ANNUAL REPORT 2009

HEP

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HEP GROUP 2009

		Change 2009/2008 (%)
Electricity sales	**17.5 TWh**	**-0.9**
Electricity production	**14.7 TWh**	**2.3**
Heat sales	**2.2 TWh**	**-0.8**
Gas sales	**157 mn m^3**	**-5.4**
Operating income	**HRK 12,600.8 mn**	**6**
EBITDA	**HRK 2,255.1 mn**	**17.3**
Group net profit	**HRK 154.4 mn**	**396**
Total assets	**HRK 32,711.1 mn**	**0.2**
Number of employees	**14.222**	**-1.1**

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PRESIDENT'S REPORT

PRESIDENT OF MANAGEMENT BOARD

LEO BEGOVIĆ

Upon the proposal and conclusions of the Government of the Republic of Croatia dated September 22, 2009, the Supervisory Board and Management Board of HEP d.d. were recalled, and a new Management Board in full complement was formed on November 2, 2009. The priority of the new Management Board is to reduce illiquidity and to consolidate in general the financial position while strengthening the financial discipline, and to strengthen transparency in relations with external parties and trust of all HEP's stakeholders.

THE BUSINESS OPERATIONS IN 2009 were carried out in the circumstances of the global economic crisis and a significant fall in economic activities in Croatia. The economic crisis has had a twofold effect on HEP Group. Due to the fall in economic activities, energy demand in Croatia decreased. Thanks to very favorable hydrologic conditions, less electricity was produced by thermal power plants, and fall in fuel prices resulted in decreased production costs. However, due to the growth in overall illiquidity and unemployment, payment collection from customers was difficult and the share of doubtful receivables increased.

In 2009. HEP Group made the highest operating income ever – 12.6 billion kuna, a net profit of 154.4 million kuna, which is significantly more than the profit made in 2008 (31.1 million).

The measures to improve liquidity, unfortunately, curtailed the planned scope of investment. The investment priority is to continue or complete the construction heat and electricity generating projects (Lešće HPP and new units at Sisak TPP and TE-TO Zagreb CHP, which has successfully begun to operate on a trial basis). Apart from these investments in production, construction work on the Croatian section of a 2x400 kV transmission line Ernestinovo-

Pecs (Hungary) was completed, and reconstruction of the hot water network in Zagreb and Osijek, financed by a World Bank loan, continued. Despite reduced investments, HEP retained the position of being one of the largest investors in Croatia.

We will be adjusting our future capital investments with the nation-wide strategic development documents. These include, first of all, the Strategy of the Energy Development of the Republic of Croatia, adopted in October 2009. The Strategy envisages the construction of 2,700 MW in base-load capacity of which 300 MW in large hydro power plants ad 2,400 MW in thermal power plants, and it also sets forth a possible launching of a nuclear energy program. Based on the Strategy, the Government made a Conclusion concerning priorities in construction of electric power projects, which constitutes the basis for the development of the electricity system and for the strengthening of the security of electricity supply in the country.

The construction of the necessary generating plants and other electric facilities goes toward the achievement of our main strategic goals – secure energy supply to customers, provision of public services at highest quality level, use of sustainable development concept in all areas of activities and businesses and maintenance of long-term competitiveness.

In 2009, total electricity turnover was 19.6 TWh, of which 14.7 TWh was produced by power plants owned wholly or partly by HEP, while the remaining 4.9 TWh was procured on the market. We met electricity needs in Croatia amounting to 17.7 TWh, and sold 1.9 TWh on the regional market. Due to the fall in economic activities in Croatia, domestic consumption in 2009 decreased by 1.7 percent.

Although the electricity market in Croatia has been fully opened since July 1, 2008 in compliance with legal requirements, Amendments to the Electricity Market Act, in force since January 1, 2009, have had a significant impact on market movements. The Amendments require all small business customers to choose their supplier or, failing that, pay for electricity at balancing energy prices. Because there is a large number of such customers from the important small business category, HEP provided them with a transitional period to adjust to the new legal requirements. During 2009, HEP Opskrba (HEP Supply) entered into contracts for electricity sale with a number of customers who had been granted the status of eligible customer and the right to choose electricity supplier. The share of eligible customers in the electricity sold in the domestic market increased to 41 percent. Electricity price in the Croatian market is still not enticing enough for competitors so HEP is still the sole electricity supplier in Croatia.

The obligations to implement the electricity market in Croatia are a part of the activities HEP has in fulfilling the obligations to implement the EU regulations governing the functioning of the energy sector. HEP's representatives, as part of Croatia's accession negotiations with the EU, continued to participate in negotiating teams for Chapter 15 (Energy), which was successfully closed, and Chapter 21 (Trans-European Networks). Regarding cooperation on European projects, it is worth mentioning that our daughter company, HEP-ESCO, has been participating in EU development programs – Intelligent Energy Europe (IEE). In October 2009, HEP ESCO was declared the best supporter in one of these projects – Greenbuilding program.

We see future HEP as a strong and dynamic entity in the Croatian economy with an emphasis on the investment cycle of building new generating plants and refurbishing the existing ones so that there is no need for HEP to import electricity by 2020 as it will be able to meet total needs from its own sources. In this investment cycle we see domestic industry and domestic construction as potential business partners.

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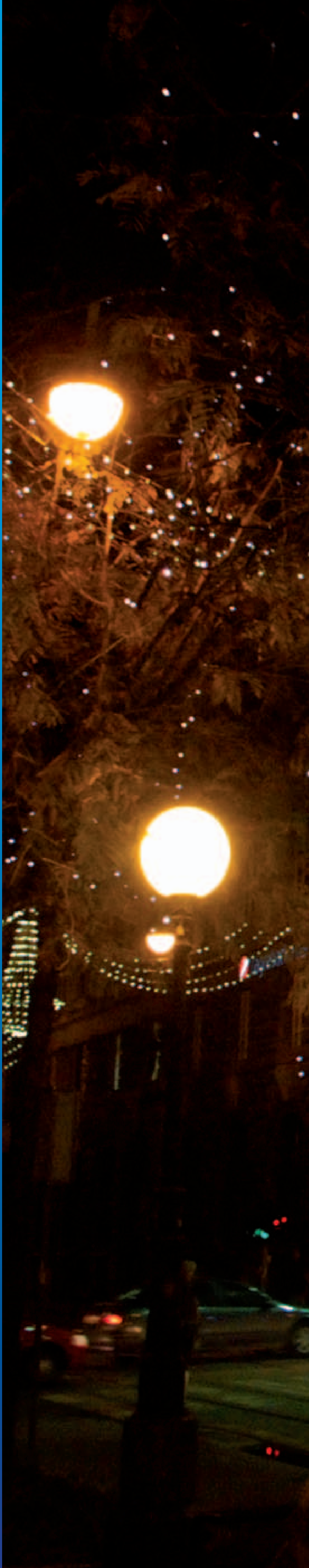


MISSION, VISION AND BASIC VALUES

We are an energy company that has been operating in the area of the Republic of Croatia for more than a century.
We support the principles of environmentally friendly production of electric and heat energy, energy efficiency and sustainable business operations with the aim of providing a high-quality service to our customers at least cost.

We are active

- within HEP Group, supporting and bringing together business strategies and business processes of subsidiary companies based on corporate principles
- outside HEP Group as a socially responsible company, establishing links with all interested parties for the common good and societal prosperity, promoting and supporting the progress of the energy industry with new information and communication technologies.

MISSION

Secure and quality supply of energy to customers, with a high level of social responsibility.

VISION

High-quality and responsible company of the future in the area of energy, which offers services according to customer wishes and requirements through constant availability, security and reliability of its services in a deregulated market.

BASIC VALUES

COMPETENCE AND CREATIVITY

Our employees are the most valuable resource and support in achieving the company's mission and vision and in creating values. With openness to new ideas and creativity, we develop skills and competencies.

QUALITY AND BUSINESS EXCELLENCE

Following requirements and expectations of all stakeholders, we improve the quality of our products and services. Our goal is the company's business excellence.

INTEGRITY

We act professionally and conscientiously in our relations toward customers, business partners, employees and assets. We affirm zero-tolerance for corruption. Our Code of Ethics defines the principles of business behavior.

ENVIRONMENTAL RESPONSIBILITY

We produce, transmit and distribute energy in an environmentally-friendly manner. We promote efficient use of energy among our customers as well as development and use of renewable energy sources.

HEP GROUP COMPANIES

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.

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, Požega-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 USLUGE ZAŠTITE OKOLIŠA d.o.o. (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.

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

For a number of years now the Republic of Croatia has been systematically harmonizing its legal framework for the energy sector with the European Union legislation. Accordingly, HEP Group has been continually adjusting its operations and organizational structure in order to efficiently adapt to the emerging and expected changes.

In June 2009 the EU adopted a third energy legislative package, consisting of two guidelines governing the internal electricity market and natural gas market, two regulations which lay down requirements for network access for cross-border electricity exchange and network access for natural gas transport, and a regulation establishing the Agency for Cooperation of Energy Regulators. The measures laid down by the third energy package should be implemented by March 3, 2011. Because Croatia is now in the EU accession process, we are facing numerous tasks of adjusting the national legal framework to the changes required by the third package.

CHANGES IN THE NATIONAL ENERGY SECTOR LEGAL FRAMEWORK IN 2009

The year 2009 was marked by activities to round up the legal framework for the functioning of the natural gas market. The following laws and regulations were adopted:

- Gas Market Act
- Rules on the Organization of the Natural Gas Market
- Grid Code for Gas Distribution System
- Grid Code for Transport System
- Rules for Use of Gas Storage System
- General Conditions of Natural Gas Supply
- Tariff System for Natural Gas Storage, Without Tariff Amounts
- Tariff System for Natural Gas Supply, with the Exception of Eligible Customers, Without Tariff Amounts
- Tariff System for Natural Gas Distribution, Without Tariff Amounts
- Tariff System for Natural Gas Transport, Without Tariff Amounts
- Regulation concerning Security of Natural Gas Supply

The legislation relating to the electricity sector was supplemented by the Rules on the Allocation and Use of Cross-Border Transmission Capacity, and in the area of district heating the Rules on Cost Allocation and Billing for Heat Energy Supplied.

In the energy regulation area, two significant documents were adopted: Rules on Licenses to Carry Out Energy Business and Regulation Concerning Validity Periods of Licenses to Carry Out Energy Business.

The Croatian Parliament passed on February 5, 2010, the Decision on the Promulgation of the Act Repealing the 2002 Hrvatska Elektroprivreda d.d. Privatization Act (NN 21/2010).

OPENING OF THE ELECTRICITY MARKET

Although the electricity market in Croatia has been fully opened since July 1, 2008 pursuant to legal requirements, Amendments to the Electricity Market Act that were passed in December 2008 to come into force on January 1, 2009, have significantly influenced the market. The Amendments require all small customers of commercial category to choose their supplier or, failing that, to pay for electricity at the price of balancing energy. Since there is a large number of such customers, belonging to a very important small business group, HEP has set a transitional period for these customers to adjust to new legal obligations.

ENERGY STRATEGY

After a public consultation, the Croatian Parliament in October 2009 passed the Energy Development Strategy of the Republic of Croatia (NN 130/09). The Strategy follows three basic energy goals:

- security of electricity supply,
- competiveness of the energy system,
- sustainability of energy development.

The Strategy contemplates the period to the year 2020, corresponding to the period for which the EU strategic energy documents were adopted.

In the part relating to the electricity sector, it predicts that the average annual growth of direct electricity consumption by 2020 will be 3.7 percent while the average annual growth in total electricity consumption will be about 3.5 percent. This means that total electricity consumption will be about 28 TWh in 2020 with a peak load of about 4,600 MW.

For the projected consumption, the Strategy envisages construction of 2700 MW of base-load generating capacity, of which 300 MW in large hydro power plants and 2,400 MW in thermal power plants, and it also provides for the launching of a nuclear energy program aimed to enable, based on preliminary work and investigations, the making of decision on construction of a nuclear power plant by 2012.

In addition to conventional sources, the Strategy envisages intensive construction of power generating facilities that use renewable sources, with all standard technologies applied such as wind parks, biomass power plants, small hydropower plants, biogas power plants, geothermal power plants and solar power plants. The objective is to maintain in the period to 2020 the share of production from large hydropower and renewable energy sources in total electricity production at present level so that it is 35 percent in 2020.

Besides the generating component, the Strategy envisages continuous physical and technological development of transmission and distribution networks.

Regarding the use of heat energy, the Strategy predicts a growth in customer district heating connections of 2.1 percent a year and energy development of towns and villages that is systematically planned and consisting of complementary development of natural gas supply and district heating system.

The Strategy also envisages encouragement of construction of distributed heat and electricity sources, as complementary systems to large energy systems.

Further to the Energy Development Strategy, the Croatian Government on April 1, 2010 passed a Conclusion Concerning Priorities of Construction of Electric Power Projects.

STRATEGIC GOALS AND DEVELOPMENT

HEP Group directs its total resources toward the achieving of several basic strategic goals:

- provide secure supply of electricity, heat energy and natural gas to customers,
- provide public services at top quality
- apply the sustainable development concept in all areas of activities and business,
- ensure long-term competitive advantage.

Proper management of existing resources is one of the most important continuous tasks of HEP employees, aimed at their optimum use and development. In 2009, refurbishment of electricity and heating plants and facilities continued.

Preparations also continued to build new facilities and to develop projects in all business areas of HEP Group.

In response to changes in the energy sector, organizational structure of HEP Group was developed and adjusted; HEP d.d., the parent, in 2009 carried out organizational changes to establish a modern functional organization of efficient corporate management of HEP Group.

ELECTRICITY PRODUCTION

In 2009 preparations to build new thermal and hydro generating plants continued. The construction was completed of a combined-cycle cogeneration unit fired by natural gas at the location of TE-TO Zagreb (100 MWe and 80 MWt), currently in trial operation. The construction of Lešće HPP (42 MW) is nearing completion. The refurbishment of Zakučac HPP continued as well as the construction of a new unit at Sisak TPP. In the area of renewable electricity sources, it is planned to put into operation the wind farm Krš Pađane (100 MW) by the end of 2012.

ELECTRICITY TRANSMISSION AND DISTRIBUTION

The construction of a double-circuit 400 kV transmission line toward Hungary, Ernestinovo-Pecs, is nearing completion as well as the introduction of a state-of-the-art information system which supports all functions necessary for the proper functioning of the electricity market.

By a series of specifically designed and targeted programs voltage conditions in the distribution system have been restored, modern metering devices registering consumption introduced, adjustments to new standards carried out as well as modernization of existing and construction of new distribution network to meet the growing needs for electricity.

GAS BUSINESS

The long-term business policy of HEP is to participate in the gas business at several levels. Preparations are underway to participate in the development and construction of a LNG terminal on the Adriatic coast of Croatia as a significant alternative supply route. Natural gas distribution and customer supply are also a business activity that has been developing.

Based on a concession right to build a gas network and to supply gas to customers for a period of 30 years, it is planned to expand the gas network in the area of Slavonia in 2010.

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. A complex multi-purpose project of supplying energy sources to the largest state university hospital in Zagreb was completed. In 2009, preparation of a number of projects to refurbish and build district heating systems in Zagreb and Velika Gorica continued.

MEMBERSHIP IN INTERNATIONAL ORGANIZATIONS

HEP d.d. and HEP Group companies are collective members and certain experts from HEP are individual members of a large number of international organizations, institutions and associations:

- **EURELECTRIC** (Union of the Electricity Industry)
- **IEEE** (The Institute of Electrical and Electronic Engineers)
- **CIGRE** (International Council on Large Electric Systems)
- **ICOLD** (International Commission of Large Dams)
- **IHA** (International Hydropower Association)
- **ENTSO-E** (European Network of Transmission System Operators for Electricity in which HEP OPS d.o.o. is a full and founding member having its representatives in the Assembly and the Board, committees and relevant regional groups)
- **SEE CAO IG** (Coordinated Auction Office Implementation Group)
- **CIRED** (Congrès International des Réseaux Electriques de Distribution)
- **LWA** (Live Working Association)
- **EFET** (European Federation of Energy Traders)
- **IAEA** (International Atomic Energy Agency)
- **ENS** (European Nuclear Society)
- **UNICHAL** (International Union of Heat Distributors)
- **EUROHEAT & POWER**
- **EWEA** (The European Wind Energy Association)
- **IIA GLOBAL** (Institute of Internal Auditors, Florida, USA, through HIIR – Institute of Internal Auditors of Croatia)
- **ISACA** (Information Systems Audit and Control Association through the Croatian branch, ISACA Chapter Croatia)
- **ISSA** (International Social Security Association)
- **ECLA** (European Company Lawyers Association) etc.

Our experts contribute to the work of these organizations with their technical papers and materials, by participating at international and national conferences and forums, professional gatherings, symposia, workshops and seminars, circular email discussions, through their work in certain bodies of these associations and in national committees. In this way they share specialist knowledge and experiences and are active members of international energy community who directly and in an organized manner take part in learning about and applying and creating of *the acquis*. Thanks to that they are important participants in creating the national energy policy and legislation and in implementing activities of interest for HEP and its customers.

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 arwe 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-fire 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 oepration
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	HEP issues corporate bonds worth 700 million kuna
2008	Construction begins of a 2x400 kV line Ernestinovo – Pecs (Hungary)
2009	Construction begins of a combined-cycle unit (230 MWe, 50 MWt) at Sisak TPP

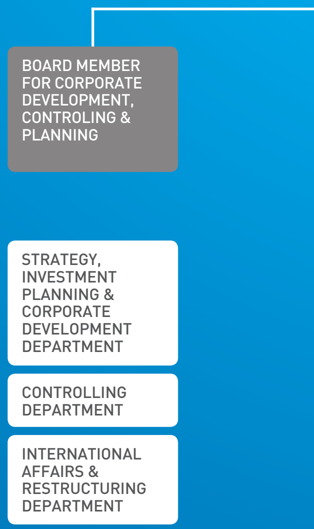
CORPORATE GOVERNANCE

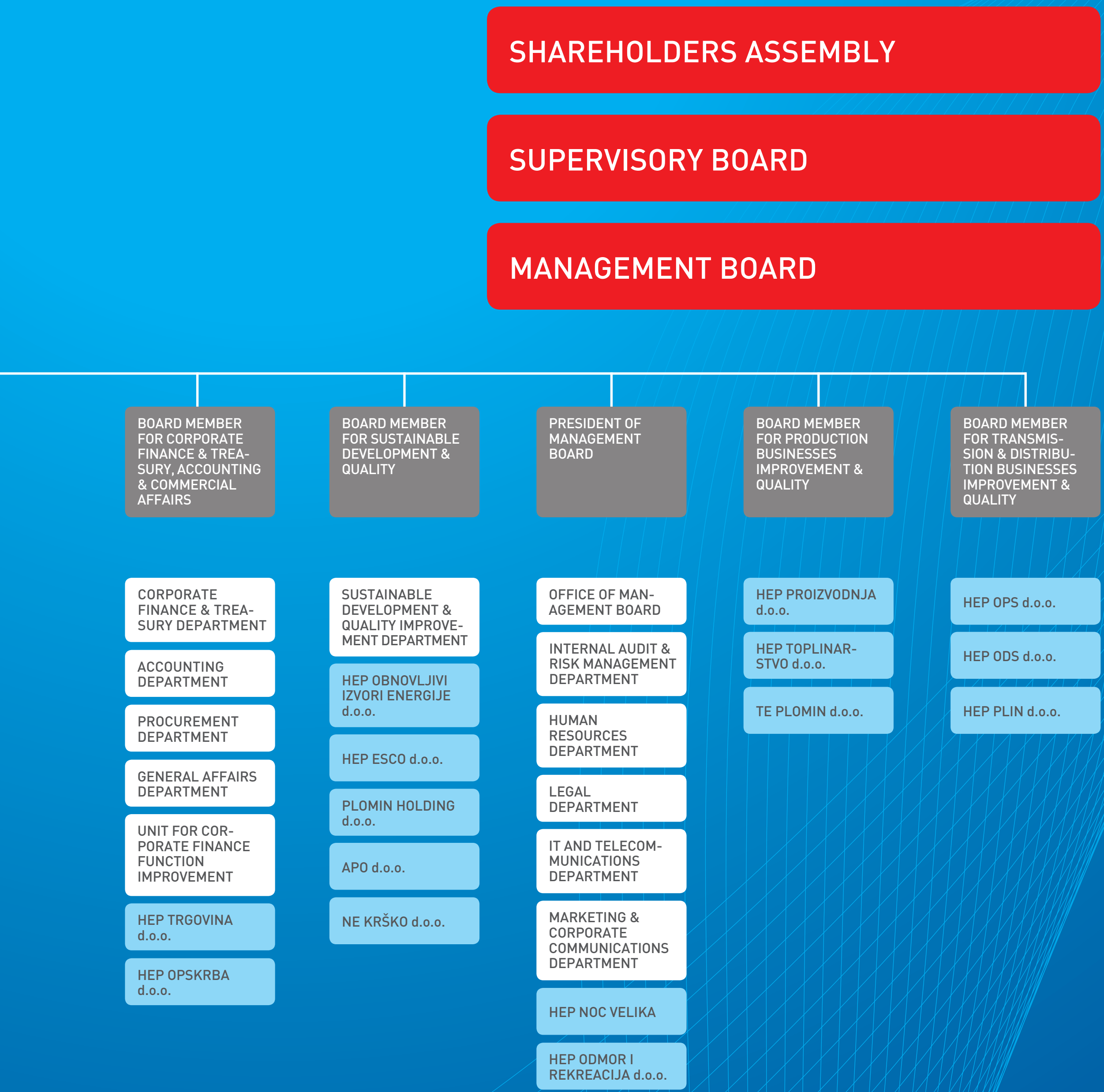
HEP d.d. ORGANIZATIONAL CHART

Since January 1, 2009, a new corporate governance model has been applied. In accordance with amendments to the HEP d.d. Rules on Organization and Job Classification, as from June 1, 2010, HEP d.d. manages and partly performs the following corporate functions:

- strategy, investment planning and corporate development
- international affairs and restructuring
- improvement in production businesses and quality
- improvement in transmission and distribution businesses and quality
- sustainable development and quality improvement
- marketing and corporate communications
- procurement
- corporate finance and treasury
- accounting
- controlling
- human resources management
- legal affairs
- information technology and telecommunications
- internal audit
- defense and safety
- risk management
- general affairs

HEP d.d., besides through corporate functions, directs, coordinates and monitors production and network as well as other businesses of subsidiaries in order to harmonize the main business activities of production subsidiaries and/or to optimize production processes. Every member of the Management Board is an executive in charge of a corporate function. The main internal organization of HEP d.d. is based on corporate governance approach and on the powers the Company has over individual business activities.




SHAREHOLDERS ASSEMBLY
SUPERVISORY BOARD
MANAGEMENT BOARD
BOARD MEMBER FOR CORPORATE FINANCE & TREASURY, ACCOUNTING & COMMERCIAL AFFAIRS
BOARD MEMBER FOR SUSTAINABLE DEVELOPMENT & QUALITY
PRESIDENT OF MANAGEMENT BOARD
BOARD MEMBER FOR PRODUCTION BUSINESSES IMPROVEMENT & QUALITY
BOARD MEMBER FOR TRANSMISSION & DISTRIBUTION BUSINESSES IMPROVEMENT & QUALITY
CORPORATE FINANCE & TREASURY DEPARTMENT
ACCOUNTING DEPARTMENT
PROCUREMENT DEPARTMENT
GENERAL AFFAIRS DEPARTMENT
UNIT FOR CORPORATE FINANCE FUNCTION IMPROVEMENT
HEP TRGOVINA d.o.o.
HEP OPSKRBA d.o.o.
SUSTAINABLE DEVELOPMENT & QUALITY IMPROVEMENT DEPARTMENT
HEP OBNOVLJIVI IZVORI ENERGIJE d.o.o.
HEP ESCO d.o.o.
PLOMIN HOLDING d.o.o.
APO d.o.o.
NE KRŠKO d.o.o.
OFFICE OF MANAGEMENT BOARD
INTERNAL AUDIT & RISK MANAGEMENT DEPARTMENT
HUMAN RESOURCES DEPARTMENT
LEGAL DEPARTMENT
IT AND TELECOMMUNICATIONS DEPARTMENT
MARKETING & CORPORATE COMMUNICATIONS DEPARTMENT
HEP NOC VELIKA
HEP ODMOR I REKREACIJA d.o.o.
HEP PROIZVODNJA d.o.o.
HEP TOPLINARSTVO d.o.o.
TE PLOMIN d.o.o.
HEP OPS d.o.o.
HEP ODS d.o.o.
HEP PLIN d.o.o.

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:

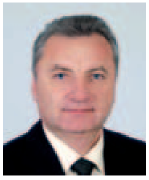
1. passes the Articles of Association and their amendments;
2. appoints and revokes the members of the Supervisory Board;
3. makes decisions on annual financial statements and use of profit;
4. appoints the auditor of the Company;
5. decides on increase or decrease in the capital stock of the Company;
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.

MEMBERS OF GOVERNING BODIES

HRVATSKA ELEKTROPRIVREDA d.d. (HEP d.d.)

SHAREHOLDERS ASSEMBLY



ĐURO POPIJAČ
Chairman of Shareholders Assembly, Minister of Economy

SUPERVISORY BOARD[1]

DARKO HORVAT[2]
Chairman of Supervisory Board, head of Energy Directorate at the Ministry of Economy, Labor and Entrepreneurship

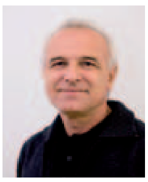
DRAŽEN BOŠNJAKOVIĆ
Vice Chairman of Supervisory Board, State Secretary at the Ministry of Justice

JADRANKO BERLENGI
member of Supervisory Board, workers' representative

KREŠIMIR DRAGIĆ
member of Supervisory Board

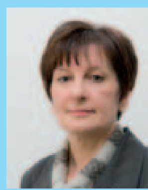
SLAVKO KONFIC
member of Supervisory Board

GORDANA OBRAN
member of Supervisory Board



ZVONIMIR SABATI
member of Supervisory Board

MANAGEMENT BOARD[3]



[1] Members of the current Supervisory Board were appointed on October 19, 2009. More on page 65
[2] Chairman of the Supervisory Board since July 20, 2010. At the end of the reporting period the chairman was Branimir Horaček.
[3] Appointed President of the Management Board on September 25, 2009, members on November 2, 2009. More on page 65

LEO BEGOVIĆ President of Management Board	Born in 1970. Graduated from the Faculty of Organization and Computer Science. First employment, from 1988 as a staff associate – advisor to the chair of Čakovec County Chamber of Commerce, in 2001 became a secretary of the County Chamber. In 2005 became Assistant Minister of Trades and Crafts, from 2006 assistant minister for investment promotion and export at Ministry of Economy, Labor and Entrepreneurship. From 2008 to being appointed president of HEP d.d. Management Board, he was state secretary at the Ministry, responsible for industry and energy. From 1999 to 2004, was member of European Integration Council of Međimurje County, from 2000 to 2005 a member of European Integration Council of Croatian Chamber of Economy. Since 2004, he has been ISO 9001 lead auditor.
DUBRAVKO LUKAČEVIĆ member of Management Board, in charge of production business improvement and quality	Born in 1954. Graduate electrical engineer, MSc (1996.). First employment as staff associate at Electrical Engineering Institute Končar (1978.). From 1983 worked at Elektroda Zagreb. In 1989 started working at HEP-u, at CCGT Jertovec, initially in maintenance of metering devices, control, computer system and communications, from 1993 as director of the Jertovec power plant. In that period he was leader of HEP team for negotiations with Enron and a member of the team for preparation of continuation of construction of Plomin TPP. From 2002 to 2009 was assistant director of HEP-Proizvodnja d.o.o.
SNJEŽANA PAUK member of Management Board, in charge of corporate development, controlling and planning	Born in 1956. Graduate economist. In 1979 started working at Tempo construction company Zagreb, in Accounting Department. Since 1986 working at HEP, initially as coordinator in Accounting, Elektroprivreda Zagreb. In 1990 became head of Accounting Improvement Section at HEP d,d, in 1997 head of Business Economics Section, and from 2007 to 2009 was director of Controlling Department.
MILJENKO PAVLAKOVIĆ member of Management Board, in charge of corporate finance and treasury, accounting and commercial affairs	Born in 1965. Graduate economist. First employment at Zagreb Airport (1990). From 1991 to 1992 worked at „Suvremena žena“ Jastrebarsko, and from1993 at Japetić d.d., Jastrebarsko. From 1998 worked at Zagreb County, initially as head of County Prefect's Office, then at State Administration Office. In 2004 joined Ministry of Economy, Labor and Entrepreneurship, as assistant minister and then as state secretary (2008-2009)
DAMIR PEČVARAC member of Management Board, in charge of transmission and distribution business improvement and quality	Born in 1952. Graduate electrical engineer, MSc (1994), DSc (2000), since 2007 Assistant Professor at Faculty of Electrical Engineering in Osijek. Entire career at HEP: Elektroslavonija Osijek as energy engineer (1977-1991), energy specialist in planning and development of network and plant (1998-2005) and in two separate periods as director of distribution area (1993-1998 and 2005-2009). From 1991 to 1995, as workers' representative, he was a member of HEP Managing Board.
VELIMIR RAJKOVIĆ member of Management Board, in charge of sustainable development and quality	Born in 1952. Graduate engineer, MSc (1979.). First employment at Electrical Engineering Institute Rade Končar, as development-research engineer and designer (from 1974). Worked then as head of Digital Electronics Section (1982), head of Electronics Department (1985) and electronics specialist (1989-1990). In 1991 started working at Junior Technical College Zagreb, as instructor, lecturer (1994-1999), from 1995 to 1999 was head of Electronics Department. He was a senior lecturer (1999-2005), and then professor at Polytechnic of Zagreb. From 1999 to 2006 head of IT Department, and for two years a deputy dean in charge of operations. From 2006 to 2009 he was dean of Polytechnic of Zagreb.

MANAGEMENT

Marija Modrić	Head of the Office of the Management Board
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
Kažimir Vrankić	Director of Sustainable Development and Quality Improvement Department
Ljubica Cvenić	Director of Strategy, Investment Planning and Corporate Development Department* and International Affairs and Restructuring Department
Nikola Mlinarić	Director of Corporate Finance and treasury Department
Vera Knez	Director of Accounting Department
Mihovil-Bogoslav Matković	Director of Marketing and Corporate Communications Department
Zvonimir Divić	Director of Procurement Department
Jerko Doko	Director of General Affairs Department

*Since May 2010. In the reporting period the director of Strategy, Investment Planning and Corporate Development was Ante Ćurković.

DIRECTORS OF HEP GROUP COMPANIES

Nikola Rukavina	HEP-Proizvodnja d.o.o.
Dubravko Sabolić	HEP-Operator prijenosnog sustava d.o.o.
Mišo Jurković	HEP – Operator distribucijskog sustava d.o.o.
Ivan Mrljak	HEP-Opskrba d.o.o.
Ante Ćurić*	HEP-Trgovina d.o.o.
Robert Krklec	HEP-Toplinarstvo d.o.o.
Nikola Liović	HEP-Plin d.o.o.
Gordana Lučić	HEP ESCO d.o.o.
Damir Subašić	APO d.o.o. usluge zaštite okoliša
Goran Slipac	HEP-Obnovljivi izvori energije d.o.o.
Igor Stankovski	HEP-Odmor i rekreacija d.o.o.
Marino Roce	Plomin Holding d.o.o.
Zdenko Miletić	HEP-Nastavno-obrazovni centar, head of the Institution

* Since April 7, 2010. In the reporting period the director was Žarko Mudrovčić.

GENERAL SHAREHOLDERS ASSEMBLY 2009

The annual meeting of the General Shareholders Assembly was held on June 16, 2009. The Assembly was presented with the Annual Report on the state of affairs and operations of HEP d.d. and HEP Group; report of the Supervisory Board on the supervision conducted over HEP d.d. conduct of operations; consolidated and non-consolidated annual financial report of HEP d.d. and HEP Group for 2008 including Independent Auditor's Report. Decision was adopted on the use of operating profit of the parent HEP d.d. achieved in 2008. 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 for the business year 2008.

AUDIT

INDEPENDENT AUDITOR

At a meeting held on June 16, 2009, 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, 2009.

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 in the process of being established in a Risk Management Unit.

In 2009, in line with the internal audit program, 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. Reports were submitted with findings of the audits conducted.

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, fulfillment of objectives and tasks of the business policy, etc. The reports indicate, in particular, assessment of adequacy, efficiency and effectiveness of the internal control system and risk management. The purpose and objective of internal audits and reports is to provide the management with 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.

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

In HEP Group, valid certificates for quality management standard **HRN EN ISO 9001:2008** are owned by TE-TO Zagreb (BVQI), EL-TO Zagreb, TPP Sisak, CCGT Jertovec, and hydro production areas North and West with all hydro power plants included. (DNV)

Valid certificates for environmental management standard **HRN EN ISO 14001:2004** within HEP Group, HEP Proizvodnja, are owned by TE-TO Zagreb (BVQI), EL-TO Zagreb, CCGT Jertovec, hydro production areas North and West with all hydro power plants included, and Elektra Zagreb of HEP ODS and Transmission Area Zagreb of HEP OPS (BVQI)

All hydro power plants within HEP group own a valid **certificate of electricity production from renewable sources** (TÜV)

HEP'S BUSINESS OPERATIONS IN 2009

BUSINESS ENVIRONMENT

FINANCIAL RESULTS ACHIEVED

RESULTS BY ACTIVITY

FINANCIAL POSITION

INVESTMENTS

CREDIT RATING

BUSINESS ENVIRONMENT

THE BUSINESS OPERATIONS IN 2009 were marked by continued global economic crisis and a significant fall in economic activities in Croatia. In neighboring countries, as in most European countries, economic activities continued to fall and only large emerging markets showed signs of recovery. As early as the last quarter of 2008 energy consumption fell and as a consequence prices of oil and coal, and later on of electricity and gas, fell significantly. Although prices rose during 2009, the uncertainty of the world's economic recovery kept them below the level they were at before the crisis.

The consequences of the economic crisis on HEP Group business operations were twofold. Due to fall of economic activities, consumption of electricity, heat and gas decreased, which contributed to lower operating costs. With above-average favorable hydrological conditions in 2009, less electricity was produced by thermal power plants and less electricity was procured on the market. Thanks to lower electricity imports and fall in fuel prices, production costs decreased. However, due to growing illiquidity and unemployment, problems increased with collection of payments from customers so that the share of doubtful receivables increased.

Electricity prices for domestic customers did not change during 2009, except that HEP Group took upon itself the increase in VAT rate for residential customers. With the increase in the selling price, the price for residential customers including VAT remained the same as before tax increase. However, revenues in 2009 increased as a result of the increase in electricity prices for domestic customers which are set out in tariff systems for each of the regulated electricity businesses as from July 1, 2008, based on the Government's approval. The growth in income as well as reduced costs of production and procurement of electricity allowed the Group's liquidity to improve.

The anti-recession measures, adopted by the Management Board in the first quarter with the aim to financially consolidate the Group, in particular, to improve liquidity, curtailed the planned volume of investments in construction, replacement and reconstruction of energy facilities, plants and network and other investments. The investment priority was given to the completion of significant construction projects that were in progress and with which the Group would increase its electricity and heat generating capacity (Lešće HPP and new units at TE-TO Zagreb and Sisak TPP) and to all investments that were necessary for secure and reliable operation of the Group's energy systems. This cut the investments planned for 2009 by 452 million kuna. In addition to reduced investment, it was planned to cut operating costs so that manageable costs decreased by more than 50 million kuna.

In spite of the reduced investment plan, the investments made in construction of new energy plants and in replacement and reconstruction of existing ones amount to nearly 2.4 billion kuna whereby the Group remained one of the largest investors in Croatia.

In April the rating agency Standard&Poor's downgraded the credit rating of Hrvatska Elektroprivreda from BBB- to BB+, as a result of the worsening liquidity of the Group. Therefore the financial consolidation included the restructuring of maturity of the loans received. Some short-term loans were repaid in full rather than being extended, and new loans, agreed in mid-year, totaling 93 million euros with a maturity of 5 years, were used not only for investment financing but also for working capital needs. The downgraded rating impacted the access to long-term financing sources in the international financial market so that a government guarantee was used to negotiate a new long-term loan of 100 million euros, which timely secured financing for the planned investments and working capital in 2010.

In 2009, the total electricity turnover reached 19.6 TWh of which 14.7 TWh was produced by power plants owned wholly or partly by the Group, and 4.9 TWh was procured in the regional market. For domestic customers' needs and coverage of network losses, 17.7 TWh was ensured and 1.9 TWh was sold in the regional market. Domestic electricity consumption decreased in 2009 by 1.7 percent in total due to falling economic activities.

The availability of power plants, transmission and distribution network was very good, without any significant disruption in the supply of electricity (other than in the Dubrovnik area at year end), heat and gas. The procurement of electricity and fuels, other than restrictions in gas deliveries early in the year, was also reliable. The new unit at TE-TO Zagreb successfully began trial production.

During 2009, the company HEP Opskrba d.o.o. made contracts for 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. The share of eligible customers in the electricity sold in the domestic market increased to 41 percent. 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	2007	2008	2009	2009/2008 (%)
Electricity sales	TWh	16.7	17.7	17.5	**-0.9**
Electricity production	TWh	13.9	14.3	14.7	**2.3**
Heat sales	TWh	2.1	2.2	2.2	**-0.8**
Gas sales	mn m^3	153	166	157	**-5.4**
Operating income	HRK mn	10,815.5	11,889.4	12,600.8	**6.0**
EBITDA	HRK mn	1,872.9	1,922.9	2,255.1	**17.3**
Group net profit	HRK mn	26.0	31.1	154.4	**396**
Total assets	HRK mn	31,070.2	32,635.4	32,711.1	**0.2**
Investments	HRK mn	3,077.0	2,644.2	2,359.7	**-10.8**
Number of employees		14,290	14,375	14,222	**-1.1**

According to financial indicators HEP is one of the largest business groupings in Croatia. The business operations in 2009 unfolded in recession conditions and the main goal was to consolidate the financial situation of the Group.

The price fall in energy inputs and favorable hydrological conditions led to reduced variable production costs but costs rose compared to 2008 due to value adjustment of short-term assets and provisions, and due to growth in other costs. In spite of falling sales of electricity and heat energy and gas, income increased due to the approved price increase (in 2008 for electricity and from the beginning of 2009 for heat energy and gas) which rose operating profit to 567.7 million kuna (in 2008 it was 289.3 million kuna). The Group's net profit is 154.4 million kuna of which 135.8 million kuna is attributable to equity holders of the parent.

CONSOLIDATED PROFIT AND LOSS ACCOUNT (ABRIDGED) (HRK mn)

	2007.	2008.	08/07 (%)	2009.	09/08 (%)
Operating income	10,815.5	11,889.4	**9.9**	12,600.8	**6.0**
Operating expenses	10,610.7	11,600.1	**9.3**	12,033.1	**3.7**
Operating profit	204.8	289.3	**41.3**	567.7	**96.2**
Group net profit	26.0	31.1	**19.6**	154.4	**396**
Net profit attributable to equity holders of the parent	3.8	11.7	**208**	135.8	**1,061**

OPERATING INCOME

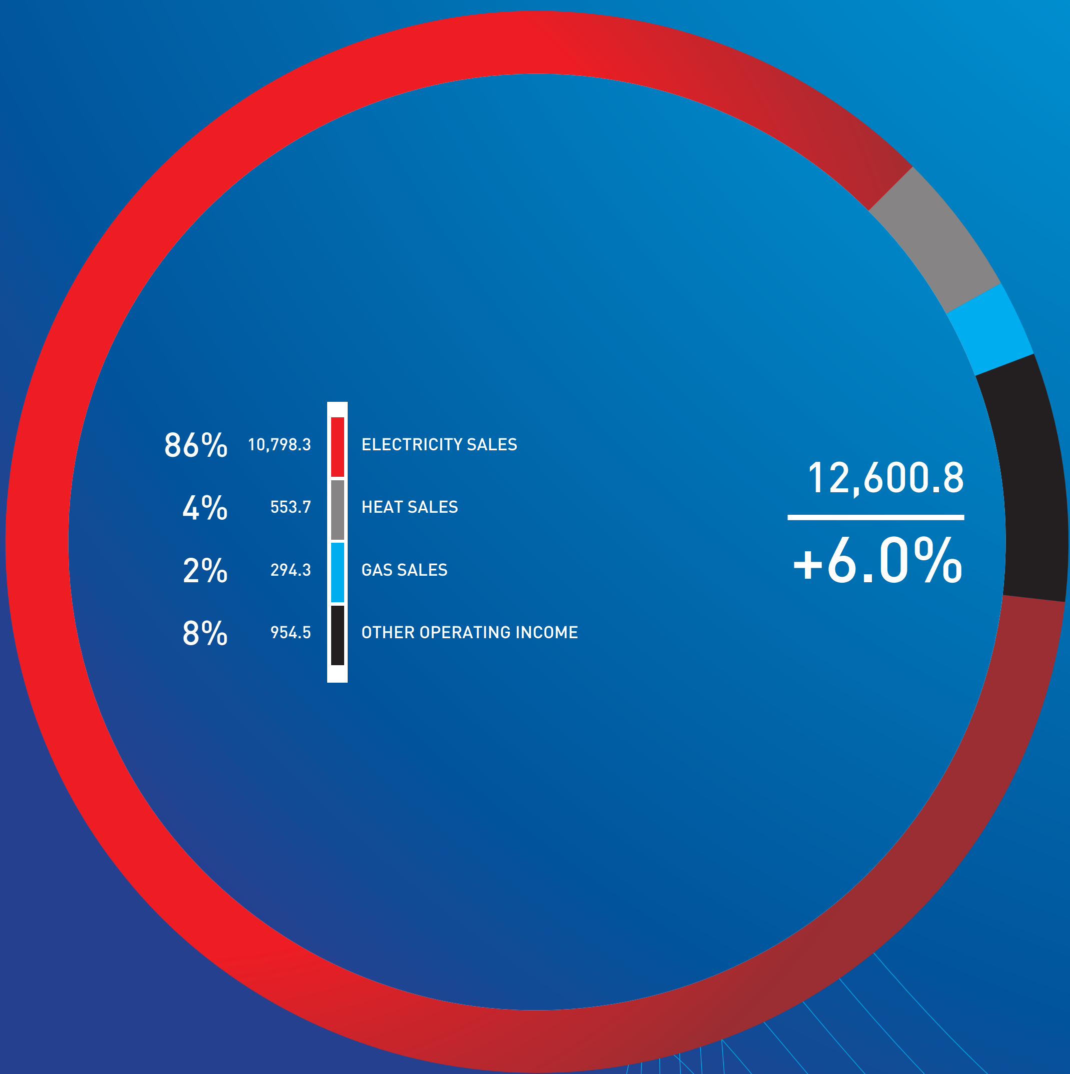
In 2009 Group achieved the highest operating income ever – 12,600.8 million kuna. This is an increase of 711.4 million kuna over 2008. The growth in operating income is the result of increased income from electricity, heat and gas sales.

Income from electricity sales, which increased 9.7 percent compared to the year before, accounts for 86 percent of the Group's operating income. Income from heat and gas sales makes a little over 6 percent of operating income, its growth in 2009 being 15.2 percent.

More than the usual factors – movements in economic activities and weather conditions during the heating season – key impact on the Group's income in 2009 came from the increase in electricity selling price as from the second half of 2008 and the increase in the selling prices of heat and gas as from January 2009.

Other operating income decreased compared to 2008 by 27 percent.

OPERATING INCOME (HRK mn)



OPERATING EXPENSES

The Group's operating expenses in 2009 increased by 433 million kuna to 12,033.1 million kuna, a growth which is by 278.4 million kuna lower than the growth in operating income.

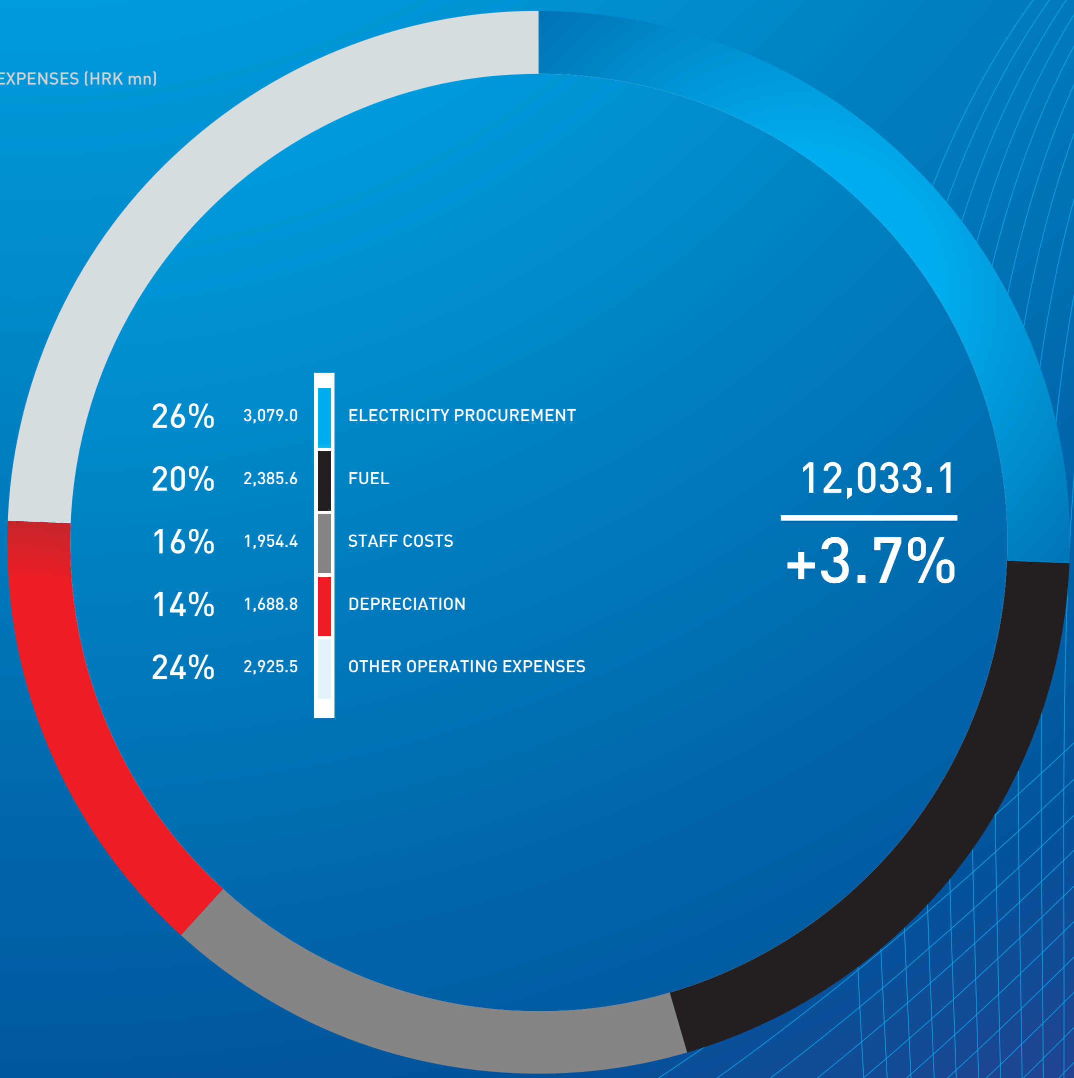
The increased operating expenses are primarily due to value adjustments of short-term assets and provisions, while the production and procurement costs of electricity and heat decreased due to the impact of the following factors:

- fall of purchase price of oil (29%) and coal (31%),
- favorable hydrology which made possible for hydro power plants to generate 6.6 TWh of electricity
- lower electricity procurement by 6%,
- lower electricity production from thermal power plants by 15%,
- lower heat production by 3%.

Staff costs are determined in the Collective Agreement which links growth in salaries to the growth in gross domestic product in the previous year.

Other operating expenses increased by 26 percent, most of which is due to cost increase due to value adjustment of inventories, investments in property, making of provisions for doubtful payment collection, for legal suits and for severance payments and write-offs of research, development and investment preparation whose implementation is uncertain. Manageable costs within the group of general operating expenses decreased by more than 50 million kuna.

OPERATING EXPENSES (HRK mn)



RESULTS BY ACTIVITY

BUSINESS RESULT (HRK mn)

	electricity			heat energy			gas distribution		
	2008	2009	09/08	2008	2009	09/08	2008	2009	09/08
Operating income	11,082.9	11,669.8	5.3%	523.4	610.4	16.6%	283.1	320.6	13%
Operating profit	460.7	671.9	45.8%	-181.5	-104.4	-42%	10.1	0.2	-98%

The greatest portion of the operating income (93 percent) as well as the total operating profit were achieved in the electricity business. Although the share of district heating in the income was only 5 percent, this business made an operating loss of 104.4 million kuna. The loss decreased compared to 2008 because heat prices increased. Gas distribution business has the smallest share in operating income (3 percent). An operating profit of 0.2 million kuna is a significant decrease on 2008.

ELECTRICITY

Production, transmission, distribution and supply of electricity are carried out by HEP Group in the entire territory of Croatia and the Group is still the sole supplier of electricity. In 2009 an operating profit of 671.9 million kuna was achieved which is a much better business result compared to 2008.

Income from electricity sales amounted to 10,798.3 million kuna, of which 95 percent was realized from supply to domestic customers and 5 percent from sales in the regional market.

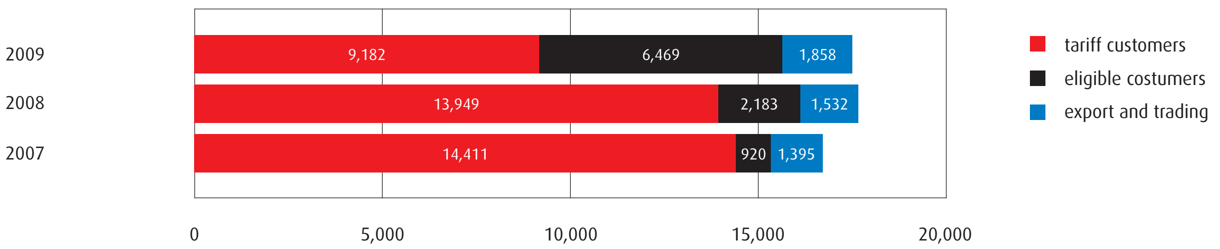
Power plants owned wholly or partly by the Group generated 14.7 TWh of electricity, which is 75 percent of total electricity turnover realized by the Group in 2009 or 83 percent of consumption in Croatia.

ELECTRICITY PRODUCTION AND PROCUREMENT (GWh)

	2007	**2008**	**2009**	**09/08 (%)**
hydro power plants	4,357	5,277	6,767	**28**
thermal power plants	6,845	6,075	5,177	**-15**
Krško nuclear power plant	2,714	2,986	2,730	**-9**
electricity procurement	5,133	5,229	4,898	**-6**

Sales to domestic customers amounted to 15.7 TWh of electricity, and with a further opening of the market in 2009 the share of sales to eligible customers increased to 41% of total sales in Croatia.

ELECTRICITY SALES (GWh)



DISTRICT HEATING

The business of production, distribution and supply of heat energy is performed in the areas of Zagreb, Osijek, Velika Gorica, Zaprešić, Samobor and Sisak.

The business made an operating loss in 2009 of 104.4 million kuna. Thanks to the increase in heat selling price, of 16 percent on average, the loss decreased by 77.1 million kuna compared to 2008. It was the first price increase since 2004, and because heat production costs rose significantly over that period due to fuel price growth, it did not enable the heating business to operate without loss.

Sales of heat and process steam were 2.19 TWh, which is 0.8 percent lower compared to 2008. With an average growth of 2 to 3 percent a year due to increase in the number of customers (mainly residential), annual consumption is strongly impacted by weather conditions in the heating season. However, in 2009 recession contributed to a decrease in sales to corporate customers of 4.1 percent.

GAS

The business of gas distribution and supply is performed in the areas of Osijek-Baranja, Virovitica-Podravina and Požega-Slavonia counties. In 2009, the business made an operating profit of 0.2 million kuna with gas sales falling by 5.4 percent. As with the heating business, consumption in this business is also greatly impacted by weather conditions during the heating season but in 2009 a crucial factor was a decrease in consumption by corporate customers of 9.6 percent. As from January 2009, price increase was approved to distributors due to increase in gas procurement price, whereby this increased cost was transferred to customers.

FINANCIAL POSITION

CONSOLIDATED BALANCE SHEET (ABRIDGED)

	Dec 31, 2008		Dec 31, 2009		09/08
	HRK mn	**share (%)**	HRK mn	**share (%)**	
Long-term assets	29,285.9	**90**	29,879.9	**91%**	**2%**
Short-term assets	3,349.5	**10**	2,831.2	**9%**	**-15%**
Total assets	**32,635.4**	**100**	**32,711.1**	**100%**	**0%**
Capital and reserves	18,130.2	**56**	18,248.1	**56%**	**1%**
Long-term liabilities	9,149.7	**28**	9,810.1	**30%**	**7%**
Short-term liabilities	5,355.5	**16**	4,652.9	**14%**	**-13%**
Total liabilities and capital	**32,635.4**	**100**	**32,711.1**	**100%**	**0%**

ASSETS

The value of total assets of HEP Group in 2009 increased by 75.7 million kuna to 32.7 billion kuna. An 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 594 million kuna. Long-term assets account for 91 percent of the value of the Group's assets.

The value of short-term assets is 2.8 billion kuna, a decrease of 518.3 million kuna. The greatest portion of short-term assets is made of accounts receivable amounting to 1.5 billion kuna, which increased due to worse payment collection. This is followed by inventories of materials, spare parts and energy fuel which amount to 967.9 million kuna with a decrease of 401.8 million kuna. The greatest decrease is in the value of energy fuel due to decrease in price and quantity of oil and coal, and the rest is related to value adjustment of inventories of materials and spare parts.

CAPITAL AND LIABILITIES

Capital and reserves at the end of 2009 amounted to 18.25 billion kuna with a share of 56 percent in the Group's total assets and an increase of 117.9 million kuna compared to 2008.

The structure of liabilities did not change significantly, short-term liabilities decreased by 702.6 million kuna compared to the beginning of the year due to which their share decreased from 16 to 14 percent. Trade payables decreased as well as liabilities for short-term loans.

Long-term liabilities for loans and securities slightly decreased. Long-term provisions for risks and costs increased due to provisions for legal suits. A significant increase is in other long-term liabilities, which is related to connections of new customers and increase in connected load of the existing customers.

Due to decrease in interest-bearing debt and increase in the value of capital and reserves, net debt to equity ratio decreased from 34 to 32 percent.

INVESTMENTS

In 2009 the value of the investments that were made was 2,359.7 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.

INVESTMENTS (HRK mn)

	2007	2008	2009	**09/08**
Investments in property, plant and equipment	3,077.0	2,644.2	2,359.7	**-11%**

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 2009 per company is given in the section Reports by HEP Group companies.

CREDIT RATING

Due to worsening liquidity during 2008, Standard&Poor's downgraded ratings of HEP d.d. on February 23, 2009 to BBB- with negative outlook, and then on April 23, 2009 downgraded it further to BB+ with negative outlook.

HEP's credit rating:	BB+/Negative/- -	
Credit rating history		
	Local currency	Foreign currency
November 13, 1998	BBB	BBB-
July 19, 2005	BBB	BBB
October 28, 2008	BBB /Negative/	
February 23, 2009	BBB- /Watch Neg/	
April 23, 2009	BB+ /Watch Neg/	
September 7, 2009	BB+ /Negative/	

REPORT ON IMPACT ON HEP GROUP STAKEHOLDERS

SOCIAL RESPONSIBILITY

HEP conducts it 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 – revised version of June 1, 2010 available in Croatian only at www.hep.hr/hep/odgovornost/etickiKodeks.pdf)
- 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)

BASIC VALUES IN RELATIONS WITH INTERESTED GROUPS

To achieve our **mission** and to fulfill our **mission**, we align all our business operations with expectations of **all interested groups**, adhering to the following principles:

OWNERS

- To make optimum business effects and an appropriate profit for the owner.

CUSTOMERS

- To satisfy the needs and expectations of the customers, providing value for money. To act in a professional and correct manner in accordance with best practices and generally accepted values, building trust in our actions.

EMPLOYEES

- To appreciate employee interests and competencies and to develop a reward and promotion system. To secure and constantly apply state-of-the art work safety measures and to encourage life-long learning, cooperative spirit and professionalism.

BUSINESS PARTNERS

- To foster and build relations with business partners, respecting their quality and professionalism. To carry out public procurement processes in a correct manner and to prevent any possible irregularity.

SOCIETY, LOCAL COMMUNITIES

- To respect cultural, religious, traditional and any other material or spiritual characteristics in cooperating with the local communities in which we are active, creating a friendly environment.

EMPLOYEES

NUMBER OF EMPLOYEES

On December 31, 2009 of the total of 14,222 employees, 14,196 were employed on a permanent basis and 26 on a temporary basis (of which 11 trainees on a temporary basis).

NUMBER OF EMPLOYEES BY HEP GROUP COMPANY (DECEMBER 31, 2009)

HEP Group company	Employees		Change
	2008	2009	2009-2008
HEP-Operator dstribucijskog sustava d.o.o.	9,603	9,525	-78
HEP-Proizvodnja d.o.o.	2,362	2,336	-26
HEP-Operator prijenosnog sustava d.o.o.	1,248	1,250	2
HEP d.d.	444	423	-21
HEP-Toplinarstvo d.o.o.	392	355	-37
HEP-Plin d.o.o.	139	140	1
HEP-Opskrba d.o.o.	50	57	7
Crpna stanica Buško Blato d.o.o.	42	42	0
APO d.o.o.	27	25	-2
HEP-ESCO	20	20	0
HEP-Trgovina d.o.o.	15	16	1
HEP – Odmor i rekreacija d.o.o.	15	14	-1
Ustanova HEP-Nastavno-obrazovni centar Velika	11	11	0
HEP- Obnovljivi izvori energije d.o.o.	7	8	1
HEP Group TOTAL	**14,375**	**14,222**	**-153**

QUALIFICATION STRUCTURE

Qualifications	Number of employees	Share (%)
DSc.and MSc	**141**	**1**
BSc	**2,046**	**14.4**
Assoc.degree	**1,078**	**7.5**
Secondary sch.	**6,060**	**42.6**
Element.sch. /semi-skilled	**853**	**6**
Highly skilled	**2,244**	**15.8**
Skilled	**1,800**	**12.7**
TOTAL	**14,222**	**100%**

AGE STRUCTURE

Years of age	Number of employees
do 20	3
20-25	190
25-30	683
30-35	1,363
35-40	1,656
40-45	1,876
45-50	2,293
50-55	2,624
55-60	2,466
60-65	1,068
TOTAL	**14,222**

EMPLOYMENT AND TRADE UNION RELATIONS AND WORKERS' COUNCILS

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

On July 1, 2008 a new Collective Agreement for HEP Group was concluded with application 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.

A standardized selection procedure is conducted across HEP Group for employment of new people and for scholarship recipients (high school and university students). There is also a process in place of introducing new employees to their job and/or mentoring of probationary employees so 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.

In different organizational units of HEP Group investigation is conducted on a yearly basis of the organizational climate and employee satisfaction with work environment so that improvements can be made over a reasonable period. In 2009, the investigation encompassed 1,065 employees.

EDUCATION AND TRAINING

HEP allocates significant financial resources for professional improvement and training that are necessary for a smooth unfolding of work processes (in the area of environmental protection and safety at work, specialist computer courses) and also significant is participation by HEP's experts in gatherings such as HRO CIGRE, MIPRO, Energy Day Forum and other professional meetings in Croatia and abroad.

In 2009 the company began to establish an internal training system. The first educational course implemented involving 14 probationary employees related to communication skills and business etiquette. This course constitutes a mandatory part of the training and development of probationary employees. It is planned to be implemented in the entire HEP Group.

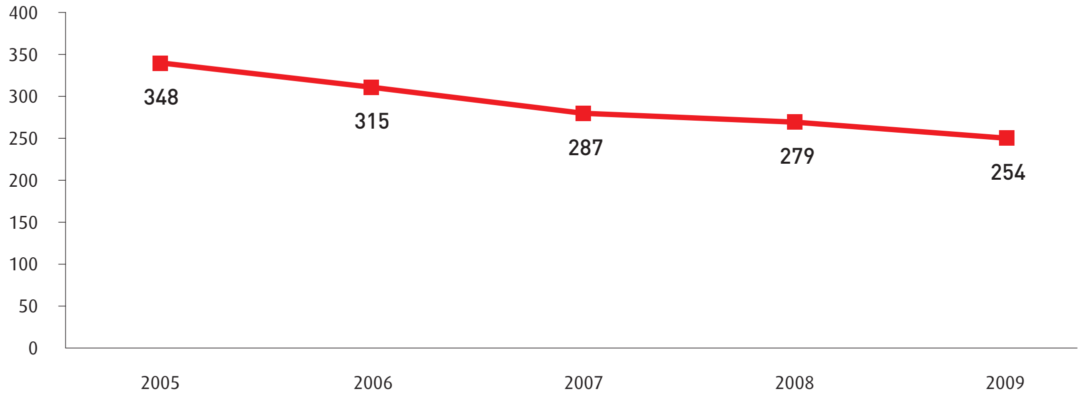
The Department for Human Resources Management organized three new internal educational courses: Presentation Skills (for probationary employees), Business Correspondence (for secretarial and administrative staff) and Leadership (for lower level management).

In 2009, Decision was adopted on the mandatory use of the software application Records of Education with an appropriate instruction about the implementation for all HEP Group companies. In cooperation with the IT and Telecommunications Department reports were prepared which systematically monitor the carrying out of education at HEP Group level.

HEALTH AND SAFETY AT WORK

HEP adjusts its health protection and safety policy with National Program for Protection of Health and Safety at Work for the period from 2009 to 2013 which sets forth a ten percent decrease in the number of injuries at work in the economy over that period.

NUMBER OF INJURIES IN HEP GROUP (2005–2009)



It can be seen from the number of injuries in HEP Group shown above that we have come closer to meeting the target. The best results were achieved in HEP ODS which has the highest number of employees and the most injuries at work but also the greatest fall in the number of injuries over the past five years. In other subsidiary companies the number of injuries varies from year to year.

A significant contribution to the total number of injuries at work comes from injuries which occur on the way to/from work. In 2009, there were 48 of such injuries out of a total of 254, making 21.3 percent. At the place of work there were 73.8 percent of injuries, on business trip 1.3 percent and elsewhere 3.6 percent. Due to injuries at work there were 13,007 work days lost in 2009. One injury at work was fatal.

Injuries at work are mainly a consequence of not using basic or special protection rules at work. The constant education of employees at all levels, direct supervisors or authorizing officers in particular, seeks to minimize injuries at work.

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 wants, besides delivering quality electricity and providing quality service, 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.

On HEP ODS website (www.hep.hr/ods) customers can ask their questions, submit meter reading, get information about their consumption in the previous period, about their bills and payments, find information on how a particular HEP ODS distribution area does its business, and learn about laws and regulations and news pertaining to electricity distribution and supply.

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.

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, and other advices or information.

Supply Sections in each distribution area 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 OPSKRBA

Due to unfinished restructuring of the supply business, in 2009 the main direction taken in 2009 was toward short-term solving of problems and issues of customer relations. Considering the available number of employees, the emphasis was primarily on small customers due to their distinct characteristics and large number, and not enough on relations with medium and large customers and, in particular, key customers.

A number of marketing activities were carried out in order to provide timely information to customers and make them aware of many changes that had happened in the electricity market and in order to resolve numerous customer problems and questions regarding electricity supply. The aggravating circumstances in customer relations were the unfavorable economic climate in the country but also a distorted media image of HEP Group for most of the year.

RELATIONS WITH HEAT CUSTOMERS (HEP TOPLINARSTVO)

In 2009 HEP Toplinarstvo provided reliable and quality supply of heat energy to all customers, the energy delivered was timely read and billed, and special attention was paid to interactive relationship with customers. In order to build quality relations and mutual trust, the company provided information with all news about its services and responded timely to all questions and complaints received from customers by post, fax, consumer phone or email (www.hep.hr/toplinarstvo/kontakti.aspx). For complaints and information about heat billing, debt, late interest or reporting and changing of property owners, heat customers have Billing and Collection Unit at their disposal and technical problems can be reported to our on-call services every day from 0 to 24 hours.

At the beginning of 2009, HEP Toplinarstvo sent to its customer addresses the notification about change of heat energy prices, advices on efficient use of energy and installation of heat cost allocators and about payment options for heat energy delivered.

During 2009, customers were informed through mass media and on notice boards in residential buildings not only about breakdowns or leakage in the district heating system but also about planned disruptions in heat energy supply caused by the implementation of phase three of the refurbishment of the main hot water pipeline consisting of replacement of 8 km of hot water section in Zagreb and 4.3 km of hot water section in Osijek.

RELATIONS WITH GAS CUSTOMERS (HEP PLIN)

Gas deliveries to customers in 2009 were timely read and billed. Relations with customers were at a satisfactory level. Individual and occasional complaints, mostly related to meter reading and gas consumption billing, were being resolved appropriately, to mutual satisfaction. The global crisis additionally aggravated customers' financial position so that in 2009 outstanding debt for natural gas sold increased compared to the year before.

Shorter gas disruptions due to planned work in the network or connecting new customers were regularly announced by direct written notices or in mass media.

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 - 2009

Reason for complaint																		
Billing			Inaccurate meter			Connection/ disconnection			Voltage conditions			Other			Meetings held	Total complaints	Total accepted	Total rejected
TOTAL	ACCEPTED	REJECTED	TOTAL	ACCEPTED	REJECTED	TOTAL	ACCEPTED	REJECTED	TOTAL	ACCEPTED	REJECTED	TOTAL	ACCEPTED	REJECTED				
191	53	138	11	4	7	8	2	6	0	0	0	27	10	17	56	236	71	165

NUMBER OF COMPLAINTS CONSIDERED BY COMMISSIONS OF HEP–TOPLINARSTVO - 2009

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			**TOTAL**		
TOTAL	ACCEPTED	REJECTED	TOTAL	ACCEPTED	REJECTED	TOTAL	ACCEPTED	REJECTED	TOTAL	ACCEPTED	REJECTED	TOTAL	ACCEPTED	REJECTED	TOTAL	ACCEPTED	REJECTED	TOTAL	ACCEPTED	REJECTED
8	4	4	3	1	2	0	-	-	2	2	0	0	-	-	2	1	1	15	8	7

NUMBER OF COMPLAINTS CONSIDERED BY COMMISSIONS OF HEP–PLIN - 2009

TOTAL	ACCEPTED	REJECTED
3	1	2

OTHER STAKEHOLDERS

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, Kalnik 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 2009, 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 are Environmental Journalists Section of the Croatian Journalists Society and APO Environmental services, a member of HEP Group.

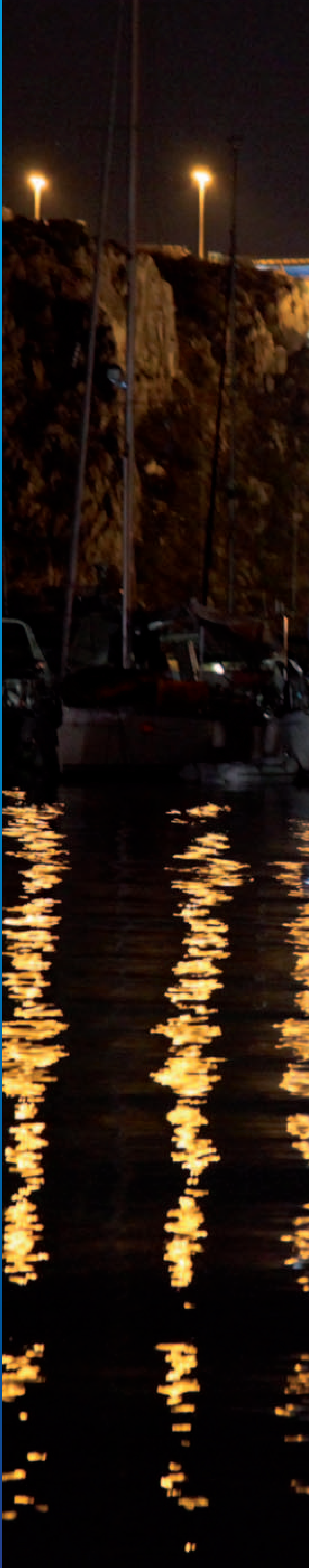
SUSTAINABLE DEVELOPMENT

POLICY AND ORGANIZATION OF NATURE AND ENVIRONMENTAL PROTECTION FUNCTION

HARMONIZATION WITH THE EU LEGISLATION

BASIC INDICATORS

MAJOR ACHIEVEMENTS IN 2009



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.

HARMONIZATION WITH THE EU LEGISLATION

Because of the importance for HEP Group of compliance with the EU legislation, in 2009 three specialist teams were set up in addition to the central HEP Environmental Coordination and Standardization Team.

The role of **Team for the implementation of the Plan of reduction of SO_2, NO_x and particulates from large combustion plants and gas turbine in Croatia** (Plan) is to inform HEP d.d. Management Board and management of subsidiaries about legal requirements arising from the Plan, about the meaning of tougher limit values of air pollutant emissions coming into force after December 31, 2009 and December 31, 2011 for HEP Group, and to create background information for HEP Management Board for the planning of HEP Group funds for the financing of projects oriented to SO_2, NO_x and particulates emission reduction, with the view of making HEP's plan operations compliant with legal requirements in force.

The task of **Team for the implementation of Kyoto Protocol provisions** is to inform HEP d.d. Management Board and management of subsidiaries about the obligations arising from legislation in the area of greenhouse gas emission reduction. The Team in June 2009 in cooperation with the Faculty of Electrical Engineering and Computing organized a workshop entitled Carbon Dioxide Management Strategy. The workshop gave, inter alia, a presentation of a list of HEP's obligations arising from the provisions of the Kyoto Protocol, description of a third phase of the European emission trading scheme, an overview of dependence of cost of emission rights on electricity supply/demand balance, description of influence of emission trading on electricity producers and presentation of emission trading tools used by energy company leaders to make decisions on strategy of greenhouse emission management.

A third is **Team for the obtaining of integrated environmental requirements**. The integrated environmental requirements (so-called "environmental permits") are a condition for continued operation of all existing thermal power plants of HEP of rated thermal capacity above 50 MW and for obtaining a siting permit for new construction and reconstruction of existing plants. The obligation arises from Integrated Pollution Prevention and Control (IPPC) Directive 2008/1/EC whose provisions were transposed into a regulation concerning the procedure of determining integrated environmental requirements. During 2009, a procedure was initiated for selection of authorizing officers who can prepare supporting documents for the obtaining of integrated environmental requirements. The Team has identified the activities that need to be implemented to obtain integrated environmental requirements, obstacles to the implementation of these activities and deadline for the obtaining of integrated environmental requirements, based on which HEP d.d. Management Board and management of subsidiaries will be able to make appropriate business decisions and to plan the necessary finance.

Upon the coming into force of the **Regulation on Declaration of Ecological Network**, some existing and some of planned HEP's plants, mostly listed in the Strategy and program for physical planning of the Republic of Croatia and in relevant county physical plans, have become a part of the ecologically significant areas and ecological corridors. After Croatia's entry into the EU, the National Ecological Network will become an integral part of the ecologically significant area of EU – NATURA 2000. Under the provisions of the Environmental Protection Act and the Regulation, protected areas and ecological network areas are subject to guidelines for protection measures applicable to all physical and legal persons using natural resources and performing actions or operations under the Act in these areas, HEP included. The protection measures under the Act and the Regulation pose uncertainty on construction of planned or continued operation of existing HEP's generating plants, and thereby energy production and security of customer supply. They also make it harder to meet the obligations arising from national and EU legislation in the area of air pollutant emission reduction, including greenhouse gases, the implementation of some activities of regular plant maintenance, protection of nature and safety at work, and contribute to increase in energy production costs. HEP has therefore reported at consulting meetings to representatives of the ministries in charge and State Administration for Nature Protection on the expected consequences of protecting the areas of existing and planned electric power facilities.

BASIC INDICATORS

During 2009, inspection controls of environmental protection were carried out in HEP plants (Peruća HPP, Varaždin HPP), water rights inspection (Sisak TPP, EL-TO Zagreb, Jertovec CCGT, Rijeka TPP and Gojak HPP) and one coordinated inspection control at TE-TO Osijek. The reports on the coordinated inspection controls are published by the Ministry of Environmental Protection, Physical Planning and Construction on its website.

According to water quality analyses carried out during 2009 by authorized laboratories as required by water laws and regulations, all HEP's plants operated in accordance with permits and legal requirements. In 2009 HEP continued to monitor air emissions of pollutants -sulfur dioxide (SO_2), nitrogen oxide (NO_x), carbon dioxide (CO_2) and particulates as required by air quality legislation, as well as the quantities of hazardous and non-hazardous waste generated by HEP.

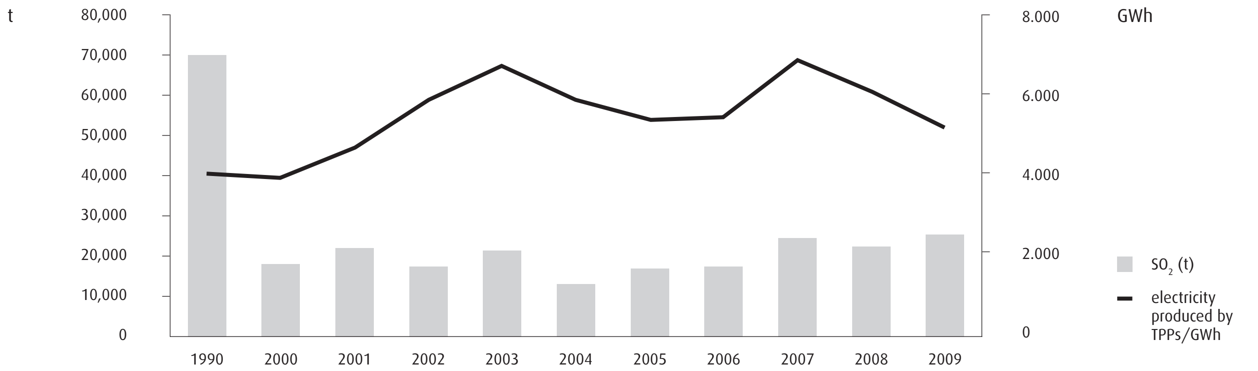
AIR EMISSIONS

In 2009 production of electricity from HEP's thermal power plants was lower than in 2008. In spite of that, sulfur dioxide (SO_2) emission went up by 13 and particulates emission by 15 percent compared to 2008. This is because emission of SO_2, occurring as a result of thermal power plants burning fossil fuels, depends on sulfur content and particulates emission depends, among other things, on the quantity of ash in a fuel.

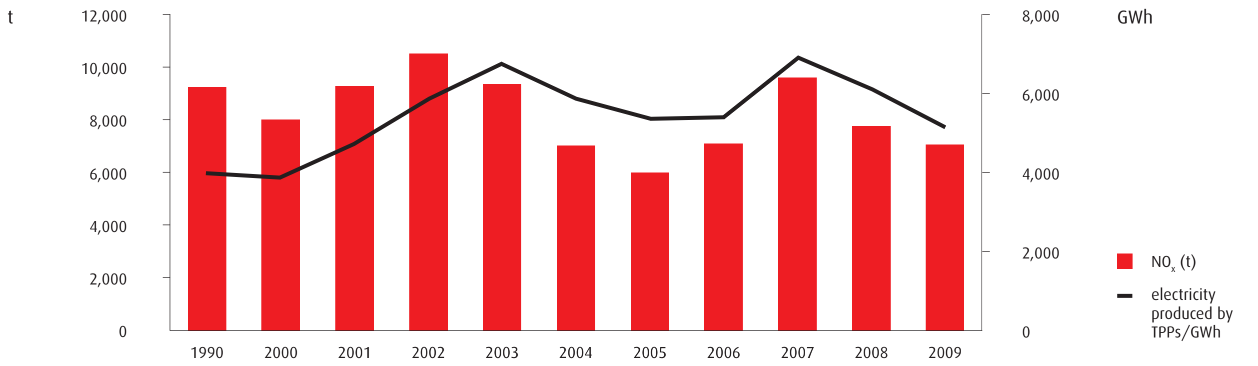
Year	SO_2 (t)	NO_x (t)	CO_2 (kt)	particulates (t)	Electricity produced from HEP's thermal power plants (GWh)
1990	*69,402*	*9,248*	*3,750*	*2,031*	*4,030*
2000	17,827	7,975	3,654	885	3,958
2001	21,669	9,222	4,347	1,382	4,713
2002	17,248	10,544	5,259	1,135	5,899
2003	21,350	9,391	5,679	1,507	6,703
2004	13,081	7,051	4,503	767	5,899
2005	16,890	6,003	4,694	664	5,387
2006	17,258	7,092	4,544	954	5,436
2007	24,376	9,532	5,460	756	6,845
2008	22,165	7,834	4,862	566	6,075
2009	24,956	7,031	4,043	651	5,178
Change 2009/2008 (%)	**+13**	**-10**	**-17**	**+15**	**-15**

TREND OF AIR POLLUTANT EMISSIONS FROM HEP'S THERMAL POWER PLANTS (1990) 2000-2009

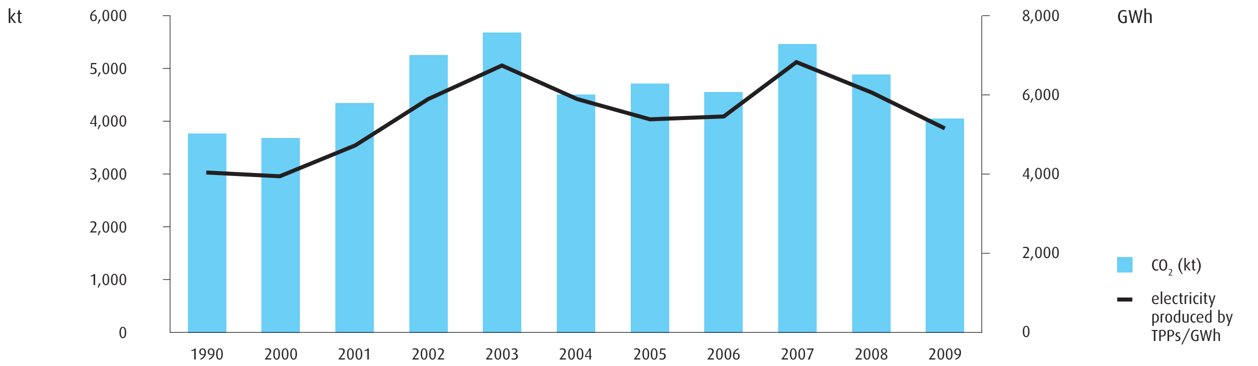
SO_2 EMISSION



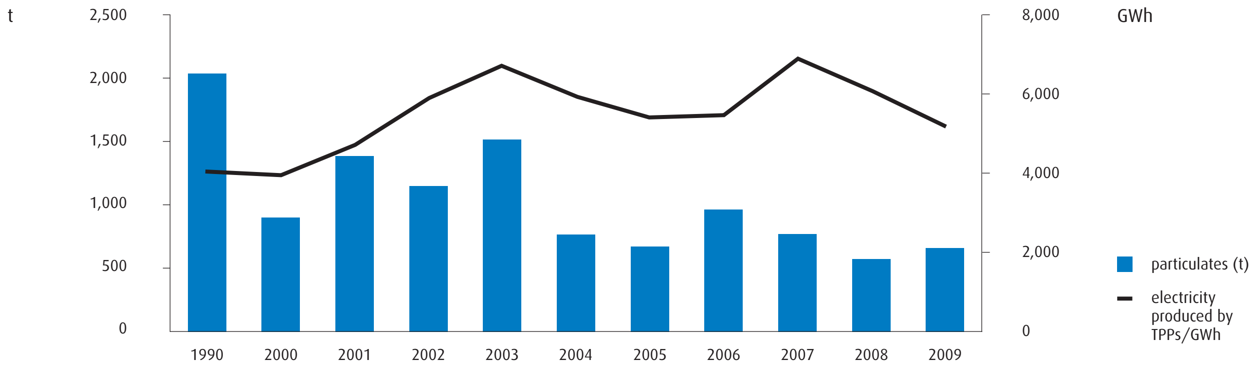
NO_x EMISSION



CO_2 EMISSION



PARTICULATES EMISSION



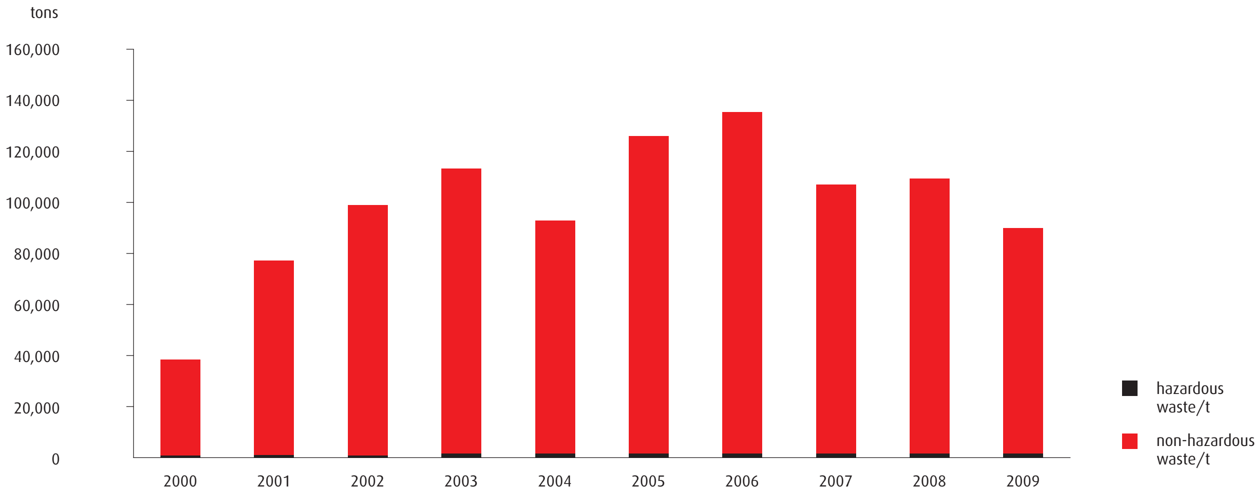
WASTE

During 2009, the trend of previous five year period of improving waste management system continued. The plants continued to build and equip temporary storages for waste and secondary raw materials and furnish them with tanks for separate waste collection. Since January 1, 2009 all HEP Group plants have begun handling waste data electronically using the application "Waste Management".

In 2009 HEP Group generated a total of 1, 100 tons of hazardous and 88,405 tons of non-hazardous waste. The waste was delivered to authorized collectors and processors for further processing and final disposal.

TOTAL QUANTITIES OF HAZARDOUS AND NON-HAZARDOUS WASTE GENERATED WITHIN HEP GROUP 2000-2009

Year	Hazardous waste (t)	Non-hazardous waste (t)
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
2009	1,110	88,405
Change 2009/ 2008 (%)	**-11**	**-18**



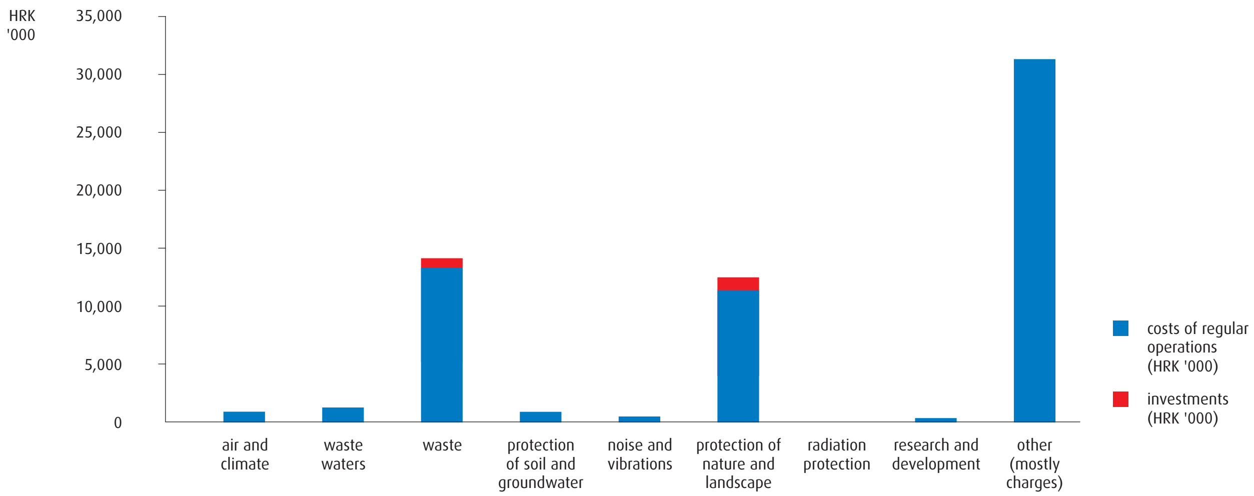
EXPENSES FOR NATURE AND ENVIRONMENTAL PROTECTION

In 2009 total expenses for nature and environmental protection incurred by HEP Group companies amounted to 61.036 million kuna. The most significant investments in 2009 were those made to improve waste management system in HEP's plants and to protect nature.

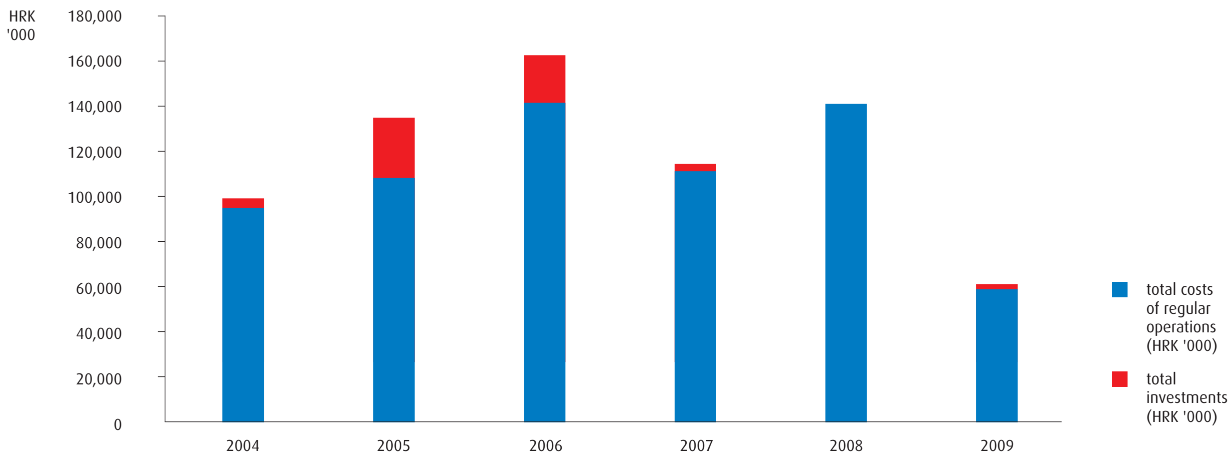
Since the beginning of the implementation of Accounting for Nature and Environmental Protection Expenses project (RETZOK) in 2004 until the end of 2009, HEP Group invested 56.068 million kuna in total in the protection of nature and the environment while total costs of regular activities to protect nature and the environment were 658.092 million kuna.

HEP GROUP EXPENSES FOR NATURE AND ENVIRONMENTAL PROTECTION IN 2009 ACCORDING TO RETZOK

Environmental area	Costs of regular operations (HRK'000)	Investments (HRK'000)
air and climate	858	0
waste waters	1,247	0
waste	13,155	788
protection of soil and groundwater	813	0
noise and vibrations	333	0
protection of nature and landscape	11,193	1,207
radiation protection	60	0
research and development	183	0
other (mostly charges)	31,185	13
TOTAL	**59,028**	**2,008**



HEP GROUP TOTAL EXPENSES FOR NATURE AND ENVIRONMENTAL PROTECTION 2004-2009



MAJOR ACHIEVEMENTS IN 2009

ACHIEVEMENTS BY THERMAL POWER PLANTS

- In 2009 the Rules on Waste Management were prepared in HEP Proizvodnja d.o.o. as well as Implementing Rules on waste management in all plants
- TE-TO Zagreb, EL-TO Zagreb, TE-TO Osijek, Sisak TPP and Rijeka TPP obtained permit to carry out the business of hazardous waste management in order to co-burn its own waste oils.
- In accordance with legal obligations, a software application was developed to verify air pollutant emissions from HEP's thermal power plants required to continuously measure emissions and a transfer of data was launched from the continuous emission monitoring system to the information system for emission monitoring managed by the Environmental Protection Agency.
- The Ministry of Environmental Protection, Physical Planning and Construction was submitted for opinion and approval security reports for Sisak TPP, TE-TO Zagreb, Rijeka TPP and TE-TO Osijek as well as notices about the presence of small quantities of hazardous substances in EL-TO Zagreb and Jertovec CCGT.
- TE-TO Zagreb and EL-TO Zagreb submitted to the City Office for Energy, Environmental Protection and Sustainable Development reports on the implementation of measures for air pollutant emission reduction as required by the Program for Air Quality Protection and Improvement in the City of Zagreb.
- All thermal power plants prepared programs for the monitoring of greenhouse gases and submitted them to the Ministry of Environmental Protection, Physical Planning and Construction for assessment and opinion, which is one of preparatory actions for joining the European emission trading scheme (EU-ETS).

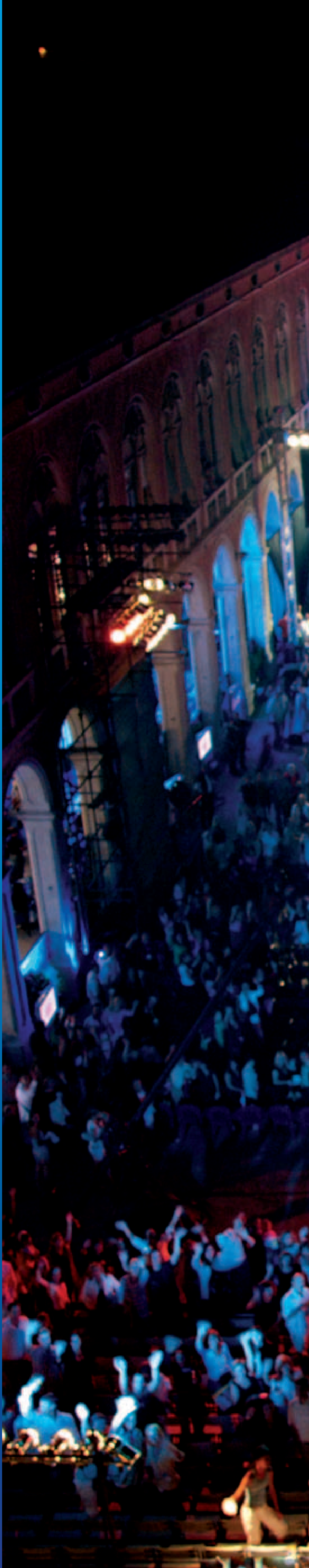
BIOLOGICAL DIVERSITY CONSERVATION PROJECTS

- The implementation continued of the Cooperation Agreement concerning the measures to protect the protected species of the white stork *Ciconia ciconia* (L.) made between HEP and the Ministry of Culture in 2004. On the Creativity and Innovation Day of the association MRAK, in May 2009, HEP's project Stork Protection was one of the three nominated for the award in the category of sustainable development.
- Based on a separate Agreement on Cooperation on monitoring and ringing of stork population in the area of Sisak-Moslavina County made in 2005, the implementation of activities continued in order to conserve biological diversity and protect nature.
- The implementation of measure to prevent birds from being killed by electric shock on medium voltage lines continued. A cooperation was established with the Directorate for Bird Protection at the Ministry of Culture, to which a report was submitted on the measures implemented to protect the birds from electric shock on medium voltage lines. Several nests were put up on overhead lines at Elektra Slavonski Brod where storks gather and in Nova Gradiška some parts of the 10 kV overhead line where birds gather were insulated.

OTHER

- In HEP Operator distribucijskog sustava and HEP Operator prijenosnog sustava , inventory was taken of condenser batteries containing polychloride biphenyls (PCB) and a plan was prepared for equipment disposal the purpose of which is the final withdrawal of PCB from use.

FINANCIAL STATEMENTS



HRVATSKA ELEKTROPRIVREDA GROUP CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2009
TOGETHER WITH INDEPENDENT AUDITOR'S REPORT

RESPONSIBILITY FOR THE CONSOLIDATED 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:

Leo Begović
President of the Board

HEP d.d.
Ulica grada Vukovara 37
10000 Zagreb
Republic of Croatia
1 June 2010

INDEPENDENT AUDITOR'S REPORT

To the Owner of HEP d.d.:

We have audited the consolidated financial statements of the HEP Group (the 'Group'), which comprise the consolidated balance sheet as at 31 December 2009 and the related consolidated income statement, consolidated statement of comprehensive income, consolidated statement 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 consolidated financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of consolidated 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 unconsolidated financial statements based on our audit. Except as provided in paragraphs b) and c), 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the consolidated 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 Company's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated 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) IMPAIRMENT ALLOWANCE ON RECEIVABLES

As described in Note 20, the Management Board provides for bad and doubtful receivables on the basis of the overall ageing structure of all receivables, as well as by reviewing individual significant accounts receivable. The individual analysis of significant trade accounts receivable at HEP Opskrba has revealed significant doubtful accounts in the amount of approximately HRK 60 million that have not been provided against.

As a result, trade receivables as of 31 December 2009 have been overstated by approximately HRK 60 million, and the result for the year then ended has been overstated by the same amount.

B) PREPAYMENTS TO HRVATSKE AUTOCESTE

As described in Note 13, the Group advanced HRK 300 million to Hrvatske autoceste on 27 December 2006, for the acquisition of electricity facilities on the Croatian motorways within two years from the date of the advance payment. As of the date of these financial statements, the legal title to those facilities has not yet been transferred to the Group. The Group is the economic beneficiary of the electricity facilities, which it uses for their intended economic purposes and in the supply of electricity to customers. As of the date of publication of these financial statements, the Group has not classified the advance payment by type of assets used in the Group's business and we have received no calculation of the economic impact of the reclassification of those assets from prepayments to assets in use from the Management Board. As a result, we are unable to assess the impact of this matter on the Group's financial statements.

INDEPENDENT AUDITOR'S REPORT
(CONTINUED)

C) APPLICATION OF IFRIC 18 TRANSFERS OF ASSETS FROM CUSTOMERS

The Group has the obligation to apply IFRIC 18 Transfers of Assets from Customers, which specifies the accounting for assets transferred from customers, by which the income from such assets are to be recognised immediately upon the transfer in profit or loss rather than deferred over the useful life of the transferred asset. The Interpretation is in force since 1 July 2009, and the Management Board has decided to apply the Interpretation to periods subsequent to 1 January 2010. As of the date of publication of these financial statements, the Group has not quantified the effect of untimely adoption of the Interpretation on the financial statements. As a result, we are unable to assess the impact of this matter on the financial statements of the Group.

QUALIFIED OPINION

In our opinion, except for the effect of the matters discussed in paragraph a) above, and the potential effects of the matters discussed in paragraphs b) and c) above, the consolidated financial statements present fairly, in all material respects, the financial position of the Group at 31 December 2009, 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) MEASUREMENT OF INVESTMENT PROPERTIES AT FAIR VALUE

We expressed a qualified opinion on the financial statements for the year ended 31 December 2008. 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 were 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 a group.

Since the Group did not apply 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.

B) REVENUE RECOGNITION POLICY

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 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, 1 June 2010

Vrtačnik

CONSOLIDATED INCOME STATEMENT - HEP GROUP

FOR THE YEAR ENDED 31 DECEMBER 2009

	Notes	2009	2008
		HRK'000	HRK'000
Revenue from electricity sales	4	10,798,272	9,845,219
Revenue from thermal power sales	4	553,732	476,796
Revenue from gas sales	4	294,262	259,228
Other operating income	5	954,520	1,308,109
Total operating income		**12,600,786**	**11,889,352**
Electricity purchase cost		(3,078,977)	(2,995,645)
Fuel costs		(2,385,583)	(2,827,850)
Staff cost	6	(1,954,350)	(1,804,925)
Depreciation and amortization expense	10,11	(1,688,750)	(1,654,886)
Other operating expenses	7	(2,925,476)	(2,316,767)
Total operating expenses		**(12,033,136)**	**(11,600,073)**
Profit from operations		**567,650**	**289,279**
Financial revenue	8	81,101	114,402
Financial costs	8	(421,642)	(355,872)
Net financial loss		**(340,541)**	**(241,470)**
Profit before tax		**227,109**	**47,809**
Income tax expense	9	(72,687)	(16,712)
Profit from operations		**154,422**	**31,097**
Attributable to:			
Equity holder		135,844	11,655
Minority interest		18,578	19,442
		154,422	**31,097**

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

Signed on behalf of the Company on 1 June 2010 by:

Leo Begovic
President of the Board

Miljenko Pavlakovic
Member of the Board

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME - HEP GROUP

FOR THE YEAR ENDED 31 DECEMBER 2009

	Notes	2009	2008
		HRK'000	HRK'000
Profit for the year		**154,422**	**31,097**
Foreign exchange rate differences		(3,881)	(231)
Fair valuation of Janaf		1,423	-
Other comprehensive income		(1,995)	(422)
Other comprehensive income for the year		(4,453)	(653)
Total comprehensive income for the year		**149,969**	**30,444**
Total comprehensive income attributable to:			
Equity holder		131,267	11,079
Minority interest		18,702	19,365
		149,969	**30,444**

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

Signed on behalf of the Company on 1 June 2010 by:

Leo Begovic
President of the Board

Miljenko Pavlakovic
Member of the Board

CONSOLIDATED BALANCE SHEET - HEP GROUP

AS AT DECEMBER 31, 2009

ASSETS	Notes	31 December 2009	31 December 2008
		HRK'000	HRK'000
Non-current assets			
Property, plant and equipment	10	24,082,799	23,227,51
Capital work in progress	10	3,130,294	3,370,610
Intangible assets	11	63,671	78,650
Investment property	12	202,467	211,074
Prepayments for property, plant and equipment	13	403,080	448,642
Investment in NPP Krško	14	1,605,593	1,609,598
Long-term loan receivables and deposits	16	1,483	2,416
Asset held for sale and other investments	17	152,997	151,374
Other non-current assets	18	117,106	119,501
Deferred tax assets	9	120,351	66,568
		29,879,841	**29,285,946**
Current assets			
Inventories	19	967,931	1,369,704
Trade receivables	20	1,493,989	1,419,114
Other short-term receivables	21	273,222	366,462
Cash and cash equivalents	22	96,071	194,213
		2,831,213	**3,349,493**
TOTAL ASSETS		**32,711,054**	**32,635,439**

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

Signed on behalf of the Company on 1 June 2010 by:

Leo Begovic
President of the Board

Miljenko Pavlakovic
Member of the Board

CONSOLIDATED BALANCE SHEET - HEP GROUP (CONTINUED)
AS AT DECEMBER 31, 2009

CAPITAL AND LIABILITIES	Notes	31 December 2009	31 December 2008
		HRK'000	HRK'000
Share capital	23	19,792,159	19,792,159
Capital reserves	23	(2,038,472)	(2,035,890)
Retained earnings	23	403,018	267,155
Equity attributable to equity holder		**18,156,705**	**18,023,424**
Minority interest	15	91,409	106,821
Total equity		**18,248,114**	**18,130,245**
Long-term borrowings	24	3,113,467	3,098,473
Long-term liabilities to the state	25	59,713	62,710
Long-term provisions	27	559,017	422,000
Liabilities under securities	28	1,150,887	1,197,070
Other long-term liabilities	29	4,927,022	4,369,412
Total non-current liabilities		**9,810,106**	**9,149,665**
Trade payables		2,179,323	2,609,773
Current portion of long-term bonds issued	28	46,690	-
Current portion of long-term borrowings	24	947,747	943,099
Short-term borrowings	30	767,805	1,122,054
Taxes payable	31	171,080	130,327
Interest payable		64,301	48,465
Liabilities to employees	32	143,132	129,831
Other short-term payables	33	332,756	371,980
Total current liabilities		**4,652,834**	**5,355,529**
TOTAL CAPITAL AND LIABILITIES		**32,711,054**	**32,635,439**

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

Signed on behalf of the Company on 1 June 2010 by:

Leo Begovic
President of the Board

Miljenko Pavlakovic
Member of the Board

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY - HEP GROUP

FOR THE YEAR ENDED 31 DECEMBER 2009

	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**	**(2,035,736)**	**256,690**	**18,013,113**	**122,064**	**18,135,177**
Refit for HROTE	-	-	(768)	(768)	-	(768)
Profit for the year	-	-	11,655	11,655	19,442	31,097
Exchange differences	-	(154)	-	(154)	(77)	(231)
Other comprehensive income	-	-	(422)	(422)	-	(422)
Total comprehensive income for the year	**-**	**(154)**	**11,233**	**11,079**	**19,365**	**30,444**
Minority interest	-	-	-	-	(22,192)	(22,192)
Distribution of dividend to RWE	-	-	-	-	(12,416)	(12,416)
Balance at 31 December 2008	**19,792,159**	**(2,035,890)**	**267,155**	**18,023,424**	**106,821**	**18,130,245**
Refit for HEP Telecom	-	-	19	19	-	19
Profit for the year	-	-	135,844	135,844	18,578	154,422
Exchange differences	-	(4,005)	-	(4,005)	124	(3,881)
Fair value of JANAF	-	1,423	-	1,423	-	1,423
Other comprehensive income	-	-	-	-	(1,995)	(1,995)
Total comprehensive income for the year	**-**	**(2,582)**	**135,863**	**133,281**	**16,707**	**149,988**
Minority interest	-	-	-	-	(19,442)	(19,442)
Distribution of dividend to RWE	-	-	-	-	(12,677)	(12,677)
Balance at 31 December 2009	**19,792,159**	**(2,038,472)**	**403,018**	**18,156,705**	**91,409**	**18,248,114**

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

Signed on behalf of the Company on 1 June 2010 by:

Leo Begovic
President of the Board

Miljenko Pavlakovic
Member of the Board

CONSOLIDATED STATEMENT OF CASH FLOWS - HEP GROUP

FOR THE YEAR ENDED 31 DECEMBER 2009

	2009	2008
	HRK'000	HRK'000
Cash flows from operating activities		
Profit for the year	154,422	31,097
Income tax expense recognised in profit	72,687	16,712
Net financial loss	340,541	241,470
Deferred tax assets	53,783	4,514
Gains on derivatives	(2,271)	(2,953)
Depreciation and amortization	1,688,750	1,654,886
Losses from decrease in inventory and equipment	79,310	14,391
Inventory surpluses	(406)	(11,933)
Loss / (gain) from real estate fair valuation	19,748	(133,533)
Increase / (decrease) in provisions for doubtful receivables	162,887	(78,024)
Increase / (decrease) in provisions	137,017	(89,317)
Operating cash flows before movements in working capital	2,706,468	1,647,310
(Increase) in trade receivables	(237,762)	(113,802)
Decrease / increase in inventories	401,773	(289,878)
Decrease in other current assets	93,240	189,860
(Decrease) / increase in trade payables	(430,450)	29,943
Increase in other liabilities	12,564	289,173
Increase in liabilities to employees	13,301	20,988
Increase in tax liabilities	40,753	40,549
Increase in long-term liabilities	512,644	584,887
Cash generated from operations	**3,112,531**	**2,399,030**
Income taxes paid	(126,470)	(21,226)
NET CASH FROM OPERATING ACTIVITIES	**2,986,061**	**2,377,804**
INVESTING ACTIVITIES		
Interest received	7,529	8,053
Increase in property, plant and equipment	(2,359,657)	(2,644,229)
(Increase) in other non-current assets	(2,512)	(125,293)
Change in minority interest	(15,412)	(15,243)
NET CASH USED IN INVESTING ACTIVITIES	**(2,370,052)**	**(2,776,712)**
FINANCING ACTIVITIES		
Repayments of borrowings	(2,004,210)	(1,785,511)
Interest paid	(336,952)	(223,842)
New bank loans raised	1,635,862	2,458,690
NET CASH (USED IN) / FROM FINANCING ACTIVITIES	**(705,300)**	**449,337**

CONSOLIDATED STATEMENT OF CASH FLOWS - HEP GROUP (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2009

NET (DECREASE) / INCREASE IN CASH AND CASH EQUIVALENTS	**(89,291)**	**50,429**
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	**194,213**	**166,512**
Effect of changes in exchange rates	(8,851)	(22,728)
CASH AND CASH EQUIVALENTS AT THE END OF YEAR	**96,071**	**194,213**

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

Signed on behalf of the Company on 1 June 2010 by:

Leo Begovic
President of the Board

Miljenko Pavlakovic
Member of the Board

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - HEP GROUP

FOR THE YEAR ENDED 31 DECEMBER 2009

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 36.

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 2009, the number of staff employed by the Group was 14,197 (31 December 2008: 14,348).

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.

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.

ENERGY LAWS (CONTINUED)

The Company has been applying the tariff models since 1 July 2008.

In December 2008 the Act on Amendments to the Law on Electricity Market stipulated that small customers are obliged to choose their suppliers till 30 July 2009 and conduct a supply contract with chosen supplier. During this period they have rights for supply of electric energy from the supplier for tariff customers.

Small customers that by the dead line do not find a supplier, will pay the electricity supply for the cost of balancing energy for the calculation of electric energy to eligible customers who have not found their supplier.

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 25th March, 2002 which was as of 5th February 2010 terminated due to fact that Law on Cessation of the Law on Privatization of the Hrvatska elektroprivreda d.d.

1. GENERAL (continued)

GOVERNANCE AND MANAGEMENT

General assembly of HEP d.d

The General assembly consists of the members representing the interests of the HEP d.d:

Đuro Popijač	President	Member since November 21, 2009
Miljenko Pavlaković	President	Member since February 14, 2008 till October 30, 2009

Supervisory Board of HEP d.d.

Members of Supervisory Board in 2009:

Branimir Horaček	President	Member since 19 October 2009
Dražen Bošnjaković	Member	Member since 19 October 2009
Krešimir Dragić	Member	Member since 19 October 2009
Slavko Konfic	Member	Member since 28 April 2008
Gordana Obran	Member	Member since 19 October 2009
Zvonimir Sabati	Member	Member since 19 October 2009
Jadranko Berlengi	Member	Member since 03 June 2008

Members of Supervisory Board in 2008:

Leo Begović	President	Member from 28 April 2008 till 22 September 2009
Krešimir Ćosić	Member	Member from 28 April 2008 till 19 October 2009
Dasenko Baldasari	Member	Member from 28 April 2008 till 19 October 2009
Luciano Delbianco	Member	Member from 28 April 2008 till 19 October 2009
Zdenko Jurčić	Member	Member from 28 April 2008 till 19 October 2009
Slavko Konfic	Member	Member from 28 April 2008
Jadranko Berlengi	Member	Member from 03 June 2008

Management Board in 2009:

Leo Begović	President	Member since 25 September 2009
Dubravko Lukačević	Member	Member since 2 November 2009
Snježana Pauk	Member	Member since 2 November 2009
Miljenko Pavlaković	Member	Member since 2 November 2009
Damir Pečvarac	Member	Member since 2 November 2009
Velimir Rajković	Member	Member since 2 November 2009

Management Board in 2008

Ivan Mravak	President	Member from 2004 till 25 September 2009
Željko Kljaković-Gašpić	Member	Member from 1 March 2008 till 25 September 2009
Darko Dvornik	Member	Member from 1 March 2008 till 25 September 2009
Stjepan Tvrdinić	Member	Member from 18 March 2008 till 25 September 2009
Željko Tomšić	Member	Member from 29 April 2008 till 25 September 2009
Nikola Rukavina	Member	Member from 29 April 2008 till 25 September 2009

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A summary of the Group'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 ("IFRS") 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 re valued 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 Group'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

The following amendments to the existing standards issued by the International Accounting Standards Board and interpretations issued by the International Financial Reporting Interpretations Committee are effective for the current period:

- IFRS 8 "Operating Segments" (effective for annual periods beginning on or after 1 January 2009),
- Amendments to IFRS 4 "Insurance contracts" and IFRS 7 "Financial Instruments: Disclosures" - Improving disclosures about financial instruments (effective for annual periods beginning on or after 1 January 2009),
- Amendments to IFRS 1 "First-time Adoption of IFRS" and IAS 27 "Consolidated and Separate Financial Statements" – Cost of investment in a subsidiary, jointly-controlled entity or associate (effective for annual periods beginning on or after 1 January 2009),
- Amendments to various standards and interpretations resulting from the Annual quality improvement project of IFRS published on 22 May 2008 (IAS 1, IFRS 5, IAS 8, IAS 10, IAS 16, IAS 19, IAS 20, IAS 23, IAS 27, IAS 28, IAS 29, IAS 31, IAS 34, IAS 36, IAS 38, IAS 39, IAS 40, IAS 41) primarily with a view to removing inconsistencies and clarifying wording (most amendments are to be applied for annual periods beginning on or after 1 January 2009),
- Amendments to IAS 32 "Financial Instruments: Presentation" and IAS 1 "Presentation of Financial Statements - Financial Instruments with the right to sell and liabilities arising on Liquidation (effective for annual periods beginning on or after 1 January 2009).
- IAS 1 (revised) "Presentation of Financial Statements" – A revised presentation (effective for annual periods beginning on or after 1 January 2009),
- IAS 23 (revised) "Borrowing Costs" (effective for annual periods beginning on or after 1 January 2009)
- IFRS 3 (revised) "Business Combinations" has been adopted in the current year in advance of its effective date (business combinations for which the acquisition data is on or after the beginning of the first annual period beginning on or after 1 July 2009).

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

Standards and Interpretations effective in the current period (continued)

- Amendments to IAS 27 "Consolidated and Separate Financial Statements" (effective for annual periods beginning on or after 1 July 2009),
- Amendments to IFRS 2 "Share-based Payment" – Vesting conditions and cancellations (effective for annual periods beginning on or after 1 January 2009),
- IAS 39 "Recognition and Measurement "- an embedded derivative (effective for annual periods beginning on or after 30 June 2009.)
- IFRIC 13 "Customer Loyalty Programs" (effective for annual periods beginning on or after 1 July 2009).
- IFRIC 15 "Agreements for the Construction of Real Estate" (effective for annual periods beginning on or after 1 January 2009),
- IFRIC 16 "Hedges of a Net Investment in a Foreign Operation" (effective for annual periods beginning on or after 1 October 2008),
- IFRIC 18 "The transfer of assets from customers" (in force for the transfer of property received from customers on or after 1 July 2009)

The Group's management has decided not to adopt IFRIC 18 "The transfer of assets from customers," at 1 July 2009. Mentioned interpretation will be applied for the transfer of assets received from customers on from 1 January 2010. Group did not quantify the effect of late adoption of the above interpretation on the financial statements of the Group. In future periods, after implementation, it will have effect to the financial statements of the Group.

Management of the Company has adopted IAS 23 in the previous periods, and will continue to capitalize interest for qualified assets.

Adoption of these other standards and interpretations had no significant effect on the financial statements of the Group.

Standards and Interpretations in issue not yet adopted

At the date of authorisation of these financial statements the following standards, revisions and interpretations were in issue but not yet effective:

- IFRS 9 "Financial Instruments" (effective for annual periods beginning on or after 1 January 2013),
- IFRS 1 (revised) "First-time Adoption of IFRS" (effective for annual periods beginning on or after 1 July 2009),
- Amendments to IFRS 1 "First-time Adoption of IFRS"- Additional Exemptions for First-time Adopters (effective for annual periods beginning on or after 1 July 2010),
- Amendments to IFRS 1 "First-time Adoption of IFRS"- Limited Exemption from Comparative IFRS 7 Disclosures for First-time Adopters (effective for annual periods beginning on or after 1 July 2010),
- Amendments to IFRS 2 "Share-based Payment" - Group cash-settled share-based payment transactions (effective for annual periods beginning on or after 1 January 2010),
- Amendments to IAS 24 "Related Party Disclosures" - Simplifying the disclosure requirements for government-related entities and clarifying the definition of a related party (effective for annual periods beginning on or after 1 January 2011),

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)

- Amendments to IAS 32 "Financial Instruments: Presentation" – Accounting for rights issues (effective for annual periods beginning on or after 1 February 2010.)
- Amendments to IAS 39 "Financial Instruments: Recognition and Measurement" - Eligible hedged items (effective for annual periods beginning on or after 1 July 2009.),
- Amendments to various standards and interpretations resulting from the Annual quality improvement project of IFRS published on 16 April 2009 (IFRS 2, IFRS 5, IFRS 8, IAS 1, IAS 7, IAS 17, IAS 18, IAS 36, IAS 38, IAS 39, IFRIC 9, IFRIC 16) primarily with a view to removing inconsistencies and clarifying wording, (most amendments are to be applied for annual periods beginning on or after 1 January 2010.),
- Amendments to IFRIC 14 "IAS 19 — The Limit on a defined benefit Asset, Minimum Funding Requirements and their Interaction" - Prepayments of a Minimum Funding Requirement (effective for annual periods beginning on or after 1 January 2011.),
- IFRIC 17 "Distribution of non-pecuniary property owners" (effective for annual reporting periods beginning on or after 1 July 2009).
- IFRIC 19 "Closing obligations with equity instruments" (effective for annual periods beginning on or after 1 July 2010).

The Group has elected not to adopt other standards, revisions and interpretations in advance of their date of entry into force. Management of the Group anticipates that the adoption of other standards and interpretations, from the above, in future periods will not significantly affect the financial statements of the Company and the Group.

THE BASIS OF THE PREPARATION OF THE COMPANY'S FINANCIAL STATEMENT

The financial statements of the Group represent aggregate amounts of the assets, liabilities, capital and reserves at 31 December 2009, 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 36. 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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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.

INVESTMENTS IN JOINTLY CONTROLLED ENTITIES

Jointly controlled entities are entities where Group and other parties are engaged in business activities under the joint control; i.e. when strategic financial and business decisions demands unanimous approval of all parties that participate in control.

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 ventures 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 venture has an interest are referred to as jointly controlled entities. The Group reports its interests in jointly controlled entities using proportionate consolidation.

REPORTING CURRENCY

The Company's and the Group's financial statements are prepared in Croatian kuna.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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.

	2009
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 6).

Jubilee bonuses

The Group provides benefits to its employees for long term work (jubilee bonuses) and severance payments when retirement. Benefit for long term work amounts from HRK to 1,650 HRK 5,500 net for work in Group from 10 to 40 years continuously.

Severance payments

As at 1 July 2008 Collective agreement has came into force (that refer to all subsidiaries within HEP Group), based on which each employee when retire, has a right for severance payment in amount of 1/8 of gross average monthly salary for last three months before retirement, for each year of continuous work with employer.

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.

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:

Buildings	**2009**
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, dispatch centres and others)	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 transformer; 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 licenses	5 years
Telecommunications equipment	5 – 20 years
Motor vehicles	5 – 8 years
Office furniture	**10 years**

In 2009, the Company reviewed the useful lives of its non-current assets as provided in IAS 16 and determined that there is no need for change of useful lives of its assets.

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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

PROPERTY, PLANT AND EQUIPMENT (continued)

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 revalue 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 revalue amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

INTANGIBLE ASSETS

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 accessed 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 as lessee

The Group has no significant finance lease arrangements and no significant operating lease arrangements were entered during 2009 and 2008. 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.

The Group as lessor

Property, plant and equipment are rented from mother company by carrying value. Rent of property, plant and equipment and intangible assets are classified as finance leases since lessee agrees with all benefits and risks resulting by ownership. Maturity date of lease is equal to remainder of depreciated leased assets useful life.

Obligations under leases are presented in the long-term liabilities of related companies. Leases bear interest only to the extent to which the lessor has obtained funds for the financing of the underlying funds from external sources. The above assets are stated at cost in order to display the underlying assets at their carrying value at which they HEP d.d. initially expressed.

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%**

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

TRADE DEBTORS AND PREPAYMENTS (continued)

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.

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 brining 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 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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

FOREIGN CURRENCIES (continued)

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.

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 determining the excess of the customer in the net fair value of identifiable assets, liabilities and contingent liabilities over cost.

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. 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.

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,

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

FINANCIAL ASSETS (continued)

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 2009 and 2008, the Company had no derivative financial instruments.

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 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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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.

Revenue recognition is based on Decision oft he Croatian Government on the tariffs from June 2008 and August 2009 and decision of HEP's management from June 2008 and June and August of 2009.

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 fully adopted IFRS 8 Operating segments and presented operating segments disclosures required by Standard, since it has debt instruments which are traded in public market.

3. CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES

CRITICAL JUDGMENTS IN APPLYING ACCOUNTING POLICIES

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

These judgments are provided in detail in the accompanying notes. However, the critical judgments 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 20, the management uses judgment to estimate whether trade and other receivables have suffer an impairment loss. The management believes that the carrying amount of the interest-rate swap approximates its fair value as disclosed in Note 26.

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.

Unbilled revenue calculation

Due to the method of calculating losses, where part of used energy when advance calculation for household is used, it is not possible to determine exact level of loss per year. After analyzing a number of different methods of approximation (five – year average, a linear approximation, etc.), Management has decided that most appropriate is method of logarithmic regression. The amount of losses on the network distribution is calculated using the percentage of the function of the logarithmic regression on the total amount of purchased power from the transmission network - the result of the losses of electricity distribution network in the current year in MWh.

The difference between the thus obtained size of losses and losses in the electric power balance for the current year is calculated.

Such difference represents basis for calculation of unbilled revenue and is multiplied by the average selling prices for households earned in the current year from those without a fixed monthly fee and the result is the difference that increases or decreases the revenues from selling electricity to households (note 21).

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 judgments used in determining cash receipts and expenditure. There were no impairments of assets of the Group that would result from the projections described above.

3. CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES (continued)

CRITICAL JUDGMENTS IN APPLYING ACCOUNTING POLICIES (continued)

Unbilled revenue calculation (continued)

The Group engaged an independent firm to appraise the fair value of NPP Krško d.o.o. as of 31 December 2009. 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.

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 2009 and 31 December 2008 amounted to HRK 120,351 thousand and HRK 66,568 thousand, respectively (see Note 9).

Actuarial estimates used in determining the retirement bonuses

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 287,849 thousand and HRK 245,247 thousand at 31 December 2009 and 31 December 2008, respectively (see Note 27).

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 27).

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 and 2009, the Group remeasured the Jadranski naftovod shares and the investment properties at fair value.

In 2008 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.

In 2009 fair value was made based on notification of Central clearing deposit company regarding open balances as of 31 December 2009. Market value of Jadranski naftovod share as at 31 December 2009 was HRK 2,826.36 Loss resulting from the fair valuation of the investment property amount to HRK 19,748 thousands, in 2008 it amounted to HRK133,533 thousand (see notes 5 and 7).

Valuation of inventories

During 2009 based on estimation, Group has made value adjustment of obsolete inventories and materials (material with no transactions in previous 2 year) according to ageing structure in total amount of HRK 110,647 thousands.

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 heating 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	
	2009	2008	2009	2008	2009	2008	2009	2008
	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000
Revenue	11,669,827	11,082,854	610,394	523,387	320,565	283,111	12,600,786	11,889,352
Income from operations	**671,859**	**460,655**	**(104,388)**	**(181,464)**	**179**	**10,088**	**567,650**	**289,279**
Finance cost							(340,541)	(241,470)
Income tax							(72,687)	(16,712)
Net profit							**154,422**	**31,097**

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	
	2009	2008	2009	2008
	HRK'000	HRK'000	HRK'000	HRK'000
Electricity	29,963,915	29,774,071	6,953,885	8,009,805
Heating	1,036,394	989,017	292,518	286,571
Gas	286,987	266,045	158,621	135,871
Unallocated	1,423,758	1,606,306	7,057,916	6,072,947
Total Group	**32,711,054**	**32,635,439**	**14,462,940**	**14,505,194**

4. SEGMENT INFORMATION (continued)

INFORMATION ON THE LARGEST CUSTOMERS

Activity from sales of electricity in 2009 amounts HRK 11,669,827 thousands (HRK 11,082,854 thousands in 2008). Revenue that Group generated from sale of electric energy to its largest customer in 2009 amounts to HRK 156,242 thousands (HRK 132,071 in 2008).

Activity from sale of heating energy in 2009 amounts HRK 610,394 thousands (HRK 523,387 thousands in 2008). Revenue that Group generated from sale of heating energy to its largest customer in 2009 amounts to HRK 12,066 thousands (HRK 12,857 thousands in 2008).

Activity from sale of gas in 2009 amounts HRK 320,565 thousands (HRK 283,111 thousands in 2008). Revenue that Group generated from sale of gas to its largest customer in 2009 amounts to HRK 12.400 thousands (HRK 12.020 thousands in 2008).

TERRITORIAL BUSINESS ANALYSIS

The Group operates in Europe, with countries that are members of the European Union and other countries that are not members of the European Union.

Below is presented territorial analysis of revenue that Group generated from active parts of the businesses with external buyers of electric energy:

	2009	**2008**
	HRK'000	HRK'000
Croatia	11,333,305	10,808,382
European Union members	323,870	231,787
Other countries non European Union members	12,652	42,685
	11,669,827	**11,082,854**

5. OTHER OPERATING INCOME

	2009	2008
	HRK'000	HRK'000
Services rendered	239,454	237,689
Income from assets received free of charge	194,762	178,208
Capitalised assets	147,151	182,605
Subsequent collection of receivables previously provided against	91,033	167,488
Late-payment interest	68,808	81,787
Income from electricity in transit – foreign	30,049	39,837
Rental income – electricity sales facilities	30,032	45,955
Income from sale of materials	20,411	67,395
Income from reversal of long-term provisions for retirement benefits and jubilee awards	18,356	14,038
Income in respect of the electricity bill reminders	17,523	14,073
Income from reversal of long-term provisions – court costs	13,816	12,321
Income in respect of court costs on claims	9,844	6,948
Recovery of receivables previously written off	8,208	19,334
Income from sale of tangible assets	7,163	7,931
Income from reversal of long-term decommissioning provision	620	3,020
Inventory surplus – fixed assets	406	11,933
Gains on fair valuation of investment properties	-	133,533
Other	56,884	84,014
	954,520	**1,308,109**

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 Group 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.

During 2009, Group has re accessed fair valuation of investment properties and incurred loss of HRK 19,748 thousands (in 2008: gain of HRK 133,533 thousand), see Note 7.

6. STAFF COSTS

	2009	2008
	HRK'000	HRK'000
Net salaries	1,157,790	1,074,508
Taxes and contributions	796,560	730,417
	1,954,350	**1,804,925**

TOTAL STAFF COSTS:

	2009	2008
	HRK'000	HRK'000
Gross salaries	1,954,350	1,804,925
Reimbursement of costs to employees (Note 7)	147,718	153,393
Employee benefits (Note 7)	89,030	65,962
	2,191,098	**2,024,280**

DIRECTORS' AND EXECUTIVES REMUNERATION:

	2009	2008
	HRK'000	HRK'000
Gross salaries	7,086	6,416
Pension contributions	1,498	1,400
Other receipts	1,091	1,082
	9,675	**8,898**

Reimbursement of costs to employees includes commutation allowances in the amount of HRK 88,867 thousand (2008: HRK 90,009), daily allowances and travelling expenses in the amount of HRK 16,870 thousand (2008: HRK 26,191 thousand), additional health insurance amounting to HRK 21,461 thousand (2008: HRK 14,807 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 46,392 thousand (2008: HRK 52,807 thousand).

7. OPERATING EXPENSES

	2009	2008
	HRK'000	HRK'000
Maintenance costs (service and material)	578,792	504,310
General and administrative expenses	453,201	464,016
Provisions for doubtful receivables	275,006	110,148
Gas costs	256,454	216,051
Other employee benefits (Note 6)	147,718	153,393
Cost of material	131,858	157,154
Value adjustment of inventory	110,648	-
Litigation provisions	105,689	8,132
Contributions to the State	104,073	109,106
NPP Krško – valuation of investment	104,506	103,882
Other material employee's rights (Note 6)	89,030	65,962
Write-off of tangible assets	79,310	14,391
Distributions and concession for water	63,803	60,764
Provisions for retirement bonuses and jubilee awards	60,964	29,124
Fee for the usage of power plant facilities	52,564	43,306
Fee for environmental protection	48,943	57,933
Calculation and collection costs	36,647	31,823
Unrealisable loss for loan valuation	28,772	-
Provisions according to contracts for damages	28,621	-
Insurance premiums	25,045	26,027
Unrealisable loss for real-estate investments	19,748	-
Purchase value of sold materials	17,233	56,057
Write-off of non claimed receivables	16,201	18,515
Development costs	13,109	15,612
Damages and indemnities	9,643	8,197
Information costs	7,719	8,735
Fees and subscription	4,084	4,229
Other	56,095	49,900
	2,925,476	**2,316,767**

During 2009 Group has made estimation of value adjustment of old inventories and materials (that had no transactions in last two years) according to ageing structure in total amount of HRK 110,647 thousands.

8. FINANCIAL REVENUE AND COSTS

	2009	2008
Financial income	HRK'000	HRK'000
Foreign exchange gains	73,572	106,349
Interest expense	7,529	8,053
Total financial income	81,101	114,402
Finance costs		
Interest expense	(333,266)	(220,208)
Foreign exchange losses	(82,419)	(129,077)
Amortization of deferred interest	(3,686)	(3,634)
Fair value of interest swap	(2,271)	(2,953)
Total financial expenses	(421,642)	(355,872)
Net finance loss	**(340,541)**	**(241,470)**

9. INCOME TAX

	2009	2008
	HRK'000	HRK'000
Current taxes	126,470	21,226
Deferred tax expense/(income) relating to the origination and reversal of temporary differences	(53,783)	(4,514)
Income tax expense	**72,687**	**16,712**

ADJUSTMENTS TO DEFERRED TAX ASSETS WERE AS FOLLOWS:

	2009	2008
	HRK'000	HRK'000
Balance at 1 January	66,568	62,477
Reversal of deferred tax assets	(1,285)	(2,703)
Deferred tax assets recognised	55,068	6,794
Balance at 31 December	**120,351**	**66,568**

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

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

	2009	2008
	HRK'000	HRK'000
Profit before taxation	227,109	47,809
Income tax at the applicable rate of 20%	45,421	9,562
Tax disallowable expense/(income)	(52,527)	2,524
Tax effect	53,783	4,514
Tax effect of losses brought forward	(90,089)	(194,026)
Tax effect of Group entities operating with loss	116,099	194,138
Tax expense for the year	**72,687**	**16,712**

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 536,237 thousand (2008: HRK 536,269 thousand), while the Group recorded a total income tax expense of HRK 126,470 thousand (2008: HRK 21,226 thousand) and reported deferred tax assets in the amount of HRK 53,783 thousand for the current year and HRK 4,514 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.

9. INCOME TAX (continued)

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
2005	62,449	2010.
2006	60,664	2011.
2007	102,889	2012.
2008	194,136	2013.
2009	116,099	2014.
	536,237	

As of 31 December 2009 and 2008 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 Group 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	Value adjustment of inventory	Provisions for jubilee and retirement benefits	Litigation provision	Depreciation at rates above statutory rates	Other	Total
At 1 January 2008	-	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
Credited to profit and loss for the year	21,675	9,299	9,972	1,085	11,752	53,783
At 31 December 2009	**21,675**	**65,163**	**17,680**	**3,519**	**12,314**	**120,351**

10. PROPERTY, PLANT AND EQUIPMENT

HRK'000	Land and buildings	Fixtures and equipment	Assets under construction	Total
COST				
At 1 January 2008	**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**
Restatement 01 January 2009	(13,998)	-	-	(13,998)
Transfers	14,853	2,635	2,547	20,035
Additions	5,462	73,814	2,279,898	2,359,174
Transfers from assets under construction	694,693	1,789,766	(2,496,205)	(11,746)
Capitalized interests	-	-	35,630	35,630
Inventory surplus	34	711	-	745
Disposals	(68,202)	(170,991)	(62,186)	(301,379)
At 31 December 2009	**33,624,793**	**32,162,924**	**3,130,294**	**68,918,011**
ACCUMULATED DEPRECIATION				
At 1 January 2008	**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**
Restatement at 01 January 2009	(2,161)	-	-	(2,161)
Transfers	14,344	17,227	-	31,571
Charge for the year	685,989	975,808	-	1,661,797
Impairment losses			-	
Value adjustment of additions	271	4,127	-	4,398
Eliminated on disposal	(60,084)	(162,706)	-	(222,790)
Inventory surplus	20	656	-	676
At 31 December 2009	**21,151,527**	**20,553,391**	**-**	**41,704,919**
CARRYING AMOUNT				
At 31 December 2009	**12,473,266**	**11,609,533**	**3,130,294**	**27,213,093**
At 31 December 2008	**12,478,803**	**10,748,710**	**3,370,610**	**26,598,123**

10. PROPERTY, PLANT AND EQUIPMENT (continued)

Disposals from capital work in progress during 2009 in the amount of HRK 62,118 thousand (2008: HRK 12,647 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 693,376 thousand (2008: HRK 942,360 thousand) to secure the banking facilities provided to TE Plomin d.o.o.

11. INTANGIBLE ASSETS

	HRK'000
COST	
At 1 January 2008	545,749
Transfers	(49)
Additions	19.096
Disposals	(371)
At 1 January 2009	564,425
Transfers	(32,161)
Additions	12,197
Disposals	(1,586)
At 31 December 2009	542,875
ACCUMULATED AMORTISATION	
At 1 January 2008	460,034
Transfers	-
Charge for the year	26,081
Disposals	(340)
At 1 January 2009	485,775
Transfers	(31,571)
Charge for the year	26,764
Disposals	(1,764)
At 31 December 2009	479,204
CARRYING AMOUNT	
At 31 December 2009	63,671
At 31 December 2008	78,650

12. INVESTMENT PROPERTIES

As of 31 December 2009, 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 Group.

At fair value	31 December 2009	31 December 2008
	HRK'000	HRK'000
Fair value	**211,074**	**73,462**
Depreciation charge for the year	(189)	(1,580)
Net gains on remeasurement at fair value	(19,748)	133,533
Other changes	11,330	5,659
Closing balance at fair value	**202,467**	**211,074**

13. PREPAYMENTS FOR FIXED ASSETS

	31 December 2009	31 December 2008
	HRK'000	HRK'000
Electricity facilities on the Croatian highways - Hrvatske Autoceste	300,000	300,000
JSC Tehnopromexport –TE Sisak	59,068	59,976
Litostroj Slovenija	8,447	11,333
Končar Inženjering d.d. – HE Lešće	5,169	20,672
Voith Siemens Austria	4,955	4,967
Ingra d.d. – HE Lešće	1,692	6,493
Konstruktor Inženjering	1,081	3,919
TPK-EPO Proizvodnja d.o.o.	-	10,768
Others	22,668	30,514
	403,080	**448,642**

In December 2006, the Group advanced a payment to Hrvatske autoceste 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 December 2009, under which the deadline for the takeover of the electricity facilities by the Company has been prolonged for two years.

In business sense, Group is using these facilities for economic purposes for which it is intended and supplies electricity to consumers.

14. INVESTMENT IN THE NUCLEAR POWER PLANT KRŠKO

	31 December 2009	31 December 2008
	HRK'000	HRK'000
Opening balance	1,609,598	1,609,752
Negative exchange difference (charged to capital reserves)	(4,005)	(154)
	1,605,593	**1,609,598**

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 30 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 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 come 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.

14. INVESTMENT IN THE NUCLEAR POWER PLANT KRŠKO (continued)

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 program (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 program. From 2004 to 2009, the Group disclosed radioactive waste disposal and decommissioning provisions in the amount of HRK 626,314 thousand, and paid HRK 579,737 thousand on a separate account in the period from 2006 to 2009. Thus, the balance at 31 December 2009 amounts to HRK 46,577 thousand, of which HRK 4,932 thousand are long-term, and HRK 41,645 thousand represent a short-term liability for the year 2009 (Notes 27 and 33).

The investment in NPPK is accounted for using the equity method and amounts to HRK 1,605,593 thousand. The negative foreign exchange difference arising on recalculating the capital from the company's investment amounting to HRK 4,005 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 2009 and 2008:

	31 December 2009	**31 December 2008**
	HRK'000	HRK'000
Property, plant and equipment	3,063,234	3,103,205
Capital and reserves	3,211,186	3,219,196
Gross sales	1,120,485	1,029,480
Net profit	-	-
Cash flows from operating activities	**352,970**	**224,498**

As at 31 December 2009, the Group 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. The calculation has determined that fair value of NE Krško is greater than their carrying value.

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 2009 the distribution of RWE invested equity amounted to HRK 12,677 thousand (2008: HRK 12,416 thousand). The remaining undistributed RWE invested capital amounted to HRK 75 million at 31 December 2009 (2008: HRK 87 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 2009, accrued undistributed interest amounted to HRK 19,577 thousand (2008: HRK 23,306 thousand).

The RWE annual return on invested capital, effectively a preferred dividend, is paid out from net profit of Plomin. The rate for 2009 and 2008 is 16% and 17%. The amount paid out in 2009 in respect of 2008 profits was HRK 19,442 thousand and in 2008 HRK 22,192 thousand in respect of 2007 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 Group 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.

	2009	2008
	HRK '000	HRK '000
Opening balance of minority share	106,821	122,064
Interest payment	(12,677)	(12,416)
Dividend payment	(19,442)	(22,192)
Increase for current year profit	18,578	19,442
Correction of tax liabilities through retained earnings	(1,995)	-
Exchange differences	124	(77)
Closing balance	**91,409**	**106,821**

16. LONG-TERM LOAN RECEIVABLES AND DEPOSITS

	31 December 2009	31 December 2008
	HRK'000	HRK'000
Loans given	1,794	2,552
Current portion of loans given	(311)	(136)
Long-term portion	**1,483**	**2,416**

Loans given to third parties

	Year loan approved	Repayment period	Loan amount	31 December 2009	31 December 2008
				HRK'000	HRK'000
Town of Pregrada	2006	10 years	1,358	914	1,358
Vrni d.o.o.	2007	3 years	247	880	164
Did d.o.o.	2007	4 years	1,010	-	715
Others				-	315
Total				**1,794**	**2,552**
Current portion				(311)	(136)
Non current portion				**1,483**	**2,416**

17. INVESTMENTS AVAILABLE FOR SALE AND OTHER INVESTMENTS

	31 December 2009	31 December 2008
	HRK'000	HRK'000
Investments available for sale	152,797	151,374
Other investments	200	-
	152,997	**151,374**

Changes in investments available for sale are presented below:

	2009	2008
	HRK '000	HRK '000
Beginning balance	151,374	2
Investments	-	151,372
Fair value of Jadranski Naftovod d.d.	1,423	-
	152,797	**151,374**

	2009	2008
	HRK '000	HRK '000
Investment in securities:		
Jadranski Naftovod d.d.	152,570	151,147
Viktor Lenac d.d.	220	220
Đuro Đaković d.d.	5	5
Kraš d.d.	2	2
	152,797	**151,374**

	2009	2008
	Amount	Amount
Other investments:		
Geopodravina d.o.o.	200	-

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.

17. INVESTMENTS AVAILABLE FOR SALE AND OTHER INVESTMENTS (continued)

According to International Accounting Standard 39, financial assets available for sale are initially recognised at fair value and any subsequent changes in the fair value are included within equity. The Group 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 share was determined at HRK 2,800, which is the value at which the share has been included in the Group'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.

In 2009 fair value was determined by notification of Central clearing deposit company of balance as of 31 December 2009. Market value of Jadranski naftovod share as of 31 December 2009 is HRK 2,826.36.

18. OTHER LONG TERM ASSETS

	2009	2008
	HRK'000	HRK'000
Housing loan receivables	54,035	57,852
Energetic efficiency receivables – long term part	43,391	38,090
Calculated intercalary interest – RWE	19,577	23,306
Other long term asset	103	253
	117,106	**119,501**

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 25). The receivables are secured by mortgages over the sold apartments.

According to association regulation, on all funds invested by RWE Power interest rate that in period of construction amounted to 17% (intercalary interest) is calculated. Calculated intercalary interest in amount of EUR 7,536 thousands, calculated in HRK 57,262 thousands is completely recorded as deferred expense depreciated over 15 years by linear method.

Repayment of intercalary interest is done along with repayment of invested funds from RWE Power and it started after electric power plant was finished. In 2009 total repaid amount was EUR 502 thousands or calculated in HRK 3,737 thousands (in 2008 EUR 502 thousands, recalculated in HRK 3,634).

As at 31 December 2009 deferred expense for intercalary interests amounted to EUR 2,679 thousands or recalculated to HRK 19,577 thousands (in 2008 EUR 3,182 thousands, recalculated in HRK 23,306 thousands). Exchange differences are represented through finance income or expenses for the year in which they occurred.

19. INVENTORIES

	31 December 2009	31 December 2008
	HRK'000	HRK'000
Inventories of fuel and other material	687,584	874,495
Electric materials	171,684	182,682
Spare parts	99,099	206,342
Construction material	84,454	80,424
Other inventories	35,757	25,761
Value adjustment of obsolete materials and spare parts	(110,647)	-
	967,931	**1,369,704**

During 2009 Group estimated value adjustment of obsolete inventories of materials (material which had no transactions in last 2 years) in accordance with ageing structure which resulted with value in total amount of HRK 110,647 thousands.

20. TRADE RECEIVABLES

	31 December 2009	31 December 2008
	HRK'000	HRK'000
Electricity – Corporate customers	1,109,074	915,259
Electricity – Households	270,576	295,100
Heating, gas and services	463,232	368,757
Foreign sales	23,386	51,726
Other	30,606	28,261
	1,896,874	**1,659,103**
Allowance for bad and doubtful receivables	(402,885)	(239,989)
	1,493,989	**1,419,114**

Ageing analysis of receivables not impaired is as follows:

	31 December 2009	31 December 2008
	HRK'000	HRK'000
Not yet due	775,460	851,656
0-60 days	507,927	444,776
61-90 days	109,517	70,123
91-120 days	49,647	15,725
121-365 days	51,438	36,834
	1,493,989	**1,419,114**

Movements in impairment allowance were as follows:

	31 December 2009	31 December 2008
	HRK'000	HRK'000
At 1 January	**239,989**	**318,013**
Provisions for potential losses (Note 7)	275,006	110,148
Reversal of prior-year provisions	(21,086)	(27,599)
Amounts collected (Note 5)	(91,033)	(160,573)
At 31 December	**402,876**	**239,989**

Management conducts a value adjustment of bad and doubtful receivables based on a review of the overall ageing structure of all receivables and based on a review of significant individual amounts involved in the receivables.

Individual analysis of significant receivables from customers in HEP Group spotted outstanding receivables from DIOKI and Dina Petrokemija in approximate amount of HRK 60 million for which is not made allowance.

21. OTHER SHORT-TERM RECEIVABLES

	31 December 2009	31 December 2008
	HRK'000	HRK'000
Accrued electricity sales – households	87,058	20,157
Demand and time deposits	56,125	124,762
VAT receivable	19,555	71,725
Income tax prepayments	5,750	28,409
Receivables for Government bonds	22,641	22,639
Receivables from the State in respect of employees	7,950	12,374
Interest receivable	2,714	2,724
Other short-term receivables	71,429	83,672
	273,222	**366,462**

The estimate of unbilled revenue is based on the calculation of losses in network of 8.46% (7.01% in 2008), determined using a logarithmic regression on the distribution level. This change has resulted in increase of income in amount of HRK 66,901 thousands.

22. CASH AND CASH EQUIVALENTS

	31 December 2009	31 December 2008
	HRK'000	HRK'000
Gyro accounts - Kunas	61,810	142,986
Gyro accounts – Foreign	22,436	44,269
Special purposes gyro accounts	11,404	6,382
Petty cash registers – Kunas	418	566
Special purposes gyro accounts – postal payments	3	10
	96,071	**194,213**

23. 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.

The value adjustment of the investment in NPP Krško in respect of exchange differences was charged to equity.

Exchange differences in NEK as of 31 December 2009 amounted to HRK 148,826 (HRK 4,005 thousands in 2009, HRK 154 thousands in 2008).

Retained earnings in the amount of HRK 403,018 thousand comprise prior year profits in the amount of HRK 119,627 thousand, legal reserves in the amount of HRK 147,546 thousands, profit for the year in the amount of HRK 135,844 thousand, The minority interest attributable to RWE amounts to HRK 91,409 thousand of which HRK 18,578 thousand represent dividends attributable to the foreign equity holder.

24. NON-CURRENT BORROWINGS

	Interest rates	31 December 2009	31 December 2008
		HRK'000	HRK'000
Domestic bank borrowings	EURIBOR+ (1.00%-6.75%)	1,062,199	925,036
Foreign bank borrowings	EURIBOR+ (0.50%-4.74%)	2,929,555	2,912,361
Liabilities to domestic companies	EURIBOR+ 1.95%	13,835	23,116
Loan from RWE		19,577	23,306
Rescheduled debt		36,048	157,753
Total long-term borrowings		**4,061,214**	**4,041,572**
Current portion		(947,747)	(943,099)
Long-term portion		**3,113,467**	**3,098,473**

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.

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 7.4 million were utilised in 2009. The drawn loan balance at 31 December 2009 amounted to EUR 18.7 million, and the undrawn loan balance at 31 December 2009 amounted to EUR 5.3 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, was concluded in 2003. The withdrawn amount during 2009 amounted to EUR 0.5 million. The drawn loan balance as at 31 December 2009 amounted EUR 4.2 million. Remaining balance of EUR 0.2 million will be, by the contract used by 30 June 2010. For the second phase of the implementation of the Energy Efficiency Project, a long-term loan agreement was concluded with SG Splitska banka for a loan of EUR 3 million. Complete amount of loan was withdrawn.

In December 2008, a new club loan of EUR 125 million was concluded, earmarked for the execution of the 2008 investment plan. The loan term is 5 years, and two-thirds of the principal amount are repayable in quarterly installments, 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. During 2009 total amount of EUR 35 million was withdrawn so as at 31 December balances amounted EUR 115 million, undrawn loan balance amounted EUR 10 million. Due date of a loan was prolongated from 16 December 2009 to 30 September 2010, since activities on block C in TE Sisak have not progress as expected.

The projects nominated by HEP-ESCO d.o.o. and HEP-obnovljivi izvori energije d.o.o. that received support by the competent Croatian ministries, and for which the Loan Agreement with KfW was concluded for a loan of EUR 50 million have started in 2009. The principal loan terms and conditions comprise: a loan utilization period of 5 years; principal repayment on a quarterly basis over a period of 10 years upon the expiry of the utilization period. Along with signed contract with KfW, Group has signed contract for finance donation with Government of Republic of Germany, total amount of donation was E UR 0.6 million. During 2009 withdrawn amount from loan amounted to EUR 0.5 million and EUR 0.2 from donations.

24. NON-CURRENT BORROWINGS (continued)

To finance investment and working plan of operations in 2009 HEP has during 2009 signed three bilateral long term loans, respectively, the amounts of EUR 30 million from Bayerische Landesbank, Raiffeisen Zentralbank and PBZ d.d. Zagreb, and earlier mentioned EUR 3 million from SG Splitska banka for finance of HEP ESCO projects. Maturity of loans is around 3 and 5 years, with quarterly or semiannual installments

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
2010.	947,747
2011.	970,030
2012.	933,640
2013.	548,176
2014.	149,999
After 2014.	511,623
Total	**4,061,214**

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

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

Currency	**31 December 2009**	**31 December 2008**
USD	7,083	24,559
EUR	548,245	531,325

RESCHEDULED DEBT

The status of rescheduled debt is presented below:

	Amount
Rescheduled Paris Club debt	-
Rescheduled London Club debt	36,048
Total rescheduled debt	**36,048**

24. NON-CURRENT BORROWINGS (continued)

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 singed 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 installments, with a regular interest equal to 6-month EURIBOR + 0.50%.

The last installment under the rescheduled Paris Club Debt was due on 31 July 2009.

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.

25. LONG-TERM LIABILITIES TO THE GOVERNMENT

The long-term debt to the Government in the amount of HRK 59,713 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.

26. 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 1.0075% at 31 December 2009 (2008: approximately 4.9931 %).

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 2009 was EUR 15,339 thousand (2008: EUR 20,452 thousand). The fair value of the interest rate swap contract, representing a future obligation, at 31 December 2009 amounted to HRK 6,284 thousand (2008: HRK 6,909 thousand). The related deferred tax asset at 31 December 2009 amounted to HRK 1,257 thousand (2008: HRK 1,382 thousand).

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

	31 December 2009	31 December 2008
	HRK'000	HRK'000
Long-term portion (Note 29)	3,513	5,721
Current portion (Note 33)	2,771	1,188
	6,284	**6,909**

27. LONG-TERM PROVISIONS

	31 December 2009	31 December 2008
	HRK'000	HRK'000
Litigation provision	145,335	53,458
Provision for retirement bonuses	233,949	185,207
Provision for jubilee awards	53,900	60,040
Thermal power plant decommissioning provision	92,280	75,648
Provision for NPP Krško – decommissioning (note 33)	4,932	47,647
Provision according to damages contract	28,621	-
	559,017	**422,000**

The thermal power plant decommissioning provision in the amount of HRK 92,280 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:

HRK'000	Legal actions	Retirement bonuses	Jubilee awards	Decommissioning - NPPK	Decommissioning of TPPs	Other	Total
At 1 January 2009	53,458	185,207	60,040	47,647	75,648	-	422,000
Current maturity	-	-	-	(41,645)	-		(41,645)
New provisions made	105,688	57,584	3,395	-	16,632	28,621	211,920
Decrease in provisions (amounts paid)	(9,312)	(7,317)	(9,098)	(1,070)	-	-	(26,797)
Decrease in provision on valuation	(4,499)	(1,525)	(437)	-	-	-	(6,461)
At 31 December 2009	**145,335**	**233,949**	**53,900**	**4,932**	**92,280**	**28,621**	**559,017**

Provision for legal cases refer to cases where possible outcome has been determined as uncertain or negative. The most important court case for which provision was made is in TE Plomin in total amount of HRK 40,715 thousands. The Group has terminated contract for coal delivery with supplier due to break on the power plant and considers that there was an occurrence of major force (force majure)

Supplier denials the right for unilateral breach of contract for coal delivery and considers that events are not result of major force. Trial is held on Court of Arbitration in Paris. Law office and Management have evaluated that total possible liability will amount up to USD 8 million, so provision was made in amount of HRK 40,715 thousands.

27. LONG TERM PROVISIONS (continued)

Other provision in amount of HRK 28,261 refer to contracts signed with Končar – Generatori i Motori, for object HE Zakučac for termination of work based by which contractor (Končar – GIM) has right for reimbursement of expenses occurred during waiting. Mentioned amount represents estimation from Končar – GIM. Group has suggested conciliation or arbitration, and outcome is uncertain at this moment.

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

	Retirement benefits	Jubilee awards	Total
	HRK'000	HRK'000	HRK'000
At 1 January 2009	**185,207**	**60,040**	**245,247**
Cost of services	8,358	2,860	11,218
Interest expenses	13,170	2,978	16,148
Benefits paid	(7,510)	(9,561)	(17,071)
Actuarial gains/(losses)	34,724	(2,417)	32,307
At 31 December 2009	**233,949**	**53,900**	**287,849**

The following assumptions were used in preparing the calculations:

- The termination rate is 1.14 percent and is based on the statistical fluctuation rates for the Company in the period from 2005 to 2009.
- 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 will not grow in other years.
- The present value of the obligation was determined using a 6.2 % discount rate.

28. 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 privatization 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 2009	**31 December 2008**
	HRK'000	HRK'000
Nominal value of bonds	1,200,000	1,200,000
Discount value	(2,423)	(2,930)
Current portion of bonds	(46,690)	-
	1,150,887	**1,197,070**

29. OTHER NON-CURRENT LIABILITIES

	31 December 2009	**31 December 2008**
	HRK'000	HRK'000
Deferred income	4,683,583	4,312,136
Deferred recognition of income – clearing debt	239,926	51,555
Long-term debt under interest rate swap (Note 26)	3,513	5,721
	4,927,022	**4,369,412**

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.

Committee for the interpretation of International Financial Reporting Standards (IFRIC) has issued in January 2009 Interpretation of the 18 - Transfer of assets from customers (IFRIC 18), with mandatory application from 01 July 2009.

In Republic of Croatia mentioned interpretation has came into force as of 1 January 2010 by decision of Standards of finance interpretation board as of 11 January 2010 (Official Gazette No. 18/2010).

Therefore, the HEP management made a decision to change accounting policy whereby the interpretation of the Committee for the interpretation of International Financial Reporting Standards 18 "The transfer of assets from the customer" applies from 1 January 2010.

The effect of adoption of IFRIC 18 as of 1 July 2009 on financial statements for year ended 31 December 2009 has not been done.

30. SHORT-TERM BORROWINGS

	31 December 2009	31 December 2008
	HRK'000	HRK'000
Borrowings from domestic banks and branch offices of foreign banks, denominated in various currencies on the following terms:	761,320	1,115,536
Interest rates ranging from EURIBOR + (1.50 – 5.79%)	-	-
Interest rates on Ministry of Finance Treasury Bills + (1.00 – 3.50%)	-	-
Secured by bills of exchange	-	-
Borrowings from domestic companies on the following terms:	2,805	2,838
Interest rate 7.25%	-	-
Secured by bills of exchange	-	-
Current portion of RWE loan	3,680	3,680
	767,805	**1,122,054**

During 2009, the Group used short-term loans from domestic banks for working capital purposes and for the settlement of trade payables.

31. LIABILITIES FOR TAXES AND CONTRIBUTIONS

	31 December 2009	31 December 2008
	HRK '000	HRK '000
Liabilities for income tax	116,563	12,952
Utility and other fees	28,573	62,711
Contributions on salaries	24,217	23,531
Environmental fund fee	39	29,923
Other	1,688	1,210
	171,080	**130,327**

32. LIABILITIES TO EMPLOYEES

	31 December 2009	31 December 2008
	HRK'000	HRK'000
Net salaries	77,334	77,432
Contributions	46,614	47,152
Other	19,184	5,247
	143,132	**129,831**

33. OTHER PAYABLES

	31 December 2009	31 December 2008
	HRK'000	HRK'000
Liabilities for renewable sources	228,351	198,951
Decommissioning NEK accrued expenses	41,645	114,810
Deferred income and received advances	11,618	12,081
Accrued expenses	5,464	6,779
Current portion of the liability under interest rate swap (Note 26.)	2,771	1,188
Other payables	42,907	38,171
	332,756	**371,980**

34. 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:

	31 December 2009	31 December 2008
	HRK'000	HRK'000
NE Krško d.o.o.		
Liabilities for purchased electricity	41,451	36,382
Cost of purchased electricity	557,575	502,903

34. RELATED PARTY TRANSACTIONS (continued)

	Sales revenue		Purchases	
HRK'000	**2009**	**2008**	**2009**	**2008**
Enterprises controlled by the Government				
Hrvatske Željeznice	92,624	86,128	15,746	16,257
INA-Industrija nafte	156,242	132,071	1,812,967	2,288,077
Hrvatske telekomunikacija	75,011	51,535	19,337	26,011
Croatia osiguranje	4,754	4,052	15,558	18,050
Hrvatska pošta	17,480	15,237	48,853	38,330
Hrvatske šume	5,959	5,076	14,364	7,585
Jadrolinija	1,202	1,099	398	572
Narodne novine	2,081	1,846	4,963	4,835
Croatian Radio & Television	13,898	15,408	1,060	1,702
Plovput	559	424	210	144
Croatia Airlines	772	768	63	475
Petrokemija Kutina	9,965	18,707	6,834	-
Ministry of Foreign Affairs	598	1,180	-	-
Ministry of Defence	34,743	29,012	58	1,949
Ministry of Interior	24,100	20,511	38	43
Elementary and secondary schools	80,008	73,074	1,027	168
Judicial institutions	11,004	10,663	69	97
Colleges and universities	32,138	34,731	15,785	13,932
Legislative, executive and other bodies of the Republic of Croatia	63,850	65,562	12,115	7,679
Health institutions and organisations	112,586	116,898	4,906	6,051
Other users	94,142	106,399	145,011	60,762
TOTAL	**833,716**	**790,381**	**2,119,362**	**2,492,719**

34. RELATED PARTY TRANSACTIONS (continued)

	Receivables		Payables	
HRK'000	31 December 2009	31 December 2008	31 December 2009	31 December 2008
Enterprises controlled by the Government				
Hrvatske Željeznice	20,229	2,689	5,091	2,531
INA-Industrija nafte	15,602	5,142	218,667	463,112
Hrvatske telekomunikacija	8,407	3,637	6,485	7,558
Croatia osiguranje	469	184		3,873
Hrvatska pošta	3,301	1,069	7,966	4,095
Hrvatske šume	1,287	479	235	2,196
Jadrolinija	195	115	487	602
Narodne novine	259	184	1,641	1,330
Croatian Radio & Television	1,636	792	275	452
Plovput	64	26	49	96
Croatia Airlines	176	37	113	312
Petrokemija Kutina	797	520	-	-
Ministry of Defence	11,455	5,263	-	-
Ministry of Interior	6,274	4,314	-	-
Elementary and secondary schools	13,477	9,715	-	-
Judicial institutions	2,148	1,387	-	-
Colleges and universities	4,411	5,152	-	-
Legislative, executive and other bodies of the Republic of Croatia	7,046	5,802	-	-
Health institutions and organisations	25,895	41,652	-	40,573
Other users	17,060	19,079	12,865	-
TOTAL	**140,188**	**107,238**	**253,874**	**526,730**

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

35. CONTINGENT LIABILITIES AND COMMITMENTS

LEGAL ACTIONS

In 2009, 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 2009, 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 2,163,949 thousand.

Most significant investments refers to investments in HEP Proizvodnja, HEP Operator prijenosnog sustava and HEP Operator Distribucijskog sustava.

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.

36. SUBSIDIARIES

As at 31 December 2009, the Group had the following subsidiaries:

Subsidiary	Country	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 plats 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
Buško Blato d.o.o.	BiH	100	Maintenance of hydro power plants
HEP-Telecom d.o.o.	Croatia	100	In liquidation
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.

37. FINANCIAL INSTRUMENTS

CAPITAL RISK MANAGEMENT

The Group 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 24 and 28, 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:

(HRK'000)	**31 December 2009**	**31 December 2008**
	HRK'000	HRK'000
Debt	6,026,596	6,360,696
Cash and cash equivalents	(96,071)	(194,213)
Net debt	5,930,525	6,166,483
Equity	18,248,114	18,130,245
Net debt to equity ratio	32%	34%

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

	31 December 2009	**31 December 2008**
Financial assets	(HRK'000)	(HRK'000)
Loans and receivables (including cash and cash equivalents)	2,267,846	2,430,847
Other non-current assets	270,103	270,875
Financial liabilities		
Non-current liabilities	5,318,504	5,301,352
Current liabilities	**3,658,396**	**4,412,430**

37. 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	
(in '000)	**31 December 2009**	**31 December 2008**	**31 December 2009**	**31 December 2008**
	(in '000)	(in '000)	(in '000)	(in '000)
European Union (EUR)	3,866	7,055	647,683	602,510
USD	198	-	82,591	124,155
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.

37. FINANCIAL INSTRUMENTS (continued)

FOREIGN CURRENCY SENSITIVITY ANALYSIS (continued)

	2009	2008
	HRK'000	HRK'000
EUR change impact		
Profit or loss	470,385	436,137
USD change impact		
Profit or loss	44,809	64,008
CHF change impact	-	**11,002**
Profit or loss		

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 2009 would decrease/increase by HRK 22,031 thousand (2008:; HRK 23,116 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 73% in 2009 (2008: 75%); 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.

37. FINANCIAL INSTRUMENTS (continued)

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.

37. 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 average effective interest rate	Less than 1 month	1 - 3 months	3 -12 months	1 - 5 years	Over 5 years	Total
	%	(HRK'000)	(HRK'000)	(HRK'000)	(HRK'000)	(HRK'000)	(HRK'000)
2009							
Non-interest bearing		1,179,933	676,596	179,562	484,635	16,569	2,537,295
Variable interest rate instruments	6.00%	24	47	207	376	-	654
Total		**1,179,957**	**676,643**	**179,769**	**485,011**	**16,569**	**2,537,949**
2008							
Non-interest bearing		1,506,664	615,352	105,765	444,131	28,509	2,700,421
Variable interest rate instruments	5.47%	39	80	337	427	418	1.301
Total		**1,506,703**	**615,432**	**106,102**	**444,558**	**28,927**	**2,701,722**

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.

37. FINANCIAL INSTRUMENTS (continued)

LIQUIDITY AND INTEREST RATE RISK TABLES (CONTINUED)

MATURITY OF NON-DERIVATIVE FINANCIAL LIABILITIES

	Weighted average effective interest rate	Less than 1 month	1 - 3 months	3 -12 months	1 - 5 years	Over 5 years	Total
	%	(HRK'000)	(HRK'000)	(HRK'000)	(HRK'000)	(HRK'000)	(HRK'000)
2009							
Non-interest bearing	-	983,852	1,290,073	641,161	14,817	20,402	2,950,305
Variable interest rate instruments	3,94%	29,215	216,748	858,979	3,682,705	688,477	5,476,124
Fixed interest rate instruments	5,96%	3,278	255,811	130,276	1,185,654	452,499	2,027,518
Total		**1,016,345**	**1,762,632**	**1,630,416**	**4,883,176**	**1,161,378**	**10,453,947**
2008							
Non-interest bearing	-	1,245,829	1,378,879	704,353	14,698	7,327	3,351,086
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		**1,395,056**	**1,861,586**	**2,269,881**	**3,923,216**	**1,030,733**	**10,480,472**

The Group has access to financing facilities, the total unused amount which is HRK 786,254 thousand at the balance sheet date. The Group expects to meet its other obligations from operating cash flows and proceeds of maturing financial assets.

37. 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 1.0075 % at 31 December 2009 (2008: 4.9931 %), as disclosed in detail in Note 26.

	Weighted average effective interest rate	Less than 1 month	1 - 3 months	3 -12 months	1 - 5 years	Over 5 years	Total
	%	(HRK'00)	(HRK'000)	(HRK'000)	(HRK'000)	(HRK'00)	(HRK'000)
31 December 2009							
Variable interest rate instruments	1.0075%	-	-	7,157	6,512	-	13,669
Fixed interest rate instruments	5.39%	-	-	(7,726)	(7,029)	-	(14,755)
Total		**-**	**-**	**(569)**	**(517)**	**-**	**(1,086)**
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)**

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.

38. APPROVAL OF THE FINANCIAL STATEMENTS

These financial statements were approved by the Board and authorised for issue on 1 June 2010

Signed on behalf of the Management Board on 1 June 2010

Leo Begović President of the Board	Miljenko Pavlaković Member of the Board

HEP d.d. – FINANCIAL STATEMENTS

INDEPENDENT AUDITOR'S REPORT

To the Owner 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 2009 and the related unconsolidated statement of income, unconsolidated statement of comprehensive 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. Except as provided in paragraph b), 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) Impairment allowance on receivables

As described in Note 6, the Management Board provides for bad and doubtful receivables on the basis of the overall ageing structure of all receivables, as well as by reviewing individual significant accounts receivable. Because of the specific nature of the organisation of the HEP Group, all electricity sales revenue and expenses pertaining to the sale of electricity are transferred to HEP d.d. from the financial statements of individual HEP Group entities.

The individual analysis of significant trade accounts receivable at HEP Opskrba has revealed significant doubtful accounts in the amount of approximately HRK 60 million that have not been provided against.

As a result, the impairment allowance on trade receivables at HEP d.d. has been understated by approximately HRK 60 million, and the result for the year ended 31 December 2009 has been overstated by the same amount.

b) Prepayment to Hrvatske autoceste

As described in Note 12, the Company advanced HRK 300 million to Hrvatske autoceste in December 2006 for the acquisition of electricity facilities on the Croatian motorways within two years from the date of the advance payment. As of the date of these financial statements, the legal title to those facilities has not yet been transferred to the Company. The Company is the economic beneficiary of the electricity facilities, which it uses for their intended economic purposes and in the supply of electricity to customers. As of the date of publication of these financial statements, the Company has not classified the advance payment by type of assets used in the Company's business and we have received no calculation of the economic impact of the reclassification of those assets from prepayments to assets in use from the Management Board. As a result, we are unable to assess the impact of this matter on the Company's financial statements.

QUALIFIED OPINION

In our opinion, except for the effect of the matter presented under a) above and the potential effects of the matter presented under b) above, the unconsolidated financial statements present fairly, in all material respects, the financial position of the Company at 31 December 2009, 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) Measurement of investment properties at fair value

We expressed a qualified opinion on the financial statements for the year ended 31 December 2008. As described in Note 4 to the financial statements, 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 included all the fair value remeasurement gains in the amount of HRK 133 million in its 2008 statement of income. HRK 128 million of the gains relate to investment properties reported in the financial statements of the subsidiaries and should not have been reported in the statement of income of HEP d.d. for the year ended 31 December 2008. As a result, non-current receivables from related parties as of 31 December and the profit for the year then ended are overstated by HRK 128 million.

b) Revenue recognition policy

Without qualifying our opinion, we draw attention to Note 2 to unconsolidated financial statements, which describes the accounting policy 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 did not provide any 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 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.

c) Accounting policy for leases

We also draw attention to Note 2 to the accompanying unconsolidated financial statements, describing the accounting policy for leases. The Company has leased fixed assets under finance lease agreements to its subsidiaries. In addition, 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 financing to construct the corresponding asset. These receivables are carried at nominal amounts because of the special organizational framework of the HEP Group.

We also draw attention to the fact that the Company has prepared the accompanying unconsolidated financial statements on the basis of, and in accordance with the Croatian laws and regulations and presented its investments in subsidiaries and associates at cost. The Company has also prepared the consolidated financial statements of Hrvatska elektroprivreda d.d. and its subsidiaries, dated 2 June 2010. Therefore, for a better understanding of the operations of the Group as a whole, the consolidated financial statements should be read in conjunction with these financial statements.

Deloitte d.o.o.
Branislav Vrtačnik, Certified Auditor
Zagreb, 1 June 2010

HRVATSKA ELEKTROPRIVREDA d.d.

UNCONSOLIDATED INCOME STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2009

	2009	2008
	HRK'000	HRK'000
Electricity sales	10,493,303	9,681,877
Service revenues – related companies	1,235,563	996,326
Other operating income	208,695	462,280
Total operating income	**11,937,561**	**11,140,483**
Purchase of electricity	(3,258,478)	(3,468,510)
Staff costs	(82,612)	(75,931)
Depreciation and amortisation	(67,500)	(62,293)
Fee expense in respect of electricity generation, transmission and distribution – related companies	(7,518,338)	(7,148,427)
Other operating expenses	(570,334)	(379,576)
Total operating expenses	**(11,497,262)**	**(11,134,737)**
Profit from operations	**440,299**	**5,746**
Financial revenue	257,807	205,993
Financial costs	(338,273)	(286,797)
Net financial loss from financial activities	**(80,466)**	**(80,804)**
Profit / (loss) before tax	**359,833**	**(75,058)**
Income tax expense	(60,276)	(423)
Profit / (loss) for the year	**299,557**	**(75,481)**

Signed on behalf of the Company on 1 June 2010 by:

Leo Begović
President of the Board

Miljenko Pavlaković
Member of the Board

HRVATSKA ELEKTROPRIVREDA d.d.

UNCONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED 31 DECEMBER 2009

	2009	2008
	HRK'000	HRK'000
Gain / (loss) for the year	**299,557**	**(75,481)**
Nuklear power plant Krško –negative exchange differences	(4,005)	(155)
Fair valuation of Janaf shares	1,423	-
Other comprehensive income, net	(2,582)	(155)
Comprehensive income/ (loss) for the year	**296,975**	**(75,636)**

Signed on behalf of the Company on 1 June 2010 by:

Leo Begović
President of the Board

Miljenko Pavlaković
Member of the Board

HRVATSKA ELEKTROPRIVREDA d.d.

UNCONSOLIDATED BALANCE SHEET

AT 31 DECEMBER 2009

ASSETS	31 December 2009	31 December 2008	1 January 2008
	HRK'000	HRK'000	HRK'000
		restated	**restated**
Property, plant and equipment	269,026	312,482	304,661
Capital work in progress	190,970	185,422	95,374
Intangible assets	24,325	28,493	27,461
Investment properties	8,010	10,832	6,715
Prepayments for tangible assets	372,470	376,285	381,453
Investment in NPP Krško	1,605,593	1,609,598	1,609,753
Investment in, and receivables from TPP Plomin	622,150	702,292	766,058
Investments in subsidiaries	6,398	6,548	6,548
Investments available for sale and other investments	152,997	151,374	2
Long-term loan receivables and deposits	914	1,537	1,235
Long-term lease receivables from related companies	17,979,281	17,465,813	17,061,389
Long-term loan receivables	158,569	159,033	159,214
Other non-current assets	183,865	120,689	66,809
Deferred tax assets	8,601	2,704	3,127
Total non-current assets	**21,583,169**	**21,133,102**	**20,489,799**
Inventories	33,751	11,045	8,044
Trade receivables	46,200	65,570	30,827
Current portion of long-term loan receivables from related companies	1,293,899	1,296,050	1,401,773
Current portion of long-term receivables	-	-	658
Other short-term receivables	181,144	245,282	189,430
Receivables from related companies	3,954,883	4,061,598	3,410,814
Cash and cash equivalents	29,185	72,376	30,452
Total current assets	**5,539,062**	**5,751,921**	**5,073,998**
TOTAL ASSETS	**27,122,231**	**26,885,023**	**25,563,797**

Signed on behalf of the Company on 1 June 2010 by:

Leo Begović
President of the Board

Miljenko Pavlaković
Member of the Board

HRVATSKA ELEKTROPRIVREDA d.d.
UNCONSOLIDATED BALANCE SHEET
AT 31 DECEMBER 2009 (CONTINUED)

EQUITY AND LIABILITIES	**31 December 2009**	**31 December 2008**	**1 January 2008**
	HRK'000	HRK'000	HRK'000
		restated	**restated**
Share capital	19,792,159	19,792,159	19,792,159
Capital reserves	(2,038,472)	(2,035,890)	(2,035,735)
Retained earnings	1,126,319	826,762	902,243
Total equity	**18,880,006**	**18,583,031**	**18,658,667**
Liabilities under issued bonds	1,150,887	1,197,070	1,196,590
Long-term borrowings	3,035,239	2,963,030	2,722,041
Long-term liabilities to the state	24,211	24,257	24,307
Other long-term liabilities	251,219	66,266	61,367
Long-term liabilities to related companies	122,342	68,627	43,907
Long-term provisions	19,859	63,623	116,747
Total non-current liabilities	**4,603,757**	**4,382,873**	**4,164,959**
Trade payables	510,328	733,410	614,704
Current portion of issued bonds	46,690	-	-
Current portion of long-term borrowings	894,540	875,619	544,999
Short-term borrowings	764,121	1,118,344	901,825
Taxes payable	126,770	37,518	144,657
Interest payable	24,161	45,680	41,954
Liabilities to related companies	1,210,306	975,772	423,317
Liabilities to employees	5,710	5,554	10,155
Other payables	55,842	127,222	58,560
Total current liabilities	**3,638,468**	**3,919,119**	**2,740,171**
TOTAL EQUITY AND LIABILITIES	**27,122,231**	**26,885,023**	**25,563,797**

Signed on behalf of the Company on 1 June 2010 by:

Leo Begović
President of the Board

Miljenko Pavlaković
Member of the Board

REPORTS BY HEP GROUP COMPANIES WITH FINANCIAL STATEMENTS

HEP-PROIZVODNJA d.o.o.

HEP-OPERATOR PRIJENOSNOG SUSTAVA d.o.o.

HEP-OPERATOR DISTRIBUCIJSKOG SUSTAVA d.o.o.

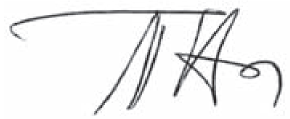
HEP-TOPLINARSTVO d.o.o.

HEP-PLIN d.o.o.

HEP-PROIZVODNJA d.o.o.

DIRECTOR

NIKOLA RUKAVINA



IN 2009 HEP PROIZVODNJA d.o.o. (HEP Production) concentrated on its main goal: to perform its business of production and delivery of electricity and heat to HEP' systems. Also, in cooperation with other HEP group companies, the Company 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), are our new commercial standard. They had been our product since 2008 and in 2009 with a contract with HEP OPS became a recognizable commercial product which brings respectable revenues to the Company.

In addition to continuous adjustments to make the Company able to respond to new economic circumstances, we worked on technological improvements in the availability of power plants. In spite of curtailed financial resources, we maintained the capability of generating plants to meet dynamic market changes, proving thereby adjustability of our generating plants to consumption and market requirements. Due to the nature of the market and frequent and rapid changes of power plant loads, our regular maintenance included constant modernization and refurbishment and upgrade of power plants' operation and control systems.

As part of the restructuring and opening of the market in Croatia in compliance with EU requirements, specialists of HEP Proizvodnja d.o.o. cooperated directly with specialists from other members of HEP Group and with HERA, HROTE and the Ministry of Economy, Labor and Entrepreneurship.

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 all components and of the status of ongoing projects was carried out and finishing work continued on the remaining parts of Lešće HPP and Unit L at TE-TO Zagreb. Main infrastructure work at the location of the construction of a cogeneration unit, Unit C at Sisak TPP, was carried out, including verification of the degree of completion by manufacturer of electromechanical equipment and boiler plant and of activities to secure gas for the power plant.

Special attention is paid to the implementation of environmental legislation. Emissions from all thermal power plants are regularly monitored using modernized emission monitoring systems. 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 CO_2 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, according to highest standards prescribed, all hydro power plants were again certified for energy production from renewable sources as well as those certified for ISO series 9000 and 14000. Preparations for obtaining certificates for the remaining power plants have continued.

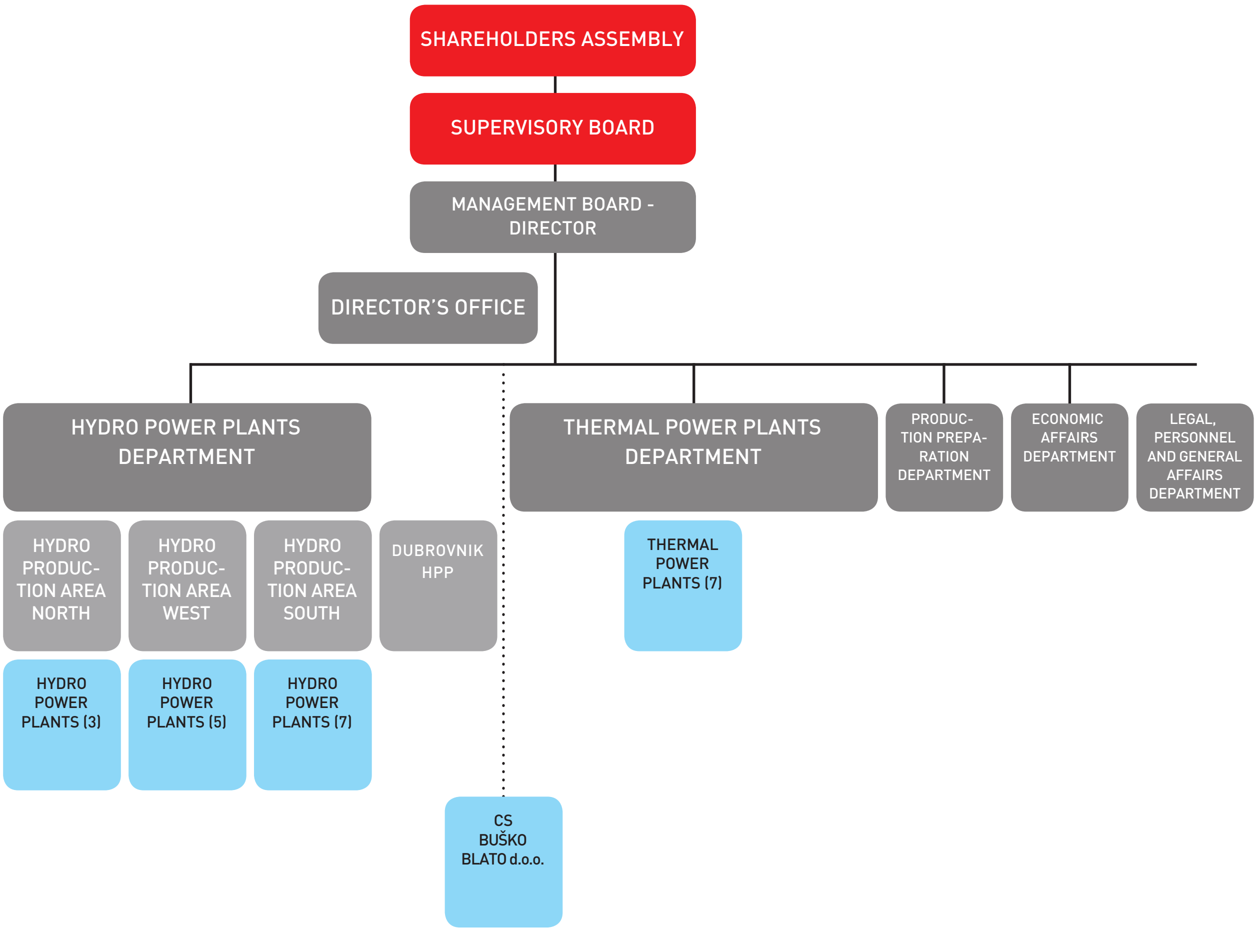
Also important for HEP Proizvodnja is safety at work and fire protection. As part of the reorganization of the company, safety and fire protection function was vertically organized as a separate department which apart from regular activities takes particular care that there is constant education and constant increase in the degree of work safety.

With a fair observation that business operations in 2009 were burdened with numerous unexpected constraints and difficulties as well as with frequent oscillations of all input fuel prices, we stress the importance of power plants availability and favorable hydrological conditions. Among unfavorable impacts on the business in 2009, there is a relatively unfavorable cost of energy produced and the selling price for all customer categories in Croatia.

During the year, as is the usual practice, internal controls were performed in order to cut all manageable internal costs. Te Company effectively activated the available internal reserves, without adversely affecting operational readiness of plants.

Finally, it can be said in conclusion that all activities in all parts of HEP Proizvodnja, in terms of technology and human resources and expertise motivated precisely by worse business conditions, resulted in good business results. This is credibly confirmed by the data and statistics presented in this Report.

ORGANIZATIONAL CHART



GENERATING PLANTS

HYDRO POWER PLANTS	AVAILABLE CAPACITY (MW)	HYDRO POWER PLANTS	AVAILABLE CAPACITY (MW)
Storage		**Natural flow**	
HE Zakučac	486	HE Varaždin	86.5
RHE Velebit	276 (-240)	HE Dubrava	77.8
HE Orlovac	237	HE Čakovec	77.4
HE Senj	216	HE Gojak	54
HE Dubrovnik	2x108*	HE Rijeka	36
HE Vinodol	90	HE Miljacka	24
HE Peruća	60	HE Jaruga	7.2
HE Kraljevac	46.4	HE Golubić	6.5
HE Đale	40.8	HE Ozalj	5.5
HE Sklope	22.5	HE Krčić	0.3
CS Buško blato	7.5/4.2 (-10.2)		
CHE Fužine	4 (-4.8)		
HE Zavrelje	2		
CHE Lepenica	0.8 (-1.3)		
HE Zeleni vir	1.7		

CS: pumping station CHE: pumped storage RHE: reversible pump turbine. One unit of Dubrovnik HPP operates for Bosnia-Herzegovina

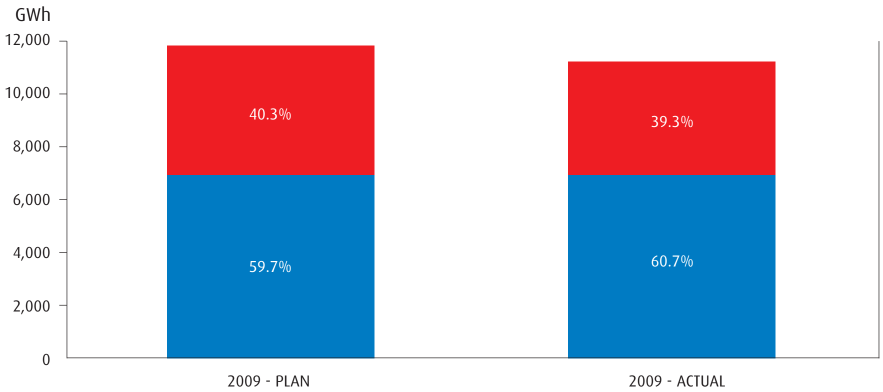
THERMAL POWER PLANTS	NET CAPACITY (MW)	FUEL
TE Sisak	396	oil / natural gas
TE-TO Zagreb	422 / 500 MWt	oil / natural gas
TE Rijeka	303	oil
TE Plomin (A)	110	coal
EL-TO Zagreb	90 / 184 MWt	oil / natural gas
TE-TO Osijek	90 / 124 MWt	oil / natural gas / extra light oil
KTE Jertovec	78	natural gas / extra light oil
TE PLOMIN (B)*	192	coal

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

ELECTRICITY AND HEAT PRODUCTION IN 2009

ELECTRICITY PRODUCTION

In 2009 HEP-Proizvodnja power plants generated 11,148 GWh of electricity (6,767 GWh or 60.7 percent by hydro power plants and 4,381 GWh or 39.3 percent by thermal power plants). Thus, owned sources covered 56.9 percent of total electricity needs of Croatia. Compared to the planned production, the actual production of electricity in 2009 was 5.9 percent down, hydro power plants by 4.3 percent and thermal power plants by 8.1 percent.



	2009 - PLAN	2009 - ACTUAL
TPP	4,769 GWh	4,381 GWh
HPP	7,074 GWh	6,767 GWh
TOTAL	11.843 GWh	11.148 GWh

HEAT ENERGY PRODUCTION

In 2009, combined-cycle plants generated 2,247,405 MWh of heat energy in total or 95.8 percent of total planned annual production. Compared to the year before heat production was lower by 2.8 percent. Process steam production was 840,493 tons (95.2 percent of the planned), or 7.5 percent lower than in the previous year (908,566 t).

Heat production in 2009 was 1,675,870 MWh or 96 percent of total production planned for 2009, which is 1 percent less than heat production in 2008 (1,693,317 MWh).

POWER PLANT AVAILABILITY

The availability of all plants (excluding Dubrovnik 2 HPP and TE Plomin d.o.o.) was 98.5 percent (HPPs – 99.5 percent; TPPs – 97.3 percent) which is 2.3 percent more than the availability level achieved in 2008.

FINANCIAL STATEMENTS
INDEPENDENT AUDITOR'S REPORT

To the Owners of HEP Proizvodnja d.o.o., Zagreb:
We have audited financial statements of HEP Proizvodnja d.o.o., Zagreb (the "Company"), which comprise the balance sheet as at 31 December 2009 and the related statement of income, statement of comprahensive 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
For the year ended as of 31 December 2008 we have issued qualified audit opinion.

The Company changed its accounting policy during 2008 applicable to 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 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.

QUALIFIED OPINION
In our opinion, except for the effect of the matters discussed in paragraph a) on the comparative information, financial statements present fairly, in all material respects, the financial position of the Company as at 31 December 2009, 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.

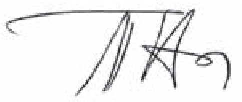
Therefore, for a better understanding of the operations of the Company, the accompanying financial statements should be read in conjunction with the consolidated financial statements of the HEP Group.

Deloitte d.o.o.
Branislav Vrtačnik, Certified Auditor
Zagreb, 01 June 2010

HEP PROIZVODNJA d.o.o., INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2009

	2009	2008
	HRK'000	HRK'000
Electricity generation fee income and other income from related companies	3,902,843	3,817,635
Other operating income	21,553	45,491
	3,924,396	**3,863,126**
Cost of energy sources, material and spare parts	2,175,127	2,427,385
Service cost	304,924	292,031
Staff costs	358,276	332,345
Depreciation and amortization	421,753	426,495
Administrative expenses – related companies	99,686	83,814
Other operating expenses	454,517	245,276
	3,814,283	**3,807,346**
Profit from operations	**110,113**	**55,780**
Finance income	297	397
Finance expenses	(98,158)	(31,491)
Net financial loss	**(97,861)**	**(31,094)**
Profit before tax	**12,252**	**24,686**
Income tax	14,135	(968)
Profit for the year	**26,387**	**23,718**

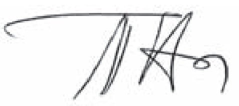
Signed on behalf of the Company on 01 June 2010 by:
Nikola Rukavina, B.E.E.
President of the Board



HEP PROIZVODNJA d.o.o., STATEMENT OF COMPRAHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2009

	2009	2008
	HRK '000	HRK '000
Profit of current year	**26,387**	**23,718**
Other comprehensive income for the year	-	-
Comprehensive profit for the year	**26,387**	**23,718**

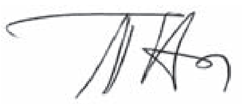
Signed on behalf of the Company on 01 June 2010 by:
Nikola Rukavina, B.E.E.
President of the Board



HEP PROIZVODNJA d.o.o., BALANCE SHEET AT 31 DECEMBER 2009

ASSETS	**31 December 2009**	**31 December 2008**
	HRK'000	HRK'000
Intangible assets	3,795	5,191
Property, plant and equipment	6,675,211	6,204,857
Investment in progress	1,507,409	1,671,369
Investment property	37,133	40,752
Prepayments for tangible assets	30,330	61,128
Investments in related companies	7	7
Receivables from the sale of flats	16,085	19,504
Deferred tax assets	44,225	11,306
Total non-current assets	**8,314,195**	**8,014,114**
Inventories	579,844	820,367
Other current assets	30,992	42,262
Receivables from related companies	694,304	613,392
Trade receivables	1,843	1,831
Current portion of long-term receivables	4,132	2,535
Cash and cash equivalents	1,924	24,374
Total current assets	**1,313,039**	**1,504,761**
TOTAL ASSETS	**9,627,234**	**9,518,875**

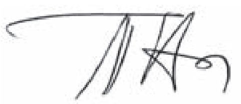
Signed on behalf of the Company on 01 June 2010 by:
Nikola Rukavina, B.E.E.
President of the Board



HEP PROIZVODNJA d.o.o., BALANCE SHEET AT 31 DECEMBER 2009 (CONTINUED)

EQUITY AND LIABILITIES	**31 December 2009**	**31 December 2008**
	HRK'000	HRK'000
Share capital	20	20
Capital reserves	9,188	9,188
Accumulated losses	(88,552)	(114,939)
Total equity	**(79,344)**	**(105,731)**
Long term liabilities to related companies	6,303,903	5,847,450
Long-term provisions	210,407	121,631
Other long-term liabilities	12,111	13,186
Total non-current liabilities	**6,526,421**	**5,982,267**
Trade payables	622,028	825,568
Liabilities to related companies	2,056,136	2,230,004
Current portion of long-term debt - related companies	421,753	426,495
Other payables	80,240	160,272
Total current liabilities	**3,180,157**	**3,642,339**
TOTAL EQUITY AND LIABILITIES	**9,627,234**	**9,518,875**

Signed on behalf of the Company on 01 June 2010 by:
Nikola Rukavina, B.E.E.
President of the Board



HEP-OPERATOR PRIJENOSNOG SUSTAVA d.o.o.

DIRECTOR

DUBRAVKO SABOLIĆ

IN ACCORDANCE with the legal and regulatory framework and within the limits of the approved Economic Plan and Investment Plan for 2009, HEP Operator prijenosnog sustava d.o.o. (HEP-OPS, HEP Transmission System Operator), in worsening business conditions 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, while providing a more intense support to the development and functioning of the Croatian electricity market taking into account its interconnections with neighboring electricity markets in the European Union and the Energy Community.

In 2009, a total electricity consumption was 17,697 GWh, slightly less than in 2008. At the same time, system peak load of 3,120 MW is a little higher compared to 2008. The share of transmission losses of 2.18 percent in total electricity transmitted (which was 23,447 GWh) is a little higher than in 2008, but it is within technically justifiable and acceptable limits. Apart from unforeseen breakdowns in Trogir and Komolac transformer stations, there were no larger-scale disturbances within the customer supply system, the estimated non-supplied electricity being 1,840 MWh.

During 2009 several transmission facilities were put into regular operation, of which the more significant are: the reconstructed cross-border 220 kV transmission line Mraclin-Prijedor (BiH), reconstructed 110 kV transmission line Dubrova-Raša, new 110 kV cable transmission line Osijek 3 – Osijek 4, and new transformer stations TS 110/10 (20) kV Osijek 4 and TS 30/110 kV Vrataruša,as well as TS 220/110 kV Đakovo (coupling-metering bay 220 kV), TS 110/35/10 kV Švarča (transformer bay 110 kV) i TS 110/20 kV Botinec (feeder bay 110 kV TE-TO).

The implementation of major investment projects continued. Construction work was completed on the Croatian section of the new cross-border transmission line 2x400 kV Ernestinovo-Pecs (Hungary) and preparatory activities began for technical inspection and putting the line into operation. The refurbishment continued of the control system of the Croatian electricity system, including National Dispatch Center and four network centers, especially of those parts that support the functioning of the electricity market. As part of the implementation of Dubrovnik program, the activities to prepare the construction of TS 220/110 kV Plat continued.

During 2009 a draft of a three-year development and construction plan for the transmission network of HEP-OPS for the period 2010-2012 was being prepared as well as a draft of the first indicative and non-binding ten-year transmission network development plan.

In 2009 HEP-OPS continued to participate in ITC mechanism for calculation and compensation of transit costs caused by cross-border electricity transfer, and towards the end of the year HEP-OPS together with other European transmission system operators, with HERA's approval, signed a new ITC Agreement for 2010. During 2009, the carrying out of direct monthly auctions for cross-border transmission capacity successfully continued and direct daily auctions for cross-border capacity began to be organized in accordance with possibilities. With the passage of new Rules on Allocation and Use of Cross-Border Transmission Capacities in November 2009 (with prior approval by HERA) conditions were created for, among other things, introducing direct (unilateral and joint) annual auctions for cross-border transmission capacities.

Also, HEP OPS and the Hungarian transmission system operator MAVIR agreed and both national regulators approved relevant bilateral Rules which in addition to existing auctions allow direct annual and daily auctions for cross-border transmission capacities. The Rules provide that joint direct annual and monthly auctions are organized by HEP-OPS while joint direct daily auctions are organized by MAVIR. Based on this, in December 2009, HEP OPS successfully organized and carried out initial joint direct annual auctions for Croatian/Hungarian border as well as direct annual auctions for other borders. HEP-OPS with the Slovenian (ELES) and Serbian (EMS) transmission system operators initiated resumption of talks regarding the introduction of joint direct auctions for the relevant borders.

HEP OPS staff continued to participate in negotiating teams for chapters 15 (Energy) and 21 (Trans-European Networks) within the framework of Croatia's accession negotiations with the EU. It has to be mentioned in this context that Chapter 15, Energy, was closed, to which and HEP OPS significantly contributed by timely executing all obligations of the acquis undertaken by Croatia, especially the implementation of Regulation 1228/2003/EC concerning network access for cross-border electricity exchanges. To this should be added active work in the Assembly and the Board and in working groups and subgroups of ENTSO, European Networks of Transmission System Operators-Electricity.

HEP-OPS, in accordance with possibilities, took all necessary actions to ensure participation in ENTSO activities, especially those that support the functioning and development of the Croatian electricity market and its better links with neighboring electricity markets by creating the conditions for introduction of cross-border indirect auctions for electricity and transmission capacities with neighboring electricity markets in the EU and Energy Community. In this sense HEP OPS, in December 2009, signed a legally non-binding Letter of intent with the Serbian EMS, and a similar letter is planned to be signed with the Hungarian MAVIR and other transmission system operators.

Within the activities undertaken under the wing of the Energy Community and relating to a regional initiative to prepare the establishment of Coordinated Auction Office (SEE CAO) for cross-border capacities of South East Europe, HEP OPS actively and consistently persisted, all the while reporting to and cooperating with the ministry in charge and HERA, in keeping the optimum position of the Croatian electricity market in two (CEE+SEE) regions for congestion management taking into account prospects of further development of the market, specifically, keeping the EU borders with Hungary and Slovenia in CEE CM region and including the borders toward Bosnia-Herzegovina and Serbia in SEE CM region (concept "2+2").

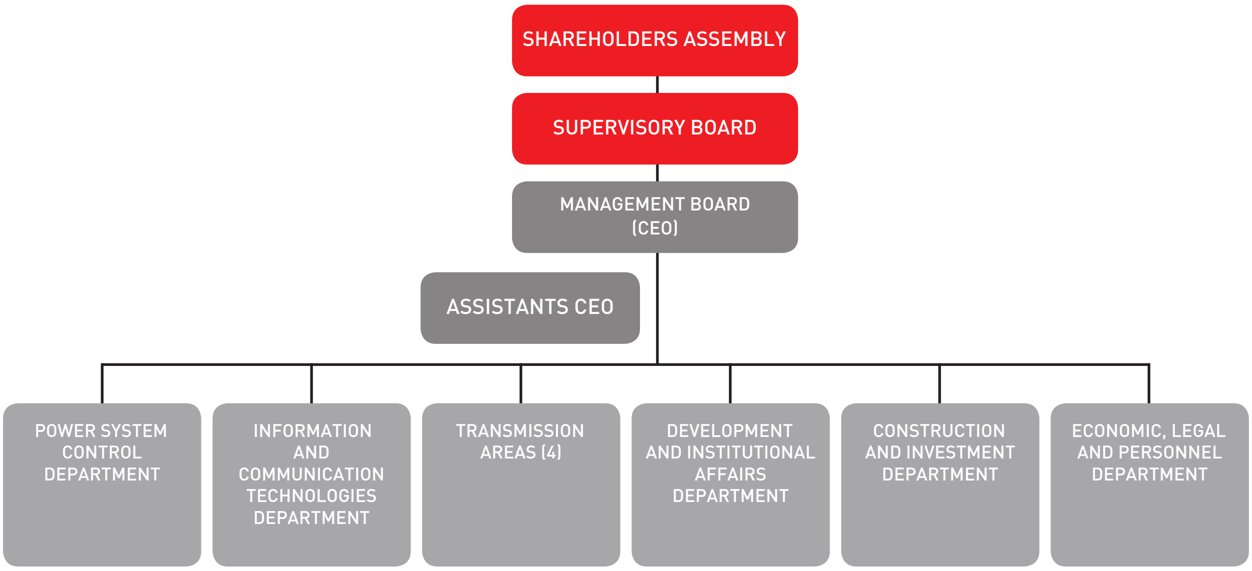
During the year the activities to enable renewable energy sources to feed the transmission network or the electricity system continued, especially wind power plants. Teams and commissions existing within HEP OPS reviewed extensive technical documentation, from research work studies through connection possibilities to basic and detailed designs, all with the aim of integrating renewable energy sources in the best possible way. HEP OPS as a user actively participated in the implementation of the contract – phase 2 of a projects financed by GEF (Global Environment Facility) grant and IBRD (International Bank for Reconstruction and Development) as GEF's implementing agency through HBOR. As part of this project, software support will be donated to HEP OPS for forecast of electricity production from wind power plants and a revision will be performed of Additional Technical Requirements for connection and operation of wind power plants with the transmission network .

Due to the continuous development and changes in the legal framework in the increasingly demanding area of environmental protection, HEP OPS has intensified investments and activities regarding preparation of a number of documents (plans, rules, information notices, etc.)

In July 2009, a constituting meeting was held of the Grid Code Committee as required by the said Code.

In conclusion, I can say that business achievements of HEP-ODS in 2009, even in aggravated business conditions, are a result of the continuity and further improvement in organization, technical and team work, responsibility and expertise in the carrying out of a growing volume of work.

COMPANY ORGANIZATIONAL CHART



TRANSMISSION NETWORK AS AT DECEMBER 31, 2009

	400 kV	220 kV	110 kV	Medium voltage	Total
Line length (km)	1,159	1,210	4,755	192	**7,315**
Transformer stations (number)	5	6	112	-	**123**
Installed capacity (MVA)	**4,100**	**2,120**	**4,881**	**-**	**11,101**

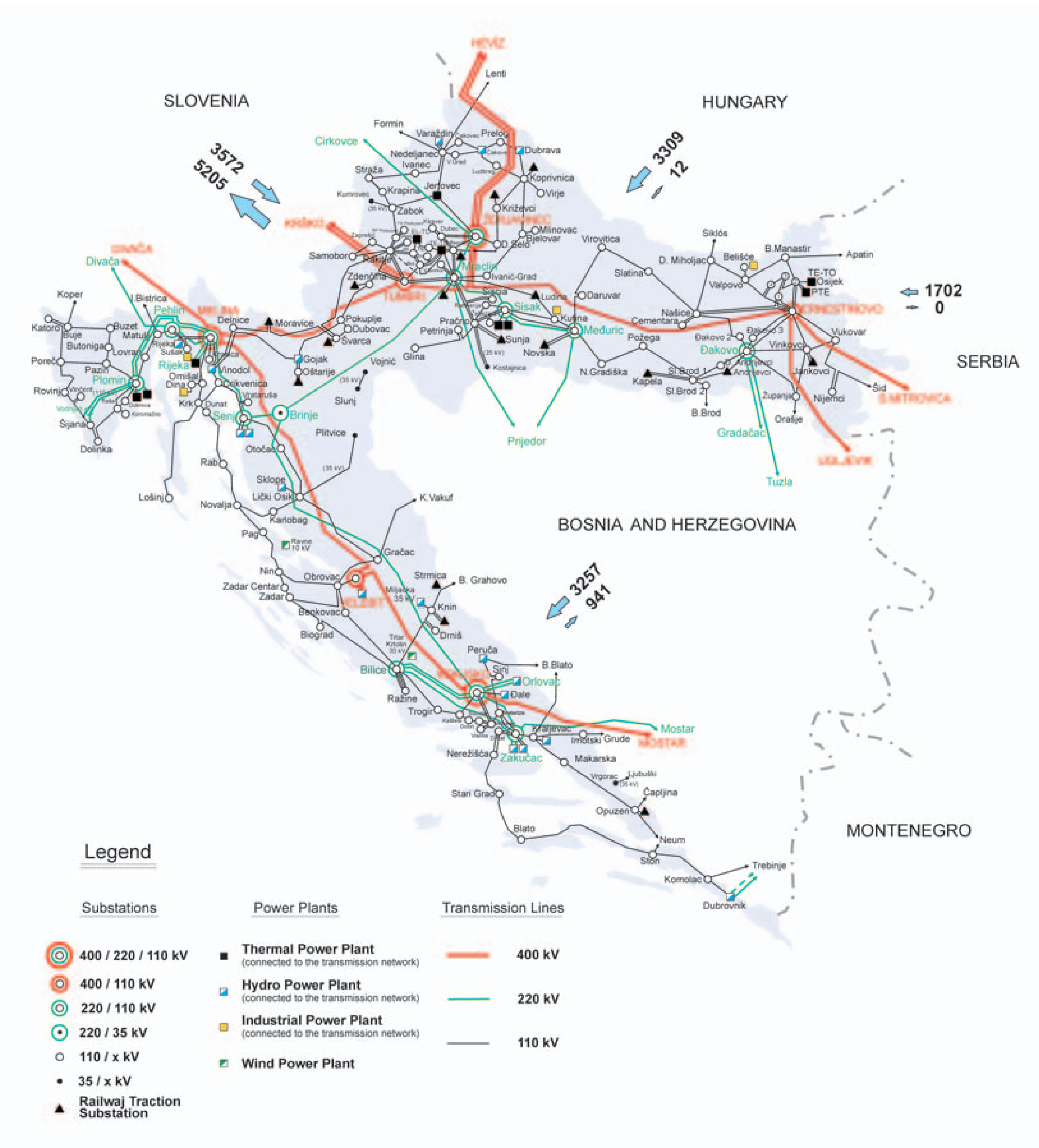
ELECTRICITY BALANCE 2009 (GWh)

Total production *	**12,015**
Import (entering Croatia)	**11,840**
Total procurement	**23,855**
Export (existing Croatia)	**6,158**
Total consumption	**17,697**
Direct procurement and consumption on distribution network	**408**
Transmission losses	**511**
Transmission consumption	**16,778**
Direct customers	**814**
Pumping and other auxiliary consumption	**163**
Delivered to distribution from transmission network	**15,800**

* Including energy received from industrial power plants and wind power plants and production taken directly by distribution network (479 GWh)

System peak load, December 21, 2009 (MWh/h)	**3,120**

CROATIAN ELECTRICITY SYSTEM SCHEME
WITH ELECTRICITY EXCHANGE BY BORDER (GWh)



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 2009 and the related statement of income, statement of comprehensive 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 2009, 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 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, 01 June 2010

HEP OPERATOR PRIJENOSNOG SUSTAVA d.o.o., INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2009

	2009	2008
	000'HRK	000'HRK
Electricity transmission income	1,148,301	956,329
Other income - related companies	24,866	14,081
Other operating income	55,884	86,551
	1,229,051	**1,056,961**
Material and spare parts expenses	(20,584)	(19,634)
Service expenses	(104,327)	(72,678)
Staff expenses	(190,916)	(173,423)
Depreciation and amortisation	(232,464)	(228,834)
Support system services expenses	(232,723)	(121,723)
Transmission grid losses	(224,854)	(197,938)
Administrative expenses – related companies	(51,863)	(44,523)
Other operating expenses	(79,676)	(60,119)
	(1,137,407)	**(918,872)**
Profit from operations	**91,644**	**138,089**
Financial income	556	215
Financial expenses	(50,673)	(68,419)
Net financial loss	**(50,117)**	**(68,204)**
Profit before taxation	**41,527**	**69,885**
Income tax	(8,596)	(7,945)
Net profit for the year	**32,931**	**61,940**

Signed on behalf of the Company on 01 June 2010 by:
Dubravko Sabolić
Managing Director

HEP OPERATOR PRIJENOSNOG SUSTAVA d.o.o., STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2009

	2009	2008
	HRK '000	HRK '000
Profit for the year	**32,931**	**61,940**
Other comprehensive income	-	-
Total comprehensive income for the year	**32,931**	**61,940**

Signed on behalf of the Company on 01 June 2010 by:
Dubravko Sabolić
Managing Director

HEP OPERATOR PRIJENOSNOG SUSTAVA d.o.o., BALANCE SHEET AS AT 31 DECEMBER 2009

ASSETS	**31 December 2009**	**31 December 2008**
	000'HRK	000'HRK
Property, plant and equipment	3,590,050	3,628,079
Investments in progress	650,056	403,061
Intangible assets	16,883	22,972
Investment properties	7,171	7,932
Prepayments for tangible assets	251	231
Receivables from sale of flats	6,420	7,021
Deferred tax assets	10,201	6,472
Total non-current assets	**4,281,032**	**4,075,768**
Inventories	18,771	28,632
Trade receivables	18,523	30,915
Receivables from related companies	412,351	283,879
Other current assets	11,539	42,406
Current portion of long-term receivables	771	782
Cash and cash equivalents	10,297	8,088
Total current assets	**472,252**	**394,702**
TOTAL ASSETS	**4,753,284**	**4,470,470**

Signed on behalf of the Company on 01 June 2010 by:
Dubravko Sabolić
Managing Director

HEP OPERATOR PRIJENOSNOG SUSTAVA d.o.o., BALANCE SHEET AS AT 31 DECEMBER 2009 (CONTINUED)

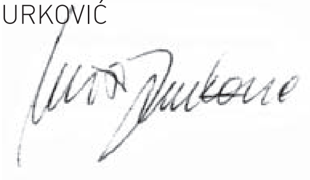
CAPITAL AND LIABILITIES	31 December 2009	31 December 2008
	000'HRK	000'HRK
Subscribed capital	20	20
Reserves	40	40
Accumulated losses/retained earnings	32,931	31,082
Total equity	**32,991**	**31,142**
Long-term liabilities to related company	3,366,368	3,431,803
Provisions for retirement and jubilee bonuses, and legal actions	32,061	25,561
Other non-current liabilities	55,822	29,048
Total non-current liabilities	**3,454,251**	**3,486,412**
Liabilities to related companies	720,760	540,241
Trade payables	274,504	156,532
Current portion of long-term liabilities to related company	232,305	228,834
Other current liabilities	38,473	27,309
Total current liabilities	**1,266,042**	**952,916**
TOTAL CAPITAL AND LIABILITIES	**4,753,284**	**4,470,470**

Signed on behalf of the Company on 01 June 2010 by:
Dubravko Sabolić
Managing Director

HEP-OPERATOR DISTRIBUCIJSKOG SUSTAVA d.o.o.

DIRECTOR

MIŠO JURKOVIĆ



HEP ODS (HEP Distribution System Operator) business operations in 2009 were aimed at meeting its legal role in the electricity market and achieving business objectives in accordance with HEP Group business policy. Improving operating cost efficiency continued, as needed to consolidate the financial situation of HEP Group by implementing Program of Anti-Recession Measures. In 2009 important business objectives remained to be: payment collection improvement, cutting of non-technical network losses, optimizing inventories of electric materials, raising electricity supply quality and increasing the quality of services in distribution and supply business.

In 2009, investments in reconstruction of 110 kV transformer stations were completed: TS 110/10(20) kV Botinec (transformation reinforcement), TS 110/10(20) kV Tupljak with MV phase arrangement, TS 110/10(20) kV Novalja (reconstruction of part of 35 kV in 20 kV switchyard), TS 110/10(20) kV Matulji (transformation reinforcement) and TS 110/10(20) kV Dubec (installation of ripple control units110 kV switchyard).

Also completed was construction or reconstruction of a number of 35 and 20 kV facilities: TS 35/10(20)kV Novi Marof, replacement of relay protection and inclusion in the remote control system; TS 35/10(20) kV Orlovnjak (full reconstruction of the transformer station destroyed in war); TS 35/10(20) kV Brodsko brdo, Brodski Stupnik, Brod 3 (reconstruction and inclusion in the remote control system); TS 35/10(20) kV Lapad (transformation reinforcement and reconstruction of part of the plant); TS 35/10(20) kV Suhopolje (transformation reinforcement and plant reconstruction); KB 35 kV Bjelovar – Predavac – Žabno (III section);); Cable and OHL 20(35) kV Pločice – Prevlaka with a branch to Molunat; RS 10(20) kV Sunja; Cable 10(20) kV from TS Ludbreg – Selnik; connecting line 10(20) kV Novigrad – Drnje; switch to 20 kV of Sunja area; refurbishment of remote control system at Elektra Pula; automation of network Rakovica-Senj. In accordance with the pace of return of displaced persons and refugees, reconstruction of war-affected areas continued.

Following the passage of subordinate legislation in 2007 aimed to encourage electricity production from renewable energy sources and cogeneration, interest in investing and building power plants in Croatia grew, especially during 2009. Most of these plants are to be connected to the distribution network. Because of the wide-ranging and numerous requests for connection, the issue of making the distribution network adapted to the distributed generation is becoming an increasingly significant part of our business. Currently underway is the preparation of technical requirements for connection of power plants to the distribution network as well as establishment of a system of monitoring access by power plants to the distribution network. In cooperation with other entities (HEP-OPS d.o.o., Ministry of Economy, Labor and Entrepreneurship, HERA, HROTE), we have been continuously working towards making the necessary procedures consistent and simpler.

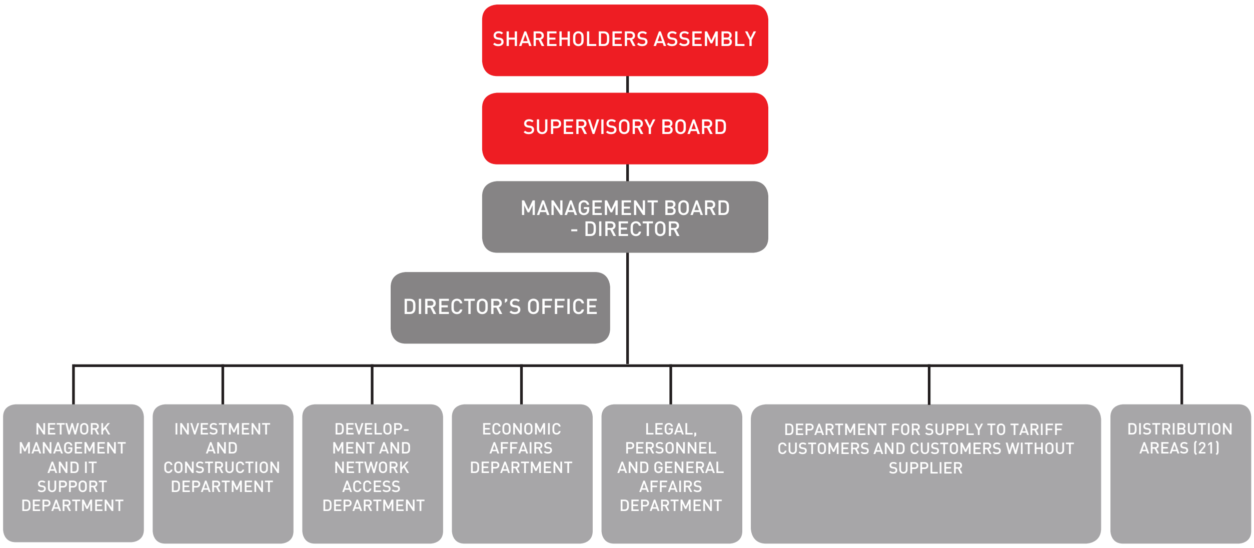
The cycle of refurbishing medium-size control centers continued, the aim of which is to establish a uniform architecture of remote monitoring and control system for the electric network of HEP-ODS. The DISPO program, in which operating events are registered for the whole distribution network, is in full application across all voltage levels. The results of the statistically processed data on planned and forced outages in the network are indicators of reliability quality; these are reported to HERA annually for each distribution area and as a total for HEP-ODS.

Currently going on is the implementation of EDM SAP project aimed to manage and exchange data between HEP-ODS and other participants in the electricity market. Separating metering data from billing and payment collection for electricity will ensure a non-biased relation toward all users of metering data in the electricity market. For this purpose the existing HEP Billing program has continued to be adjusted to be able to work with EDM SAP application.

As part of the investment program Metering Points Renovation 2008/2009, the installation continued of remote-communication interval meters. The metering points concerned are included in the automated meter reading (AMR) system of HEP ODS. HEP ODS thereby meets its legal obligations and enables collecting of metering data needed for the functioning of the electricity system aimed at determining hourly consumption of electricity. 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.

HEP-ODS continues to systematically follow and monitor the quality of services provided to customers, with a non-biased relation toward all customers in the electricity market.

COMPANY ORGANIZATIONAL CHART



NUMBER OF TRANSFORMER STATIONS BY VOLTAGE LEVEL

TS 110/10(20) kV	TS 35(30)/10(20) kV	TS 20/0,4 kV	TS 10/0,4 kV
8	325	3,421	20,916

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
61.1	11	5.8	3,308.5	1,281.6	135	2,747.6	2,280.5	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
19,614.3	10,512.8	214.3	23,521.6	23,334.6	15,702.7	4,868.1	15,415.9	9,920

NUMBER OF CUSTOMERS / METWERING POINTS BY CONSUMPTION CATEGORY (VOLTAGE LEVEL)

Description	Number of metering points
High voltage 110 kV	4
Total medium voltage	2,081
Low voltage – commercial (excl. public lighting)	188,775
Low voltage – commercial (public lighting)	20,818
Low voltage - residential	2,099,133
TOTAL	**2,310,811**

CONSUMPTION OF ELECTRICITY BY CUSTOMER CATEGORY IN 2009 (kWh)

Description	Total -Croatia
Commercial - high voltage (HV)	180,326,004
Commercial – medium voltage (MV)	3,362,145,314
TOTAL Commercial HV and MV	**3,542,471,318**
Commercial – low voltage (LV)	4,240,355,944
Commercial – low voltage (LV) – public lighting	446,329,284
Residential – low voltage (LV)*	6,471,768,469
TOTAL LOW VOLTAGE	**11,158,453,696**
TOTAL TARIFF CUSTOMERS	9,045,823,702
ELIGIBLE CUSTOMRES**	5,655,101,312
TOTAL SALES TO ALL CUSTOMERS	**14,700,925,014**

NOTES:
*Data on electricity sold to residential customers are based on estimated consumption billing.
**Sales to eligible customers within HEP Group are the responsibility of HEP Opskrba d.o.o.

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 2009 and the related income statement, statement of comprehensive 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. Except as provided in paragraph b), 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

On the financial statements for the year ended 31 December 2008 we expressed a qualified opinion. During 2008, the Company changed its accounting policy 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.

b) The application of IFRIC 18 Transfer of assets from the customer

The Company is subject to the application of the interpretation IFRIC 18 Transfer of assets from customers, which specifies the process accounting records transfer of assets to customers, so that the income from such assets is recognized immediately upon transfer of the assets in the income statement and not deferred over the lives of those assets. The above interpretation is effective from 01 July 2009. The Company's management has decided to adopt the above interpretation for the transfer of assets from customers in the period after the 1 January 2010. Until the publication of financial statements, the Company did not quantify the effect of late adoption of the above interpretation of the financial statements, and therefore we are unable to assess the impact on the financial statements of the Company.

OPINION

In our opinion, execept for the effect of the matters discussed in paragraph b) and the effect of the facts set forth in section a) on the corresponding information, financial statements present fairly, in all material respects, the financial position of the Company as at 31 December 2009, 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 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, 1 June 2010

HEP OPERATOR DISTRIBUCIJSKOG SUSTAVA d.o.o., INCOME STATMENT FOR THE YEAR ENDED 31 DECEMBER 2009

	2009	2008
	HRK '000	HRK '000
		restated
Electricity distribution fee income – related companies	3,155,948	2,980,228
Services rendered	139,256	159,590
Other operating income	356,395	369,041
Total operating income	**3,651,599**	**3,508,859**
Cost of externally purchased energy	(12,054)	(12,565)
Grid losses	(663,420)	(500,443)
Service expenses	(289,201)	(272,029)
Staff expenses	(1,215,694)	(1,127,048)
Depreciation and amortisation	(750,252)	(718,717)
Administrative expenses – related companies	(176,233)	(159,430)
Other operating expenses	(558,446)	(485,116)
Total operating expenses	**(3,665,300)**	**(3,275,348)**
(Loss)/ Profit from operations	**(13,701)**	**233,511**
Financial income	1,550	1,159
Finance costs	(40,906)	(36,585)
Net financial loss	**(39,356)**	**(35,426)**
(Loss)/ Profit before tax	**(53,057)**	**198,085**
Income tax expense	(11,281)	(1,511)
(Loss)/Profit for the year	**(64,338)**	**196,574**

Signed on behalf of the Company on 1 June 2010 by:
Mišo Jurković, B.E.E.
Managing Director

HEP OPERATOR DISTRIBUCIJSKOG SUSTAVA d.o.o., STATMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2009

	2009	2008
	HRK '000	**HRK '000**
		restated
(Loss) / gain before tax	**(64,338)**	**196,574**
Other current comprehensive income	-	-
Total current comprehensive (loss) / gain	**(64,338)**	**196,574**

Signed on behalf of the Company on 1 June 2010 by:
Mišo Jurković, B.E.E.
Managing Director

HEP OPERATOR DISTRIBUCIJSKOG SUSTAVA d.o.o. BALANCE SHEET AT 31 DECEMBER 2009

ASSETS	**31 December 2009**	**31 December 2008**	**1 January 2008**
		HRK'000	HRK'000
		restated	**restated**
Property, plant and equipment	11,750,952	11,233,889	10,498,146
Capital work in progress	701,611	1,026,703	1,218,791
Intangible assets	16,477	19,513	23,432
Investment properties	56,132	61,916	31,969
Receivables from sale of flats	27,004	29,360	32,008
Prepayments for tangible assets	12	11	17
Deferred tax assets	56,293	45,364	41,140
Total non-current assets	**12,608,481**	**12,416,756**	**11,845,503**
Inventories	213,480	250,474	274,895
Trade receivables	663,908	778,458	915,154
Receivables from related companies	1,311,541	1,078,433	540,420
Current portion of long-term receivables	3,618	3,879	4,040
Other current assets	58,095	45,001	153,369
Cash and cash equivalents	27,749	57,457	20,822
Total current assets	**2,278,391**	**2,213,702**	**1,908,700**
Total assets	**14,886,872**	**14,630,458**	**13,754,203**

Signed on behalf of the Company on 01 June 2010 by:
Mišo Jurković, B.E.E.
Managing Director

HEP OPERATOR DISTRIBUCIJSKOG SUSTAVA d.o.o. BALANCE SHEET AT 31 DECEMBER 2009 (CONTINUED)

EQUITY AND LIABILITIES	**31 December 2009**	**31 December 2008**	**1 January 2008**
	HRK ‘000	HRK ‘000	HRK ‘000
		restated	**restated**
Subscribed capital	20	20	20
Accumulated losses	(14,077)	50,261	(146,313)
Total equity	**(14,057)**	**50,281**	**(146,293)**
Long term liabilities to related companies	7,543,351	7,503,559	7,341,252
Other non-current liabilities	18,503	19,976	21,643
Deferred income	4,351,403	4,022,063	3,482,149
Long-term provisions	246,085	199,525	185,200
Total non-current liabilities	**12,159,342**	**11,745,123**	**11,030,244**
Trade payables	557,942	666,810	641,832
Liabilities to related companies	1,258,278	1,263,212	1,516,512
Current portion of long-term liabilities to related company	571,063	568,352	553,427
Other current liabilities	354,304	336,680	158,481
Current liabilities	**2,741,587**	**2,835,054**	**2,870,252**
TOTAL CAPITAL AND LIABILITIES	**14,886,872**	**14,630,458**	**13,754,203**

Signed on behalf of the Company on 1 June 2010 by:
Mišo Jurković, B.E.E.
Managing Director

HEP-TOPLINARSTVO d.o.o.

DIRECTOR

ROBERT KRKLEC

IN 2009, HEP-TOPLINARSTVO d.o.o. (HEP Heating) fulfilled completely its main business goal – all customers were provided with quality and reliable deliveries of heat energy and process steam, despite difficult business conditions caused by recession.

During 2009, HEP-Toplinarstvo d.o.o. worked with dedication to implement the economic plan and investment plan. The most important investment project was the third phase of the refurbishment of the hot water network in Zagreb and Osijek, financed by a World Bank loan. The refurbishment included replacement of hot water network of 7.6 km and 4.4 km in length in Zagreb and Osijek respectively, the biggest work of its kind since the network was originally built. The result is cutting of costs of heat and service water, cutting of costs for maintenance and emergency repairs, increasing of reliability of supply and direct positive environmental impact. Also worth mentioning is the project of construction, operation and maintenance of the energy plant for Zagreb University Hospital at Rebro Hospital location.

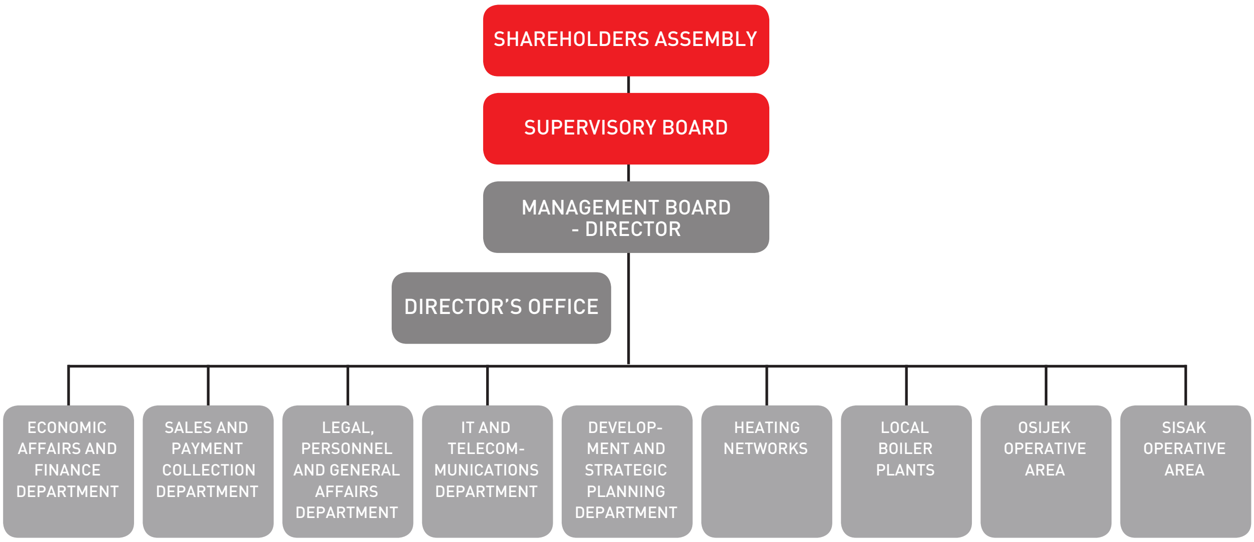
Special attention in implementing the plans for 2009 was paid to meeting our business objectives, cutting of operating costs, reducing losses, and to payment collection for energy supplied, communications with customers and to employee training and professional improvement.

Unfortunately, in 2009 again the biggest problem of our operations and development of the heating business was not solved – unrealistic ratio of prices of fuels needed to produce heat energy in cogenerating plants and separate boiler plants to selling prices of heat energy. More specifically, the continuous growth of input costs has not been followed by appropriate change in revenues from energy supplied, which is the most important factor enabling normal operations and development of the business.

In order to contribute to the furthering of heat energy production, distribution and supply, HEOP-Toplinarstvo will continue to be actively involved in adopting and amending the rules and regulations which will fully regulate the heating sector and whose application will eventually lead to normalization of business operations and/or financial viability and development of the heating business.

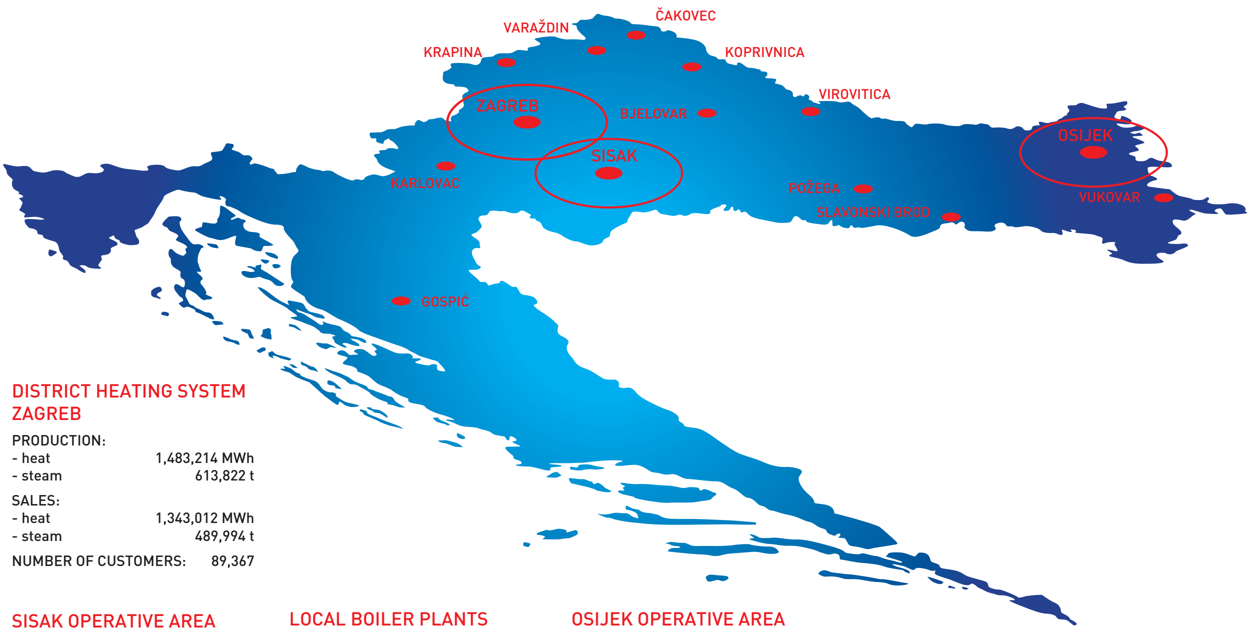
I would mention in the end that, regardless of the problems and complex business conditions, we can consider 2009 a successful business year, which is the result of dedicated work and commitment on the part of all employees of HEP-Toplinarstvo d.o.o. I believe that by working together we will succeed and in the period ahead continue to provide all our customers with quality and reliable service.

COMPANY ORGANIZATIONAL CHART (AS AT DECEMBER 31, 2009)



* NOTE. New organization and job classification was carried out during 2009.

HEP TOPLINARSTVO d.o.o. IN 2009



DISTRICT HEATING SYSTEM ZAGREB

PRODUCTION:

- heat	1,483,214 MWh
- steam	613,822 t

SALES:

- heat	1,343,012 MWh
- steam	489,994 t

NUMBER OF CUSTOMERS: 89,367

SISAK OPERATIVE AREA

PRODUCTION:

- heat	77,604 MWh
- steam	17,575 t

SALES:

- heat	61,482 MWh
- steam	15,656 t

NUMBER OF CUSTOMERS: 4,053

LOCAL BOILER PLANTS

PRODUCTION:

- heat	198,265 MWh

SALES:

- heat	192,959 MWh

NUMBER OF CUSTOMERS: 16,945

OSIJEK OPERATIVE AREA

PRODUCTION:

- heat	199,195 MWh
- steam	126,443 t

SALES:

- heat	185,330 MWh
- steam	91,126 t

NUMBER OF CUSTOMERS: 11,698

HEP TOPLINARSTVO d.o.o. IN 2009

HEP Toplinarstvo d.o.o. is a member of HEP Group, performing the businesses of production, distribution and supply of heat energy to households and industry. The company provides its services to consumers in the areas of the cities of Zagreb, Samobor, Velika Gorica, Zaprešić, Osijek ans Sisak.

During 2009 the number of heat energy customers rose by 0.4 percent to a total number of 122,054 at the end of 2009, of which 116,136 households and 5,918 corporate entities.

In heat consumption (district heat and process steam) households accounted for 61 percent (49 percent in income) and corporate entities for 39 percent (50 percent in income). In total consumption of district heat, the share of Zagreb (including Samobor, Velika Gorica and Zaprešić) was 85.4 percent, Osijek 11.3 percent, and Sisak 3.3 percent.

Consumption of steam delivered for industrial processes was 596,776 (Zagreb 82.11 percent, Osijek 15.27% percent, Sisak 2.62 percent. The ratio of the heat supplied (hot water) to process steam in MWh was 81.5% : 18.5%.

Although the number of customers grew a little compared to the year before, heat sales registered the opposite trend, being lower by 0.8 percent. Taking our two main products separately, sales of district heat was higher by 1.5 percent while sales of process steam fell by 10.1 percent. The reason for these results can be found in the fact that the economic crisis closed the businesses of some customers who used steam for process purposes.

Due to the increase in customer number in 2009, the contracted load in the area of the city of Zagreb increased, by 3.09 MW in Zagreb and by 2.3 MW in Osijek.

FINANCIAL STATEMENTS
INDEPENDENT AUDITOR'S REPORT

To the Owner 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 2009 and the related statement of income, statement of comprehensive inocme, 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. Except as provided in paragraph a), 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.

MATTER AFFECTING THE OPINION

a) Application of IFRIC 18 Transfers of Assets from Customers

The Company has the obligation to apply IFRIC 18 Transfers of Assets from Customers, which specifies the accounting for assets transferred from customers, by which the income from such assets are to be recognised immediately upon the transfer in profit or loss rather than deferred over the useful life of the transferred asset. The Interpretation is in force since 1 July 2009, and the Management Board has decided to apply the Interpretation to periods subsequent to 1 January 2010. As of the date of publication of these financial statements, the Company has not quantified the effect of untimely adoption of the Interpretation on the financial statements. As a result, we are unable to assess the impact of this matter on the financial statements of the Company.

QUALIFIED OPINION

In our opinion, except for the effect of the matters discussed in paragraph a) above, the financial statements present fairly, in all material respects, the financial position of the Company at 31 December 2009, 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, Certificated Auditor
Zagreb, 01 June 2010

HEP TOPLINARSTVO d.o.o. INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2009

	2009	2008
	HRK'000	HRK'000
Income from thermal energy sale	557,408	478,097
Income from thermal energy and other income – related companies	3,802	3,626
Other operating income	49,184	41,664
	610,394	**523,387**
Energy, material and spare parts expenses	(77,881)	(82,755)
Service expenses	(26,413)	(24,948)
Staff expenses	(52,428)	(49,444)
Depreciation and amortisation	(54,882)	(56,093)
Expense in respect of electricity generation and other expenses – related companies	(419,831)	(447,900)
Other operating expenses	(83,347)	(49,132)
	(714,782)	**(710,272)**
Loss from operations	**(104,388)**	**(186,885)**
Financial revenues	5,930	5,478
Financial expenses	(15,072)	(8,965)
Net financial loss	**(9,142)**	**(3,487)**
Loss before tax	**(113,530)**	**(190,372)**
Income tax	-	-
Loss for the year	**(113,530)**	**(190,372)**

Signed on behalf of the Company on 01 June 2010 by:
Robert Krklec, B.E.E.,
Director

HEP TOPLINARSTVO d.o.o. STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2009

	2009	2008
	HRK '000	HRK '000
Loss of current year	**(113,530)**	**(190,372)**
Other comprehensive income for the year	-	-
Comprehensive loss profit for the year	**(113,530)**	**(190,372)**

Signed on behalf of the Company on 01 June 2010 by:
Robert Krklec, B.E.E.,
Director

HEP TOPLINARSTVO d.o.o., BALANCE SHEET AT 31 DECEMBER 2009

ASSETS	**31 December 2009**	**31 December 2008**
	HRK'000	HRK'000
Property, plant and equipment	788,312	724,646
Assets under construction	73,991	71,518
Intangible assets	1,331	1,890
Receivables from sale of flats	790	1,293
Investment property	360	360
Receivables from related companies	122,342	68,627
Total non-current assets	**987,106**	**868,334**
Inventories	29,569	51,627
Trade receivables	123,233	107,876
Receivables from related companies	3,240	8,732
Other current assets	7,336	25,360
Current portion of long-term receivables	294	73
Cash and cash equivalents	11,198	4,374
Total current assets	**174,870**	**198,042**
TOTAL ASSETS	**1,161,976**	**1,066,376**

Signed on behalf of the Company on 01 June 2010 by:
Robert Krklec, B.E.E.,
Director

HEP TOPLINARSTVO d.o.o., BALANCE SHEET AT 31 DECEMBER 2009 (CONTINUED)

	31 December 2009	31 December 2008
	HRK'000	HRK'000
Capital and reserves	-	-
Share capital	20	20
Reserves	20	20
Accumulated losses	(678,137)	(564,607)
Total equity	**(678,097)**	**(564,567)**
Long-term liabilities to related companies	865,822	738,098
Other long-term liabilities	510	553
Long-term provisions	5,881	7,820
Deferred income	167,305	165,452
Total non-current liabilities	**1,039,518**	**911,923**
Trade payables	53,191	51,556
Liabilities to related companies	681,733	606,274
Current portion of long-term debt to related companies	54,882	56,093
Other short-term liabilities	10,749	5,097
Total current liabilities	**800,555**	**719,020**
TOTAL EQUITY AND LIABILITIES	**1,161,976**	**1,066,376**

Signed on behalf of the Company on 01 June 2010 by:
Robert Krklec, B.E.E.,
Director

HEP-PLIN d.o.o.

DIRECTOR

NIKOLA LIOVIĆ

HEP-PLIN (HEP Gas) carries out two energy businesses of the gas sector: gas distribution and gas supply to customers. The main determinants for the carrying out of these businesses are regulated by separate laws – Energy Act and Gas Market Act and a number of implementing regulations. In accordance with this, the company's main business goals are:

- reliable and uninterrupted gas distribution according to regulated principles of public service provision together with the highest degree of environmental protection and development of the existing distribution system and expansion into new areas, and
- gas supply to customers in existing and new supply areas, namely: tariff customers (households) according to regulated principles of public service provision and other customers according to market principles by negotiating mutual rights and obligations.

The business operations and state of affairs of the company in 2009 were marked by several important events and facts. The continuity of gas supply at the beginning of the year was jeopardized due to suspension of gas deliveries from Russia and insufficient gas reserves in the gas storage facility. The Government of Croatia took Decision declaring state of crisis and the Ministry in charge prescribed measures for reduction and/or suspension of gas in order to keep the gas system functioning for the needs of the most vulnerable customer categories (households and protected customers), which HEP-PLIN carried out with certain difficulties. Gas supply was not fully normalized until January 23, 2009. This is one of the reasons for decreased gas sales in 2009.

A second important characteristic of business operations was stagnation of business activities in the country, which began to reflect on gas sales to corporate customers, especially our large customers. In a third place is the planned further cutting of all operating costs that do not directly jeopardize the security and continuity of gas supply to customers.

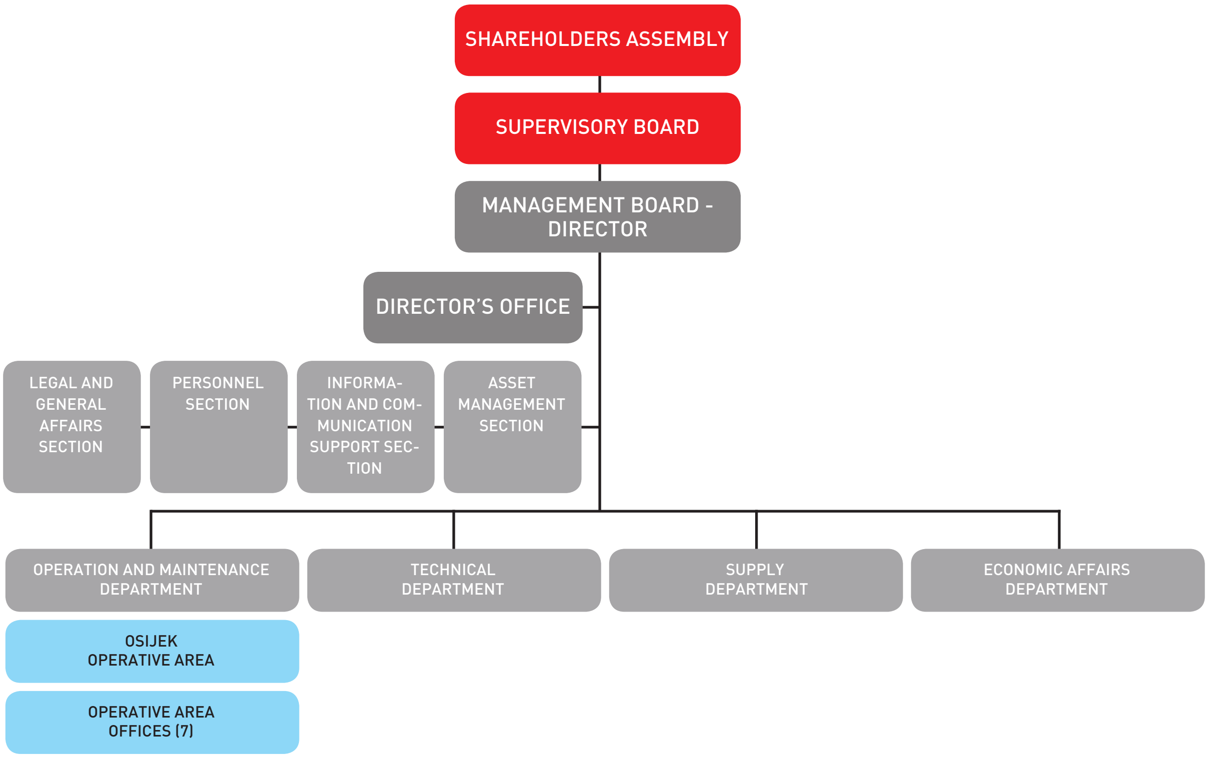
Finally, for the business operations at the beginning of the year it was a very important fact that implementing regulations important for the gas sector were still not passed at the national level (General Conditions of Gas Supply, Rules on organization of the natural gas market) Rules on charges for connection, change of tariff system for gas distribution and gas supply, decision on amounts of concession charges, etc.) which would allow business operations to be further harmonized with the Gas Market Act. After General Conditions and Rules on organization of natural gas market were passed in April but not in force until November 2009, additional activities were needed relating to their application (prescribing standard forms for network access, drafting of standardized contracts for connection to the distribution system, contracts for gas supply to end customers and contracts for gas supply to tariff customers as well as nominating of transport system capacities and ensuring balancing energy of the gas system, etc.).

Day-to day- tasks arising from the objectives we had set were being successfully carried out in 2009 to our satisfaction and to the satisfaction of most of our customers and our concessionaires – 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 resulting from a major breakdown in the gas network. Occasional minor breakdowns were not the consequence of the state of the network but damages caused by contractors within the perimeter of the gas network. In case of any damage and any works particular attention is paid to protecting the environment from methane release.

The gas supplied is billed at prices adopted by the Government in 2008, except that from September 1, 2009 gas price for residential customers decreased by 0.01 kn/m^3. The payment collection for gas in 2009 was increasingly difficult, due to which the company's solvency became significantly worse. Nevertheless, thanks to, inter alia, the centralized finance function in HEP Group, the worse solvency did not affect the timely execution of our obligations for the gas procured.

Last year we continued to build under concession the gas network in Baranja, and in the municipalities of Ernestinovo, Podgorač and Sopje. Unfortunately, connecting of new customers to the built network, due to the economic crisis, did not unfold as expected. The necessary modifications and reconstruction of the existing network were carried out in accordance with the reduced funds for investment.

COMPANY ORGANIZATIONAL CHART (AS AT DECEMBER 31, 2009)



HEP-PLIN d.o.o. IN 2009

NUMBER OF CUSTOMERS

Supply area		Customer category	
Osijek-Baranja County	57,836	TM1 - Residential	63,499
Požega-Slavonija County	7,437	TM2 – Commercial (up to 1 million m³)	5,360
Virovitica-Podravina County	3,604	TM3 - Commercial (above 1 million m³)	18
Total	**68,877**	**Total**	**68,877**
		TM – tariff model	

GAS NETWORK

	2008	2009	2009/2008 (%)
Gas lines – owned by HEP d.d. (km)	1,602	1,691	6.2
Gas lines – owned by other parties (km)	531	531	0
Gas lines – total	**2,133**	**2,222**	**4.2**
Reducing stations – DRS (number)	**51**	**52**	**2**
Odorizors (number)	**25**	**26**	**4**

ENERGY BALANCE (10^3 m^3)

	2008	2009	2009/2008 (%)
Procurement (10^3 m^3)	168,414	165,114	- 2
Sales (10^3 m^3)	**166,308**	**157,346**	**- 5.4**

STRUCTURE OF GAS SALES (10^3 m^3)

Customer category	2008	2009	2009./2008. (%)
TM1 - Residential	89,869	88,291	- 1.8
TM2 - Commercial (up to 1 million m^3)	47,089	44,291	- 5.9
TM3 - Commercial (above 1 million m^3)	29,350	24,765	- 15.6
Total	**166,308**	**157,347**	**- 5.4**

FINANCIAL STATEMENTS
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 2009 and the related statement of income, statement of comprehensive 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. Except as provided in paragraph a), 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.

MATTER AFFECTING THE OPINION
a) Application of IFRIC 18 Transfers of Assets from Customers
The Company has the obligation to apply IFRIC 18 Transfers of Assets from Customers, which specifies the accounting for assets transferred from customers, by which the income from such assets are to be recognised immediately upon the transfer in profit or loss rather than deferred over the useful life of the transferred asset. The Interpretation is in force since 1 July 2009, and the Management Board has decided to apply the Interpretation to periods subsequent to 1 January 2010. As of the date of publication of these financial statements, the Company has not quantified the effect of untimely adoption of the Interpretation on the financial statements. As a result, we are unable to assess the impact of this matter on the financial statements of the Company.

QUALIFIED OPINION
In our opinion, except for the effect of the matters discussed in paragraph a) above, the financial statements present fairly, in all material respects, the financial position of the Company at 31 December 2009, 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, 01 June 2010

HEP PLIN d.o.o., INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2009

	2009	2008
	HRK'000	HRK'000
Gas sales	294,263	259,228
Service revenues	2,379	2,849
Income from related companies	1,814	1,383
Other operating income	22,109	19,651
Total operating income	**320,565**	**283,111**
Cost of power sources, fuel and material	(258,673)	(217,926)
Service expenses	(3,799)	(2,929)
Staff expenses	(19,203)	(17,468)
Depreciation and amortization	(10,648)	(13,872)
Expenses with related parties	(4,321)	(4,340)
Other operating expenses	(23,742)	(16,488)
Total operating expenses	**(320,387)**	**(273,023)**
Profit from operations	**179**	**10,088**
Financial income	81	247
Financial expenses	(729)	(10)
Net financial (loss) / profit	**(648)**	**237**
(Loss) / profit from operations before tax	**(469)**	**10,325**
Income tax	(204)	(168)
(Loss) / profit for the year	**(673)**	**10,157**

Signed on behalf of the Company on 01 June 2010 by:
Nikola Liović
Managing Director

HEP PLIN d.o.o., STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2009

	2009	2008
	HRK '000	HRK '000
(Loss) / profit for the year	**(673)**	**10,157**
Other comprehensive income	-	-
Total comprehensive (loss) / profit for the year	**(673)**	**10,157**

Signed on behalf of the Company on 01 June 2010 by:
Nikola Liović
Director

HEP PLIN d.o.o., BALANCE SHEET AT 31 DECEMBER 2009

ASSETS	31 December 2009	31 December 2008
	HRK'000	HRK'000
Property, plant and equipment	179,521	163,266
Investment in progress and prepayments	4,201	8,999
Intangible assets	186	185
Advances for tangible assets	7	-
Deferred tax assets	126	107
Total non-current assets	**184,041**	**172,557**
Inventories	1,966	2,525
Trade receivables	95,304	78,747
Receivables from related companies	829	9,339
Other current assets	4,850	4,230
Cash and cash equivalents	826	7,986
Total current assets	**103,775**	**102,827**
Total assets	**287,816**	**275,384**

Signed on behalf of the Company on 01 June 2010 by:
Nikola Liović
Managing Director

HEP PLIN d.o.o., BALANCE SHEET AT 31 DECEMBER 2009 (CONTINUED)

EQUITY AND LIABILITIES	**31 December 2009**	**31 December 2008**
	HRK '000	HRK '000
Share capital	20	20
Accumulated losses	(4,792)	(4,119)
Total equity	**(4,772)**	**(4,099)**
Long term liabilities to related companies	77,359	66,308
Deferred income	99,755	95,558
Other non-current liabilities	2,336	2,239
Total non-current liabilities	**179,450**	**164,105**
Trade payables	44,328	24,688
Liabilities to related companies	56,608	77,269
Current portion of long-term liabilities to related Companies	6,347	8,488
Other current liabilities	5,855	4,933
Total current liabilities	**113,138**	**115,378**
TOTAL CAPITAL AND LIABILITIES	**287,816**	**275,384**

Signed on behalf of the Company on 01 June 2010 by:
Nikola Liović
Managing Director

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.

HEP-ODMOR I REKREACIJA d.o.o.

USTANOVA HEP-NASTAVNO-OBRAZOVNI CENTAR

HEP-OPSKRBA d.o.o.

DIRECTOR

IVAN MRLJAK

THE YEAR BEHIND US was marked by a key step forward in HEP-Opskrba (HEP Supply) operations. In 2008 the Company already set very high business objectives for itself, the most important of which was to keep current customers, who numbered more than 2,600 at the end of the year, and gain new ones. Although it seemed that amendments to the Electricity Market Act, which came into force in 2009, would be beneficial to our objective, the reverse almost happened. With inadequate staffing level and insufficient IT support we took on a large-scale and demanding process of making contracts with almost one hundred thousand customers of the small business category.

At the end of the business year we had more than 51,000 customers or an increase of 25 times. The number of contracted metering points rose by almost four times – from 33 thousand to 125 thousand. That result is to be credited to exceptional efforts of all employees, especially those in the sales function. Despite the economic crisis and numerous problems in the economy, total sales increased three times, amounting to 6.45 TWh. A total of 3.1 billion kuna was invoiced. Receivables collected were 2.84 billion kuna or four times more than the year before.

It should be mentioned here that at the same time the number of employees increased by only seven people. Therefore, staffing and strengthening the Company's ability to operate in a competitive market will be one of the key business objectives in the year ahead.

Although for a number of problems we literally had to look for "quick fixes" there was not a moment that billing and payment collection was jeopardized. Huge efforts were invested in order to carry out the billing and collect 94 percent of due receivables with the existing number of employees, at the time of recession, when liquidity in almost all segments of operations was uncertain. In doing that, it was necessary to instigate more than a hundred seizure procedures to collect our receivables.

On the other hand, we participated in more than 500 public procurement processes carried out by our electricity customers.

The business operations were considerably affected by anti-recession measures imposed toward the end of the year, which with too small a number of employees left trace on the quality of relations with customers. These relations should have been much better and the company will definitely have to work hard this year to improve them.

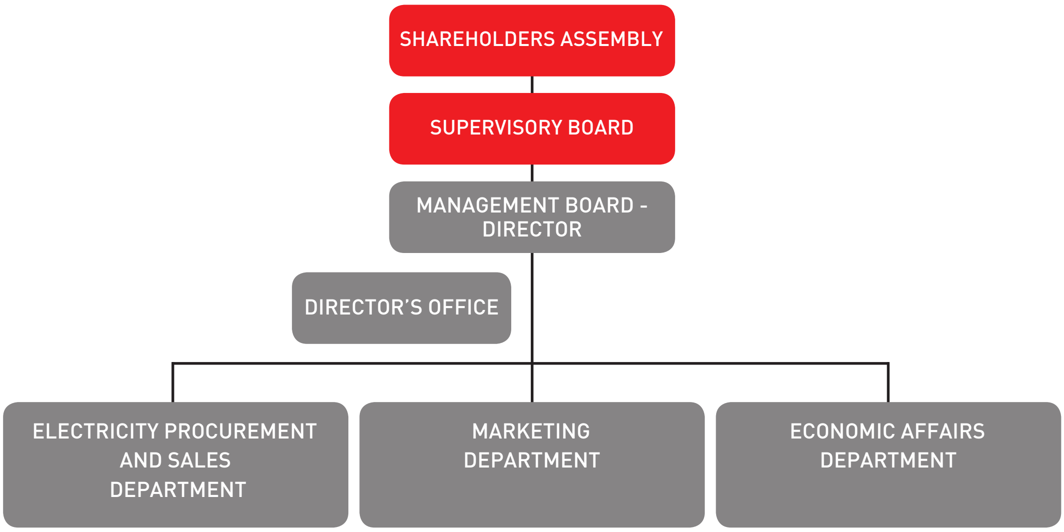
While recognizing all optimization and stabilization programs we are certain that taking care of employee education and training should continue for their motivation and better long-term performance. This is certainly a better and more efficient way of achieving savings for improvement in future operations.

Taking all business circumstances in consideration, the Company has fulfilled its task in HEP Group. The results achieved are a guarantee that the process of forming a competitive company within HEP Group, which sells its core product – electricity, will continue to develop in a positive direction on conditions and in the manner that can be expected from a competitive company.

MISSION AND VISION

MISSION – to provide customers with a quality electricity supply service
VISION – to be the leading supplier in the region

ORGANIZATIONAL CHART

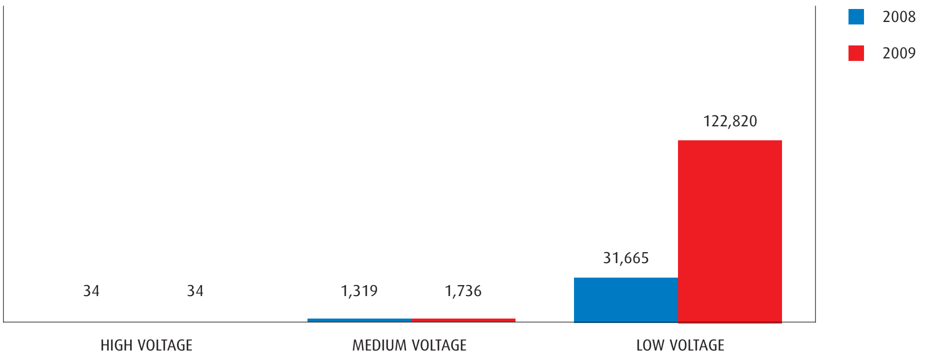


NUMBER OF METERING POINTS*

Customer category	2008	2009	Index 2009/2008
High voltage	34	34	1
Medium voltage	1,319	1,736	1.3
Low voltage	31,665	122,820	3.9
Total eligible costumers	**33,018**	**124,590**	**3.8**

* Supply contracts are made on the principle: one customer – one contract – one invoice for all metering points

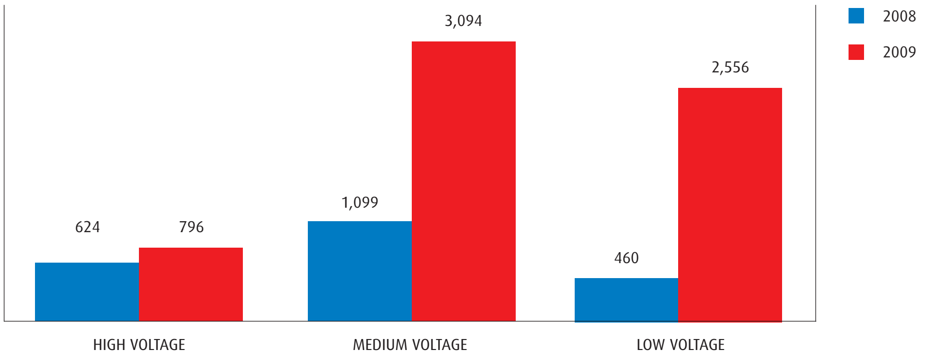
NUMBER OF METERING POINTS



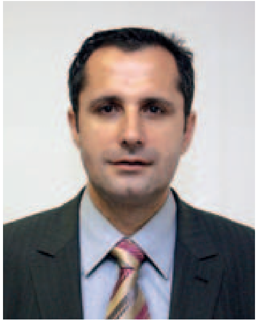
ELECTRICITY SALES

			GWh
Customer category	**2008**	**2009**	**Index 2009/2008**
High voltage	624.4	796.1	1.3
Medium voltage	1,099.4	3,094.5	2.8
Low voltage	460.0	2,556.1	5.6
Total eligible costumers	**2,184**	**6,447**	**3**

SALES PER VOLTAGE LEVEL (GWh)



HEP-TRGOVINA d.o.o.



DIRECTOR

ANTE ĆURIĆ

Ante Ćurić

HEP-TRGOVINA d.o.o. (HEP Trade) was established as a company within HEP Group in 2007. During 2009, by optimizing the operation of HEP Group power plants in combination 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.

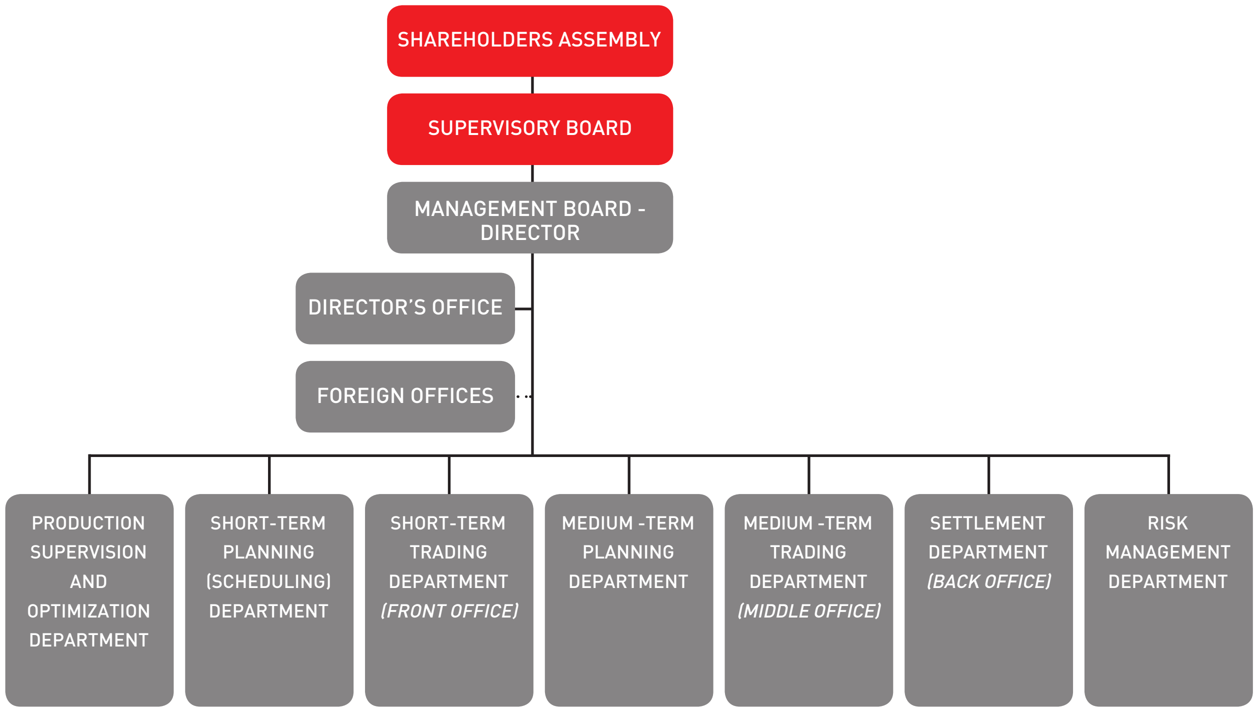
During 2009 HEP Trgovina d.o.o., with the aim of increasing profit, continued the activities concerning foreign companies in neighboring countries. The basic task of foreign companies is to trade in electricity in the markets of the countries in which they are established and in the markets of third 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). In 2009, the companies in Slovenia and Serbia began operating on these markets.

During 2009 HEP-Trgovina 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 17,697 GWh, a decrease of 1.7 percent compared to 2008 or 2.6 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 4.3 percent due to a markedly dry period from September to November 2009. Hydroelectric production met 38.2 percent of total consumption. Due to high prices of liquid fuel on the market, thermal power plants production was lower by 8.1 percent than planned. Production by TE Plomin d.o.o. was 14 percent lower than planned due to longer non-availability than planned. Electricity shortage was compensated by a 2.9 percent higher than planned electricity import, whereby the lower than planned consumption of electricity was fully covered. Due to the circumstances on the electricity market the export was 8.9 percent lower than planned. During 2009, the volume of trade was realized in the amount of 6,750 GWh, which corresponds to the planned level.

ORGANIZATIONAL CHART



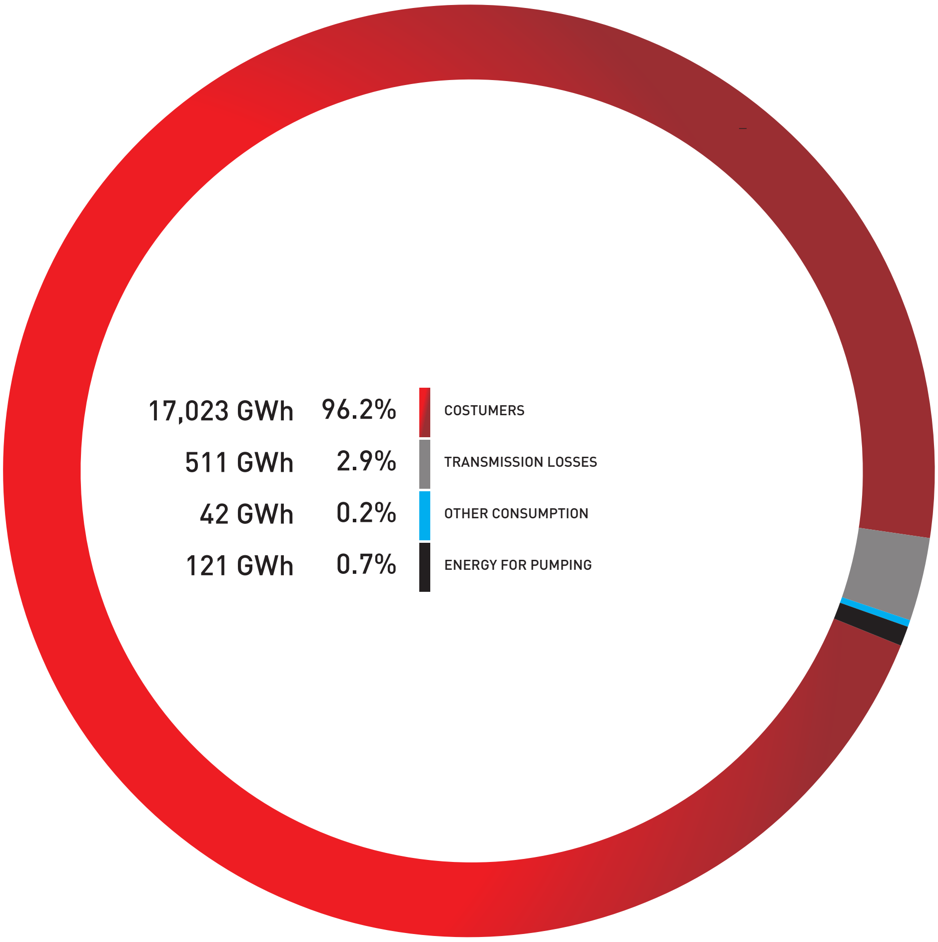
ACHIEVEMENTS IN 2009 - ENERGY DATA

ELECTRICITY BALANCE

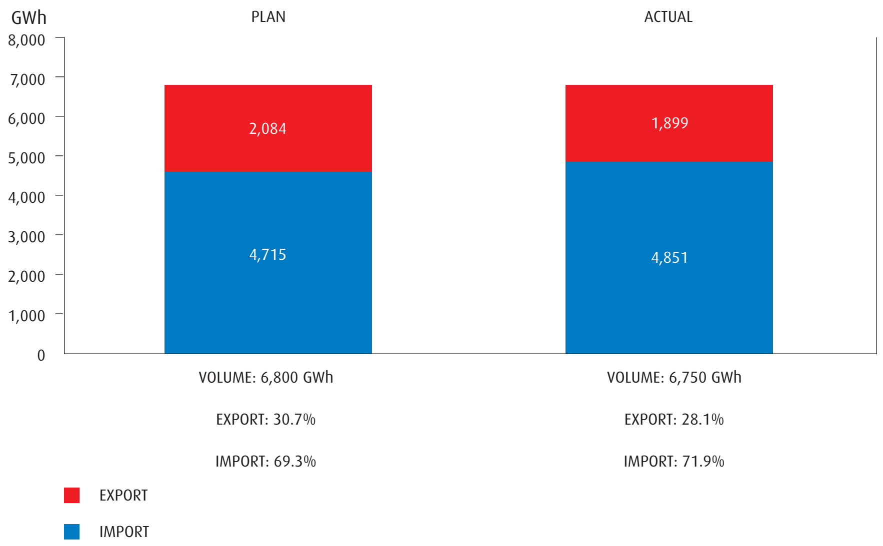
GWh

	2008	2009	2009/2008	2009 (plan)	2009/2009 (plan)
Total consumption on transmission network	**17,996**	**17,697**	**-1.7**	**18,176**	**-2.6**
Production by HPPs	5,277	6,767	28.2	7,074	-4.3
Production by TPPs	4,561	4,381	-3.9	4,769	-8.1
NE Krsko d.o.o.	2,986	2,730	-8.6	2,711	0.7
TE Plomin d.o.o.	1,514	796	-47.4	926	-14.0
Import	5,178	4,851	-6.3	4,715	2.9
Export	-1,587	-1,899	19.6	-2,084	-8.9
Industrial power plants	29	20	-32.4	25	-19.6
Eligible producers	38	50	32.4	41	22.3
Available electricity	**17,996**	**17,697**	**-1.7**	**18,176**	**-2.6**

STRUCTURE OF ELECTRICITY CONSUMPTION IN 2009



TRADE VOLUME 2009



HEP-ESCO d.o.o.

DIRECTOR

GORDANA LUČIĆ

AFTER 7 YEARS OF OPERATING in the energy efficiency market in Croatia, in mid-2010 HEP-ESCO will successfully complete the Energy Efficiency Project supported by the World Bank and GEF. Based on this experience, the operations are planned to be supplemented in accordance with trends in energy efficiency and environmental protection in the EU. This is primarily related to the introduction of a combination of renewable sources and energy efficiency measures, then to the orientation to offering operating leasing to clients and energy savings guarantee and to an increasing orientation to private sector clients. The new approaches to the operations are necessary if HEP-ESCO is to keep its position in the Croatian energy efficiency market.

The special characteristic of the business of HEP-ESCO d.o.o. compared to other HEP Group companies is a full market orientation and the need for constant development of new lines of business in order to keep and expand the market. This demands great commitment and enthusiasm from all employees.

Securing finance is a key issue for HEP-ESCO because project financing is the basis of the business operations and/or of contracting with clients on ESCO model. It must be mentioned here that energy efficiency projects push a country's economic growth, especially at local levels: project preparation and execution involves solely domestic small and medium-sized, mainly local, companies (more than 140 until now). In addition, these projects help local communities (towns and counties) to improve public standard and quality of living by modernizing public lighting, schools, hospitals, etc.

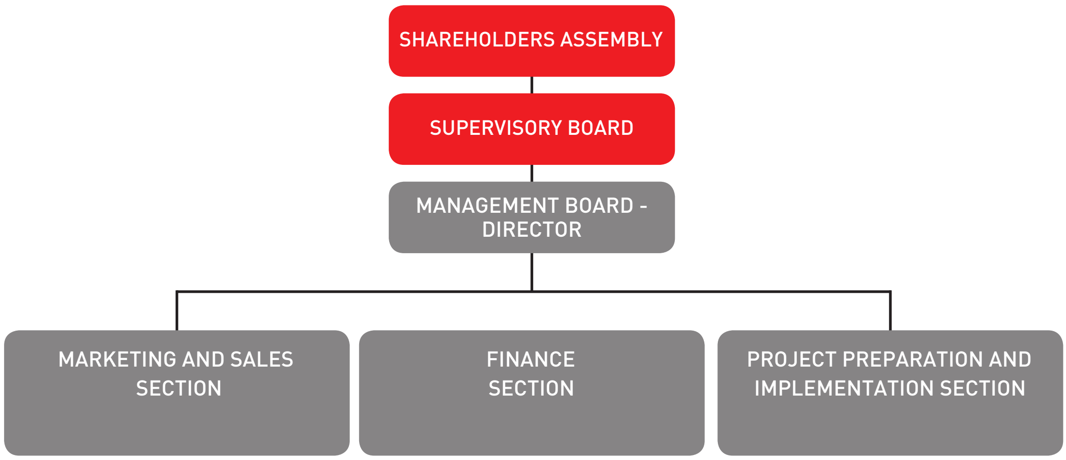
A main obstacle to the further implementation of projects is, according to the Opinion of the Finance Ministry (February 2010) referring to the Budget Act (of January 2009), that energy efficiency projects on ESCO model represent supplier's credit to budget users. This completely stopped preparation and execution of our projects in local self-government units. Our position is that ESCO projects, in which investment is paid back from savings and which help to solve major communal problems, e.g. in schools and public lighting, cannot be considered credit borrowings incurred by towns or counties. We expect that this problem will be solved in rules to be derived from the Efficient Use of Energy in Direct Consumption Act which was passed at the end of 2008.

HEP-ESCO operations in 2009 were under the influence of the economic crisis which also affected local communities and industry, especially wood industry. Some towns withdrew from public lighting modernization projects although the projects were largely close to being contractually agreed.

To the end of 2009, 28 energy efficiency projects were contractually agreed, of which 18 has been completed and for the remaining nine we hope to be implemented in 2010. The execution of these projects means an annual savings of 12.9 million kuna or 21,794 MWh of heat and electrical energy, or 8,286 tons of CO_2.

HEP-ESCO also participates in development programs of the European Union – Intelligent Energy Europe (IEE). These projects are Bio.Sol-Esco and Permanent, and GreenBuilding. Within Bio-Sol-Esco we cooperate with ten companies from seven EU countries. The project unites renewable sources and ESCO model of project preparation, execution and financing. The Permanent project relates to the processes of measuring and verifying of savings and is carried out in cooperation with five EU countries. Regarding the Greenbuilding project, HEP-ESCO was declared in October 2009 the best supporter of that program.

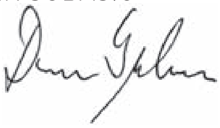
ORGANIZATIONAL CHART



APO d.o.o., USLUGE ZAŠTITE OKOLIŠA

DIRECTOR

DAMIR SUBAŠIĆ



APO d.o.o. USLUGE ZAŠTITE OKOLIŠA (APO Environmental Services) is a consulting and engineering company specializing in environmental protection. In 2009, APO provided significantly fewer services to other HEP Group companies, but increased the scope of work in the environmental protection market outside HEP, rendering services to corporate entities, government bodies, counties and units of local government and self-government.

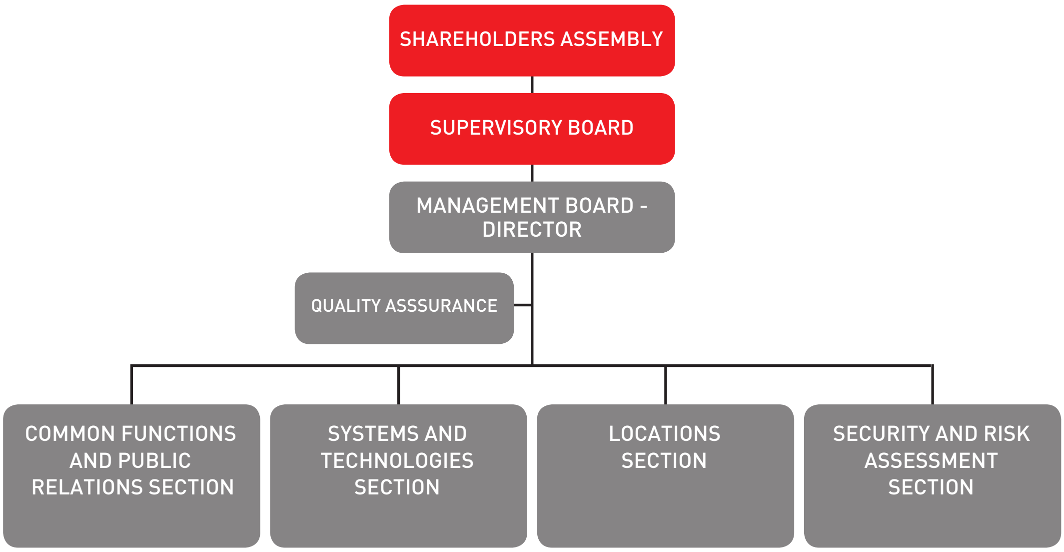
During the past year, APO, in accordance with the powers and concessions it has, prepared and delivered to clients 64 different documents in the area of environmental protection and waste management, from strategic documents and programs through safety reports, integrated environmental requirements, environmental impact studies, environmental emergency plans to waste management plans and rules.

In 2009 APO prepared and delivered to the Ministry of Environmental Protection, Physical Planning and Construction the first two documents produced in accordance with the provisions of the Regulation on Integrated Environmental Requirements (NN 114/08): The analysis of the state of affairs in Viro sugar factory and Request for determination of integrated environmental requirements of the Center for Waste Management of the Zadar County. Supervision was carried out of cleanup of five sites. In the same period, a total of 1,128,085 tons of mainly hazardous waste was managed.

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
- Cleanup of contaminated areas
- Site selection and investigation
- State of affairs reports in line with provisions of the Regulation on Integrated Environmental Requirements – IPPC
- Eco-auditing and EMS and ISO 14.000 introduction
- Preparation of safety reports
- General environmental protection consulting
- Sustainable development
- Decommissioning, radioactive waste and radioactive materials
- Public relations relating to environmental protection and sustainable development

ORGANIZATIONAL CHART



HEP-OBNOVLJIVI IZVORI ENERGIJE d.o.o.

DIRECTOR

GORAN SLIPAC

Goran Slipac

HEP-OBNOVLJIVI IZVORI ENERGIJE (HEP Renewable Energy Sources) entered the year 2009 with the aim of further developing the defined projects, primarily wind and biomass projects, and then solar and small hydro power plants.

At the beginning of the year, a contract was signed with the German development bank KfW, which secured finance to HEP for the implementation of renewable energy and energy efficiency projects. The proceeds of the KfW loan amounting to 50 million euro were allocated to HEP- Obnovljivi izvori energije for renewable energy power plant projects and to HEP ESCO for energy efficiency projects.

Besides the loan, HEP and KfW signed a grant agreement. A smaller portion of the grant was used to buy specialized software for wind potential assessment and staff training, and a larger portion will be used for consultancy services in the preparing of wind projects. Consultancy services financed from the grant were agreed at the end of 2009 to be provided during 2010.

For our most important project, the Krš Pađene wind park, being developed in cooperation with Austrian companies Bewag and Verbund and Croatian Dalekovod, all necessary documentation was prepared by mid-2009 (conceptual design and connection of the wind park to the electricity system, environmental impact assessment, incorporation into special plans, obtaining of preliminary energy approval, etc.) whereby all conditions were met for the siting permit. The legally valid siting permit was issued in September 2009 for the first phase of the 100 MW project. Also, mutual agreements and contracts were finalized between project participants whereby the basis was created for the establishment of project companies for the project implementation. It is expected that the project will be financed through project financing.

Other wind power projects continued to be developed. During the year, decisions to issue preliminary energy approvals for several projects were received from the Ministry of Economy, Labor and Entrepreneurship. Also, preparatory activities began for incorporation of the projects into physical plans as well as investigations necessary to assess environmental impact.

Further, as part of the development of biomass power plant projects, priority sites were defined and preparatory activities began to draft the necessary documentation. In further development of the project, cooperation with other HEP Group members is expected, primarily with HEP-Toplinarstvo, HEP-Proizvodnja and HEP ESCO. Studies and investigations to define potential sites for the construction of small hydro power plants were also completed.

At the end of the year a consortium agreement was signed within the European Community Program FP7. The project, Solution, is aimed at encouraging public and private partners in creating self-sustained municipalities by applying energy efficiency measures and using renewable energy sources. The project involves 17 partners from Switzerland, Finland, Austria, Slovenia and Croatia with the island of Hvar chosen as a showcase area. HEP-Obnovljivi izvori energije d.o.o. is a potential investor in a solar power plant, on the model of co-financing by the EU.

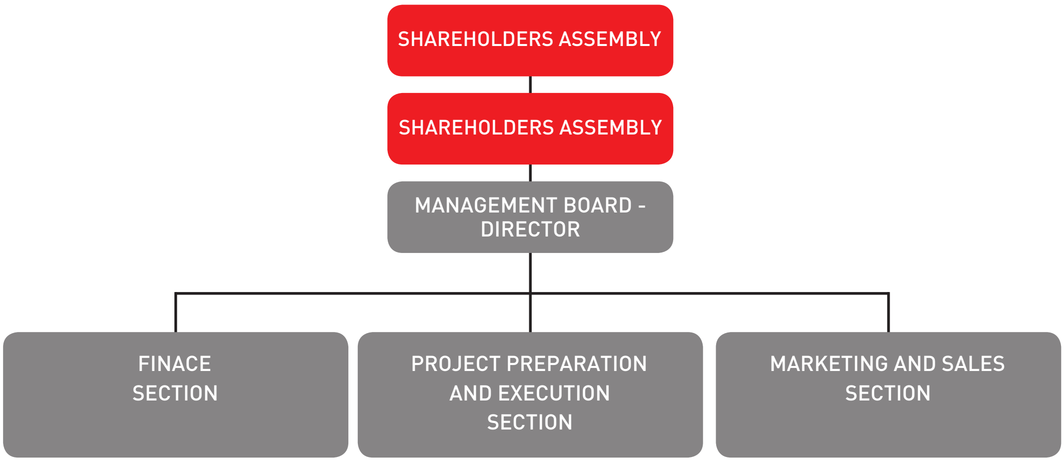
The successful cooperation with the Ministry of Economy, Labor and Entrerpreneurship continued concerning registration of projects for co-financing from structural funds of the EU.

In the area of environmental protection, the Company's plan for the implementation of renewable energy projects was included in the Plan for CO_2 emission reduction of the whole HEP Group.

The work to develop new competencies and raise awareness of the role of renewable energy sources continued inside and outside HEP, in the professional community and general public. For this reason, HEP OIE was strongly present in HEP's publications, including HEP's redesigned website, and at professional gatherings and conferences.

Accordingly, it can be concluded that fulfilling of the objectives has successfully continued, in accordance with the Company's mission and vision, that further development of quality projects continued and that the activities within European projects opened the opportunities for further progress and expansion and better positioning of HEP OIE in the domestic and foreign market.

ORGANIZATIONAL CHART



HEP-ODMOR I REKREACIJA d.o.o.

DIRECTOR

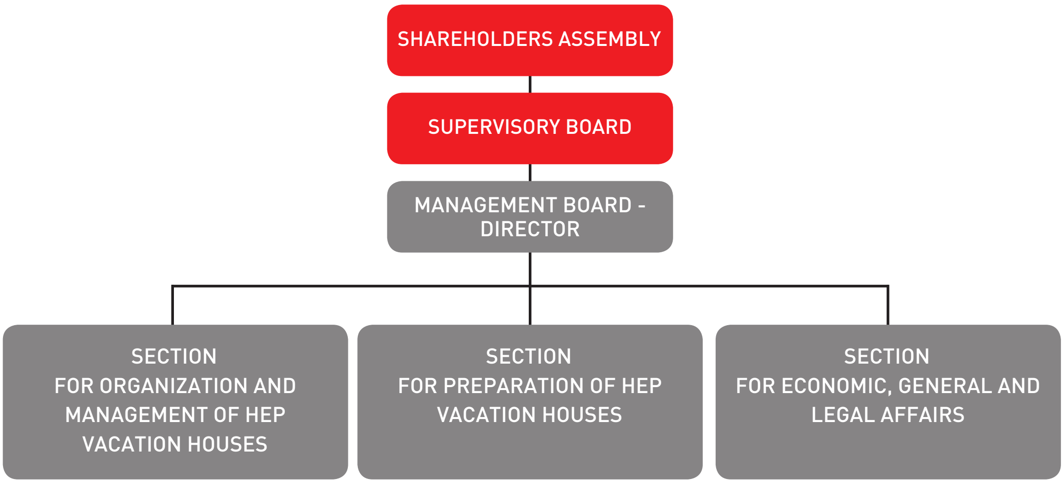
IGOR STANKOVSKI

HEP – ODMOR I REKREACIJA d.o.o. (HEP Leisure and Recreation) was established on May 1, 2007, for coordination, management and use of vacation houses, including their refurbishment and improvement of services in tourist and recreation domain. Based on the Lease Agreement on behalf of the owner, HEP d.d., the Company operates 30 vacation facilities with 362 accommodation units and a total of 1,226 beds, solely for the needs of HEP Group employees.

In 2009, there were 53,960 bed nights in the vacation houses.

*Appointed director on January 15, 2010. In the reporting period the director was Edo Virgini.

COMPANY ORGANIZATIONAL CHART (AS AT DECEMBER 31, 2009)



NOTE: A new organization of the Company was established at the end of January 2010 which would be followed by new job classification.

HEP-NASTAVNO OBRAZOVNI CENTAR

HEAD

ZDENKO MILETIĆ

HEP NOC (HEP (HEP Education and Training Center) is primarily intended for education and professional improvement of HEP Group employees and introduction of live work technology. Also, its purpose is to train HEP's employees in other technologies and/or provide education 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 programs for training and professional improvement meant that all legal preconditions for additional training and acquiring new qualifications have been met.

Based on the Secondary Schooling Act and Constitution of the Institution, the Administrative Council adopted Annual Plan and Program – Adult Education for the School Year 2008/2009. The Plan and Program is aligned with those of similar institutions in Europe and with the objectives and needs of HEP Group. Also, for the purpose of the planned accreditation of the inspection and testing laboratory to the Croatian standard for calibration and testing laboratories HRN EN ISO/IEC 17025:2007 by mid-2010, the Constitution of the Institution was amended to include the activities of technical testing of insulation of tools and protective equipment, and additional registration for the activity was performed.

HEP-NOC has continued to offer its services outside HEP Group. The most significant result in 2009 was export of technology to Bosnia and Herzegovina where education and application of live work technology at low voltage has been successfully carried out at JP Elektroprivreda BiH d.d., and the 2008 contract for the transfer of live work technology to the electricity company of the Republic of Slovenia is expected to continue. 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 offers 22 verified educational programs and lecturers have been continuously receiving additional training by attending andragogue schooling, participating in professional gatherings of EDZ, CIRED and CIGRE as well as in specialized seminars organized by the Croatian Accreditation Agency and CROLAB.

In 2009, 14 employees of HEP and 55 employees of other companies received live work training and informative course was given to 14 managers of HEP and to 22 managers from other companies. HEP's employees, 369 of them, in addition to live work training attended other types of training and educational seminars.

The inspection and testing laboratory of HEP-NOC expanded the scope of its work on periodic testing (inspection) of insulation tools and equipment used by HEP-ODS. Besides existing users as from this year it provides periodic testing services for Elektra Sisak and users outside HEP Group such as Uljanik shipyard, Mistral d.o.o., Pentra d.o.o. In 2009, almost 900 pieces of special insulation tools and protective equipment were inspected and tested. In 2009, HEP-NOC continued to work as a full member of the Croatian association of laboratories CROLAB, and brought the procedure of accreditation for its laboratory from the Croatian Accreditation Agency under the standard HRN EN 17025:2007 to the phase of preliminary assessment and final assessment.

The majority of educational programs was conducted by HEP NOC employees. For specialist seminars and working sessions external collaborators – lecturers were hired, mostly safety specialists from HEP-ODS, university professors, and specialists from other companies.

The operations in 2009 were significantly impacted by slower economic activities, cost cutting measures in HEP Group, and in other companies in the area, which reflected especially on educational and training segment. In these circumstances, trainee groups were hard to form, and some companies, after education was completed did not have funds to continue the cycle which consisted of purchase of materials and tools. Last year was therefore special in that the orientation was to companies in close proximity, due to which revenues from external companies and those from within the parent company were almost equal for the first time. A positive step forward is expected in the business year 2010, with continuation of cost cutting and with the expected increase in overall economic activity. This is supported by the fact that investment in education will have to be increased as Croatia fulfills the requirements for EU membership.

HEP NOC will know how to respond to the new requirements and ensure professional improvement of HEP Group employees and through its work to continue to create a positive image of HEP as a company that takes special care for the wellbeing of its employees and users of its services.

HEP NOC OBJECTIVES

- carry out 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.

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