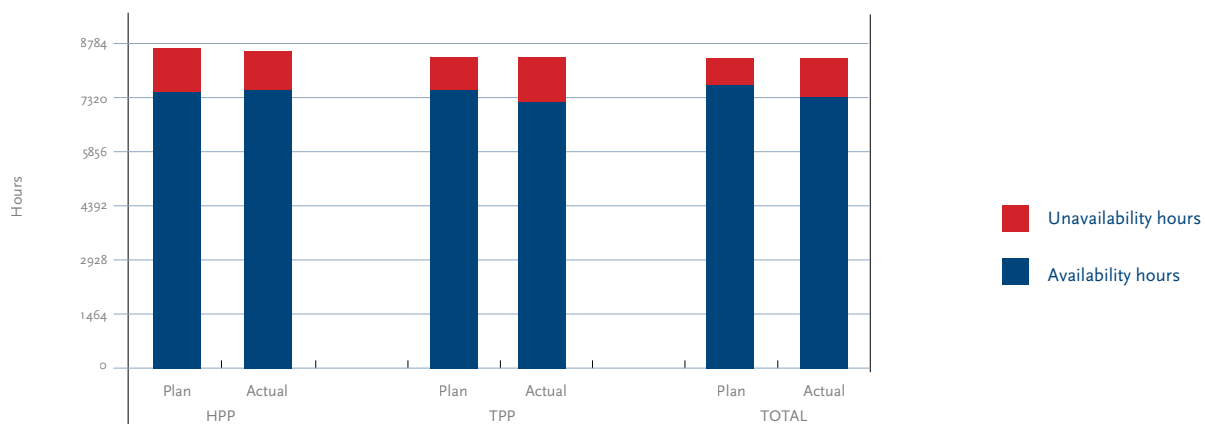
* One unit of Dubrovnik HPP operates for Bosnia and Herzegovina

THERMAL POWER PLANTS	AVAILABLE NET CAPACITY (MW)	FUEL
TPP Sisak	396	oil / natural gas
TPP-TO Zagreb	312 / 400 MWt	oil / natural gas
TPP Rijeka	303	oil
TPP Plomin (A)	110	hard coal
EL-TO Zagreb	90 / 184 MWt	oil / natural gas
TPP-TO Osijek	90 / 124 MWt	oil / natural gas / extra light oil
CCPP Jertovec	72	natural gas / extra light oil
TPP PLOMIN (B)*	192	coal

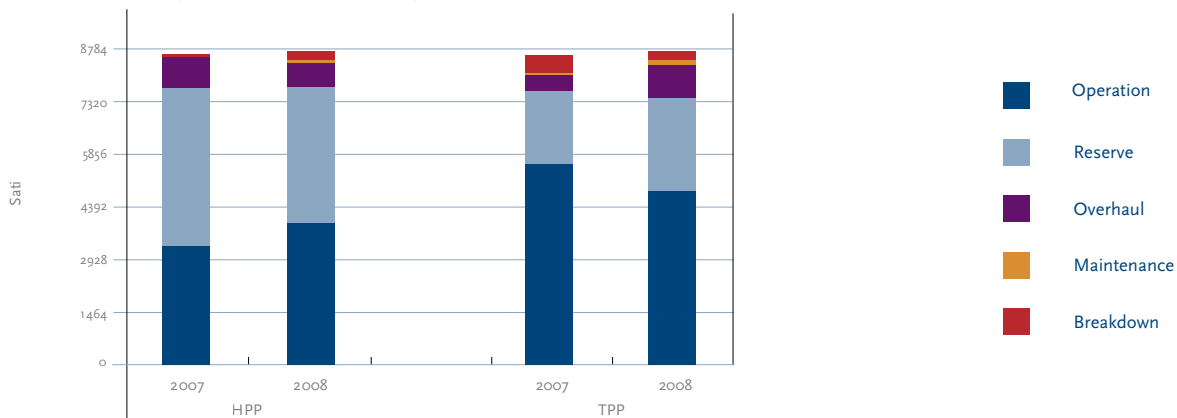
* Owned by TPP Plomin d.o.o. (HEP : RWE Power - 50% : 50%); HEP-Proizvodnja d.o.o. – O&M contract

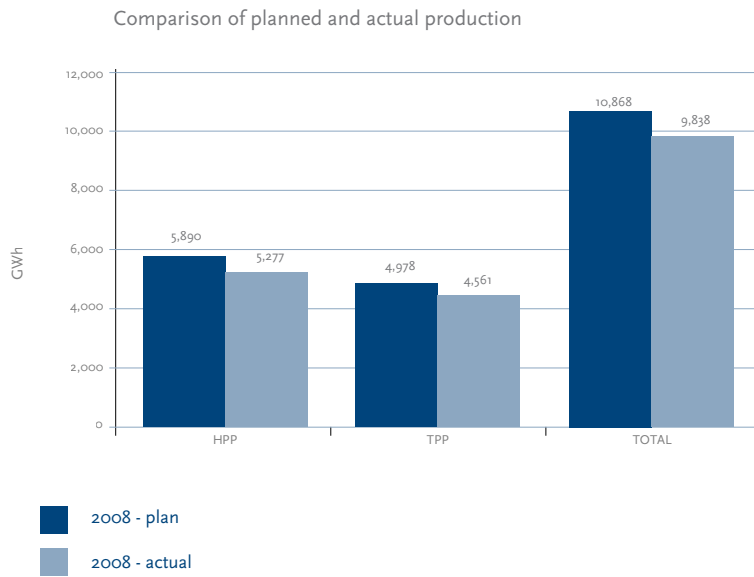
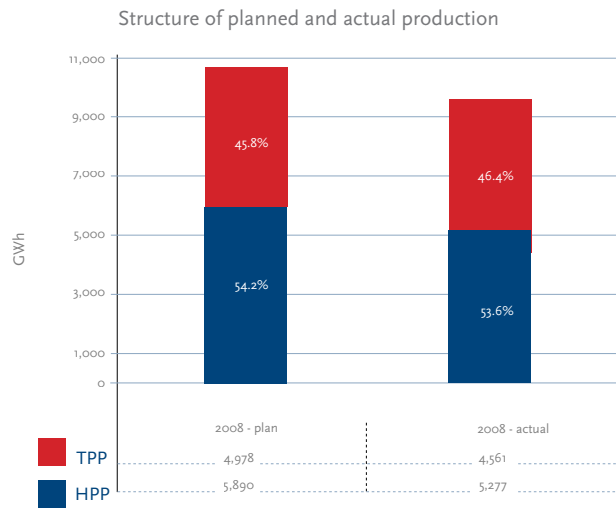
■ Availability and electricity production – HPPs and TPPs in 2008

Planned and actual availability



Comparison of actual availability in 2007 and 2008





Independent Auditor's Report

To the Owners of HEP Proizvodnja d.o.o.:

We have audited financial statements of HEP Proizvodnja d.o.o. (the "Company"), which comprise the balance sheet as at 31 December 2008 and the related statement of income, statements of changes in equity and of cash flows 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 independent 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 entities' 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.

Matters affecting the opinion

a) Measurement of investment properties at fair value

During 2008, the Company changed its accounting policy during 2008 in respect of the valuation of its investment property from the cost model to the fair value model. In accordance with International Accounting Standard 40 Investment Property, investment properties are initially carried at cost and subsequently measured either at cost or fair value. The Company has booked the effect of the remeasurement of the investment property leased from HEP d.d. as an increase in long-term liabilities to related parties. This is not in accordance with International Accounting Standard 8, which requires that the effects of changes in accounting policies are recognized retrospectively each year in the financial statements of the Company.

Consequently, long-term liabilities to related parties as of 31 December 2008 are overstated by HRK 26 million, whereas retained earnings and the net profit for the year then ended are understated by the cumulative effect of the fair valuation and of the remeasurement at fair value in 2008 arisen from the changed accounting policy.

Opinion

In our opinion, except for the effect of the matters discussed in paragraph a), financial statements present fairly, in all material respects, the financial position of the Company as at 31 December 2008, the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Emphasis of matter

a) Revenue recognition

Without qualifying our opinion, we draw attention to Note 2 to financial statements, discussing the accounting policies for revenue recognition. The Company recognizes revenue when it is probable that the economic benefits associated with the transactions will flow to the Company and their amount can be measured reliably. Sales revenue is recognised net of taxes and discounts. Income from provision of services is recognised by reference to the stage of completion. Operating income generated from electricity and thermal power generation services to a related company is recognised upon the completion of services, at the date of billing.

The current regulatory framework does not provide details of allocation of the rewards pertaining to the electricity generation activity. In accordance with the Law on the Amendments to the Energy Law from December 2004, a model for determining the tariff systems for different customers was developed in December 2006, the application of which was postponed to July 2007. The Group developed the model that was applicable throughout the year 2007. In June 2008, the Government of the Republic of Croatia promulgated a „Decision on The Electricity Generation Tariff Model, with the exemption of eligible customers, with no tariff item amounts; The Electricity Transmission Tariff

Model, with no tariff item amounts; The Electricity Distribution Tariff Model, with no tariff amounts; and the Electricity Supply Tariff Model, with the exemption of eligible customers, with no tariff amounts". The Group has been applying the tariff models since 1 July 2008.

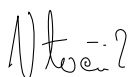
b) going concern

We draw attention to Note 2 to the financial statements describing the matters regarding the ability of the Company to continue as a going concern. The explanation provided shows that the business operations could be maintained in the longer term with a continuous support by the parent. As a result, the accounting principles applied are based on the assumption that the Company will be able to continue as a going concern.

c) accounting policy for leases

We also draw attention to Note 2 to the accompanying financial statements discussing the accounting policy for leases. Due to the special organizational structure, fixed assets under lease are carried at their original book value as originally stated by HEP d.d.. The financial lease liabilities are stated within long term-liabilities at nominal value. The leases bear interest only to the extent that the lessor has acquired external financing to construct the corresponding asset.

Therefore, for a better understanding of the operations of the Company, the accompanying financial statements should be read in conjunction with the consolidated financial statements of the HEP Group.



Deloitte d.o.o.
Branislav Vrtačnik, certified auditor

Zagreb, 08 May 2009

Income Statement HEP Proizvodnja d.o.o. HRK'000
For the year ended 31 December 2008

	2008	2007
	HRK'000	HRK'000
Electricity generation fee income and other income from related companies	3,817,635	3,478,141
Other operating income	45,491	101,475
	3,863,126	3,579,616
Cost of energy sources, material and spare parts	2,427,385	2,244,370
Service cost	292,031	308,656
Staff costs	332,345	305,669
Depreciation and amortization	426,495	432,823
Administrative expenses – related companies	83,814	127,721
Other operating expenses	245,276	246,146
	3,807,346	3,665,385
PROFIT /(LOSS) FROM OPERATIONS	55,780	(85,769)
Finance income	397	306
Finance expenses	(31,491)	(24,607)
NET FINANCIAL LOSS	(31,094)	(24,301)
PROFIT /(LOSS) BEFORE TAX	24,686	(110,070)
Income tax	(968)	(1,452)
LOSS FOR THE YEAR	23,718	(111,522)

Signed on behalf of the Company on 08 May 2009 by:




Petar Čubelić, B.E.E.
President of the Board

■ Balance Sheet HEP Proizvodnja d.o.o.
As at 31 December 2008

ASSETS	31 December 2008	31 December 2007
	HRK'000	HRK'000
Intangible assets	5,191	7,656
Property, plant and equipment	6,204,857	6,382,839
Investment in progress	1,671,369	1,206,137
Investment property	40,752	15,552
Prepayments for tangible assets	61,128	107,032
Investments in related companies	7	7
Receivables from the sale of flats	19,504	21,544
Deferred tax assets	11,306	12,274
TOTAL NON-CURRENT ASSETS	8,014,114	7,753,041
Inventories	820,367	634,946
Other current assets	42,262	133,245
Receivables from related companies	613,392	376,873
Trade receivables	1,831	1,701
Current portion of long-term receivables	2,535	2,420
Cash and cash equivalents	24,374	6,210
TOTAL CURRENT ASSETS	1,504,761	1,155,395
TOTAL ASSETS	9,518,875	8,908,436

Signed on behalf of the Company on 08 May 2009 by:


Petar Čubelić, B.E.E.
President of the Board

CAPITAL AND LIABILITIES	31 December 2008	31 December 2007
	HRK'000	HRK'000
Share capital	20	20
Capital reserves	9,188	9,188
Accumulated losses	(114,939)	(138,657)
TOTAL EQUITY	(105,731)	(129,449)
Long term liabilities to related companies	5,847,450	6,005,155
Long-term provisions	121,631	126,807
Other long-term liabilities	13,186	14,394
TOTAL NON-CURRENT LIABILITIES	5,982,267	6,146,356
Trade payables	825,568	868,094
Liabilities to related companies	2,230,004	1,501,793
Current portion of long-term debt - related companies	426,495	432,823
Other payables	160,272	88,819
TOTAL CURRENT LIABILITIES	3,642,339	2,891,529
TOTAL EQUITY AND LIABILITIES	9,518,875	8,908,436

Signed on behalf of the Company on 08 May 2009 by:



Petar Čubelić, B.E.E.
President of the Board

■ HEP - Operator prijenosnog sustava d.o.o.



In accordance with the legal and regulatory framework and within the limits of the approved Economic Plan and Investment Plan for 2006, HEP Operator prijenosnog sustava d.o.o. (HEP-OPS, HEP Transmission System Operator) continued to perform its basic tasks – control of the electricity system of the Republic of Croatia, electricity transmission, maintenance and development and construction of the transmission network, as well as support to the development and functioning of the electricity market of the Republic of Croatia and the Energy Community.

In 2008, a further increase was registered not only of consumption in the Croatian electricity system, which reached 18 TWh, but also of consumption at the levels of the transmission network and total energy transmitted. In spite of this, technical losses in the transmission network were further reduced and there were no major disturbances in the electricity supply. The total amount of non-supplied electricity due to supply disruptions is estimated at 666 MWh.

During 2008, several transmission facilities were put into regular operation, of which the most significant for the security of supply were the new 2x220(110) kV Plomin-Vodnjan line, the new 110 (35) kV Pračno-Kostajnica line (part of Banovina Program implementation), the new TS 110/10(20) kV Buzet (which together with the expansion of TS 110/35 kV Pazin completed a comprehensive work to create the conditions for putting into operation the 110 kV Pazin-Butoniga-Buzet-Buje line), the 110 kV Plomin-Dubrova line, the reconstructed TS 110/35 kV Zabok, expansion of TS 110/35 kV Pokuplje and TS 110/10(20) kV Dubovac (which makes it possible to put the Pokuplje-Dubovac line under the voltage of 110 kV as part of Karlovac Program implementation). The connecting of TS 110/20 kV to the transmission network continued as well as replacement and reconstruction of primary and secondary equipment and auxiliary plants of transformer stations, and replacement of equipment and repair of structural elements of some 110 kV lines.

Of the new investment projects, the most significant was the beginning of construction work on the new cross-border 2x400

kV line Ernestinovo-Pecs (Hungary) and the beginning of implementation of a strategic project to refurbish the information and communication equipment of the control system including the national dispatch center and four network centers. Also, construction was started of TS 220/110 kV Plat with associated lines as part of the Dubrovnik Program.

In June 2008, CERA approved the Plan for Transmission Network Development and Construction for the Period 2008-2010, and an appropriate Plan for the period 2009-2011 is in preparation. Also, activities have begun concerning the preparation of a ten-year transmission network development plan.

After the Government of the Republic of Croatia issued Decision on determination of tariff rates of the new tariff system for electricity transmission, activities began concerning contracting for the use of the transmission network. By the end of the year, relations with eleven eligible customers and one eligible generator were regulated. In a bilateral contract with HEP-Proizvodnja d.o.o. provision of auxiliary services was regulated, which significantly contributes to the safe operation of the electricity system and to the transparency of business operations.

As part of Croatia's accession negotiations with the European Union (Chapter 15 of the acquis, Energy), HEP-OPS was the host to a peer review mission in October 2008 which in their positive report found that HEP-OPS had fulfilled the obligations relating to the full application of the EU acquis in the area of electricity, in particular Regulation 1228/03/EC.

Monthly auctions successfully continued for cross-border transmission capacity of HEP OPS on the borders with Slovenia, Bosnia and Herzegovina and Serbia, as well as the implementation of joint monthly direct auctions for cross-border capacity of HEP-OPS and the Hungarian transmission system operator for the Croatian-Hungarian border. In compliance with regulation 1228/03/EC, HEP OPS has launched the initiative to establish joint auctions for cross-border capacity with the transmission system operators of Bosnia and Herzegovina, Slovenia and Serbia, while with the Hungarian operator activities have begun to expand joint auctions for cross-border capacity to include other time periods.

The Decision of the Energy Community's Ministerial Council of June 2008 obligates transmission system operators of the parties to the Energy Community to apply the guidelines for congestion management laid down in Appendix to Regulation 1228/03/EC. For this purpose, in December 2008 HEP OPS, based on prior approvals by CERA, published new Rules on allocation and use of cross-border transmission capacity and signed Memorandum of Understanding for implementation of common procedures for congestion management and establishment of an auction office of South-Eastern Europe for coordinated transmission capacity auctions between transmission system operators of South-Eastern Europe.

Participation continued in the European ITC mechanism for calculation and compensation of transit costs caused by cross-

border electricity transfer. In June 2008, HEP OPS signed with other European transmission system operators Agreement on data publication on ETSO Vista website, which provides a transparent means to market participants from the EU and the Energy Community to access the data.

Furthering the cooperation with other transmission system operators and the cooperation through operators' associations (UCTE and ETSO/SETSO), in December 2008 HEP-ODS as one of the 42 founding members established a new association of transmission system operators of the whole Europe – ENTSO-E.

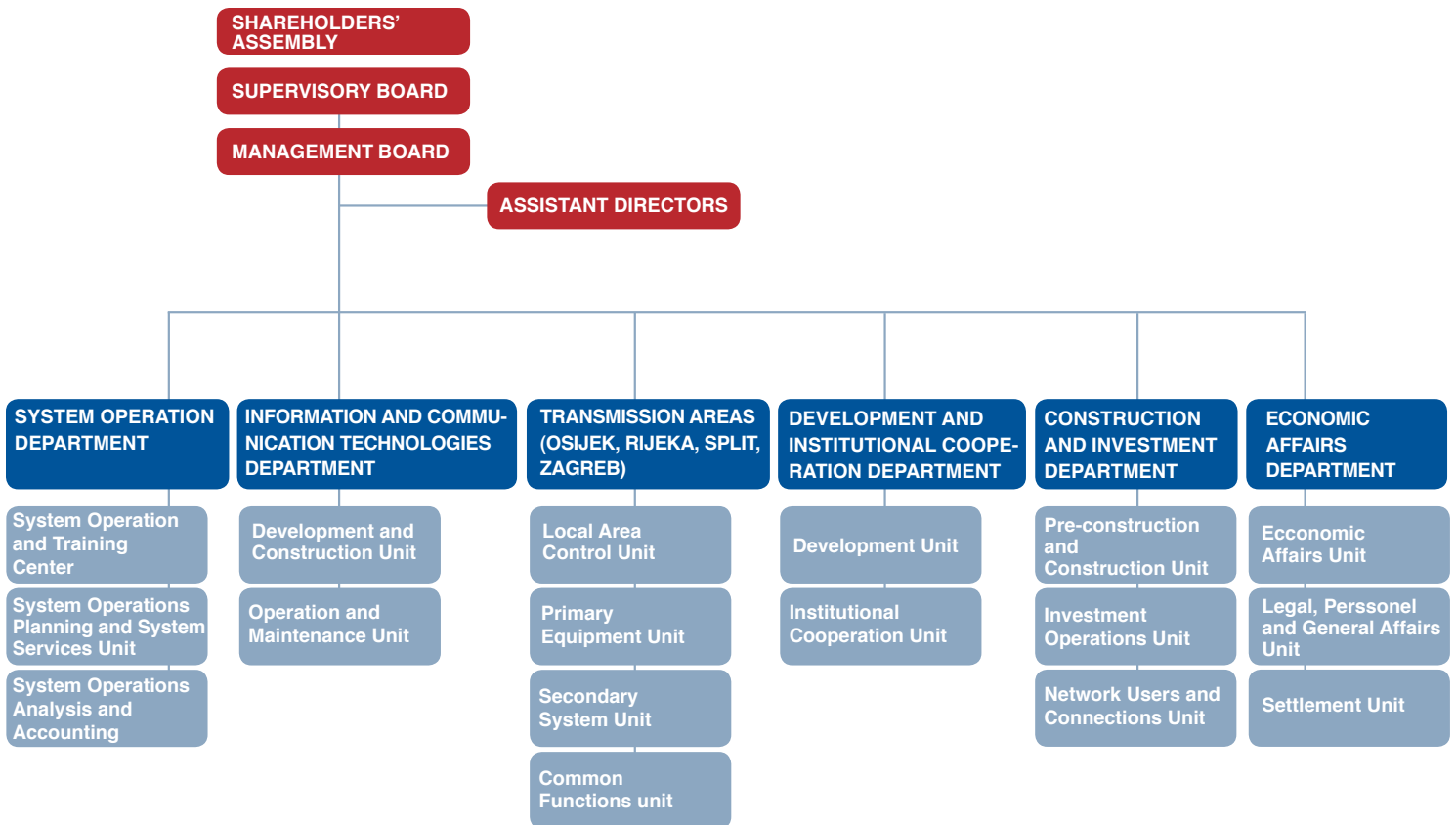
Thanks to a GEF and IBRD grant for Renewable Energy Sources Project, implemented through the Croatian Bank for Reconstruction and Development and the Ministry of the

Economy, Labor and Entrepreneurship, HEP-OPS procured the software for forecast of electricity production from wind power plants. Also, HEP-OPS conducted large-scale activities to determine Additional technical requirements for connection and operation of wind power plants with the transmission network which after public consideration were adopted and came into force at the end of 2008.

Business achievements of HEP-OPS in 2008 are the result of a good organization, professional and team work, responsibility and expertise in performing an ever growing scope of both regular and new duties with a minimum increase in the number of employees, from 1240 to 1248.

 Dubravko Sabolić
Director

■ Company organizational chart



■ Realization in 2008 - energy data

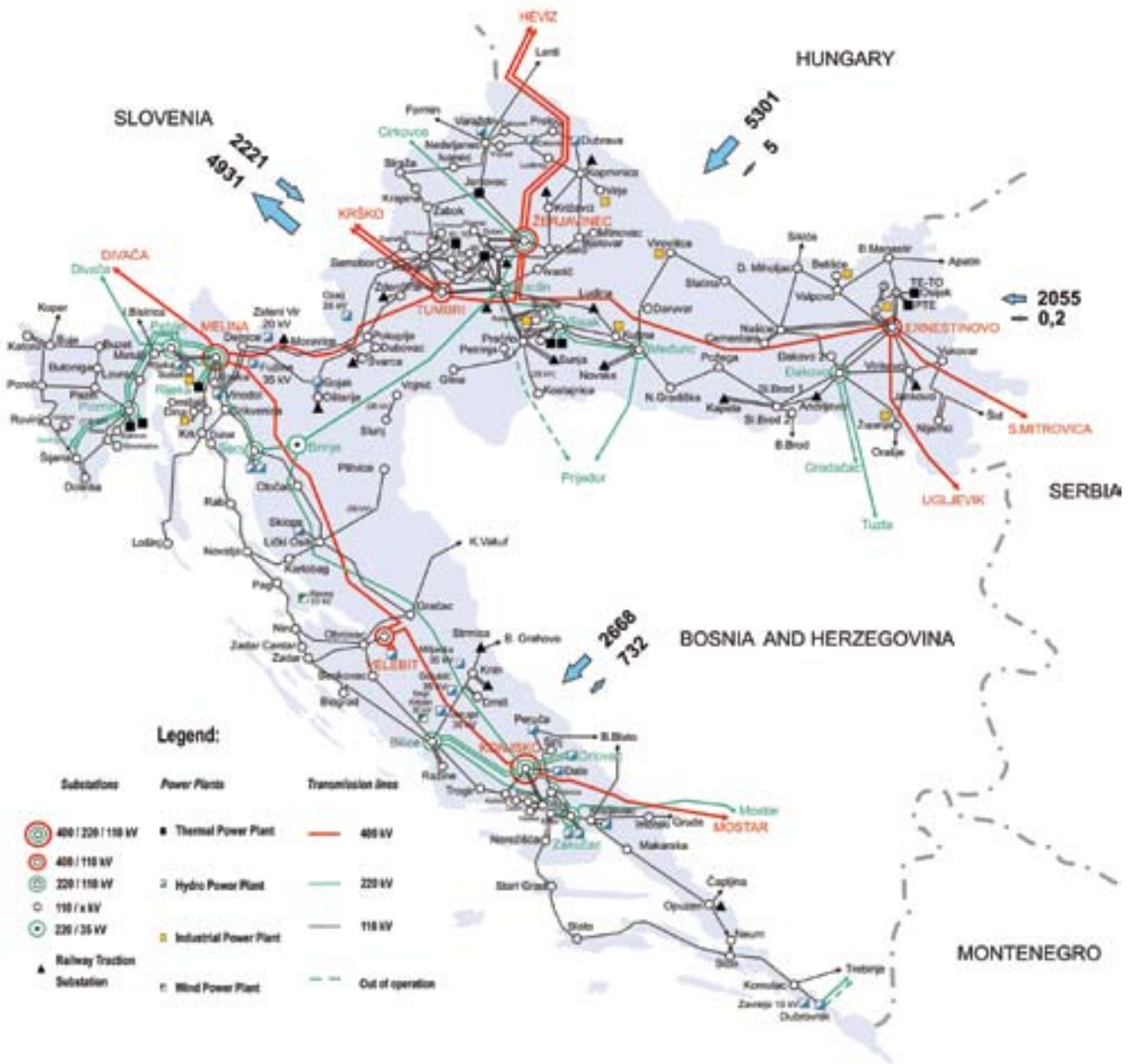
Electricity balance	GWh
TOTAL PRODUCTION*	11,419
Import (entering Croatia)	12,245
TOTAL PROCUREMENT	23,664
Export (exiting Croatia)	5,668
TOTAL CONSUMPTION	17,996
Direct procurement and consumption on distribution network	395
Transmission losses	484
TRANSMISSION CONSUMPTION	17,117
Direct customers	979
Pumping and other auxiliary consumption	193
DELIVERED TO DISTRIBUTION FROM TRANSMISSION NETWORK	15,946
SYSTEM PEAK LOAD	3,009 MWh/h

*Including energy supplied by industrial and wind power plants and production supplied directly into distribution network (464 GWh)

*Transmission network as at December 31, 2008
(in operation)*

	400 kV	220 kV	110 kV	medium voltage	Total
Line length (km)	1,159	1,144	4,634	184	7,121
Transformer stations (number)	5	6	106	-	117
Installed capacity (MVA)	4,100	2,100	4,903	-	11,103

Croatian electricity system and cross-border exchanges (GWh)



■ Independent Auditor's Report

To the Owner of HEP Operator prijenosnog sustava d.o.o.:

We have audited the accompanying financial statements of HEP Operator prijenosnog sustava d.o.o. (the "Company"), which comprise the balance sheet as at 31 December 2008 and the related statement of income, statement of changes in equity and cash flows 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 entities' 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 financial statements present fairly, in all material respects, the financial position of the Company as at 31 December 2008, and their financial performance and their cash flows for the year then ended in accordance with International Financial Reporting Standards.

Emphasis of matter

a) Revenue recognition

Without qualifying our opinion, we draw attention to Note 2 to the financial statements discussing the accounting policies for revenue recognition. The Company recognized revenue based on the decision of the Energy Regulation Council regarding the tariff system in October 2003. Under this decision, the Company is reimbursed for transmission services by its parent company, HEP d.d.. This reimbursement is based on electricity invoiced by HEP Operator distribucijskog sustava d.o.o. to the final customer multiplied by a fixed tariff. This policy is in accordance with the Croatian law.

In accordance with the Law on the Amendments to the Energy Law from December 2004, a model for determining the tariff systems for different customers was developed in December 2006, with its implementation postponed until 2007. The Group has applied the model in the preparation of the financial statements for the year ended 31 December 2007. In June 2008, the Government of the Republic of Croatia promulgated a „Decision on The Electricity Generation Tariff Model, with the exemption of eligible customers, with no tariff item amounts; The Electricity Transmission Tariff Model, with no tariff item amounts; The Electricity Distribution Tariff Model, with no tariff amounts; and the Electricity Supply Tariff Model, with the exemption of eligible customers, with no tariff amounts“. The Group has been applying the tariff models since 1 July 2008.

b) Accounting policy for leases

We also draw attention to Note 2 to the accompanying financial statements discussing the accounting policy for leases. Due to the special organizational structure, fixed assets under lease are carried at their original book value as originally stated by HEP d.d.. The liabilities for leases are stated within long term-liabilities at nominal value. The leases bear interest only to the extent that the lessor has acquired external financing to construct the corresponding asset.

Therefore, for a better understanding of the operations of the Company, the accompanying financial statements should be read in conjunction with the consolidated financial statements of the HEP Group.

Deloitte d.o.o.
Branislav Vrtačnik, certified auditor

Zagreb, 08 May 2009

■ Income statement - HEP Operator prijenosnog sustava d.o.o.
For the year ended 31 December 2008

	2008	2007
	HRK'000	HRK'000
Electricity transmission income	956,329	639,159
Other income - related companies	14,081	19,054
Other operating income	86,551	115,782
	1,056,961	773,995
Material and spare parts expenses	(19,634)	(24,838)
Service expenses	(72,678)	(63,541)
Staff expenses	(173,423)	(152,691)
Depreciation and amortisation	(228,834)	(217,688)
Support system services expenses	(121,723)	-
Transmission grid losses	(197,938)	(189,648)
Administrative expenses – related companies	(44,523)	(43,394)
Other operating expenses	(60,119)	(57,083)
	(918,872)	(748,883)
PROFIT FROM OPERATIONS	138,089	25,112
Financial income	215	213
Financial expenses	(68,419)	(55,736)
NET FINANCIAL LOSS	(68,204)	(55,523)
(LOSS)/PROFIT BEFORE TAXATION	69,885	(30,411)
Income tax	(7,945)	(447)
(LOSS)/NET PROFIT FOR THE YEAR	61,940	(30,858)

Signed on behalf of the Company on 08 May 2009 by:

Dubravko Sabolić
Managing director

■ Balance sheet - HEP Operator prijenosnog sustava d.o.o.
As at 31 December 2008

ASSETS	31 December 2008	31 December 2007
	HRK'000	HRK'000
Property, plant and equipment	3,628,079	3,463,878
Investments in progress	403,061	400,553
Intangible assets	22,972	24,559
Investment properties	7,932	3,318
Prepayments for tangible assets	231	2,104
Receivables from sale of flats	7,021	7,654
Deferred tax assets	6,472	5,771
TOTAL NON-CURRENT ASSETS	4,075,768	3,907,837
Inventories	28,632	34,260
Trade receivables	30,915	16,660
Receivables from related companies	283,879	35,810
Other current assets	42,406	107,282
Current portion of long-term receivables	782	777
Cash and cash equivalents	8,088	1,388
TOTAL CURRENT ASSETS	394,702	196,177
TOTAL ASSETS	4,470,470	4,104,014

Signed on behalf of the Company on 08 May 2009 by:



Dubravko Sabolić
Managing director

CAPITAL AND LIABILITIES	31 December 2008	31 December 2007
	HRK'000	HRK'000
Subscribed capital	20	20
Reserves	40	40
Accumulated losses/retained earnings	31,082	(30,858)
TOTAL EQUITY	31,142	(30,798)
Long-term liabilities to related company	3,431,803	3,276,891
Provisions for retirement and jubilee bonuses, and legal actions	25,561	25,315
Other non-current liabilities	29,048	6,808
TOTAL NON-CURRENT LIABILITIES	3,486,412	3,309,014
Liabilities to related companies	540,241	388,078
Trade payables	156,532	202,911
Current portion of long-term liabilities to related company	228,834	217,688
Other current liabilities	27,309	17,121
TOTAL CURRENT LIABILITIES	952,916	825,798
TOTAL CAPITAL AND LIABILITIES	4,470,470	4,104,014

Signed on behalf of the Company on 08 May 2009 by:



Dubravko Sabolić
Managing director

■ HEP - Operator distribucijskog sustava d.o.o.



HEP ODS (HEP Distribution System Operator) operations in 2008 continued to focus on performing its legal role in the electricity market and achieving business objectives in accordance with HEP Group business policies. Cutting of operating costs continued, especially maintenance costs of electric facilities according to a partly reduced plan. In 2008 the important business objectives of the Company remained to be: improvement in payment collection, reduction in non-technical network losses, optimization of inventories of electric materials, increase in electricity quality and raising of quality of service in the supply business.

In the investment area, in 2008 we focused on completion and continuation of investments in reconstruction and construction of projects begun in previous years, and on preparation and beginning of realization of new investments.

Work was completed on the construction of 110 kV transformer stations (TS 110/10(20) kV Osijek 4 – new construction and TS 110/10(20) kV Nin - reconstruction) and 35 and 20 kV facilities in particular TS 35/10(20) kV Varaždinske Toplice (replacement of relay protection and introduction in RCS), TS 35/10(20) kV Ludbreg (reconstruction), TS 35/10(20) kV Grobnik (reconstruction), TS 35/10(20) kV Generalski Stol (reconstruction), RS 10(20) kV Komolac, RS 10(20) kV Petrokemija Kutina, changeover to 20 kV of the areas of Velika Gorica and Botinec and KB 20 kV phase arrangement from TS Dobri.

Investments into the following facilities continued: 110/10(20) kV Turnić (Elektroprimorje Rijeka), TS 110/10(20) kV Dugopolje (Elektrodalmacija Split, connection of the industrial zone Dugopolje), TS 110/20 kV Tupljak, (Elektroistra Pula, connection of the industrial zone Podpićan), TS 110/30/10(20) kV Dugo Selo (Elektra Zagreb), TS 110(30)/20(10) kV Podi (Elektra Šibenik, connection of the industrial zone Podi) and ripple control units of 110 kV switchyard Dubec (Elektra Zagreb). Currently

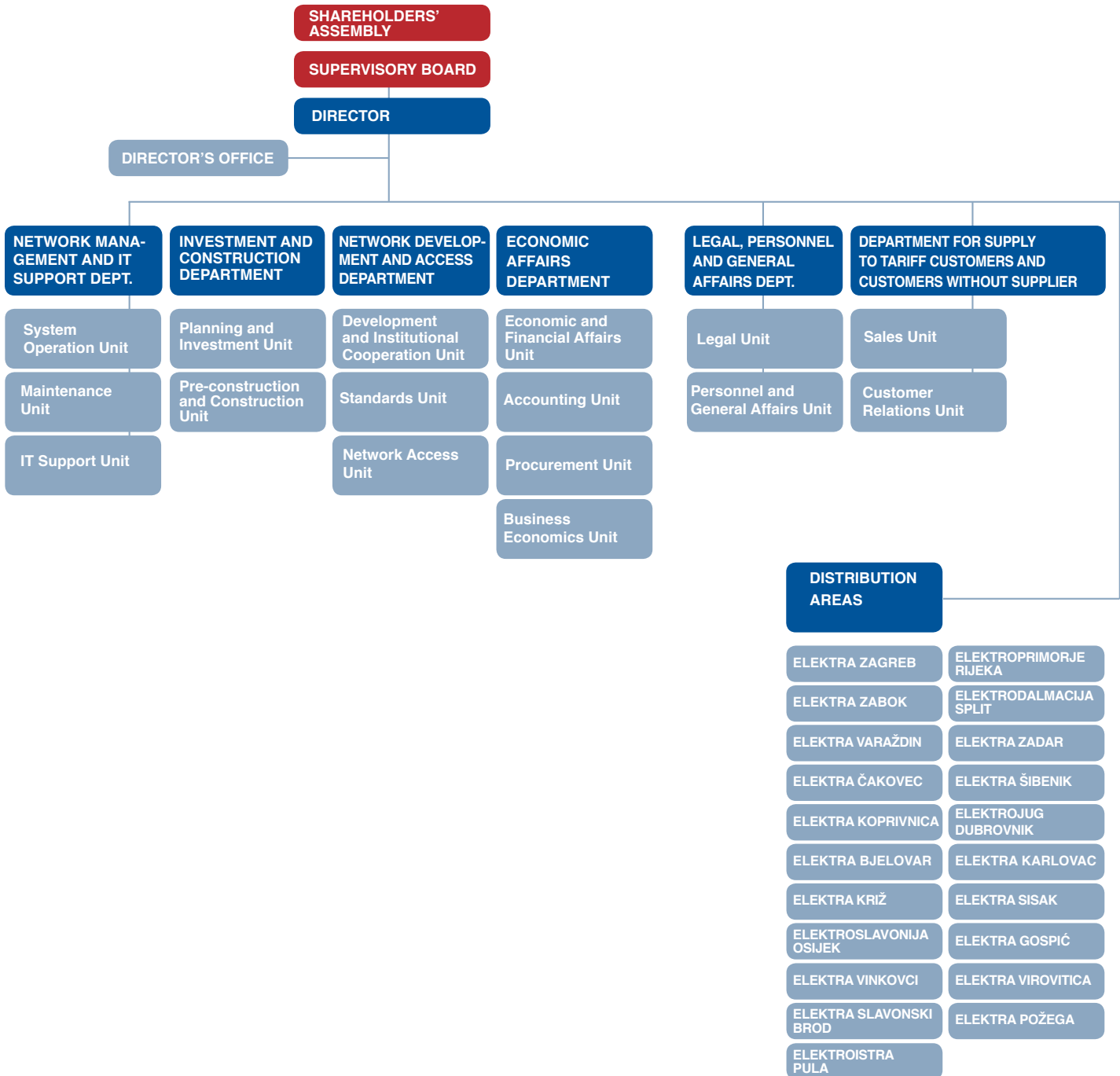
underway is change to 20 kV of the following areas: Jastrebarsko (Elektra Karlovac), Krapina (Elektra Zabok), Slavonski Brod (Elektra Slavonski Brod), Đakovo (Elektroslavonija Osijek) and Nin (Elektra Zadar).

Repair and reconstruction in war-affected areas were performed with the aim of connecting homes to the network in accordance with the pace of return of displaced persons and refugees. The refurbishment of large and medium-size control centers continued with the aim of establishing a uniform architecture of the remote monitoring and control system of HEP ODS network. DISPO program, in which operational events for the whole distribution network are logged, is in full application. Based on statistically processed data on planned and forced outages in the network, reliability quality indicators were derived for each distribution area and as a total for HEP ODS, which are reported to CERA on an annual basis. During 2008, a Proposal for standard quality levels of electricity supply in the distribution network was prepared, consisting of Rules on voltage quality in the distribution network, Rules on supply reliability in the distribution network and Rules on service quality. When adopted, they will allow systematic monitoring of voltage quality and reporting to CERA. Distribution areas control carry out checks of voltage quality and keep records of voltage quality complaints.

HEP-ODS has begun to systematically monitor and supervise quality of customer services. With the aim of integrating all data on customers and metering devices, the project EDM SAP has been initiated. Separation of metering data from electricity billing and collection will allow unbiased relation toward all users of metering data in the electricity market. For this purpose the adaptation was begun of existing HEP Billing program to make it compatible with EDM SAP application. A single base of remotely-read customer metering points above 30kW in connected load has been continuously expanding and now contains metering data from more than 15 thousand metering points. Also, investigations have been initiated to determine compensating load curves for particular customer categories that have meters without the possibility of storing energy data in a time interval.

Mišo Jurković
Director

■ Company organizational chart



Number of transformer stations by voltage level

TS 110/35(30)/10(20) kV	TS 110/10(20) kV	TS 35(30)/10(20) kV	TS 20/0,4 kV	TS 10/0,4 kV
2	8	327	3,188	20,782

Line lengths by voltage level and line type

Lines 110 kV (km)			Lines 35, 30 kV (km)			Lines 20 kV (km)		
OHL	Cable	Undersea	OHL	Cable	Undersea	OHL	Cable	Undersea
104.1	16.8	5.8	3,340.5	1,238.1	135,0	2,761.3	1,923.0	2.6

Lines 10 kV (km)			Network 0.4 kV (km)			Household connections (km)		
OHL	Cable	Undersea	OHL-bare	OHL-insulated	Cable	OHL-bare	OHL-insulated	Cable
19,668.3	10,168.0	217.1	23,957.6	21,682.9	14,832.1	5,089.4	15,081.1	9,289.5

Number of customers / metering points by consumption category (voltage level)

Description	Number of metering points
High voltage 110 kV	5
Total medium voltage	2,056
Low voltage - commercial	191,520
Low voltage – commercial (public lighting)	20,401
Low voltage – residential	2,069,016
TOTAL	2,282,998

Electricity consumption by distribution area in 2008 (kWh)

Description	Commercial HV 110 kV	Commercial MV 35 kV	TOTAL HV and MV	Commercial LV	LV - public lighting	Households LV	TOTAL LV	Total tariff customers	Eligible customers	TOTAL SALES
Elektra Zagreb	32,104,050	649,186,677	681,290,727	1,153,565,524	123,680,465	1,426,735,206	2,703,981,195	3,385,271,922	434,836,915	3,820,108,837
Elektra Zabok	-	45,042,392	45,042,392	98,523,737	9,202,930	154,700,669	262,427,336	307,469,728	101,265,796	408,735,524
Elektra Varaždin	-	127,984,665	127,984,665	121,639,999	12,118,798	169,837,138	303,595,935	431,580,600	50,418,949	481,999,549
Elektra Čakovec	-	53,915,753	53,915,753	84,584,417	5,577,815	124,145,500	214,307,732	268,223,485	30,783,994	299,007,479
Elektra Koprivnica	5,448,894	40,619,935	46,068,829	74,431,243	8,167,180	130,080,554	212,678,977	258,747,806	70,976,131	329,723,937
Elektra Bjelovar	5,457,194	18,626,820	24,084,014	101,806,542	8,340,548	137,341,759	247,488,849	271,572,863	28,040,764	299,613,627
Elektra Križ	22,004,981	102,697,300	124,702,281	102,448,723	11,421,041	182,923,411	296,793,175	421,495,456	83,320,030	504,815,486
Elektroslavonija Osijek	-	183,341,930	183,341,930	189,800,096	23,983,777	445,022,628	658,806,501	842,148,431	163,938,784	1,006,087,215
Elektra Vinkovci	6,108,850	66,252,860	72,361,710	87,369,074	17,242,093	261,671,064	366,282,231	438,643,941	34,528,547	473,172,488
Elektra Sl. Brod	19,558,066	69,918,216	89,476,282	69,282,737	11,960,011	186,802,432	268,045,180	357,521,462	34,304,264	391,825,726
Elektroistra Pula	-	230,655,146	230,655,146	259,471,487	26,683,111	474,448,685	760,603,283	991,258,429	171,731,490	1,162,989,919
Elektroprimorje Rijeka	2,557,313	200,326,151	202,883,464	353,582,191	31,536,595	656,122,110	1,041,240,896	1,244,124,360	242,709,760	1,486,834,120
Elektrodalmacija Split	210,498,494	206,404,019	416,902,513	498,077,353	51,442,294	978,104,485	1,527,624,132	1,944,526,645	117,394,841	2,061,921,486
Elektra Zadar	-	92,745,765	92,745,765	139,053,171	22,611,062	350,161,304	511,825,537	604,571,302	38,180,255	642,751,557
Elektra Šibenik	59,419,251	43,830,183	103,249,434	111,776,777	14,629,756	211,738,548	338,145,081	441,394,515	26,756,485	468,151,000
Elektrojug Dubrovnik	-	51,656,811	51,656,811	103,848,809	12,508,924	199,241,161	315,598,894	367,255,705	25,638,741	392,894,446
Elektra Karlovac	17,549,290	110,988,597	128,537,887	99,339,345	19,553,988	215,473,689	334,367,022	462,904,909	39,609,736	502,514,645
Elektra Sisak	109,773,762	47,083,872	156,857,634	58,438,142	12,716,148	162,665,282	233,819,572	390,677,206	79,720,941	470,398,147
Elektrolika Gospić	-	24,194,805	24,194,805	57,324,390	6,832,886	89,062,829	153,220,105	177,414,910	11,831,998	189,246,908
Elektra Virovitica	-	40,530,831	40,530,831	36,741,450	4,335,422	78,812,530	119,889,402	160,420,233	17,240,736	177,660,969
Elektra Požega	-	40,228,842	40,228,842	24,142,617	5,610,225	76,324,228	106,077,070	146,305,912	18,700,325	165,006,237
TOTAL	490,480,145	2,446,231,570	2,936,711,715	3,825,247,824	440,155,069	6,711,415,212	10,976,818,105	13,913,529,821	1,821,929,482	15,735,459,303

*Data on electricity sales for residential customers are based on estimated consumption billing.

**Sales to eligible customers within HEP Group are the responsibility of HEP Opskrba d.o.o.

Independent Auditor's Report

To the owners of HEP - Operator distribucijskog sustava d.o.o.:

We have audited financial statements of HEP –Operator distribucijskog sustava d.o.o (the “Company”), which comprise the balance sheet as at 31 December 2008 and the related income statement, statements of changes in equity and of cash flows 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 independent 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 entities' 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.

Matters affecting the opinion

a) Measurement of investment properties at fair value

During 2008, the Company changed its accounting policy during 2008 in respect of the valuation of its investment property from the cost model to the fair value model. In accordance with International Accounting Standard 40 Investment Property, investment properties are initially carried at cost and subsequently measured either at cost or fair value. The Company remeasured its investment property, leased from HEP d.d., at fair value and presented the resulting amount as an increase in long-term liabilities to related parties rather than in the earliest period presented in accordance with International Accounting Standard 8, which requires that the effects of changes in accounting policies are recognised retrospectively in the financial statements of the Company.

As a result, long-term debt to related parties has been overstated by HRK 30 million, whereas retained earnings and the net profit have been understated by the opening balance of the cumulative effect of the change in the accounting policy i.e. the effect of the change in the accounting policy in the current year.

Opinion

In our opinion, except for the effect of the matters discussed in paragraph a), financial statements present fairly, in all material respects, the financial position of the Company as at 31 December 2008, the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Emphasis of matter

a) Revenue recognition

Without qualifying our opinion, we draw attention to Note 2 to financial statements, discussing the accounting policies for revenue recognition. The Company recognized revenue based on the decision of the Energy Regulation Council regarding the tariff system in October 2003. Under this decision, the Company is reimbursed for distribution services by its parent company, HEP d.d.. This reimbursement is based on electricity delivered to the final customer multiplied by a fixed tariff for distribution services. This policy is in accordance with the Croatian laws and regulations.

Based on the current regulation, one of the main activities of the Company is to invoice electricity to end-users (See Note 2). The receivables recognized in the accompanying financial statements represent these amounts invoiced. Recognized revenues represent only the distribution portion of the fees to end-users.

In accordance with the Law on the Amendments to the Energy Law from December 2004, a model for determining the tariff systems for different customers was developed in December 2006, the application of which was postponed to 2007. The Group developed the model that was applicable throughout the year 2007.

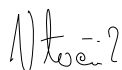
In June 2008, the Government of the Republic of Croatia promulgated a „Decision on The Electricity Generation Tariff Model, with the exemption of eligible customers, with no tariff item amounts; The Electricity Transmission Tariff Model, with no tariff item amounts; The

Electricity Distribution Tariff Model, with no tariff amounts; and the Electricity Supply Tariff Model, with the exemption of eligible customers, with no tariff amounts". The Group has been applying the tariff models since 1 July 2008.

b) Accounting policy for leases

We also draw attention to Note 2 to the accompanying financial statements discussing the accounting policy for leases. Due to the special organizational structure, fixed assets under lease are carried at their original book value as originally stated by HEP d.d. The financial lease liabilities are stated within long term-liabilities at nominal value. The leases bear interest only to the extent that the lessor has acquired external financing to construct the corresponding asset.

Therefore, for a better understanding of the operations of the Company, the accompanying financial statements should be read in conjunction with the consolidated financial statements of the HEP Group.



Deloitte d.o.o.
Branislav Vrtačnik, certified auditor

Zagreb, 08 May 2009

Income statement HEP Operator distribucijskog sustava d.o.o.
For the year ended 31 December 2008

	2008	2007
	HRK'000	HRK'000
Electricity distribution fee income – related companies	2,980,228	2,552,049
Services rendered	159,590	161,485
Other operating income	369,041	387,293
TOTAL OPERATING INCOME	3,508,859	3,100,827
Cost of externally purchased energy	(12,565)	(2,466)
Grid losses	(579,017)	(512,789)
Service expenses	(299,388)	(305,043)
Staff expenses	(1,127,048)	(1,035,929)
Depreciation and amortisation	(718,717)	(677,211)
Administrative expenses – related companies	(159,430)	(163,075)
Other operating expenses	(457,757)	(465,982)
TOTAL OPERATING EXPENSES	(3,353,922)	(3,162,495)
(LOSS)/ PROFIT FROM OPERATIONS	154,937	(61,668)
Financial income	1,159	857
Finance costs	(36,585)	(37,392)
NET FINANCIAL LOSS	(35,426)	(36,535)
(LOSS)/ PROFIT BEFORE TAX	119,511	(98,203)
Income tax expense	(1,511)	(3,500)
(LOSS)/PROFIT FOR THE YEAR	118,000	(101,703)

Signed on behalf of the Company on 08 May 2009 by:



Mišo Jurković
Director

■ Balance sheet HEP Operator distribucijskog sustava d.o.o.
As at 31 December 2008

ASSETS	31 December 2008	31 December 2007
	HRK'000	HRK'000
Property, plant and equipment	11,233,889	10,498,146
Capital work in progress	1,026,703	1,218,791
Intangible assets	19,513	23,432
Investment properties	61,916	31,969
Receivables from sale of flats	29,360	32,008
Prepayments for tangible assets	11	17
Deferred tax assets	45,364	41,140
TOTAL NON-CURRENT ASSETS	12,416,756	11,845,503
Inventories	250,474	274,895
Trade receivables	778,458	915,154
Receivables from related companies	1,078,433	540,420
Current portion of long-term receivables	3,879	4,040
Other current assets	45,001	153,369
Cash and cash equivalents	57,457	20,822
TOTAL CURRENT ASSETS	2,213,702	1,908,700
TOTAL ASSETS	14,630,458	13,754,203

Signed on behalf of the Company on 08 May 2009 by:



Mišo Jurković
Director

EQUITY AND LIABILITIES	31 December 2008	31 December 2007
	HRK'000	HRK'000
Subscribed capital	20	20
Accumulated losses	(28,313)	(146,313)
TOTAL EQUITY	(28,293)	(146,293)
Long term liabilities to related companies	7,503,559	7,341,252
Other non-current liabilities	19,976	21,643
Deferred income	4,022,063	3,482,149
Long-term provisions	199,525	185,200
TOTAL NON-CURRENT LIABILITIES	11,745,123	11,030,244
Trade payables	666,810	641,832
Liabilities to related companies	1,341,786	1,516,512
Current portion of long-term liabilities to related company	568,352	553,427
Other current liabilities	336,680	158,481
CURRENT LIABILITIES	2,913,628	2,870,252
TOTAL CAPITAL AND LIABILITIES	14,630,458	13,754,203

Signed on behalf of the Company on 08 May 2009 by:



Mišo Jurković
Director

■ HEP - Toplinarstvo d.o.o.



In accordance with HEP's mission, in 2008 HEP-Toplinarstvo d.o.o. (HEP District Heating) fully met its basic objective – secure and reliable supply of heat energy and process steam to all of its customers. The Company carried out, in line with best practices and all legal requirements applicable to district heating, the business activities of production, distribution and supply of heat energy, and of development and construction of heating networks and plants in all our service areas.

During 2008, the implementation of major investment projects of HEP-Toplinarstva d.o.o., which began the year before, continued – refurbishment of the hot water networks in Zagreb and Osijek funded by a World Bank loan, and construction of a full-scale energy plant for Zagreb University Hospital Center, in the location of Rebro Hospital.

HEP-Toplinarstvo specialists actively participated during 2008 in preparing parts of subordinate legislation important for the reform of the energy sector in the area of district heating. This relates in particular to Rules on the method of cost allocation and billing for the heat energy supplied which came into force at the end of 2008. The Rules regulate the area of heat consumption management by users and/or installation of devices for heat control and local distribution of heat supplied on an individual level. There is a huge interest in this area on the part of our customers as they will finally be able to influence by themselves comfort and cost for the heat supplied.

At the end of 2008, after prices had not changed for years despite rising fuel costs, Decision was adopted to increase heat prices, applicable from the beginning of 2009. Actually, the main problem of district heating operations and development is an unrealistic ratio of prices of fuel (oil and natural gas), as the main input cost of heat production in cogeneration processes and in separate boiler rooms, and selling prices of heat energy. As I always emphasize, achieving an appropriate level of heat price is one of the key factors which will ensure financial viability of HEP-Toplinarstvo and make it possible to

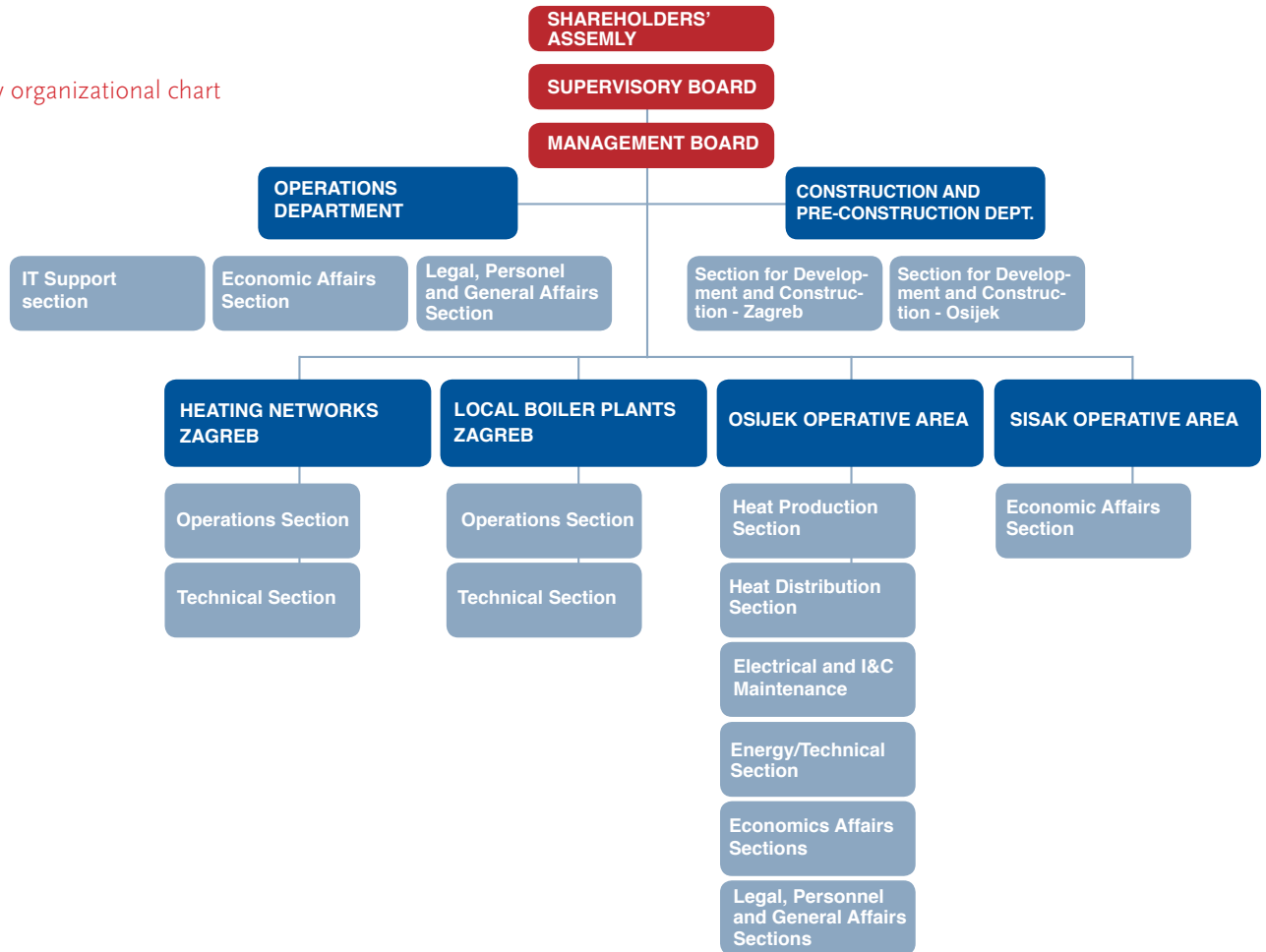
invest in the system development and expansion. HEP-Toplinarstvo is aware of the significant role it has in the society and seeks to justify the trust of our customers and to maintain its position of the biggest and most important district heating company. We have been therefore working continuously to raise the technological level of the system, introduce new services, improve customer relations and energy efficiency and environmental protection.

Despite very difficult business conditions resulting from global recession, I am confident that HEP-Toplinarstvo d.o.o. and its employees have the knowledge, will and strength to successfully overcome all challenges posed before us by new legislation, new construction and expansion projects, new customer connections and maintenance and improvement of the heating system.

A handwritten signature in blue ink, appearing to read 'Robert Krklec', written over a light blue background.

Robert Krklec
Director

Company organizational chart



HEP - Toplinarstvo d.o.o. in 2008

DISTRICT HEATING SYSTEM ZAGREB

Production:	
- Heat	1,501,739 MWh
- Steam	656,392 t
Sales:	
- Heat	1,327,369 MWh
- Steam	536,655 t
Number of customers:	88,969

LOCAL BOILER PLANTS: ZAGREB, V.GORICA, SAMOBOR, ZAPREŠIĆ

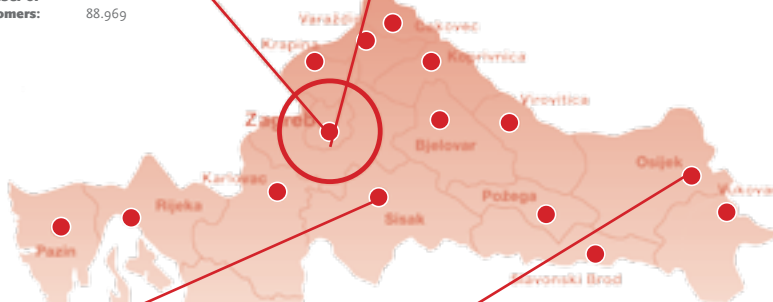
Production:	
- Heat	208,695 MWh
Sales:	
- Heat	181,173 MWh
Number of customers:	16,938

SISAK OPERATIVE AREA

Production:	
- Heat	76,593 MWh
- Steam	31,247 t
Sales:	
- Heat	61,808 MWh
- Steam	28,971 t
Number of customers:	4,010

OSIJEK OPERATIVE AREA

Production:	
- Heat	196,991 MWh
- Steam	144,623 t
Sales:	
- Heat	185,291 MWh
- Steam	97,992 t
Number of customers:	11,659



HEP-Toplinarstvo d.o.o., in Zagreb, Samobor, Velika Gorica, Zaprešić, Osijek and Sisak, at the end of 2008, had 121,576 heat customers, of which 115,689 households and 5,887 corporate entities.

In heat consumption (district heat and process steam) households accounted for 60 percent (49 percent in income) and corporate entities for 40 percent (51 percent in income). In total consumption of district heat, the share of Zagreb (including Samobor, Velika Gorica and Zaprešić) was 86 percent, Osijek 11 percent, and Sisak 3 percent.

Consumption of process steam was 663,618 tons, the share of Zagreb being 81 percent, Osijek 15 percent, and Sisak 4 percent. Of the total supplied energy in MWh, 80 percent was district heat (hot water), and the remaining 20 percent was process steam. Compared to 2007, the number of customers grew 1 percent, consumption of process steam was 7 percent higher, and consumption of district heat rose by 6 percent as a result of lower outdoor temperatures in the heating season.

Capacity contracted by district heat customers from 2004 to 2008 increased by 79 MW (from 1,155 MW to 1,234 MW) or 7 percent. In the Zagreb area the increase was 49 MW (5 percent), in the Osijek area 19 MW (14 percent) and in the Sisak area 11 MW (40 percent).

Independent Auditor's Report

To the Owners of HEP Toplinarstvo d.o.o.:

We have audited the accompanying financial statements of HEP Toplinarstvo d.o.o. (the "Company"), which comprise the balance sheet as at 31 December 2008 and the related statement of income, statements of changes in equity and of 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 entities' 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 financial statements present fairly, in all material respects, the financial position of the Company as at 31 December 2008, the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Emphasis of matter

a) going concern

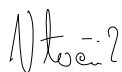
Without qualifying our opinion, we draw attention to Note 2 to the financial statements, describing the matters regarding the ability of the Company to continue as a going concern. The explanation provided shows that the business operations could be maintained in the longer term. As a result, the accounting principles applied are based on the assumption that the Company will be able to continue as a going concern.

b) accounting policy for leases

We also draw attention to Note 2 to the accompanying financial statements discussing the accounting policy for leases. Due to the special organizational structure, fixed assets under lease are carried at their original book value as originally stated by HEP d.d.. The financial lease liabilities are stated within long term-liabilities at nominal value. The leases bear interest only to the extent that the lessor has acquired external financing to construct the corresponding asset.

Therefore, for a better understanding of the operations of the Company, the accompanying financial statements should be read in conjunction with the consolidated financial statements of the HEP Group.

Deloitte d.o.o.



Branislav Vrtačnik, certified auditor

Zagreb, 08 May 2009

■ Income statement HEP Toplinarstvo d.o.o.
For the year ended 31 December 2008

	2008	2007
	HRK'000	HRK'000
Income from thermal energy sale	478,097	453,381
Income from thermal energy and other income – related companies	3,626	5,496
Other operating income	41,664	43,217
	523,387	502,094
Energy, material and spare parts expenses	(82,755)	(75,248)
Service expenses	(24,948)	(22,880)
Staff expenses	(49,444)	(43,765)
Depreciation and amortisation	(56,093)	(52,083)
Expense in respect of electricity generation and other expenses – related companies	(447,900)	(372,465)
Other operating expenses	(49,132)	(49,249)
	(710,272)	(615,690)
LOSS FROM OPERATIONS	(186,885)	(113,596)
Financial revenues	5,478	15,843
Financial expenses	(8,965)	(4,105)
NET FINANCIAL GAINS	(3,487)	11,738
LOSS BEFORE TAX	(190,372)	(101,858)
Income tax	-	-
LOSS FOR THE YEAR	(190,372)	(101,858)

Signed on behalf of the Company on 08 May 2009 by:



Robert Krklec, B.E.E.
Director

■ Balance sheet HEP Toplinarstvo d.o.o.
As at 31 December 2008

ASSETS	31 December 2008	31 December 2007
	HRK'000	HRK'000
Property, plant and equipment	724,646	668,910
Assets under construction	71,518	93,299
Intangible assets	1,890	2,176
Receivables from sale of flats	1,293	1,388
Investment property	360	243
Receivables from related companies	68,627	43,907
TOTAL NON-CURRENT ASSETS	868,334	809,923
Inventories	51,627	27,976
Trade receivables	107,876	120,562
Receivables from related companies	8,732	14,923
Other current assets	25,360	20,055
Current portion of long-term receivables	73	24
Cash and cash equivalents	4,374	11,617
TOTAL CURRENT ASSETS	198,042	195,157
TOTAL ASSETS	1,066,376	1,005,080

Signed on behalf of the Company on 08 May 2009 by:



Robert Krklec, B.E.E.
Director

CAPITAL AND LIABILITIES	31 Decembr 2008	31 December 2007
	HRK'000	HRK'000
Capital and reserves	-	-
Share capital	20	20
Reserves	20	20
Accumulated losses	(564,607)	(374,235)
TOTAL EQUITY	(564,567)	(374,195)
Long-term liabilities to related companies	738,098	661,192
Other long-term liabilities	553	613
Long-term provisions	7,820	10,454
Deferred income	165,452	158,172
TOTAL NON-CURRENT LIABILITIES	911,923	830,431
Trade payables	51,556	52,167
Liabilities to related companies	606,274	439,742
Current portion of long-term debt to related companies	56,093	52,083
Other short-term liabilities	5,097	4,852
TOTAL CURRENT LIABILITIES	719,020	548,844
TOTAL EQUITY AND LIABILITIES	1,066,376	1,005,080

Signed on behalf of the Company on 08 May 2009 by:



Robert Kirklec, B.E.E.
Director

■ HEP - Plin d.o.o.



The business objective of HEP-Plin (HEP Gas) derives from Gas Market Act, Energy Act and Decision Establishing the Company: secure, reliable and uninterrupted gas distribution and supply to customers on regulated principles of public service provision at the highest degree of environmental protection, and development of the existing distribution and supply area and expansion to new areas. Current tasks arising from this objective have been successfully performed to our satisfaction and to the satisfaction of a large majority of our customers and units of area and local self-governments.

The distribution network has been maintained in the proper and functional working order and breakdowns at gas supply points were repaired in the shortest period possible by duty crews. There were no major disruptions in gas deliveries, other than for the purposes of repair and reconstruction of Plinacro's transport system. In the gas supply business, great efforts were made in the area of billing and payment collection.

In accordance with legal requirements, in 2008, the accounts of businesses of gas distribution and gas supply were separated. Based on this, we prepared a proposal for changes of gas selling price in accordance with tariff systems for gas distribution and gas supply. The proposal was submitted to the relevant ministry and to CERA for assessment and further submission to the Government for approval of tariff rates. However, the Government adopted, irrespective of our proposal, tariff rates which included all increases in gas purchase and transport prices while the contributory margin was increased by only 0.03 kn/m³.

In 2007 at the open tendering we won concession for gas distribution and supply in the area of Osijek-Baranja County for 11 new units of self-governments. The subject matter of the

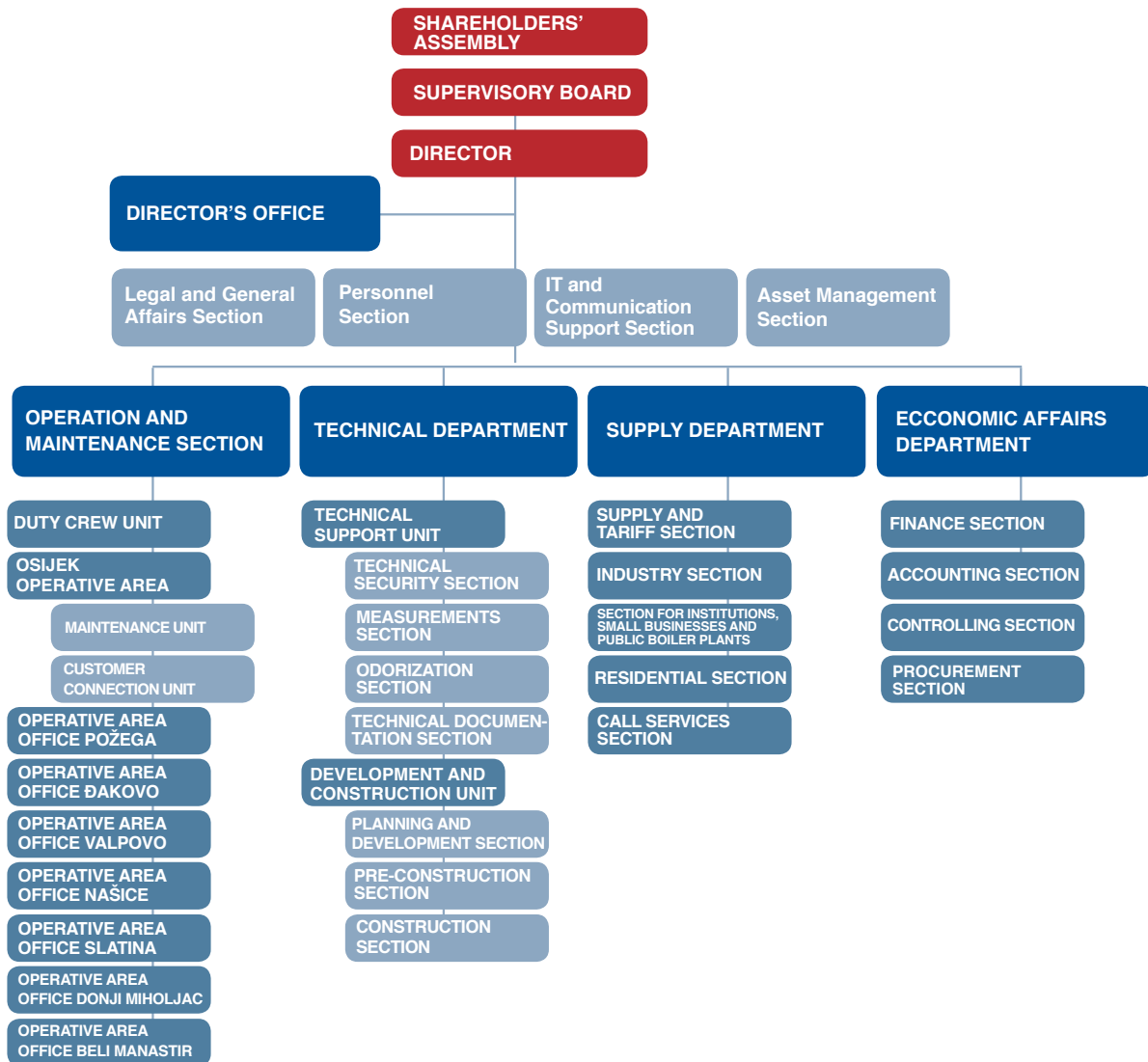
concession was gas network construction and gas distribution. We thereby expanded our distribution and supply area and fulfilled development objectives of the Company. In 2008, all preparatory work for the planned construction in 2009 was carried out.

Although the financial result was relatively favorable (a profit of 10.1 million kuna), it was not realized from core business activities (gas distribution and gas supply), but from other operating activities (from deferred income from connection charges, income from connection point services and other extraordinary income). The core businesses activities, in spite of savings and business efficiency measures that were implemented, continue to reveal an operating loss (about 1.5 million kuna). The main reason is insufficient distribution margin which serves to cover operating costs. It must be emphasized that our selling price has been for years among the lowest compared to all other gas distributors in Croatia.

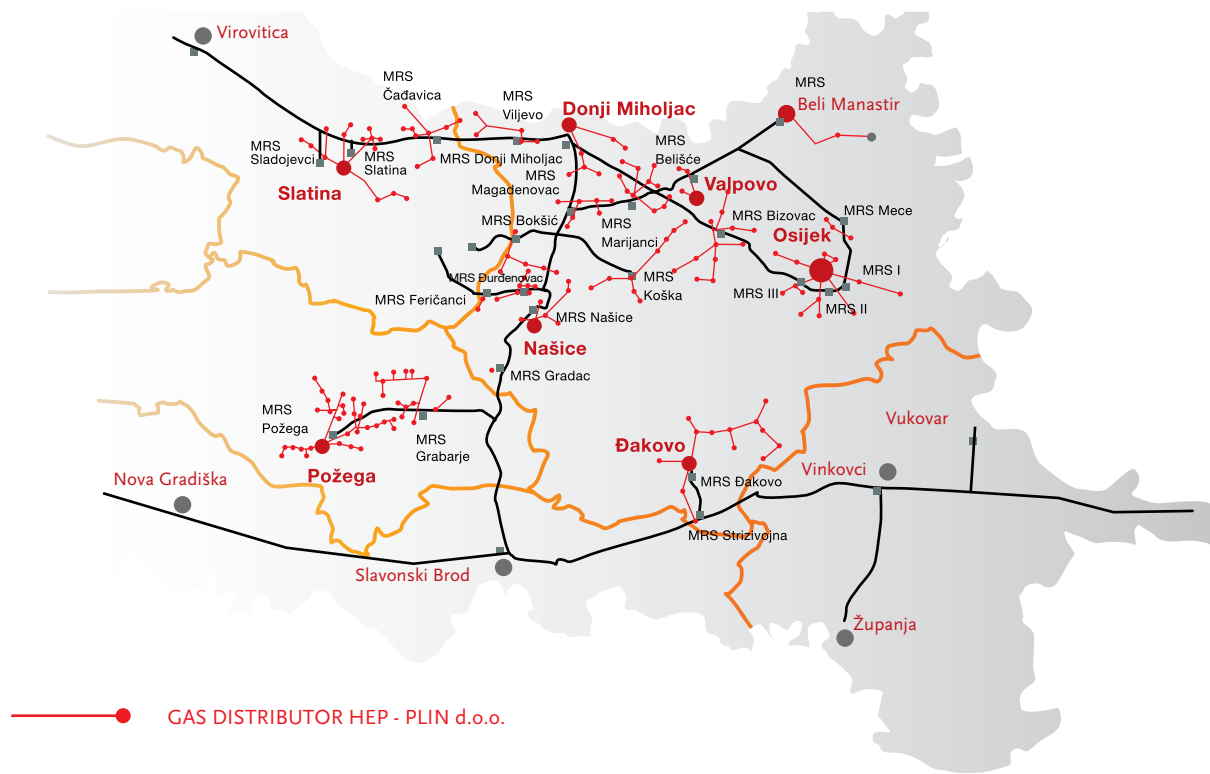
A handwritten signature in blue ink, appearing to read 'N. Liović'.

Nikola Liović
Director

■ Company organizational chart



■ HEP-Plin d.o.o. in 2008



Number of customers

Supply area	
Osijek-Baranja County	55,741
Požega-Slavonija County	7,237
Virovitica-Podravina County	3,508
Total	66,486

Structure of customers	2007	2008	Change (%)
Industrial	1,110	1,179	6.2
Commercial	3,421	3,765	10.1
Residential	59,295	61,542	3.8
Total	63,826	66,486	4.2

Gas network

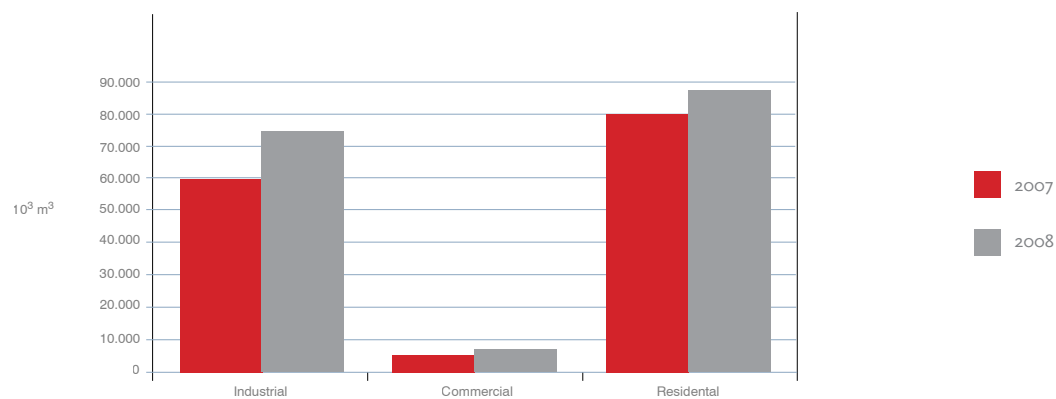
	2007	2008	Change (%)
Gas lines – owned by HEP d.d. (km)	1,472	1,602	8.8
Gas lines – owned by other parties (km)	562	531	-5.5
Gas lines – total	2,034	2,133	4.9
Reducing stations – DRS (number)	51	51	0.0
Odorizers (number)	25	25	0.0

Energy balance (10³ m³)

	2007	2008	Change (%)
Procurement	161,667	168,414	4.2
Sales	153,115	166,308	8.6
Losses	8,552	2,106	-75.4
Losses (%)	5.29	1.25	-76.4

Structure of gas sales (10³ m³)

Customer category	2007	2008	Change (%)
Industrial	63,112	67,560	7.0
Commercial	7,824	8,879	13.5
Residential	82,179	89,869	9.4
Total	153,115	166,308	8.6

Gas sales

■ Independent Auditor's Report

To the Owners of HEP Plin d.o.o.:

We have audited financial statements of HEP Plin d.o.o. (the "Company"), which comprise the balance sheet as at 31 December 2008 and the related statement of income, statements of changes in equity and of cash flows for the year then ended, and a summary of significant accounting policies and notes to the financial statements.

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.

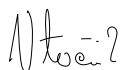
An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or 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 entities' 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, financial statements present fairly, in all material respects, the financial position of the Company as at 31 December 2008, the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Deloitte d.o.o.



Branislav Vrtačnik, certified auditor

Zagreb, 08 May 2009

Income Statement HEP Plin d.o.o.
For the year ended 31 December 2008

	2008	2007
	HRK'000	HRK'000
Gas sales	259,228	235,534
Service revenues	2,849	1,756
Income from related companies	1,383	2,695
Other operating income	19,651	22,545
TOTAL OPERATING INCOME	283,111	262,530
Cost of power sources, fuel and material	(217,926)	(201,396)
Service expenses	(2,929)	(3,412)
Staff expenses	(17,468)	(15,601)
Depreciation and amortization	(13,872)	(14,012)
Expenses with related parties	(4,340)	(4,313)
Other operating expenses	(16,488)	(19,080)
TOTAL OPERATING EXPENSES	(273,023)	(257,814)
LOSS FROM OPERATIONS	10,088	4,716
Financial income	247	411
Financial expenses	(10)	(70)
NET FINANCIAL PROFIT	237	341
PROFIT FROM OPERATIONS BEFORE TAX	10,325	5,057
Income tax	(168)	-
PROFIT FOR THE YEAR	10,157	5,057

Signed on behalf of the Company on 08 May 2009 by:



Nikola Liović
Managing Director

■ Balance Sheet HEP Plin d.o.o.
As at 31 December 2008

ASSETS	31 December 2008	31 December 2007
	HRK'000	HRK'000
Property, plant and equipment	163,266	157,690
Investment in progress and prepayments	8,999	5,967
Intangible assets	185	157
Deffered tax assets	107	-
TOTAL NON-CURRENT ASSETS	172,557	163,814
Inventories	2,525	2,951
Trade receivables	78,747	67,524
Receivables from related companies	9,339	987
Other current assets	4,230	3,622
Cash and cash equivalents	7,986	33,236
TOTAL CURRENT ASSETS	102,827	108,320
TOTAL ASSETS	275,384	272,134

Signed on behalf of the Company on 08 May 2009 by:



Nikola Liović
Managing Director

CAPITAL AND LIABILITIES	31 December 2008	31 December 2007
	HRK'000	HRK'000
Share capital	20	20
Accumulated losses	(4,119)	(14,276)
TOTAL EQUITY	(4,099)	(14,256)
Long term liabilities to related companies	66,308	68,989
Deferred income	95,558	95,794
Other non-current liabilities	2,239	1,770
TOTAL NON-CURRENT LIABILITIES	164,105	166,553
Trade payables	24,688	43,785
Liabilities to related companies	77,269	63,096
Current portion of long-term liabilities to related companies	8,488	8,865
Other current liabilities	4,933	4,091
TOTAL CURRENT LIABILITIES	115,378	119,837
TOTAL CAPITAL AND LIABILITIES	275,384	272,134

Signed on behalf of the Company on 08 May 2009 by:



Nikola Liović
Managing Director



A photograph showing several people looking out of a window. The window frame is white, and the wall is made of stone. A red banner with white text is overlaid on the image.

Reports by other HEP Group companies

HEP-Opskrba d.o.o.

HEP-Trgovina d.o.o.

HEP ESCO d.o.o.

APO d.o.o. usluge zaštite okoliša

HEP - Obnovljivi izvori energije d.o.o.

Ustanova HEP - Nastavno-obrazovni centar

■ HEP - Opskrba d.o.o.



HEP-Opskrba d.o.o. (HEP Supply) will certainly inscribe the fifth year of its business operations as one of the key years of its existence.

The basic business objectives of the Company in 2008 were:

- staffing and making the Company ready to operate in the open market,
- improving payment collection and/or reducing debtor days,
- keeping the existing and attracting new customers,
- adjusting the Company to market conditions,
- improving the public image of HEP by improving relations with customers, adaptation of Billing program to the Company's requirements, contracting for and development of SAP applications.

At the beginning of the year the Company set a very high objective for itself: to sign contracts with at least 2,500 largest customers in Croatia, which seemed almost unrealistic considering only 23 employees. Recruiting staff from within HEP Group, as well as accepting a certain number of scholarship recipients, required additional education and training in how to do business in an open market. At the end of the year the Company had 50 employees, of which 90 percent with university or associate degrees, including four masters of science.

Although the Company began the year 2008 with only 19 contracts with customers whose annual consumption was 920 GWh at the end of the year we had 2,693 contracts (consumption 6.1 TWh) at 36,349 metering points in total. The business year was marked by good financial results. Thanks to the Company's business policy, in the last quarter of 2008 an increase in income was realized of 56.1 million kuna and 93.2 percent of receivables billed and due were collected.

The biggest step forward was in our approach to customers. In the process of preparing for contracting and during contracting

we were in direct contact with more than 3,000 customers. Although most of the contracting activities took place during the annual vacation season, with exceptional efforts of all employees the planned number of signed contracts was reached. The good response by customers was also due to our basic contracting principle: one customer – one contract – one bill for all metering points.

Not less significant was a successful promotion and participation in tendering procedure for electricity procurement undertaken by customers that are subject to the Public Procurement Act. This novelty and an unknown for many customers in Croatia was successfully overcome with HEP Opskrba specialists making an exceptional contribution to that end. We thereby strengthened the position of HEP Group, but also of Croatia as a whole, because this segment was proved to function according to legal principles.

The year 2008 from the aspect of organizing and preparing for the open market can be positively assessed. A significant step forward into a completely unknown area was taken, with no experiences of our own but using our acquired knowledge and skills. We are proud to say that the electricity market in Croatia is functioning thanks to a large extent to the serious, responsible and professional approach of HEP Opskrba employees.

In the electricity market there is a company that seized its chance. The signing of almost 3,400 contracts covering consumption of more than 6.4 TWh is a good basis for further development and expansion of the market activity. At the same time, it is an obligation that calls for seriousness and responsibility from all, with support that is expected within HEP Group.

A handwritten signature in black ink, appearing to read 'Ivan Mrljak'.

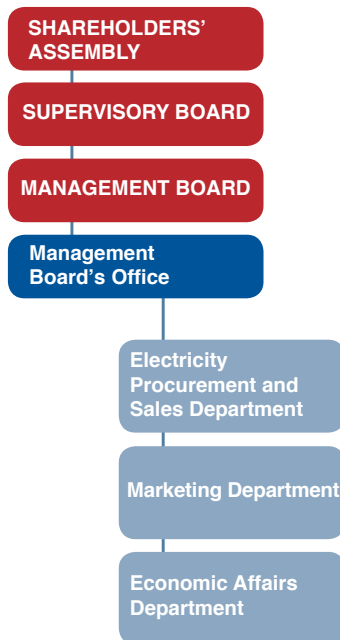
Ivan Mrljak
Director

■ Mission and vision

MISSION - to provide customers with a quality electricity supply service

VISION – to be the leading supplier in the region

■ Company organizational chart



■ HEP - Trgovina d.o.o.



HEP Trgovina d.o.o. (HEP Trade) was established as a company within HEP Group on March 1, 2007. During 2007, by optimizing the operation of HEP Group power plants combined with sales and purchase of electricity on the electricity market the Company fulfilled all of its business tasks, thereby contributing to the fulfillment of HEP Group mission. In discharging its day-to-day duties the Company had to make adjustments to the changing conditions in the electricity market, oscillations in electricity consumption, unfavorable hydrologic conditions, and occasional unavailability of generating plants. Despite unplanned aggravating circumstances we have achieved good business results thanks to, among other things, the cooperation with other companies of HEP Group.

During 2008 HEP Trgovina d.o.o., with the aim of increasing profit, continued the activities to establish companies in neighboring countries. The basic task of foreign companies is to trade in electricity in the markets of the countries in which they are established and in the markets of third countries, and to form balance groups or join existing balance groups to have the possibility of supply to eligible customers in other countries. In 2007, HEP Trade d.o.o. Belgrade (Serbia) and HEP Trgovina d.o.o. in Brežice (Slovenia) were established, and in 2008 – HEP Trade d.o.o. Mostar (Bosnia and Herzegovina) and HEP Magyarorszag Energia Kft. in Budapest (Hungary). During 2008 employees participated in national and international conferences for professional improvement and to keep up with trends in the electricity market, contributing thereby to the realization of HEP Group vision. The Company continued to actively participate in the work of EFET (European Federation of Energy Traders).

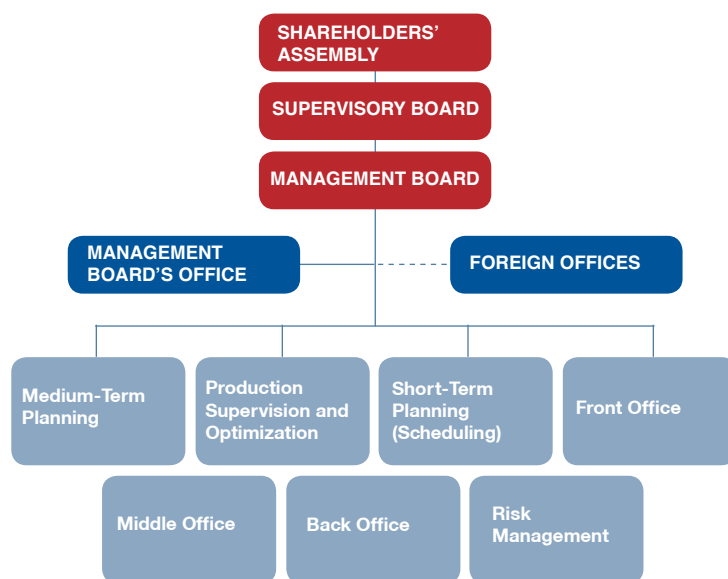
Total electricity consumption on the transmission network was 17,996 GWh, an increase of 2.1 percent compared to 2007, and 1.1 percent compared to the consumption planned in the electricity balance. Tariff and eligible customers accounted for 96.2 percent of the consumption.

Hydroelectric production was lower than planned by 10.4 percent due to low reservoir levels at the beginning of 2008 and dry periods in January and February and from July to

November of 2008. Due to reduction in natural gas deliveries and high prices of liquid fuel on the market, thermal power plants production was lower by 8.4 percent than planned. Production shortage was compensated by a 29.3 percent higher than planned electricity import. During 2008, the volume of trade was realized in the amount of 6,765 GWh, which is 21.1 percent more than planned, primarily due to greater electricity imports.

Žarko Mudrovčić
Director

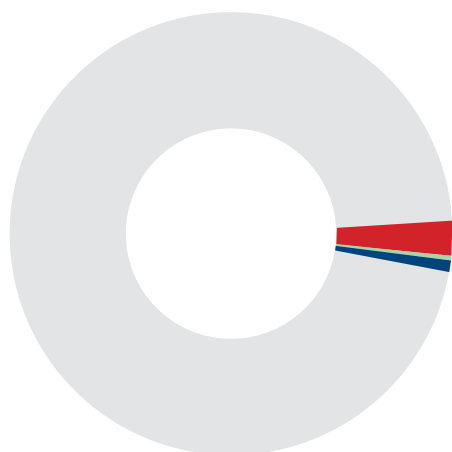
■ Company organizational chart



Electricity Balance

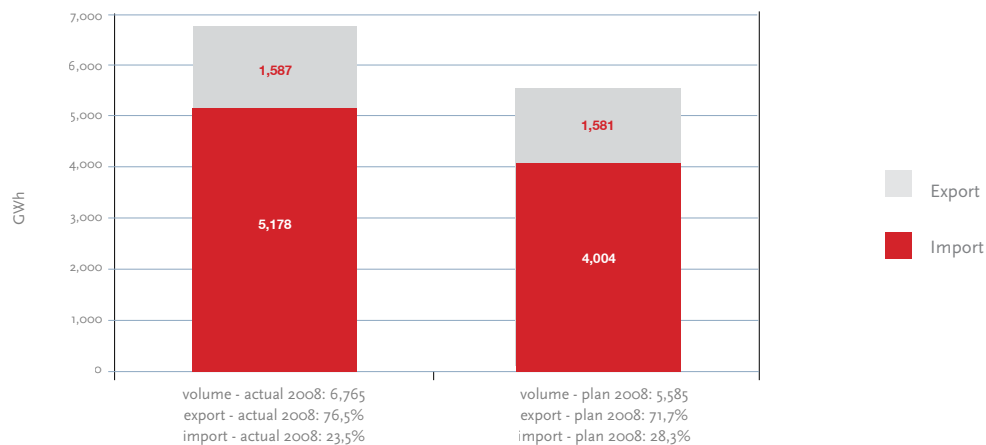
	GWh				
	2007	2008	08/07	2008 (plan)	08/08 (plan)
Total consumption on transmission network	17,630	17,996	2.1	17,800	1.1
Production by HPPs	4,357	5,277	21.1	5,890	-10.4
Production by TPPs	5,444	4,561	-16.2	4,978	-8.4
NE Krško d.o.o.	2,714	2,986	10.0	2,945	1.4
TE Plomin d.o.o.	1,401	1,514	8.1	1,500	0.9
Import	5,098	5,178	1.6	4,004	29.3
Export	-1,451	-1,587	9.4	-1,581	0.4
Industrial and wind power plants	66	67	1.3	65	4.1
Available electricity	17,630	17,996	2.1	17,800	1.1

Structure of electricity consumption in 2008



- Customers; 17,319 GWh (96,2%)
- Transmission losses; 483 GWh (2,7%)
- Other consumption; 35 GWh (0,2%)
- Energy for pumping; 158 GWh (0,9%)

Volume of trade



■ HEP - ESCO d.o.o.



The five years of existence of HEP-ESCO d.o.o has shown that the development of new activities in preparing, implementing and financing of energy efficiency projects represents, in addition to promotion of environmental protection, a significant contribution to the country's economic development by employing small and medium enterprises, mostly on the local level. They work on reconstruction of buildings with all energy and water consumption systems, modernization of public lighting of cities, reconstruction of energy systems in industrial plants and modernization of heating systems in cities. Until now, of a total of 195 contracts with domestic firms, 176 of them were concluded with small and medium enterprises.

After the organizational/legal/economic model of preparation, implementation and financing of energy efficiency projects was set up in previous years, during 2008 more attention was paid to marketing and presentation of advantages of ESCO project implementation model according to which investments are paid back through energy savings. HEP ESCO has thus been involved in preparation and implementation of several projects of the European Union in the area of energy efficiency and renewable sources (Intelligent Energy). We have presented our experiences in applying ESCO model at several conferences in EU countries and the region – South-Eastern Europe.

The Company has operated at a profit in the past three years as a result of preparation and implementation of a growing number of projects. In our work program we have more than 50 projects in different stages of preparation or implementation across Croatia. Six public lighting projects in cities have been completed and currently in implementation are three projects in Solin, Čakovec and Pula. In the business area of buildings, projects in hospitals in Varaždin and Sisak have been completed as well as those in 38 schools in five cities and counties. Until now, a total of 83 million kuna has been invested in energy efficiency projects.

Currently underway is the implementation of a cogeneration biomass cogeneration construction project at the wood industry Strizivojna Hrast and modernization of the water heating and distribution at Ruder Bošković Institute Zagreb and in 30 schools in Karlovac, Međimurje and Krapina-Zagorje counties. The value of these projects is 63 million kuna.

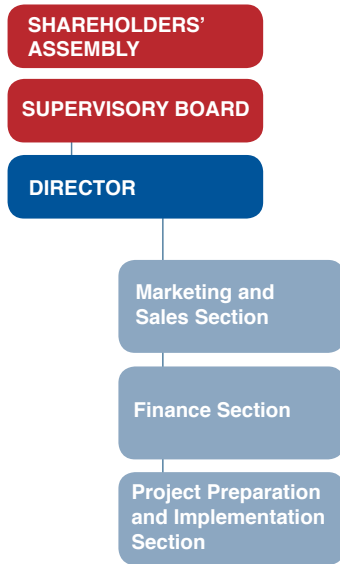
Financial institutions in Croatia have provided financing for energy efficiency projects, recognizing commercial aspects of the projects and/or their capability to pay for themselves. The banks participating in the financing of energy efficiency projects are: IBRD (World Bank), GEF – Global Environment Facility, Zagrebačka, Erste&Steiermarkische, Privredna, RBA, Splitska and OTP banks. HEP d.d. received a loan in 2008 from the German development bank KfW in the amount of 50 million euro, of which 10 million was allocated to HEP-ESCO d.o.o..

Income in 2008 amounting to 34.475 million kuna was realized from sales of services to external parties and from the proceeds of GEF grant which were used as planned for a part of technical assistance, preparation of feasibility studies and investment studies and for procurement of some equipment and works needed for the implementation of energy efficiency projects on end user sites. The profit in 2008 was 1.843 million kuna.

A handwritten signature in black ink, appearing to read 'G. Lučić'.

Gordana Lučić
Director

■ Company organizational chart



European Energy Service Initiative - European Energy Service Awards proclaimed HEP ESCO d.o.o the best European company for 2007 that provides energy services for energy efficiency projects.

■ APO d.o.o. usluge zaštite okoliša



APO d.o.o. usluge zaštite okoliša (APO Environmental Services) – a member of HEP Group, is a consulting and engineering company specializing in environmental protection. In 2008, APO provided services, in addition to HEP Group members, to corporate entities, government bodies, counties and units of local government and self-government.

During the past year, APO, in accordance with the powers and concessions it has, prepared and delivered to clients 124 documents in the area of environmental protection and waste management, from strategic documents and programs through environmental state reports, environmental impact studies, environmental emergency plans to waste management plans and rules.

The main groups of services provided by APO were:

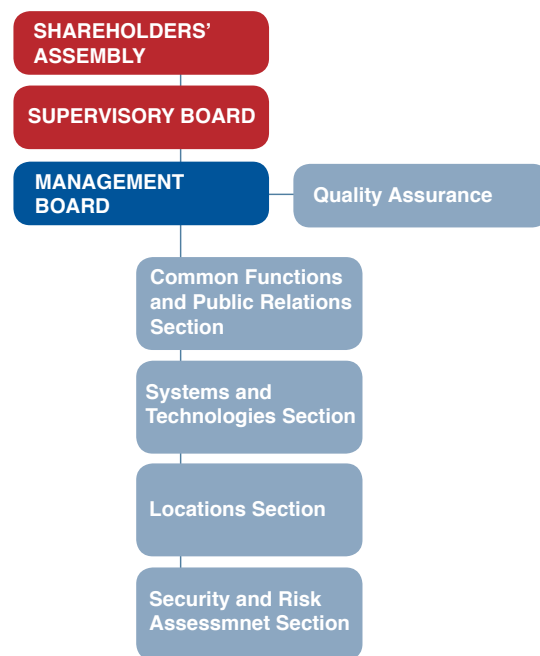
- Preparation of basic documents on environmental protection system
- Preparation of environmental protection studies, reports and plans
- Hazardous waste management
- Clean-up and supervision of contaminated areas
- Site selection and investigation
- Eco-auditing and EMS introduction
- General environmental protection consulting
- Sustainable development
- Decommissioning, radioactive waste and radioactive materials
- Public relations relating to environmental protection and sustainable development

Supervision of clean-up of seven sites was carried out. In the same period, a total of 714.7 tons of mainly hazardous waste was managed.

APO prepared a Draft Strategy of Croatia's Sustainable Development and a number of plans and programs for clean-up of contaminated areas. In a time of a growing intensity of development of renewable energy sources in Croatia, a large number of environmental impact studies has been prepared for wind power, biomass and other sources.

Damir Subašić
Director

■ Company organizational chart



■ HEP - Obnovljivi izvori energije d.o.o



In 2008, HEP-Obnovljivi izvori energije d.o.o. (HEP Renewable Energy Sources) defined key projects whose implementation was to be continued, deepened cooperation with its business partners and secured finance for further development of projects.

Currently, the most important project is the wind power plant Krš Padene (100 MW) near the city of Knin, which is being developed in cooperation with the Austrian BEWAG and Verbund and the Croatian Dalekovod d.d. At the same time active work has been going on to develop other wind power plant sites. For the location of Zelovo (33 MW) in Split- Dalmatia County, a preliminary energy approval was issued by the Ministry of Economy, Labor and Entrepreneurship at the end of 2008.


Other potential sites of wind power plants have also been Identified (Orlovac, Orljača, Stražbenica, Pliš, Konavle), for which documentation has been prepared. Preliminary energy approvals and beginning of measurements of wind power potential are expected in 2009. Some of these sites are being developed entirely by HEP OIE, others will be realized in cooperation with Dalekovod d.d.

Studies and investigations continued to be performed for biomass power plant projects and a number of potential sites for development were defined in cooperation with Croatian Forests. The sites are in Croatia's mainland where the implementation of projects could help to develop local economies. During 2008 other renewable projects were also considered such as small hydro and solar power plants so that determination of priority sites is expected in the next period.

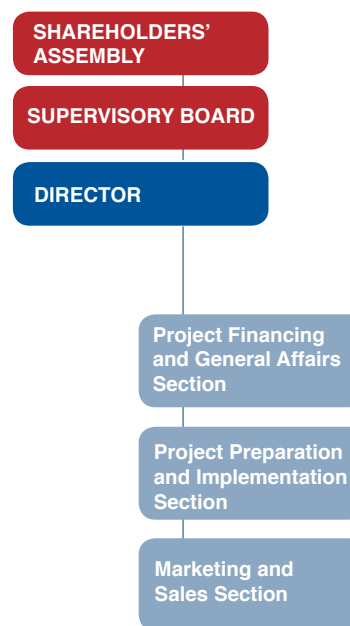
Toward the end of 2008, a 50 million euro loan was agreed with the German development bank KfW, to be used to finance renewable energy projects.

The work to develop new competencies and raise awareness of the role of renewable energy sources continued, in the professional community and within HEP. For this reason, HEP OIE participated in a number of professional gatherings and conferences, presented itself in HEP's publications and on its redesigned website which is part of HEP Group website.

We can conclude that the objectives set for 2008 have been fulfilled. Promising sites have been selected, contacts with potential partners and local communities have been established, finance for project development has been secured, and the company has continued to actively promote renewable energy sources in the professional community.

 Goran Slipac
Director

■ Company organizational chart



■ Ustanova HEP - Nastavno-obrazovni centar



The main task of HEP Nastavno-obrazovni centar (HEP Education and Training Center) is education and professional improvement of HEP Group employees and introduction of live work technology, as well as training in other technologies and/or as may be needed by HEP. This establishes HEP-NOC as a business school of HEP, and by being approved and registered as an Institution the Center has been granted public access.

The verification of 22 programs for training and professional improvement meant that all legal preconditions for additional training and acquiring new qualifications have been met.

The Administrative Council adopted Annual Plan and Program of HEP NOC: Adult Education for the School Year 2007/2008.

The Plan and Program is in form and substance aligned with the objectives and needs of HEP Group, and account was taken of experiences of similar institutions and for the first time of our own experiences from the second year of working independently. The Business Plan for 2008 was derived from the proposed Annual Work Program and Plan, with the aim to ensure profitable operations of the Institution.

In 2008, live work training was delivered to 45 employees of HEP, and 12 management staff completed an information course. Another 159 of HEP's employees attended other types of training and educational seminars.

HEP-NOC continues to offer its services outside HEP Group. The most significant result in 2008 was the program for education and application of live work technology for the Krško Nuclear Power Plant in Slovenia. Also, we are expecting to sign a contract for transfer of live work technology to electricity companies in Bosnia and Herzegovina. Education of employees of HEP's subcontractors is also significant, as they become increasingly aware of the potential and benefits of live work technology.

HEP-NOC continued in 2008 its work as a full member of the Croatian association of laboratories CROLAB, and initiated the procedure to obtain accreditation for its laboratory from the

Croatian Accreditation Agency under the standard HRN EN 17025. The inspection/testing laboratory expanded the scope of its work in periodic testing (inspection) of insulation tools and equipment used by HEP ODS, from seven to ten distribution areas. In 2008, almost 800 pieces of special insulation tools were inspected and tested. The laboratory and/or the Institution HEP NOC, continued the excellent cooperation with the Faculty of Electrical Engineering in Osijek and the Faculty of Electrical Engineering and Computing in Zagreb. In 2008 we retained all certificates for live work at low and medium voltage issued by EdF-SERECT.

The majority of educational programs was conducted by HEP NOC employees who have been continuously receiving additional training and participating in professional gatherings of EDZ, CIRED and CIGRE, as well as in specialized live work seminars such as in 2008 was ICOLIM (International Conference on Live Maintenance) in Poland. For the needs of specialized seminars and workshops, external lecturers (HEP ODS safety specialists, university professors, and experts from other companies) were engaged.

We are happy today when we are proving what we can do and tomorrow we must do better, more efficiently and based on market criteria. In the overall education process, participants' old work habits should be changed and new ones instilled, self-confidence and sense of loyalty to the company should be developed with an emphasis on rational and responsible behavior.

HEP NOC will thus in 2009 continue to successfully provide adult education and to create a positive image of HEP as a company that cares about the wellbeing of its employees and its customers.



Zdenko Miletić
Head

■ HEP NOC objectives

- preparation and introduction of new educational programs for the needs of HEP Group which improve HEP's business operations
- raising awareness of education as a long-term investment rather than cost, at all levels of business operations
- active cooperation with HEP's Human Resources Management
- encouraging practical application of the knowledge acquired, especially live work at low voltage
- entering the market with corporate educational programs (private companies, electricity companies in the region)
- cooperation on education in the area of safety at work of employees of HEP's subcontractors
- active participation in the development of the Croatian occupational classification and in defining competencies and knowledge of vocational school students

■ Notes

Report timeframe

This Annual Report gives an overview of the business year 2008, covering the period from January 1 to December 31, 2008. It also provides information on events important for HEP Group operations occurring after December 31, 2008 but no later than June 30, 2009.

Comparability of energy data

This Annual Report may occasionally give different numerical data under the same or similar title (the section Business Operations in 2008 – Results by activity – Electricity; the section reports by HEP Group companies with financial statements – HEP Proizvodnja d.o.o. and HEP Operator prijenosnog sustava d.o.o. and the section Reports by other HEP Group companies – HEP Trgovina d.o.o.). For example, in the case of HEP OPS, in accordance with its role of public service provider for all entities in the Croatian electricity market, “Total production” refers to the production in Croatia which includes production by industrial power plants and wind power plants not owned or co-owned by HEP but excludes production by Krško NPP for HEP (as opposed to the section Business operations in 2008 where data are shown based on HEP’s ownership or co-ownership of generating facilities). All data in the Annual Report have been verified and audited and when using or interpreting them one should bear in mind the context in which they appear.

Overview of financial statements of HEP Group companies

In the financial statements of companies in the section Reports by HEP Group companies with financial statements, the authorized auditor gives reference to the notes that are part of the financial statements. For reasons of scope, these accompanying notes are not published in this Annual Report. Full reports with the notes are available in companies’ main offices.

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ABBREVIATIONS USED IN THE REPORT

(HRO) CIGRE – (Croatian Committee of) International Council on Large Electric Systems
BVQI – Bureau Veritas Quality Insurance
CCPP – combined-cycle power plant
CERA – Croatian Energy Regulatory Agency
CIRED – International Conference on Electricity Distribution
CISEM – Central information system for monitoring of emissions of pollutants into the air
CS – pumping station
DISPO – program for statistical processing of distribution reliability
EDZ – Electrical Engineering Society Zagreb
EFET – European Federation of Energy Traders
EIC – ETSO identification code
EL-TO – power plant-heating plant
ETSO – European Transmission System Operators
FINA – Croatian financial agency
GEF – Global Environment Facility
HPP – hydro power plant
HROTE – Croatian Energy Market Operator
HV – high voltage
IAEA – International Atomic Energy Agency
ICOLD – International Commission of Large Dams
IEEE – Institute of Electrical and Electronics Engineers
IHA – International Hydropower Association
LNG – Liquefied natural gas
LV – low voltage
MTU – ripple control units
MV – medium voltage
NN – Narodne novine, Croatian Official Gazette
NPP – nuclear power plant

OHL - Overhead line
RETZOK – Accounting for expenses for nature and environmental protection
TE-TO – thermal power plant – heating plant
TPP – thermal power plant
TS – transformer station
UCTE – Union for the Co-ordination of Transmission of Electricity
UNICHAL – an association for heat energy and district heating plants

