Annual Report 2010

DRAVA, KUPA,

RJE... , LOKVARKA, LIČANKA

... DOBRA

... MRE...

ZRMANJA, OPSENICA, RIČICA

OT... A

BUTIŠNIC... KRKA

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HEP

HEP GROUP 2010

		Change 2010 / 2009 (%)
Electricity sales	**17.6 TWh**	**0.5**
Electricity production	**15.8 TWh**	**7.6**
Heat sales	**2.4 TWh**	**3.8**
Gas sales	**162 mn m³**	**3.0**
Operating income	**HRK 12,923.0 mn**	**2.6**
EBITDA	**HRK 3,831.1 mn**	**70**
Group net profit	**HRK 1,435.4 mn**	**830**
Total assets	**HRK 33,621.0 mn**	**2.8**
Number of employees	**14,016**	**-1.4**

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CHAIRMAN'S REPORT

DARKO HORVAT

CHAIRMAN OF THE SUPERVISORY BOARD

In 2010 HEP Group was able to consolidate its financial operations, maintain operating liquidity and provide the citizens and industry in the Republic of Croatia with a competitive, quality and uninterrupted supply of electricity, heat energy and gas.

TOGETHER WITH FULFILLING THE MAIN OBJECTIVES, HEP d.d. Management Board successfully carried out a number of measures aimed to improve operating efficiency, in accordance with the conclusions of Croatia's Government set out for management boards of state majority-owned companies. The number of employees was reduced, staff costs decreased and since July 2010 payments to creditors have been made as they fall due.

Efficiency improvement and operational transparency in particular were also helped by the implementation of HEP Action Plan for the implementation of Anti-Corruption Program for State Majority-Owned Companies for the Period 2010-2012. The Anti-Corruption Program, which is based on the Government's Anti-Corruption Strategy, gives a special emphasis on the strengthening of accountability and operational transparency, creation of conditions for prevention of corruption at all levels and zero-tolerance approach to corruption.

It can be said that last year was a turning point for HEP's future operations but also for electricity customers. Although the electricity market in Croatia was fully opened in 2008, when all conditions for the proper functioning of the market were fulfilled, it was not until 2010 that real changes took place when in addition to HEP Opskrba d.o.o. three suppliers outside HEP Group began to actively participate in the market. The number of supplier switches has continued to grow and other suppliers playing an active part creates new challenges.

In 2010, in the Ministry of the Economy, Labour and Entrepreneurship the most important activities of relevance to HEP Group were directed toward harmonization of energy legal framework with the EU legislation and toward preparation of implementing development documents of the Government in accordance with the Energy Development Strategy of the Republic of Croatia adopted in late 2009 by the Croatian Parliament. The Government, together with a consortium of consultants is about to complete the Strategy Implementation Program which will place the activities of the Strategy within three-year time frames and assess the financial value and time schedules of individual energy projects, aiming at and as part of the economic recovery of the Republic of Croatia.

Already in 2009, the negotiating chapters relating to electricity were temporarily closed, namely Chapter 15 – Energy and Chapter 21 – Trans-European Networks, which means that we were able to successfully implement standard-related and other necessary adjustments of the energy sector. During 2010 a number of new regulations and/or amendments to pieces of primary and subordinate legislation were adopted which govern the functioning of electricity, heat energy and natural gas markets.

The European Union in 2009 adopted the third legislative package which consists of two guidelines for the organization of the internal electricity market and natural gas market, two regulations setting out conditions for network access for cross-border electricity exchange and access to natural gas transport networks, and a regulation establishing the Agency for the Cooperation of Energy Regulators. The time-limit for the implementation of measures prescribed by the third legislative package was March 3 this year so that the Republic of Croatia, being in the process of acceding to the European Union, during 2010 carried out numerous activities to adjust the national legal framework. As part of these activities HEP d.d. has been implementing organizational/legal status changes according to ITO model which has been chosen among the three possible models as the strategically best for the electricity sector.

The Energy Development Strategy of the Republic of Croatia sets out three basic energy goals for the period to 2020: security of electricity supply, competitiveness of the energy system and sustainability of energy development. The Strategy pays special attention to the development of the electricity sector since Croatia at present imports more than 20 percent of electricity. The strategic goal is to cover domestic needs with domestic production in the year 2020. The construction of new base-load power plants is therefore of primary importance for future security of supply.

In that sense, the Government of the Republic of Croatia, in April 2010, in its special Conclusion, determined the priority of construction of electric power structures for production, transmission and distribution. In September 2010 the Government determined Catalogue of Investment Projects of interest for the Republic of Croatia in which projects in the area of energy are strongly present, especially power plant construction projects, among which I single out the combined-cycle cogeneration unit fired by natural gas at Sisak TPP, a replacement unit at Plomin TPP and Ombla hydro power plant.

In meeting the objectives of greenhouse gas emission reduction, a significant contribution is expected from renewable sources. Therefore, giving full support to the plans for construction of generating plants that use renewable sources such as the wind farm Krš-Pađene and bio-power plant at Velika Gorica, the Ministry of the Economy, Labour and Entrepreneurship has given high priority to these projects within WBIF (Western Balkan Investment Framework) regional fund.

Considering the fact that HEP Group in 2010 remained one of the largest investors in Croatia, we can conclude that it is necessary to launch a greater investment cycle, especially if one bears in mind that the energy sector is an important driver of the economic recovery and further economic development of the Republic of Croatia. In addition, before joining the EU, Croatia should create conditions for secure energy supply and reduce its import dependence. Our obligation, as a future EU member state, is to meet our energy needs in our territory and to secure for them reserve supply sources of sufficient and competitive energy.

A HEP Group priority task and a strategic determinant of the Government is a continuous presence of HEP Group in inter-state projects to connect electricity transmission systems and in other energy projects of interest for the Republic of Croatia. We expect HEP Group as a strong and integral energy company to continue to provide Croatian citizens and industry with sufficient, competitive and reliable energy supply and to advance in the common European energy market as a participant and an important factor of the regional energy policy.

PRESIDENT'S REPORT

LEO BEGOVIĆ

PRESIDENT OF MANAGEMENT BOARD

As announced in last year's Report, the priority of the Management Board in 2010 was to consolidate in general HEP's financial position while strengthening its financial discipline, and in relations with third parties to strengthen transparency and trust of all HEP's stakeholders.

IN 2010 HEP GROUP made an operating income of 12.9 billion kuna with a net profit for the year of 1.44 billion kuna, which is a significant profit growth compared to 2009 (154.4 million kuna). This growth was due to reduction in electricity production costs and to the implementation of the measures in our business operations with which we achieved savings and reduced manageable general costs and payroll costs.

The business operations in 2010 unfolded in the circumstances of the global recovery from the consequences of the economic crisis and stagnation of economic activities in Croatia. The recovery of the world economy prompted price growth of fuel and electricity but the prices never returned to the level they reached in the first half of 2008.

After energy demand in Croatia fell in 2009, there was a little growth in consumption in 2010. The very favorable hydrological conditions with record water inflows allowed HEP to achieve record electricity production in its hydro power plants and to reduce import and thermal power plant-generated electricity.

In 2010, the total electricity turnover was 19.8 TWh of which 15.8 TWh was produced in power plants owned wholly or partly by HEP and the remaining 4 TWh was procured on the market. We met the needs for electricity in Croatia in the amount of 17.9 TWh and sold 1.9 TWh on neighboring markets. Domestic consumption, after the 2009 fall, grew by 1.4 percent in 2010.

The year 2010 is significant for future operations of HEP as the main supplier of electricity in Croatia. During the year other licensed suppliers outside HEP Group began their activities and a smaller number of customers left HEP Opskrba, whereby the electricity market in Croatian actually began to really open.

In 2010, HEP remained one of the largest investors in Croatia. The priority was to continues and/or complete construction of electricity and heat generating facilities (the new unit in Sisak TPP, Lešće HPP, and a new unit at TE-TO Zagreb, which successfully passed test production phase). In the transmission activity, the largest facility was put into operation, the 2x400 kV Ernestinovo-Pecs (Hungary) line. The reconstruction of the hot water network in Zagreb and Osijek, financed by a World Bank loan, was completed.

We have been 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. The Strategy envisages the construction of 2,700 MW in base-load capacity of which 300 MW in large hydro power plants and 2,400 MW in thermal power plants, and it also sets forth a possible launching of a nuclear energy program. It also encourages intensive construction of renewable energy sources. In April 2010, the Government adopted the Conclusion about determination of priorities of construction of electric power plants and facilities, and in September the Inventory of investment projects of interest for the Republic of Croatia in which energy projects are strongly represented, especially power plant construction projects.

These are, above all, the Ombla hydro power plant near Dubrovnik, for which open tendering is being prepared, and a replacement unit at Plomin thermal power plant, for which siting permit procedure is underway. We have been planning, developing and building all our new projects in accordance with best available techniques, complying with increasingly strict environmental standards. Construction of generating plants and other power facilities, of which I single out the Plat transformer station within the Dubrovnik Program (whose construction began at the end of 2010), goes toward the achievement of our 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 achieving the strategic goals the most valuable resource and support is our employees. That is why we pay an increasing attention to the development and application of state-of-art human resource management techniques which aim at preparing the company and its employees for open market competition. New people are employed on the basis of published procedures and for scholarship recipients a standardized selection procedure is conducted. In the area of relations with employees, we confirm that all employers within HEP Group have fulfilled all prescribed or agreed obligations toward the registered trade unions and toward workers. One of the results of the good cooperation I would mention here is the agreement of HEP Group employers and all four trade unions regarding the entering into the new Collective Agreement for HEP Group, in operation since January 1, 2011.

A considerable portion of HEP's activities over the last decade, including 2010, was related to the implementation of the provisions and requirements of numerous new laws and regulations adopted to harmonize the national legal framework with the EU legislation. In early 2010, the Act Rescinding the Hrvatska Elektroprivreda Privatization d.d. Act was passed, and some fifteen other pieces of legislation were adopted until the end of the year governing the markets of electricity, heat energy and natural gas. Of the current obligations, I would mention those relating to the harmonization of the legal framework with the changes brought about by the so-called third energy package of the European Union. For HEP, the most important are the activities conducted to implement ITO (Independent Transmission Operator) model which has been chosen out of three possible models as the strategically best for the electricity sector.

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. Therefore, besides maintenance of a high degree of liquidity, in our business plan 2011 we have increased the funds intended for investments and maintenance of power plants and facilities. In this investment cycle we see domestic industry and domestic construction as potential business partners.

COMPANY PROFILE

MISSION, VISION AND BASIC VALUES

HEP GROUP COMPANIES

LEGAL FRAMEWORK

STRATEGIC OBJECTIVES AND DEVELOPMENT

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SHORT HISTORICAL OVERVIEW

MISSION, VISION AND BASIC VALUES

We are an energy company whose business activities in the area of the Republic of Croatia are more than a century old. To ensure a high-quality service to all our customers on a least-cost basis we support the principles of an environmentally acceptable production of electrical and heat energy, and energy efficiency and sustainable business.

We are active:

- within HEP Group, supporting and uniting the business strategies and processes of subsidiary companies based on corporate principles
- outside HEP Group as a socially responsible company, networking with all interested parties for the common good and societal wellbeing, promoting and encouraging the progress of the energy industry supported by new information and communication technologies.

MISSION

To provide secure and quality energy supply to customers, with a high degree of social responsibility.

VISION

High-quality and responsible energy company of the future offering services according to customer wishes and demands, based on constant availability, security and reliability of its services in the conditions of 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 for the company. 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 towards 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 acceptable manner. We promote efficient use of energy among our customers as well as development and use of renewable energy sources.

HEP GROUP COMPANIES

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

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

HEP-Operator prijenosnog sustava d.o.o. (HEP Transmission System Operator) is responsible for the transmission of electricity produced by 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

The Republic of Croatia has been systematically harmonizing its legal framework for the energy sector with the relevant 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 time-limit for the implementation of the measures laid down in the third energy package was March 3, 2011. Because Croatia is now in the EU accession process, numerous activities have begun to adjust the national legal framework to the changes required by the third package. HEP is carrying out preparatory activities for adjustment on the basis of ITO (Independent Transmission Operator) model which has been chosen out of the three possible models as strategically the most favorable for the electricity sector.

CHANGES IN THE NATIONAL ENERGY SECTOR LEGAL FRAMEWORK IN 2010

Within the legal framework governing the functioning of electricity, heat energy and natural gas markets, in 2010 the following pieces of primary or subordinate legislation were amended:

- The Act Amending the Heat Energy Production, Distribution and Supply Act
- The Act Rescinding the Hrvatska Elektroprivreda d.d. Privatization Act
- Amendment to the Tariff System for the Services of the Energy Activities of Production, Distribution and Supply of Heat Energy, without the amount of tariff items
- Amendments to the Tariff System for Electricity Supply, with the exception of eligible customers, without the amounts of tariff items
- Amendments to the Tariff System for Electricity Production, with the exception of eligible customers, without the amount of tariff items
- Amendments to the Tariff System for Electricity Distribution, without the amount of tariff items
- Amendments to the Tariff System for Electricity Transmission, without the amount of tariff items
- Regulation on the amount and method of payment of concession charges for gas distribution and of concession for construction of the distribution system
- Amendments to the Tariff System for Natural Gas Distribution, without the amount of tariff charges
- Amendments to the Tariff System for the Services of the Energy Activities of Heat Production, Distribution and Supply, without the amount of tariff items
- Decision on the amendment to the Decision on the implementation of measures for mitigation of electricity price increase for citizens and households
- Regulation on the amendments to the Regulation on greenhouse gases emission quotas and method of emission units trading
- Rules on the organization of natural gas market
- Act Amending the Energy Act
- Amendments to the Rules on the electricity market functioning
- Decision on the implementation of a special measure for mitigation of price increase of natural gas in households in 2011

OPENING OF THE ELECTRICITY MARKET

The electricity market in Croatia has been fully opened since July 1, 2008. Although all conditions were fulfilled at that time for the market to properly function, real changes happened in 2010 when, besides HEP Opskrba, three suppliers outside HEP Group began to actively participate in the market. Specifically, in the second half of 2010 first cases of supplier switch occurred, especially in the public sector, based on open tendering procedures. The supplier switching rate continues to grow and active participation of suppliers outside HEP Group requires certain qualitative changes in the market regulation, among other things, amendments to the Electricity Market Act and to the Electricity Act. These changes are also required by the EU directive, which will additionally influence the electricity market in Croatia to improve.

ENERGY STRATEGY

The Energy Development Strategy of the Republic of Croatia (official gazette Narodne Novine130/09) sets three basic energy objective for the period to 2020: security of electricity supply, competiveness of the energy system, and sustainability of energy development.

For the electricity sector, it is projected that the average annual growth of total electricity consumption by 2020 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; in 2012 the Croatian Parliament is expected to take position on a potential construction of a nuclear power plant based on preliminary work and investigations.

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 the share of production from large hydropower and renewable energy sources in total electricity production at present level in the period to 2020 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.

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 2010, the Government adopted two documents very important for the functioning and development of the Croatian electricity sector – Conclusion about the determination of priorities of construction of electric power projects, and a Catalogue of projects of interest for the Republic of Croatia, in which projects in the area of energy, especially construction of power plants, are strongly present.

ELECTRICITY PRODUCTION

The Government's Conclusion announces the implementation of the following generating plants:

- a combined-cycle cogeneration unit fired by natural gas at Sisak TPP (230 MWe, 50 MWt);
- a 500 MW coal-fired replacement unit at Plomin TPP;
- multi-purpose hydropower plant on the Sava (120 MW, expected annual production 600 GWh);
- Ombla hydropower plant (68 MW, expected annual production 223 GWh);
- hydropower system of the Lika and the Gacka (Kosinj reservoir, Kosinj HPP, Senj 2 HPP –additional 400 MW and 450 GWh);
- two natural flow hydropower plants of 50 MW each on the Drava (Molve 1 and Molve 2).

Among the investment projects of interest for the Republic of Croatia, there is also Dubrovnik II HPP as well as renewable energy sources.

To finance the construction of Ombla HPP, HEP intends to secure funding from an international financial institution while the replacement unit at Plomin TPP is currently in the phase of obtaining the siting permit and of preparing for selection of partners for the project implementation.

In 2010, the construction of Lešće HPP (42 MW) was completed and the construction of a new unit at Sisak TPP continued.

In the area of renewable electricity sources, HEP is developing the wind power project Krš Pađene (100 MW), expected to be put into service in 2013, and a biomass power project, Velika Gorica, of 20 MWe and 35 MWt (also on the list of investment projects of interest for Croatia).

In addition to construction of new generating plants, replacement of equipment, reconstruction and refurbishment work on existing plants has been continuously carried out, the most extensive of which is the refurbishment of Zakučac HPP.

ELECTRICITY TRANSMISSION AND DISTRIBUTION

The Government's Conclusion prioritizes construction of electricity transmission and distribution projects:

- Dubrovnik Program (TS 220/110/35/20(10) kV Plat with associate power lines and TS 110/10(20) kV Srđ with associated power lines);
- electricity system control function;
- Program Rijeka – stage 2 (TS 110/20 kV Turnić, TS 220/110 kV Pehlin – replacement plant 110 kV, 2x110 kV Pehlin-Turnić cable, 110 kV Pehlin-Zamet-Turnić cable, 110 kV Turnić-Sušak cable);
- 2x110 kV Vinodol-Melina line; replacement of power lines in the Zagreb area (2x110 kV Rakitje-Botinec line and 2x110 kV Samobor-Rakitje line).

The construction of a double-circuit 400 kV transmission line toward Hungary, Ernestinovo-Pecs, was completed in 2010 and a state-of-the-art information system was introduced which supports all functions necessary for the proper functioning of the electricity market. In December 2010, construction began of TS Plat with associated power lines, as part of the Dubrovnik Program which is scheduled for completion in 2013.

It is planned to step up the modernization and construction of a new distribution network in order to meet the growing needs for electricity and for connection of new customers, especially in major cities, tourist and industrial zones.

GAS BUSINESS

The long-term business policy of HEP is to participate in the gas business at several levels.

The activities of natural gas distribution and supply have been continuously developed. Based on a concession right to build a gas network and to supply gas to customers for a period of 30 years, gas network expansion started in 2010 in the area of Slavonia and Baranja has continued into 2011.

Preparations are underway for an active participation in the development and construction of a LNG terminal on the Adriatic coast of Croatia as a significant alternative supply route.

DISTRICT HEATING

The refurbishment project of the heating networks of Zagreb and Osijek has been completed. It is planned to expand the district heating business in Sisak by building a new unit at Sisak TPP, which is in progress. In 2010, preparation of a number of projects to refurbish and build district heating systems in Zagreb and Velika Gorica continued.

OTHER

There is a project underway to introduce e-mobility, which represents a business leap into the future and the formation of a new customer base.

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, directly and in an organized manner taking part in learning about, 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
2009	Trial operation of the combined-cycle cogeneration unit L (100 MWe, 80 MWt) at TE-TO Zagreb
	Construction begins of a combined-cycle unit (230 MWe, 50 MWt) at Sisak TPP
2010	Trial operation of Lešće HPP (42 MW)
	2x400 kV Ernestinovo – Pecs (Hungary) power line in operation

CORPORATE GOVERNANCE

HEP d.d. ORGANIZATIONAL CHART

In accordance with the HEP Group corporate governance model, 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. 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**
  - 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.
- **BOARD MEMBER FOR SUSTAINABLE DEVELOPMENT & QUALITY**
  - 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.
- **PRESIDENT OF MANAGEMENT BOARD**
  - 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.
- **BOARD MEMBER FOR PRODUCTION BUSINESSES IMPROVEMENT & QUALITY**
  - HEP PROIZVODNJA d.o.o.
  - HEP TOPLINARSTVO d.o.o.
  - TE PLOMIN d.o.o.
- **BOARD MEMBER FOR TRANSMISSION & DISTRIBUTION BUSINESSES IMPROVEMENT & QUALITY**
  - 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,
5. carries out other work in accordance with the law and corporate rules and regulations

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.

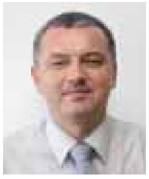
MEMBERS OF GOVERNING BODIES

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

SHAREHOLDERS ASSEMBLY

ĐURO POPIJAČ
Chairman of Shareholders Assembly
Minister of Economy, Labor and Entrepreneurship

SUPERVISORY BOARD



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

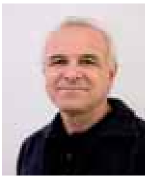
DRAŽEN BOŠNJAKOVIĆ
Vice Chairman of Supervisory Board, State Secretary at the Ministry of Justice

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

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
Petra Subašić	Acting 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 and General Affairs Department

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

GENERAL SHAREHOLDERS ASSEMBLY 2010

The annual meeting of the General Shareholders Assembly was held on June 30, 2010. The Assembly was presented with the Annual Report on the state of affairs and operations of HEP d.d. and HEP Group in 2009; report of the Supervisory Board on the supervision conducted over HEP d.d. conduct of operations in 2009; consolidated and non-consolidated annual financial reports of HEP d.d. and HEP Group for 2009 including Independent Auditor's Report. Decision was adopted on the use of operating profit for 2009 and retained earnings from previous years. The Assembly carried out the Government's Conclusion which proposed Darko Horvat for a new member of the Supervisory Board of HEP d.d. since Branimir Horaček had resigned from the position of the president and member of the Supervisory Board.

AUDIT

INDEPENDENT AUDITOR

At the meeting held on December 8, 2010, 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, 2010.

INTERNAL AUDIT AND RISK MANAGEMENT

Internal Audit and Risk Management Department is responsible for the corporate function of internal audit and risk management. The Department is a part of the internal supervision of HEP d.d. and HEP Group, which consists of an internal control system, internal controls, controlling, treasury and other forms of internal supervision (inspection, management accounting, IT, etc.)

The management is responsible for overseeing the business operations and for the establishment and functioning of internal control systems, and the internal audit is responsible for verifying how they function. During 2010, HEP d.d. Management Board adopted decisions and guidelines for the establishment of internal control systems in HEP Group.

In 2010, the Department carried out internal audits in line with the internal audit program and submitted reports thereon. The purpose and the 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.

Reports on the internal audits carried out were submitted to HEP d.d. Management Board and management, giving an objective assessment of the state of affairs and business processes, internal control systems, HEP's compliance with laws and internal rules and regulations, meeting of objectives and tasks of the business policy, etc. The reports give a separate assessment of the adequacy, efficiency and effectiveness of the internal control system and of risk management.

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

Valid certificates for environmental management standard **HRN EN ISO 14001:2004** within HEP Group are owned by:

- in HEP Proizvodnja d.o.o. – TE-TO Zagreb (BVQI), EL-TO Zagreb (DNV), KTE Jertovec (DNV), hydro production areas North and West with all hydro power plants included (SGS);
- in HEP ODS d.o.o. – Elektra Zagreb (BVQI)
- in HEP OPS d.o.o. – Transmission Area Zagreb (BVQI)

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

All hydro power plants in HEP Group have valid **certificates of electricity production from renewable sources** (TÜV).

HEP'S BUSINESS OPERATIONS IN 2010

BUSINESS ENVIRONMENT

FINANCIAL RESULTS ACHIEVED

RESULTS BY ACTIVITY

FINANCIAL POSITION

INVESTMENTS

CREDIT RATING

BUSINESS ENVIRONMENT

ONE OF THE MAIN OBJECTIVES of the Management Board in 2010, besides secure and reliable supply of electricity, heat and natural gas to domestic customers, was to consolidate the financial state of the Group. In addition, conclusions and demands posed by the Government on management boards of state-owned companies related to reduction in the number of employees and payroll costs, and to fulfilling of obligations towards creditors by due dates. Therefore, a whole series of measures was undertaken to improve efficiency of business operations, which contributed to achieving these objectives.

Business operations in 2010 were carried out in the circumstances of global recovery from the consequences of the economic crisis. Neighboring countries as well as most European countries, but not Croatia, achieved growth in economic activities. The prices of oil, coal, gas and electricity rose during 2010, but the uncertainty about the pace of recovery of the world economy kept them below the level they were at before the crisis.

The fall in the consumption of electricity, heat and gas, which occurred in 2009, was stopped and consumption somewhat rose in 2010. With above-average hydrological circumstances, a record electricity production was achieved by hydropower plants allowing lower production by thermal power plants and lower electricity purchase on the market. Thanks to such a structure of electricity sources, production costs decreased despite increased fuel prices.

In addition to reducing production costs, cuts in other operating costs, namely manageable general costs and payroll and other employees' receipts, were planned and achieved.

The income growth achieved as a result of growth in consumption of electricity, heat and gas, as well as decreased costs of production and electricity purchase allowed the Group's liquidity to improve satisfactorily. Since July 2010 all HEP Group companies have been fulfilling their obligations toward suppliers by due dates. However, due to illiquidity and unemployment in Croatia, problems in debt collection from customers continued so that provisions for uncertain debt as well as their share in total accounts receivable increased.

In order to financially consolidate the Group, with an emphasis on liquidity improvement, the planned scope of investment in construction, replacement and reconstruction of energy plants, networks and facilities and other investments was reduced for 2010. Investment priority was given to the completion of significant construction projects in progress, which increase the Group's electricity and heat generating capacity (Lešće HPP and new units at TE-TO Zagreb and Sisak TPP), preparation of new power plant construction projects and all investments necessary for the safety and reliability of energy systems of the Group.

In spite of the curtailed investment plan, the actual investment in construction of new plants and in replacement and reconstruction of existing facilities amounted to almost 1.7 billion kuna whereby the Group retained the position of being one of the largest investors in Croatia. The new hydro power plant Lešće – the first hydropower plant to have been built in Croatia since the country's becoming independent, was connected to the electricity system. Of the new generating facilities, HEP is preparing construction of the Ombla hydro power plant, 68 MW, and a replacement coal-fired unit of 500 MW at the Plomin power plant.

The prices of electricity and heat for domestic customers have not changed during 2010. Only the selling price of gas in the supply activity increased, as a consequence of the simultaneous increase of gas purchase price approved by the Government at the beginning of the year.

In September, the rating agency Standard&Poor's downgraded the credit rating of Hrvatska elektroprivreda from BB+ to BB, and in December, as a consequence of the downgrade of sovereign credit rating, to BB- with stable outlook. Since one of the weaknesses of the Group is a relatively short maturity of long-term debt, the financial consolidation included the restructuring of debt maturity. Some short-terms loans were repaid and the use of short-term credit lines was reduced. New loans, agreed in the first quarter, totaling 110 million euro with a 5 year maturity are being used, in addition to investment financing, for the needs of working capital. For a new long-term loan agreement of 100 million euro, which ensures timely financing of planned investments and working capital in 2010, a government guarantee was used.

In 2010, the total electricity turnover reached 19.8 TWh of which 15.8 TWh was produced by power plants owned wholly or partly by the Group, and 4.0 TWh was procured in the regional market. For domestic customers' needs and coverage of network losses, 17.9 TWh was ensured and 1.9 TWh was sold in the regional market. Domestic electricity consumption increased in 2010 by 1.4 percent.

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 the beginning of the year), heat and gas. The procurement of electricity and fuels was also reliable.

During 2010, other suppliers, outside HEP Group, became active in the electricity market taking over some HEP Opskrba customers. Their market share is estimated to be up to 1 percent. Some business category customers, mainly with lower consumption, did not exercise their right to choose a supplier and they continued to be supplied by HEP Operator distribucijskog sustava. The share of eligible customers in the electricity sold in the domestic market increased to 48 percent.

FINANCIAL RESULTS

BASIC INDICATORS

	unit	2008	2009	2010	2010/2009
Electricity sales	TWh	17.7	17.5	**17.6**	**0.5%**
Electricity production	TWh	14.3	14.7	**15.8**	**7.6%**
Heat sales	TWh	2.2	2.2	**2.4**	**3.8%**
Gas sales	m^3 mn	166	157	**162**	**3.0%**
Operating income	HRK mn	11,889.4	12,600.8	**12,968.6**	**2.9%**
EBITDA	HRK mn	1,922.9	2,255.1	**3,831.1**	**70%**
Group net profit	HRK mn	31.1	154.4	**1,435.4**	**830%**
Total assets	HRK mn	32,635.4	32,711.1	**33,621.0**	**2.8%**
Investments	HRK mn	2,644.2	2,359.7	**1,693.3**	**-28%**
Number of employees		14,375	14,222	**14,016**	**-1.4%**

According to financial indicators HEP is one of the largest business groupings in Croatia. The business operations in 2010 unfolded in recession conditions and the main goal of consolidating the financial situation of the Group was achieved.

The favourable hydrological conditions, despite growth in energy input prices contributed to the significant decrease in variable production costs, and the implemented measures for efficiency improvement of business operations resulted in decrease in the costs of salaries and other workers receipts as well as in manageable general costs. This cost cutting together with increase in operating income, due to a slight growth in energy consumption, increased operating profit to 2,210.9 million kuna (567.7 million kuna in 2009). Group net profit is 1,435.4 million kuna of which 1,421.3 is attributable to equity holders of the parent.

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

	2008	2009	09/08	2010	10/09
Operating income	11,889.4	12,600.8	**6.0%**	**12,968.6**	**2.9%**
Operating expenses	11,600.1	12,033.1	**3.7%**	**10,757.7**	**-10.6%**
Operating profit	289.3	567.7	**96.2%**	**2,210.9**	**289%**
Group net profit	31.1	154.4	**396%**	**1,435.4**	**830%**
Net profit attributable to equity holders of the parent	11.7	135.8	**1,061%**	**1,421.3**	**947%**

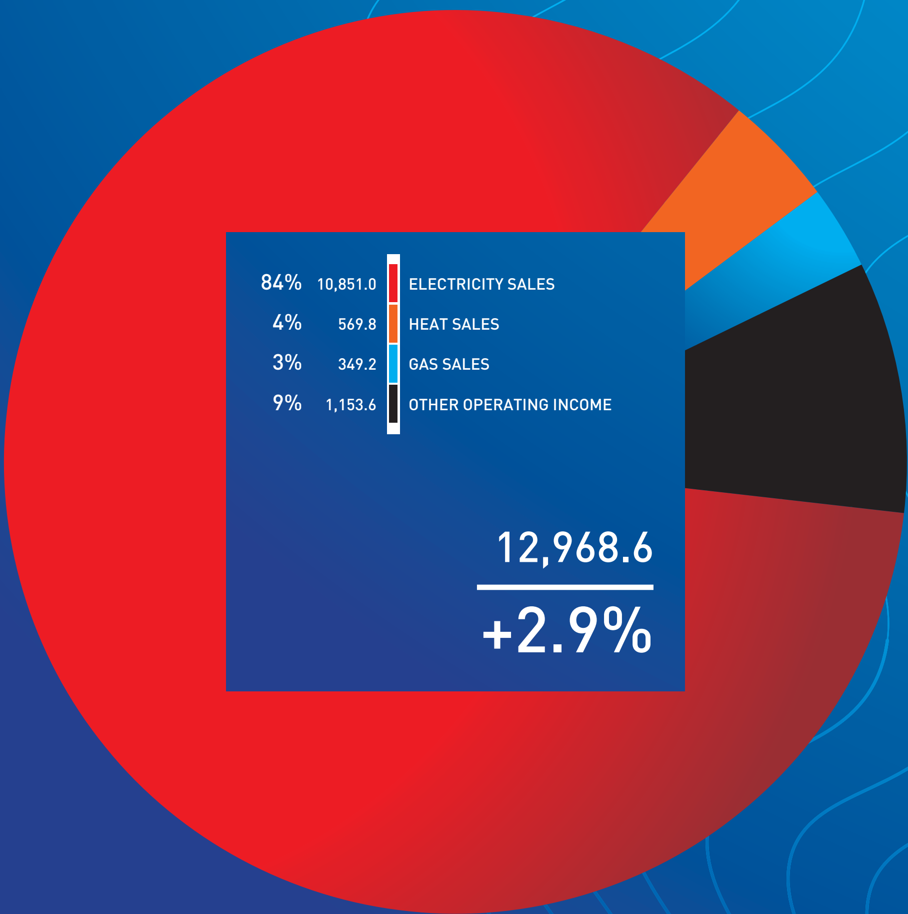
OPERATING INCOME

In 2010 the Group achieved an operating income of 12,968.6 million kuna. This is an increase of 367.8 million kuna over 2009. The growth in operating income is the result of increased income from electricity, heat and gas sales and from other operating income.

Income from electricity sales, which increased only 0.5 percent compared to the year before, accounts for 84 percent of the Group's operating income. Income from heat and gas sales makes a little over 4 percent and 3 percent of operating income, respectively.

Other operating income increased by 8.9 percent compared to the year before and in that group there was increase in network connection services, uncertain debt provided for was collected as well as income from default interest on accounts receivable.

OPERATING INCOME (HRK million)



OPERATING EXPENSES

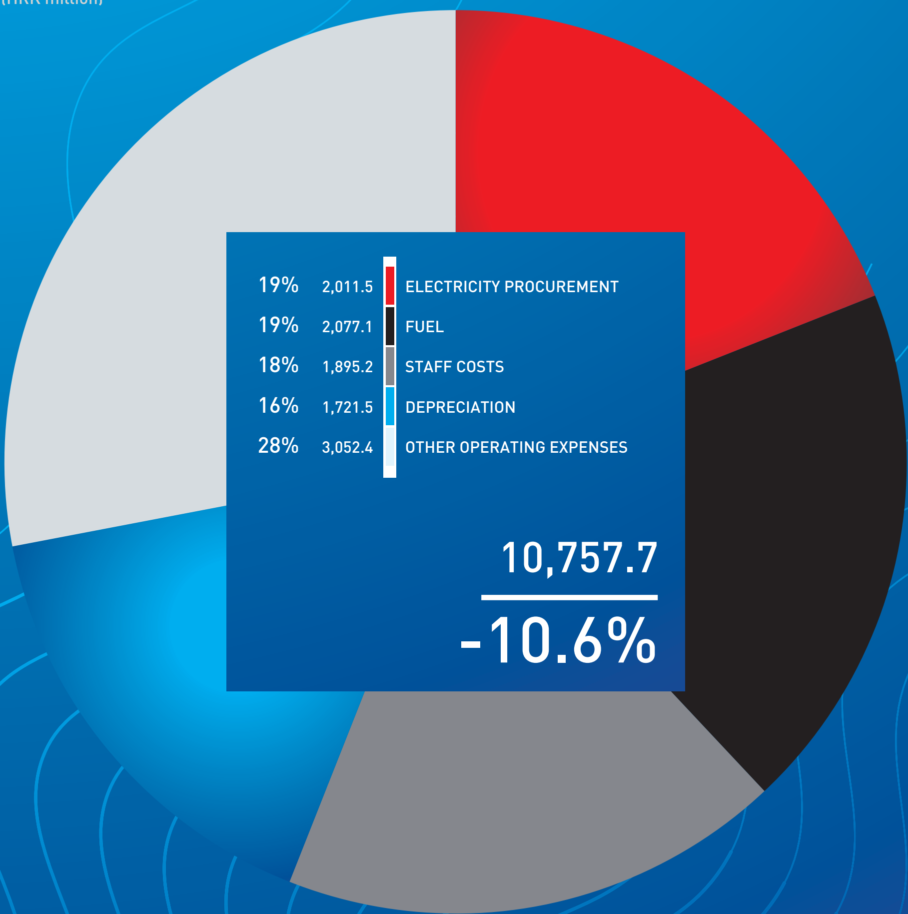
The Group's operating expenses in 2010 decreased by 1,275.4 million kuna to 10,757.7 million kuna. The decreased operating expenses are due to the implemented measures for reduction in staff costs and manageable general cost. The costs of production and purchase of electricity significantly decreased due to the impact of the following factors:

- favorable hydrology which made possible for hydro power plants to generate 8.3 TWh of electricity
- lower costs of electricity procured on the market by 31 percent,
- lower procurement of electricity by 17 percent,
- lower electricity production by oil-fired power plants due to which total electricity production by thermal power plants was lower by 8 percent.

Staff costs are determined in the Collective Agreement which links growth in salaries to the growth in Croatia's gross domestic product in the previous year. In 2010, annexes to the Collective Agreement were signed which reduce or modify some rights which, in addition to reduction in the number of employees, contributed to decrease in staff costs by 62 million kuna.

Other operating expenses increased by 6 percent, most of which is cost increase due to making of provisions for doubtful payment collection, for legal suits, unused annual vacations, severance payments in accordance with the Collective Agreement, costs of investment and damage in connection with contracts. The continuous measures reduced manageable costs within the group of general operating expenses by 49 million kuna.

OPERATING EXPENSES (HRK million)



RESULTS BY ACTIVITY

BUSINESS RESULT (HRK mn)

	electricity			heat energy			gas distribution		
	2009	**2010**	**10/09**	2009	**2010**	**10/09**	2009	**2010**	**10/09**
Operating income	11,669.8	**11,916.1**	**2.1%**	610.4	**629.7**	**3.2%**	320.6	**422.8**	**32%**
Operating profit	671.9	**2,356.6**	**251%**	-104.4	**-142.6**	**37%**	0.2	**-3.1**	

The greatest portion of the operating income (92 percent) as well as the total operating profit of the Group were achieved in the electricity business. A significant profit growth in that activity is a consequence of reduction in costs of production and purchase of electricity. Although the share of district heating in the income is only 5 percent, this business made an operating loss of 142.6 million kuna. The loss increased compared to 2009 because of fuel price increase – oil and gas, while at the same time heat energy price remained unchanged. The activity of gas distribution has the least share in operating income (3 percent). While the activity achieved an operating profit in 2009, in 2010 there was an operating loss of 3.1 million kuna, a key effect on which were provisions for uncertain debt.

ELECTRICITY

Production, transmission, distribution and supply of electricity are carried out by HEP Group in the entire territory of Croatia and the Group is the largest supplier of electricity. In 2010 an operating profit of 2,356.6 million kuna was achieved which is a much better business result compared to 2009, achieved due to reduction in operating costs.

Income from electricity sales amounted to 10,851.0 million kuna, of which 95 percent was realized from supply to domestic customers and 5 percent from sales in the regional market.

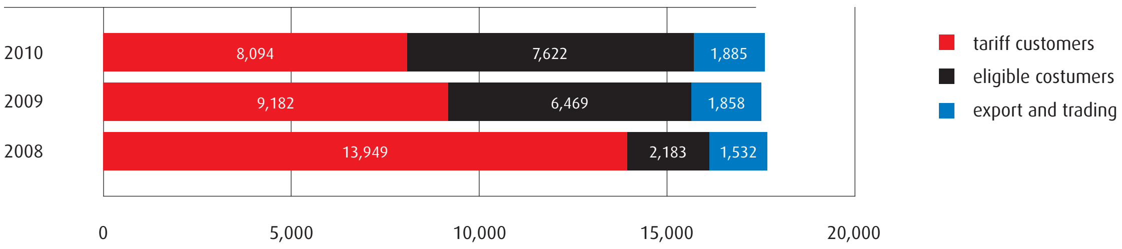
Power plants owned wholly or partly by the Group generated 15.8 TWh of electricity, which is 80 percent of total electricity turnover realized by the Group in 2010. In the generation mix, according to the quantity produced, hydropower plants domineer, achieving in 2010 their historical high of 8,309 GWh of electricity due to record water inflows. Therefore, production by oil-fired power plants was considerably reduced in 2010 as well as procurement of electricity on the market.

ELECTRICITY PRODUCTION AND PROCUREMENT (GWh)

	2008	**2009**	**2010**	**10/09**
hydro power plants	5,277	6,767	**8,309**	**23%**
thermal power plants	6,075	5,177	**4,787**	**-8%**
Krško nuclear power plant	2,986	2,730	**2,690**	**-1%**
electricity procurement	**5,229**	**4,898**	**4,046**	**-17%**

Sales to domestic customers amounted to 15.7 TWh of electricity, which is a mild growth of 0.4 percent, and the share of sales to eligible customers increased to 48 percent of the total sales in Croatia. At the end of the year, some customers chose electricity supplier outside HEP Group.

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 2010 of 142.6 million kuna. Due to the increase in heat production costs resulting from the increase in fuel prices of 18 percent and 14 percent on average for gas and oil respectively, the loss increased compared to 2009 by 38.2 million kuna. The necessary increase in selling prices was not approved so that the trend of growing loss returned after being stopped in 2009 owing to price increase of 16 on average.

Sales of heat and process steam were 2.37 TWh, which is 3.8 percent more than in 2009. 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.

GAS

The business of gas distribution and supply is performed in the areas of Osijek-Baranja, Virovitica-Podravina and Požega-Slavonia counties. In 2010, the business made an operating profit of 3.1 million kuna with gas sales growth of 3 percent. As with the heating business, consumption in this business is also greatly impacted by weather conditions during the heating season. In 2010, there was a further decrease in consumption by non-residential customers of 2 percent, while residential customers increased their consumption by 7 percent. As from January 2010, price increase was approved to distributors due to increase in gas purchase price, whereby this increased cost was transferred to customers. Due to payment collection problems, provisions for accounts receivable increased.

FINANCIAL POSITION

CONSOLIDATED BALANCE SHEET (ABRIDGED)

	Dec 31, 2009		Dec 31, 2010		10/09
	HRK mn	share	**HRK mn**	share	
Long-term assets	29,879.9	91%	**29,867.8**	89%	**0%**
Short-term assets	2,831.2	9%	**3,753.2**	11%	**33%**
Total assets	**32,711.1**	**100%**	**33,621.0**	**100%**	**3%**
Capital and reserves	18,248.1	56%	**19,679.9**	59%	**8%**
Long-term liabilities	9,810.1	30%	**9,948.1**	30%	**1%**
Short-term liabilities	4,652.9	14%	**3,993.0**	12%	**-14%**
Total liabilities and capital	**32,711.1**	**100%**	**33,621.0**	**100%**	**3%**

ASSETS

The value of total assets of HEP Group in 2010 increased by 909.9 million kuna to 33.6 billion kuna. The increase was achieved in short-term assets while long-term assets remained of approximately the same value as at the end of 2009 due to investment in construction, replacement and reconstruction of energy plants and networks being lower than annual value adjustment for depreciation. Long-term assets account for 89 percent of the value of the Group's assets.

The value of short-term assets is 3.8 billion kuna, an increase of 922.0 million kuna, with the greatest increase in the item of cash and cash equivalents. The most significant item in short-term assets is accounts receivable amounting to 1.7 billion kuna, which increased in 2010 due to worse payment collection. This is followed by inventories of materials, spare parts and energy fuel which amount to 1.1 billion kuna with an increase in the value of fuel inventories due to higher prices and quantities of oil and coal.

CAPITAL AND LIABILITIES

Capital and reserves at the end of 2010 amounted to 19.7 billion kuna with a share of 59 percent in the Group's total assets and an increase of 1,431.8 million kuna compared to 2009, due to the profit of the year.

The structure of liabilities did not change significantly, short-term liabilities decreased by 659.9 million kuna compared to the beginning of the year due to which their share decreased from 14 to 12 percent. Trade payables decreased as well as liabilities for short-term loans. Since July 2010, all GEP Group companies have settled their trade payables by due dates.

Long-term liabilities for loans and securities decreased, but the current portion of these liabilities whose repayment is due in 2011 increased. Long-term provisions for risks and costs increased due to provisions for legal suits, unused annual vacations, severance payments in accordance with the Collective Agreement, damage arising from contracts and increase in estimated costs of nuclear plant decommissioning.

Due to decrease in interest-bearing debt and increase in the value of capital and reserves, net debt to equity ratio decreased from 32 to 24 percent.

INVESTMENTS

In 2010 the value of the investments that were made by the Group was 1,693.3 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)

	2008	2009	2010	10/09
Investments in property, plant and equipment	2,644.2	2,359.7	**1,693.3**	**-28%**

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 2010 per company is given in the section Reports by HEP Group companies.

CREDIT RATING

In September 2010, Standard&Poor's downgraded Hrvatska Elektroprivread's credit rating from BB+ to BB, and in December, as a consequence of the downgraded Croatia's sovereign rating, to BB- with stable outlook.

HEP's credit rating:	BB- /Stable/	
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/	
September 23, 2010	BB /Negative/	
December 22, 2010	BB- /Stable/	

REPORT ON IMPACT ON HEP GROUP STAKEHOLDERS

SOCIAL RESPONSIBILITY

BASIC PRINCIPLES IN RELATIONS WITH STAKEHOLDERS

ANTI-CORRUPTION PROGRAM

EMPLOYEES

CUSTOMERS

DONATIONS

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
- Code of Ethics of the Croatian Chamber of Economy
- Code of Corporate Governance (Zagreb Stock Exchange and HANFA);

and membership in social responsibility organizations and initiatives:

- 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 PRINCIPLES IN RELATIONS WITH STAKEHOLDERS

To achieve our **mission** and to fulfill our **vision**, we align all our business operations with expectations of **all stakeholders**, 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.

ANTI-CORRUPTION PROGRAM

In 2009, the Government of the Republic of Croatia adopted Ant-Corruption Program for state majority-owned companies for the period 2010-2012 which includes HEP d.d. The Anti-Corruption Program is based on the Anti-Corruption Strategy adopted by the Government in 2008 and on the Action Plan, the implementation of which involves government authorities. The guidelines, solutions and objectives set in the Anti-Corruption Strategy and Action Plan apply also to the operations of public enterprises, with a particular emphasis on the strengthening of responsibility and transparency, creating of conditions for corruption prevention at all levels and promoting zero-tolerance to corruption.

At the beginning of 2010, HEP adopted an Action Plan which defined the responsibilities and time-limits for completion of actions. As part of the Action Plan the following measures and actions have been carried out:

- Documents were defined and published: Mission, vision and basic value of HEP Group; Basic principles in relations with stakeholders; and Code of Ethics.
- In the area of procurement and contracting, at HEP's website all HEP Group public procurement notices are posted as well as an overview of contract awards and implementation. In the procurement procedures involving higher values the tenderers are obligated to sign an Integrity statement, whereby they guarantee their correctness in the public procurement procedure, no corrupt practice or fraud and they express their agreement that an independent audit be performed of the public procurement procedure.
- The website includes postings of job vacancies.
- In HEP Group companies, ethics commissionaires were appointed who constitute the Ethics Commission at HEP Group level; these persons are in charge of receiving reports of irregularities in business operations. Contact data and/or reported unethical behaviour or irregularity are posted on HEP's intranet and on its website.
- A list of duties and job titles assessed as being at high risk for corruption has been determined. Employees in such positions sign a Confidentiality and Impartiality Statement in which they confirm that in the previous year they had carried out all their duties in accordance with laws, regulations and company's internal rules, acting in the process completely objectively, independently and impartially, securing the confidentiality and non-disclosure of business information in compliance with the company's internal rules and that in the next year they would act in the same manner. Also, these employees attend an internal education program – Corruption Prevention and Business Ethics. Appropriate educational material is available to them and to all other employees on the intranet.
- A list of decisions made by the Management Board with the consent from the Government of the Republic of Croatia is published on the website.
- An Information Catalogue is published on the website.

EMPLOYEES

NUMBER OF EMPLOYEES

On December 31, 2010 of the total of 14,016 employees, 13,990 were employed on a permanent basis and 22 on a temporary basis (of which 6 trainees on a temporary basis) and 4 employees were on unpaid leave.

NUMBER OF EMPLOYEES BY HEP GROUP COMPANY (DECEMBER 31, 2010)

HEP Group company	No. of Employees		Change
	2009	2010	2010- 2009
HEP-Operator dstribucijskog sustava d.o.o.	9,525	**9,370**	-155
HEP-Proizvodnja d.o.o.	2,336	**2,311**	-25
HEP-Operator prijenosnog sustava d.o.o.	1,250	**1,239**	-11
HEP d.d.	423	**424**	1
HEP-Toplinarstvo d.o.o.	355	**336**	-19
HEP-Plin d.o.o.	140	**139**	-1
HEP-Opskrba d.o.o.	57	**61**	4
Crpna stanica Buško Blato d.o.o.	42	**43**	1
APO d.o.o.	25	**26**	1
HEP-ESCO	20	**19**	-1
HEP-Trgovina d.o.o.	16	**16**	0
HEP-Odmor i rekreacija d.o.o.	14	**13**	-1
Ustanova HEP-Nastavno-obrazovni centar Velika	11	**12**	1
HEP-Obnovljivi izvori energije d.o.o.	8	**7**	-1
HEP Group TOTAL	**14,222**	**14,016**	**-206**

QUALIFICATION STRUCTURE

Qualification		(%)
DSc and MSc	146	1
BSc	2,063	14.7
Assoc. degree	1,082	7.7
Secondary sch.	5,962	42.5
Element. sch. / semi-skilled	808	5.8
Highly skilled	2,211	15.8
Skilled	1,744	12.4
TOTAL	**14,016**	**100%**

AGE STRUCTURE

Years of age	No. of Employees
under 20	0
20-25	116
25-30	660
30-35	1,187
35-40	1,665
40-45	1,765
45-50	2,169
50-55	2,584
55-60	2,554
60-65	1,316
TOTAL	**14,016**

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.

Since the Collective Agreement for HEP Group was to expire on June 30, 2010, on April 7, 2010 the first meeting was held of the negotiating committees of trade unions and employers concerning a new Collective Agreement. On June 10, 2010, Addendum 1 to the Collective Agreement was made and on July 23, 2010 Addendum 2 was made which, along with certain modifications and amendments, extended the period of the agreement to December 31, 2010. The negotiations over the new Collective Agreement resumed on October 5, 2010 and ended on December 7, 2010 with an agreement between HEP Group employers and all four trade unions concerning the conclusion of the new Collective Agreement for HEP Group, which came into force on January 1, 2011.

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 trainees 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.

EDUCATION AND TRAINING

In line with employee qualification structure and the need for constant professional improvement of employees at all levels, HEP has invested significant financial resources in education and training, sending its employees to various types of educational and professional improvement and training courses. Especially significant is participation by HEP's specialists at gatherings such as HRO CIGRE, MIPRO, Energy Day Forum and other professional meetings in Croatia and abroad.

In 2010 the HR Department followed trainees on a continuous basis, providing an additional educational course "Communication skills and business etiquette", which is a mandatory part of trainee education and development and whose implementation is planned in all of HEP Group.

Education for secretarial and administrative staff was also continuously provided as "Business correspondence" and two internal educations "Presentation skills" (for trainees) and "Management" (for lower management).

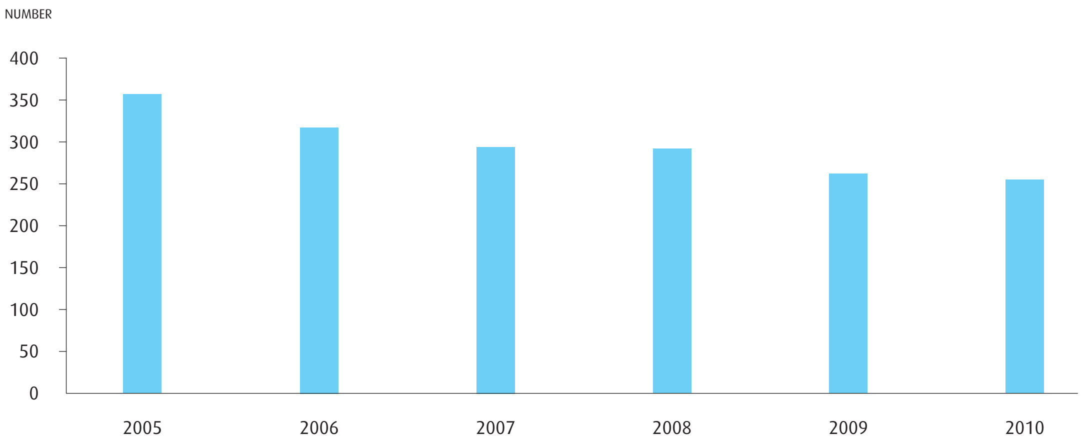
As part of the List of Measures for improvement in business processes and operating cost reduction in HEP Group, the proposal of the Human Resources Department for the establishment of an internal training center was accepted. The internal training center and a multi-disciplinary team of internal trainers from various areas (energy, law, economy), who design and implement internal education according to employees' needs, will raise the level of knowledge on the overall organizational level, with the aim of employees' participation in exchange and evaluation of knowledge.

Through the mandatory use of the software application Records of Education, education was systematically followed by type of education at HEP Group level and the necessary reports were defined in cooperation with The IT and telecommunications Department.

HEALTH AND SAFETY AT WORK

Health and safety at work in HEP has a significant position in the company's business operations. 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 with the aim of decreasing the number of injuries at work and thereby decreasing the costs. The number of injuries at work has been falling from year to year, the most in HEP Operator distribucijskog sustava d.o.o.

NUMBER OF INJURIES IN HEP GROUP (2005-2009)



In 2010, due to injuries at work, 15,525 work days were lost or 124,201 work hours, which represents a direct cost. Considering that indirect costs are up to six times the direct costs, all investments in safety at work are justified.

Since relevant laws include injuries occurring to and from work into injuries at work, these significantly increase the total annual number of injuries. In 2010 there were 55 such injuries out of a total of 255, which makes about 21 percent of the total number of injuries.

Of the total number of injuries at work, 179 occurred at workplace, 12 on business travel and 12 elsewhere. There was a total of 30 serious injuries at work. Of the total serious injuries, 23 occurred at workplace, seven on the way to/from work. Of the 23 injuries at workplace, seven were due to electric arc and touch with live conductors, 15 were due to fall (on a slippery terrain, stairs, ladder) and one was due to a wire striking the eye. The injuries that occurred at workplace during normal work were mostly due to non-compliance with safety measures.

Of the total number of serious injuries that occurred at workplace, the Croatian Health and Safety at Work Office did not recognize six injuries because workers had not applied the prescribed safety at work measures so they did not have the right to a privileged sick leave.

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

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.

RELATIONS WITH ELECTRICITY CUSTOMERS – HEP ODS

The main tasks performed within the network and supply activity of HEP Operator distribucijskog sustava d.o.o. (HEP ODS) are: electricity supply to customers in the public supply service system and provision of use of network service to all customers/users of the distribution network. The activities of HEP ODS are directed towards improving of electricity supply quality and providing of services, trying to recognize customer wishes and needs in the process.

Although as part of optimization of business processes HEP ODS in 2010 began the process of ending the service of receiving payments in its own premises, paying electricity bills without extra charge is still possible at all FINA and Croatian Postal Service offices. Customers can also pay their electricity bills by direct debit set up with commercial banks or credit card companies.

During 2010, HEP ODS website (www.hep.hr/ods) was expanded to include additional information and services to customers such as receiving questions, meter reading submission, access to previous period consumption, balance of account and overview of payments, price information, laws and regulations and news pertaining to electricity supply disruption due to planned works. Customer telephone number 9820 was replaced with a new system (0800 300 4xx) covering the entire territory of Croatia. The number can be used by customers to submit meter reading, file a complaint or receive the information they need. Besides the website and customer telephone, in each distribution area customers can communicate directly – submit meter reading, receive the information they need or file a complaint.

Supply Sections in each distribution area responsible for billing and payment collection for the electricity supplied and for network use charges. They systematically follow and record provision of services, information and complaints and process 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

In its business operations HEP Opskrba d.o.o. is driven primarily by the basic principles of a competitive market which means that the customer comes first. The company seeks to anticipate customer needs, inform and provide its services to customers at the highest quality possible, taking care that the product it offers has certain specific characteristics and the that the sale of the product and service to the customer has certain laws.

The priority is to provide fast information to customers using all possible modern communication options in order for the customers to have all relevant information quickly and at a time most convenient to them. Available to HEP Opskrba customer are Call Center, website and Facebook. Regular updates are made to facilitate the finding of information.

Despite the strengthening of online communication, HEP Opskrba employees in 2010 responded to about 35,000 Call Center calls and sent more than 1,000 written answers. Besides, customers had at their disposal personal customer assistant and also received information by postal letters and promotional leaflets and twice a month through Newsletter with news and matters and events of interest from the area of energy.

In accordance with the legal obligation, but even more as an expression of social responsibility, HEP Opskrba informs its customers and encourages them to use electricity efficiently. For key customers the company organized in 2010 participation in ZUKE Conference where energy efficiency specialists presented to them the possibilities and effects of the application, legal framework and obligations of business entities in the application of energy efficiency.

In the next period HEP Opskrba will pay special attention to introducing additional services according to customer needs.

RELATIONS WITH HEAT CUSTOMERS (HEP TOPLINARSTVO)

Besides carrying out its main task – reliable and quality supply of heat energy to all customers, in 2010 HEP Toplinarstvo achieved an efficient communication with its customers.

In collaboration with HEP's IT and Telecommunications Department, the project to customize NAPTOP application to heat payment collection, developed as a new module for heat cost billing in accordance with legal requirements and customer needs, has been completed. New forms of heat bills have been designed which enable customers to see detailed data on billing and allocation of heat energy as well as data on the metering point and on heat meter reading.

Residential customer bills have begun to be marked with 2D bar code which allows bills to be paid more quickly and safely at Fina offices, Croatian Postal Service and banks, and since October 2010 bills have been issued to customers in closed envelopes to secure protection of personal details.

In order to maximize the quality of service, HEP Toplinarstvo renovated its customer counters at its Zagreb headquarters where customers can obtain all services related to payment of bills and change of personal details as well as information on heat billing, debt or default interest. Consumer telephone number is in place as well as the telephone number of 24/7 on-call staff for technical problems.

In 2010 HEP Toplinarstvo continued its good communication with heat customers by timely answering their questions and complaints, and by educating and informing customers in informative leaflet, mass media and notice boards in residential buildings.

RELATIONS WITH GAS CUSTOMERS (HEP PLIN)

Gas deliveries to customers in 2010 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 economic crisis additionally aggravated financial state in the economic and social environment so that in 2010 debt collection for natural gas sold, especially from commercial category customers, was difficult and outstanding receivables for gas sold increased compared to the year before.

COMPLAINT COMMISSIONS

As required by the Consumer Protection Act, commissions are in place 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 – 2010

Reason for complaint															**TOTAL**		
Billing			Inaccurate meter			Connection/ disconnection			Voltage conditions			Other			TOTAL	ACCEPTED	REJECTED
TOTAL	ACCEPTED	REJECTED	TOTAL	ACCEPTED	REJECTED	TOTAL	ACCEPTED	REJECTED	TOTAL	ACCEPTED	REJECTED	TOTAL	ACCEPTED	REJECTED			
208	62	146	8	1	7	12	2	10	0	0	0	40	7	33	266	72	195

NUMBER OF COMPLAINTS CONSIDERED BY COMMISSIONS OF HEP-TOPLINARSTVO – 2010

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			TOTAL		
TOTAL	ACCEPTED	REJECTED	TOTAL	ACCEPTED	REJECTED	TOTAL	ACCEPTED	REJECTED	TOTAL	ACCEPTED	REJECTED	TOTAL	ACCEPTED	REJECTED	TOTAL	ACCEPTED	REJECTED
10	3	7	4	3	1	1	1	0	3	1	2	2	0	2	20	8	12

NUMBER OF COMPLAINTS CONSIDERED BY COMMISSIONS OF HEP-PLIN – 2010

TOTAL	ACCEPTED	REJECTED
1	1	0

DONATIONS

OPEN CONTEST FOR DONATIONS

In 2010 HEP for the first time announced an open competition for donations entitled Light on our journey together". The participants (registered associations, clubs and Croatia-based institutions) could enter competition with their projects for 2010 in the following areas: youth, art and cultural heritage, humanitarian action or environment. In accordance with the conditions, there were applications for 1,072 projects. Based on the evaluation of project quality and originality, utility for local or broader community and donation spending efficiency, HEP selected 178 projects whose implementation it co-financed with donation proceeds.

OTHER

- 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, 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.
- On the occasion of Earth Day, April 22, Degenia Velebitica, an annual award for the best piece of environmental journalism, is presented. The founders of the award are Environmental Journalists Section of the Croatian Journalists Society and APO Environmental services, a member of HEP Group.
- HEP regularly supports the work of the HEP Pensioners Association and HEP's Croatian Homeland War Veterans Association by giving donations.

SUSTAINABLE DEVELOPMENT

POLICY AND ORGANIZATION OF NATURE AND ENVIRONMENTAL PROTECTION FUNCTION

HARMONIZATION WITH THE EU LEGISLATION

BASIC ENVIRONMENTAL INDICATORS

ACTIVITIES AND ACHIEVEMENTS IN HEP GROUP AREAS AND PLANTS IN 2010

POLICY AND ORGANIZATION OF NATURE AND ENVIRONMENTAL PROTECTION FUNCTION

HEP CONTINUOUSLY MONITORS and analyzes the impact of its business processes on the environment. The most important indicators of such impacts are emissions of pollutants into the air and quantity of production waste. 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.

For employee education and information purposes, the Sustainable Development and Quality Improvement Department continuously follows and systematically in printed bulletins prepares overviews of legal requirements from the field of environmental and nature protection. Considering the large number of new or amended laws and regulations in 2010, the Department prepared a list and an analysis thereof, with an assessment of the implications for operations of HEP Group companies.

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. The basic task of the Team is to analyze and valuate the environmental activities in HEP Group with an emphasis on the planning, coordination, internal communication and preparation of proposals for improvements.

HARMONIZATION WITH THE EU LEGISLATION

OBTAINING ENVIRONMENTAL PERMITS

In the process of aligning Croatia's environmental legislation with that of the EU, the provisions of Integrated Pollution Prevention and Control (IPPC) Directive 2008/1/EC were transposed into the national Environmental Protection Act and into regulation on the procedure for the determination of integrated environmental requirements. The integrated environmental requirements ("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. Coordinated by HEP's Team for the obtaining of integrated environmental requirements, analyses of the existing situation were prepared and discrepancies against Best Available Techniques were determined, and a proposal for alignment was prepared accordingly.

GREENHOUSE GAS EMISSIONS

By ratifying the Kyoto Protocol and conducting negotiations over the EU accession, Croatia has undertaken to reduce greenhouse gas emissions and to join the emission trading scheme (EU-ETS). HEP owns large combustion plants – thermal power plants –which emit large quantities of greenhouse gases into the atmosphere. From January 1, 2013, these plants will be part of the emission trading scheme for CO_2, meaning that HEP will have to buy all CO_2 emission rights at auctions and include these additional costs in the delivered product – electricity. To prepare HEP for the conditions of trading in greenhouse emissions, team for the implementation of Kyoto Protocol provisions has defined the actions to be carried out by the time of HEP's entry into the trading scheme. At the same time, for all large thermal power plants plans for the monitoring of greenhouse gases have been prepared.

ECOLOGICAL NETWORK

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, became 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 laid down in the Act and in the Regulation pose uncertainty on construction of planned or continued operation of existing HEP's generating plants, and thereby on energy production and security of customer supply. They also make it harder to meet the obligations arising from national and EU legislation concerning reduction in greenhouse gases and other pollutant emissions into the air as well as to implement some of the work on regular plant maintenance, nature protection and safety at work, and they influence energy production costs.

BASIC ENVIRONMENTAL INDICATORS

AIR EMISSIONS

During 2010, HEP continued to monitor pollutant emissions into the air – sulfur dioxide (SO_2), nitrogen oxides (NO_x), carbon dioxide particulates as required by air quality legislation.

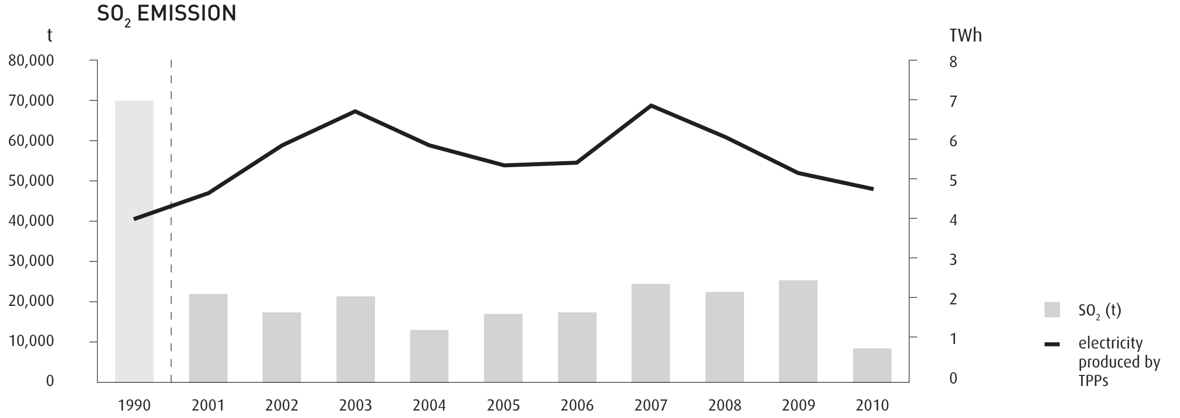
Pollutant emissions into the air come predominantly from HEP's large combustion plants – thermal power plants TE-TO Osijek, Sisak, TE-TO Zagreb, EL-TO Zagreb, Jertovec, Rijeka, Plomin 1 and Plomin 2. In 2010, total electricity production from HEP's thermal power plants decreased in comparison with 2009 by about 7.5 percent, thanks to higher hydroelectric production and favorable conditions on electricity markets.

Therefore, compared to 2009, consumption of high-sulfur fuel oil decreased by about 350,000 tons and consumption of environmentally acceptable natural gas increased by about 90 million m^3. The new unit L at TE-TO Zagreb, built in accordance with Best Available Techniques, contributed to the increased gas consumption. The increased coal consumption in 2010 compared to 2009 did not contribute to pollutant emissions because the additional 265,000 tons of coal spent by Plomin 2 thermal power plant is equipped with low NO_x burners, electrostatic precipitator for reduction in emissions of solid particulates and a desulphurization plant.

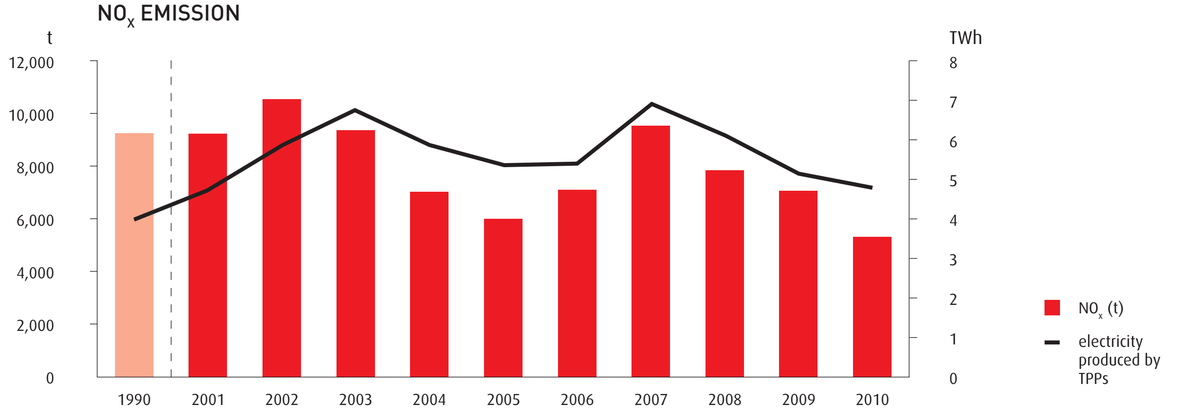
EMISSION TREND OF AIR POLLUTANTS FROM HEP'S THERMAL POWER PLANTS (1990) 2001-2010

Year	SO_2 (t)	NO_x (t)	CO_2 (kt)	Particulates (t)	Electricity produced (GWh)
1990	*69,402*	*9,248*	*3,750*	*2,031*	*4,030*
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
2010	8,277	5,318	3,899	313	4,787
Change 2010/ 2009 (%)	**-67**	**-24**	**-4**	**-52**	**-7.5**

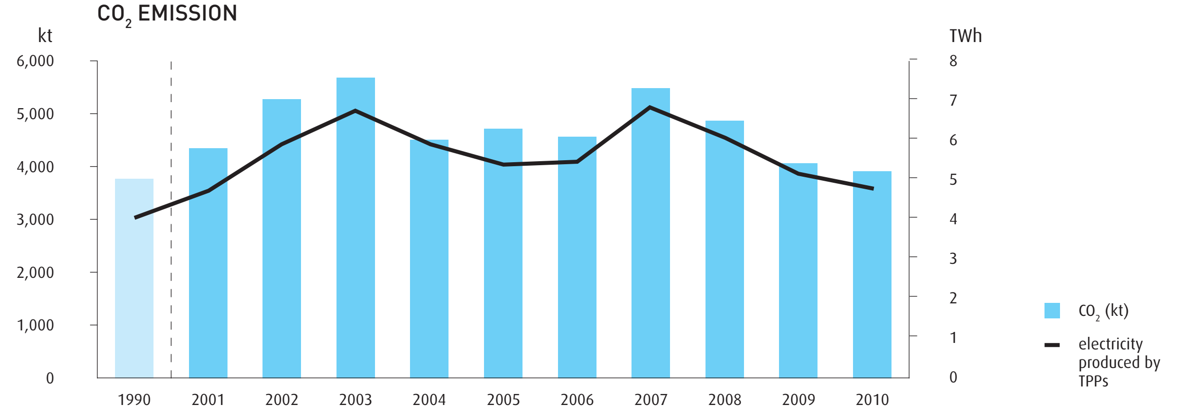
SO_2 EMISSION



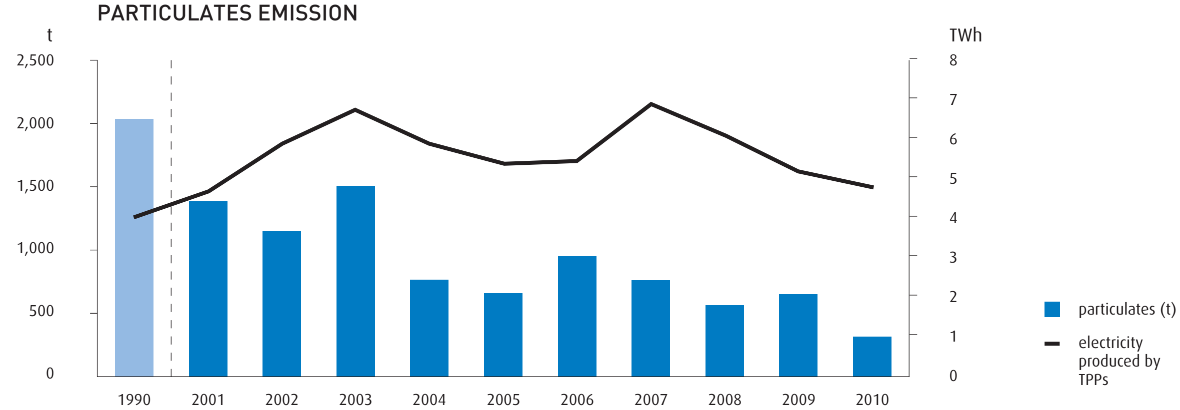
NO_x EMISSION



CO_2 EMISSION



PARTICULATES EMISSION



WASTE

During 2010, the years-long trend of improving waste management system continued by investing in existing and new temporary waste storages and in employee education to which special attention is paid

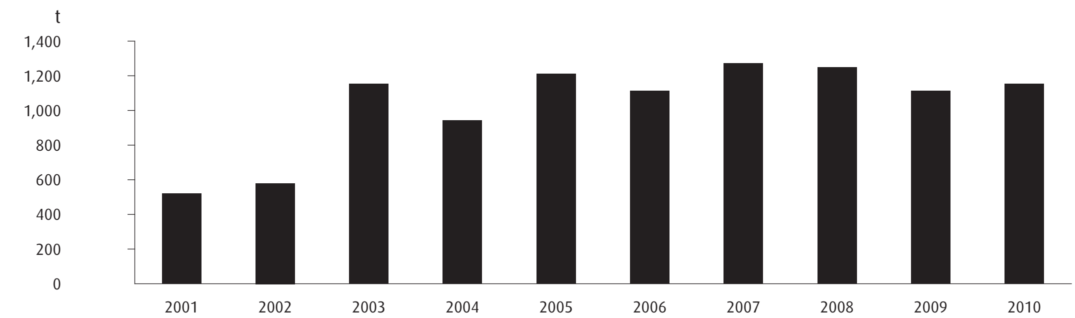
The plants continued to build and equip temporary storages for waste and secondary raw materials and furnish them with tanks for separate waste collection. In all HEP Group plants the managing of waste data electronically using the application "Waste Management" continued.

In order to fulfil the obligations specified in the Chemicals Act, the application Chemicals Consumption Inventory has been implemented The application was developed in HEP with support of the IT and Telecommunications Department of HEP d.d. For the purpose of education and introduction to work with the application, workshops were held for all HEP Group companies which use hazardous chemicals.

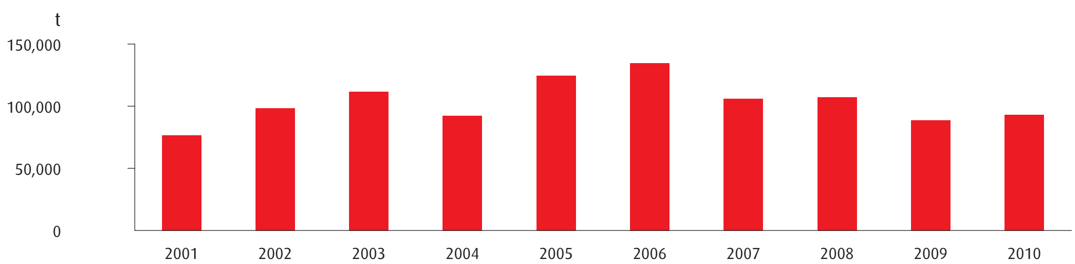
TOTAL QUANTITIES OF HAZARDOUS AND NON-HAZARDOUS WASTE GENERATED WITHIN HEP GROUP 2001-2010

Year	Hazardous waste (t)	Non-hazardous waste (t)
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
2010	1,152	93,185
Change 2010/ 2009 (%)	**+4**	**+5**

TOTAL QUANTITIES OF HAZARDOUS WASTE GENERATED WITHIN HEP GROUP



TOTAL QUANTITIES OF NON-HAZARDOUS WASTE GENERATED WITHIN HEP GROUP



In 2010, a total of 1,152 tons of hazardous waste and 93,185 tons of non-hazardous waste was produced in HEP Group. Larger quantities of generated waste compared to 2009 are a result of increased production by coal-fire power plants and/or disposal of their by-products – ash, slag and gypsum. All of the generated waste was handed over to authorized collectors, exporters or processors for further processing and final disposal.

WATER

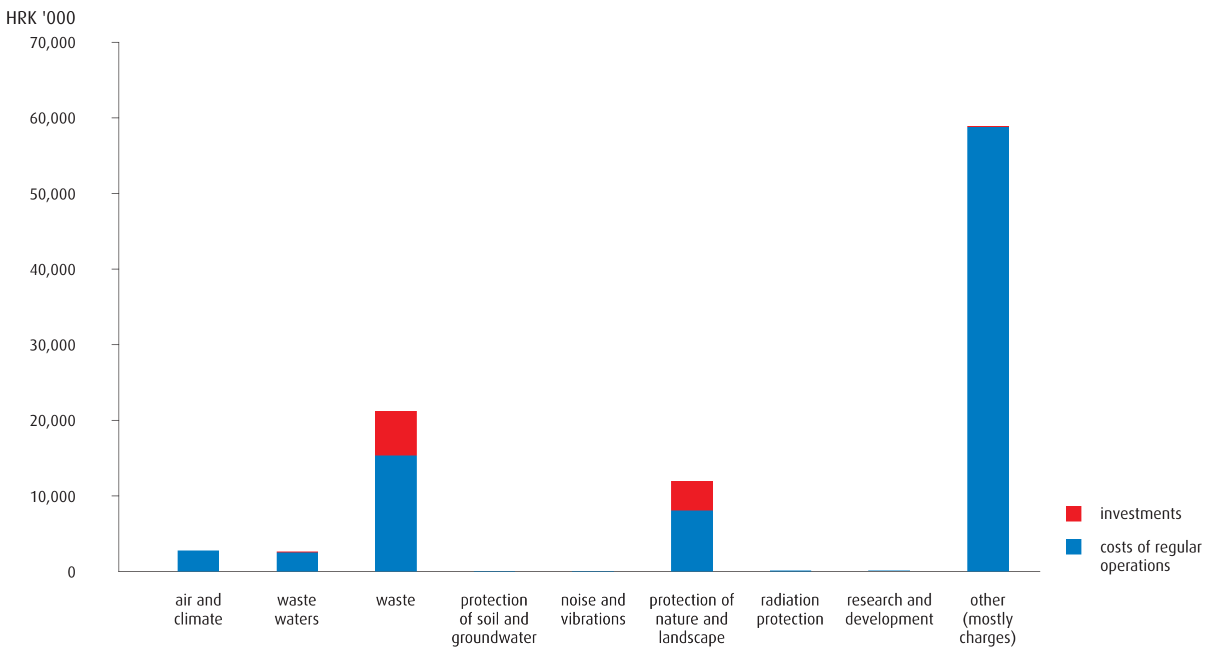
According to the results of water quality analysis conducted in 2010 by authorized laboratories in accordance with water rights documents, all HEP's plants operated in compliance with permits and legal requirements.

EXPENSES FOR ENVIRONMENTAL AND NATURE PROTECTION

In 2010 total expenses for nature and environmental protection incurred by HEP Group companies amounted to a little more than 97.5 million kuna. The most significant investments in 2010 were those made to improve waste management system in HEP's plants and to protect nature.

EXPENSES FOR NATURE AND ENVIRONMENTAL PROTECTION IN 2010 ACCORDING TO RETZOK REPORTS

Environmental area	Costs of regular operations (HRK'000)	Investments (HRK'000)
air and climate	2,726	0
waste waters	2,491	118
waste	15,284	5,916
protection of soil and groundwater	31	0
noise and vibrations	14	0
protection of nature and landscape	8,051	3,892
radiation protection	84	0
research and development	57	0
other (mostly charges)	58,769	97
TOTAL	**87,507**	**10,023**



ACTIVITIES AND ACHIEVEMENTS IN HEP GROUP AREAS AND PLANTS IN 2010

WASTE AND WASTE WATER MANAGEMENT

- Replacement and disposal of PCB-containing condenser batteries was carried out from all transformer stations 10(20)/0.4 kV at more than 1,500 locations in nine distribution areas of HEP ODS, of a total mass of more than 40 tons.
- Repair and improvement of waste water drainage system was carried out in the plants of Rijeka TPP, Sisak TPP, EL-TO Zagreb CHP, Čakovec HPP, Elektra Slavonski Brod and Elektra Križ.
- Cleaning and testing of water-tightness was carried out on the waste water drainage system in the plants of Sisak TPP, EL-TO Zagreb CHP, Varaždin HPP, Elektra Čakovec, Elektra Zabok and Elektra Virovitica.
- Operational plans for emergency water pollution measures were adopted as well as rules on operation and maintenance of drainage structures for individual transformer stations in the area of Elektroslavonjja, Elektra Čakovec and Elektrojug.
- Waste management plans were adopted by the plants of Hydro Production Area South, Sisak TPP, Elektra Koprivnica, Elektra Karlovac, Elektroslavonija, Elektra Vinkovci and Elektrojug.
- A system for collection and drainage of waste waster was built and tested in the area of the new 110/20(20)-30/10 kV Podi transformer station.
- A new water treatment plant was built at Sisak TPP. Thus an optimum use of chemicals during an automated water treatment process was achieved as well as raw water savings and reduction in waste water production.
- Reconstruction of concrete channels and replacement of ELLU pipeline for supply to Plomin 1 TPP and Plomin 2 TPP was carried out.
- Measuring equipment and a control valve were installed on the slag scraper for makeup raw water. The estimated water savings are about 3,000 m^3/year, production of waste water is reduced as well as use of chemicals at Plomin 1.
- The internal drainage system of TE-TO Zagreb CHP is connected with the public drainage system and/or with the newly built main drainage collector for waste water treatment. For connection purposes, a pre-pumping station was built with an electrical plant and a separator of oily water from the fuel oil facility area.
- At TE-TO Osijek CHP, the project of cooling water return to use the waste water again for cooling system purposes was carried out.

AIR QUALITY IMPROVEMENT

- At TE-TO CHP, the construction of a hot water boiler VK 4 was completed and boiler tests and settings began.
- In cooperation with the Technical Faculty Rijeka, a mathematical model was made of dispersion and distribution of pollutants from flue gases of Rijeka TPP. To maximize the accuracy of meteorological data, an autonomous weather station was procured.
- The preparation began of study documentation for the construction of a DeNOx plant at Plomin 2 TPP.
- At TE-TO Zagreb, reconstruction of the main stack of 202 m in height was carried out after which the stack was put into operation for another 30 years.
- HEP Toplinarstvo d.o.o. began works to convert the boiler plant Vidrićeva in Velika Gorica from a liquid fuel to a gas fired plant. The project is to improve energy efficiency of the boiler plant and significantly reduce pollutant emissions into the environment.

BIOLOGICAL DIVERSITY CONSERVATION PROJECTS

- Based on the Cooperation Agreement made between HEP and the Ministry of Culture (2004) the implementation of measures to protect the protected species of the white stork (*Ciconia ciconia)* continued. Based on the Cooperation Agreement on the monitoring of the population and ringing of storks in the area of Sisak-Moslavina County of 2005, additional measures continued to be implemented in the area.
- Based on an agreement between HEP Operator distribucijskog sustava d.o.o. and the Ministry of Culture, Directorate for Nature Protection of September 2009, distribution areas systematically monitored bird casualties from electric shock on medium-voltage distribution lines and other plants in order to determine critical parts of the network. These plants (overhead lines, switches and pole-mounted substations) were fitted with insulation material to protect the birds from electric shock.

- Natural Resources Management Plan was prepared for the hydroelectric system of Production Area North, which includes the manner of using natural resources and conditions and measures for nature protection prescribed by the Ministry of Culture.
- In the area of Hydro Production Area North, inventory taking and marking of habitats of certain species: orchids (*Orchidaceae*), tamarisks (*Myricariagermanica (L.) Desv.)* and beavers (*Castorfiber L.)*
- In the area of Hydro Production Area North, in spawning locations water level is controlled during spawning, incubation and early development of the larvae, and stocking of the hydroelectric system with fish which regulate the invasive species of molluscs and water plague is co-financed.
- At the recommendation from the Faculty of Forestry University of Zagreb, a metal grid was placed on the pipeline outlet to the right drainage channel of Čakovec HPP to protect from wood material created by beavers building dams being deposited and the trees close to the pipeline outlet were removed.

OTHER

- In the transformer station 10/0.4 kV No. 140 in Šibenik, equipment for noise and vibration reduction was installed.
- In Rijeka TPP, Plomin TPP and Elektra Virovitica, lighting fixtures were replaced with energy-efficient lighting fixtures that do not cause light pollution.
- In the area of TE-TO Zagreb, reconstruction of the damaged incoming channel was carried out as well as of the junction of incoming channel and the Sava River, part of the crest of primary and secondary gates along the left and right shore of the river, and part of the access road along the embankment.

FINANCIAL STATEMENTS

HEP GROUP – CONSOLIDATED FINANCIAL STATEMENTS AND AUDITOR'S REPORT

HEP d.d. – FINANCIAL STATEMENTS

HRVATSKA ELEKTROPRIVREDA GROUP CONSOLIDATED FINANCIAL STATEMENTS

AS OF 31 DECEMBER 2010
TOGETHER WITH INDEPENDENT AUDITOR'S REPORT

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 Group 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
25 May 2011

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 statement of financial position as at 31 December 2010 and the related consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

MANAGEMENT'S RESPONSIBILITY FOR THE CONSOLIDATED FINANCIAL STATEMENTS

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

AUDITOR'S RESPONSIBILITY

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. Except as provided in paragraphs a) and c) below, 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 Group'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) PREPAYMENTS TO HRVATSKE AUTOCESTE d.o.o.

As described in Note 13, the Group advanced HRK 300 million to Hrvatske autoceste d.o.o. 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 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 and the related depreciation from the Management Board. As a result, we are unable to assess the impact of this matter on the Group's financial statements.

B) IMPAIRMENT ALLOWANCE ON RECEIVABLES

The auditor's opinion on the consolidated financial statements for the year ended 31 December 2009 was modified in respect of the provision for bad and doubtful receivables. During 2010, the Group recognised a provision for those receivables in the statement of comprehensive income. As at 31 December 2009, a provision for doubtful receivables of approximately HRK 60 million and the related taxation effect of approximately HRK 12 million were not recorded. As a result, the result for the year ended 31 December 2009 and shareholder's equity at 31 December 2009 were overstated by approximately HRK 48 million and the result for the year ended 31 December 2010 has been understated by the same amount.

C) APPLICATION OF IFRIC 18 TRANSFERS OF ASSETS FROM CUSTOMERS

The Group has not applied IFRIC 18 Transfers of Assets from Customers, which specifies the accounting for assets transferred from customers, by which the income from such assets should be recognised immediately upon the transfer in the statement of comprehensive income 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 statement of the comprehensive income of the Group for the year ended 31 December 2009 and on shareholder's equity for the year ended 31 December 2010. .

MODIFIED OPINION

In our opinion, except for the effect of the matters discussed in paragraph b) above, and the potential effects of the matters discussed in paragraphs a) and c) above, the consolidated financial statements present fairly, in all material respects, the financial position of the Group at 31 December 2010, 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, 25 May 2011

CONSOLIDATED INCOME STATEMENT – HEP GROUP

FOR THE YEAR ENDED 31 DECEMBER 2010

	Notes	2010	2009
		HRK'000	HRK'000
Revenue from electricity sales	4	10,851,054	10,798,272
Revenue from thermal power sales	4	569,784	553,732
Revenue from gas sales	4	394,182	294,262
Other operating income	5	1,153,590	954,520
Total operating income		**12,968,610**	**12,600,786**
Electricity purchase cost		(2,011,535)	(3,078,977)
Fuel costs		(2,077,105)	(2,385,583)
Staff cost	6	(1,895,205)	(1,954,350)
Depreciation and amortization expense	10,11	(1,721,472)	(1,688,750)
Other operating expenses	7	(3,052,380)	(2,925,476)
Total operating expenses		**(10,757,697)**	**(12,033,136)**
Profit from operations		**2,210,913**	**567,650**
Financial revenue	8	65,479	81,101
Financial costs	8	(439,224)	(421,642)
Net financial loss		**(373,745)**	**(340,541)**
Profit before tax		**1,837,168**	**227,109**
Income tax expense	9	(401,802)	(72,687)
Profit from operations		**1,435,366**	**154,422**
Attributable to:			
Equity holder		1,421,303	135,844
Non-controlling interest		14,063	18,578
		1,435,366	**154,422**

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

Signed on behalf of the Company on 25 May 2011 by:

Leo Begović
President of the Board

Miljenko Pavlaković
Member of the Board

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME – HEP GROUP

FOR THE YEAR ENDED 31 DECEMBER 2010

	Notes	2010	2009
		HRK'000	HRK'000
Profit for the year		**1,435,366**	**154,422**
Foreign exchange rate differences		17,840	(3,881)
Fair valuation of the Janaf shares		7,499	1,423
Other comprehensive income		-	(1,995)
Other comprehensive income / (loss)		**25,339**	**(4,453)**
Total comprehensive income for the year		**1,460,705**	**149,969**
Total comprehensive income attributable to:			
Equity holder		1,446,156	131,267
Non-controlling interest		14,549	18,702
		1,460,705	**149,969**

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

Signed on behalf of the Company on 25 May 2011 by:

Leo Begović
President of the Board

Miljenko Pavlaković
Member of the Board

CONSOLIDATED STATEMENT OF FINANCIAL POSITION – HEP GROUP

AS AT 31 DECEMBER 2010

ASSETS	Notes	31 December 2010	31 December 2009
		HRK'000	HRK'000
Non-current assets			
Property, plant and equipment	10	24,090,370	24,082,799
Capital work in progress	10	3,046,316	3,130,294
Intangible assets	11	65,010	63,671
Investment property	12	223,094	202,467
Prepayments for property, plant and equipment	13	386,055	403,080
Investment in NPP Krško	14	1,622,947	1,605,593
Long-term loan receivables and deposits	16	1,183	1,483
Asset held for sale and other investments	17	162,380	152,997
Other non-current assets	18	110,973	117,106
Deferred tax assets	9	159,429	120,351
		29,867,757	**29,879,841**
Current assets			
Inventories	19	1,116,671	967,931
Trade receivables	20	1,730,328	1,493,989
Other short-term receivables	21	144,064	225.459
Cash and cash equivalents	22	762,157	143.834
		3,753,220	**2,831,213**
TOTAL ASSETS		**33,620,977**	**32,711,054**

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

Signed on behalf of the Company on 25 May 2011 by:

Leo Begović
President of the Board

Miljenko Pavlaković
Member of the Board

CONSOLIDATED STATEMENT OF FINANCIAL POSITION – HEP GROUP (CONTINUED)

AS AT 31 DECEMBER 2010

CAPITAL AND LIABILITIES	Notes	31 December 2010	31 December 2009
		HRK'000	HRK'000
Share capital	23	19,792,159	19,792,159
Capital reserves	23	(1,005,546)	(2,038,472)
Retained earnings	23	816,246	403,018
Equity attributable to equity holder		**19,602,859**	**18,156,705**
Non-controlling interest	15	76,993	91,409
Total equity		**19,679,852**	**18,248,114**
Long-term borrowings	24	2,883,554	3,113,467
Long-term liabilities to the state	25	33,734	59,713
Long-term provisions	27	799,945	559,017
Liabilities under securities	28	1,058,042	1,150,887
Other long-term liabilities	29	5,170,943	4,927,022
Deferred tax liability		1,874	-
Total non-current liabilities		**9,948,092**	**9,810,106**
Trade payables		1,553,211	2,179,323
Current portion of long-term bonds issued	28	93,380	46,690
Current portion of long-term borrowings	24	1,184,921	947,747
Short-term borrowings	30	292,493	767,805
Taxes payable	31	444,985	171,080
Interest payable		30,489	64,301
Liabilities to employees	32	134,226	143,132
Other short-term payables	33	259,328	332,756
Total current liabilities		**3,993,033**	**4,652,834**
TOTAL CAPITAL AND LIABILITIES		**33,620,977**	**32,711,054**

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

Signed on behalf of the Company on 25 May 2011 by:

Leo Begović
President of the Board

Miljenko Pavlaković
Member of the Board

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY – HEP GROUP

FOR THE YEAR ENDED 31 DECEMBER 2010

	Share capital	Capital reserves	Retained earnings/ (Accumulated losses)	Equity attributable to the equity holder of the Parent	Non.controlling interest	Total equity
	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000
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**
Non-controlling 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**
Allocation of retained earnings	-	1,008,073	(1,008,073)	-	-	-
Balance at 1 January 2010	**19,792,159**	**(1,030,399)**	**(605,057)**	**18,156,703**	**91,409**	**18,248,112**
Profit for the year	-	-	1,421,303	1,421,303	14,063	1,435,366
Exchange differences	-	17,354	-	17,354	486	17,840
Fair value of the JANAF shares	-	7,499	-	7,499	-	7,499
Total comprehensive income for the year	**-**	**24,853**	**1,421,303**	**1,446,156**	**14,549**	**1,460,705**
Non-controlling interest	-	-	-	-	(16,583)	(16,583)
Distribution of dividend to RWE	-	-	-	-	(12,382)	(12,382)
Balance at 31 December 2010	**19,792,159**	**(1,005,546)**	**816,246**	**19,602,859**	**76,993**	**19,679,852**

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

Signed on behalf of the Company on 25 May 2011 by:

Leo Begović
President of the Board

Miljenko Pavlaković
Member of the Board

CONSOLIDATED STATEMENT OF CASH FLOWS – HEP GROUP

FOR THE YEAR ENDED 31 DECEMBER 2010

	2010	2009
	HRK'000	HRK'000
Cash flows from operating activities		
Profit for the year	1,435,366	154,422
Income tax expense recognised in profit	401,802	72,687
Net financial loss	373,745	340,541
(Gain) / loss from real estate fair valuation	(19,865)	19,748
Loss on derivatives	1,871	2,271
Depreciation and amortization	1,721,472	1,688,750
Increase in provisions for doubtful receivables	332,139	275,006
Increase in provision for inventories	15,070	110,647
Increase in provisions	240,928	137,017
Operating cash flows before movements in working capital	**4,502,528**	**2,801,089**
Increase in trade receivables	(568,478)	(349,881)
(Increase) / decrease in inventories	(163,810)	291,126
Decrease in other current assets	81,395	24,699
Decrease in trade payables	(626,112)	(430,450)
Increase in other liabilities	(121,984)	30,666
Increase in long-term liabilities	217,942	555,613
Cash generated from operations	**3,321,481**	**2,922,862**
Income taxes paid	(161,137)	(126,470)
Interest paid	(270,324)	(336,952)
NET CASH FROM OPERATING ACTIVITIES	**2,890,020**	**2,459,440**
INVESTING ACTIVITIES		
Interest received	14,480	7,529
Increase in property, plant and equipment	(1,693,299)	(2,359,657)
Write off property, plant and equipment	21,462	79,310
Increase of other assets	48,088	14,766
Change in the non-controlling interest and dividend payment to RWE	(28,479)	(33,971)
NET CASH USED IN INVESTING ACTIVITIES	**(1,637,748)**	**(2,292,023)**
FINANCING ACTIVITIES		
(Repayments) / proceeds from issuance of bonds	(46,155)	507
Received long-term loans	903,857	970,476
Repayment of long-term loans	(956,881)	(950,834)
Received short-term loans	566,692	710,092
Repayment of short-term loans	(1,101,462)	(1,064,341)
NET CASH (USED IN) / FROM FINANCING ACTIVITIES	**(633,949)**	**(334,100)**

CONSOLIDATED STATEMENT OF CASH FLOWS – HEP GROUP (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2010

	2010	2009
	HRK'000	HRK'000
NET (DECREASE) / INCREASE IN CASH AND CASH EQUIVALENTS	**618,323**	**(166,683)**
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	**143,834**	**310,517**
CASH AND CASH EQUIVALENTS AT THE END OF YEAR	**762,157**	**143,834**

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

Signed on behalf of the Company on 25 May 2011 by:

Leo Begović
President of the Board

Miljenko Pavlaković
Member of the Board

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF THE HEP GROUP

FOR THE YEAR ENDED 31 DECEMBER 2010

1. GENERAL

Hrvatska elektroprivreda Group (the 'Group') consists of the parent company Hrvatska elektroprivreda d.d., Zagreb ('HEP d.d.' 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 the HEP Group are the 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 generation 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 2010, the number of staff employed by the Group was 13,990 (31 December 2009: 14,197).

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.

HEP d.d. and its subsidiaries continue to provide their services as regulated public services as follows:

electricity generation for tariff-based customers, electricity transmission, electricity distribution and electricity supply for tariff-based customers.

Generation and supply of electricity for eligible customers, (eligibility as described by the group of tariff laws) and trading on the energy market are performed as market activities.

The supply of electricity to eligible customers is performed according to rules governing market relations, which allow negotiating electricity quantities and prices on a free-market basis. Electricity for households and those preferential customers that have not exercised their right to select the electricity supplier or are left without a supplier is supplied as part of the system of obligatory public services.

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.

In December 2008, the Law on the Amendments to the Electricity Market Law became effective, under which small customers were obliged to choose their supplier and sign a contract with that chosen supplier by 30 June 2009, which is the date until which they are entitled to receive energy supplied by suppliers of tariff customers.

Small customers failing to select their electricity supplier until the given date will be charged for the supply of electricity based on the balancing electricity price charged to customers who have not selected their supplier either.

According to the new laws, HEP d.d. restructured its operations, by forming separate companies for electricity generation, transmission of electricity, distribution of electricity, electricity supply and electricity trading. HEP d.d. has restructured the Group in accordance with the amended laws.

LAW ON THE PRIVATISATION OF HEP d.d.

The Law on the Privatisation of Hrvatska Elektroprivreda d.d. was passed on 25 March 2002. On 5 February 2010 this law was annulled as the Government passed the Law on Invalidity of the Law on the Privatization of Hrvatska elektroprivreda d.d.

1. GENERAL (continued)

GOVERNANCE AND MANAGEMENT

General assembly

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

Đuro Popijač	President	Member since 21 November 2009
Miljenko Pavlaković	President	Member from 14 February 2008 until 30 October 2009

Supervisory Board of HEP d.d.

Members of Supervisory Board in 2010 and 2009:

Darko Horvat	President	Member since 30 June 2010, President since 20 July 2010
Branimir Horaček	President	Member from 19 October 2009 until 6 May 2010
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 3 June 2008
Leo Begović	President	Member from 28 April 2008 until 22 September 2009
Krešimir Ćosić	Member	Member from 28 April 2008 until 19 October 2009
Dasenko Baldasari	Member	Member from 28 April 2008 until 19 October 2009
Luciano Delbianco	Member	Member from 28 April 2008 until 19 October 2009
Zdenko Jurčić	Member	Member from 28 April 2008 until 19 October 2009
Slavko Konfic	Member	Member from 28 April 2008
Jadranko Berlengi	Member	Member from 03 June 2008

Management Board in 2010 and 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
Ivan Mravak	President	Member from 2004 till 25 September 2009
Željko Kljaković-Gašpić	Member	Member from 1 March 2008 until 25 September 2009
Darko Dvornik	Member	Member from 1 March 2008 until 25 September 2009
Stjepan Tvrdinić	Member	Member from 18 March 2008 until 25 September 2009
Željko Tomšić	Member	Member from 29 April 2008 until 25 September 2009
Nikola Rukavina	Member	Member from 29 April 2008 until 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 Group'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 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 1 (revised) "First-time Adoption of IFRS"** (effective for annual periods beginning on or after 1 July 2009),
- **IFRS 3 (revised) "Business Combinations"** (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 January 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 27 "Consolidated and Separate Financial Statements"** (effective for annual periods beginning on or after 1 July 2009),
- **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 "Improvements to IFRSs (2009)"** resulting from the annual 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 and 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),
- **IFRIC 17 "Distributions of Non-Cash Assets to Owners"** (effective for annual periods beginning on or after 1 July 2009),
- **IFRIC 18 "Transfers of Assets from Customers"** (effective for transfer of assets from customers received on or after 1 July 2009)

The adoption of these amendments to the existing standards and interpretations has not led to any changes in the Group's accounting policies.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

ADOPTION OF NEW AND REVISED STANDARDS (CONTINUED)

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),
- **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 1 "First-time Adoption of IFRS"** – Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters (effective for annual periods beginning on or after 1 July 2011),
- **Amendments to IFRS 7 "Financial Instruments: Disclosures"** – Transfers of Financial Assets (effective for annual periods beginning on or after 1 July 2011),
- **Amendments to IAS 12 "Income Taxes"** – Deferred Tax: Recovery of Underlying Assets (effective for annual periods beginning on or after 1 January 2012),
- **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),
- **Amendments to IAS 32 "Financial Instruments: Presentation"** – Accounting for rights issues (effective for annual periods beginning on or after 1 February 2010),
- **Amendments to various standards and interpretations "Improvements to IFRSs (2010)"** resulting from the annual improvement project of IFRS published on 6 May 2010 (IFRS 1, IFRS 3, IFRS 7, IAS 1, IAS 27, IAS 34, IFRIC 13) 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 2011),
- **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 19 "Extinguishing Financial Liabilities with Equity Instruments"** (effective for annual periods beginning on or after 1 July 2010).

The Group has elected not to adopt these standards, revisions and interpretations in advance of their effective dates. The Group anticipates that the adoption of these standards, revisions and interpretations will have no material impact on the financial statements of the Group in the period of initial application except for IFRS 9 *Financial Instruments* which will have an impact on the measurement and disclosure of financial instruments.

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

The financial statements of the Group represent aggregate amounts of the assets, liabilities, capital and reserves, and the results of its operations for the year then ended. All intragroup 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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

PRINCIPLES AND METHODS OF CONSOLIDATION (continued)

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 intragroup transactions, balances, income and expenses are eliminated on consolidation.

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

INVESTMENTS IN ASSOCIATES

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

The results and assets and liabilities of associates are incorporated in these consolidated financial statements using the equity method of accounting except when classified as held for sale in accordance with IFRS 5 *Non-current Assets Held For Sale and Discontinued Operations.*

Investments in associates are carried in the consolidated statement of financial position 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 full consolidation.

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.

	2010
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).

RETIREMENT BENEFITS AND JUBILEE AWARDS

The Group provides benefits to its employees, which include long-service benefits (jubilee awards) and one-off retirement benefits. The obligation and the cost of these benefits are determined using the 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 obligation is measured at the present value of estimated future cash flows using a discount rate that is similar to the interest rate on government bonds where the currency and terms of the Government bonds are consistent with the currency and estimated terms of the benefit obligation. Calculations of the obligation and cost of these benefits are performed by a certified actuary.

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

A Collective Agreement has been in effect since 1 July 2008, under which the employees are entitled to a retirement benefit to the extent of 1/8 of the average gross monthly salary earned in the period of three months prior to the retirement for each completed year of continuous employment at the employer. The effective date of the Collective Agreement was extended until 31 December 2010. A new Collective Agreement was adopted as of 12 January 2011, effective from 1 January 2011, and is valid until 31 December 2012.

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 recognised within income statement.

Property, plant and equipment in use are depreciated using the straight-line method on the following bases:

Buildings	**2010 and 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 centers 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

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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

PROPERTY, PLANT AND EQUIPMENT (continued)

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

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

Impairment of tangible and intangible assets

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

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

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

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

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

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

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

INTANGIBLE ASSETS

Intangible fixed assets include patents, trademarks 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 are properties held to earn rentals and/or for capital appreciation (including property under construction for such purposes). Investment properties are measured initially at cost, including transaction costs. Subsequent to initial recognition, investment properties are measured at fair value. Gains and losses arising from changes in the fair value of investment properties are included in profit or loss in the period in which they arise.

An investment property is derecognised upon disposal or when the investment property is permanently withdrawn from use as well as when no future economic benefits are expected from the disposal. Any gain or loss arising on derecognition of the property (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in profit or loss in the period in which the property is derecognised.

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 2010 and 2009. Amounts payable under operating leases are recognised as expense on a straight-line basis over the term of the relevant lease, unless there is another systematic basis that would be more representative of the time pattern of the user's benefit.

TRADE DEBTORS AND PREPAYMENTS

Trade receivables are carried at cost less provision for bad and doubtful receivables.

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 Group makes an allowance for unrecoverable amounts, based on a reasonable estimate and past experience, in order to value adjust those amounts as follows during 2009 year:

Ageing of past due	Allowance percentage
61 – 90 days	5%
91 – 120 days	10%
121 – 365 days	20%
Over one year	100%

In 2010 Group has changed percentages of allowance based on review of actual experience :

Ageing of past due	Allowance percentage
31 – 60 days	1.5%
61 – 90 days	3%
91 – 180 days	9%
181 – 365 days	30%
Over one year	90%

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

TRADE DEBTORS AND PREPAYMENTS (continued)

Outstanding receivables claimed through court and those included in bankruptcy estate (the debt principal and interest) are fully provided for, regardless of the number of past due days, and the provision is charged to expenses.

INVENTORIES

Inventories comprise mainly of materials and small items and are carried at the lower of cost, determined using the weighted average price less allowance for obsolete and excessive inventories, and net realisable value. The management provides for inventories based on a review of the overall ageing structure of inventories and non-recurring transfers over the years, as well as of individual significant amounts of inventories.

Cost comprises the invoiced amount as well as all other costs directly attributable to brining inventories to their location and the condition of being readily available for use.

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 are 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 reporting 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 date of the statement of financial position. Income and expense items 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 Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the end of reporting period.

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 are 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 the end of each reporting period 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 end of the reporting period. The measurement of deferred tax liabilities and assets reflects the amount in which the Group expects, at the reporting date, to recover or settle the carrying amount of its assets and liabilities.

Current and deferred tax for the period

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

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

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 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 end of reporting period. 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 the end of each reporting period. 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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

FINANCIAL ASSETS (continued)

Impairment of financial assets (continued)

With the exception of AFS equity instruments, if, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

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

Investments

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

FINANCIAL LIABILITIES

Other financial liabilities (including borrowings) are subsequently measured at amortised cost using the effective interest method.

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 (including all fees and points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the financial liability, or (where appropriate) a shorter period, to the net carrying amount on initial recognition.

Derecognition of financial liabilities

The Group derecognises financial liabilities when, and only when, the Group's obligations are discharged, cancelled or they expire. The difference between the carrying amount of the financial liability derecognised and the consideration paid and payable is recognised in profit or loss.

DERIVATIVE FINANCIAL INSTRUMENTS

The Group entered into an interest rate swap to manage its exposure to interest rate. Further details of derivative financial instruments are disclosed in Note 26.

Derivatives are initially recognised at fair value at the date the derivative contracts are entered into and are subsequently remeasured to their fair value at the end of each reporting period. The resulting gain or loss is recognised in profit or loss immediately unless the derivative is designated and effective as a hedging instrument, in which event the timing of the recognition in profit or loss depends on the nature of the hedge relationship.

EMBEDDED DERIVATIVES

During 2010 and 2009, the Group had no embedded derivative financial instruments.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

USE OF ESTIMATES IN THE PREPARATION OF THE FINANCIAL STATEMENTS

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

REVENUE RECOGNITION

Revenue is earned primarily from the sale of electricity to households, industrial and other customers within Croatia. These sales constitute the main source of the Group's operating income.

Revenue recognition is based on the Decision of the Croatian Government on the tariff Amounts from June 2008 and August 2009.

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

REVENUE FROM CONNECTION FEES

Up to 1 January 2010 connection fees received from customers were deferred and recognised in income over the expected useful life of asset, i.e. connection fee. Such policy is still used for connection fees received before 1 January 2010.

As of 1 January 2010 Group has adopted IFRIC 18 Transfers of Assets from Customers.

IFRIC 18 clarifies the requirements of IFRSs for agreements in which an entity receives from a customer asset (item or property, plant and equipment or cash) that the entity must then use either to connect the customer to a network or to provide the customer with ongoing access to a supply of goods or services. When the item of property, plant and equipment transferred from a customer meets the definition of an asset the Company must recognize the asset in its financial statements.

As a result since 1 January 2010 the connection fees received from customers are recognized in the income when the fee is received and are not deferred over the period of 20 years as was the case in prior periods.

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 Group 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 NPPK.

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

Over / under billed revenue adjustment

After analyzing a number of different methods of approximation (five – year average, a linear approximation, etc.), Management has decided that the most appropriate is a method of logarithmic regression is the most appropriate. 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 over/under billed revenue balance for the current year is calculated.

Such difference represents basis for calculation of over / under billed 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)

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 2010 and 31 December 2009 amounted to HRK 159,429 thousand and HRK 120,351 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 348,425 thousand and HRK 287,849 thousand at 31 December 2010 and 31 December 2009, respectively (see Note 27).

Consequences of certain legal actions

There are a number of legal actions involving the Group, which have arisen from the regular course of their operations. If there is a present obligation as a result of a past event (taking into account all available evidence, including the opinion of law experts) for which is probable that outflow of resources will be required to settle the obligation and if a reliable estimate can be made of the amount of the obligation, provisions are recorded (see Note 27).

Remeasurement of the Janaf shares and investment property at fair value

During 2010 and 2009, the Group remeasured the Jadranski naftovod shares and the investment properties at fair value.

In 2010 and 2009 fair value was made based on notification of Central clearing deposit company regarding open balances as of 31 December 2010 and 2009. Market value of Jadranski naftovod share as at 31 December 2010 was HRK 3,000 (2009: 2,826)

Gain resulting from the fair valuation of the investment property amount to HRK 19,865 thousands, while in 2009 loss resulting from fair valuation was in amount of HRK19,748 thousand (see notes 5 and 7).

Valuation of inventories

During 2010 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 15,070 thousands (2009: 110,647 thousand).

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, transmission, 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	
	2010	**2009**	**2010**	**2009**	**2010**	**2009**	**2010**	**2009**
	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000
Revenue	10,851,054	10,798,272	569,784	553,732	394,182	294,262	11,815,020	11,646,266
Other income allocated to segments	1,065,005	871,555	59,928	56,662	28,657	26,303	1,153,590	954,520
Income from operations	**2,356,596**	**671,859**	**(142,592)**	**(104,388)**	**(3,091)**	**179**	**2,210,913**	**567,650**
Net financial loss							(373,745)	(340,541)
Income tax							(401,802)	(72,687)
Net profit							**1,435,366**	**154,422**

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 NPPK, 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.

4. SEGMENT INFORMATION (continued)

	Total segment assets		Total segment liabilities	
	2010	2009	2010	2009
	HRK'000	HRK'000	HRK'000	HRK'000
Electricity	28,409,155	29,963,915	6,995,442	6,953,885
Heating	1,097,458	1,036,394	220,139	237,636
Gas	319,336	286,987	180,345	158,621
Unallocated	3,795,028	1,423,758	6,545,198	7,112,798
Total Group	**33,620,977**	**32,711,054**	**13,941,124**	**14,462,940**

INFORMATION ON THE LARGEST CUSTOMERS

Activity from sales of electricity in 2010 amounts HRK 10,851,054 thousands (HRK 10,798,272 thousands in 2009).

Activity from sale of heating energy in 2010 amounts HRK 569,784 thousands (HRK 553,732 thousands in 2009).

Activity from sale of gas in 2010 amounts HRK 394,182 thousands (HRK 294,262 thousands in 2009).

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:

	2010	2009
	HRK'000	**HRK'000**
Croatia	10,600,969	10,461,750
European Union members	185,373	323,870
Other countries non European Union members	64,712	12,652
	10,851,054	**10,798,272**

5. OTHER OPERATING INCOME

	2010	2009
	HRK'000	HRK'000
Income from assets received free of charge	218,769	194,762
Services rendered	150,423	239,454
Service for connection to network	139,245	-
Subsequent collection of receivables previously provided against	134,531	91,033
Capitalised assets	112,592	147,151
Late-payment interest	80,126	68,808
Income from sale of materials	48,512	20,411
Income from electricity in transit – foreign	45,715	30,049
Foreign exchange gain on loans	25,707	-
Reversal of long-term provisions for retirement benefits and jubilee awards	24,449	18,356
Income from sale of cross – border transmission capacity	21,584	30,032
Gains on fair valuation of investment properties	19,865	-
Income in respect of the electricity bill reminders	19,462	17,523
Reversal of long-term provisions – court costs	18,144	13,816
Income in respect of court costs on claims	7,673	9,844
Income from reversal of long-term decommissioning provision	4,706	620
Income from balancing energy	4,067	-
Recovery of receivables previously written off	2,585	8,208
Income from sale of tangible assets	1,889	7,163
Inventory surplus – fixed assets	870	406
Other	72,676	56,884
	1,153,590	**954,520**

In 2010 the Group generated income from services for connection to a network in amount of HRK 139,245 thousand based on IFRIC 18 (Transfer of assets from customers) that in Republic of Croatia came into force as of 1 January 2010 (Official Gazette No. 18/2010). 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.

6. STAFF COSTS

	2010	2009
	HRK'000	HRK'000
Net salaries	1,134,137	1,157,790
Taxes and contributions	761,068	796,560
	1,895,205	**1,954,350**

TOTAL STAFF COSTS:

	2010	2009
	HRK'000	HRK'000
Gross salaries	1,895,205	1,954,350
Reimbursement of costs to employees (Note 7)	156,673	147,718
Employee benefits (Note 7)	77,055	89,030
	2,128,933	**2,191,098**

DIRECTORS' AND EXECUTIVES REMUNERATION:

	2010	2009
	HRK'000	HRK'000
Gross salaries	6,483	7,086
Pension contributions	1,424	1,498
Other receipts	1,023	1,091
	8,930	**9,675**

Reimbursement of costs to employees includes commutation allowances in the amount of HRK 80,158 thousand (2009: HRK 88,867), daily allowances and travelling expenses in the amount of HRK 17.636 thousand (2009: HRK 16,870 thousand), additional health insurance amounting to HRK 17,209 thousand (2009: HRK 21,461 thousand), receipts based on tax inspection in the amount of HRK 15,561 and other similar expenses.

Employee benefit costs include benefits under Collective Agreement and consist primarily of Christmas and Easter allowances, solidarity support, jubilee awards, family separation allowances and fieldwork bonuses, holiday bonuses, child benefits and other in the total amount of HRK 54,424 thousand (2009: HRK 46,392 thousand).

7. OTHER OPERATING EXPENSES

	2010	2009
	HRK'000	HRK'000
Maintenance costs (service and material)	645,098	578,792
General and administrative expenses	380,020	453,201
Provisions for doubtful receivables	332,139	275,006
Gas costs	355,869	256,454
Other employee benefits (Note 6)	156,673	147,718
Cost of material	118,136	131,858
NPPK – decommissioning expense in accordance with Government decision	103,854	104,506
Contributions to the State	99,264	104,073
Provisions for retirement bonuses and jubilee awards	86,762	60,964
Litigation provisions	75,986	105,689
Other material employee's rights (Note 6)	77,055	89,030
Distributions and concession for water	74,601	63,803
Fee for the usage of power plant facilities	66,115	52,564
Accrual for unused vacation days	64,477	-
Provision for NPPK de-commissioning costs	53,838	-
Provisions according to contracts for damages	52,179	28,621
Purchase value of sold materials	40,710	17,233
Provision for investment in HE Lešće	39,286	-
Damages and indemnities	37,449	9,643
Calculation and collection costs	34,823	36,647
Fee for environmental protection	27,299	48,943
Insurance premiums	24,860	25,045
Provision for delivered electric energy from wind power plants	22,031	-
Write-off of tangible assets	21,462	79,310
Provision for inventory	15,070	110,647
Write-off of non claimed receivables	11,249	16,201
Development costs	9,229	13,109
Information costs	6,282	7,719
Decommissioning provision for thermal power plant	5,549	5,252
Fees and subscription	3,099	4,084
Foreign exchange loss on loans	-	28,772
Losses on fair value of investment properties	-	19,748
Other	11,916	50,844
	3,052,380	**2,925,476**

8. FINANCIAL REVENUE AND COSTS

	2010	**2009**
Financial income	HRK'000	HRK'000
Foreign exchange gains	50,999	73,572
Interest expense	14,480	7,529
Total financial income	**65,479**	**81,101**
Finance costs		
Interest expense	(272,471)	(358,907)
Foreign exchange losses	(167,029)	(82,419)
Amortization of deferred interest	(3,858)	(3,686)
Fair value of interest swap	(1,871)	(2,271)
Financial expenses	**(445,229)**	**(447,283)**
Capitalised interest	6,005	25,641
Total financial expenses	**(439,224)**	**(421,642)**
Net finance loss	**(373,745)**	**(340,541)**

9. INCOME TAX

	2010	2009
	HRK'000	HRK'000
Current taxes	440,880	126,470
Deferred tax expense/(income) relating to the origination and reversal of temporary differences	(39,078)	(53,783)
Income tax expense	**401,802**	**72,687**

Adjustments to deferred tax assets were as follows:

	2010	2009
	HRK'000	HRK'000
Balance at 1 January	120,351	66,568
Reversal of deferred tax assets	(21,345)	(1,285)
Deferred tax assets recognised	60,423	55,068
Balance at 31 December	**159,429**	**120,351**

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:

	2010	2009
	HRK'000	HRK'000
Profit before taxation	1,837,168	227,109
Income tax at the applicable rate of 20%	**367,433**	**45,421**
Tax non-allowable expense/(income)	(157,509)	(52,527)
Tax effect of permanent differences	39,078	53,783
Tax effect of losses brought forward	-	(90,089)
Tax effect of Group entities operating with loss	152,800	116,099
Tax expense for the year	**401,802**	**72,687**

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 626,588 thousand (2009: HRK 536,237 thousand), while the Group recorded a total income tax expense of HRK 440,880 thousand (2009: HRK 126,470 thousand) and reported deferred tax assets in the amount of HRK 39,078 thousand for the current year and HRK 53,783 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
2006	60,664	2011
2007	102,889	2012
2008	194,136	2013
2009	116,099	2014
2010	152,800	2015
	626,588	

As of 31 December 2010 and 2009 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 2009	**-**	**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**
Credited to profit and loss for the year	4,324	12,381	(13,130)	1,335	34,168	39,078
At 31 December 2010	**25,999**	**77,544**	**4,550**	**4,854**	**46,482**	**159,429**

9. INCOME TAX (continued)

Following table summarizes movement of deferred tax liability recognised in respect of fair valuation of assets available for sale:

	31 December 2010
	In HRK thousands
Gain on fair valuation of assets available for sale (see Note 15)	9,373
Deferred tax liability recognized on gain from fair valuation at 20%	(1,874)
Gain on fair valuation of assets available for sale recognized in other comprehensive income	**7,499**

10. PROPERTY, PLANT AND EQUIPMENT

HRK'000	**Land and buildings**	**Fixtures and equipment**	**Assets under construction**	**Total**
COST				
At 1 January 2009	**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 borrowing costs	-	-	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**
Restatement 01 January 2010	(211)	211	-	-
Transfers	(747)	(75)	428	(394)
Additions	4,997	75,362	1,579,319	1,659,678
Transfers from assets under construction	604,745	1,027,172	(1,657,440)	(25,523)
Capitalized borrowing costs	-	-	7,161	7,161
Inventory surplus	400	512	-	912
Disposals	(61,172)	(134,031)	(13,446)	(208,649)
At 31 December 2010	**34,172,805**	**33,132,075**	**3,046,316**	**70,351,196**
ACCUMULATED DEPRECIATION				
At 1 January 2009	**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
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**	**-**	**41,704,918**
Restatement at 01 January 2010	(182)	182	-	-
Transfers	(764)	1,217	-	453
Charge for the year	689,028	1,007,579	-	1,696,607
Eliminated on disposal	(59,728)	(128,314)	-	(188,042)
Inventory surplus	263	311	-	574
At 31 December 2010	**21,780,144**	**21,434,366**	**-**	**43,214,510**
CARRYING AMOUNT				
At 31 December 2010	**12,392,661**	**11,697,709**	**3,046,316**	**27,136,686**
At 31 December 2009	**12,473,266**	**11,609,533**	**3,130,294**	**27,213,093**

10. PROPERTY, PLANT AND EQUIPMENT (continued)

Disposals from capital work in progress during 2010 in the amount of HRK 13,446 thousand (2009: HRK 62,118 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 560,384 thousand (2009: HRK 693,376 thousand) to secure the banking facilities provided to TE Plomin d.o.o.

11. INTANGIBLE ASSETS

	HRK'000
COST	
At 1 January 2009	**564,425**
Transfers	(32,161)
Additions	12,197
Disposals	(1,586)
At 1 January 2010	**542,875**
Transfers	140
Additions	25,937
Disposals	(221)
At 31 December 2010	**568,731**
ACCUMULATED AMORTISATION	
At 1 January 2009	**485,775**
Transfers	(31,571)
Charge for the year	26,764
Disposals	(1,764)
At 1 January 2010	**479,204**
Transfers	57
Charge for the year	24,678
Disposals	(218)
At 31 December 2010	**503,721**
CARRYING AMOUNT	
At 31 December 2010	**65,010**
At 31 December 2009	**63,671**

12. INVESTMENT PROPERTIES

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 end of reporting period. All the investment properties are owned by the HEP d.d.

At fair value	**31 December 2010**	**31 December 2009**
	HRK'000	HRK'000
Fair value	**202,467**	**211,074**
Depreciation charge for the year	(187)	(189)
Net gains on remeasurement at fair value	19,865	(19,748)
Other changes	949	11,330
Closing balance at fair value	**223,094**	**202,467**

13. PREPAYMENTS FOR PROPERTY, PLANT AND EQUIPMENT

	31 December 2010	31 December 2009
	HRK'000	HRK'000
Electricity facilities on the Croatian highways – Hrvatske Autoceste	300,000	300,000
JSC Tehnopromexport –TE Sisak	56,530	59,068
Litostroj Slovenija	4,457	8,447
Končar Inženjering d.d. – HE Lešće	1,249	5,169
Voith Siemens Austria	3,978	4,955
Ingra d.d. – HE Lešće	307	1,692
Konstruktor Inženjering	432	1,081
Others	19,102	22,668
	386,055	**403,080**

In December 2006, the Group advanced a payment to Hrvatske autoceste d.o.o. 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 Group, and an agreement was concluded with Hrvatske autoceste d.o.o. in December 2009, under which the deadline for the takeover of the electricity facilities by the Group has been prolonged for another 2 years.

The Group is the beneficial owner of these facilities, as it uses those assets for their intended economic purpose which is to supply electricity to customers.

As of the date of issue of these financial statements, the Group has not classified these assets by type, and the economic effect of transfer of these assets from prepayments to tangible assets has not been calculated as well as the related depreciation.

14. INVESTMENT IN THE NUCLEAR POWER PLANT KRŠKO

	31 December 2010	31 December 2009
	HRK'000	HRK'000
Opening balance	1,605,593	1,609,598
Positive / (negative) exchange difference (charged to capital reserves)	17,354	(4,005)
	1,622,947	**1,605,593**

INVESTMENT BACKGROUND

The legal status of the Nuclear Power Plant Krško ("NPPK") 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 NPPK 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 NPPK into a public company, Nuclear Power Plant Krško 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 d.d. from NPPK was cut on 30 July 1998 and was not restored until 19 April 2003.

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 d.d. 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 d.d. 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 d.d. 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.

The investment in NPPK is accounted as associate using the equity method and amounts to HRK 1,622,947 thousand, as HEP does not have joint control over NPPK. The positive foreign exchange difference in the amount of HRK 17,354 thousand arisen on retranslation of the Company's net investment was charged to capital reserves.

By the end of 2003, the provisions of the agreement have been implemented according to which HEP d.d. 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 d.d. 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 NPPK 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 accepted the decommissioning program (including radioactive waste disposal),Once the Croatian Parliament has adopted the decommissioning program (including radioactive waste disposal), the establishment of a Croatian fund for gathering decommissioning funds and for nuclear waste management is expected. The amount of annual payments to be made to the Fund will be determined taking into account the decommissioning program. From 2004 to 2010, the Group disclosed radioactive waste disposal and decommissioning provisions in the amount of HRK 964,917 thousand, and paid HRK 959,893 thousand on a separate account in the period from 2006 to 2010. Provision as of 31 December 2010 amounts to HRK 5,024 thousands which in fact represents current portion (Note 33).

The investment in NPPK is accounted for using the equity method and amounts to HRK 1,622,947 thousand. The positive foreign exchange differences arising on recalculating the capital from the Group's investment amounting to HRK 17,354 thousand (2009: 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 2010 and 2009:

	31 December 2010	31 December 2009
	HRK'000	HRK'000
Property, plant and equipment	3,089,065	3,063,234
Capital and reserves	3,245,896	3,211,186
Gross sales	1,214,576	1,120,485
Net profit	-	-
Cash flows from operating activities	313,211	352,970

15. INVESTMENT IN TPP PLOMIN

In November 1996, HEP d.d. 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 d.d. 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 2010 the distribution of RWE invested equity amounted to HRK 12,382 thousand (2009: HRK 12,677 thousand). The remaining undistributed RWE invested capital amounted to HRK 63 million at 31 December 2010 (2009: HRK 75 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 16,076 thousand (2009: HRK 19,577 thousand).

The RWE annual return on invested capital, effectively a preferred dividend, is paid out from net profit of Plomin. The rate for 2010 and 2009 is 17% and 16%. The amount paid out in 2010 in respect of 2009 profits was HRK 15,674 thousand and in 2009 HRK 19,442 thousand in respect of 2008 profits.

These distributions have priority to HEP d.d. interest in the results of the joint venture and any other payments to HEP d.d.. Since HEP d.d. share has been used to pay RWE interest on capital since 2000, HEP d.d. 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 d.d. 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.

	2010	2009
	HRK '000	HRK '000
Opening balance of the non-controlling share	91,409	106,821
Interest payment	(12,382)	(12,677)
Dividend payment	(16,583)	(19,442)
Increase for current year profit	14,063	18,578
Correction of tax liabilities through retained earnings	-	(1,995)
Exchange differences	486	124
Closing balance	**76,993**	**91,409**

16. LONG-TERM LOAN RECEIVABLES AND DEPOSITS

	31 December 2010	31 December 2009
	HRK'000	HRK'000
Loans given	1,318	1,794
Current portion of loans given	(135)	(311)
Long-term portion	**1,183**	**1,483**

Loans given to third parties

	Year loan approved	Repayment period	Loan amount	31 December 2010	31 December 2009
				HRK'000	HRK'000
Town of Pregrada	2006	10 years	1,358	950	914
Did d.o.o.	2007	4 years	1,010	368	880
Total				**1,318**	**1,794**
Current portion				(135)	(311)
Non-current portion				**1,183**	**1,483**

17. INVESTMENTS AVAILABLE FOR SALE AND OTHER INVESTMENTS

	31 December 2010	31 December 2009
	HRK'000	HRK'000
Investments available for sale	162.170	152,797
Other investments	210	200
	162,380	**152,997**

Changes in investments available for sale are presented below:

	2010	2009
	HRK '000	HRK '000
Beginning balance	152,797	151,374
Fair value of Jadranski Naftovod d.d.	9,373	1,423
	162,170	**152,797**

	2010	2009
	HRK '000	HRK '000
Investment in securities:		
Jadranski Naftovod d.d.	161,943	152,570
Viktor Lenac d.d.	220	220
Đuro Đaković d.d.	5	5
Kraš d.d.	2	2
	162.170	**152,797**
Other investments		
Geopodravina d.o.o.	200	200
LNG Hrvatska d.o.o.	10	-
	162,380	**152,997**

In December 2008, HEP d.d. 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.

In 2010 and 2009 fair value was determined by notification of Central clearing deposit company of balance as of 31 December. Market value of Jadranski naftovod share as of 31 December 2010 is HRK 3,000 (2009: HRK 2,826). Fair value of investment in Jadranski naftovod as of 31 December 2010 is HRK 9,373 thousands (2009: 1,423 thousands).

On 1 June 2010 HEP d.d. and Plinacro concluded the Articles of Incorporation of LNG Hrvatska d.o.o., a liquefied natural gas company. The share capital of the company amounts to HRK 20 thousand, with HEP d.d. and Plinacro each holding 50 percent of the equity shares.

18. OTHER LONG TERM ASSETS

	2010	2009
	HRK'000	HRK'000
Housing loan receivables	42,890	54,035
Energetic efficiency receivables – long term part	51,930	43,391
Calculated interest – RWE	16,078	19,577
Other long term asset	75	103
	110,973	**117,106**

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% interest is calculated. Calculated interest in amount of EUR 7,536 thousands, calculated in HRK 55,653 thousands is completely recorded as deferred expense depreciated over 15 years by linear method.

Repayment of interest is done along with repayment of invested funds from RWE Power and it started after electric power plant was finished. In 2010 total repaid amount was EUR 502 thousands or calculated in HRK 3,650 thousands (in 2009 EUR 502 thousands, recalculated in HRK 3,737).

As at 31 December 2010 deferred expense for interests amounted to EUR 2,177 thousands or recalculated to HRK 16,078 thousands (in 2009 EUR 2,679 thousands, recalculated in HRK 19,577 thousands). Exchange differences are represented through finance income or expenses for the year in which they occurred.

19. INVENTORIES

	31 December 2010	31 December 2009
	HRK'000	HRK'000
Inventories of fuel and other material	748,065	553,996
Electric materials	162,486	171,684
Spare parts	175,536	99,099
Construction material	83,211	84,454
Other inventories	73,090	169,345
Allowance for obsolete materials and spare parts	(125,717)	(110,647)
	1,116,671	**967,931**

During 2010 Group estimated provision for 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 15,070 thousands (2009: 110,647 thousand).

20. TRADE RECEIVABLES

	31 December 2010	31 December 2009
	HRK'000	HRK'000
Electricity – Corporate customers	1,355,919	1,109,074
Electricity – Households	336,814	270,576
Heating, gas and services	446,462	444,020
Foreign sales	73,461	23,386
Connection to transmission network	33,131	-
Other	59,951	49,818
	2,305,738	**1,896,874**
Allowance for bad and doubtful receivables	(575,410)	(402,885)
	1,730,328	**1,493,989**

20. TRADE RECEIVABLES (continued)

Ageing analysis of receivables not impaired is as follows:

	31 December 2010		31 December 2009
	HRK'000		HRK'000
Not yet due	1,044,409		
0-30 days	347,291	Not yet due	775,460
31-60 days	145,786	0-60 days	343,778
61-90 days	64,544	61-90 days	109,517
91-180 days	68,461	91-120 days	49,647
181-365 days	50,294	121-365 days	152,228
Over 365 days	9,543	Over 365 days	63,359
	1,730,328		**1,493,989**

In 2010 the Group changed its estimates of receivable ageing categories and allowance percentages. The effect of the change in the estimates reflected through an decrease of provisions for 2010 by HRK 10,630 thousand.

Movements in impairment allowance were as follows:

	31 December 2010	31 December 2009
	HRK'000	HRK'000
At 1 January	**402,876**	**239,989**
Provisions for potential losses on receivables and interest on receivables (Note 7)	332,139	275,006
Reversal of prior-year provisions	(25,074)	(21,086)
Amounts collected (Note 5)	(134,531)	(91,033)
At 31 December	**575,410**	**402,876**

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.

21. OTHER SHORT-TERM RECEIVABLES

	31 December 2010	31 December 2009
	HRK'000	HRK'000
VAT receivable	27,560	19,555
Advances for working capital	26,196	18,865
Receivables from the State in respect of employees	6,403	7,950
Interest receivable	3,564	2,714
Demand and time deposits	1,735	8,362
Accrued electricity sales – households	380	87,058
Income tax prepayments	-	5,750
Receivables for Government bonds	-	22,641
Other short-term receivables	78,226	52,564
	144,064	**225,459**

The adjustment to the household electricity sales at 31 December 2010 has been determined using a logarithmic curve using grid losses of 8.74 percent, whereas the grid loss percentage used in the calculation for the year ended 31 December 2009 was 8.46 percent. The above-mentioned percentage change resulted in a decrease in receivables and revenue in amount of HRK 86.6 million compared to the prior year.

22. CASH AND CASH EQUIVALENTS

	31 December 2010	31 December 2009
	HRK'000	HRK'000
Current accounts – HRK	71,510	61,810
Current accounts – Foreign	27,352	22,436
Current accounts for special purposes	5,710	11,407
Petty cash registers – HRK	287	418
Deposits due till 90 days	559,800	13,865
Daily deposits	97,498	33,898
	762,157	**143,834**

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 NPPK in respect of exchange differences was charged to equity.

Exchange differences in NPPK as of 31 December 2010 amounted to HRK 131,472 (HRK 17,354 thousands in 2010, HRK 4,005 thousands in 2009).

Retained earnings in the amount of HRK 816,246 thousand comprise prior year profits in the amount of HRK 118,245 thousand, transferred loss in the amount of HRK 723,302 thousands, profit for the year in the amount of HRK 1,421,303 thousand. The non-controlling interest attributable to RWE amounts to HRK 76,993 thousand of which HRK 14,063 thousand represent dividends attributable to the foreign equity holder.

CAPITAL RESERVES

	31 December 2010	31 December 2009
	HRK'000	HRK'000
Opening balance of reserves	(2,038,472)	(1,891,069)
Transfer from retained earnings	1,008,073	-
Exchange differences – NPPK	17,354	(148,826)
Fair valuation of shares	7,499	1,423
	(1,005,546)	**(2,038,472)**

RETAINED EARNINGS

	31 December 2010	31 December 2009
	HRK'000	HRK'000
Opening balance	403,018	267,174
Correction of opening balance	(2)	-
Transfer to reserves	(1,008,073)	-
Profit for the year	1,421,303	135,844
	816,246	**403,018**

Based on General Assembly decision dated from June 30,2010 about distribution of profits from 2009 and retained earnings from prior year transfer in amount of HRK 1,008,073 thousand was done to cover negative reserves from previous years.

On 2 April 2011, the Government of the Republic of Croatia adopted a decision on the distribution of profit, that a minimum of half of the current year's profit of companies owned by the Republic of Croatia that operate with profit should be distributed. The decision should be ratified in the General Shareholders' Meeting of the Company.

24. NON-CURRENT BORROWINGS

	Interest rates	31 December 2010	31 December 2009
		HRK'000	HRK'000
Domestic bank borrowings	EURIBOR+ (1.00%-6.35%)	1,040,610	1,062,199
Foreign bank borrowings	EURIBOR+ (0.50%-4.74%)	3,010,835	2,929,555
Liabilities to domestic companies	EURIBOR+ 1.95%	4,661	13,835
Loan from RWE		12,369	19,577
Rescheduled debt		-	36,048
Total long-term borrowings		**4,068,475**	**4,061,214**
Current portion		(1,184,921)	(947,747)
Long-term portion		**2,883,554**	**3,113,467**

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

During 2010, the following loan facilities, agreed in previous years, were fully utilised:

- EBRD loan (EUR 24 million), for the purpose of the Termal Power Generation Project: HRK 38,368 thousand utilized in 2010;
- EBRD loan (EUR 4.4 million), for the Energy Efficiency Project: HRK 1,745 thousand utilized in 2010;
- Club loan (EUR 125 million), for the Capital Investment Project – Block C of the TPP Sisak: HRK 72,909 thousand utilized in 2010.

Unutilized balances represent the loan facility of KfW Entwicklungsbank in the amount of EUR 50,000,000 for financing the projects of the subsidiaries HEP ESCO and HEP Renewable Energy Sources. The key lending terms and conditions are as follows: utilisation period of 5 years; quarterly repayment of the loan principal over a period of 10 years following the expiry of the utilization period. The amount drawn under the KfW loan at 31 December 2010 was EUR 470,000, i.e. the unused loan funds amounted to EUR 49,530,000.

As the unfavourable economic trends in Croatia throughout 2010 prevented the utilization of the loan, intensified draw downs are expected in 2011. At the time of the conclusion of the agreement with KfW, which was in late 2008, a Financial Grant Agreement was concluded with the Government of the Federal Republic of Germany, under which Hrvatska elektroprivreda received a GEF grant in the amount of EUR 0.6 million. The total balance utilized as of 31 December 2010 was EUR 0.3 million.

To finance investments and operations in 2010, HEP d.d. signed two bilateral long-term loan agreements during the year in the amount of EUR 10 million and EUR 100 million with SG- Splitska banka d.d. and Deutsche bank, respectively, such loans being guaranteed by the Government of the Republic of Croatia. The loans mature in 5 years..

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.

24. NON-CURRENT BORROWINGS (continued)

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

	Amount
2011	1,184,921
2012	1,152,849
2013	784,028
2014	342,016
2015	157,605
After 2015	**447,056**
Total	**4,068,475**

The covenants, as defined in the applicable loan agreements, specifically require the Group to meet certain prescribed levels of the following ratios based on consolidated financial statements: 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 2010	31 December 2009
USD	-	7,083
EUR	549,223	548,245

RESCHEDULED DEBT

The status of rescheduled debt is presented below:

	2010	2009
Rescheduled London Club debt	-	36,048
Total rescheduled debt	**-**	**36,048**

LONDON CLUB DEBT

During 2010 Company repaid last two instalments in accordance with long term rescheduled loans for NPPK – London Club Debt series "A" which amounted to USD 77,579,248, and ZERC –London club – series „A" Splitska bank in amount of USD 335,082.

By repayment of mentioned loans are filled all liabilities towards all members of London club taken in year 1997.

25. LONG-TERM LIABILITIES TO THE GOVERNMENT

The long-term debt to the Government in the amount of HRK 33,734 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 d.d. has no liability to remit the funds, unless and until they are collected from the employee. Decrease of liabilities in comparison to 2009 year is caused by write off of receivables from banks based on sold apartments paid with old foreign-currency savings as well as liabilities towards State up to 65% of sold apartments also paid with old foreign-currency savings.

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 1.2019% at 31 December 2010 (2009: approximately 1.0075 %).

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 2010 was EUR 10,226 thousand (2009: EUR 15,339 thousand). The fair value of the interest rate swap contract, representing a future obligation, at 31 December 2010 amounted to HRK 2,875 thousand (2009: HRK 6,284 thousand). The related deferred tax asset at 31 December 2010 amounted to HRK 575 thousand (2009: HRK 1,257 thousand).

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

	31 December 2010	**31 December 2009**
	HRK'000	HRK'000
Long-term portion (Note 29)	672	3,513
Current portion (Note 33)	2,203	2,771
	2,875	**6,284**

27. LONG-TERM PROVISIONS

	31 December 2010	31 December 2009
	HRK'000	HRK'000
Litigation provision	162,443	145,335
Provision for retirement bonuses	302,157	233,949
Provision for jubilee awards	46,268	53,900
Thermal power plant decommissioning provision	93,121	92,280
Decommission costs of NPPK	-	4,932
Provision for NPPK decommissioning (long-term)	53,838	-
Provision according to damages contract	80,800	28,621
Provision for delivered electricity from wind power plants	22,031	-
Provision for investment in HE Lešće	39,287	-
	799,945	**559,017**

The thermal power plant decommissioning provision in the amount of HRK 93,121 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	Decommission-ing – NPPK	Decommission-ing of TPPs	Other	Total
At 1 January 2010	**145,335**	**233,949**	**53,900**	**4,932**	**92,280**	**28,621**	**559,017**
Current portion	-	-	-	-	-	-	-
New provisions made	75,986	85,360	1,402	53,838	5,548	113,497	335,631
Decrease in provisions (amounts paid)	(58,808)	(17,152)	(9,030)	(4,932)	-	-	(89,922)
Decrease in provision on valuation	(70)	-	(4)	-	(4,707)	-	(4,781)
At 31 December 2010	**162,443**	**302,157**	**46,268**	**53,838**	**93,121**	**142,118**	**799,945**

27. LONG-TERM PROVISIONS (continued)

Provision for legal cases refers to cases where possible outcome has been determined as uncertain or negative, total amount of provision for legal cases is HRK 162,443 thousand. The most important court case for which provision was made is in HEP Proizvodnja d.o.o. for dispute with Zagrebački Holding (provision expense in 2010 amounts to HRK 29,611 thousand and refers to suit for reimbursement of fee for purification of waste water) and Projektni biro Split (expense in 2010 amounts to HRK 10,605 thousand and refers to suit for not conducting contract based on public tender); in HEP Operator prijenosnog sustava d.o.o. (expense in 2010 amounts to HRK 13,445 thousand and refers to suit of private person for reimbursement of fee for expropriated property in State county office in Split.

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 2010	**233,949**	**53,900**	**287,849**
Cost of services	(15,499)	(8,885)	24,384
Interest expenses	18,025	2,717	20,742
Recognized cost in prior period	-	(6,170)	(6,170)
Benefits paid	10,924	2,389	13,313
Actuarial gains/(losses)	54,758	2,317	57,075
At 31 December 2010	**302,157**	**46,268**	**348,425**

The following assumptions were used in preparing the calculations:

- The termination rate is from 0% to 10% percent and is based on the statistical fluctuation rates for the Company in the period from 2005 to 2010.
- 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 6.5% discount rate for HEP d.d. and 6.6% for other Companies within Group.

28. ISSUED BONDS

	31 December 2010	31 December 2009
	HRK'000	HRK'000
Nominal value of bonds	1,200,000	1,200,000
Repayment	(46,690)	-
Discount value	(1,888)	(2,423)
Current portion of bonds	(93,380)	(46,690)
	1,058,042	**1,150,887**

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 instalments, 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 listed on the Zagreb Stock Exchange.

29. OTHER NON-CURRENT LIABILITIES

	31 December 2010	31 December 2009
	HRK'000	HRK'000
Deferred income	4,753,554	4,683,583
Deferred recognition of income – clearing debt	414,938	239,926
Long-term debt under interest rate swap (Note 26)	672	3,513
Other	1,779	-
	5,170,943	**4,927,022**

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, which applies to contracts for connection to the network concluded by 31 December 2009. After 1 January 2010 the fee for connection is recognized as income in the amount of funds received from the customer in the period when the customer is connected to the network or when permanent access to the delivery of the service is given.

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 d.d. 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 2010	31 December 2009
	HRK'000	HRK'000
Borrowings from domestic banks and branch offices of foreign banks, denominated in various currencies on the following terms:	282,252	761,320
Interest rates ranging from EURIBOR + (1.50 – 5.90%)	-	-
Interest rates on Ministry of Finance Treasury Bills + (1.00 – 2.00%)	-	-
Secured by bills of exchange	-	-
Borrowings from domestic companies on the following terms:	2,805	2,805
Secured by bills of exchange	-	-
Current portion of RWE loan	7,436	3,680
	292,493	**767,805**

During 2010, the Group used short-term loans from domestic banks for working capital purposes and for the settlement of trade payables. Due to improved liquidity situation during the year, the Group has reduced short term debt by 75% over the previous year.

31. LIABILITIES FOR TAXES AND CONTRIBUTIONS

	31 December 2010	31 December 2009
	HRK '000	HRK '000
Liabilities for income tax	357,228	116,563
Utility and other fees	25,596	28,573
Contributions on salaries	23,953	24,217
Liabilities for custom	20,153	5
Contributions and taxes for benefits in kind	14,880	-
Other	3,175	1,722
	444,985	**171,080**

32. LIABILITIES TO EMPLOYEES

	31 December 2010	31 December 2009
	HRK'000	HRK'000
Net salaries	81,133	77,334
Contributions	41,953	46,614
Other	11,140	19,184
	134,226	**143,132**

33. OTHER PAYABLES

	31 December 2010	31 December 2009
	HRK'000	HRK'000
Liabilities for renewable sources	16,446	228,351
Decommissioning NPPK accrued expenses	5,023	41,645
Deferred income and received advances	117,752	7,117
Accrued expenses for unused vacation days	64,477	-
Accrued expenses	9,459	5,464
Current portion of the liability under interest rate swap (Note 26)	2,203	2,771
Other payables	43,968	47,408
	259,328	**332,756**

34. RELATED PARTY TRANSACTIONS

The Group has a 50% ownership in the capital of the NPPK.

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

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

	31 December 2010	31 December 2009
	HRK'000	HRK'000
NE Krško d.o.o.		
Liabilities for purchased electricity	61,090	41,451
Cost of purchased electricity	**594,612**	**557,575**

34. RELATED PARTY TRANSACTIONS (continued)

	Sales revenue		Purchases	
HRK'000	**2010**	**2009**	**2010**	**2009**
Enterprises controlled by the Government				
Hrvatske Željeznice	123,627	92,624	16,260	15,746
INA-Industrija nafte	135,772	155,097	1,480,394	1,660,633
Prirodni plin	134	171	427,615	152,322
Plinacro	1,102	974	38,508	12
Hrvatske telekomunikacije	77,854	75,011	29,382	19,337
Croatia osiguranje	6,181	4,754	15,842	15,558
Hrvatska pošta	21,115	17,480	51,251	48,853
Hrvatske šume	6,572	5,959	13,784	14,364
Jadrolinija	1,107	1,202	603	398
Narodne novine	2,081	2,081	5,667	4,963
Croatian Radio & Television	12,763	13,898	1,124	1,060
Plovput	543	559	163	210
Croatia Airlines	807	772	110	63
Petrokemija Kutina	8,311	9,965	133	6,834
Ministry of Foreign Affairs	621	598	-	-
Ministry of Defence	31,172	34,743	-	-
Ministry of Interior	25,621	24,100	-	-
Elementary and secondary schools	78,697	80,008	-	-
Judicial institutions	10,563	11,004	-	-
Colleges and universities	29,715	32,138	4,869	15,785
Legislative, executive and other bodies of the Republic of Croatia	48,470	63,850	7,648	12,115
Health institutions and organisations	92,427	112,586	4,027	4,906
Other users	109,474	94,142	143,354	146,203
TOTAL	**824,729**	**833,716**	**2,240,734**	**2,119,362**

34. RELATED PARTY TRANSACTIONS (continued)

	Receivables		Payables	
HRK'000	**31 December 2010**	**31 December 2009**	**31 December 2010**	**31 December 2009**
Enterprises controlled by the Government				
Hrvatske Željeznice	34,957	20,229	3,238	5,091
INA-Industrija nafte	8,483	15,559	210,541	164,723
Prirodni Plin	7	28	76,652	53,944
Plinacro	32	15	9,631	-
Hrvatske telekomunikacije	8,761	8,407	8,879	6,485
Croatia osiguranje	668	469	-	-
Hrvatska pošta	3,156	3,301	4,637	7,966
Hrvatske šume	2,017	1,287	925	235
Jadrolinija	242	195	561	487
Narodne novine	246	259	1,397	1,641
Croatian Radio & Television	2,233	1,636	143	275
Plovput	68	64	49	49
Croatia Airlines	150	176	64	113
Petrokemija Kutina	668	797	-	-
Ministry of Defence	4,531	11,455	-	-
Ministry of Interior	7,442	6,274	-	-
Elementary and secondary schools	15,135	13,477	-	-
Judicial institutions	2,983	2,148	-	-
Colleges and universities	4,516	4,411	-	-
Legislative, executive and other bodies of the Republic of Croatia	7,038	7,046	-	-
Health institutions and organizations	34,970	25,895	-	-
Other users	16,245	17,060	9,888	12,865
TOTAL	**154,548**	**140,188**	**326,605**	**253,874**

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 2010, the Group established a provision for legal actions estimated to be ruled against HEP d.d..

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 2010, 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 1,986,175 thousands (2009: HRK 2,163,949 thousand).

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

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 2010, 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 plants production
HEP-Plin d.o.o.	Croatia	100	Gas distribution
TE Plomin d.o.o.	Croatia	50	Electricity generation
Agencija za posebni otpad d.o.o.	Croatia	100	Special waste management
HEP ESCO d.o.o.	Croatia	100	Financing of energy efficiency projects
Plomin Holding d.o.o.	Croatia	100	Development of infrastructure in area around Plomin
Buško Blato d.o.o.	BiH	100	Maintenance of hydro power plants
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 yearend can be presented as follows:

(HRK'000)	**31 December 2010**	**31 December 2009**
Debt	5,512,390	6,026,596
Cash and cash equivalents	(762,157)	(143,834)
Net debt	4,750,233	5,882,762
Equity	19,679,852	18,248,114
Net debt to equity ratio	**24%**	**32%**

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

(HRK'000)	**31 December 2010**	**31 December 2009**
Financial assets		
Loans and receivables (including cash and cash equivalents)	3,022,637	2,267,846
Other non-current assets	111,029	270,103
Financial liabilities		
Non-current liabilities	5,672,893	5,318,504
Current liabilities	2,713,686	3,658,396

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	
	31 December 2010	**31 December 2009**	**31 December 2010**	**31 December 2009**
	(in '000)	*(in '000)*	*(in '000)*	*(in '000)*
European Union (EUR)	88,390	3,866	573,176	647,683
USD	34	198	75,315	82,591

37. FINANCIAL INSTRUMENTS (continued)

FOREIGN CURRENCY SENSITIVITY ANALYSIS

The Group is mainly exposed to the changes of euro (EUR) and US dollar (USD). The following table details the Group's sensitivity to a 10% increase and decrease in the HRK against EUR and USD. 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.

	2010	**2009**
	HRK'000	HRK'000
EUR change impact		
Profit or loss	350,872	470,385
USD change impact		
Profit or loss	38,853	44,809

INTEREST RATE RISK MANAGEMENT

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

The Group's exposures to interest rates on financial assets and financial liabilities are shown in section of this note, 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 date of the statement of financial position.. For floating rates, the analysis is prepared assuming the amount of liability outstanding at the reporting 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 2010 would decrease/increase by HRK 21,153 thousand (2009: HRK 22,031 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 77% in 2010 (2009: 73%); 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 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.

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)*
2010							
Non-interest bearing		1,096,670	1,424,595	194,103	396,981	21,317	3,133,666
Variable interest rate instruments	5.00%	23	46	196	105	-	370
Total		**1,096,693**	**1,424,641**	**194,299**	**397,086**	**21,317**	**3,134,036**
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**

37. FINANCIAL INSTRUMENTS (continued)

LIQUIDITY RISK MANAGEMENT (continued)

Liquidity and interest rate risk tables (continued)

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

MATURITY OF NON-DERIVATIVE FINANCIAL LIABILITIES

	Weighted 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)
2010							
Non-interest bearing		784,785	792,584	839,403	441,593	15,824	2,874,189
Variable interest rate instruments	3.57%	43,200	571,673	982,759	2,539,715	451,013	4,588,360
Fixed interest rate instruments	5.93%	8,766	-	186,200	1,111,980	204,721	1,511,667
Total		**836,751**	**1,364,257**	**2,008,362**	**4,093,288**	**671,558**	**8,974,216**
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**

The Group has access to financing facilities, the total unused amount of which is HRK 665,014 thousand at the reporting date. The Group expects to meet its other obligations from operating cash flows and proceeds of maturing financial assets.

37. FINANCIAL INSTRUMENTS (continued)

LIQUIDITY RISK MANAGEMENT (continued)

Liquidity and interest rate risk tables (continued)

MATURITY OF DERIVATIVE FINANCIAL LIABILITIES

The Group has an interest rate swap, which it uses to hedge its ex posure 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 1.2019 % at 31 December 2010 (2009: 1.0075 %), 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 2010							
Variable interest rate instruments	1.2019%	-	-	1,108	476	-	1,584
Fixed interest rate instruments	5.39%	-	-	(4,969)	(2,136)	-	(7,105)
Total		**-**	**-**	**(3,861)**	**(1,660)**	**-**	**(5,521)**
31 December 2009							
Variable interest rate instruments	1.0075%	-	-	1,444	1,314	-	2,758
Fixed interest rate instruments	5.39%	-	-	(7,726)	(7,029)	-	(14,755)
Total		**-**	**-**	**(6,282)**	**(5,715)**	**-**	**(11,997)**

FAIR VALUE OF FINANCIAL INSTRUMENTS

Valuation methods or assumptions in determining fair value

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 (excluding derivative instruments) is determined in accordance with generally accepted pricing models based on discounted cash flow analysis using prices from observable current market transactions and dealer quotes for similar instruments.
- fair value of derivative instruments is calculated using the listed price. Where such prices are not available, the analysis uses discounted cash flows using the current yield curve for the period of the instruments under optional derivatives, while the optional derivative used models for pricing options. Forward currency contracts are valued using quoted forward exchange rates and yield curves derived from quoted interest rates for contracts with similar maturity. Interest rate swaps are valued at the present value of estimated future cash flows and discounted based on the current yield curve derived from quoted interest rates.

37. FINANCIAL INSTRUMENTS (continued)

FAIR VALUE MEASUREMENTS RECOGNIZED IN THE STATEMENT OF FINANCIAL POSITION

The table below analyzes the financial instruments remeasured subsequently at fair value, classified into three groups depending on the availability of indicators of fair value:

1. Level 1 observable indicators – indicators of fair value derived from (unadjusted) prices quoted in active markets for identical assets and liabilities are identical
2. Level 2 observable indicators – indicators of fair value derived from data other than quoted prices from Level 1 for observable assets or liabilities (i.e. their prices) or indirectly (derived from the price), and
3. Level 3 indicators – indicators derived from valuation techniques using as input data on the assets or liabilities that are not based on available market data (unobservable input).

THE INDICATORS OF FAIR VALUE RECOGNIZED IN THE BALANCE

	1st level	2nd level	3rd level	Total
	HRK'000	HRK'000	HRK'000	HRK'000
2010				
Assets available for sale	162,380	-	-	**162,380**
Interest swap liability (current and non current portion)	-	2,875	-	**2,875**
2009				
Assets available for sale	152,797	-	-	**152,797**
Interest swap liability (current and non current portion)	-	6,284	-	**6,284**

38. APPROVAL OF THE FINANCIAL STATEMENTS

These financial statements were approved by the Board and authorised for issue on 25 May 2011

Signed on behalf of the Management Board on 25 May 2011:

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 statement of financial position as at 31 December 2010 and the related unconsolidated statement of income, unconsolidated statement of comprehensive income, unconsolidated statement of changes in equity and unconsolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

MANAGEMENT'S RESPONSIBILITY FOR THE UNCONSOLIDATED FINANCIAL STATEMENTS
Management is responsible for the preparation and fair presentation of these unconsolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of unconsolidated financial statements that are free from material misstatement, whether due to fraud or error.

AUDITOR'S RESPONSIBILITY
Our responsibility is to express an opinion on these unconsolidated financial statements based on our audit. Except as provided in paragraph a) below, 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 unconsolidated 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 unconsolidated 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 unconsolidated 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 unconsolidated 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) Prepayment to Hrvatske autoceste d.o.o.
As described in Note 12, the Company advanced HRK 300 million to Hrvatske autoceste d.o.o. 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 and the related depreciation from the Management Board. As a result, we are unable to assess the impact of this matter on the Company's financial statements.

b) Impairment allowance on receivables
The auditor's opinion on the unconsolidated financial statements for the year ended 31 December 2009 was qualified in respect of the provision for bad and doubtful receivables. At 31 December 2009, a provision for doubtful receivables of approximately HRK 60 million and the related taxation effect of approximately HRK 12 million were not recorded. During 2010, the Company recognised a provision for those receivables in the statement of comprehensive income. Accordingly the result for the year ended 31 December 2009 and shareholder's equity at 31 December 2009 were overstated by approximately HRK 48 million and the result for the year ended 31 December 2010 has been understated by the same amount.

MODIFIED OPINION

In our opinion, except for the effect of the matter presented under b) above and the potential effects of the matter presented under a) above, the unconsolidated financial statements present fairly, in all material respects, the financial position of the Company at 31 December 2010, the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

EMPHASES OF MATTER

a) Revenue recognition policy

As described in Note 1 to the accompanying unconsolidated financial statements, the Company recognizes revenue based on the invoicing of its subsidiary HEP Operator distribucijskog sustava d.o.o., HEP Opskrba d.o.o. and HEP Operator prijenosnog 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 relevant laws based on group of tariff laws. Our opinion is not modified in respect of this matter.

b) Accounting policy for leases

As described in Note 1 to the accompanying unconsolidated financial statements, the Company has leased certain property, plant and equipment under finance lease agreements to its subsidiaries. The leases bear interest to the extent of the rates applicable to external funding acquired by the Company to construct those assets. These lease receivables are carried at nominal amounts because of the special organizational framework of the HEP Group. Our opinion is not modified in respect of this matter.

c) Unconsolidated financial statements

The Company has prepared the accompanying unconsolidated financial statements in accordance with International Financial Reporting Standards and the requirements imposed by 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 30 April 2011. 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. Our opinion is not modified in respect of this matter.

Deloitte d.o.o.
Branislav Vrtačnik, Certified Auditor
Zagreb, 25 May 2011

UNCONSOLIDATED INCOME STATEMENT – HEP d.d.

FOR THE YEAR ENDED 31 DECEMBER 2010

	2010	2009
	HRK'000	HRK'000
Electricity sales	10,849,131	10,493,303
Service revenues – related companies	1,273,025	1,235,563
Other operating income	263,373	203,189
Total operating income	**12,385,529**	**11,932,055**
Purchase of electricity	(2,554,853)	(3,258,478)
Staff costs	(77,678)	(82,612)
Depreciation and amortisation	(68,177)	(67,500)
Fee expense in respect of electricity generation, transmission and distribution – related companies	(7,597,287)	(7,518,338)
Other operating expenses	(701,851)	(570,334)
Total operating expenses	**(10,999,846)**	**(11,497,262)**
Profit from operations	**1,385,683**	**434,793**
Financial revenue	229,525	263,313
Financial costs	(391,332)	(338,273)
Net financial loss from financial activities	**(161,807)**	**(74,960)**
Profit before tax	**1,223,876**	**359,833**
Income tax expense	(237,125)	(60,276)
Net profit for the year	**986,751**	**299,557**

Signed on behalf of the Company on 25 May 2011 by:

Leo Begović
President of the Board

Miljenko Pavlaković
Member of the Board

UNCONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME – HEP d.d.

FOR THE YEAR ENDED 31 DECEMBER 2010

	2010	2009
	HRK'000	HRK'000
Profit for the year	**986,751**	**299,557**
Other comprehensive income / (loss), net	24,853	(2,582)
Comprehensive income for the year	**1,011,604**	**296,975**

Signed on behalf of the Company on 25 May 2011 by:

Leo Begović
President of the Board

Miljenko Pavlaković
Member of the Board

UNCONSOLIDATED STATEMENT OF FINANCIAL POSITION – HEP d.d.

AT 31 DECEMBER 2010

ASSETS	31 December 2010	31 December 2009
	HRK'000	HRK'000
Property, plant and equipment	231,808	269,026
Capital work in progress	270,425	190,970
Intangible assets	18,466	24,325
Investment properties	8,010	8,010
Prepayments for tangible assets	364,965	372,470
Investment in NPP Krško	1,622,947	1,605,593
Investment in, and receivables from TPP Plomin	538,046	622,150
Investments in subsidiaries	6,378	6,398
Investments available for sale and other investments	162,380	152,997
Long-term loan receivables and deposits	815	914
Long-term lease receivables from related companies	17,945,115	17,979,281
Long-term loan receivables	158,368	158,569
Other non-current assets	223,692	183,865
Deferred tax assets	32,989	8,601
Total non-current assets	**21,584,404**	**21,583,169**
Inventories	26,282	33,751
Trade receivables	175,172	46,200
Current portion of long-term loan receivables from related companies	1,291,036	1,293,899
Current portion of long-term receivables	-	-
Other short-term receivables	46,211	141,912
Receivables from related companies	3,959,022	3,954,883
Cash and bank balances	680,306	68,417
Total current assets	**6,178,029**	**5,539,062**
TOTAL ASSETS	**27,762,433**	**27,122,231**

Signed on behalf of the Company on 25 May 2011 by:

Leo Begović
President of the Board

Miljenko Pavlaković
Member of the Board

UNCONSOLIDATED STATEMENT OF FINANCIAL POSITION – HEP d.d. (CONTINUED)

AT 31 DECEMBER 2010

EQUITY AND LIABILITIES	**31 December 2010**	**31 December 2009**
	HRK'000	HRK'000
Share capital	19,792,159	19,792,159
Capital reserves	(1,005,546)	(2,038,472)
Retained earnings	1,104,997	1,126,319
Total equity	**19,891,610**	**18,880,006**
Liabilities under issued bonds	1,058,042	1,150,887
Long-term borrowings	2,851,424	3,035,239
Long-term liabilities to the state	1,172	24,211
Other long-term liabilities	423,900	251,219
Long-term liabilities to related companies	174,283	122,342
Provisions	132,764	19,859
Deferred tax liability	1,874	-
Total non-current liabilities	**4,643,459**	**4,603,757**
Trade payables	288,927	510,328
Current portion of issued bonds	93,380	46,690
Current portion of long-term borrowings	1,145,398	894,540
Short-term borrowings	285,054	764,121
Taxes payable	236,204	126,770
Interest payable	27,215	24,161
Liabilities to related companies	1,123,657	1,210,306
Liabilities to employees	5,334	5,710
Other payables	22,195	55,842
Total current liabilities	**3,227,364**	**3,638,468**
TOTAL EQUITY AND LIABILITIES	**27,762,433**	**27,122,231**

Signed on behalf of the Company on 25 May 2011 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.

NIKOLA RUKAVINA

DIRECTOR

THE EXCEPTIONAL BUSINESS RESULTS achieved by HEP Proizvodnja d.o.o. (HEP Production) in 2010 contributed to a record success of HEP Group business operations. Especially favourable hydrological conditions during the year made it possible for hydro power plants to achieve a record production in the amount of 8.3 TWh. It should be stressed that at the end of the year 2010 HEP Proizvodnja had high water levels in reservoirs of hydro power plants and high fuel levels in tanks for cogenerating plants. With the synchronization of Units A, B and C in August 2010 a period of trial operation of Lešće HPP began. In 2010, significant civil works were carried out for the needs of construction of Unit C of 230 MW at Sisak TPP.

Due to the recession in most European countries, consumption of electricity and natural gas decreased, making natural gas supply in the European energy market sufficient and leading as a result to a decrease in electricity prices. Together with a record hydroelectric production in 2010 in Croatia, this made it possible to decrease production in less cost-competitive power plants fired by oil.

It should be emphasized that HEP Proizvodnja continued in 2010 to maintain an appropriate high level of availability of generating plants and/or did not have any major failures or damages resulting in jeopardizing electricity or heat deliveries. Although most of HEP Proizvodnja production plants are aged, the cumulative investments in preventive maintenance and dedication by maintenance staff have ensured an appropriate condition of production plants.

Along with fulfilling its core business of electricity and heat production and delivery to HEP systems and a high level of availability of generating plants, HEP Proizvodnja ensured the possibility of providing various auxiliary services for the needs of operating the Croatian electricity system within the European interconnected system. As in the previous six years, HEP Proizvodnja obtained certificates for 2010 of a hundred percent electricity production from renewable sources in hydro power plants. For several hydro power plants, ISO certificates 9000 and 14000 were obtained. Professional improvement and training continued, depending on specific needs of different plants, production areas and headquarters of HEP Proizvodnja.

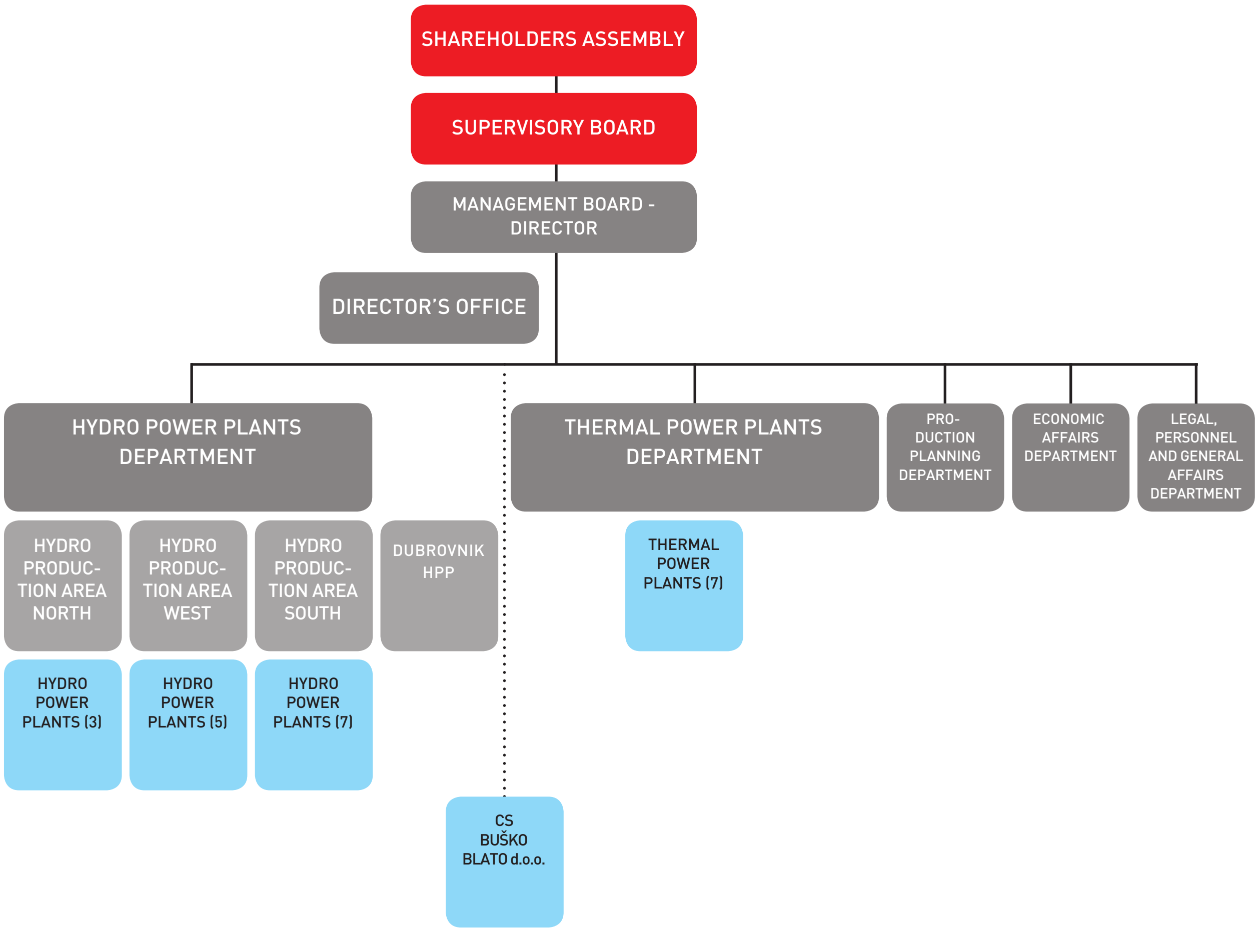
Through regular maintenance, modernization and refurbishment, in 2010 the activities continued to improve control and management systems of power plants to make it capable of quickly changing loads and switching status as required by the system operator. The activities intensified on construction of the Cetina River Basin Center in order for HEP OPS, MC Split to take over the planning and control of power plants.

In accordance with the Rules on Organization and Systematization of HEP Proizvodnja d.o.o. (2007) in 2009 Economic Affairs Department and Department for Legal, Personnel and General Affairs were set up and in 2010 Department for Production Planning was established.

In 2010 the company successfully cooperated with HEP Group members, especially intensively with HEP OPS and HEP Trgovina considering the direct technological and economic interconnection. As part of the restructuring of the energy market according to EU requirements and Croatia's pre-accession activities., HEP Proizvodnja specialists have been closely cooperating with specialists from other HEP Group members and with HERA, HROTE and the Ministry of the Economy, Labor and Entrepreneurship.

Special attention is paid to the implementation of environmental legislation. A program to reduce CO_2 emissions has been prepared in accordance with Croatia's obligations under the Kyoto protocol and other international documents. In 2010, most of the activities concerning the obtaining of environmental permits for thermal power and cogenerating plants were carried out.

ORGANIZATION CHART



GENERATING PLANTS

HYDRO POWER PLANTS	AVAILABLE CAPACITY (MW))	HYDRO POWER PLANTS	AVAILABLE CAPACITY (MW)
Storage		**Natural flow**	
HE Zakučac	486	HE Varaždin	92.5
RHE Velebit	276 (-240)	HE Dubrava	77.8
HE Orlovac	237	HE Čakovec	77.4
HE Senj	216	HE Gojak	55.5
HE Dubrovnik	2x108*	HE Lešće	42.3
HE Vinodol	90	HE Rijeka	36.2
HE Peruća	60	HE Miljacka	24
HE Kraljevac	46.4	HE Jaruga	7.2
HE Đale	40.8	HE Golubić	6.5
HE Sklope	22.5	HE Ozalj	5.5
CS Buško blato	7.5/4.2 (-10.2)	HE Krčić	0.3
CHE Fužine	4.6		
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**

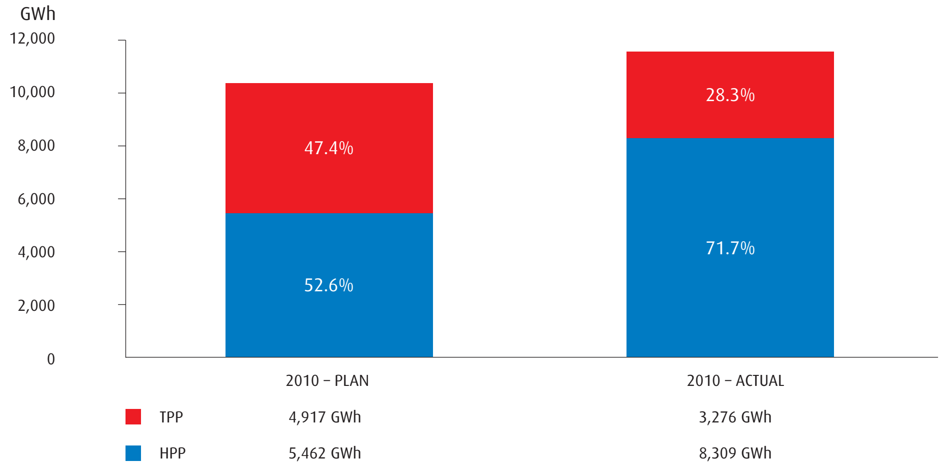
ELECTRICITY AND HEAT PRODUCTION IN 2010

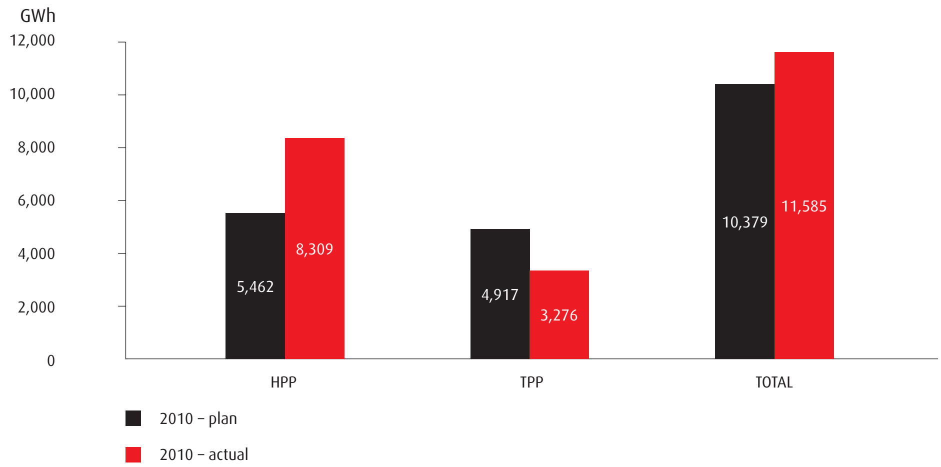
ELECTRICITY PRODUCTION

In 2010 HEP-Proizvodnja power plants generated 11,585 GWh of electricity. Hydro power plants generated 8,309 GWh or 71.7 percent and thermal power plants generated 3,276 GWh or 28.3 percent. Thus, HEP Proizvodnja's sources covered 58.3 percent of total electricity needs of Croatia.

Compared to the 2010 planned production, the actual production of electricity was higher by 11.6 percent with hydro power plants producing 52.1 percent more and thermal power plants 33.4 percent less.

Compared to 2009, total electricity production increased by 3.9 percent with hydro power plants generating 1,542 GWh or 22.8 percent more and thermal power plants 1,105 GWh or 25.2 percent less.





HEAT ENERGY PRODUCTION

In 2010, HEP Proizvodnja combined-cycle plants generated a total of 2,493,349 MWh of heat energy, which is 3.6 percent more than the total planned annual production. Compared to the year before heat production was higher by 10.9 percent. Process steam production was 828,942, which is 96.8 percent of the planned production (856,569 t), and 1.4 percent less than the production in 2009 (840,493 t).

Heat production in 2009 was 1,802,564 MWh or 6.4 percent more than the total planned production (1,694,082 MWh) and 7.6 percent more than the heat produced in 2009 (1,675,870 MWh).

Combined-cycle plants in 2010 produced 90.9 percent of the total heat energy.

POWER PLANT AVAILABILITY

The availability of all plants (excluding Dubrovnik 2 HPP and TE Plomin d.o.o.) was 98.2 percent which is 0.3 percent lower than the availability level achieved in 2009.

FINANCIAL STATEMENTS
INDEPENDENT AUDITOR'S REPORT

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

We have audited financial statements of HEP-Proizvodnja d.o.o.. (the "Company"), which comprise the statement of financial position as at 31 December 2010 and the related statement of income, statements of changes in shareholder's 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 unconsolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of unconsolidated financial statements that are free from material misstatement, whether due to fraud or error.

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.

OPINION

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

EMPHASIS OF MATTER

Revenue recognition

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. Our opinion is not modified in respect of this matter.

Accounting policy for leases

As described in Note 1 to the accompanying unconsolidated financial statements, the Company has received in lease certain property, plant and equipment under finance lease agreements from HEP D.D. The leases bear interest to the extent of the rates applicable to external funding acquired by the HEP D.D to construct those assets. These lease liability are carried at nominal amounts because of the special organizational framework of the HEP Group. Our opinion is not modified in respect of this matter.

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, 25 May 2011

HEP-PROIZVODNJA d.o.o. INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2010

	2010	2009
	HRK'000	HRK'000
Electricity generation fee income and other income from related companies	3,931,476	3,902,843
Other operating income	37,672	21,553
	3,969,148	**3,924,396**
Cost of energy sources, material and spare parts	1,704,769	2,175,127
Service cost	379,658	304,924
Staff costs	347,686	358,276
Depreciation and amortization	435,907	421,753
Administrative expenses – related companies	102,423	99,686
Other operating expenses	399,608	454,517
	3,370,051	**3,814,283**
Profit from operations	**599,097**	**110,113**
Finance income	233	297
Finance expenses	(62,530)	(98,158)
Net financial loss	**(62,297)**	**(97,861)**
Profit from operations before tax	**536,800**	**12,252**
Income tax (expense) / income	(108,046)	14,135
Profit for the year	**428,754**	**26,387**

Signed on behalf of the Company on 25 May 2011 by:
Nikola Rukavina,
President of the Board

HEP-PROIZVODNJA d.o.o. STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2010

	2010	2009
	HRK'000	HRK'000
Profit for the year	**428,754**	**26,387**
Other comprehensive income for the year	-	-
Total comprehensive income for the year	**428,754**	**26,387**

Signed on behalf of the Company on 25 May 2011 by:
Nikola Rukavina,
President of the Board

HEP-PROIZVODNJA d.o.o. STATEMENT OF FINANCIAL POSITION AT 31 DECEMBER 2010

ASSETS	31 December 2010	31 December 2009
	HRK'000	HRK'000
Intangible assets	4,355	3,795
Property, plant and equipment	6,424,526	6,675,211
Investment in progress	1,790,818	1,507,409
Investment property	39,195	37,133
Prepayments for tangible assets	20,871	30,330
Investments in related companies	7	7
Receivables from the sale of flats	16,026	16,085
Deferred tax assets	52,682	44,225
Total non-current assets	**8,348,480**	**8,314,195**
Inventories	727,079	579,844
Other current assets	15,224	30,992
Receivables from related companies	1,168,282	694,304
Trade receivables	1,369	1,843
Current portion of long-term receivables	2,310	4,132
Cash and cash equivalents	5,706	1,924
Total current assets	**1,919,970**	**1,313,039**
TOTAL ASSETS	**10,268,450**	**9,627,234**

Signed on behalf of the Company on 25 May 2011 by:
Nikola Rukavina,
President of the Board

HEP-PROIZVODNJA d.o.o. STATEMENT OF FINANCIAL POSITION AT 31 DECEMBER 2010 (CONTINUED)

EQUITY AND LIABILITIES	**31 December 2010**	**31 December 2009**
	HRK'000	HRK'000
Share capital	20	20
Capital reserves	-	9,188
Accumulated losses	349,390	(88,552)
Total equity	**349,410**	**(79,344)**
Long term liabilities to related companies	6,040,962	6,303,903
Long-term provisions	324,880	210,407
Other long-term liabilities	10,998	12,111
Total non-current liabilities	**6,376,840**	**6,526,421**
Trade payables	496,576	622,028
Liabilities to related companies	2,414,731	2,056,136
Current portion of long-term debt – related companies	435,907	421,753
Other payables	194,986	80,240
Total current liabilities	**3,542,200**	**3,180,157**
TOTAL EQUITY AND LIABILITIES	**10,268,450**	**9,627,234**

Signed on behalf of the Company on 25 May 2011 by:
Nikola Rukavina,
President of the Board

HEP-OPERATOR PRIJENOSNOG SUSTAVA d.o.o.

DUBRAVKO SABOLIĆ

DIRECTOR

IN ACCORDANCE with the legal and regulatory framework and within the limits of the approved Economic Plan and Investment Plan for 2010, HEP Operator prijenosnog sustava d.o.o. (HEP-OPS, HEP Transmission System Operator), in worsening business conditions continued to perform its basic tasks – operation of the electricity system of the Republic of Croatia, electricity transmission, maintenance and development and construction of the transmission network. The company provided 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 2010, a total electricity consumption was 17,944 GWh, which is 1 percent more than the total consumption in 2009. At the same time, system peak load of 3,121 MW is almost identical to the one in 2009. The share of transmission losses of 2.11 percent in total electricity transmitted (which was 25,284 GWh) is a little lower than in 2009 and is at a level of that of other transmission system operators in Europe

There were no larger disruption in the electricity supply system in 2010. Compared to 2009, the availability of the electricity system increased to 99.99 percent and non-supplied electricity, estimated at 867 MWh, significantly decreased.

In 2010, as in previous years, several transmission network facilities were put in operation, the most important of which are new transmission lines 2x400 kV Ernestinovo-Pecs, 2x110 kV Vinodol-Melina and 110 kV Plomin-Tupljak-Pazin, the new transformer station 110/20(35) kV Vrbovsko, while the transmission line Gojak HPP – Lešće HPP was put into operation at the voltage of 110 kV.

As part of the implementation of the Dubrovnik Program, activities continued to prepare the construction of TS 220/110 kV Plat.

In 2010, intensive activities continued to develop the first medium-term (ten-year) plan for the development of the Croatian transmission network for the period 2011-2020 in accordance with the provisions of the EU third energy legislative package.

Continuing to participate in the ITC mechanism, in 2010 HEP OPS continued to fulfil the requirements of Regulation 1228/2003/EC and Congestion Management Guidelines (Annex to the Regulation) concerning the establishment of joint actions for cross-border capacity of Croatian borders with the EU at all time levels. In this context we emphasize the successful introduction of joint annual, monthly and daily actions for cross-border transmission capacity on the Slovenia/Croatia border and, based on bilateral talks, it is expected that joint auctions toward Serbia and Bosnia and Herzegovina will be established in 2011.

HEP OPS employees cooperated with the relevant Ministry in overseeing the implementation of the obligations taken under the temporarily closed chapters 15 Energy and 21 Trans-European Networks within Croatia's EU accession negotiations. Following European Commission Progress Report, at the end of 2010 HEP OPS signed a conditional Statement on the Co-financing of the Costs of Project Team Company which is responsible for the establishment of a coordinated auction of the 8th Congestion Management region of South-Eastern Europe in Montenegro.

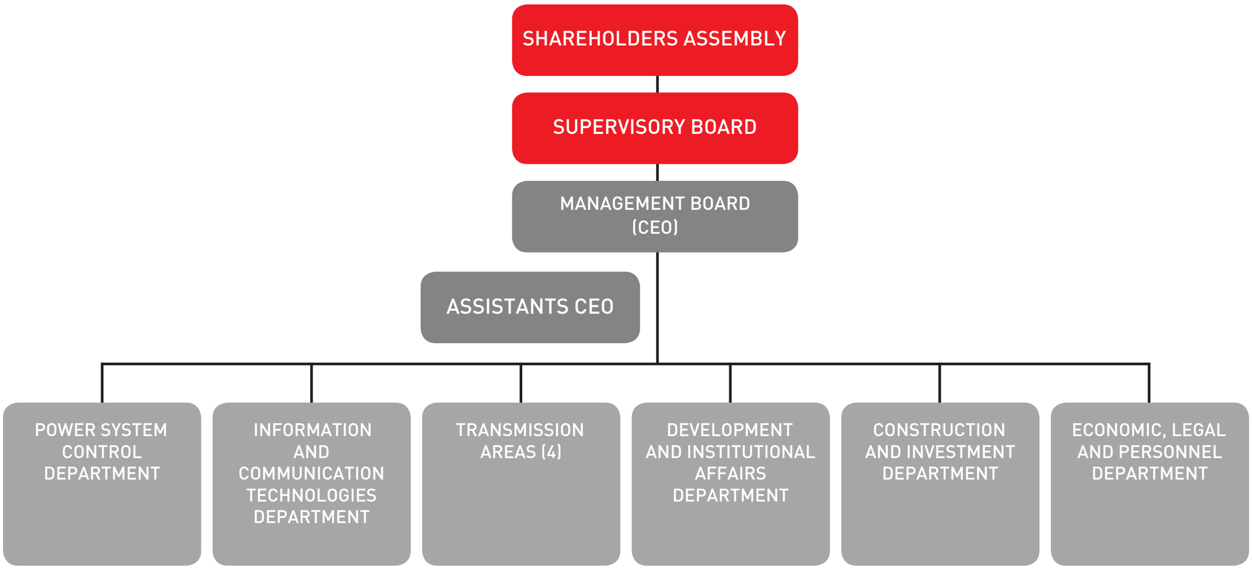
HEP OPS continued to participate, in accordance with the possibilities, in the work of the ENTSO Assembly, Board and working bodies (committees and groups).

In order to ensure the full functionality of the Croatian open electricity system, HEP OPS has initiated amendments to the Electricity System Balancing Rules.

HEP OPS continued with the extensive activities directed towards receiving an increased electricity production from wind parks. All HEP OPS obligations relating to environmental and nature protection have been met fully and on time in accordance with Croatia's laws and regulations, toward state institutions, local self governments and HEP Group members.

In conclusion, I can say that business achievements of HEP-ODS in 2010, 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.

ORGANIZATION CHART



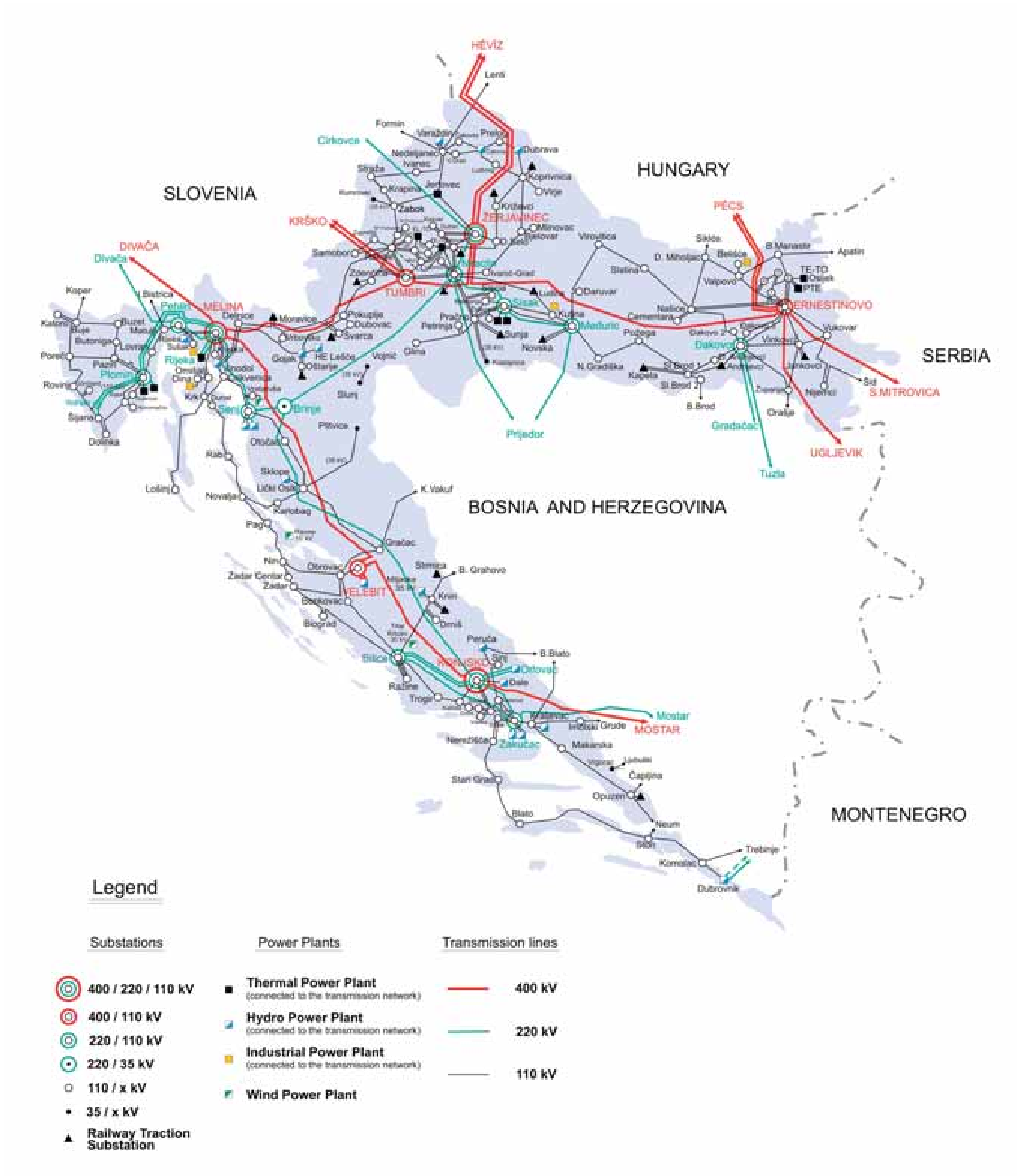
ELECTRICITY BALANCE 2010 (GWh)

Total production *	**13,268**
Import (entering Croatia)	12,359
Total procurement	25,627
Export (exiting Croatia)	7,683
Total consumption	17,944
Direct procurement and consumption on distribution network	471
Transmission losses	533
Transmission consumption	16,940
Direct customers	852
Pumping and other auxiliary consumption	210
Delivered to distribution from transmission network	**15,878**

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

System peak load, December 21, 2010 (MWh/h)	**3,121**

CROATIAN ELECTRIC POWER SYSTEM



TRANSMISSION NETWORK DECEMBER 31, 2010

	400 kV	220 kV	110 kV	Medium voltage	Total
Line lenght (km)	1,247	1,273	4,830	147	7,497
Transformer stations (number)	5	6	116	-	127
Installed capacity (MVA)	4,100	2,120	4,881	-	11,101

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 statement of financial position as at 31 December 2010 and the related statement of income, statement of comprehensive income, statement of changes in shareholders 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, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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 2010, 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 accounting policy

Without qualifying our opinion, we draw attention to Note 1 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. Such a policy is in accordance with applicable regulations and the laws regulations relating to tariffs. Our opinion is not modified in respect of this matter.

b) Accounting policy for leases

As described in Note 1 to the accompanying unconsolidated financial statements, the Company has received in lease certain property, plant and equipment under finance lease agreements from HEP D.D. The leases bear interest to the extent of the rates applicable to external funding acquired by the HEP D.D to construct those assets. These lease liabilities are carried at nominal amounts because of the special organizational framework of the HEP Group. Our opinion is not modified in respect of this matter.

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, 25 May 2011

HEP OPERATOR PRIJENOSNOG SUSTAVA d.o.o. INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2010

	2010	2009
	000'HRK	000'HRK
Electricity transmission income – related parties	1,154,253	1,148,301
Income from balancing energy – related parties	61,281	-
Income from sale of cross-border transmission capacity – related parties	87,186	22,964
Other income – related companies	1,486	1,902
Other operating income	112,261	55,884
	1,416,467	**1,229,051**
Material and spare parts expenses	(21,823)	(20,584)
Service expenses	(86,560)	(104,327)
Staff expenses	(186,884)	(190,916)
Depreciation and amortisation	(230,465)	(232,464)
Support system services expenses	(235,726)	(232,723)
Transmission grid losses	(260,263)	(224,854)
Purchase of balancing energy	(65,348)	-
Administrative expenses – related companies	(52,065)	(51,863)
Other operating expenses	(79,549)	(79,676)
	(1,218,683)	**(1,137,407)**
Profit from operations	**197,784**	**91,644**
Financial income	806	556
Financial expenses	(48,795)	(50,673)
Net financial loss	**(47,989)**	**(50,117)**
Profit before taxation	**149,795**	**41,527**
Income tax	(30,205)	(8,596)
Net profit for the year	**119,590**	**32,931**

Signed on behalf of the Company on 25 May 2011 by:
Dubravko Sabolić
Director

HEP OPERATOR PRIJENOSNOG SUSTAVA d.o.o.
STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2010

	2010	2009
	HRK '000	HRK '000
Profit for the year	**119,590**	**32,931**
Other comprehensive income	**-**	-
Total comprehensive income for the year	**119,590**	**32,931**

Signed on behalf of the Company on 25 May 2011 by:
Dubravko Sabolić
Director

HEP OPERATOR PRIJENOSNOG SUSTAVA d.o.o. STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2010

ASSETS	**31 December 2010**	**31 December 2009**
	000'HRK	000'HRK
Property, plant and equipment	3,807,668	3,590,050
Capital work in progress	438,158	650,056
Intangible assets	24,179	16,883
Investment properties	8,751	7,171
Prepayments for tangible assets	169	251
Receivables from sale of flats	5,955	6,420
Deferred tax assets	11,293	10,201
Total non-current assets	**4,296,173**	**4,281,032**
Inventories	17,808	18,771
Trade receivables	46,807	18,523
Receivables from related companies	423,908	412,351
Other current assets	23,613	8,838
Current portion of long-term receivables	673	772
Cash and cash equivalents	11,570	12,997
Total current assets	**524,379**	**472,252**
TOTAL ASSETS	**4,820,552**	**4,753,284**

Signed on behalf of the Company on 25 May 2011 by:
Dubravko Sabolić
Director

HEP OPERATOR PRIJENOSNOG SUSTAVA d.o.o. STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2010 (CONTINUED)

CAPITAL AND LIABILITIES	**31 December 2010**	**31 December 2009**
	000'HRK	000'HRK
Subscribed capital	20	20
Reserves	40	40
Retained earnings	119,590	32,931
Total equity	**119,650**	**32,991**
Long-term liabilities to related company	3,546,045	3,366,368
Provisions for retirement and jubilee bonuses, and legal actions	50,852	32,061
Other non-current liabilities	94,021	55,822
Total non-current liabilities	**3,690,918**	**3,454,251**
Liabilities to related companies	559,622	720,760
Trade payables	162,249	274,504
Current portion of long-term liabilities to related company	229,919	232,305
Other current liabilities	58,194	38,473
Total current liabilities	**1,009,984**	**1,266,042**
TOTAL CAPITAL AND LIABILITIES	**4,820,552**	**4,753,284**

Signed on behalf of the Company on 25 May 2011 by:
Dubravko Sabolić
Director

HEP-OPERATOR DISTRIBUCIJSKOG SUSTAVA d.o.o.

MIŠO JURKOVIĆ

DIRECTOR

HEP ODS (HEP Distribution System Operator) business operations in 2010 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 and HEP d.d. Management Board decision concerning reduction in manageable and partly manageable costs was implemented. Great significance was given to the processes related to the functioning of the electricity market, primarily through improvement in IT support in the process of supplier switching and exchanging metering data.

The trend of diminishing number of cases of ascertained unauthorized electricity consumption continued as a result of permanent activities to refurbish metering points. The continuous business objectives have been to improve payment collection, optimize inventories, raise the quality of electricity supply, and raise the quality of services in the activities of distribution and supply.

During the year, 16 capital projects were successfully completed (of the voltage level 110 kV, 35 kV and 20 kV). Other investments were also fully carried out. Investments in the reconstruction of 110 kV transformer stations were completed: TS 110/10(20) kV Đakovo 3, TS 110/10(20) kV Dugo Selo, TS 110/10(20) kV Vrbovsko i TS 110/30/10(20) kV Podi. Also completed was construction or reconstruction of several 35 kV and 20 kV facilities: TS 35/10(20)kV Čakovec Istok, Sali, Park, Križ, Postira i Vrata; KB 20/35 kV Kostajnica – Dvor; KB 10(20) kV TS 110/35/10(20) kV Poreč – Poreč 1 – Poreč 2; PKB 20 kV Turanj – Babac – Pašman; DV 10(20) kV Kolan – Gajac; changeover to 20 kV in the Krapina area and additions to DC Vinkovci with equipment replacement.

In 2010, procurement and installation of 1,000 remote-communication interval meters was carried out, which were incorporated in AMR (Automatic Meter Reading) system, whereby metering data necessary for the functioning of the electricity market were secured (determination of electricity consumption in hourly intervals). As part of the program of refurbishment of metering points, 871 hand-held terminal were procured with software support and a meter reading probe, for all distribution areas.

In accordance with the pace of return of displaced persons and refugees, reconstruction continued in areas war affected areas.

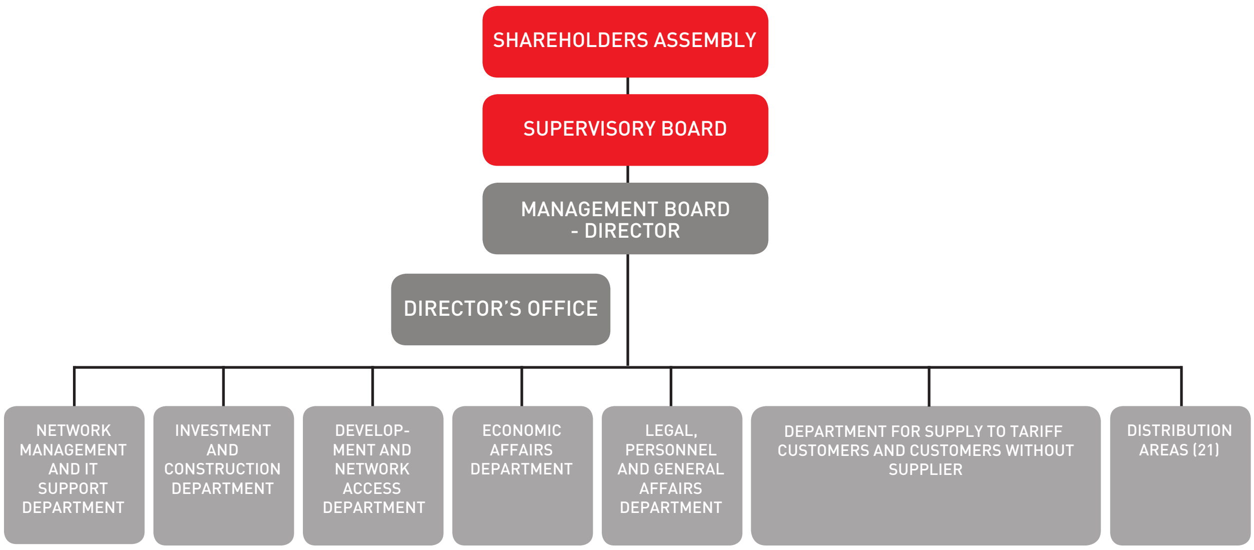
During 2010, the activities intensified to connect power plants which are in the renewable sources incentive system to the distribution network. In the preparatory part, analyses of connection possibilities and studies on optimum technical solutions encompassed 23 power plants of 80 MW of combined capacity and 16 preliminary connection approvals were issued for a total capacity of 61 MW. During 2010, six power plants of 14 MW in total were connected to the distribution network. Connecting power plants to the network raises questions about trial operation of power plants on the network, network operation with distributed generation and maintenance of the distribution network which is not radially supplied any more. We face numerous challenges, from coordination with HEP OPS through adoption of standards to recognition of distributed production which will increasingly affect the concept of development, operation and maintenance of the distribution system.

The refurbishment cycle of medium-sized control centers aimed at establishing a state-of-the-art architecture of the electricity network remote control and monitoring system was completed. HEP ODS expert team initiated the development of SCADAinfo application for these centers, which makes it possible to access data from SCADA through the internet in HEP’s business network.

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. In 2010, a pilot project to install meters with remote switch- off was successfully implemented.

Overseeing the quality of services provided to customers is a permanent obligation of HEP ODS as well as a non-biased relation toward all participants in the electricity market and monitoring and analysis of electricity supply quality, all of which is reported to HERA annually.

ORGANIZATION 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
7	324	3,501	21,087

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
72.1	11.0	5.8	3,317.4	1,295.2	135.3	2,934.5	2,373.5	2.6

Lines 10 kV (km)			Mreža 0.4 kV (km)			Household connections (km)		
OHL	Cable	Undersea	OHL – bare	OHL – insulated	Cable	OHL – bare	OHL – insulated	Cable
19,297.1	10,724.8	234.8	22,947.1	23,674.2	16,375.8	4,741.1	15,820.6	10,159.3

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

Description	Number of metering points
High voltage 110 kV	4
Total medium voltage	2,112
Low voltage – commercial (excl. public lighting)	190,711
Low voltage – commercial (public lighting)	21,126
Low voltage – residential	2,116,379
TOTAL	**2,330,332**

SALES OF ELECTRICITY BY CUSTOMER CATEGORY IN 2010 (kWh)

Description	Total Croatia
Commercial – high voltage (HV)	147,957,833
Commercial – medium voltage (MV)	3,399,354,134
TOTAL Commercial HV and MV	**3,547,311,967**
Commercial – low voltage (LV)	4,210,544,743
Commercial – low voltage (LV) – public lighting	440,314,330
Residential – low voltage (LV)*	6,664,706,848
TOTAL LOW VOLTAGE	**11,315,565,921**
Public supply service	8,093,168,885
Eligible customers**	6,769,709,003
TOTAL SALES ON DISTRIBUTION NETWORK	**14,862,877,888**
Sales to customers without supplier on transmission network	47,257,342

NOTES:
*Data on electricity sold to residential customers are based on estimated consumption billing.
**There are four eligible customers' suppliers active in the electricity market. 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 statement of financial position as at 31 December 2010 and the related income statement, statement of comprehensive income, statements of changes in shareholder's equity and statement 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, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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 controls 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.

BASIS FOR MODIFIED OPINION

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

The Company has not applied IFRIC 18 Transfers of Assets from Customers, which specifies the accounting for assets transferred from customers, by which the income from such assets should be recognized immediately upon the transfer in the statement of comprehensive income 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 statement of the comprehensive income of the Company for the year ended 31 December 2009 and on shareholders' equity for the year ended 31 December 2010.

MODIFIED OPINION

In our opinion, except for the effect of the matters discussed in paragraph a), financial statements present fairly, in all material respects, the financial position of the Company as at 31 December 2010, 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) Accounting policy for leases

As described in Note 1 to the accompanying unconsolidated financial statements, the Company has leased certain property, plant and equipment under finance lease agreements to its subsidiaries. The leases bear interest to the extent of the rates applicable to external funding acquired by the Company to construct those assets. These lease receivables are carried at nominal amounts because of the special organizational framework of the HEP Group. Our opinion is not modified in respect of this matter.

Deloitte d.o.o.
Branislav Vrtačnik, Certified Auditor
Zagreb, 25 May 2011

HEP OPERATOR DISTRIBUCIJSKOG SUSTAVA d.o.o. INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2010

	2010	2009
	HRK '000	HRK '000
Electricity distribution fee income – related companies	3,262,219	3,155,948
Services rendered	180,367	139,256
Other operating income	333,595	356,395
Total operating income	**3,776,181**	**3,651,599**
Cost of externally purchased energy	(19,170)	(12,054)
Grid losses and balancing energy purchases	(680,651)	(663,420)
Service expenses	(243,438)	(289,201)
Staff expenses	(1,181,872)	(1,215,694)
Depreciation and amortisation	(768,409)	(750,252)
Administrative expenses – related companies	(161,233)	(176,233)
Other operating expenses	(577,402)	(558,446)
Total operating expenses	**(3,632,175)**	**(3,665,300)**
Profit / (loss) from operations	**144,006**	**(13,701)**
Financial income	706	1,550
Finance costs	(37,083)	(40,906)
Net financial loss	**(36,377)**	**(39,356)**
Profit / (loss) before tax	**107,629**	**(53,057)**
Income tax expense	(22,499)	(11,281)
Profit / (loss) for the year	**85,130**	**(64,338)**

Signed on behalf of the Company on 25 May 2011 by:
Mišo Jurković,
Managing Director

HEP OPERATOR DISTRIBUCIJSKOG SUSTAVA d.o.o. STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2010

	2010	2009
	HRK '000	HRK '000
Profit / (loss) before tax	**85,130**	**(64,338)**
Other comprehensive income for the year	-	-
Total comprehensive income / (loss) for the year	**85,130**	**(64,338)**

Signed on behalf of the Company on 25 May 2011 by:
Mišo Jurković,
Managing Director

HEP OPERATOR DISTRIBUCIJSKOG SUSTAVA d.o.o. STATEMENT OF FINANCIAL POSITION AT 31 DECEMBER 2010

ASSETS	**31 December 2010**	**31 December 2009**
	HRK'000	HRK'000
Property, plant and equipment	11,893,722	11,750,952
Capital work in progress	502,836	701,611
Intangible assets	16,150	16,477
Investment properties	72,143	56,132
Receivables from sale of flats	24,695	27,004
Prepayments for tangible assets	5	12
Deferred tax assets	60,612	56,293
Total non-current assets	**12,570,163**	**12,608,481**
Inventories	204,341	213,480
Trade receivables	700,054	663,908
Receivables from related companies	1,156,065	1,311,541
Current portion of long-term receivables	3,451	3,618
Other current assets	38,409	58,095
Cash and cash equivalents	31,630	27,749
Total current assets	**2,133,950**	**2,278,391**
Total assets	**14,704,113**	**14,886,872**

Signed on behalf of the Company on 25 May 2011 by:
Mišo Jurković,
Managing Director

HEP OPERATOR DISTRIBUCIJSKOG SUSTAVA d.o.o. STATEMENT OF FINANCIAL POSITION AT 31 DECEMBER 2010 (CONTINUED)

EQUITY AND LIABILITIES	**31 December 2010**	**31 December 2009**
	HRK '000	HRK '000
Subscribed capital	20	20
Retained earnings	71,053	(14,077)
Total equity	**71,073**	**(14,057)**
Long-term liabilities to related companies	7,491,403	7,543,351
Other non-current liabilities	17,031	18,503
Deferred income	4,389,927	4,351,403
Long-term provisions	279,031	246,085
Total non-current liabilities	**12,177,392**	**12,159,342**
Trade payables	351,872	557,942
Liabilities to related companies	1,212,123	1,258,278
Current portion of long-term liabilities to related company	568,842	571,063
Other current liabilities	322,811	354,304
Current liabilities	**2,455,648**	**2,741,587**
TOTAL CAPITAL AND LIABILITIES	**14,704,113**	**14,886,872**

Signed on behalf of the Company on 25 May 2011 by:
Mišo Jurković,
Managing Director

HEP-TOPLINARSTVO d.o.o.

ROBERT KRKLEC

DIRECTOR

IN 2010, HEP Toplinarstvo d.o.o. (HEP Heating) successfully carried out its activities of production, distribution and supply of heat energy as well as development and construction of the heating network in Zagreb, Osijek, Sisak, Velika Goprica, Samobor and Zaprešić. Despite harder business conditions, caused by the economic crisis as well as by inadequate heat selling prices, the company provided quality and reliable deliveries of heat energy and process steam for 116,534 household and 5,950 economic entities.

As part of the Investment Plan, HEP Toplinarstvo continued the implementation of the existing investment projects and started new ones. Especially worth mentioning is the completion of the Hot Water Network Refurbishment Project in Zagreb and Osijek, financed by a World Bank loan and partly by our own funds. As part of this capital project, implemented from 2006 to 2010, 20 km of hot water network in Zagreb and 7.2 km of hot water network in Osijek were refurbished and 2.6 km of new hot water pipelines in Osijek were built. The refurbishment of the hot water network has been the largest work of its type ever since the network was originally constructed. The refurbished network increases the safety of the heating system, reduces distribution losses of heat energy as well as makeup service water, whereby large financial savings are achieved, number of emergency repair decreases, new technologies are adopted, armature handling is facilitated and its life is extended, network monitoring system is improved, and indirectly a positive environmental impact is achieved.

In 2010, the construction was completed of new power facilities as part of the project of construction, operation and maintenance of the energy plant for Zagreb University Hospital at Rebro Hospital location. The project encompasses a complete supply to the hospital of all energy forms – heat energy, cooling energy, process steam and electricity.

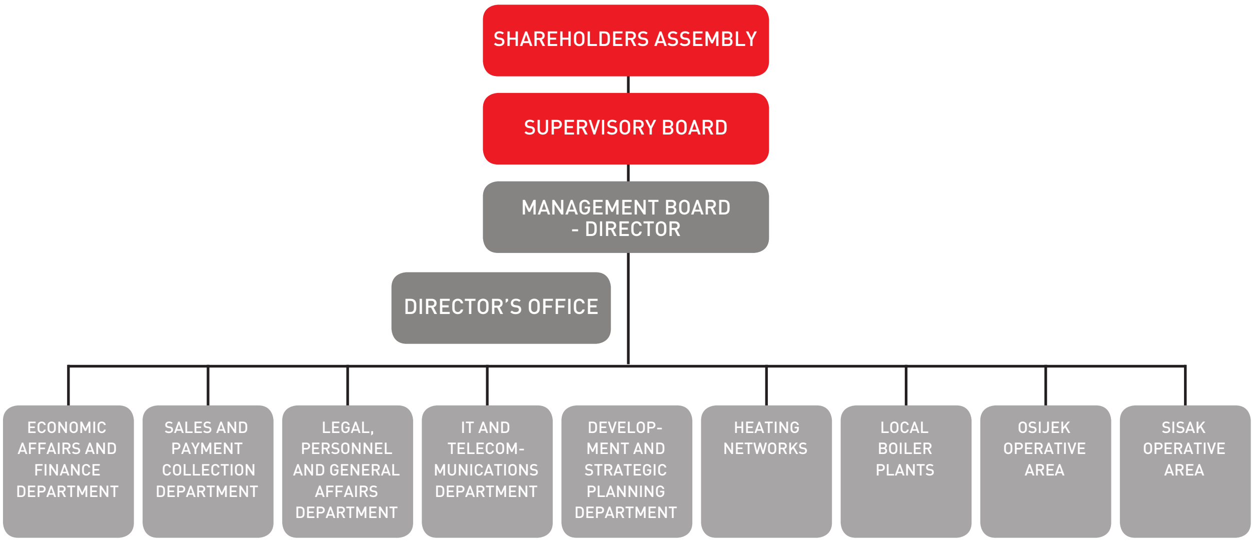
In addition to the above projects, the implementation of energy efficiency projects began in cooperation with HEP ESCO – the project to introduce gas to boiler G3 (the largest boiler plant in Velika Gorica, 20 MWt) and to build a connecting hot water pipeline between boiler plants G3 and G1, as well as the project of technological and economic optimization of the district heating system in Zagreb (TERMIS) system). The main objectives of these projects are more economical business operations, environmental protection and development of new technological solutions for the application of energy efficiency measures, in accordance with the strategic interests of the national energy policy.

In spite of the utmost efforts of the Company, in 2010 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. The continuous growth of input costs has not been followed by appropriate change in selling prices and/or revenues from heat energy supplied, which is crucial for normal operations and development of the business.

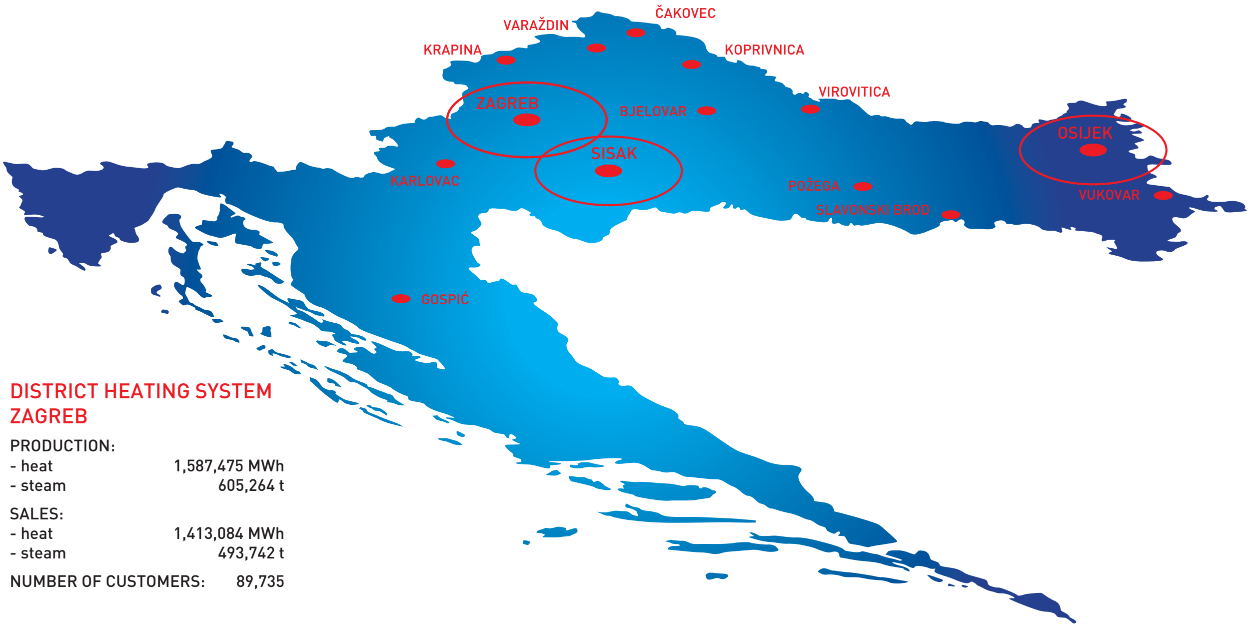
It must be also mentioned that the amendments to the Energy Act of October 2010 transfer decision making concerning change of amount of tariff items in the Tariff System for energy activities of heat energy production, distribution and supply to the level of representative bodies of local self government, which is very unfavorable for the heating activity. HEP Toplinarstvo experts have participated from the very beginning in legislative procedures vital for the reform of the energy sector in the area of heating, and we intend to continue to do so in the future.

Finally, I believe that HEP Toplinarstvo through the organized, professional and dedicated work of its experts will successfully carry out the planned investment projects, new connections, maintenance work, make heating system improvement and meet the requirements facing the heating activity upon the coming into force of the new legislation as well as all other challenges that lie ahead in 2010, in spite of aggravated business conditions.

ORGANIZATION CHART



HEP TOPLINARSTVO d.o.o. IN 2010



DISTRICT HEATING SYSTEM ZAGREB

PRODUCTION:	
- heat	1,587,475 MWh
- steam	605,264 t
SALES:	
- heat	1,413,084 MWh
- steam	493,742 t
NUMBER OF CUSTOMERS:	89,735

SISAK OPERATIVE AREA

PRODUCTION:	
- heat	99,413 MWh
- steam	15,243 t
SALES:	
- heat	64,855 MWh
- steam	11,132 t
NUMBER OF CUSTOMERS:	4,098

LOCAL BOILER PLANTS

PRODUCTION:	
- heat	213,691 MWh
SALES:	
- heat	196,565 MWh
NUMBER OF CUSTOMERS:	16,949

OSIJEK OPERATIVE AREA

PRODUCTION:	
- heat	220,535 MWh
- steam	124,633 t
SALES:	
- heat	198,692 MWh
- steam	87,485 t
NUMBER OF CUSTOMERS:	11,702

During 2010 the number of heat energy customers rose by 0.4 percent to a total number of 122,484, of which 116,1534 households and 5,950 corporate entities. Due to new customer connection, the contracted load increased by 4.6 MW in the Zagreb area and by 0.4 MW in the Osijek area.

In heat consumption (district heat and process steam) households make 59 percent (50 percent in income) and corporate entities 41 percent (50 percent in income). The ratio of delivered heat energy (hot water) to process steam in MWh was 79.1% : 20.9%.

In consumption of district heat, the share of Zagreb (including Samobor, Velika Gorica and Zaprešić) was 85.9 percent, Osijek 10.6 percent, and Sisak 3.5 percent. Consumption of steam delivered for industrial processes was 592,360 (Zagreb 83.3 percent, Osijek 14.8% percent, Sisak 1.9 percent.

In 2010, heat energy sales increased by 3.8 percent compared to the year before (sales of district heat increased by 5.1 percent and sales of process steam decreased by 0.7 percent), a consequence of a somewhat colder heating season and higher number of customers.

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 statement of financial position as at 31 December 2010 and the related statement of income, statement of comprehensive income, statements of changes in equity and of cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

MANAGEMENT'S RESPONSIBILITY FOR THE FINANCIAL STATEMENTS
Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

AUDITOR'S RESPONSIBILITY
Our responsibility is to express an opinion on these financial statements based on our audit. Except as provided in paragraph a) Matter affecting the opinion, 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 not applied IFRIC 18 Transfers of Assets from Customers, which specifies the accounting for assets transferred from customers, by which the income from such assets should be recognised immediately upon the transfer in the statement of comprehensive income 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 statement of the comprehensive income and of the Company for the year ended 31 December 2009 and on the shareholders' equity for the year ended 31 December 2010.

MODIFIED 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 2010, 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 with continuous support of 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. Our opinion is not modified in respect of this matter.

b) Accounting policy for leases

As described in Note 1 to the accompanying financial statements, the HEP d.d. has leased certain property, plant and equipment under finance lease agreements to its subsidiaries. The leases bear interest to the extent of the rates applicable to external funding acquired by the HEP d.d. to construct those assets. These lease receivables are carried at nominal amounts because of the special organizational framework of the HEP Group. Our opinion is not modified in respect of this matter.

Deloitte d.o.o.
Branislav Vrtačnik, Certificated Auditor
Zagreb, 25 May 2011

HEP TOPLINARSTVO d.o.o. INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2010

	2010	2009
	HRK'000	HRK'000
Income from thermal energy sale	572,718	556,684
Income from sale of electric energy to eligible customers	8,026	-
Income from thermal energy and other income – related companies	3,791	3,802
Restaurant income	530	750
Other operating income	44,647	49,184
	629,712	**610,394**
Energy, material and spare parts expenses	(101,517)	(77,881)
Service expenses	(27,791)	(26,413)
Staff expenses	(47,141)	(52,428)
Depreciation and amortisation	(56,240)	(54,882)
Expense in respect of electricity generation and other expenses – related companies	(484,075)	(419,831)
Other operating expenses	(55,540)	(83,347)
	(772,304)	**(714,782)**
Loss from operations	**(142,592)**	**(104,388)**
Financial revenues	7,567	5,930
Financial expenses	(12,171)	(15,072)
Net financial loss	**(4,604)**	**(9,142)**
Loss before tax	**(147,196)**	**(113,530)**
Income tax	-	-
Loss for the year	**(147,196)**	**(113,530)**

Signed on behalf of the Company on 25 May 2011 by:
Robert Krklec
Director

HEP TOPLINARSTVO d.o.o. STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2010

	2010	2009
	HRK '000	HRK '000
Loss for the year	**(147,196)**	**(113,530)**
Other comprehensive income for the year	-	-
Total comprehensive loss for the year	**(147,196)**	**(113,530)**

Signed on behalf of the Company on 25 May 2011 by:
Robert Krklec
Director

HEP TOPLINARSTVO d.o.o. STATEMENT OF FINANCIAL POSITION AT 31 DECEMBER 2010

ASSETS	**31 December 2010**	**31 December 2009**
	HRK'000	HRK'000
Property, plant and equipment	864,816	788,312
Assets under construction	38,494	73,991
Intangible assets	953	1,331
Receivables from sale of flats	705	790
Advances for property, plant and equipment	44	-
Investment property	903	360
Receivables from related companies	174,283	122,342
Total non-current assets	**1,080,198**	**987,106**
Inventories	24,225	29,569
Trade receivables	137,562	123,233
Receivables from related companies	15,098	3,240
Other current assets	19,934	7,336
Current portion of long-term receivables	294	294
Cash and cash equivalents	9,528	11,198
Total current assets	**206,641**	**174,870**
TOTAL ASSETS	**1,286,839**	**1,161,976**

Signed on behalf of the Company on 25 May 2011 by:
Robert Krklec
Director

HEP TOPLINARSTVO d.o.o. STATEMENT OF FINANCIAL POSITION AT 31 DECEMBER 2010 (CONTINUED)

	31 December 2010	31 December 2009
	HRK'000	HRK'000
Share capital	20	20
Reserves	20	20
Accumulated losses	(825,333)	(678,137)
Total equity	**(825,293)**	**(678,097)**
Long-term liabilities to related companies	1,003,074	865,822
Other long-term liabilities	477	510
Long-term provisions	7,664	5,881
Deferred income	164,248	167,305
Total non-current liabilities	**1,175,463**	**1,039,518**
Trade payables	40,889	53,191
Liabilities to related companies	832,679	681,733
Current portion of long-term debt to related companies	56,240	54,882
Other short-term liabilities	6,861	10,749
Total current liabilities	**936,669**	**800,555**
TOTAL EQUITY AND LIABILITIES	**1,286,839**	**1,161,976**

Signed on behalf of the Company on 25 May 2011 by:
Robert Krklec
Director

HEP-PLIN d.o.o.

NIKOLA LIOVIĆ

DIRECTOR

HEP-PLIN (HEP Gas) carries out two energy businesses of the gas sector: gas distribution and gas supply to customers. The conditions for the carrying out of these activities are laid down, in addition to the Companies Act, in special laws: Energy Act and Gas Market Act and in 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 its 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 2010 were marked by stagnation of business activities in Croatia, reflected as decrease in gas sales to commercial customers, especially to our large customers. In contrast to that, in residential customers, who use by far the most gas for heating, gas consumption slightly increased due to colder weather than in the previous year in the heating season.

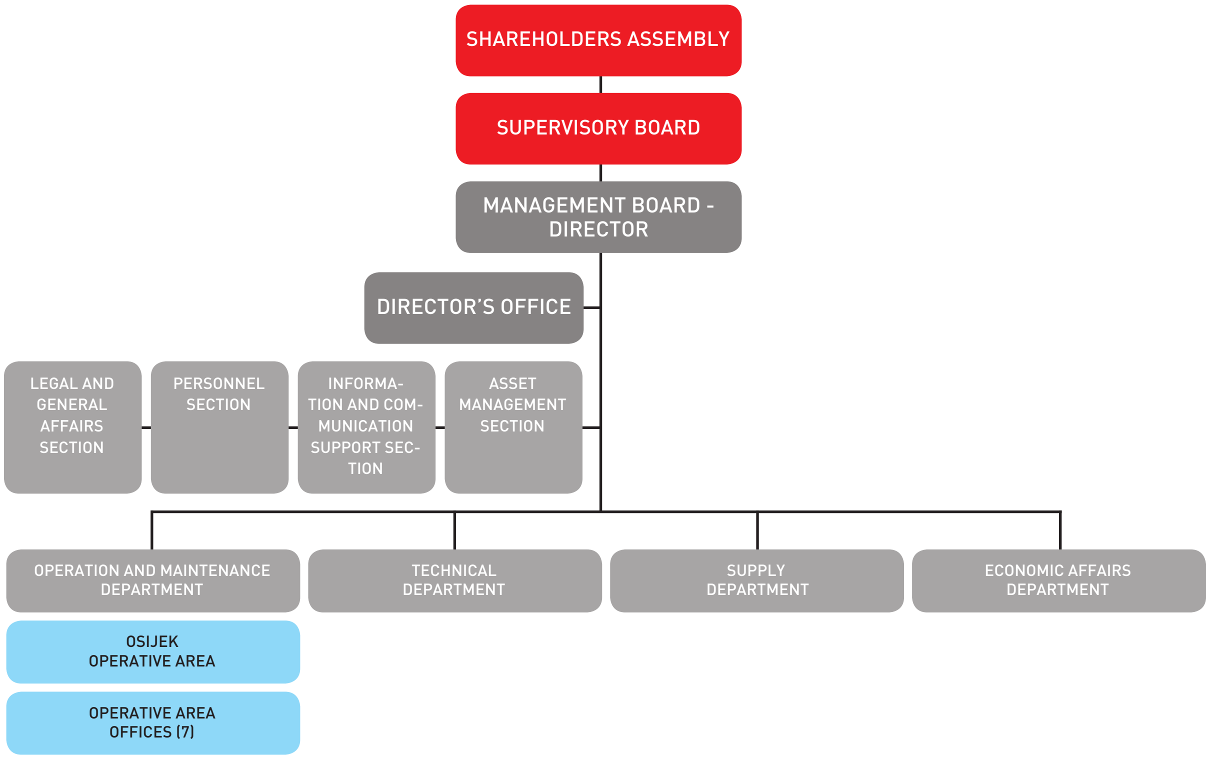
Due to the implementation of savings measures it is planned to further cut all costs that do not directly affect the security and continuity of gas supply to customers.

Current tasks arising from the set objectives were successfully carried out to our and our customers' satisfaction and to the satisfaction of our concession grantors – 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 third party works within the perimeter of the gas network.

The gas delivered was billed at prices adopted by the Government. Changes were unusually frequent, as many as five times during 2010 – at the beginning of each quarter and on November 1. In 2010, payment collection difficulties continued, especially from commercial customers, which considerably worsened the Company's solvency. In spite of that, thanks to among other things the centralized financial function in HEP Group, the worse solvency did not considerably affect the fulfilling of our obligations for the purchased gas.

In the area of development, last year we continued concession construction of the gas network in Baranja and in the municipalities of Gorjani, Punitovci and Šodolovci. Unfortunately, connection of new customers to the completed network did not unfold according to our plans and expectations due to the economic and social crises. The existing network underwent the necessary modifications and reconstruction in accordance with the reduced investment funds.

ORGANIZATION CHART



HEP-PLIN d.o.o. IN 2010

GAS DISTRIBUTOR HEP PLIN d.o.o. OSIJEK

GAS TRANSPORTER PLINACRO d.o.o. ZAGREB

NUMBER OF CUSTOMERS

Supply area		Customer category	
Osijek-Baranja County	59,060	TM1 – Residential	64,986
Požega-Slavonija County	7,579	TM2 – Commercial (up to 1 million m^3)	5,315
Virovitica-Podravina County	3,680	TM3 – Commercial (above 1 million m^3)	18
Total	**70,319**	**Total**	**70,319**

TM – tariff model

GAS NETWORK

	2009	2010	2010/2009 (%)
Gas lines – owned by HEP d.d. (km)	1,691	1,781	5.3
Gas lines – owned by other parties (km)	531	531	0
Gas lines – total	**2,222**	**2,312**	**4.1**
Reducing stations – DRS (number)	**52**	**52**	**0**
Odorizors (number)	**26**	**27**	**0**

ENERGY BALANCE (10^3 m^3)

	2009	2010	2010/2009 (%)
Procurement (10^3 m^3)	165,114	170,823	3.5
Sales (10^3 m^3)	157,346	162,014	3.0

GAS SALES STRUCTURE (10^3 m^3)

Customer category	**2009**	**2010**	**2010/2009 (%)**
TM1 – Residential	88,291	94,169	6.7
TM2 – Commercial (up to 1 million m^3)	44,291	45,229	2.1
TM3 – Commercial (above 1 million m^3)	24,765	22,616	-8.7
Total	**157,347**	**162,014**	**3.0**

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

We have audited financial statements of HEP Plin d.o.o. (the "Company"), which comprise of the statement of financial position as at 31 December 2010 and the related statement of income, statements of changes in shareholders' 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, and for such internal control as management determines is necessary to enable the preparation of unconsolidated financial statements that are free from material misstatement, whether due to fraud or error.

AUDITOR'S RESPONSIBILITY

Our responsibility is to express an opinion on these unconsolidated financial statements based on our audit. Except as provided in paragraph a) below, 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 unconsolidated 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 unconsolidated 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 unconsolidated 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 unconsolidated 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

Application of IFRIC 18 Transfers of Assets from Customers

The Company has not applied IFRIC 18 Transfers of Assets from Customers, which specifies the accounting for assets transferred from customers, by which the income from such assets should be recognised immediately upon the transfer in the statement of comprehensive income 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 the untimely adoption of the Interpretation on the financial statements. As a result, we are unable to assess the impact of this matter on the statement of the comprehensive income and of the Company for the year ended 31 December 2009 and on the shareholder's equity for the year ended 31 December 2010.

MODIFIED 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 2010, 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, 25 May 2011

HEP PLIN d.o.o. INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2010

	2010	2009
	HRK'000	HRK'000
Gas sales	394,182	294,263
Service revenues	3,970	2,379
Income from related companies	2,264	1,814
Other operating income	22,422	22,109
Total operating income	**422,838**	**320,565**
Cost of gas purchase and material used	(358,003)	(258,673)
Service expenses	(3,757)	(3,799)
Staff expenses	(18,631)	(19,203)
Depreciation and amortization	(10,929)	(10,648)
Expenses with related parties	(4,765)	(4,321)
Other operating expenses	(29,844)	(23,742)
Total operating expenses	**(425,929)**	**(320,386)**
(Loss) / Profit from operations	**(3,091)**	**179**
Financial income	46	81
Financial expenses	(1,190)	(729)
Net financial (loss)	**(1,144)**	**(648)**
Loss from operations before tax	**(4,235)**	**(469)**
Income tax	743	(204)
Loss for the year	**(3,492)**	**(673)**

Signed on behalf of the Company on 25 May 2011 by:
Nikola Liović
Director

HEP PLIN d.o.o. STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2010

	2010	2009
	HRK'000	HRK'000
Loss for the year	**(3,492)**	**(673)**
Other comprehensive income for the year	-	-
Total comprehensive (loss) for the year	**(3,492)**	**(673)**

Signed on behalf of the Company on 25 May 2011 by:
Nikola Liović
Director

HEP PLIN d.o.o. STATEMENT OF FINANCIAL POSITION AT 31 DECEMBER 2010

ASSETS	31 December 2010	31 December 2009
	HRK'000	HRK'000
Property, plant and equipment	188,104	179,521
Investment in progress and prepayments	1,570	4,201
Intangible assets	210	186
Prepayments for non-current assets	-	7
Deferred tax assets	869	126
Total non-current assets	**190,753**	**184,041**
Inventories	2,173	1,966
Trade receivables	120,584	95,304
Receivables from related companies	7,903	829
Other current assets	4,404	4,850
Cash and cash equivalents	1,422	826
Total current assets	**136,486**	**103,775**
Total assets	**327,239**	**287,816**

Signed on behalf of the Company on 25 May 2011 by:
Nikola Liović
Director

HEP PLIN d.o.o. STATEMENT OF FINANCIAL POSITION AT 31 DECEMBER 2010 (CONTINUED)

SHAREHOLDERS'EQUITY AND LIABILITIES	31 December 2010	31 December 2009
	HRK '000	HRK '000
Share capital	20	20
Accumulated losses	(4,792)	(4,119)
Loss for the year	(3,492)	(673)
Total equity	**(8,264)**	**(4,772)**
Long-term liabilities to related companies	86,236	77,359
Deferred income	100,802	99,755
Other non-current liabilities	3,030	2,336
Total non-current liabilities	**190,068**	**179,450**
Trade payables	71,512	44,328
Liabilities to related companies	62,546	56,608
Current portion of long-term liabilities to related Companies	6,376	6,347
Other current liabilities	5,001	5,855
Total current liabilities	**145,435**	**113,138**
TOTAL CAPITAL AND LIABILITIES	**327,239**	**287,816**

Signed on behalf of the Company on 25 May 2011 by:
Nikola Liović
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.

VLADIMIR KUREČIĆ

PROCURATOR

FOR HEP-OPSKRBA (HEP Supply), as the leading electricity supplier, the year 2101 was a sort of a turning point in the electricity market in Croatia. Although the development of the electricity market is measured by a series of parameters, one of the key ones is the number of switches from one supplier to another. And the number of switches in the past year points to the increasing activity of the market, which is additionally substantiated by the data on the number of active suppliers.

In such circumstances, HEP Opskrba made efforts to improve its services in order to keep its leading supplier position. This can be illustrated by the fact that we ended the year 2010 with more than 50 thousand customers and more than 123 thousand contractual metering points. It should be pointed out that in the overall market in 2010 HEP Opskrba achieved 84 percent of sales in the commercial category and, despite anti-recession measures, sold 7.5 TWh of electricity, or 48 percent of total sales in the Croatian market. A total of 3.5 billion kuna was invoiced of which 3.5 billion kuna was collected. Although we ended the year, financially speaking, successfully, the emphasis on payment collection has remained a priority.

In cost management good results were achieved, although some costs, which are frequently a consequence of inherited habits of the customers and in the entire system alike, could have been lower.

The intensified sales activity and provision of additional services we had to cover with the number of employees that had not changed considerably and is still far from the optimum and planned number. Therefore the new organization and job classification plan will be one of our key tasks in the next year. All of the above mentioned has reflected on the planned education, professional improvement and training courses, which we had to reduce to a minimum in order for current business operations to run smoothly.

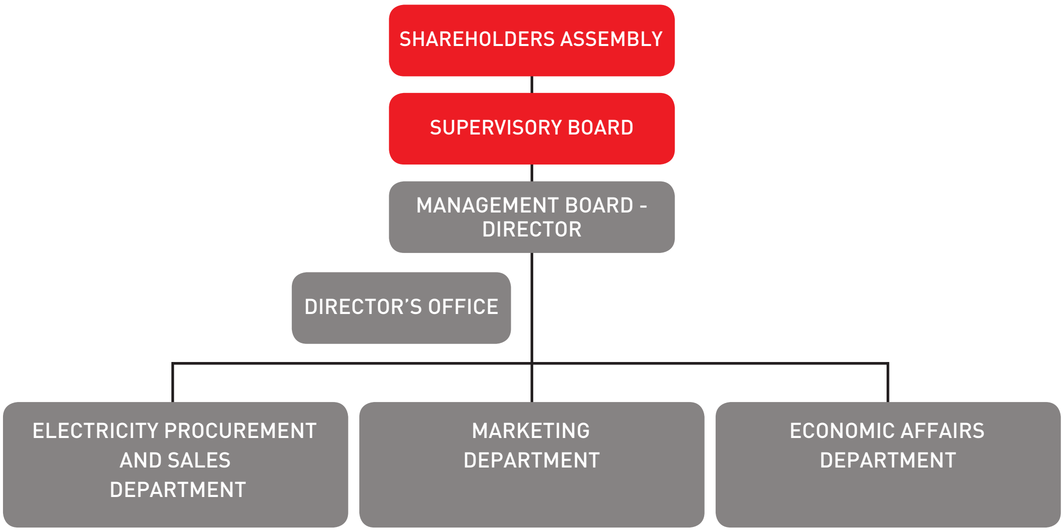
In spite of all the difficulties that we encountered in our work last year, we invested maximum efforts to meet customer needs and to provide them with timely information they needed to properly function. We also tried to be educational, directing them to the efficient use of electricity, making thereby our own, socially responsible, contribution.

Although last year can be characterized as an exceptionally turbulent year in all respects, marked by the intensified activity in the electricity market in Croatia, HEP Opskrba in 2010 fulfilled its main task in HEP Group and achieved results that guarantee our further growth and progress.

MISSION AND VISION

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

ORGANIZATION CHART

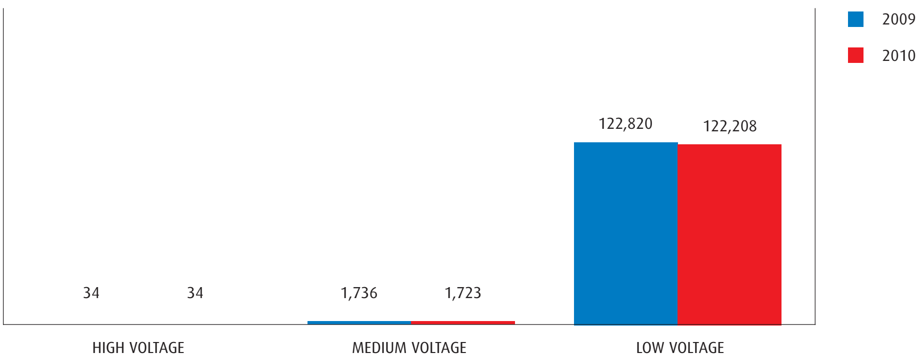


NUMBER OF METERING POINTS*

Customer category	2009	2010	10/09 (%)
High voltage	**34**	**34**	**0.0**
Medium voltage	**1,736**	**1,723**	**-0.7**
Low voltage – commercial	109,038	107,610	-1.3
Low voltage – public lighting	13,397	14,228	6.2
Low voltage – residential	385	370	-3.9
Total low voltage	**122,820**	**122,208**	**-0.5**
Total	**124,590**	**123,965**	**-0.5**

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

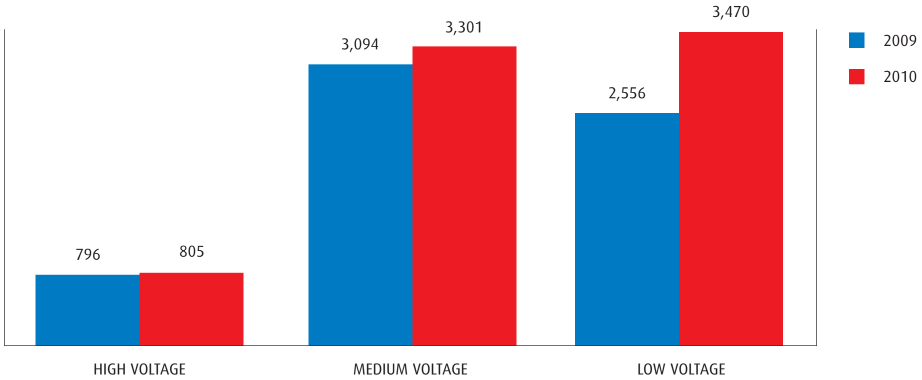
NUMBER OF METERING POINTS



ELECTRICITY SALES (GWh)

Customer category	2009	2010	10/09 (%)
High voltage	**796**	**805**	**1.1**
Medium voltage	**3,094**	**3,301**	**6.7**
Low voltage – commercial	2,387	3,196	33.9
Low voltage – public lighting	166	270	62.4
Low voltage – residential	2	4	55.2
Total low voltage	**2,556**	**3,470**	**35.8**
Total eligible customers	**6,447**	**7,576**	**17.5**

SALES PER VOLTAGE LEVEL (GWh)



HEP-TRGOVINA d.o.o.

ANTE ĆURIĆ

DIRECTOR

HEP-TRGOVINA d.o.o. (HEP Trade) was established as a company within HEP Group in 2007. During 2010, 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 fulfilment 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, changing 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 2010 HEP Trgovina d.o.o., with the aim of increasing profit by achieving lower prices in buying and selling of electricity, continued the activities concerning foreign companies registered in neighboring countries (Slovenia, Hungary, Serbia and Bosnia-Herzegovina). The company's operation in Slovenia intensified. 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.

During 2010 HEP-Trgovina employees participated in national and international conferences for professional improvement and to keep up with trends in the electricity market. The Company continued to actively participate in the work of EFET (European Federation of Energy Traders).

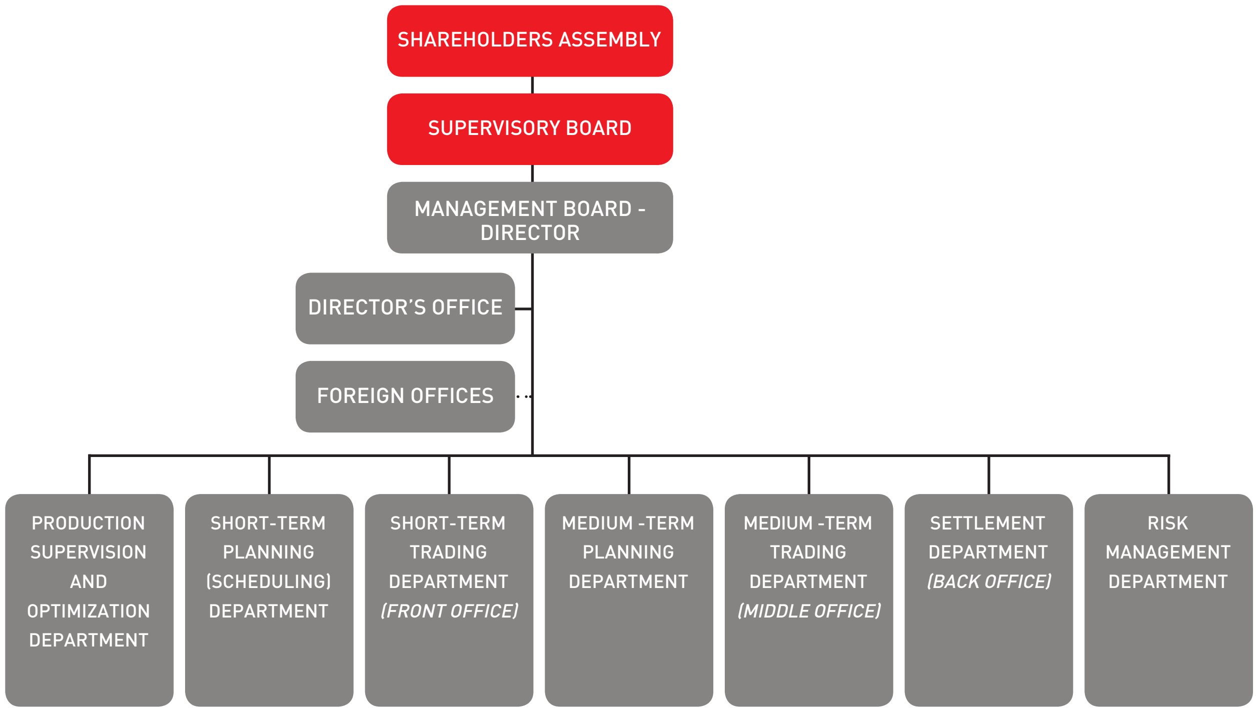
Total electricity consumption on the transmission network was 17,947 GWh, an increase of 1.4 percent compared to 2009 or 1.6 percent compared to the consumption planned in the electricity balance. On December 16, 2010 an all-time high daily consumption of electricity of 63, 400 MWh occurred. On the same day in the 18th hour the highest peak load in the electricity system occurred – 3,121 MW.

Due to exceptionally favourable hydrological conditions, hydroelectric production was historically the highest ever, amounting to 8,309 GWh or 52 percent higher than planned, participating in the coverage of the total consumption with a high 46 percent. Also the highest ever was the energy value of water inflows, amounting to 8,947 GWh or 64 percent more than planned. The historically highest reservoir levels occurred on April 19, 2010 in the amount of 1,602 GWh (87 percent of the maximum content).

Production by thermal power plants in 2010 was therefore lower by 33 percent compared to the plan (with a record low consumption of fuel oil of 124,426 t). Export was 65 percent higher than planned while import was 3 percent lower than planned.

During 2010, the volume of trade was realized in the amount of 5,820 GWh, which is 12 percent higher than planned, primarily due to higher export.

ORGANIZATION CHART

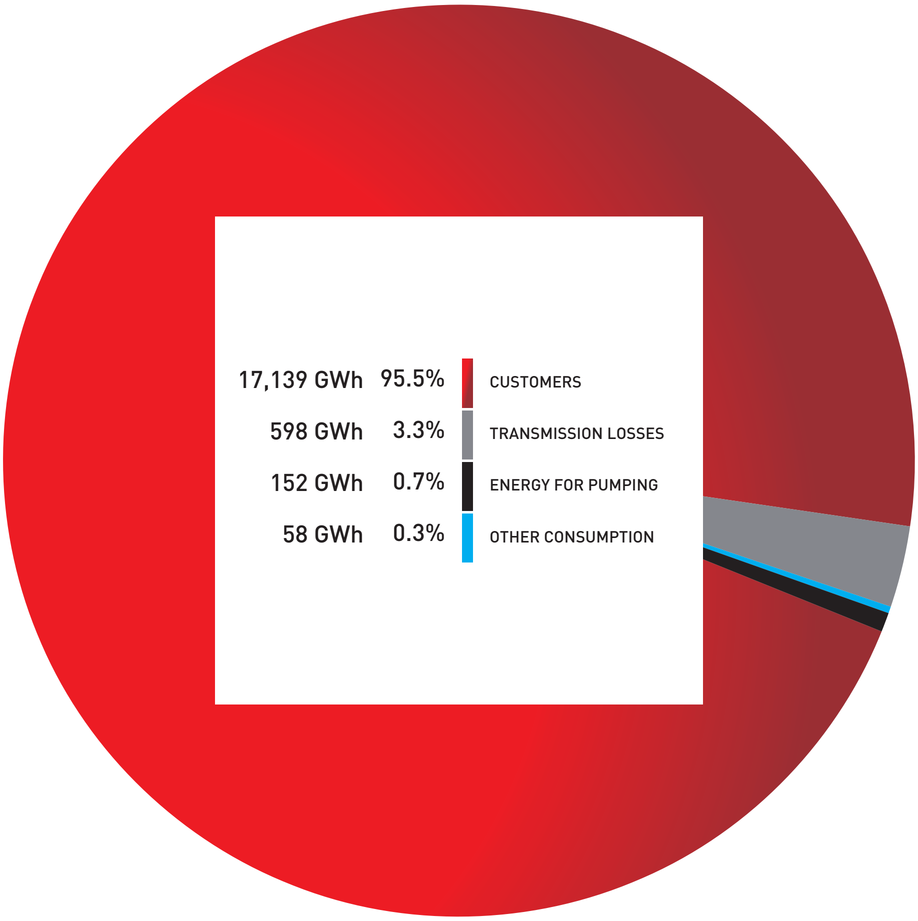


ACHIEVEMENTS IN 2010 – ENERGY DATA

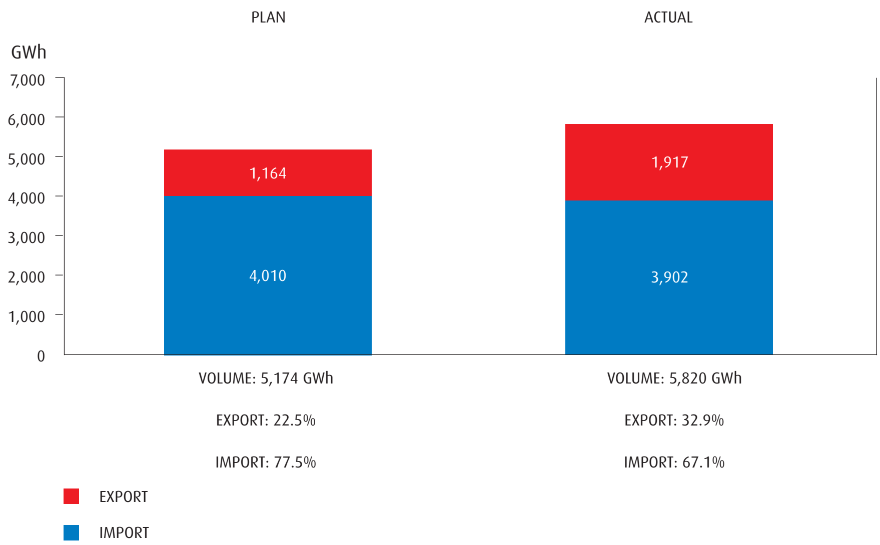
ELECTRICITY BALANCE

					GWh
	2009	**2010**	**2010/2009**	**2010 (plan)**	2010/2010 (plan)
Total consumption on transmission network	**17,697**	**17,947**	**1.4**	**17,670**	**1.6**
Production by HPPs	6,767	8,309	22.8	5,462	52.1
Production by TPPs	4,381	3,276	-25.2	4,917	-33.4
NE Krsko d.o.o.	2,730	2,690	-1.4	2,695	-0.2
TE Plomin d.o.o.	796	1,511	89.7	1,500	0.7
Import	4,851	3,902	-19.6	4,010	-2.7
Export	-1,899	-1,917	1.0	-1,164	64.8
Industrial power plants	20	21	9.0	21	2.8
Eligible producers	50	155	206.7	228	-32.2
Available electricity	**17,697**	**17,947**	**1.4**	**17,670**	**1.6**

STRUCTURE OF ELECTRICITY CONSUMPTION IN 2010



TRADE VOLUME



HEP-ESCO d.o.o.

GORDANA LUČIĆ

DIRECTOR

AFTER EIGHT YEARS of operating in the energy efficiency market in Croatia, in mid-2010 HEP-ESCO successfully completed the Energy Efficiency Project supported by the World Bank and GEF. Based on this experience, the business operations are planned to be supplemented in accordance with trends in energy efficiency and environmental protection in the EU. Above all, this is related to a combination of renewable sources and energy efficiency measures, then to offering operating leases to clients and energy savings guarantee and to an increasing orientation to private sector clients. The new business approaches 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. within HEP Group 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. The aggravating factor is the outdated organization of the Company and inadequate valuation of jobs.

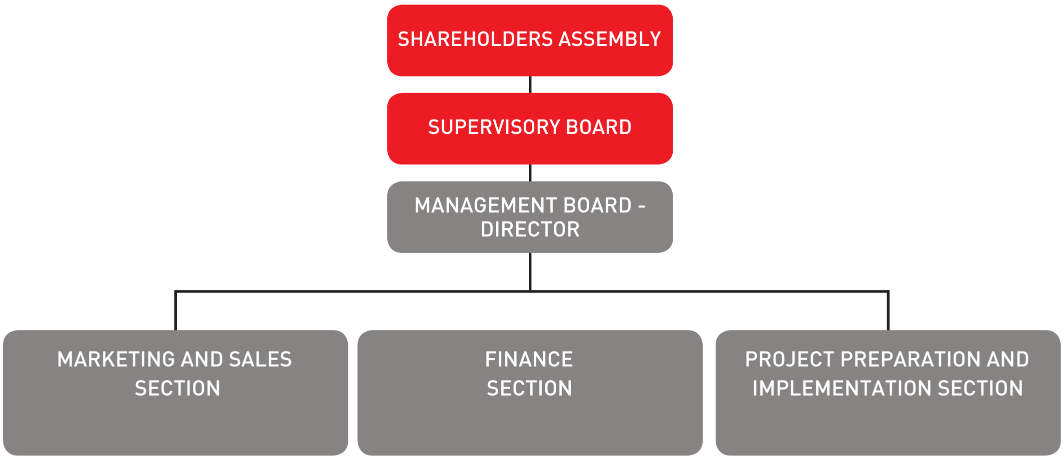
Securing finance is a key issue for HEP-ESCO because project financing is the basis of the business operations and/or of contracting with clients on ESCO model. It must be mentioned here that energy efficiency projects push a country's economic growth, especially at local levels: project preparation 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. That is to say that the loans extended to HEP ESCO serve in fact the purposes of Croatia's economy.

Due to the decreased number of projects in 2010, the achieved income was only 70 percent of the planned amount. This result was mostly the consequence of the Opinion of the Finance Ministry (February 2010) relating to the Budget Act (of January 2009) according to which 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 for which HEP ESCO until then had executed 90 percent of its projects. 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 borrowings made 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.

To the end of 2010, HEP ESCO d.o.o. had contractually agreed 33 projects in a total value of 176 million kuna. In 2010, 4 projects were contractually agreed in the amount of 29 million kuna. These were: the project in which the use of solar energy for sanitary water heating was integrated into energy efficiency measures in the meat processing industry Milivoj Medven (project completed in September 2010), project in the Adria Hotel in Biograd, and two projects for HEP Toplinarstvo d.o.o. currently being implemented – modernization of the heating system in Velika Gorica and engineering and economic optimization of the district heating system, in Zagreb.

In the increasingly important area of international collaboration, in 2010 HEP ESCO continued to work on the EU development programs – Intelligent Energy Europe (IEE). These projects are Bio.Sol-Esco and Permanent. 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.

ORGANIZATION CHART



APO d.o.o., USLUGE ZAŠTITE OKOLIŠA

DAMIR SUBAŠIĆ

DIRECTOR

APO d.o.o. usluge zaštite okoliša (APO Environmental Services) is a consulting and engineering company specializing in environmental protection. In 2010, APO's business operations were influenced by a number of negative parameters. The greatest problem was the general economic crisis and recession, manifested as lack of cash for the financing of services offered by APO on the market and as a decrease in the prices of services almost to the level of unprofitability. There was a lack also of services, and thereby no planned income from the services provided within HEP Group, which APO partly compensated by the increasing of income outside HEP, thanks to greater efforts made in the external market.

At the end of last year, thanks to APO's professional references and staff, the Ministry of Environmental Protection, Physical Planning and Construction, on the basis of the Rules on conditions for the issuance of consents to legal persons for the carrying out of environmental protection activities issued to APO the authorizations for the preparation of 15 different documents in the area of environmental protection. The authorizations relate to professional activities of preparing strategic studies, engineering solutions for plants concerning integrated environmental requirements which include the activities of preparing of studies on engineering solutions and the activities of preparing and processing of documentation for the request for the determination of integrated environmental requirements, including preparation of preliminary analyses and studies, safety reports, environmental protection programs, reports on the state of the environment, action plans and other documents, which together with existing authorizations and concessions open the opportunities to APO for expansion of activities to include preparation of almost all environmental and nature protection documents.

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

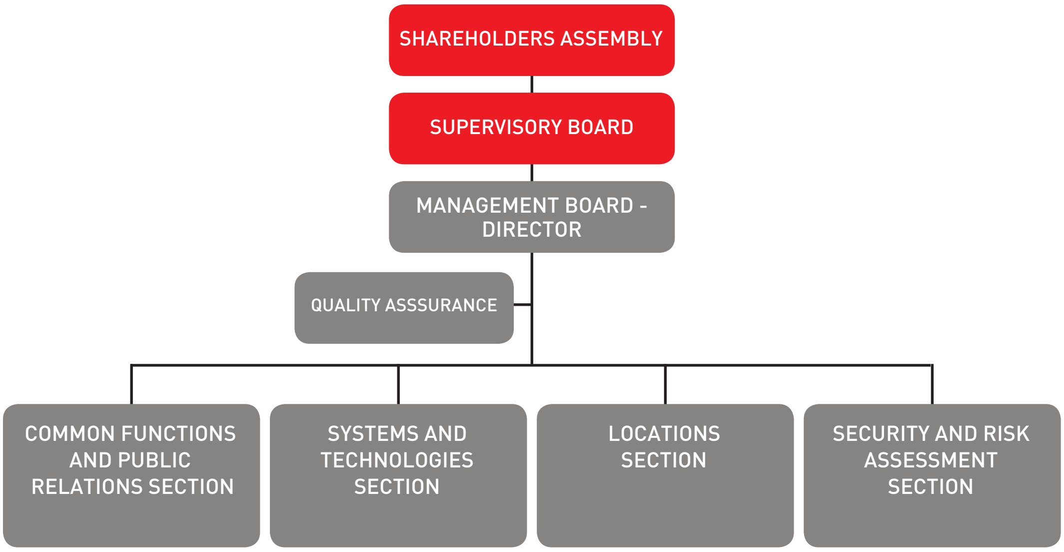
In 2010, either prepared or under preparation were 96 studies and documents from the area of environmental protection and waste management (strategic documents and programs, safety reports, integrated environmental requirements, environmental impact studies, environmental protection programs, plans and rules on waste management). Supervision was carried out over clean-up of three locations. Waste, mainly hazardous, in the amount of 538,173, was disposed of.

APO followed and promptly reacted to new requirements posed by legislation on companies in 2010. APO's expert team prepared several environmental protection studies for IPARD competition, namely, for the measures 101 and 103 for which the greatest number of calls for proposals has been published so far.

For Kepol terminal d.o.o. Zadar APO prepared Request for determination of integrated environmental requirements for the future production of biodiesel and for a tank area for liquid media with relevant project engineering solution. Based on the request and an integrated assessment procedure concerning the impact of the project on the environment and determination of integrated environmental requirements, the Ministry of Environmental Protection, Physical Planning and Construction on September 30, 2010 issued decision on integrated environmental requirements or “environmental permit”, as the first such decision issued in Croatia, in accordance with the Environmental Protection Act and Regulation concerning the procedure of determining integrated environmental requirements.

We have to mention in the end that one employee of APO was a member of Working Group for Chapter 27 – Environment in the EU accession negotiations. The negotiations were successfully completed by closing the chapter.

ORGANIZATION CHART



HEP-OBNOVLJIVI IZVORI ENERGIJE d.o.o.

GORAN SLIPAC

DIRECTOR

HEP-OBNOVLJIVI IZVORI ENERGIJE (HEP Renewable Energy Sources) in 2010 continued to develop the priority projects – wind parks Krš Pađene and Pađene, bio-cogenerating plant Velika Gorica, and solar photovoltaic power plants Concerto Hvar and Konjsko. Also, the company has been very active in development of other renewable energy projects.

At the beginning of 2009, HEP signed a contract with the German development bank KfW, for a loan and a grant. Loan proceeds in the amount of 50 million euros were allocated to HEP- Obnovljivi izvori energije for renewable energy power plant projects and to HEP ESCO for energy efficiency projects.

The grant, its smaller portion, was used to buy specialized software for wind potential assessment and staff training, and a larger portion was used for consultancy services in the preparing of wind projects. Loan proceeds have started to be used, namely, for the putting up of three measure poles to gauge wind characteristics, 100 meters in height, and for preparation of documentation for the siting permit for the bio-power plant Velika Gorica. In further biomass power plant project development cooperation is expected with other HEP Group members, primarily with HEP Toplinartsvo, HEP Proizvodnja and HEP ESCO.

Also, a campaign has been launched to measure wind characteristics in several locations in southern and mainland Croatia, which will by the end of 2011 show the potential and profitability of these locations. The company was also actively working towards including the locations in county physical plans, which will be continued in 2011. Further, initial talks were held with wind generating set manufacturers who all expressed their interest in wind power projects of HEP OIE.

An important contact was established, that with the European bankers fund Western Balkan Investment Framework, for which project proposals have been prepared. If project proposals pass all evaluation rounds, HEP OIE will receive a grant for the development of several promising projects, wind power plants and small power plants.

Activities relating to European FP7 project of photovoltaic power plant Concerto Hvar continued. Specifically, 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 EU funds.

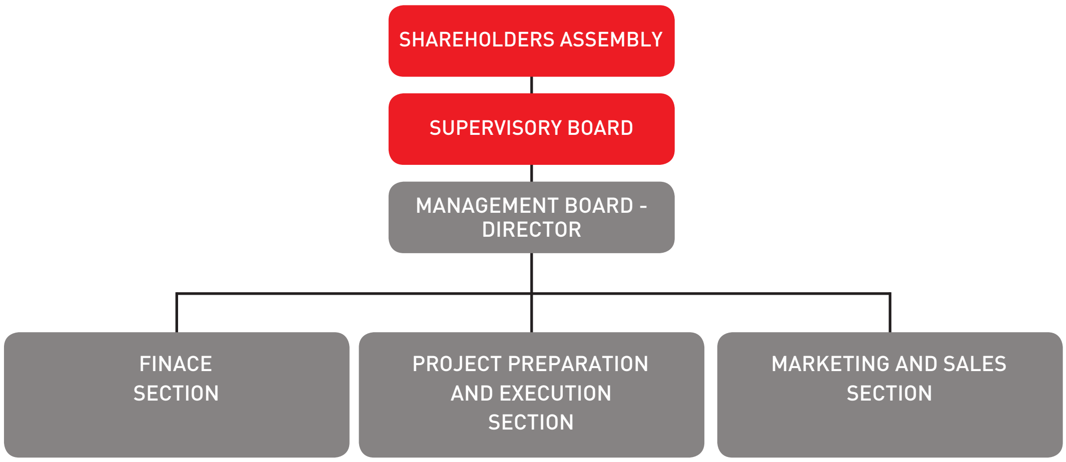
The successful cooperation with the Ministry of Economy, Labor and Entrerpreneurship continued concerning registration of projects for co-financing from structural funds of the EU.

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 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.

ORGANIZATION CHART



HEP-ODMOR I REKREACIJA d.o.o.

IGOR STANKOVSKI

DIRECTOR

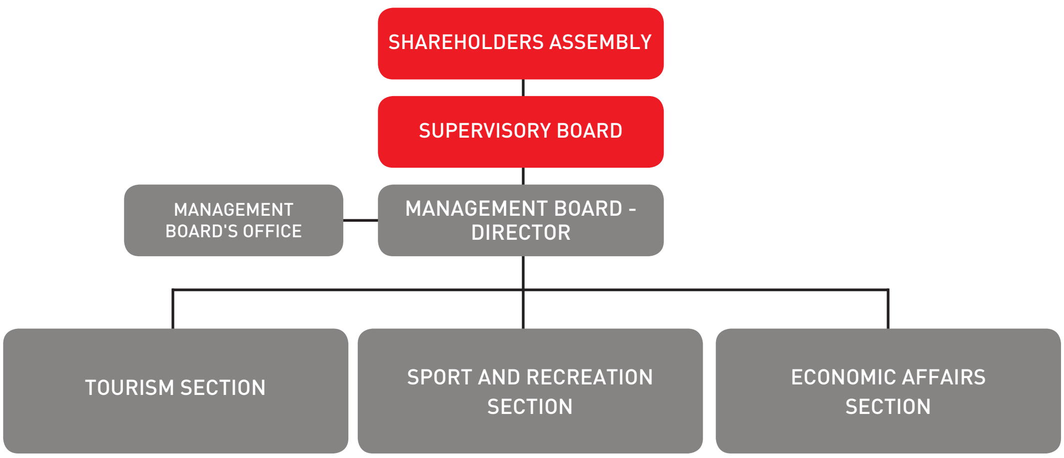
HEP – ODMOR I REKREACIJA d.o.o. (HEP Leisure and Recreation) was established to provide vacation and recreation services to HEP Group employees.

There are vacation houses available to HEP Group employees on 22 locations along the Adriatic coast with 260 accommodation units. These units are used only by HEP Group employees based on the results of the contest for use of vacation houses. The contest for the use of vacation houses covers the period from June 20 to September 8 each year and employees use the units in ten-day shifts (eight shifts). The intention of the company is to extend the season to at least 120 days and in certain vacation houses to year-round operation. During 2010, there were 48,291 bed nights.

In 2010, the company provide recreation services only to some HEP Group companies. At the end of the year the company prepared a plan and program of recreation for HEP Group employees with an assessment of funds for recreation, annually per employee. One of the main reasons why this company was founded was to establish a centralized planning and supervision of the implementation of recreation activities and to centralize the financial resources approved for recreation of employees. HEP Odmor i rekreacija is responsible for the implementation of recreation for all employees in the Zagreb area, and for supervision of recreation programs in the entire HEP Group.

In the first half of 2010 the company employed 15 people assigned to three sections (Organization and Management of Vacation Houses, Preparation and Maintenance of Vacation Houses, and Economic, Legal and General Affairs). The reorganization and a new systematization of the company set up new sections (Office of the Management Board, Tourism Section, Sports and Rcreation Section, Economic Affairs Section) and the number of employees was reduced to 13. The new systematization should ensure a new approach and improvement in operations, better organization and above all more efficient performance of all tasks facing the company.

ORGANIZATION CHART



HEP-NASTAVNO OBRAZOVNI CENTAR

ZDENKO MILETIĆ

HEAD

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.

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 2010 HEP-NOC continued to work as a full member of the Croatian association of laboratories CROLAB, and completed the procedure for accreditation of its laboratory from the Croatian Accreditation Agency under the standard HRN EN ISO/IEC 17025:2007. The excellent cooperation with the Faculty of Electrical Engineering in Osijek and the Faculty of Electrical Engineering and Computing in Zagreb continued.

In 2010, 67 employees of HEP and 20 employees of other companies received live work training and informative course was given to 13 managers of HEP and to 18 managers from other companies. Dispatcher training was given to 23 HEP employees for switching to 41 employees from HEP and to 28 from other companies. Other programs were attended by 143 HEP employees and four from other companies. In May 2010 an informative course in live work was held for the employees of JP EP HZ Herceg Bosne d.d. Mostar in Livno for 17 employees. The majority of educational programs were carried out by the staff of HEP NOC and for specialized seminars and gatherings external collaborators-lecturers were engaged, of which most were safety at work specialists from HEP ODS.

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. In 2010, 1,296 pieces of special insulation tools and protective equipment were inspected and tested.

Compared to 2009, the volume of testing increased by 30 percent which points to the greater awareness and responsible approach of users in handling equipment and tools.

In addition to the services contracted for 2011, we expect the continuation of the 2009 contract for transfer of live work technology to the Slovenian power company.

The success of HEP NOC depends on a large number of elements. Unfortunately, many elements cannot be influenced such as general economic activities, lower financial liquidity and savings measures in all segments of the business. On the other hand, we expect that with the accelerated adoption of a large number of documents, issuance of rules and alignment of Croatian legislation in the process of joining the EU, education will gain in importance and education expenses will have an appropriate share in the total economic activities. With its unique and specific programs, HEP NOC will certainly take an appropriate status and ensure further professional progress of HEP Group employees.

In the end, it is my special pleasure to announce an international live work conference which will be organized by HEP d.d. with the technical support of HEP NOC and held under the auspices of the Ministry of the Economy, Labor and Entrepreneurship in Zagreb, from May 31 to June 2, 2011.

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.

HEP GROUP ADDRESS LIST

HRVATSKA ELEKTROPRIVREDA d.d.
10000 Zagreb, Ulica grada Vukovara 37
TELEPHONE: 01/63 22 111
www.hep.hr

OFFICE OF MANAGEMENT BOARD
TELEPHONE: 01/ 61 71 294
FAX: 01/ 63 22 787

MARKETING AND CORPORATE COMMUNICATIONS DEPARTMENT
TELEPHONE: 01/ 63 22 202
FAX: 01/ 63 22 102

HEP-PROIZVODNJA d.o.o.
10000 Zagreb, Ulica grada Vukovara 37
TELEPHONE: 01/ 63 22 111
FAX: 01/ 61 72 016

HEP-OPERATOR PRIJENOSNOG SUSTAVA d.o.o.
10000 Zagreb, Kupska 4
TELEPHONE: 01/ 63 22 111
FAX: 01/ 61 70 442

HEP-OPERATOR DISTRIBUCIJSKOG SUSTAVA d.o.o.
10000 Zagreb, Ulica grada Vukovara 37
TELEPHONE: 01/ 63 22 111
FAX: 01/ 61 70 956

HEP OPSKRBA d.o.o.
10000 Zagreb, Ulica grada Vukovara 37
TELEPHONE: 01/63 21 432
FAX: 01/63 22 409

HEP-TRGOVINA d.o.o.
10000 Zagreb, Ulica grada Vukovara 37
TELEPHONE: 01/ 63 22 111
FAX: 01/ 61 70 478

HEP-TOPLINARSTVO d.o.o.
10000 Zagreb, Miševečka 15 a
TELEPHONE: 01/ 60 09 555
FAX: 01/ 61 31 978

HEP-PLIN d.o.o.
31000 Osijek, Cara Hadrijana 7
TELEPHONE: 031/ 24 48 88
FAX: 031/21 31 99

HEP ESCO d.o.o.
10000 Zagreb, Ulica grada Vukovara 37
TELEPHONE: 01/63 22 302
FAX: 01/63 22 459

HEP-OBNOVLJIVI IZVORI ENERGIJE d.o.o.
10 000 Zagreb, Ulica grada Vukovara 37
TELEPHONE: 01/ 63 22 111
FAX: 01/63 22 531

APO d.o.o., usluge zaštite okoliša
10000 Zagreb, Savska cesta 41/IV
TELEPHONE: 01/ 63 11 999
FAX: 01/ 61 76 734

HEP-NASTAVNO-OBRAZOVNI CENTAR
34330 Velika, Luke Ibrišimovića 9
TELEPHONE: 034/313-037
FAX: 034/233-084

HEP-ODMOR I REKREACIJA d.o.o.
10000 Zagreb, Ulica grada Vukovara 37
TELEPHONE: 01/63 22 845
FAX: 01/63 22 080

C.S. BUŠKO BLATO d.o.o.
80101 Livno, Podgradina bb
Bosna i Hercegovina
TELEPHONE: ++387 34/ 245 148
FAX: ++387 34/ 245 666

TE PLOMIN d.o.o.
52234 Plomin, Plomin luka bb
TELEPHONE: 052/ 86 64 00
FAX: 052/ 86 34 91

PLOMIN HOLDING d.o.o.
52234 Plomin, Plomin b.b.
TELEPHONE: 052/ 86 33 47
FAX: 052/ 86 33 44

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tel. +385 1 63 22 111,
www.hep.hr

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