

annual ²⁰¹¹
report

annual
2011
report



**HEP
GROUP
2011**

16.6^{TWh}

ELECTRICITY SALES

▾ -5.7 %

12.7^{TWh}

ELECTRICITY PRODUCTION

▾ -19.7 %

2.3^{TWh}

HEAT
SALES

▾ -2.4 %

150,000,000^{m³}

GAS SALES

▾ -7.6 %

13,074.1<sup>HRK
mn</sup>

OPERATING
INCOME

▴ 1.0 %

EBITDA

▾ -46 %

2,074.2

HRK
mn

-3.3

HRK
mn

GROUP NET
PROFIT (LOSS)

▾ -100 %

2,132.6

HRK mn

INVESTMENTS

▴ 25.9 %

33,746.4

HRK
mn

TOTAL ASSETS

▾ -0.02 %

NUMBER OF EMPLOYEES

▾ -1.7 %

13,784

* Change 2011/2010 (%)

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PRESIDENT'S REPORT

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Chairman's Report

The eight Supervisory Board of HEP d.d. worked in the period ending with its 20th meeting held on December 21, 2011. The Government of the Republic of Croatia proposed to the General Shareholders Assembly, on February 23, 2012, to recall the members of the Supervisory Board before the end of their term and to select new members. By the Decision of the General Shareholders Assembly of February 23, the members of the eight Supervisory Board of HEP d.d. were recalled and a new Supervisory Board was selected. The ninth Supervisory Board was constituted on the same day and began to perform its function in accordance with the law and the Company's internal rules and regulations.

Considering the abovementioned circumstances and the timeframe of the activity of the current Supervisory Board, I am not in the position to give an adequate account in this report of the work of the Management Board and business operations of HEP Group in 2011.

I base this report therefore on the Report of the Supervisory Board of the Company on the supervision of the company's conduct of affairs carried out in the business year 2011, adopted at the fourth meeting held on May 24, 2012 and submitted to the General Shareholders Assembly of the Company.



The Report states that the Supervisory Board supervised the conduct of affairs of the Company and carried out other work in accordance with the Companies Act, Articles of Association of the Company and Rules of Procedure of the Supervisory Board; discussed and accepted the information provided by the Management Board concerning overall conditions in the Company, business policy and relations with related companies, decisions affecting significantly the position of the Company, and matters in principle of future conduct of the Company. It also accepted the reports on the Company's business operations submitted during the business year and gave all necessary consents to the Management Board decisions, as provided for in the Articles of Association of Hrvatska elektroprivreda d.d.

The current ninth Supervisory Board gave its consent to the revised Consolidated Economic Plan and Investment Plan of HEP Group for 2012. (the Consolidated Economic Plan and Investment Plan of HEP Group for 2012 was given consent, at the proposal of the Company's Management Board, by the eight Supervisory Board.)

The Supervisory Board has reviewed the business and financial reports and determined that the stock company Hrvatska elektroprivreda and the group of subsidiary companies have been conducting their affairs in accordance with the Companies Act, Articles of Association, decisions of the Shareholders Assembly and the internal rules and regulations of the Company.

Nikola Bruketa
Chairman of the Supervisory Board

President's Report

On February 23, 2012 the new Supervisory Board recalled the current and appointed a new Management Board of HEP d.d. Therefore, in this Report we give the state of affairs at the beginning of our term and set our objectives for the next four years.

The conditions in which the business operations in 2011 unfolded were those of the recession and stagnation of economic activities. Due to unfavorable hydrological conditions, electricity import needs increased. As the purchase price of imported electricity rose so did electricity procurement costs, while fuel costs increased due to a significant fuel price increase, especially natural gas and coal. The increase in the costs, despite growth in operating income, decreased the operating profit to 453.4 million kuna (in 2010 it was 2,185.2 million kuna). The Group net loss is 3.3 million kuna (a loss of 14.8 million kuna is attributable to equity holders of the parent).

Due to unfavorable economic conditions, illiquidity of companies and rise in unemployment, the planned improvement in collection of accounts receivable was not achieved, and the relative share of doubtful receivables increased. Despite the adverse factors, the liquidity of HEP Group in 2011 can be assessed as satisfactory, which was confirmed by rating agencies.



The availability of power plants, transmission and distribution network was very good, without any major disturbance in the deliveries of electricity, heat energy and gas. Electricity and fuel supply was reliable. For illustration, the availability of the electricity system in 2011 was 99.998 percent.

The important event for the electricity system in 2011 was the obtaining of the operating permit for Unit L of the Zagreb TE-TO cogenerating plant (100 MWe, 80 MWt, in trial operation since 2009) whereby TE-TO Zagreb became HEP's largest thermal power facility. In addition to securing a high efficiency and stable electricity and heat source, what was achieved was reduction in liquid fuel consumption and in overall emissions of pollutants in the location of TE-TO Zagreb.

In the location of Sisak TPP, the construction has continued of the new unit C – a combined-cycle cogenerating plant of 230 MWe/50MWt. Because of the high degree of fuel conversion (natural gas) and efficiency, at this location, too, the overall air pollutant emissions will be reduced.

This is a brief outline of the elements of the business year and the state of affairs and position of HEP Group at the start of our term.

The new Management Board of HEP d.d. prepared the Restructuring Program for HEP Group for the Period 2012-2016 which, after being adopted by the Supervisory Board, was presented to the Government of the Republic of Croatia at the end of June 2012.

The Management Board of which I am the president has set the following strategic goals for the period of its term: long-term security of supply of electricity and other forms of energy, competitiveness in the domestic and the regional market, sustainable development and improvement in business operations as the precondition for achieving other strategic goals.

In that sense, HEP's obligation is to satisfy the energy needs with its own sources to a maximum degree, keeping and strengthening its competitive ability in the open market. The competitiveness of our main product, electricity, is the fundamental requirement for construction of new and refurbishment of existing power plants. Investment in new production capacity is also necessary because some of the thermal power plants will soon retire as they will not be able to meet the new, more stringent, environmental requirements.

As part of the new construction program, nearing the implementation is Plomin C thermal power plant and Ombla hydro power plant. For the unit replacement project of 500 MW (3.5 TWh/year) to be fuelled by coal at Plomin TPP (C), in June 2012, the advisory expert commission gave a positive opinion on the environmental impact study. At the time of writing this report, the Ministry of Environmental and Nature Protection is expected to issue the integrated environmental requirements, a step in obtaining the siting permit.

The construction of Ombla HPP (68 MW, 223 GWh) will be mostly financed from a syndicated loan approved by the EBRD at the end of 2011. In various stages of preparation are the projects of Dubrovnik 2 HPP, hydro power plants on the Lika and the Gacka, river training and hydropower utilization of the Sava in the area of Zagreb, multi-purpose hydro engineering system Osijek and natural gas cogeneration projects in Osijek and Zagreb.

Zlatko Koračević
President of the Management Board

In 2012, we plan to significantly increase investments, to a total of 3.5 billion kuna, of which one third is to go in the refurbishment of thermal and hydro power plants (most in Zakučac HPP), and the remaining two thirds in transmission and distribution. The low voltage network will be reconstructed and our customers in all parts of Croatia will be provided with the quality of voltage to the international standard. Over the four-year period, we plan to invest 19 billion kuna in total.

An especially significant step forward that we plan is in the area of green energy economy, by introducing innovative and integrated products and services. An ever increasing importance will be given to implementing and financing of energy efficiency projects on ESCO model for our customers and clients outside and within HEP Group. We will introduce additional services for our customers such as energy audits and consulting. In the area of renewable energy sources we plan the construction of a number of plants based on all commercially available technologies. Among other things, on the buildings we own we will place photovoltaic and solar heating systems. The project I want to mention in the end is the introduction of electromobility, representing a business advance and creation of a new customer base. As part of the establishment of the European network, Croatia has been developing the infrastructure for accepting the electric vehicles in the system.

All of these projects are based on the application of new specialist inter-disciplinary knowledge and skills. It is therefore one of the primary business tasks to improve the age and qualification structure of HEP Group employees. By implementing combined measures we expect that by 2016 about 3,500 employees will leave HEP and that at least 500 new people will be employed over the same period, able to respond to the business goals that have been set.

By saving in staff costs and in procurement procedures, reducing network losses, saving in general operating costs, implementing energy efficiency measures in owned properties, activating green certificates on the market, increasing the revenues from energy services and introducing small hydro power plants into the incentive system – we would be able to achieve a positive effect on the business result of 2.2 billion kuna in total.

Our goal is for HEP to be the locomotive of the economy, a center of excellence and the strongest energy company in the region. As well as meeting our own business goals, we want to encourage the development and the unique capabilities of the domestic electric manufacturing and supporting industries. I have no doubt that we have the strong basis to achieve this vision in people and tradition, knowledge and courage.

COMPANY PROFILE



The availability of the electricity system
in 2011 was **99.998 PERCENT.**

reliab



Our strategic goal is a long-term **SECURITY** of supply of electricity and other forms of energy. This means the ability of the system to respond to **CUSTOMER NEEDS** at all times for electricity, heat energy and natural gas, implying proper management, operation, maintenance and development of all technological units of the system.

HEP GROUP

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.

Company Profile

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.

Strategic goals

LONG-TERM SUPPLY SECURITY OF ELECTRICITY AND OTHER ENERGY FORMS

The ability of the system to meet the needs of its customers at any time for electricity, heat energy and natural gas, which implies proper management, operation, maintenance and development of all technological wholes of the system.

COMPETITIVENESS IN THE ENERGY MARKET IN CROATIA AND THE REGION

The ability of the business system of HEP Group to ensure its dominant presence in the market in the near future and in the long term, and to ensure system development by applying good management standards and socially responsible behavior.

SUSTAINABLE DEVELOPMENT

With a systematic approach and observing the sustainability criteria in defining investment priorities, to open new opportunities for development of the Group's business system. With good planning and in an organized manner, to use the potential of various types of incentives or financing sources or newly created markets.

BUSINESS IMPROVEMENT

The harmonization of HEP Group business activities with EU legislation, optimization of the organizational structure, decrease in operating costs and increase in efficiency, increase in HEP Group revenues, regional business expansion, strengthening of capacities for access to EU funds and implementation of other programs and actions.

HEP Group companies

HEP d.d. (HRVATSKA ELEKTROPRIVREDA d.d.) is the parent company of HEP Group, wholly owned by the state, the founder and the sole (100%) owner of the subsidiary companies; it consolidates management of HEP Group subsidiaries and is the owner of the assets which are contractually transferred to subsidiary or daughter companies for management.

SUBSIDIARY COMPANIES OWNED WHOLLY BY HEP d.d.

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. Daughter companies *HEP-TRGOVINA d.o.o. BREŽICE* (Slovenia) and *HEP MAGYARORSZAG ENERGIA KFT* (Hungary) have the task of electricity trading in the markets of the countries in which they are established and in third markets.

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.

HEP – ODMORI 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 – DEVELOPMENT OF MULTI-PURPOSE REAL ESTATE PROJECTS d.o.o. is registered (April 2012) for real estate design, construction, operation, maintenance and transactions.

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.

COMPANIES IN MIXED OWNERSHIP

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

LNG HRVATSKA d.o.o. co-owned by HEP d.d. and Plinacro d.o.o. (50%:50%), established in order to take over an 11% stake in the international consortium Adria LNG d.o.o.

NE KRŠKO d.o.o. (KRŠKO NUCLEAR POWER PLANT), Republic of Slovenia, is a company outside HEP Group, co-owned by HEP d.d. and GEN Energija (50%:50%).

Legal framework

The national legal framework for the energy sector comprises “Third Energy Package” adopted in 2009, Energy Development Strategy of the Republic of Croatia (2009) and fundamental laws that regulate the energy sector in the Republic of Croatia.

The fundamental laws are:

- Energy Act
- Electricity Market Act
- Energy Regulation Act
- Gas Market Act
- Heat Energy Production, Distribution and Supply Act

Subordinate legislation of the greatest importance for the functioning of the electricity market comprises:

- Tariff systems for electricity production, distribution and supply
- Tariff system for electricity production from renewable energy sources and cogeneration
- General Conditions of Electricity Supply
- Grid Code

For the natural gas and heat energy markets the most important subordinate legislation comprises:

- Tariff systems for natural gas storage, distribution, transport and supply
- General Conditions of Natural Gas Supply
- Tariff system for heat energy production, distribution and supply

ENERGY ACT (NN 68/01, NN 67/07, NN 152/08, NN 177/04, 127/10) regulates the measures for secure supply of energy and its efficient production and use. It defines the documents which regulate and under which energy policy, energy system planning, carrying out of energy businesses in the market or as public services and carrying out of energy businesses in consideration of environmental measures are implemented.

ELECTRICITY MARKET ACT (NN 177/04, NN 76/07, NN 152/08, NN 14/11) regulates the carrying out of energy businesses of production, transmission, distribution and supply of electricity, and organization of the electricity market.

During 2011 the following pieces of primary or secondary legislation were passed:

- Amendments to Electricity Market Code
- Decision modifying the Decision to implement measures for mitigation of electricity price increase for citizens and households
- Regulation amending the Regulation on charges for incentivizing electricity production from renewable sources and cogeneration
- Regulation amending the Regulation on minimal share of electricity produced from renewable energy sources and cogeneration whose production is incentivized
- Act Supplementing the Electricity Market Act
- Rules supplementing the Rules on acquiring the status of eligible electricity producer
- Methodology for provision of electricity balancing services in the electricity system
- Tariff system for the services of energy businesses of heat energy production and supply, without amounts of tariff items
- Act Modifying the Gas Market Act
- Rules amending the Rules on natural gas market organization
- Tariff system for natural gas transport, without amounts of tariff items
- Amendments to the Rules on electricity system balancing
- Rules modifying the Rules on cost allocation and billing for heat energy supplied
- Rules on charges for connection to the gas distribution or transport system and for increase in connected capacity..

THIRD ENERGY PACKAGE

In June 2009 the EU adopted the Third Energy 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 main objectives of the third energy package are increase in market competition and liquidity, improvement of the functioning of network infrastructure, security of supply, customers' active role and protection, and promotion of renewable energy sources. Now in the EU accession process, Croatia is obligated to adjust the national legal framework to the third energy package. HEP is carrying out preparatory activities for adjustment on the basis of ITO (Independent Transmission Operator) model, considered best for the Croatian electricity sector.

ENERGY DEVELOPMENT STRATEGY

The Energy Development Strategy of the Republic of Croatia (NN 130/2009) is the umbrella document which sets forth the energy policy and plans the energy development of Croatia for the period to 2020. The three fundamental objectives of the Strategy are security of electricity supply, competitiveness of the energy system and sustainability of energy development. For the electricity sector, it envisages an increase in the total consumption of electricity to the year 2020 and closure of existing conventional thermal power plants totaling 1,100 MW. Consequently, the Strategy envisages construction of base-load production facilities running on coal and gas and large hydro power plants. In addition to conventional sources, the Strategy provides for intensive construction of renewable energy facilities. The objective is to maintain the share of production from large hydropower and renewable energy sources in total electricity consumption at present level in the period to 2020 so that it is 35 percent in 2020. Besides generating plants, the Strategy envisages further development of transmission and distribution networks.

By implementing an extensive investment cycle, we have been doing everything to fulfill in the **BEST** possible way the obligation to secure sufficient quantities of energy for all our customers, at reasonable prices. This makes us a **TRUE...**



dr vi

for ng rce



...OF THE ECONOMY.

HEP has been researching, preparing and developing a number of construction projects of hydro and thermal power plants. The project to renew the transmission network lines by 2016 includes the renewal and reconstruction of 800 km of lines.

MODERNIZATION and **CONSTRUCTION** of the distribution network have been going on to meet the growing needs for electricity and connect new customers.

Development – determinants, current and planned projects

ELECTRICITY PRODUCTION

Generating plants, in all development phases, must satisfy the requirements for supply security, competitiveness and sustainability. HEP researches, prepares and develops a number of construction projects of hydro and thermal power plants.

- Under construction is a natural gas combined-cycle cogenerating unit at *SISAK TPP – UNIT C* (230 MWe, 50 MWt), scheduled to be put into operation in 2013.
- As part of the program for construction of new generating plants, nearing implementation are Plomin C TPP and Ombla HPP. A unit replacement project of 500 MW (3.5 TWh/yr) to run on coal at *PLOMIN TPP (TPP C)* is in the phase of assessment of the Environmental Impact Study, which is a step in the obtaining of the siting permit. The beginning of on-site work is expected at the end of 2012. The construction of *OMBLA HPP* (68 MW, 223 GWh) will be financed for the most part from the EBRD loan and, according to schedule, preparatory work is to begin in the second half of 2012.
- According to the level of preparedness, the above are followed by the following projects: Dubrovnik II TPP (300 MW, 318 GWh), Senj II/Kosinj HPP (412 MW, 450 GWh) and EL-TO Zagreb CHP (120 MW). More detailed definition of technical and economic parameters and time schedule for the implementation of the project will be provided in the further development.
- The *HYDROELECTRIC PROJECT ON THE SAVA* (120 MW, 600 GWh) is a multi-purpose project in which the share of energy is 20 to 25 percent, but considering that HEP has until now provided a significant portion of project and other documentation, it has taken the lead role in the further preparation for the implementation.

The projects of Rijeka TPP, TE-TO Osijek CHP, a TPP adjacent to the LNG at Omišalj, a multi-purpose hydraulic engineering system Osijek, Molve HPP 1 and 2, Korita HPP, Mosor HPP, Vinodol HPP are in the research phase. Based on the feasibility study and ranking criteria, further activities to develop these projects will be determined. Several other potential sites for construction of thermal and hydro power plants are under consideration.

In the period to 2016 the following hydro power plants will be renewed: Zakučac, Dubrovnik, Varaždin, Senj, Ozalj, Rijeka, Gojak, Orlovac and plants on the Krka, whose combined capacity will be increased by 157 MW.

ELECTRICITY TRANSMISSION

The transmission system operator will, in accordance with legal requirements, follow construction projects of generating plants by building the necessary transmission capacity and creating other conditions in the existing network to ensure reliable and safe operation of these plants once they come on line. In the further development of the transmission network, in addition to investments in new facilities, special attention will be paid to the "Transmission Lines Renewal Project" which will involve the renewal or reconstruction of 800 km of lines in the period to 2016.

The most important investments in new facilities over the next period comprise the completion of construction of TS 220/110/35/20(10) kV Plat and TS 110/10(20) kV Srđ (Dubrovnik Program), completion of the project „Control Functions“ – renewal of the dispatching center and network centers, completion of entry/exit of the 220 kV Mraclin - Prijedor line at Sisak TPP (to connect Sisak TPP C to the network), construction of the 2x400 kV Plomin – Melina line (to integrate Plomin TPP C with the electricity system), construction of TS 400/110 kV Lički Osik (to improve cross-border capacity and integrate more renewable energy sources as well as Senj 2/Kosinj), entry/exit of 110 kV Zakučac-Meterize 3 line at TS Vrboran (to create conditions in the network of the city of Split for putting into service the renewed Zakučac HPP) and installation of attenuators at TS Konjsko and TS Ernestinovo.

ELECTRICITY DISTRIBUTION

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

Smart Grid Project is being prepared for implementation by introducing smart meters at customers' locations, two-way communication and connection of distributed electricity sources and customers. The main activities focus on the continuation of investments in capital projects of 110 kV, 35 kV and 10(20) kV and launching of new ones, implementation of Dubrovnik Program projects (TS Srđ and associated lines), continuation of investments in construction of telecommunication links to provide for integration of important plants and business infrastructure into HEP's telecommunications system as well as to ensure conditions for implementation of smart grid concept, continuation of investment in replacement of worn-out and construction of new submarine cables, preparation and construction of medium and low voltage facilities, reconstruction of household connections in areas in which the network has been reconstructed, implementation of the investment program Voltage Restoration, continuation of investment in regular replacement of metering equipment at metering points and investment to improve metering points in accordance with regulations, and launching of investment program to increase security of supply in areas where it is jeopardized.

ELECTRICITY SUPPLY AND TRADE

Supply and Trade in the next period will offer new products and energy services through energy efficiency projects, green energy, green certificate trading, CO₂ emission trading. The volume of trade and supply of electricity will be increased through presence on neighboring markets.

GAS BUSINESS

The long-term business policy of HEP is to participate in the gas sector at several levels. Considering the establishment of a new gas supply route, the opportunities open for new arrangements in wholesale. Also, natural gas distribution and supply businesses will be developed based on concessions by expanding the gas network in the area of Slavonia and Baranja.

Preparations are being made for active participation in the development and construction of the LNG (liquefied natural gas) terminal on the Croatian Adriatic Coast, a significant alternative supply route.

DISTRICT HEATING

In addition to bringing the district heating business to the level of economic viability, the main development objectives are to expand the heating business in Sisak by constructing a new unit at Sisak TPP, which is underway, continue the projects of renewal of hot water and steam network, build the heating systems in Zagreb and Velika Gorica, connect existing customers to the district heating system and retire separate boiler plants, implement the project of technical and economic optimization of the district heating system and renew heating substations.

ENERGY EFFICIENCY

Increasing importance will be given to the implementation and financing of energy efficiency using ESCO model for customers and clients outside and within HEP Group. Customers will be continuously provided with additional services through energy inspections, advises, etc.

RENEWABLE ENERGY SOURCES

One of the basic business objectives is to build plants for electricity and heat production from renewable energy sources in all commercially available technologies: small hydro (up to 10 MW), wind, biomass, photovoltaic and collectors. On HEP's plants and facilities, photovoltaic and solar thermal systems will be prepared and built.

OTHER

The project to introduce e-mobility is currently underway, which represents a business step into the future and creation of a new customer base. The infrastructure for acceptance of electrical vehicles by the system is being developed.

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)
- *ENTSO-E* (European Network of Transmission System Operators for Electricity) where HEP OPS d.o.o. is a full and founding member having representatives in the Assembly and the Board, committees and working groups
- *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)
- *TSC (TSO SECURITY CO-OPERATION)*
- *CIREN* (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 in 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 UNIPEDA founders
- 1937 Vice Roy’s Electrica Company is founded
- 1941 State electrical company is founded
- 1943 110 kV line Rakitje (Zagreb) - Brestanica (Slovenia) is built
- 1945 Electrical company of Croatia is founded
- 1954 Union of electricity companies of Croatia is founded
- Beginning of district heating: hot water pipeline for Končar factory from EL-TO Zagreb plant
- 1957 110kV Zagreb – Jajce (BiH) line goes into service; synchronous operation of western and central system
- 1961 Business association of electricity distribution companies of Croatia is founded
- 1962 First line of 220 kV network Zakučac HPP (Split) - Brinje – Mraclin (Zagreb)
- 1965 United electricity industry of Croatia is founded
- 1974 Union of electricity organizations of Croatia is founded
- Gas distribution and supply begins within Elektroslavonija Osijek
- 1977 First 400 kV transformer station, Ernestinovo (Osijek), and first 400 kV line, Ernestinovo – Mladost, are built

- 1981 Krško nuclear power plant goes into service

1990 Public enterprise Hrvatska elektroprivreda (HEP) is founded

- 1991 Heavy war destruction to power plants and facilities
- 1992 400 kV line TS Meline (Rijeka) – TS Tumbri (Zagreb) is put into operation
- 1993 About 120 MW emergency diesel and gas power plants are installed in Dalmatia
- 1994 Island interconnection 110 kV TS Melina (Rijeka) – Krk – Rab – Pag – Zadar is built
- 1995 Reconstruction and refurbishment of Peruća dam is completed (blasted in 1993)
- 1997 Eastern Slavonia reintegrated into the Croatian electricity system
- 1998 Gas-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 operation
- 2004 TS 400/220/110 kV Žerjavinec and the reconstructed TS 400/110 kV Ernestinovo are put into operation
- Reconnection of UCTE zones 1 and 2 is coordinated from HEP’s headquarters
- 2005 Construction work on Lešće HPP (42 MW) begins
- 2006 HEP issues corporate bonds worth 500 million kuna
- Construction begins of a combined-cycle cogeneration unit (230 MWe, 50 MWt at TE-TO Zagreb)
- 2007 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
- 2011 EBRD approves a syndicated loan to HEP for the financing of construction of Ombla HPP

CORPORATE
GOVERNANCE

2

Corporate Governance

In accordance with the HEP Group corporate governance model, HEP d.d. manages and partly performs the following corporate functions:

- strategy
- investment planning
- corporate development
- international affairs
- restructuring
- improvement in production businesses
- optimization of production plants
- energy trading
- improvement in transmission and distribution businesses
- optimization of network system operation
- sustainable development and quality improvement
- marketing and corporate communications
- procurement
- corporate finance and treasury
- improvement in corporate finance function
- accounting
- controlling
- human resources management
- legal affairs
- information technology and telecommunications
- internal audit
- risk management
- defense and safety
- 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.

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

THE MANAGEMENT BOARD OF THE COMPANY

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

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

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

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

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

THE SUPERVISORY BOARD

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

The Supervisory Board:

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

GENERAL SHAREHOLDERS ASSEMBLY

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

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

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

Members of governing bodies

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

In the reporting period

SHAREHOLDERS ASSEMBLY

Đuro Popijač

SUPERVISORY BOARD

Darko Horvat	Chairman
Dražen Bošnjaković	Deputy Chairman
Jadranko Berlengi	Member, workers' representative
Krešimir Dragić,	Member
Slavko Konfić	Member
Gordana Obran	Member
Zvonimir Sabati	Member

MANAGEMENT BOARD

Leo Begović	President
Dubravko Lukačević	Member, in charge of improvement in production businesses and quality
Snježana Pauk	Member, in charge of corporate development and planning
Miljenko Pavlaković	Member, in charge of corporate finance and treasury, accounting and commercial affairs
Damir Pečvarac	Member, in charge of improvement in network businesses and quality
Velimir Rajković	Member, in charge of sustainable development and quality

MEMBERS OF GOVERNING BODIES

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

SHAREHOLDERS ASSEMBLY

SUPERVISORY BOARD



Radimir Čačić

Member
First Deputy Prime Minister
and Minister of Economy

Nikola Bruketa

Chairman

Alen Leverić

Deputy Chairman

CURRENT (SINCE FEBRUARY 23, 2012)



Jadranko Berlengi

Member
Workers'
Representative

Žarko Primorac

Member

Ante Ramljak

Member

Ivo Uglešić

Member

MANAGEMENT BOARD

Zlatko Koračević

President

Zvonko ErcegovicMember, in charge of
production**Krunoslava Grgić Bolješić**Member, in charge of business
development

Born in 1955. Graduate mechanical engineer (1981). From 1982 to 1987 worked in IGM-TPM Lepoglava as project engineer and designer, head of production preparation and head of production. In the period to 2005, director of the wood furniture factory Lepa Lepoglava. From 2001 to 2004, volunteer prefect of the Bednja County. In the fifth Croatian Parliament (2005-2008), MP and member of Finance and National Budget Committee. In the sixth Croatian Parliament (2008-2011), chaired the Regional Development, Forestry and Water Management Committee and was a member of Finance and National Budget Committee and of Agriculture, Fishery and Rural Tourism Committee. In the HBOR Supervisory Board, was an alternate member.

Born in 1965. University specialist in economics (2008) and graduate electrical engineer (electrical energy program) (2005). In 1992 a graduate degree in electromechanical engineering. State exam in the area of electrical engineering passed at the Ministry of Construction and Environmental Protection in 1993. Before being appointed member of the Management Board, director of Supply Department, HEP Plin from 1989, preceded by the position of protection engineer and head of Sales and Customer Relations. From 2006 to 2010 a member of HERA Council.

Born in 1974. Bachelor of Law (1999), postgraduate study in Commercial Law and Company Law. Bar exam in 2002. After attorney traineeship, 2000, worked as court trainee at the Municipal Court in Ozalj, and until December 2002 as senior staff member with Croatia banka in Zagreb. After that took the position of secretary of Energy Regulatory Council (until December 2005), then secretary of HERA. From 2007 worked in HERA as head of personnel and general affairs and as a senior staff member. Member of HRO CIGRE, Study Committee for electricity market and regulation.

Rodoljub Lalić

Member, in charge of development and investments

Ivan Matasić

Member, in charge of finance

Tomislav Šerić

Member, in charge of transmission and distribution



Born in 1956. Graduate civil engineer (1980). Passed State exam in 1983, since 1999 registered in the Directory of licensed civil engineers. In 1980 joined the design office of Elektroprivreda Dalmacija as project engineer and from 1991 as project engineer, head of Architectural/ Construction Section of Design Office of Hrvatska elektroprivreda. From 1998, director and lead project engineer of the design and engineering firm Projektni biro Split d.o.o. which then separated from Hrvatska elektroprivreda. From 1982 to 1993, assistant lecturer at the Faculty of Civil Engineering in Split – the course Use of water power and hydraulic structures. President of the local branch of Croatian Chamber of Architects and Engineers in Civil Engineering.

Born in 1974. Graduated at the Faculty of Electrical Engineering and Computing, received a MSc degree in 1999 and a DSc degree in 2003. Since 2004 holder of a MBA degree. From 1996 to 2002 junior researcher at the Faculty of Electrical Engineering and Computing, at which during studies received “Josip Lončar” award and University President’s Award. Founded and was the director of Rego-Stan d.o.o. Zagreb (1998-2002), from 2003 to 2004 member of the Management Board of Elektropromet d.d., Zagreb, in charge of finance and logistics. In A.T. Kearney was a consultant from 2005 to 2008, and then an independent consultant. Since late 2009 a member of the Management Board of HŽ Infrastruktura, in charge of procurement, finance, controlling and internal audit.

Born in 1973. Graduate electrical engineer (1998) and since 2006 holder of a MBA degree (Paris). After working shortly in 1999 in Ekspert as safety specialist for electrical installations and in Siemens in 2000 as computer programmer/developer, realized an entrepreneurial project which he managed until 2005. Then until 2008 as a manager for marketing strategy, programs and processes worked in T-Mobile, and until 2009 as director in Osječki promet i gospodarstvo. From 2009 the leader of Poslovni inkubator BIOS in Osijek. Member of Renewable Energy Sources Affiliation of Croatian Chamber of Economy.

General Shareholders Assembly

GENERAL SHAREHOLDERS ASSEMBLY 2011

The annual meeting of the General Shareholders Assembly was held on June 17, 2011. The Assembly was presented with the Annual Report on the state of affairs and operations of HEP d.d. and HEP Group in 2010; report of the Supervisory Board on the supervision over HEP d.d. operations in 2010; consolidated and non-consolidated annual financial reports of HEP d.d. and HEP Group for 2010 including Independent Auditor's Report. Decision was adopted by the Assembly at the proposal of the Supervisory Board on the use of operating profit for 2010, based on the Decision of the Government of the Republic of Croatia regarding actions by members of supervisory boards and shareholders assemblies with respect to payment into the national budget of a part of profits made by companies in which the Republic of Croatia has shares or stakes. Statements of release were given to members of the Management Board and members of the Supervisory Board for the business year 2010.

GENERAL SHAREHOLDERS ASSEMBLY 2012

The annual meeting of the General Shareholders Assembly was held on May 24, 2012. The Assembly reviewed consolidated and non-consolidated annual financial statements of the Company and HEP Group for 2011 with the Independent Auditor's Report; Annual Report on the state of affairs and operations of HEP d.d. and HEP Group in 2011; Report of the Supervisory Board on the supervision conducted in 2011. The Assembly accepted the proposal of the Supervisory Board and adopted the Decision on the use of operating profits made in 2011. Statements of release were given to members of the Management Board and members of the Supervisory Board for the business year 2011.

Audit

INDEPENDENT AUDITOR

At the meeting held on November 9, 2011, 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, 2011.

INTERNAL AUDIT AND RISK MANAGEMENT

Internal Audit and Risk Management Department is responsible for the corporate function of internal audit and risk management. Internal audit and risk management are pivotal functions of HEP d.d. Management Board and a part of the internal supervision of HEP d.d. and HEP Group. Internal supervision comprises, in addition to internal audit, an internal control system, internal controls, controlling, management accounting, treasury, IT and other forms of internal supervision carried out by the management for the purpose of achieving business objectives.

In 2011, HEP d.d. Management Board adopted Guidelines for the establishment of internal control system within HEP Group. Also, the process of implementing the internal control system continued by preparing technical background materials and adopting new documents in which elements of the internal control system were incorporated.

During the year, the Department carried out internal audits in line with the internal audit program and submitted reports thereon. 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.

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.

Based on the audits and activities carried out to establish the internal control system, it was assessed that the internal control system in HEP Group was reliable and that the main business risks had been identified. The Department submits semi-annual and annual reports on its work on a regular basis.

Certificates

Certification and re-certification is conducted within HEP Group based on the standards HRN EN ISO 14001:2004 and HRN EN ISO 9001:2008. The activities in this area are coordinated by the Department for Sustainable Development and Quality Improvement of HEP d.d.

Valid certificates for environmental management standard *HRN EN ISO 14001:2004* 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;
- in HEP OPS d.o.o. – Transmission Area Zagreb (BVQI);
- in HEP ODS d.o.o. - Elektra Zagreb (BVQI).

Currently underway are certification processes in 7 distribution areas. Certificates are expected to be obtained during 2012.

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

The standard HRN EN ISO 9001:2008 is being prepared for introduction in HEP d.d.

All hydro power plants in HEP Group have valid TÜV *CERTIFICATES OF ELECTRICITY PRODUCTION FROM RENEWABLE SOURCES* (Green Energy Certificate).

The project currently underway is to introduce **E-MOBILITY**, representing a business achievement and the creation of a new customer base. The infrastructure for accommodating electric drive vehicles in the system is being developed.

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Supply and Trade have been preparing new products and energy services to be offered through energy efficiency projects, **GREEN ENERGY**, green certificate trading and CO₂ emission trading.

BUSINESS OPERATIONS

IN 2011

3

HEP Business Operations in 2011

Business environment

HEP Group business operations in 2011 unfolded in the circumstances of continued multi-year economic crisis. While most European countries achieved growth in economic activities, the Croatian economy was characterized by further stagnation.

A number of world-scale events during 2011 produced significant consequences for HEP Group operations (nuclear accident in Japan, decision by German government to close older nuclear plants, political instability in the countries of North Africa and Middle East, a months-long drought in Europe), affecting energy prices in the international market.

Due to exceptionally unfavorable hydrologic conditions throughout the year and increase in input energy prices, operating costs rose significantly. Since the prices of electricity and heat did not increase, this was reflected as decrease in operating income compared to 2010.

The hydrologically favorable beginning of the year was followed by a dry period with record low water inflows. Lower hydroelectric production was replaced with higher imports and production from thermal power plants, which, together with price increase of all fuels and of imported electricity and with the euro exchange rate rising, greatly increased variable operating costs.

The unfavorable effects on business in 2011 came also as a result of decrease in electricity, heat and gas consumption compared to 2010.

Moreover, regardless of any actions that had been taken, due to continued unfavorable economic circumstances and further unemployment, the planned improvement in payment collection from customers was not achieved. Economic stagnation, growing number of insolvent legal entities and high unemployment rate contributed to the increase in the relative share of doubtful receivables.

In order to minimize the impact of unfavorable business conditions in 2011 HEP Group continued to successfully implement the measures for business efficiency improvement which resulted in lower maintenance costs and lower general operating costs compared with the planned values. Trade payables during the whole of 2011 were paid as they fell due.

Despite unfavorable factors, liquidity of HEP Group in 2011 can be assessed as satisfactory which was confirmed by rating agencies. Due to its improved liquidity Hrvatska Elektroprivreda d.d. received an upgraded rating from Standard & Poor's from BB- to BB, and Ba1 with stable outlook from Moody's.

Contributing to better liquidity rating of HEP Group were investment loans agreed for a longer term, namely, two loans totaling 170 million euro with a maturity of 7 years, and an EBRD loan totaling 123 million kuna with a maturity of 13 and 15 years, as well as an increased portfolio of available short-term credit lines with timely extension of their use for another year.

In 2011, intensive investments continued in the construction of new energy plants and facilities as well as replacement or reconstruction of the existing. Total investments amounted to 2.1 billion kuna. Unit L was connected to the electricity system, whereby TE-TO Zagreb CHP became the largest thermal power operation within HEP Group. Preparation intensified for the construction of capital projects such as the replacement unit at Plomin TPP, Ombla HPP, Kosinj/Senj HPP, HPPs on the Sava and Dubrovnik II HPP.

Replacement of equipment, reconstruction and renewal of power plants and facilities were continuously carried out.

In 2011, the total electricity turnover reached 18.6 TWh of which 12.7 TWh was generated in power plants owned fully or partly by the Group, and 5.9 TWh was procured on the market. For domestic customer needs and coverage of network losses, 17.6 TWh was secured and 1 TWh was sold on neighboring markets. Domestic electricity consumption fell by 1.6 percent in 2011.

The availability of power plants, transmission and distribution network was very good, without any significant disruption in the supply of electricity, heat or gas. The procurement of electricity and fuels was also reliable.

During 2011, other licensed suppliers, outside HEP Group, were active in the electricity market. Their market share is estimated at about 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 in 2011 was 48 percent.

Financial results

BASIC INDICATORS

	unit	2009	2010	2011	2011/ 2010
Electricity sales	TWh	17.5	17.6	16.6	-5.7%
Electricity production	TWh	14.7	15.8	12.7	-19.7%
Heat sales	TWh	2.2	2.4	2.3	-2.4%
Gas sales	m ³ mn	157	162	150	-7.6%
Operating income	HRK mn	12,600.8	12,942.9	13,074.1	1.0%
EBITDA	HRK mn	2,255.1	3,831.1	2,074.2	-45.9%
Group net profit (loss)	HRK mn	154.4	1,435.4	-3.3	-100.2%
Total assets	HRK mn	32,711.1	33,752.4	33,746.4	-0.02%
Investments	HRK mn	2,359.7	1,693.3	2,132.6	25.9%
Number of employees		14,222	14,016	13,784	-1.7%

In addition to the recession and further stagnation of economic activities, HEP Group business operations were adversely affected by other adverse factors as well. Due to unfavorable hydrological conditions the need for imports of electricity increased. Due to increase in price of imported electricity, electricity procurement costs increased as well, whereas fuel costs increased due to significant price increase in fuels, especially natural gas and coal. Cost increase, despite growth in operating income, reduced operating income to 453.4 million kuna (in 2010 it was 2,185.2 million kuna). Group net loss is 3.3 million kuna and a loss of 14.8 million kuna is attributable to equity holders of the parent.

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





	2009	2010	10/09	2011	11/10
Operating income	12,600.8	12,942.9	2.7%	13,074.1	1.0%
Operating cost	12,033.1	10,757.7	-10.6%	12,620.6	17.3%
Operating profit	567.7	2,185.2	285.0%	453.4	-79.3%
Group net profit	154.4	1,435.4	829.5%	-3.3	-100.2%
Net profit attributable to equity holders of the parent	135.8	1,421.3	946.3%	-14.8	-101.0%

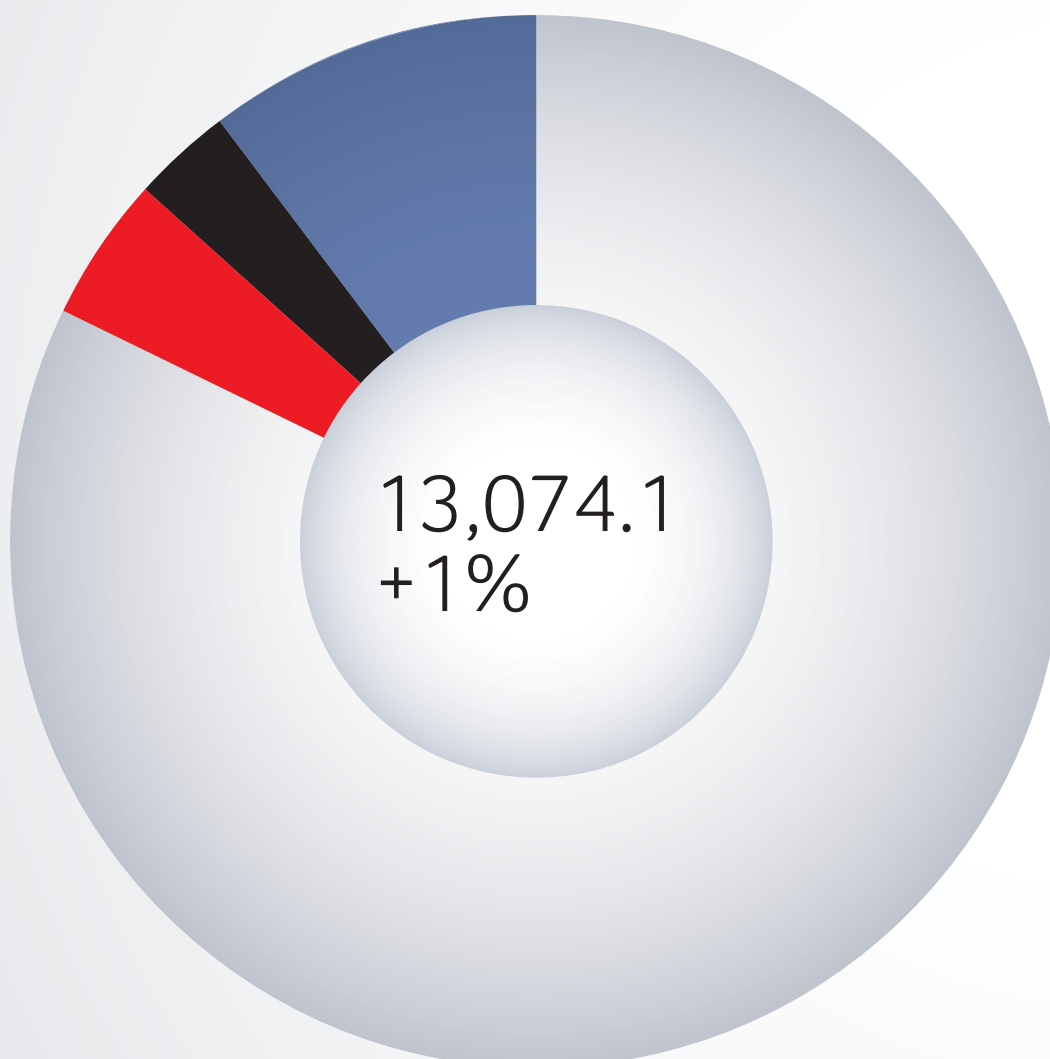
OPERATING INCOME

In 2011 the Group's operating income was 13,074.1 million kuna. This is an increase of 131.1 million kuna compared to 2010. Growth in operating income is the result of increased income from heat sales, income from services and other operating income.

Income from electricity sales, which decreased by 0.7 percent compared to the year before, accounts for 82 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 accounts for 10 percent, an increase of 18.9 percent compared to the year before; in that group income increased from network connection and energy balancing services, from assets received without compensation, from abandoning making long-term provisions for annual vacations and from sales of cross-border transmission capacity.

OPERATING INCOME (HRK mn)

	Electricity sales	10,769.9	82.4%
	Heat sales	582.4	4.5%
	Gas sales	381.2	2.9%
	Other operating income	1,340.6	10.3%



OPERATING EXPENSES

The Group's operating expenses in 2011 increased by 1,862.9 million kuna to 12,260.6 million kuna. Costs of production and procurement of electricity significantly increased due to the impact of the following factors:

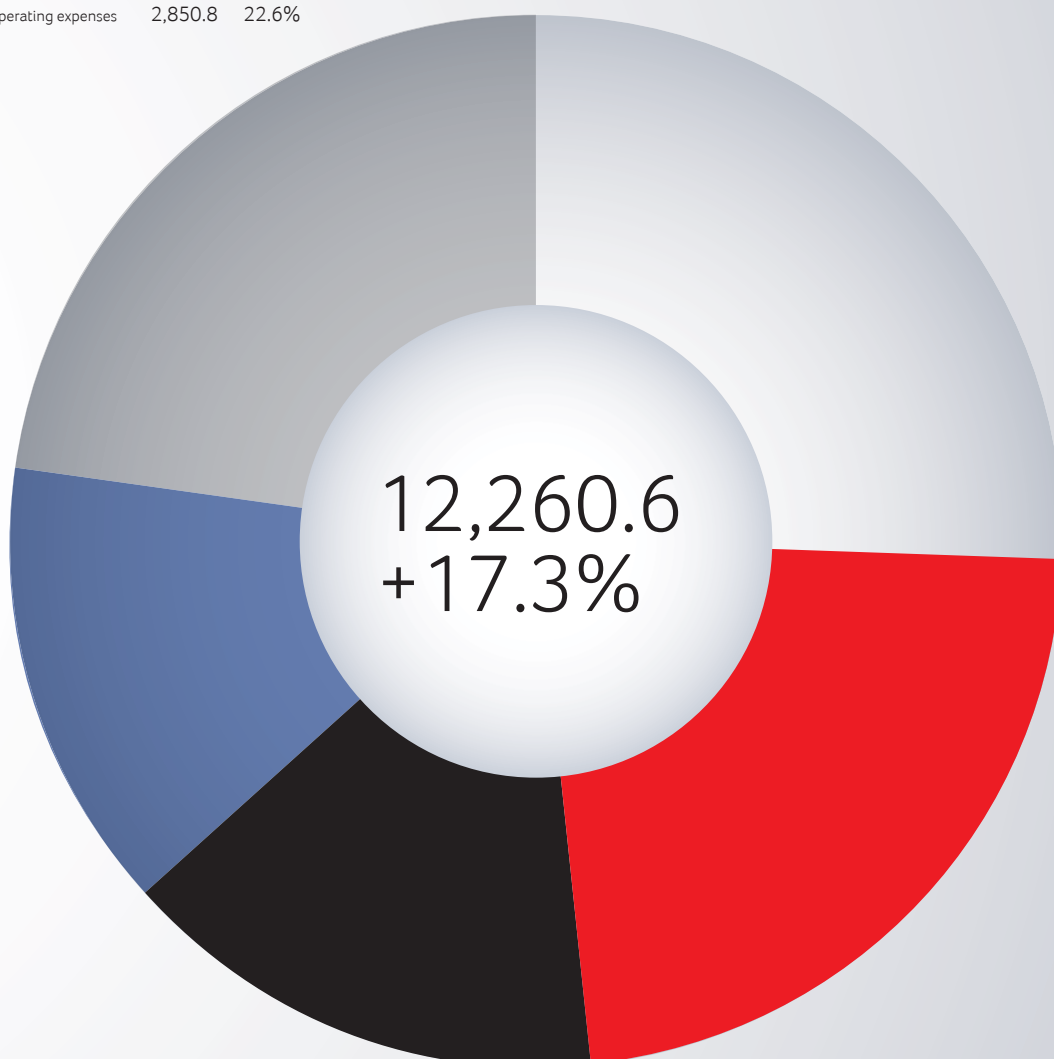
- production of only 4.6 TWh by hydro power plants due to unfavorable hydrology
- higher procurement of electricity on the market by 1.6 TWh,
- increase in price of imported electricity of 17.2 percent,
- higher electricity production by oil-fired power plants and higher prices of all kinds of fuel.

Staff costs are linked to the application of the Collective Agreement which ties the growth in salaries to Croatia's GDP growth in the previous year. Reduction in the number of employees decreased the costs of salaries by 5 million kuna while other staff costs rose by 18.4 million kuna compared to 2010.

Other operating expenses decreased by 6.6 percent due to lower costs of provisioning, reduction in damage compensation and lower power plants' occupancy charges and reduction in general and administrative costs through continuous efficiency measures.

OPERATING EXPENSES (HRK mn)

Electricity procurement	3,260.0	25.8%
Fuel	2,870.1	22.7%
Staff costs	1,890.2	15.0%
Depreciation	1,749.5	13.9%
Other operating expenses	2,850.8	22.6%



Results by activity

BUSINESS RESULT (HRK mn)

	electricity		heat energy		gas distribution		Group	
	2010	2011	2010	2011	2010	2011	2010	2011
Income from core activity	10,851.1	10,769.9	569.8	582.4	394.2	381.2	11,815.0	11,733.4
Other income	1,065.0	1,234.7	59.9	72.8	28.7	33.1	1,153.6	1,340.6
Operating profit (loss)	2,356.6	766.2	-142.6	-314.7	-3.1	2.0	2,185.2	453.4
Net financial expense							-348.0	-371.3
Profit tax							-401.8	-85.5
Net profit							1,435.4	-3.3

Most of operating income (92 percent) and total operating profit of the Group were achieved in the electricity business. A significant fall in profit in this business is a consequence of increase in costs of electricity production and procurement.

Although the district heating business accounts for 5 percent in the income, operating loss in this business is 314.7 million kuna. The loss increased relative to 2010 due to continuous growth in fuel prices coupled with unchanged heat selling price.

Gas distribution has the smallest share in operating income (3 percent). While in 2010 this business made an operating loss in 2011 there is an operating profit of 2 million kuna, primarily due to lower costs of the concession, and lower costs of gas procurement.

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 2011 an operating profit of 766.2 million kuna was achieved which is a much worse business result compared to 2010, due to the growth in electricity procurement costs and fuel costs for production.

Income from electricity sales amounted to 10,769.9 million kuna, of which 96.7 percent was realized from supply to domestic customers and 3.3 percent from sales in neighboring market.

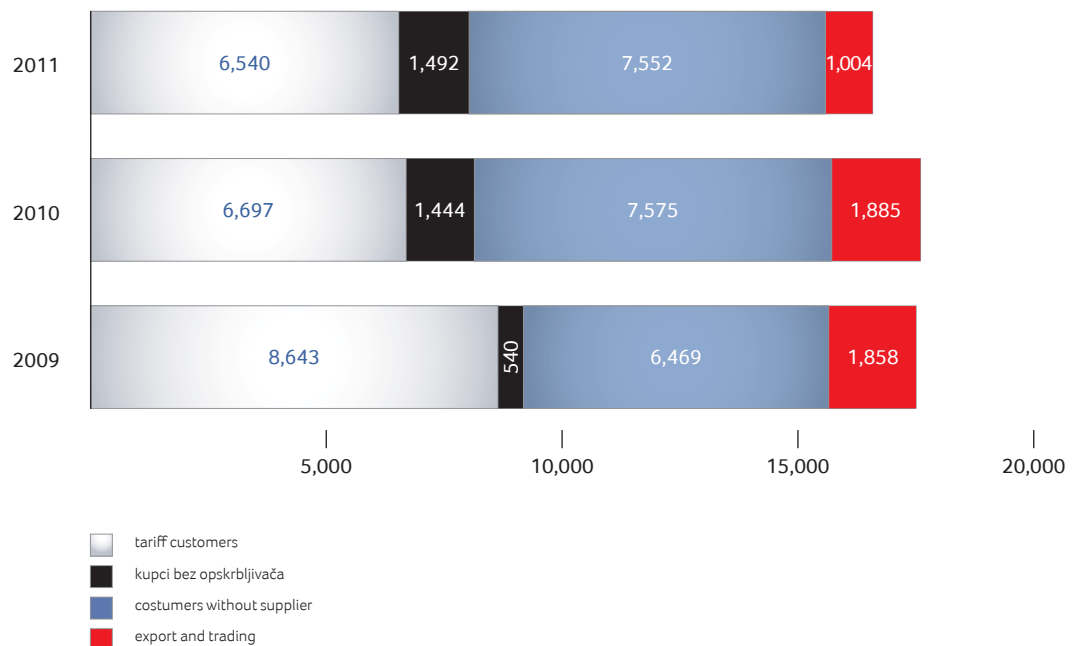
Power plants owned wholly or partly by the Group generated 12.7 TWh of electricity, which is 68 percent of total electricity turnover realized in 2011. Due to the exceptionally dry year with record lows of water inflows, electricity generation mix was considerably more unfavourable compared to the previous year. Hydro power plants produced 4,577 GWh of electricity which is 45 percent less compared to historically highest production achieved in 2010. Shortage of electricity was covered for the most part by increasing imports by 45 percent. To optimize the generation mix in the circumstances of high fuel prices, production by thermal power plants increased only 8 percent.

ELECTRICITY PRODUCTION AND PROCUREMENT (GWh)

	2009	2010	2011	11/10
hydro power plants	6,767	8,309	4,577	-45%
thermal power plants	5,177	4,787	5,147	+8%
Krško nuclear power plant	2,730	2,690	2,951	+10%
electricity procurement	4,898	4,046	5,863	+45%

Sales to domestic customers amounted to 15.6 TWh of electricity, which is a mild fall of 0.8 percent. In the structure of electricity sold, tariff customers account for 42 percent (6,540 GWh), customers who have not chosen supplier 10 percent (1,492 GWh) and eligible customers 48 percent (7,552 GWh). Sales in foreign markets amount to 1,004 GWh or 46.8 percent less than in 2010.

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, Zaprrešić, Samobor and Sisak. The business made an operating loss in 2011 of 314.7 million kuna. Due to the increase in heat production costs resulting from the increase in fuel prices (on average 43.8% for gas and 10.3% for oil), the loss increased compared to 2010 by 172.1 million kuna. The necessary increase in selling prices was not approved so that the trend of growing loss returned after being stopped in 2009 by price increase of 16 on average.

Sales of heat and process steam were 2.68 TWh, which is 2.2 percent less than in 2010.

GAS

The business of gas distribution and supply is performed in the areas of Osijek-Baranja, Virovitica-Podravina and Požega-Slavonia counties. In 2011, the business made an operating profit of 2 million kuna with gas sales fall of 7.6 percent. As with the heating business, consumption is greatly impacted by weather conditions during the heating season. In 2011, there was a further decrease in consumption by non-residential customers of 9.6 percent, while residential customers decreased their consumption by 6.2 percent. Lower consumption led to lower income from gas sales compared to 2010.

Financial position

CONSOLIDATED BALANCE SHEET (ABRIDGED)

	December 31, 2010		December 31, 2011		Change 11/10
	HRK mn	share	HRK mn	share	
Long-term assets	29,999.2	89%	30,364.4	90%	1%
Short-term assets	3,753.2	11%	3,382.0	10%	-10%
Total assets	33,752.4	100%	33,746.4	100%	0%
Capital and reserves	19,811.3	59%	19,279.8	57%	-3%
Long-term provisions	799.9	2%	778.6	2%	-3%
Long-term liabilities	9,148.1	27%	8,850.8	26%	-3%
Short-term liabilities	3,993.0	12%	4,837.1	14%	21%
Total capital and liabilities	33,752.4	100%	33,746.4	100%	0%

ASSETS

The value of total assets of HEP Group in 2010 decreased in 2011 by 6.1 million kuna to 33.7 billion kuna. The increase of 365.2 million kuna was achieved in long-term assets owing to significant investments in construction, replacement and reconstruction of electric facilities, plants and networks. Long-term assets account for 90 percent of the value of the Group's assets.

The value of short-term assets is 3.4 billion kuna, a decrease of 371.2 million kuna, as a result of decrease of 355 million kuna in the item of cash and cash equivalents, decrease in inventories of 53.2 million kuna and increase in total accounts receivable of 36.9 million kuna. The most significant item in short-term assets is accounts receivable amounting to 1.5 billion kuna, which decreased in 2011 due to a larger share of doubtful receivables. This is followed by inventories of materials, spare parts and energy fuel which amount to 1.1 billion kuna the value of which decreased due to lower quantities of oil and coal in inventories.

CAPITAL AND LIABILITIES

Capital and reserves at the end of 2011 amounted to 19.3 billion kuna with a share of 57 percent in the Group's total assets. This is a decrease of 531.5 million kuna compared to 2010 due to the loss for the year and payment of dividends into the national budget.

The structure of liabilities did not change significantly, but short-term liabilities increased by 844.1 million kuna compared to the beginning of the year due to which their share increased from 12 to 14 percent. Trade payables increased by 874 million kuna and liabilities for short-term loans increased by 310.7 million kuna, while liabilities for taxes and contributions decreased by 404.2 million kuna.

Long-term liabilities amount to 8.9 billion kuna and account for 26 percent in total liabilities and capital. They decreased by 297.3 million kuna due to decrease in liabilities for long-term loans of 349.1 million kuna while other long-term liabilities increased by 149.7 million kuna. Long-term provisions for risks and costs decreased due to decrease in other provisions for costs.

Due to increase in interest-bearing debt and decrease in the value of capital and reserves, net debt to equity ratio increased from 24 to 26 percent.

Investments

In 2011 the value of the investments made by the Group was 2,132.6 million kuna, of which the greatest part was in new construction, replacement and reconstruction of existing energy facilities, plants and networks. The remaining portion is related to information technology and telecommunications infrastructure, remote control systems, measuring devices and instruments, business premises and transport vehicles.

INVESTMENTS (HRK mn)

	2009	2010	2011	11/10
Investments in property, plant and equipment	2,359.7	1,693.3	2,132.6	+25.9%

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 2011 per company is given in the section Reports by HEP Group companies.

Credit rating

In their report of October 28, 2011 Standard&Poor's upgraded the long-term credit rating of Hrvatska elektroprivreda d.d. from BB- to BB due to the strengthening of liquidity of HEP Group, noting that change in sovereign rating would consequently lower HEP's rating.

In their report of December 7, 2011 Moody's assessed HEP's long-term capability to serve all its financial obligations with Ba1, reflecting HEP's significant investment needs in the future and exposure to increased refinancing, exchange rate and interest risks. In their report of June 18, 2012 HEP's Ba1 outlook was changed from stable to negative, primarily as a direct consequence of changed sovereign outlook from stable to negative.

We foster and build relationships with our business partners, appreciating their quality and professionalism.

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Partnership

An ever growing importance will be given to the implementation and financing of **ENERGY EFFICIENCY** projects using ESCO model for customers and purchasers. The customers will be **CONTINUOUSLY** provided with energy audit, consultancy and other additional services.

REPORT ON IMPACT
ON STAKEHOLDERS

4

Report on Impact on Stakeholders

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

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

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 2011 HEP continued to implement Action Plan for the implementation of Anti-Corruption Program of Croatia's Government applicable to state majority-owned companies for the period 2010-2012, in order to strengthen responsibility and transparency, create conditions for prevention of corruption at all levels and promote zero-tolerance to corruption. The following has been carried out as part of the Action Plan:

- The website includes postings of job vacancies.
- Ethics commissioners were appointed in HEP Group companies who constitute Ethics Commission at Group level as well as a person for receiving reports of irregularities in business. Information about contact and/or reporting unethical behaviour and irregularities in business was posted on HEP's internal website and on the internet 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.
- In June 2011, Information Officer for HEP Group was appointed, To the end of the year the Officer received four requests for access to information, which were responded to within the legal time-limit. In accordance with the Right to Access to Information Act, the Information Officer prepared a Report on the implementation of the Act for 2011 and sent it to the Croatian Personal Data Protection Agency. The Report also states that information on a company's business operations, as required by the Act, must be published through the internet website on which Information Catalogue is also posted.
- The website should also include the list of decisions of the Management Board of the Company made with consent of the Government of Croatia.

PUBLIC PROCUREMENT

NUMBER OF PROCUREMENT PROCEDURES CARRIED OUT IN 2011 BY HEP GROUP COMPANY

HEP Group company	Number of public procurement processes in 2011
HEP d.d.	123
HEP – PROIZVODNJA d.o.o.	780
HEP – OPERATOR PRIJENOSNOG SUSTAVA d.o.o.	281
HEP – OPERATOR DISTRIBUCIJSKOG SUSTAVA d.o.o.	1,404
HEP – PLIN d.o.o.	23
HEP – TOPLINARSTVO d.o.o.	147
HEP – TRGOVINA d.o.o.	1
HEP – OPSKRBA d.o.o.	1
HEP – ODMOR I REKREACIJA d.o.o.	23
HEP – OBNOVLJIVI IZVORI ENERGIJE d.o.o.	4
TOTAL	2,787

Considering the large number of items that are subject to public procurement, HEP has been continuously performing comprehensive activities to fight corruption, with a special emphasis on transparency and strengthening of responsibility. As part of the Action Plan for the implementation of the Anti-Corruption Program of the Government of Croatia the following measures have been implemented:

SEPARATION OF BUSINESS AND PRIVATE INTERESTS IN ACCORDANCE WITH THE PUBLIC PROCUREMENT ACT

All members of the Supervisory Board and of the Management Board of HEP d.d., members of supervisory boards and managing directors of subsidiary companies signed statements (negative or affirmative) of ownership of more than 20 percent of business interests, shares or other rights in an economic entity based on which the information was posted on HEP internet website listing business entities with which no contracts may be made.

After the reporting period, the signing of (non-)existence of conflict of interest was aligned with the new Public Procurement Act (in force since January 1, 2012). Also, for every public procurement procedure, statements of (non-)existence of conflict of interest must be additionally signed by authorized representatives and other persons that have influence on the selection of tenderers.

PUBLISHING OF INFORMATION REGARDING PROCUREMENT PROCEDURES

On HEP website all public procurement procedures within HEP Group are posted. Also posted are the procedures that are not subject to the Public Procurement Act if another type of invitation to tender/tendering is applied.

PUBLISHING OF CONTRACT AWARD AND PERFORMANCE

In accordance with the Conclusion of the Government of Croatia dated March 17, 2011, public authorities are obligated to publish the information about public procurement contracting on their website. Therefore, since April 16, 2011 HEP Group members, which are subject to the Public Procurement Act, publish the information on awards and performance of framework agreements and contracts made on the basis of an appropriate public procurement procedure on HEP website.

INTEGRITY

In case of procurement procedures or contracts whose estimated worth exceeds 6 million kuna for goods and services or 12 million kuna for works, irrespective of the type of procurement procedure, tenderers are obligated to sign Integrity Statement in which they guarantee correctness in the public procurement procedure, absence of corrupt practices or fraud and express their consent to an independent audit of the public procurement procedure. In case of procurement below the above stated amounts, the general part of the tender documents is supplemented with an integrity clause.

The primary business objective in this area is to build a reliable system of public procurement, characterized by predictability, more competition, efficient and effective management of resources, value for money and orderly procedure (timely procurement). To achieve these objectives, HEP will continue to strengthen transparency, providing more information to prospective tenderers with the aim of giving equal opportunity to all those wishing to participate in the public procurement procedure.

Employees

NUMBER OF EMPLOYEES

On December 31, 2011 of the total of 13,784 employees, 13,765 were employed on a permanent basis and 13 on a temporary basis (of which 2 trainees on a temporary basis) and 6 employees were on unpaid leave.

NUMBER OF EMPLOYEES BY HEP GROUP COMPANY (DECEMBER 31, 2011)

HEP Group company	Employees		Change
	2010	2011	2011-2010
HEP-Operator distribucijskog sustava d.o.o.	9,370	9,224	-146
HEP-Proizvodnja d.o.o.	2,311	2,263	-48
HEP-Operator prijenosnog sustava d.o.o.	1,239	1,196	-43
HEP d.d.	424	425	1
HEP-Toplinarstvo d.o.o.	336	351	15
HEP-Plin d.o.o.	139	136	-3
HEP-Opskrba d.o.o.	61	62	1
Crpna stanica Buško Blato d.o.o.	43	42	-1
APO d.o.o.	26	22	-4
HEP-ESCO d.o.o.	19	18	-1
HEP-Trgovina d.o.o.	16	16	0
HEP – Odmor i rekreacija d.o.o.	13	11	-2
Ustanova HEP-Nastavno-obrazovni centar Velika	12	11	-1
HEP- Obnovljivi izvori energije d.o.o.	7	7	0
HEP Group TOTAL	14,016	13,784	-232

QUALIFICATION STRUCTURE

Qualification	No. of Employees	(%)
DSc and MSc	185	1
BSc	2,023	14.7
Associate degree	1,071	7.7
Secondary school	5,861	42.5
Elementary school / semi skilled	780	5.8
Highly skilled	2,167	15.8
Skilled	1,697	12.4
TOTAL	13,784	100%

AGE STRUCTURE

Years of age	No. of Employees
under 20	0
20-25	85
25-30	562
30-35	1,025
35-40	1,649
40-45	1,687
45-50	2,058
50-55	2,584
55-60	2,576
60-65	1,559
TOTAL	13,784

EMPLOYMENT AND TRADE UNION RELATIONS AND WORKERS' COUNCILS

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

On January 12, 2011 a new Collective Agreement was concluded for HEP Group, applicable from January 1, 2011 to December 31, 2012, plus one year of extended application. In accordance with Article 152, the parties to the Collective Agreement set up a Joint Commission for the interpretation of the provisions of the Agreement. The commission met periodically, in accordance with the provisions of the Collective Agreement and depending on the requests for interpretation they received.

Responding to the requirements and expectations of all stakeholders, we raise the quality of our products and services. Our goals is business

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HEP makes sure that its employees attend professional improvement courses and training, necessary for smooth business processes (in the field of environmental protection and safety at work; specialist computer courses, etc.). The establishment of the internal training center will allow **SPECIALIST KNOWLEDGE** to be exchanged within HEP and **OPTIMUM USE OF THE KNOWLEDGE**.

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 at HEP Group level 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

HEP allocates significant financial resources to education and training, necessary for smooth work processes (in the area of environmental protection and safety at work; specialist IT courses), including participation by HEP experts in gatherings such as HRO CIGRE, MIPRO, Energy Day Forum and other professional meetings in Croatia and abroad.

In 2009, the company began to establish an internal training system since when trainees have been receiving education in the area of social skills. Education on communication skills and business etiquette constitutes a mandatory part of the trainee program and its implementation is planned to be implemented in the whole of HEP Group.

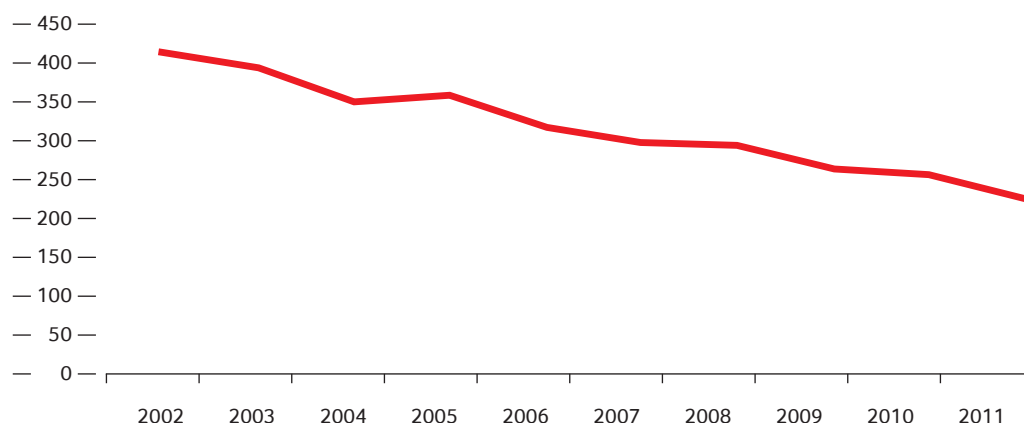
Human Resources Department organized three new educational courses: "Presentation skills" (for trainees) "Business correspondence" (for secretarial and administrative staff) and "Management" (for lower management).

In 2011 the Management Board of HEP d.d. appointed a team for the development of an internal training center. The establishment of the center will make it possible to exchange specialist knowledge within HEP, use knowledge in an optimal manner and implement the system of internal trainers.

Records of Education, a software application, unifies records in the area of education and data and reports for HEP Group.

HEALTH AND SAFETY AT WORK

Health and safety at work in HEP has a significant position in the company's business operations and have been systematically implemented in all HEP Group companies and organizational units. Under the law, the implementation of protective measure is the responsibility of the employer and in organizational units the responsibility lies with employer's authorized officers on behalf of the employer. As required by law, in each organizational unit there is one or more safety specialists, depending on the number of employees. Safety specialists provide their professional assistance to the employer and its authorized officers in the implementation and improvement of safety at work and protection of health of employees. The activities taken by HEP in the area of work safety and health protection have produced visible results.

TOTAL NUMBER OF INJURIES AT WORK IN HEP GROUP 2002-2011

Since the laws specify that injuries occurring to and from work are also injuries at work, these significantly increase the total annual number of injuries. In 2011 there were 44 such injuries out of a total of 225, which makes about 20 percent of the total number of injuries.

There were 166 injuries at workplace, 2 on business travel and 13 elsewhere. One injury ended fatally and 23 were serious injuries at work.

Of the total number of serious injuries, 17 occurred at workplace and five on the way to/from work. Of the 17 injuries at workplace, two were due to electric arc and touch with live conductors, eight were due to fall (on a slippery terrain, stairs, canal) and two were due to fall from the pylon, one in traffic and four for other reasons. The injuries that occurred at workplace during normal work were mostly due to non-compliance with safety measures. Last year 11, 502 working days or 92,010 working hours were lost due to injuries at work. Due to non-compliance with safety measures or other conditions stipulated by law, the Croatian Health and Safety at Work Office did not recognize 21 injuries.

Injuries at work are mainly a consequence of not applying basic or special protection rules at work. That is why more and more attention has been paid since a few years ago to constant education of employees at all levels, especially direct supervisors and/or authorized officers.

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

HEP Operator distribucijskog sustava d.o.o. (HEP ODS) is a company that provides the network use service to all customers connected to the distribution network. HEP ODS is also the provider of the electricity supply service to customers who are in the public supply system. Day-to-day activities of HEP ODS are directed towards improving the quality of electricity it delivers and services it provides. In the carrying out of its business HEP ODS has been continuously improving its relationship with customers, according to their needs and expectations.

After making electricity bills payable without extra charge at all FINA and Croatian Postal Service offices, there was no need to keep HEP ODS premises for that purpose. Customers can now pay their bills without extra charge though direct debit agreed with a commercial bank or a credit card company with which HEP ODS has the contract for this service.

Through HEP ODS website customers can communicate fast and directly through email, use meter submission application, see their consumption and payment data and get other information relating

to the use of services such as overview of planned works on the distribution network and/or overview of electricity outage announcements for any part of Croatia. In addition, HEP ODS website provides information on tariff models, legislation governing HEP ODS business and other useful information. Besides the website, customers can use free telephone number (0800 300 4xx) to submit meter reading value, file complaint or receive information. In addition to these channels of communication, in each distribution area customers can communicate directly with employees to submit meter reading, get information or file a complaint.

RELATIONS WITH ELECTRICITY CUSTOMERS- HEP OPSKRBA

The priority of HEP Opskrba in its work program for 2011 was to provide the customer with instant information. The application My Account on the webpage was launched to allow all customers to view their balances, accounts, get account transcript, graphical overview of consumption, view open items etc. The interest that this application arose additionally confirmed that the information expected by the customer from HEP ODS be on-line. In just two days the application was accessed by 18,000 visitors. Regardless of the internet and Facebook sites, classical communication through Call Center was not neglected. In 2011 the number of calls did not decrease much. Communication unfolded also on paper and through leaflets informing customers about all things of importance for the cooperation between customers and HEP Opskrba.

The greatest interest, with respect to information, is in Newsletter, issued by email to customers as a rule monthly or more frequently in case of important events or new projects.

Customers show increasing interest in and expect additional services from HEP Opskrba. These have been under preparation for some time but their real application cannot be expected before the first half of 2012.

RELATIONS WITH HEAT CUSTOMERS (HEP TOPLINARSTVO)

HEP Toplinarstvo d.o.o. in 2011 continued to pay special attention to improvement in relations with heat energy customers whose satisfaction is a business interest of the company. All customers were provided with quality and reliable supply of heat energy, and energy delivered was timely meter-read and billed. Sporadic disruptions in heat supply were communicated to customers in mass media or on notice boards in residential or office buildings, and the planned suspension of heat supply was communicated to customers of industrial and commercial category by fax.

Communication with heat customers was organized through regular postal service, consumer phone numbers, on-duty staff phone number available 24/7, fax, e-mail and the company's website (www.hep.hr/toplinarstvo). Frequently asked questions in 2011 were related to heat billing, debt for heat supplied and debt payment options, late interest calculation, registration and change of residential/business space, technical faults and difficulties in heat supply, and to possibility of installation of heat cost allocators. All questions and complaints by customers received timely answers in accordance with time-limits prescribed in General Conditions of Heat Energy Supply (NN 129/06).

Answers to frequently asked questions of heat customers were unified in an informative leaflet, sent to customers with November 2011 bills. Promoting energy savings and energy efficiency, HEP Toplinarstvo in this leaflet and on its website educated customers about efficient use of heat energy.

RELATIONS WITH GAS CUSTOMERS (HEP PLIN)

Gas deliveries to customers in 2011 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 the poor financial situation in the economic and social environment so that in 2011 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.

Short disruptions in gas delivery due to planned works in the network or connecting new customers were regularly announced through direct written notifications or in mass media.

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.

NUMBER OF COMPLAINTS CONSIDERED BY COMMISSIONS OF HEP ODS - 2011

Billing	Faulty meter	Connection/ disconnection	Voltage conditions	Other	TOTAL
total 233	total 10	total 6	total 1	total 58	total 308
accepted 72	accepted 5	accepted 1	accepted 0	accepted 10	accepted 88
rejected 161	rejected 5	rejected 5	rejected 1	rejected 48	rejected 220

NUMBER OF COMPLAINTS CONSIDERED BY COMMISSIONS OF HEP-TOPLINARSTVO - 2011

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 3	total 0	total 0	total 1	total 1	total 5
accepted 2	accepted 0	accepted 0	accepted 1	accepted 0	accepted 3
rejected 1	rejected 0	rejected 0	rejected 0	rejected 1	rejected 2

NUMBER OF COMPLAINTS CONSIDERED BY COMMISSIONS OF HEP-PLIN - 2011

total 2
accepted 0
rejected 2

Donations

OPEN COMPETITION FOR DONATIONS

In 2011 HEP for the second 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 2011 in the following areas: youth, art and cultural heritage, humanitarian action or environment. In accordance with the conditions, there were applications for 1,404 projects. Based on the evaluation of project quality and originality, utility for local or broader community and donation spending efficiency, HEP selected 196 projects whose implementation it co-financed with donation proceeds in the total amount of 2.5 million kuna.

DEMINING ASSISTANCE

The most significant single donation in 2011 was awarded to the Croatian Mine Action Center for the implementation of demining projects in southern Croatia, in accordance with safety priorities of the annual demining plan of the Government of the Republic of Croatia. HEP thereby contributed to one of the most important national projects, significant for population safety and economic development in the mine-contaminated areas.

OTHER (MULTI-YEAR COOPERATION)

- 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, 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

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HEP operates in compliance with **LAWS** and **ETHICAL STANDARDS**, on the principles of sustainable development and social responsibility, based on its own Code of Ethics, Code of Ethics of the Croatian Chamber of Economy and Corporate Governance Code (Zagreb Stock Exchange).

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Total expenses of HEP Group for **NATURE AND ENVIRONMENTAL PROTECTION** in 2011 amounted to a little over 111 million kuna, an increase of about 14 percent compared to 2010.

Sustainable Development

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. Technical support to these employees is provided by the Sustainable Development and Quality Improvement Department of HEP d.d. and by the members of HEP's Team for Environmental Protection Coordination and Standardization. The basic task of the Team is to analyze and evaluate the environmental activities in HEP Group with an emphasis on the planning, coordination, internal communication and preparation of proposals for improvements in the area of environmental protection.

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 MWt and for obtaining a siting permit for new construction or reconstruction of existing plants. Coordinated by HEP's Team for the obtaining of integrated environmental requirements, preparatory activities have been conducted to align all HEP-owned thermal power plants with Best Available Techniques whose application will result in reduced detrimental impact on the environment. During 2011, the analyses of the existing situation and draft compliance studies were prepared for all thermal power plants of rated thermal capacity above 50 MWt. The proposed harmonization measures seek to maximize the duration of investment cycles for existing plants and to give priority to construction of new, replacement generating units of higher efficiency and environmental acceptability.

GREENHOUSE GAS EMISSIONS

By ratifying the Kyoto protocol, Croatia has undertaken to reduce greenhouse gas emissions and by signing the EU accession treaty Croatia has obligated itself 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 CO₂, meaning that HEP will have to buy all CO₂ emission rights at auctions and include these additional costs in the delivered product – electricity and heat. To prepare HEP for the conditions of greenhouse emission trading, Team for the implementation of Kyoto Protocol provisions has begun to prepare HEP for the new conditions; in 2011 a number of workshops were held to analyze HEP's obligations deriving under emission trading legislation, market and participant structure and market trends, and to identify market risks and examine the impact of emission trading on HEP's business operations.

Also, a market simulator, PLEXOS, was used to model the impact of the amount of CO₂ emitted in electricity generation and to estimate the impact of change of CO₂ unit price on the national electricity system (planning of annual financial resources for the purchase of emission quotas, impact of CO₂ price change on electricity price, planning of fuel type and quantity, planning of operation of individual generating units).

During 2011, a program to reduce CO₂ emissions was developed, for all HEP's stationary sources emitting more than 30 tons of CO₂ a year, which is submitted to relevant national authorities for their information about all HEP's actions to reduce greenhouse gases.

ECOLOGICAL NETWORK

Upon the coming into force of the Regulation Declaring the 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 or performing actions or executing projects under the Act in these areas.

The establishment of the national ecological network within Natura 2000 will cause significant additional requirements for the economy, especially in the energy sector. The requirements will include those related to the construction of the rest of the planned hydro power plants as such projects use large spaces. The ecological network declaration process was carried out without appropriate participation by stakeholders and without a full-scale analysis of the impact on other strategic and developmental interests of Croatia. Also, the legislation does not state clearly whether the areas of National Ecological Network and/or the future network Natura 2000 prevail over physical planning documents or vice versa. 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. The measures also make it harder to meet the obligations to reduce air pollutants, greenhouse gases included, arising from national and EU legislation, and to carry out some of regular plant maintenance work, nature protection and safety at work, and they increase energy production costs.

KEEPING UP WITH LEGAL REQUIREMENTS

To educate and inform the employees, the Sustainable Development and Quality Improvement Department continuously follows and systematically, in the form of printed bulletins, prepares overviews of legal requirements in the area of environmental and nature protection of importance for operations and business of all HEP Group companies. Given the large number of new or amended laws and regulations in the last 12 months, the Department has prepared the newest overview and analysis.

Within HEP Group, Register of Waste Generation and Processes and Register of Chemicals Consumption have been implemented in order to fulfill the legal obligations in the area of waste and chemicals management. During 2011, some ten workshops were held to inform HEP employees about legal obligations in the area of waste management and about how to maintain the registers at HEP Group level.

Basic indicators

During 2010, HEP continued to monitor pollutant emissions into the air – sulfur dioxide (SO₂), nitrogen oxides (NO_x), carbon dioxide and particulates as required by air quality legislation, as well as the quantities of hazardous and non-hazardous waste generated within HEP and concentration of hazardous substances in waste water.

AIR EMISSIONS

Pollutant emissions into the air come predominantly from HEP's large combustion plants – thermal power plants Plomin 1, Plomin 2, TE-TO Zagreb, EL-TO Zagreb, TE-TO Osijek, Sisak, Jertovec and Rijeka. In 2011, total electricity production from HEP's thermal power plants increased in comparison with 2010 by about 7.6 percent. The higher engagement of thermal power plants was the result of requirements for stability and/or safety of the electricity system and unfavorable hydrologic conditions. Due to the increased operation of thermal power plants, fuel consumption increased accordingly – oil by about 25,000 t and coal by about 50,000 t. The specific emission of all pollutants and/or emission of pollutants per kWh was mildly reduced as a result of system optimization and engagement of more efficient generating units.

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
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
2011	9,621	5,574	4,035	220	5,149
Change 2011/ 2010 (%)	+16	+5	+4	-32	+7,6

NOTE:

A graph showing the trend of air pollutant emissions from thermal power plants for the period (1990) 2002 - 2011 is given on the pages 72-73.

WASTE

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.

All HEP Group companies and 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 plants the managing of waste data electronically using the application "Waste Management" continued.

In 2011, a total of 1,574 tons of hazardous waste and 116,236 tons of non-hazardous waste was produced within HEP Group. Larger quantities of generated waste compared to 2010 are a result of increased production by Plomin coal-fired power plants and/or disposal of by-products – ash, slag and gypsum and due to an increased scope of overhauls and reconstruction in other plants. All of the generated waste was handed over to authorized collectors, exporters or processors for further processing and final disposal.

TOTAL QUANTITY OF HAZARDOUS AND NON-HAZARDOUS WASTE GENERATED WITHIN HEP GROUP 2002-2011

Year	Hazardous waste (t)	Non-hazardous waste (t)
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
2011	1,574	116,236
Change 2011/ 2010 (%)	+4	+5

NOTE:

A graph is given on page 74

EXPENSES FOR ENVIRONMENTAL AND NATURE PROTECTION

In 2011, total expenses for nature and environmental protection incurred by HEP Group companies amounted to a little more than 111 million kuna. The most significant investments in 2011 were the projects to improve waste management system in HEP's plants and to protect nature and the environment.

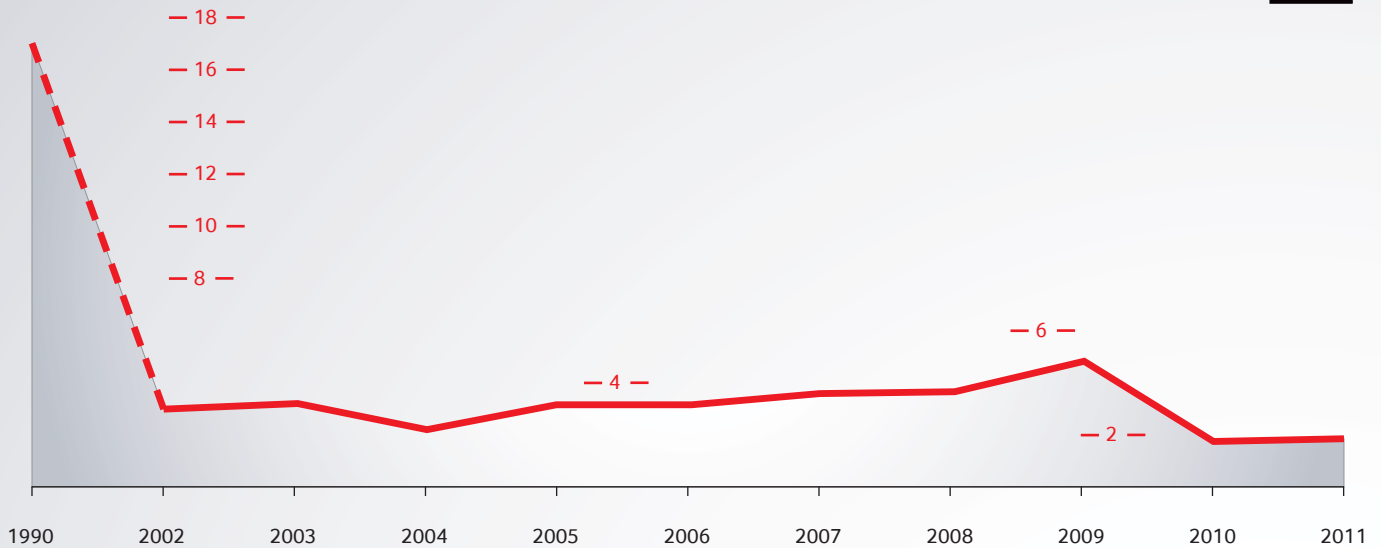
EXPENSES FOR NATURE AND ENVIRONMENTAL PROTECTION IN 2011 ACCORDING TO RETZOK REPORTS

Environmental area	Costs of regular operations (HRK'000)	Investments (HRK'000)
air and climate	3,561	
waste waters	2,796	42
waste	13,200	4,110
protection of soil and groundwater	366	4
protection of nature and landscape	12,471	3,151
radiation protection	65	10
research and development	667	
other (mostly charges)	71,000	180
TOTAL	104,126	7,469

TREND OF SPECIFIC EMISSION OF AIR
POLLUTANTS FROM THERMAL POWER PLANTS
(1990) 2002-2011

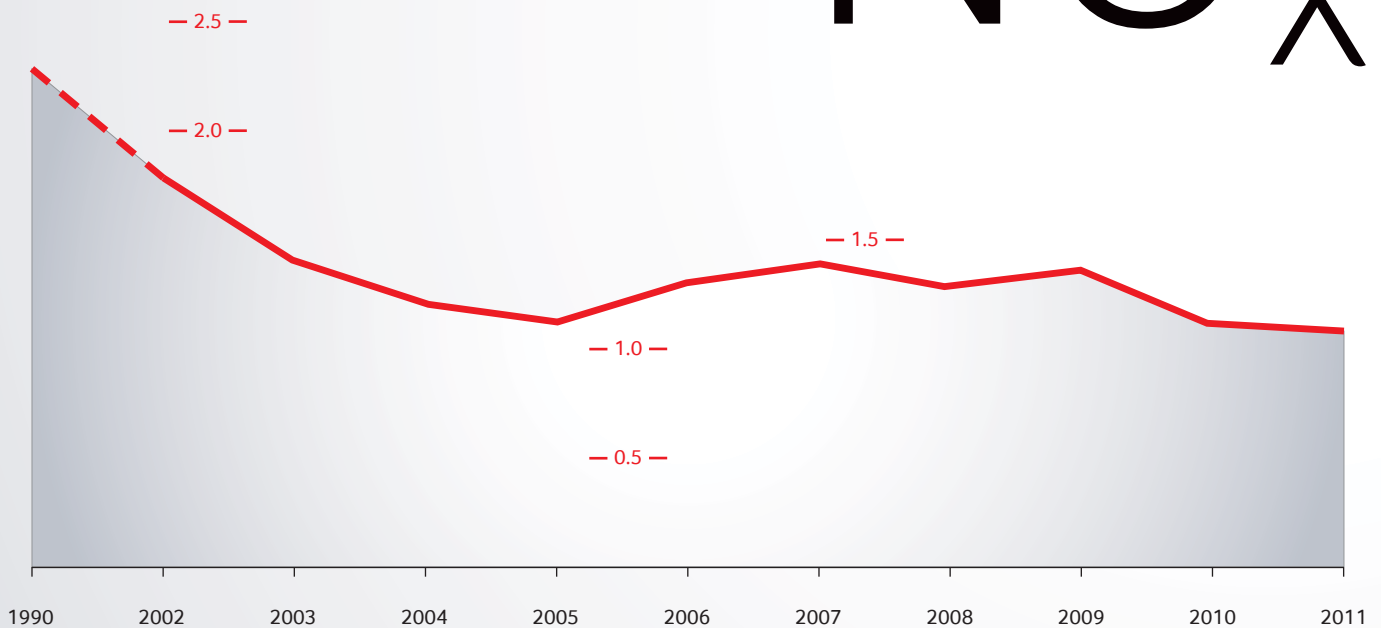
SO₂ SPECIFIC EMISSION (t SO₂/GWh)

SO₂



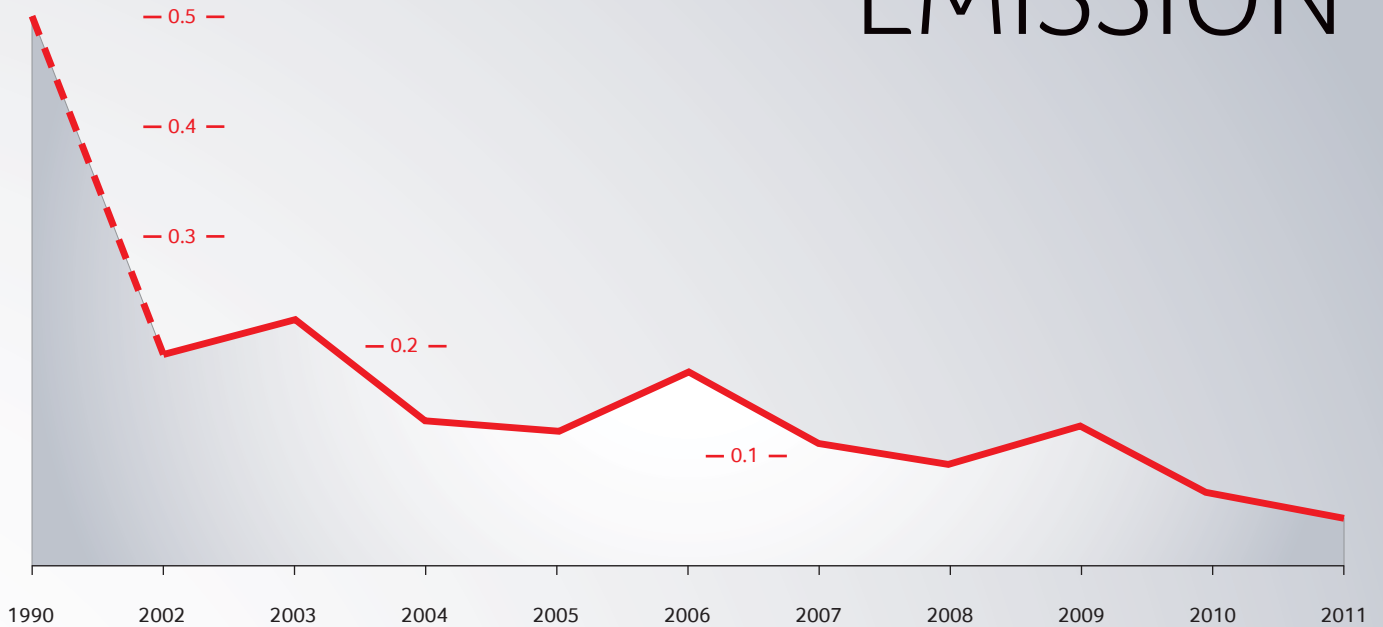
NO_x SPECIFIC EMISSION (t NO_x/GWh)

NO_x



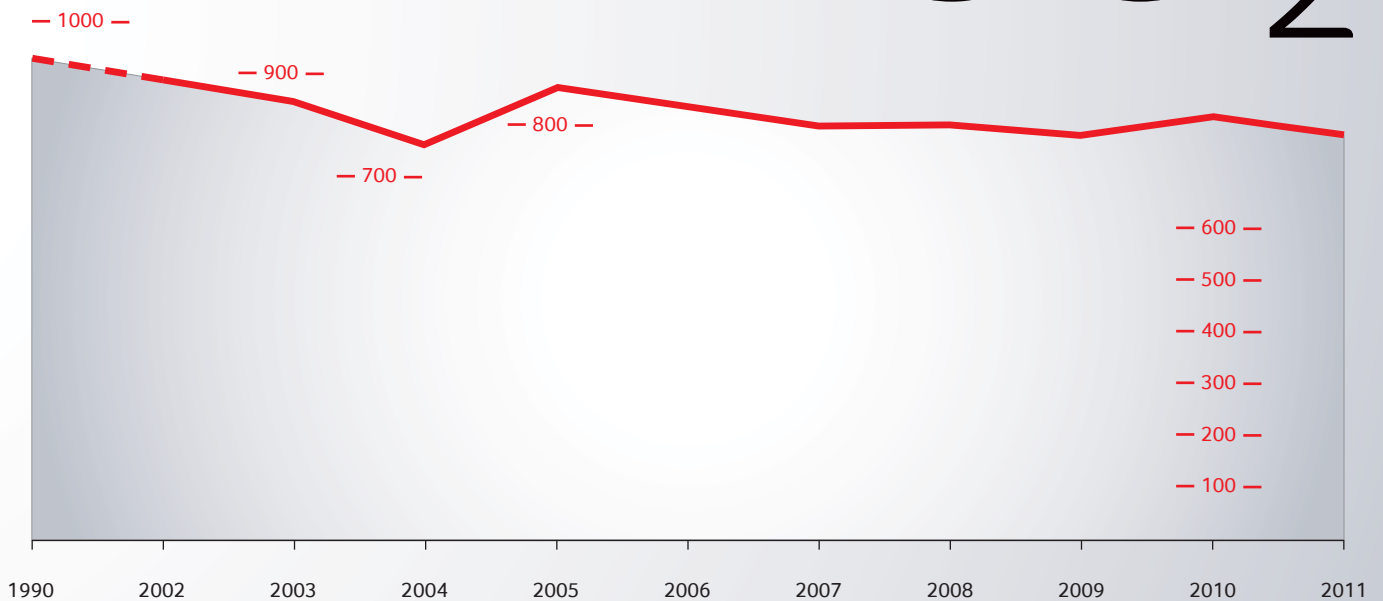
PARTICULATES SPECIFIC EMISSION
(t PARTICULATES/GWh)

PARTICULATES EMISSION

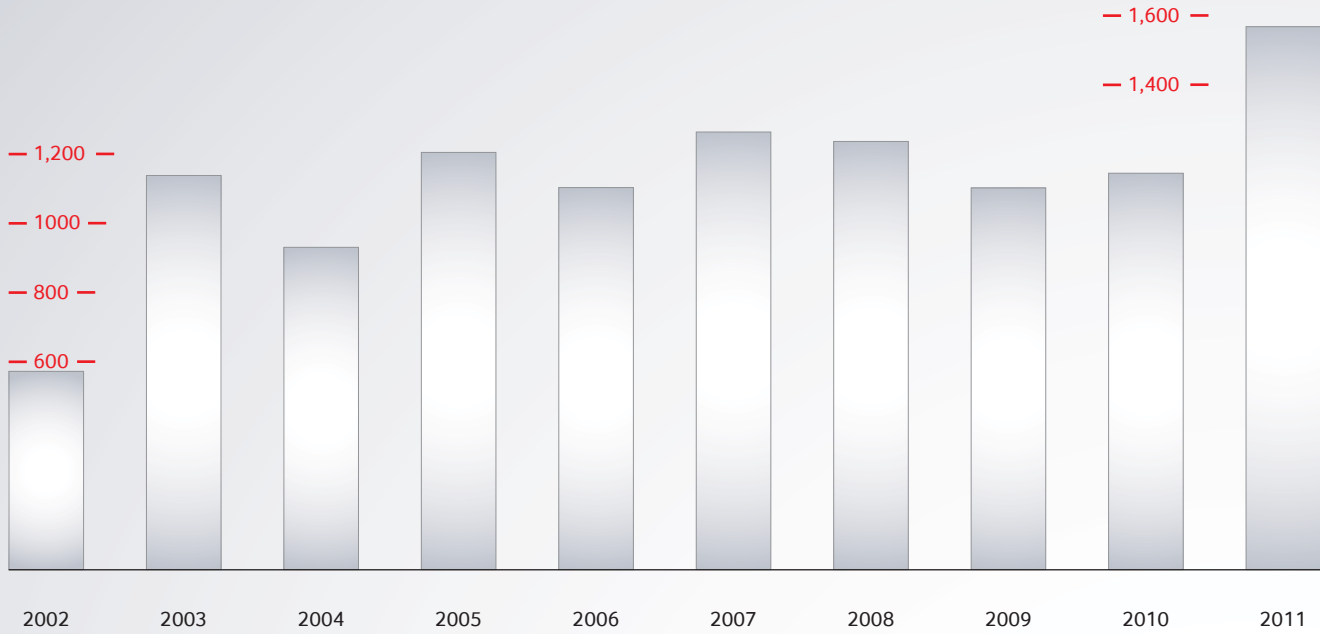


CO₂ SPECIFIC EMISSION (t CO₂/GWh)

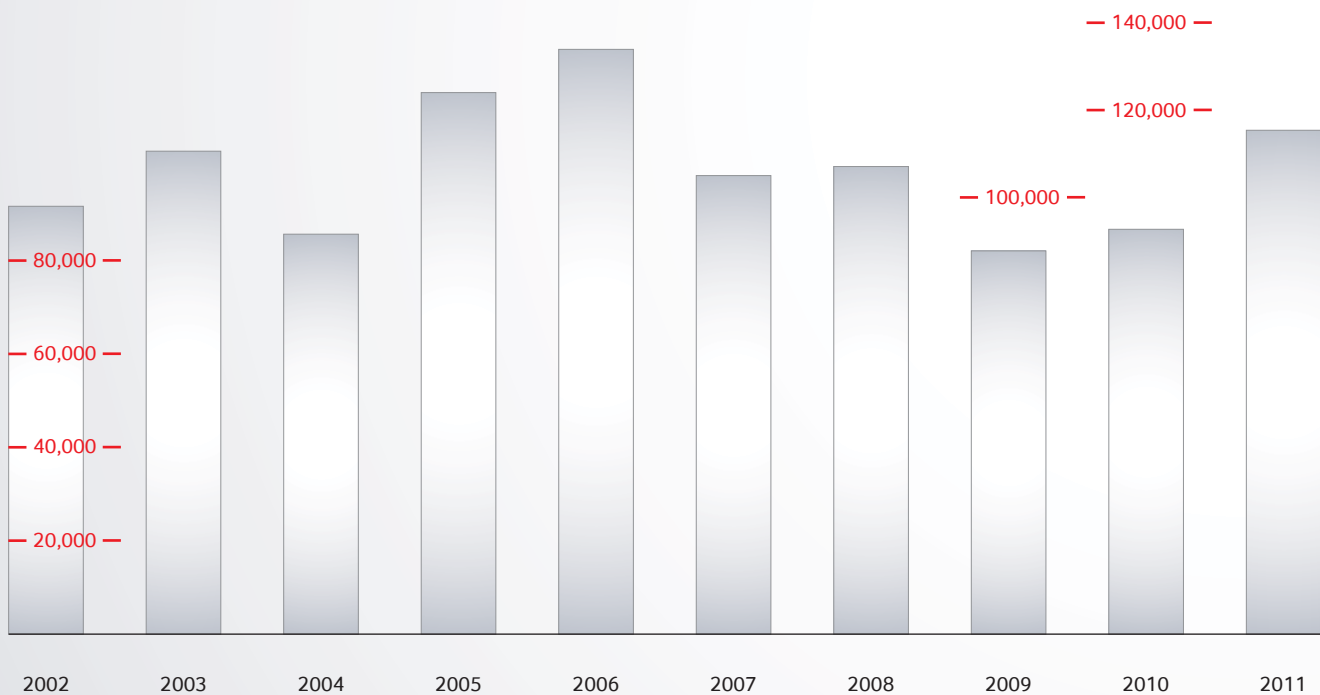
CO₂



TREND OF HAZARDOUS WASTE GENERATION (t)



TREND OF NON-HAZARDOUS WASTE GENERATION (t)



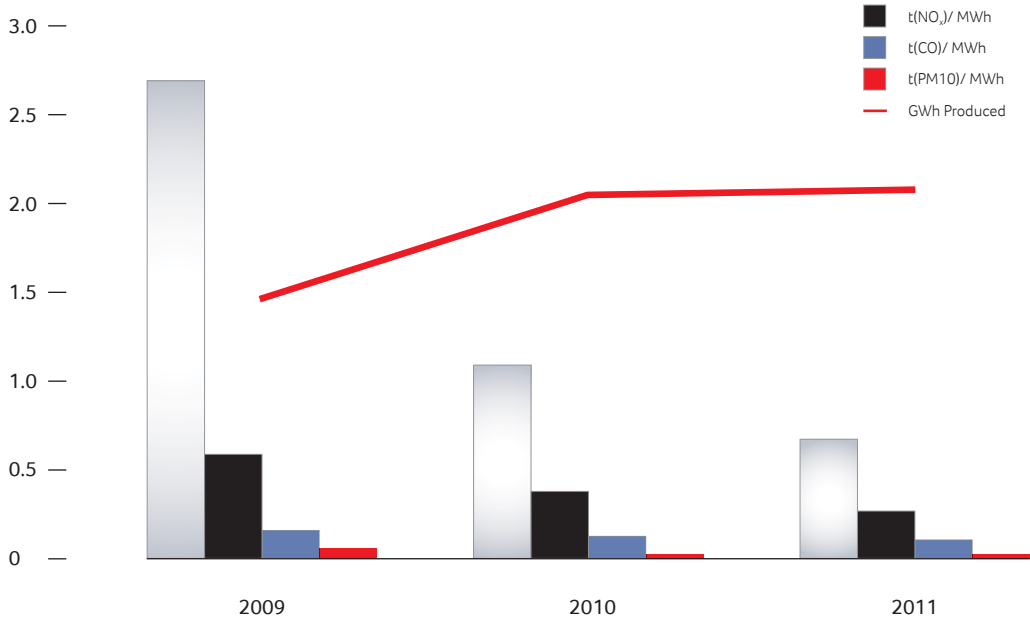
Major achievements in 2011

OPERATING PERMIT FOR UNIT L AT TE-TO ZAGREB

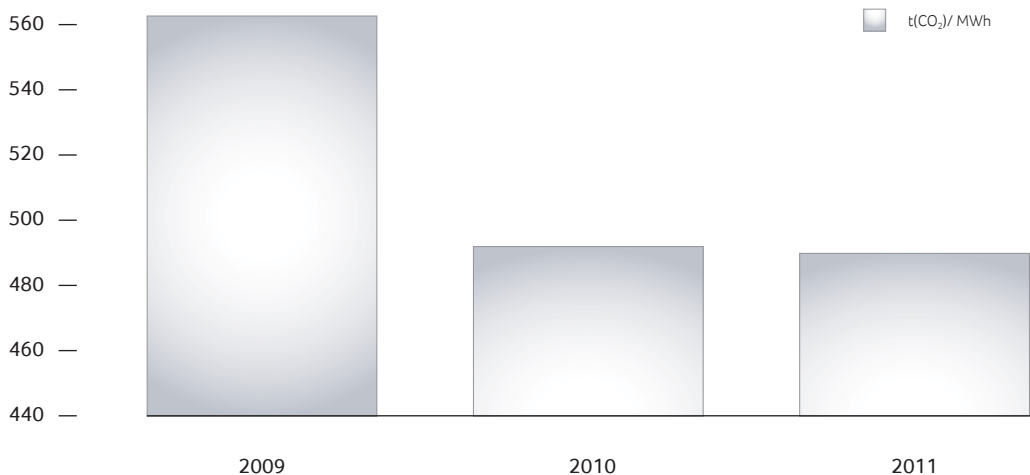
Unit L is a combined-cycles cogenerating unit, built as the replacement for the worn-out cogenerating unit A at TE-TO Zagreb, the purpose being to ensure a stable source of electricity and heat with lower environmental impact. Unit L was put into trial operation in 2009 and the operating permit was obtained in May 2011.

With Unit L and the associated hot water heaters in service, operation of Unit C hot water boilers decreased. Greater quantities of gas that have been ensured will extend the operation of Units K and L for heat supply and prolong the start of operation of Unit C (end of November). Also reduced or eliminated will be the need for firing hot water boilers in early morning hours due to the compensation of so-called hot water rush hour. Switching to natural gas reduces the use of oil and increases the efficiency of fuel conversion. The result of Unit L construction is a more efficient plant together with reduced consumption of liquid fuel and reduced pollutant emissions.

SO₂, NO_x, CO AND PM10 SPECIFIC EMISSIONS (t/MWh)



CO₂ SPECIFIC EMISSION (t CO₂/MWh)



CONSTRUCTION OF UNIT C AT SISAK TPP

In the location of Sisak TPP, construction of a new unit, C - a combined-cycle cogenerating plant of 230 MW_{el}/50 MW_t, is in progress, planned to go into trial operation in 2013. With the new unit C, in addition to a high level of fuel utilization (combined-cycle) and higher efficiency (cogeneration) and because of reduced dispatch of existing units and use of only natural gas as fuel, air pollutant emissions will be reduced too.

WASTE AND WASTE WATER MANAGEMENT

- For TE-TO Zagreb, the basic design was developed and confirmed for the project to build a new water treatment plant and condensate treatment plant. Due to the age of the plant and lack of cost-effectiveness of the reconstruction of the existing plant, a new fully automatic plant of state-of-the-art technology will be installed with microprocessor control technique. As part of the project it is planned to build a condensate treatment plant with return to the demi water feeding the boilers. Also, waste water discharge was connected to Zagreb's public drainage system.
- In HEP ODS distribution area (Elektra Zabok, Elektra Čakovec, Elektra Vinkovci, Elektroistra, Elektroprimorje, Elektra Virovitica and Elektra Križ) and in the Osijek transmission area (HEP OPS d.o.o.), new tanks for separate waste collection were placed with equipment for prevention of leakage of hazardous substances into the environment.
- In HEP ODS distribution area (Elektra Vinkovci, Elektra Šibenik and Elektra Slavonski brod), a new temporary waste storage was built.
- Clean-up and improvement were carried out in the waste water drainage system in TE-TO Osijek, Sisak TPP, EL-TO Zagreb, Velebit HPP, Elektra Zabok, Elektra Koprivnica, Elektroslavonija, Elektra Slavonski Brod, Elektra Virovitica and Rijeka transmission area.
- Cleaning and testing was carried out of the water-tightness of the waste water drainage system in Zakučac HPP, Elektra Varaždin, Elektra Čakovec, Elektra Koprivnica, Elektra Bjelovar, Elektra Križ, Elektra Slavonski Brod, Elektroistra Pula and Elektrolika.
- Operational plans with measures for water pollution emergency were prepared as well as Rules concerning operation and maintenance of waste water drainage for substations in the authority of Elektra Čakovec, Elektra Vinkovci, Elektra Varaždin, Elektroprimorje Rijeka (all HEP ODS) and in all HEP OPS transmission areas.
- Water quality monitoring for the area of Buško Blato was agreed with the Adriatic Sea Water Area Mostar.
- In Đale HPP, a hydraulic crane was installed with equipment for deposit removal.
- In Zakučac HPP, two new boats were procured for the drainage canal of Zakučac HPP and Prančević dam, for the purpose of placing floating dams in case of damage – oil leakage from the power plant.
- In Plomin TPP, a system was built for return of treated waste water and its re-use in the flue gas desulphurization plant, aimed at reducing waste water quantity being released.

AIR QUALITY IMPROVEMENT

- In TE-TO Zagreb, work has begun to replace burners and reconstruct firing plant of K3 boiler (Unit C). It is planned to replace all 8 combined gas-oil burners, 8 ignition gas burners, 8 complete safety and control fittings for gas, oil, purging steam and combustion air, bay measuring equipment, installation of burner management system and its integration into the unit and C boiler control system and reconstruction of boiler furnace and air ducts due to technological requirements for new equipment. The completion of the work which will reduce CO₂ particulate emission is planned before the end of 2012.
- Monitoring plans were prepared for greenhouse gas emissions from all HEP Proizvodnja thermal power plants.
- In EL-TO, trial operation of a new, environmentally acceptable, hot water boiler VK4 was completed. Preparations began to replace burners on the hot water boiler VK3.
- Remediation Program was prepared to reduce the emission of solid particulates from EL-TO Zagreb plant, which was accepted by the City of Zagreb Council.

- Local Boiler Plants Department of HEP Toplinarstvo finished the project to make the 18.5 MW Galženica boiler plant run on gas, which will take over heat production for sanitary hot water preparation and heat for space heating in the transitional period for the most part of the city of Velika Gorica.
- In Ludbreg operation of Elektra Varaždin, new efficient heat recovery boilers were installed replacing old poor-performance boiler plants.

BIOLOGICAL DIVERSITY CONSERVATION PROJECTS

- Based on the Cooperation Agreement made between HEP and the Ministry of Culture (2004) the measures to protect the protected species of the white stork (*Ciconia ciconia*) continued to be implemented by HEP ODS. Based on an agreement between HEP Operator distribucijskog sustava d.o.o. and the Ministry of Culture, Directorate for Nature Protection, of September 2009, in 2011 distribution areas systematically monitored bird casualties on medium-voltage distribution lines and other plants in order to determine critical parts of the network.
- Based on the previous monitoring of bird casualties, public procurement was conducted for supply of insulation materials to protect the birds from electric shock on medium-voltage facilities of HEP ODS (overhead lines, switches and pole-mounted substations).
- Activities were conducted by Elektroprimorje Rijeka to protect the birds from electric shock in the area of the island of Cres where the griffon vulture lives. The Ministry of Culture, Directorate for Bird Protection, the non-governmental organization Eco-centar Caput Insulae and HEP ODS, Elektroprimorje Rijeka, based on the Action Plan for the protection of the last population of griffon vultures (*Gyps fulvus*) in Croatia, entered into a contract for the preparation of the Study on the Protection of Birds and Small Animals from Electrocutation on MV 10(20) kV Lines in the Areas of Cres and Lošinj. As provided in the Action Plan, new technical solutions will be applied for the construction of overhead lines within the existing electricity network, and such solutions will be also used for replacement of worn-out electric pylons and lines in the existing network, so that bird fatalities (collisions, electrocution) are minimized.
- In Elektra Koprivnica and Elektrodalmacija Split, the equipment for insulation of busbars on 35/10 kV transformers was installed to protect and preserve animal species and for operational safety reasons.

OTHER

- Regular internal and external audits of quality management system and environmental management system according to ISO 9001:2008 and ISO 14001:2004 are carried out.
- In hydro power plants re-audits are carried out for re-certification of energy production from renewable sources.
- Extensive activities were carried out on the preparation of seven distribution areas (HEP ODS) for introduction of environmental management system according to HRN EN ISO 14001:2009.
- The Heating Networks Department of HEP Toplinarstvo carried out replacement of about 400 meters of the main hot water network and 400 meters of hot water branches to decrease heat losses and improve reliability of heat supply. Also, the implementation began of technical-economic optimization of the remote heating system to optimize hot water system management and reduce losses in heat transport and distribution.
- In Sisak operative area of HEP Toplinarstvo, a number of projects will begin (return of condensate from Caprag area from TS 1, 2 and 3 to the industrial power plant, return of condensate from TS Brzaj to TS 1 in Caprag area, return of condensate from the industrial power plant to Sisak TPP, construction of steam pipeline from the industrial power plant to Sisak TPP), which will result in reduced heat losses and lower pollutant emissions.
- The procedure was initiated for environmental impact assessment for the construction of a 2x220 kV connecting line from Sisak thermal power plant to the 220 kV Mraclin-Prijedor line.

FINANCIAL STATEMENTS



Hrvatska elektroprivreda Group

Consolidated financial statements

As of 31 December 2011
Together with Independent Auditor's Report

RESPONSIBILITY FOR THE CONSOLIDATED FINANCIAL STATEMENTS

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

After making enquiries, the Management Board has a reasonable expectation that the 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:
Zlatko Koračević
President of the Board

HEP d.d.
Ulica grada Vukovara 37
10000 Zagreb
Republic of Croatia
16 April 2012

Independent Auditor's Report

To the Owner of Hrvatska elektroprivreda 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 2011 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 described Matters affecting the opinion paragraph 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

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 purchase of electricity facilities on the Croatian motorways within two years from the date of the advance payment. As of the date of these consolidated financial statements, the legal title to these 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 in the supply of electricity to customers. As of the date of preparation of these consolidated 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.

Independent Auditor's Report (continued)

MODIFIED OPINION

In our opinion, except for the potential effects of the matters discussed in paragraph above, the consolidated financial statements present fairly, in all material respects, the financial position of the Group at 31 December 2011, 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, 16 April 2012

Consolidated Income Statement - HEP Group

For the year ended 31 December 2011

	Notes	2011	2010
		HRK'000	HRK'000
			Restated
Revenue from electricity sales	4	10,769,900	10,851,054
Revenue from thermal power sales	4	582,352	569,784
Revenue from gas sales	4	381,177	394,182
Other operating income	4,5	1,340,622	1,127,883
Total operating income		13,074,051	12,942,903
Electricity purchase cost		(3,259,984)	(2,011,535)
Fuel costs		(2,870,113)	(2,077,105)
Staff cost	6	(1,890,228)	(1,895,205)
Depreciation and amortization expense	10,11	(1,749,518)	(1,721,472)
Other operating expenses	7	(2,850,790)	(3,052,380)
Total operating expenses		(12,620,633)	(10,757,697)
Profit from operations		453,418	2,185,206
Financial revenue	8	57,718	91,187
Financial costs	8	(428,989)	(439,224)
Net financial expense		(371,271)	(348,037)
Profit before tax		82,147	1,837,168
Income tax expense	9	(85,453)	(401,802)
(Loss) / profit from operations		(3,306)	1,435,366
Attributable to:			
Equity holder		(14,820)	1,421,303
Non-controlling interest		11,514	14,063
		(3,306)	1,435,366

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

Signed on behalf of the Company on 16 April 2012 by:

Zlatko Koračević
President of the Board

Ivan Matasić
Member of the Board

Consolidated Statement of comprehensive Income - HEP Group

For the year ended 31 December 2011

	Notes	2011	2010
		HRK'000	HRK'000
			Restated
(Loss) / profit for the year		(3,306)	1,435,366
Foreign translation differences		1,071	486
Fair valuation adjustment of Janaf shares		(8,921)	7,499
Other comprehensive (loss)/ income		(7,850)	7,985
Total comprehensive (loss) / income for the year		(11,156)	1,443,351
Total comprehensive (loss) income attributable to:			
Equity holder		(23,741)	1,428,802
Non-controlling interest		12,585	1,443,351
		(11,156)	1,435,366

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

Signed on behalf of the Company on 16 April 2012 by:

Zlatko Koračević
President of the Board

Ivan Matasić
Member of the Board

Consolidated Statement of Financial Position – HEP Group

As at 31 December 2011

ASSETS	Notes	31 December 2011	31 December 2010	1 January 2010
		HRK'000	HRK'000	HRK'000
			Restated	Restated
Non-current assets				
Property, plant and equipment	10	24,390,612	24,090,370	24,082,799
Capital work in progress	10	3,092,220	3,046,316	3,130,294
Intangible assets	11	57,647	65,010	63,671
Investment property	12	234,760	223,094	202,467
Prepayments for property, plant and equipment	13	427,039	386,055	403,080
Investment in NPP Krško	14	1,754,419	1,754,419	1,754,419
Long-term loan receivables and deposits	16	719	1,183	1,483
Assets held for sale and other investments	17	120,915	162,380	152,997
Other non-current assets	18	107,153	110,973	117,106
Deferred tax assets	9	178,902	159,429	120,351
		30,364,386	29,999,229	30,028,667
Current assets				
Inventories	19	1,063,520	1,116,671	967,931
Trade receivables	20	1,496,236	1,730,328	1,493,989
Other short-term receivables	21	415,105	144,064	225,459
Cash and cash equivalents	22	407,123	762,157	143,834
		3,381,984	3,753,220	2,831,213
TOTAL ASSETS		33,746,370	33,752,449	32,859,880

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

Signed on behalf of the Company on 16 April 2012 by:
Zlatko Koračević
President of the Board

Ivan Matasić
Member of the Board

Consolidated Statement
of Financial Position – HEP Group (continued)
As at 31 December 2011

CAPITAL AND LIABILITIES	Notes	31 December 2011	31 December 2010	1. January 2010
		HRK'000	HRK'000	HRK'000
			Restated	Restated
Share capital	23	19,792,159	19,792,159	19,792,159
Capital reserves	23	(438,957)	(874,074)	(1,889,646)
(Accumulated loss)/ retained earnings	23	(136,262)	816,246	403,018
Equity attributable to equity holder		19,216,940	19,734,331	18,305,531
Non-controlling interest	15	62,847	76,993	91,409
Total equity		19,279,787	19,811,324	18,396,940
Long-term borrowings	24	2,534,489	2,883,554	3,113,467
Long-term liabilities to the state	25	30,466	33,734	59,713
Long-term provisions	27	778,629	799,945	559,017
Bonds issued	28	965,202	1,058,042	1,150,887
Other long-term liabilities	29	5,320,676	5,170,943	4,927,022
Deferred tax liability		-	1,874	-
Total non-current liabilities		9,629,462	9,948,092	9,810,106
Trade payables		2,427,184	1,553,211	2,179,323
Current portion of long-term bonds issued	28	93,380	93,380	46,690
Current portion of long-term borrowings	24	1,174,713	1,184,921	947,747
Short-term borrowings	30	603,163	292,493	767,805
Taxes payable	31	40,755	444,985	171,080
Interest payable		23,191	30,489	64,301
Liabilities to employees	32	127,934	134,226	143,132
Other short-term payables	33	346,801	259,328	332,756
Total current liabilities		4,837,121	3,993,033	4,652,834
TOTAL CAPITAL AND LIABILITIES		33,746,370	33,752,449	32,711,054

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

Signed on behalf of the Company on 16 April 2012 by:

Zlatko Koračević
President of the Board

Ivan Matasić
Member of the Board

Consolidated Statement of Changes in Equity - HEP Group

For the year ended 31 December 2011

	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 1 January 2010, before restatement	19,792,159	(2,038,472)	403,016	18,156,703	91,409	18,248,112
Effect of restatement (Note 3)	-	148,826	-	148,826	-	148,826
Balance at 1 January 2010, restated	19,792,159	(1,889,646)	403,016	18,305,529	91,409	18,396,938
Allocation of retained earnings	-	1,008,073	(1,008,073)	-	-	-
Profit for the year	-	-	1,421,303	1,421,303	14,063	1,435,366
Translation differences	-	-	-	-	486	486
Other comprehensive income, net, before restatement	-	24,853	-	-	-	-
Effect of restatement (Note 3)	-	(17,354)	-	-	-	-
Other comprehensive income, net, restated	-	7,499	-	7,499	-	7,499
Total comprehensive income, restated	-	7,499	1,421,303	1,428,802	14,549	1,443,351
Non-controlling interest	-	-	-	-	(16,583)	(16,583)
Distribution of dividend to RWE	-	-	-	-	(12,382)	(12,382)
Balance at 31 December 2010, restated	19,792,159	(874,074)	816,246	19,734,331	76,993	19,811,324
Allocation of retained earnings	-	444,038	(444,038)	-	-	-
Dividends paid	-	-	(493,376)	(493,376)	-	(493,376)
Losses carried forward – Trgovina Mađarska	-	-	(274)	(274)	-	(274)
<i>Loss for the year</i>	-	-	(14,820)	(14,820)	11,514	(3,306)
<i>Translation differences</i>	-	-	-	-	1,071	1,071
<i>Janaf shares fair value</i>	-	(8,921)	-	(8,921)	-	(8,921)
Total comprehensive income for the year	-	(8,921)	(14,820)	(23,741)	12,585	(11,156)
Non-controlling interest	-	-	-	-	(14,063)	(14,063)
Distribution of dividend RWE	-	-	-	-	(12,668)	(12,668)
Balance 31 December 2011	19,792,159	(438,957)	(136,262)	19,216,940	62,847	19,279,787

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

Signed on behalf of the Company on 16 April 2012 by:

Zlatko Koračević
President of the Board

Ivan Matasić
Member of the Board

Consolidated Statement of cash flows – HEP Group

For the year ended 31 December 2011

	2011	2010
	HRK'000	HRK'000
		Restated
Cash flows from operating activities		
(Loss)/profit for the year	(3,306)	1,435,366
Income tax expense recognised in profit	85,453	401,802
Net financial expense	371,271	348,037
Gain from real estate fair valuation	(7,676)	(19,865)
Loss on fair value adjustment of derivatives	1,080	1,871
Depreciation and amortization	1,749,518	1,721,472
Increase in provisions for doubtful receivables	403,568	332,139
Increase in provision for inventories	11,330	15,070
(Decrease)/ increase in provisions	(21,316)	240,928
Operating cash flows before movements in working capital	2,589,922	4,476,820
Increase in trade receivables	(169,476)	(568,478)
Decrease/ (increase) in inventories	41,821	(163,810)
(Increase)/ decrease in other current assets	(285,084)	81,395
Increase/ (decrease) in trade payables	877,038	(600,404)
Increase/(decrease) in other liabilities	156,866	(88,667)
Increase in long-term liabilities	92,160	217,942
Cash generated from operations	3,303,247	3,354,798
Income taxes paid	(600,873)	(194,454)
Interest paid	(236,874)	(270,324)
NET CASH FROM OPERATING ACTIVITIES	2,465,500	2,890,020
INVESTING ACTIVITIES		
Interest received	12,979	14,480
Acquisition of Property, Plant and Equipment	(2,132,612)	(1,693,299)
Write off property, plant and equipment	44,311	21,462
(Decrease)/ increase of other assets	(49,467)	48,088
Change in the non-controlling interest and dividend payment to RWE	(26,732)	(28,479)
NET CASH USED IN INVESTING ACTIVITIES	(2,151,521)	(1,637,748)

Consolidated Statement
of cash flows – HEP Group (continued)
For the year ended 31 December 2011

	2011	2010
	HRK'000	HRK'000
		Restated
FINANCING ACTIVITIES		
Repayments of bonds issued	(92,840)	(46,155)
Long-term loans raised	793,839	903,857
Repayment of long-term loans	(1,193,750)	(956,881)
Short-term loans raised	997,924	566,692
Repayment of short-term loans	(680,810)	(1,101,462)
Dividends paid to owner	(493,376)	-
NET CASH USED IN FINANCING ACTIVITIES	(669,013)	(633,949)
NET (DECREASE) / INCREASE IN CASH AND CASH EQUIVALENTS	(355,034)	618,323
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	762,157	143,834
CASH AND CASH EQUIVALENTS AT THE END OF YEAR	407,123	762,157

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

Signed on behalf of the Company on 16 April 2012 by:

Zlatko Koračević
President of the Board

Ivan Matasić
Member of the Board

Notes to the consolidated financial statements of the HEP Group

For the year ended 31 December 2011

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 2011, the number of staff employed by the Group was 13,762 (31 December 2010: 13,990).

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.

At 31 December 2011 the total current liabilities exceed the total current assets by HRK 1,455,137 thousand. In order to meet the current liquidity requirements in the next period, the Company intends to extend all the existing short-term credit lines and facilities, as well as raise new short-term loans. To carry out the approved 2012 investment plan, the Company plans obtaining new long-term sources of funding. Having in view an increase in electricity prices, the Company expects its operating income to rise during 2012.

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.

Notes to the consolidated financial statements of the HEP Group (continued)
For the year ended 31 December 2011

1. GENERAL (continued)

ENERGY LAWS (CONTINUED)

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.

GOVERNANCE AND MANAGEMENT

GENERAL ASSEMBLY

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

Radimir Čačić	President	Member since 26 January 2012
Đuro Popijač	President	Member from 21 November 2009 until 25 January 2012

SUPERVISORY BOARD OF HEP D.D.

Members of Supervisory Board in 2012, 2011 and 2010:

Nikola Bruketa	President	Member since 23 February 2012
Alen Leverić	Member	Member since 23 February 2012
Ante Ramljak	Member	Member since 23 February 2012
Hubert Bašić	Member	Member since 23 February 2012
Žarko Primorac	Member	Member since 23 February 2012
Ivo Uglešić	Member	Member since 23 February 2012
Jadranko Berlengi	Member	Member since 3 June 2008

Darko Horvat	President	Member from 30 June 2010, President from 30 July 2010 until 23 February 2012
Branimir Horaček	President	Member from 19 November 2009 until 6 May 2010
Dražen Bošnjaković	Member	Member from 19 November 2009 until 22 February 2012
Krešimir Dragić	Member	Member from 19 November 2009 until 22 February 2012
Slavko Konfić	Member	Member from 28 April 2008 until 22 February 2012
Gordana Obran	Member	Member from 19 October 2009 until 22 February 2012
Zvonimir Sabati	Member	Member from 19 October 2009 until 22 February 2012
Jadranko Berlengi	Member	Member from 3 June 2008

Notes to the consolidated financial
statements of the HEP Group (continued)
For the year ended 31 December 2011

1. GENERAL (continued)

GOVERNANCE AND MANAGEMENT (CONTINUED)

Management Board in 2012, 2011 and 2010:

Zlatko Koračević	President	Member since 23 February 2012
Zvonko Ercegovac	Member	Member since 23 February 2012
Krunoslava Grgić-Bolješić	Member	Member since 23 February 2012
Rodoljub Lalić	Member	Member since 23 February 2012
Ivan Matasić	Member	Member since 23 February 2012
Tomislav Šerić	Member	Member since 23 February 2012
Leo Begović	President	Member from 25 September 2009 until 22 February 2012
Dubravko Lukačević	Member	Member since 2 November 2009 until 22 February 2012
Snježana Pauk	Member	Member since 2 November 2009 until 22 February 2012
Miljenko Pavlaković	Member	Member since 2 November 2009 until 22 February 2012
Damir Pečvarac	Member	Member since 2 November 2009 until 22 February 2012
Velimir Rajković	Member	Member since 2 November 2009 until 22 February 2012

Notes to the consolidated financial statements of the HEP Group (continued)
For the year ended 31 December 2011

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 fair value. 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.

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.

The Group's financial statements are prepared in Croatian kuna (HRK).

ADOPTION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS STANDARDS AND INTERPRETATIONS EFFECTIVE IN THE CURRENT PERIOD

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

- **Amendments to IFRS 1 "First - time adoption to IFRS"** – limited exemption from Comparative IFRS 7 Financial instruments – Disclosure for first time adopters (effective for annual periods beginning on or after 1 July 2010),
- **Amendments to IAS 24 "Related Party Disclosures"** – simplifying the disclosure requirements for government-related entities and clarifying the definition of a related party (effective for annual periods beginning on or after 1 January 2011),
- **Amendments to IAS 32 "Financial instruments – Presentations"** – accounting for rights issues (effective for annual periods beginning on or after 1 February 2010),
- **Amendments to various standards and interpretations (2010)** resulting from the Annual quality 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, (amendments are to be applied for annual periods beginning on or after 1 July 2010 or 1 January 2011 depending on standard/interpretation),
- **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 adoption of these amendments to the existing standards and interpretations has not led to any changes in the HEP Group accounting policies.

Notes to the consolidated financial statements of the HEP Group (continued)
For the year ended 31 December 2011

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

ADOPTION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS (CONTINUED) STANDARDS AND INTERPRETATIONS IN ISSUE NOT YET ADOPTED

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”, as amended in 2010, (effective for annual periods beginning on or after 1 January 2013),
- IFRS 10 “Consolidated Financial Statements”, published on May 2011, supersedes the previous version of IAS 27 (2008) “Consolidated and Separate Financial Statements”, (effective for annual periods beginning on or after 1 January 2013),
- IFRS 11 “Joint Arrangements”, published on May 2011, superseded IAS 31 “Interests in Joint Ventures” (effective for annual periods beginning on or after 1 January 2013),
- IFRS 12 “Disclosure of Interests in Other Entities”, published on May 2011 (effective for annual periods beginning on or after 1 January 2013),
- IFRS 13 “Fair Value Measurement”, published on May 2011 (effective for annual periods beginning on or after 1 January 2013),
- IAS 27 “Separate Financial Statements” (as amended in 2011), consolidation requirements previously forming part of IAS 27 (2008) have been revised and are now contained in IFRS 10 “Consolidated Financial Statements”, (effective date of IAS 27 (as amended in 2011) for annual periods beginning on or after 1 January 2013),
- IAS 28 (as amended in 2011) “Investments in Associates and Joint Ventures” issued. This version supersedes IAS 28 (2003) “Investments in Associates” (effective date of IAS 28 (as amended in 2011) for annual periods beginning on or after 1 January 2013).
- 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” –Transfer of Financial Assets (effective for annual periods beginning on or after 1 July 2011),
- Amendments to IAS 1 “Presentation of Financial Statements” - Revising the way of presenting the other comprehensive income (effective for annual periods beginning on or after 1 July 2012).
- Amendments to IAS 12 “Income tax”, - Deferred tax: Recovery of Underlying Assets (effective for annual periods beginning on or after 1 January 2012),
- Amendments to IAS 19 “Employee Benefits” - Improvements to the Accounting for Post-Employment Benefits (effective for annual periods beginning on or after 1 January 2013)

HEP Group has elected not to adopt these standards, revisions and interpretations in advance of their effective dates.

The amendments to IFRS 7 increase the disclosure requirements for transactions involving transfers of financial assets. These amendments are intended to provide greater transparency around risk exposures when a financial asset is transferred but the transferor retains some level of continuing exposure in the asset. The amendments also require disclosures where transfers of financial assets are not evenly distributed throughout the period.

The management does not anticipate that these amendments to IFRS 7 will have a significant effect on the Group’s disclosures regarding transfers of trade receivables previously affected.

Notes to the consolidated financial statements of the HEP Group (continued)
For the year ended 31 December 2011

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

ADOPTION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS (CONTINUED) STANDARDS AND INTERPRETATIONS IN ISSUE NOT YET ADOPTED (CONTINUED)

Key requirements of IFRS 9 are described as follows:

- Requires all recognised financial assets that are within the scope of IAS 39 Financial Instruments: Recognition and Measurement to be subsequently measured at amortised cost or fair value.

In May 2011, a package of five Standards on consolidation, joint arrangements, associates and disclosures was issued, including IFRS 10, IFRS 11, IFRS 12, IAS 27 (as revised in 2011) and IAS 28 (as revised in 2011).

Key requirements of these five Standards are described below:

IFRS 10 replaces the parts of IAS 27 *Consolidated and Separate Financial Statements* that deal with consolidated financial statements. Under IFRS 10, there is only one basis for consolidation that is control. New definition of control that contains three elements: (a) power over an investee, (b) exposure, or rights, to variable returns from its involvement with the investee, and (c) the ability to use its power over the investee to affect the amount of the investor's returns.

IFRS 11 replaces IAS 31 *Interests in Joint Ventures*. Under IFRS 11, joint arrangements are classified as joint operations or joint ventures, depending on the rights and obligations of the parties to the arrangements. In addition, joint ventures under IFRS 11 are required to be accounted for using the equity method of accounting, whereas jointly controlled entities under IAS 31 can be accounted for using the equity method of accounting or proportionate accounting.

IFRS 12 is a disclosure standard and is applicable to entities that have interests in subsidiaries, joint arrangements, associates and/or unconsolidated structured entities. In general, the disclosure requirements in IFRS 12 are more extensive than those in the current standards.

IFRS 13 establishes a single source of guidance for fair value measurements and disclosures about fair value measurements. The Standard defines fair value, establishes a framework for measuring fair value, and requires disclosures about fair value measurements. The scope of IFRS 13 is broad; it applies to both financial instrument items and non-financial instrument items for which other IFRSs require or permit fair value measurements and disclosures about fair value measurements, except in specified circumstances. The amendments to IAS 1 require additional disclosures to be made in the other comprehensive income section such that items of other comprehensive income are grouped into two categories: (a) items that will not be reclassified subsequently to profit or loss; and (b) items that will be reclassified subsequently to profit or loss when specific conditions are met. Income tax on items of other comprehensive income is required to be allocated on the same basis.

The amendments to IAS 12 provide an exception to the general principles in IAS 12 that the measurement of deferred tax assets and deferred tax liabilities should reflect the tax consequences that would follow from the manner in which the entity expects to recover the carrying amount of an asset. Specifically, under the amendments, investment properties that are measured using the fair value model in accordance with IAS 40 *Investment Property* are presumed to be recovered through sale for the purposes of measuring deferred taxes, unless the presumption is rebutted in certain circumstances.

The amendments to IAS 19 change the accounting for defined benefit plans and termination benefits. The most significant change relates to the accounting for changes in defined benefit obligations and plan assets.

Notes to the consolidated financial
statements of the HEP Group (continued)
For the year ended 31 December 2011

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

ADOPTION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS (CONTINUED) STANDARDS AND INTERPRETATIONS IN ISSUE NOT YET ADOPTED (CONTINUED)

HEP Group has elected not to adopt these standards, revisions and interpretations in advance of their effective dates. The management anticipates that the adoption of IFRS 9 “Financial instruments” will have a significant impact on measurement and disclosure of financial instruments and application of IFRS 13 “Fair Value Measurement” will result in more extensive disclosures in the financial statements. The management anticipates that the adoption of other standards (IFRS 10 “Consolidated Financial Statements”, IFRS 11 “Joint Arrangements” and IFRS 12 “Disclosure of Interests in Other Entities”), revisions and interpretations will have no material impact on the financial statements of Group in the period of initial application.

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. (it's subsidiaries). A listing of the Group's subsidiaries is provided in Note 36. Control is achieved where HEP d.d. has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate. Where necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with those used by other members of the Group.

All 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.

REPORTING CURRENCY

Financial statements of Group are prepared in Croatian Kuna (HRK '000).

Notes to the consolidated financial statements of the HEP Group (continued)
For the year ended 31 December 2011

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

INVESTMENTS IN ASSOCIATES

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

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

Investments in associates are carried in the consolidated 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.

Notes to the consolidated financial
statements of the HEP Group (continued)
For the year ended 31 December 2011

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.

	2011 and 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 payment. 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 Company provides long-service benefits (jubilee awards) and retirement benefits to its employees. The long-service benefits range from HRK 1,500.00 to HRK 5,500.00, net, and are provided for a discontinued tenure from 10 to 45 years (under the provisions of the Collective Agreement in effect until 31 December 2010, the long-service benefits amounted from HRK 1,650 to HRK 5,500, net, and were granted for 10 to 40 years of continuous employment with the employer).

SEVERANCE PAYMENTS

A new Collective Agreement was adopted as of 1 January 2011 (which covers all the HEP Group members), 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 is until 31 December 2012.

Notes to the consolidated financial statements of the HEP Group (continued)
For the year ended 31 December 2011

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	2011, 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 centres and others)	20 – 40 years
Water and steam pipelines and other thermal power generation and transmission plants and facilities	33 years
Gas pipelines	20 – 25 years
Administrative buildings	50 years
Plant and equipment	
Hydroelectric power plants	10 – 33 years
Thermal power plants	6 – 25 years
Electricity transmission plants and facilities (electric parts of transformer stations and transformer; and electric parts of transmission lines)	15 – 40 years
Electricity distribution plants and facilities (electric parts of transformer stations and transformers, electric parts of distribution lines, measuring instruments, meters and other equipment)	8 – 40 years
Thermal power stations, hot-water pipelines and other equipment	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.

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.

Notes to the consolidated financial
statements of the HEP Group (continued)
For the year ended 31 December 2011

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

PROPERTY, PLANT AND EQUIPMENT (CONTINUED)

Any gains or losses arising from the disposal or withdrawal of property, plant and equipment is determined as the difference between the proceeds gains on sale and the carrying amount of the asset and are credited or 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, the risks specific to the asset of the estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life. Recoverable amounts are estimated for individual assets or, if it is not possible, for the relevant cash-generating unit.

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

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

Notes to the consolidated financial statements of the HEP Group (continued)
For the year ended 31 December 2011

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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.

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 de-recognition 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 2011 and 2010. Amounts payable under operating leases are recognised as expense on a straight-line basis over the term of the relevant lease, unless there is another systematic basis that would be more representative of the time pattern of the user's benefit.

TRADE DEBTORS AND PREPAYMENTS

Trade receivables are carried at invoiced amount less any impairment for doubtful accounts.

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

	2010 and 2011 Allowance percentage
Ageing of past due	
31-60 days	1.5%
61-90 days	3%
91-180 days	9%
181-365 days	30%
Over one year	90%

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

Notes to the consolidated financial
statements of the HEP Group (continued)
For the year ended 31 December 2011

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 bringing 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.

Notes to the consolidated financial statements of the HEP Group (continued)
For the year ended 31 December 2011

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.

Notes to the consolidated financial
statements of the HEP Group (continued)
For the year ended 31 December 2011

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

TAXATION (CONTINUED)

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.

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.

Notes to the consolidated financial statements of the HEP Group (continued)
For the year ended 31 December 2011

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

FINANCIAL ASSETS (CONTINUED)

LOANS AND RECEIVABLES

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

IMPAIRMENT OF FINANCIAL ASSETS

Financial assets are assessed for indicators of impairment at 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.

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.

Notes to the consolidated financial
statements of the HEP Group (continued)
For the year ended 31 December 2011

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 2011 and 2010, the Group had no embedded derivative financial instruments.

PROVISIONS

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event and it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. Provisions are reviewed at the end of each reporting period and adjusted to reflect the current best estimate. Where the effect of discounting is material, the amount of the provision is the present value of the expenditures expected to be required to settle the obligation. Where discounting is used, the increase in provisions that reflects the passage of time is recognized as interest expense.

Notes to the consolidated financial statements of the HEP Group (continued)
For the year ended 31 December 2011

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 from the sale of electricity is recognised according to the best management estimate of the actual energy consumed based on the energy data and tariff items under the cost-recovery models called Electricity Transmission Tariff Model With No Tariff 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. Revenue recognition is based on the Decision of the Croatian Government on the level of tariff items from June 2008 and August 2009 (see Note 1).

REVENUE FROM CONNECTION FEES

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. Since 1 January 2010 the connection fees received from customers have been recognized in the income when the fee is received in a moment when customer is connected to grid or in a moment when it has continuous access to services.

SEGMENTAL DISCLOSURES

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

Notes to the consolidated financial
statements of the HEP Group (continued)
For the year ended 31 December 2011

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 suffered 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.), the 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).

Notes to the consolidated financial statements of the HEP Group (continued)
For the year ended 31 December 2011

3. CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES (continued)

CRITICAL JUDGMENTS IN APPLYING ACCOUNTING POLICIES (CONTINUED)

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.

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 2011 and 31 December 2010 amounted to HRK 178,902 thousand and HRK 159,429 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 357,632 thousand and HRK 348,425 thousand at 31 December 2011 and 31 December 2010, 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).

RE-MEASUREMENT OF THE JANAF SHARES AND INVESTMENT PROPERTY AT FAIR VALUE

During 2011 and 2010, the Group remeasured the Jadranski naftovod shares and the investment properties at fair value.

In 2011 and 2010 fair value was determined based on a notification of Central clearing deposit company regarding open balances as of 31 December 2011 and 2010. The market value of the Jadranski naftovod share as at 31 December 2011 was HRK 2,230 (2010: HRK 3,000).

The gain resulting from the fair valuation of the investment property amounts to HRK 7,676 thousand, while a loss of HRK 19,865 thousand was recognised on the fair valuation in 2010 (see Note 5).

VALUATION OF INVENTORIES

During 2011, based on an estimation, the Group made value adjustments for obsolete inventories and materials (material with no turnover in the previous 2 years) according to the ageing structure in the total amount of HRK 11,330 thousand (2010: HRK 15,070 thousand).

Notes to the consolidated financial statements of the HEP Group (continued)
For the year ended 31 December 2011

3. CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES (continued)

RESTATEMENT OF THE VALUE OF INVESTMENT IN NUCLEAR POWER PLANT KRŠKO

The Company's investment in Nuclear Power Plant Krško was denominated in euro at the transaction date and was subsequently translated at the end of each financial year into kuna. This accounting treatment is not in accordance with IFRSs and, accordingly, the investment had to be restated back to historical cost, which is the euro investment converted to kuna at the transaction date.

The effect of this restatement reflected through an increase in the value of the investment in the Nuclear Power Plant Krško by HRK 131,472 thousand and HRK 148,826 thousand in 2010 and 2009, respectively, and the resulting adjustment made in equity of HRK 131,472 thousand in 2010 and HRK 148,826 thousand in 2009.

The effects of the restatement are as follows:

Effect on investment	31 December 2010	1 January 2010
	HRK '000	HRK '000
Investment in NPP Krsko, before restatement	1,622,947	1,605,593
Foreign exchange differences recognized in equity	131,472	148,826
Investment in NPP Krsko, as restated	1,754,419	1,754,419
Effect on reserves	31 December 2010	1 January 2010
	HRK '000	HRK '000
Reserves, before restatement	(1,005,546)	(2,038,472)
Foreign exchange differences recognized in equity	131,472	(148,826)
Reserves, as restated	(874,074)	(1,889,646)
Effect on other comprehensive income	31 December 2010	1 January 2010
	HRK '000	HRK '000
Other comprehensive income, before restatement	24,853	(2,582)
Change	(17,354)	4,005
Other comprehensive income, net, restated	7,499	1,423

Due to the restatement of the prior year and as required by IAS 1 Presentation of Financial Statements, the Company has presented balances from earliest period presented, i.e. 1 January 2010. The above restatement has had no impact on the income statement of the Company and the results for the years ended 31 December 2010 and 2011.

Notes to the consolidated financial statements of the HEP Group (continued)
For the year ended 31 December 2011

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	
	2011	2010	2011	2010	2011	2010	2011	2010
	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000
								Restated
Revenue	10,769,900	10,851,054	582,352	569,784	381,177	394,182	11,733,429	11,815,020
Other income allocated to segments	1,234,733	1,065,005	72,768	59,928	33,121	28,657	1,340,622	1,153,590
Income from operations	766,187	2,356,596	(314,738)	(142,592)	1,969	(3,091)	453,418	2,185,206
Net financial expense							(371,271)	(348,037)
Income tax							(85,453)	(401,802)
Net loss/ (profit)							(3,306)	1,435,366

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.

	Total segment assets		Total segment liabilities	
	2011	2010	2011	2010
	HRK'000	HRK'000	HRK'000	HRK'000
				Restated
Electricity	29,095,594	28,409,155	7,350,694	6,995,442
Heating	1,138,791	1,097,458	245,176	220,139
Gas	322,338	319,336	170,566	180,345
Unallocated	3,189,647	3,926,500	6,680,147	6,545,199
Total Group	33,746,370	33,752,449	14,446,583	13,941,125

Notes to the consolidated financial
statements of the HEP Group (continued)
For the year ended 31 December 2011

4. SEGMENT INFORMATION (continued)

INFORMATION ON THE LARGEST CUSTOMERS

In 2011 electricity sales amount to HRK 10,769,900 thousand (HRK 10,851,054 thousand in 2010).

Heating energy sales for the year 2011 amount to HRK 582,352 thousand (HRK 569,784 thousand in 2010).

In 2011 gas sales amount to HRK 381,177 thousand (HRK 394,182 thousand in 2010).

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.

Presented below is the territorial analysis of the revenue that the Group generated from continuing operations with external buyers of electric energy:

	2011	2010
	HRK'000	HRK'000
		Restated
Croatia	10,582,154	10,600,969
European Union member states	27,463	185,373
Other countries –non-European Union member states	160,283	64,712
	10,769,900	10,851,054

Notes to the consolidated financial statements of the HEP Group (continued)
For the year ended 31 December 2011

5. OTHER OPERATING INCOME

	2011	2010
	HRK'000	HRK'000
		Restated
Service for connection to network	249,943	139,245
Income from assets received free of charge	231,908	218,769
Subsequent collection of receivables previously provided against	139,266	134,531
Services rendered	118,859	150,423
Capitalised assets	109,502	112,592
Late-payment interest	93,220	80,126
Reversal of long-term provisions – vacation	64,477	-
Income from sale of materials	52,070	48,512
Income from sale of cross – border transmission capacity	49,997	21,584
Income from electricity in transit – foreign	33,877	45,715
Reversal of long-term provisions for retirement benefits and jubilee awards	26,514	24,449
Reversal of long-term provisions – court costs	23,088	18,144
Income in respect of the electricity bill reminders	21,702	19,462
Income from balancing energy	14,479	4,067
Income in respect of court costs on claims	8,831	7,673
Gains on fair valuation of investment properties	7,676	19,865
Income from reversal of long-term decommissioning provision	-	4,706
Inventory surplus – fixed assets	5,648	870
Income from sale of tangible assets	4,835	1,889
Recovery of receivables previously written off	4,286	2,585
Other	80,444	72,676
	1,340,622	1,127,883

In 2011 the Group generated income from grid connection services in the amount of HRK 249,943 thousand (2010: HRK 139,245 thousand) based on IFRIC 18 Transfer of Assets From Customers which became effective in the Republic of Croatia on 1 January 2010 (Official Gazette No. 18/2010).

Notes to the consolidated financial
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For the year ended 31 December 2011

6. STAFF COSTS

	2011	2010
	HRK'000	HRK'000
		Restated
Net salaries	1,135,278	1,134,137
Taxes and contributions	754,950	761,068
	1,890,228	1,895,205

TOTAL STAFF COSTS:

	2011	2010
	HRK'000	HRK'000
		Restated
Gross salaries	1,890,228	1,895,205
Reimbursement of costs to employees (Note 7)	143,885	156,673
Employee benefits (Note 7)	108,285	77,055
	2,142,398	2,128,933

DIRECTORS' AND EXECUTIVES REMUNERATION:

	2011	2010
	HRK'000	HRK'000
		Restated
Gross salaries	19,104	18,693
Pension contributions	4,305	4,115
Other receipts	2,185	2,266
	25,594	25,074

Reimbursement of costs to employees includes transportation allowances in the amount of HRK 83,925 thousand (2010: HRK 80,158), daily allowances and travelling expenses in the amount of HRK 15,530 thousand (2010: HRK 17,636 thousand), additional health insurance amounting to HRK 15,530 thousand (2010: HRK 17,209 thousand), receipts based on tax inspection in the amount of HRK 1,299 (2010: HRK 15,561 thousand), and other similar expenses.

Employee benefit costs include benefits under the 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 85,488 thousand (2010: HRK 54,424 thousand).

Notes to the consolidated financial
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For the year ended 31 December 2011

7. OTHER OPERATING EXPENSES

	2011	2010
	HRK'000	HRK'000
		Restated
Maintenance costs (service and material)	669,345	645,098
Provisions for doubtful receivables	403,568	332,139
Gas costs	352,066	355,869
General and administrative expenses	341,278	380,020
Other employee benefits (Note 6)	143,885	156,673
Cost of material	123,038	118,136
Other material employee's rights (Note 6)	108,285	77,055
NPPK – decommissioning expense	106,005	103,854
Contributions to the State	96,524	99,264
Litigation provisions	78,265	75,986
Distributions and concession for water	68,789	74,601
Accrual for unused vacation days	63,900	64,477
Fee for the usage of power plant facilities	48,539	66,115
Write-off of tangible assets	47,854	21,462
Purchase value of sold materials	45,464	40,710
Calculation and collection costs	39,859	34,823
Provisions for retirement bonuses and jubilee awards	35,721	86,762
Fee for gas storage	30,753	-
Insurance premiums	24,607	24,860
Fee for environmental protection	21,217	27,299
Damages and indemnities	16,027	37,449
Provision for delivered electric energy from wind power plants	-	22,031
Provisions according to contracts for damages	-	52,179
Provision for investment in HE Lešće	(39,286)	39,286
Provision for NPPK additional decommissioning costs	(53,838)	53,838
Other	78,925	62,894
	2,850,790	3,052,380

Notes to the consolidated financial
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For the year ended 31 December 2011

8. FINANCIAL REVENUE AND COSTS

	2011	2010
Financial income	HRK'000	HRK'000
		Restated
Foreign exchange gains	41,515	76,707
Interest expense	12,979	14,480
Janaf dividend	3,224	-
Total financial income	57,718	91,187
Finance costs		
Interest expense	(242,560)	(272,471)
Foreign exchange losses	(160,266)	(167,029)
Amortization of deferred interest	(3,740)	(3,858)
Fair value of interest rate swap	(1,080)	(1,871)
Fair valuation adjustment of Janaf shares	(30,769)	-
Financial expenses	(438,415)	(445,229)
Less: Capitalised borrowing cost allocated to PPE	9,426	6,005
Total financial expenses	(428,989)	(439,224)
Net finance expense	(371,271)	(348,037)

Notes to the consolidated financial statements of the HEP Group (continued)
For the year ended 31 December 2011

9. INCOME TAX

	2011	2010
	HRK'000	HRK'000
		Restated
Current taxes	104,926	440,880
Deferred tax income relating to the origination and reversal of temporary differences	(19,473)	(39,078)
Income tax expense	85,453	401,802

Adjustments to deferred tax assets were as follows:

	2011	2010
	HRK'000	HRK'000
		Restated
Balance at 1 January	159,429	120,351
Reversal of deferred tax assets	(29,869)	(21,345)
Deferred tax assets recognised	49,342	60,423
Balance at 31 December	178,902	159,429

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:

	2011	2010
	HRK'000	HRK'000
		Restated
Profit before taxation	82,147	1,837,168
Income tax at the applicable rate of 20%	16,429	367,433
Non-taxable income and realisation of deferred tax asset previously not recognised	(149,725)	(157,509)
Tax effect of permanent differences	159,920	39,078
Tax effect of losses brought forward	(4,429)	-
Unrecognised deferred tax asset on losses carry forward	63,259	152,800
Tax expense for the year	85,453	401,802

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 including HEP d.d. reported total tax losses of HRK 1,000,859 thousand (2010: HRK 626,588 thousand), while the Group recorded a total income tax expense of HRK 104,926 thousand (2010: HRK 440,880 thousand) and reported deferred tax assets in the amount of HRK 19,473 thousand for the current year and HRK 39,078 thousand for prior years.

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

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

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

Year of loss origination	Total tax loss reported by the Group	Year of expiry
2007	102,889	2012
2008	194,136	2013
2009	116,099	2014
2010	152,800	2015
2011	434,935	2016
	1,000,859	

As of 31 December 2011 and 2010 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 2010	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
Credited to profit and loss for the year	3,385	1,638	(4,550)	2,081	16,919	19,473
At 31 December 2011	29,384	79,182	-	6,935	63,401	178,902

Notes to the consolidated financial statements of the HEP Group (continued)
For the year ended 31 December 2011

10. PROPERTY, PLANT AND EQUIPMENT

HRK'000	Land and buildings	Fixtures and equipment	Assets under construction	Total
COST				
At 1 January 2010, restated	33,624,793	32,162,924	3,130,294	68,918,011
Restatement 01 January 2010	(211)	211	-	-
Additions	4,997	75,362	1,553,796	1,634,155
Transfers from assets under construction	604,745	1,027,172	(1,631,917)	-
Capitalized borrowing costs	-	-	7,161	7,161
Inventory (shortages) / surplus	(347)	437	428	518
Disposals	(61,172)	(134,031)	(13,446)	(208,649)
At 31 December 2010, restated	34,172,805	33,132,075	3,046,316	70,351,196
Restatement 01 January 2011	-	3,305	(49)	3,256
Additions	9,380	67,386	2,029,690	2,106,456
Transfers from assets under construction	759,134	1,196,938	(1,956,072)	-
Capitalized borrowing costs	-	-	10,427	10,427
Inventory (shortages) / surplus	5,343	4,146	1,982	11,471
Disposals	(51,995)	(134,329)	(40,074)	(226,398)
At 31 December 2011	34,894,667	34,269,521	3,092,220	72,256,408
ACCUMULATED DEPRECIATION				
At 1 January 2010, restated	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
Disposals	(59,728)	(128,314)	-	(188,042)
Inventory surplus	263	311	-	574
At 31 December 2010, restated	21,780,144	21,434,366	-	43,214,510
Restatement at 01 January 2011	-	1,517	-	1,517
Transfers	(2,509)	9,043	-	6,534
Charge for the year	697,423	1,028,908	-	1,726,331
Disposals	(50,173)	(126,279)	-	(176,452)
Inventory surplus	242	894	-	1,136
At 31 December 2011	22,425,127	22,348,449	-	44,773,576
CARRYING AMOUNT				
At 31 December 2011	12,469,540	11,921,072	3,092,220	27,482,832
At 31 December 2010, restated	12,392,661	11,697,709	3,046,316	27,136,686
At 1 January 2010, restated	12,473,266	11,609,533	3,130,294	27,213,093

Notes to the consolidated financial
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10. PROPERTY, PLANT AND EQUIPMENT (continued)

Disposals from capital work in progress during 2011 in the amount of HRK 40,074 thousand (2010: HRK 13,446 thousand) represent write-offs based on the management estimate 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 with a carrying amount of approximately HRK 427,392 thousand (2010: HRK 560,384 thousand) to secure the banking facilities provided to TE Plomin d.o.o.

Notes to the consolidated financial
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11. INTANGIBLE ASSETS

	HRK'000
COST	
At 1 January 2010, restated	542,875
Transfers	140
Additions	25,937
Disposals	(221)
At 31 December 2010, restated	568,731
Transfers	(5,972)
Additions	15,729
Disposals	(2,304)
At 31 December 2011	576,184
ACCUMULATED AMORTISATION	
At 1 January 2010, restated	479,204
Transfers	57
Charge for the year	24,678
Disposals	(218)
At 31 December 2010, restated	503,721
Transfers	(5,972)
Charge for the year	23,078
Disposals	(2,290)
At 31 December 2011	518,537
CARRYING AMOUNT	
At 31 December 2011	57,647
At 31 December 2010, restated	65,010
At 1 January 2010, restated	63,671

Notes to the consolidated financial
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12. INVESTMENT PROPERTIES

As of 31 December 2011 investment properties comprise properties held for the purpose of generating earnings from rental and or capital appreciation, and are carried at fair value based on market price at the end of reporting period. All the investment properties are owned by the HEP d.d.

At fair value	31 December 2011	31 December 2010	1 January 2010
	HRK'000	HRK'000	HRK'000
		Restated	Restated
Fair value	223,094	202,467	211,074
Depreciation charge for the year	(109)	(187)	(189)
Net gain/(loss) on fair value adjustment	7,676	19,865	(19,748)
Other changes	4,099	949	11,330
Closing balance at fair value	234,760	223,094	202,467

Notes to the consolidated financial statements of the HEP Group (continued)
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13. PREPAYMENTS FOR PROPERTY, PLANT AND EQUIPMENT

	31 December 2011	31 December 2010	1 January 2010
	HRK'000	HRK'000	HRK'000
		Restated	Restated
Power facilities – Hrvatske autoceste	300,000	300,000	300,000
JSC Tehnopromexport – TE Sisak	94,299	56,530	59,068
Končar GIM	17,067	17,905	18,257
Litostroj Slovenia	2,891	4,457	8,447
VOITH Siemens, Austria	3,054	3,978	4,955
Končar Inženjering d.d. – TE Sisak	2,896	-	-
Končar Inženjering d.d. – HE Lešće	-	1,249	5,169
Others	6,832	1,936	7,184
	427,039	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.

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14. INVESTMENT IN THE NUCLEAR POWER PLANT KRŠKO

	31 December 2011	31 December 2010	1 January 2010
	HRK'000	HRK'000	HRK'000
		Restated	Restated
Opening balance	1,754,419	1,754,419	1,754,419
	1,754,419	1,754,419	1,754,419

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

The agreement acknowledges the ownership rights of HEP 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.

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.

Notes to the consolidated financial statements of the HEP Group (continued)
For the year ended 31 December 2011

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. According to the current programme for the decommissioning of the Nuclear Power Plant Krško and disposal of nuclear waste, HEP d.d. is obliged to pay in the fund EUR 14,250 thousand per year. From 2004 to 2011, the Company disclosed radioactive waste disposal and decommissioning provisions in the amount of HRK 836,161 thousand, which is also the amount it paid onto the Fund's account in the period from 2006 to 2011.

The investment in NEK is accounted for using the equity method and amounts to HRK 1,754,419 thousand. The investment in NEK and the capital reserves of HEP d.d. were increased by accrued foreign exchange losses arisen on translation of the net investment in the period from 2004 to 2010 in the amount of HRK 131,471,749.66. The prior periods were restated to reflect this change.

EXTRACTED FINANCIAL INFORMATION

The following table presents the financial information extracted from the financial statements of NPPK as at 31 December 2011 and 2010:

	31 December 2011	31 December 2010	1 January 2010
	HRK'000	HRK'000	HRK'000
Property, plant and equipment	3,023,770	3,089,065	3,063,234
Capital and reserves	3,309,732	3,245,896	3,211,186
Gross sales	1,492,491	1,214,576	1,120,485
Cash flows from operating activities	495,358	313,211	352,970

Liabilities for received electrical energy from NPP Krško as at 31 December 2011 amount to HRK 64,667 thousand (2010: HRK 61,090 thousand). The Company has breakeven from the results for the financial years 2011 and 2010.

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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 2011 the distribution of RWE invested equity amounted to HRK 12,668 thousand (2010: HRK 12,382 thousand). The remaining undistributed RWE invested capital amounted to HRK 51 million at 31 December 2011 (2010: HRK 63 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 2011, accrued undistributed interest amounted to HRK 12,611 thousand (2010: HRK 16,078 thousand).

The RWE annual return on invested capital, effectively a preferred dividend, is paid out from net profit of Plomin. The rate for 2011 is 17% as well as for 2010. The amount paid out in 2011 in respect of 2010 profits was HRK 14,063 thousand and in 2010 HRK 16,583 thousand in respect of 2009 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.

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15. INVESTMENT IN TPP PLOMIN (continued)

	2011	2010	2009
	HRK '000	HRK '000	HRK '000
Opening balance of non-controlling share	76,993	91,409	106,821
Interest payment	(12,668)	(12,382)	(12,677)
Dividend payment	(14,063)	(16,583)	(19,442)
Share of current year's profit	11,514	14,063	18,578
Correction of tax liabilities through retained earnings	-	-	(1,995)
Exchange differences	1,071	486	124
Closing balance	62,847	76,993	91,409

Notes to the consolidated financial
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16. LONG-TERM LOAN RECEIVABLES AND DEPOSITS

	31 December 2011	31 December 2010	1 January 2010
	HRK'000	HRK'000	HRK'000
		Restated	Restated
Loans given	1,022	1,318	1,794
Current portion of loans given	(167)	(135)	(311)
Short term portion of Long term loans	(136)	-	-
Long-term portion	719	1,183	1,483

Loans given to third parties

	Year loan approved	Repayment period	Loan amount	31 December 2011	31 December 2010	1 January 2010
				HRK'000	HRK'000	HRK'000
					Restated	Restated
Town of Pregrada	2006	10 years	1,358	815	950	914
Did d.o.o.	2007	4 years	1,010	207	368	880
Total				1,022	1,318	1,794
Value adjustment				(167)	(135)	(311)
Current portion				(136)	-	-
Non-current portion				719	1,183	1,483

Notes to the consolidated financial statements of the HEP Group (continued)
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17. INVESTMENTS AVAILABLE FOR SALE AND OTHER INVESTMENTS

	31 December 2011	31 December 2010	1 January 2010
	HRK'000	HRK'000	HRK'000
		Restated	Restated
Investments available for sale	120,605	162,170	152,797
Other investments	310	210	200
	120,915	162,380	152,997

Changes in investments available for sale are presented below:

	31 December 2011	31 December 2010	1 January 2010
	HRK'000	HRK'000	HRK'000
		Restated	Restated
Beginning balance	162,170	152,797	151,374
Fair value adjustment of Jadranski Naftovod d.d.	-	9,373	1,423
Fair valuation adjustment of investments in Jadranski naftovod d.d. presented in income	(41,565)	-	-
	120,605	162,170	152,797

	31 December 2011	31 December 2010	1 January 2010
	HRK'000	HRK'000	HRK'000
		Restated	Restated
Investment in securities:			
Jadranski Naftovod d.d.	120,378	161,943	152,570
Viktor Lenac d.d.	220	220	220
Đuro Đaković d.d.	5	5	5
Kraš d.d.	2	2	2
	120,605	162,170	152,797
Other investments			
Geopodravina d.o.o.	200	200	200
LNG Hrvatska d.o.o.	110	10	-
	120,915	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.

Notes to the consolidated financial
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17. INVESTMENTS AVAILABLE FOR SALE AND OTHER INVESTMENTS (continued)

In 2011 and 2010 fair value was determined by notification of the central clearing deposit company as of 31 December. The market value of Jadranski naftovod shares as of 31 December 2011 is HRK 2,230 (2010: HRK 3,000). The fair valuation of the investment in Jadranski naftovod as of 31 December 2011 is reduced by HRK 41,565 thousand (2010: increase by 9,373 thousand).

On 1 June 2010 HEP d.d. and Plinacro d.o.o. concluded the Articles of Incorporation of LNG Hrvatska d.o.o., a liquefied natural gas company. In 2011 a decision was made to increase the share capital of LNG Hrvatska d.o.o. from HRK 20 thousand to HRK 220 thousand. HEP d.d. and Plinacro d.o.o. each hold 50 percent of the equity share.

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For the year ended 31 December 2011

18. OTHER NON-CURRENT ASSETS

	31 December 2011	31 December 2010	1 January 2010
	HRK'000	HRK'000	HRK'000
		Restated	Restated
Housing loan receivables	38,095	42,890	54,035
Energy efficiency receivables – long-term portion	56,415	51,930	43,391
Accrued cumulative interest – RWE	12,611	16,078	19,577
Other long-term assets	32	75	103
	107,153	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 7.0%. The amounts owed to the state, which represent 65% of the value of the sold apartments, are included in non-current liabilities to the state (Note 25). The receivables are secured by mortgages over the sold apartments.

According to the Statute of Plomin, intercalary interest was accrued on all the funds invested by RWE in the period of construction at a rate of 17 percent. The accrued interest balance of EUR 7,536 thousand, equivalent to HRK 55,653 thousand has been recognised as deferred expense subject to straight-line amortisation over a period of 15 years.

Repayment of interest is done along with the repayment of invested funds from RWE Power and it started after the electric power plant was finished. In 2011 the total amount repaid was EUR 502 thousand equivalent to HRK 3,734 thousand (in 2010 EUR 502 thousand, equivalent to HRK 3,650 thousand).

As at 31 December 2011 deferred expense for the interest amounted to EUR 1,675 thousand equivalent to HRK 12,611 thousand (2010: EUR 2,177 thousand, equivalent to HRK 16,078 thousand). The related exchange differences are included in the financial revenue or financial cost for the year in which they arise.

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19. INVENTORIES

	31 December 2011	31 December 2010	1 January 2010
	HRK'000	HRK'000	HRK'000
		Restated	Restated
Inventories of fuel and other material	644,113	748,065	553,996
Electric materials	187,740	162,486	171,684
Spare parts	212,512	175,536	99,099
Construction material	90,418	83,211	84,454
Other inventories	65,784	73,090	169,345
Impairment of obsolete materials and spare parts	(137,047)	(125,717)	(110,647)
	1,063,520	1,116,671	967,931

In 2011, the Group estimated the impairment for obsolete inventories of materials (material with no turnover in the last 2 years), in accordance with the ageing structure, at HRK 11,330 thousand (2010: HRK 15,070 thousand).

Notes to the consolidated financial statements of the HEP Group (continued)
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20. TRADE RECEIVABLES

	31 December 2011	31 December 2010	1 January 2010
	HRK'000	HRK'000	HRK'000
		Restated	Restated
Electricity – Corporate customers	1,422,139	1,355,919	1,109,074
Electricity – Households	313,463	336,814	270,576
Heating, gas and services	443,354	446,462	444,020
Foreign sales	35,625	71,530	23,386
Connection to transmission network	-	33,131	-
Other	63,255	61,882	49,818
	2,277,836	2,305,738	1,896,874
Impairment of bad and doubtful receivables	(781,600)	(575,410)	(402,885)
	1,496,236	1,730,328	1,493,989

Ageing analysis of receivables not impaired is as follows:

	31 December 2011	31 December 2010		1 January 2010
	HRK'000	HRK'000		HRK'000
		Restated		Restated
Not yet due	876,451	1,044,409		
0-30 days	309,826	347,291	Not yet due	775,460
31-60 days	138,013	145,786	0-60 days	343,778
61-90 days	67,558	64,544	61-91 days	109,517
91-180 days	61,198	68,461	91-120 days	49,647
181-365 days	37,075	50,294	121-365 days	152,228
Over 365 days	6,115	9,543	Over 365 days	63,359
	1,496,236	1,730,328		1,493,989

Movements in impairment allowance were as follows:

	31 December 2011	31 December 2010	1 January 2010
	HRK'000	HRK'000	HRK'000
		Restated	Restated
At 1 January	575,410	402,876	239,989
Impairment for potential losses on receivables and interest on receivables (Note 7)	403,568	332,139	275,006
Reversal of prior-year provisions	(58,112)	(25,074)	(21,077)
Amounts collected (Note 5)	(139,266)	(134,531)	(91,033)
At 31 December	781,600	575,410	402,885

Management performs review of receivables and recognises impairment of bad and doubtful receivables based on a review of the overall ageing structure of all receivables and of significant individual amounts receivable.

Notes to the consolidated financial
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21. OTHER SHORT-TERM RECEIVABLES

	31 December 2011	31 December 2010	1 January 2010
	HRK'000	HRK'000	HRK'000
		Restated	Restated
VAT receivable	179,965	27,560	19,555
Prepayments of income tax	138,719	-	5,750
Advances for working capital	13,616	26,196	18,865
Receivables from the State in respect of employees	10,284	6,403	7,950
Interest receivable	2,553	3,564	2,714
Demand and time deposits	4,328	1,735	8,362
Deferred income from the sale of electricity to household	-	-	87,058
Receivables for Government Bonds	-	-	22,641
Other short-term receivables	65,640	78,606	52,564
	415,105	144,064	225,459

22. CASH AND CASH EQUIVALENTS

	31 December 2011	31 December 2010	1 January 2010
	HRK'000	HRK'000	HRK'000
		Restated	Restated
Current accounts - HRK	123,916	71,510	61,810
Current accounts - Foreign	92,117	27,352	22,436
Current accounts for special purposes	6,105	5,710	11,407
Petty cash registers - HRK	280	287	418
Deposits due till 90 days	5,120	559,800	13,865
Daily deposits	179,585	97,498	33,898
	407,123	762,157	143,834

Notes to the consolidated financial statements of the HEP Group (continued)
For the year ended 31 December 2011

23. CAPITAL AND RESERVES

The share capital was first registered on 12 December 1994 in German Marks (DEM) and amounted to DEM 5,784,832 thousand. On 19 July 1995, the share capital was reregistered in Croatian Kuna in the amount 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.

Accumulated losses in the amount of HRK 136,262 thousand comprise legal reserves in the amount of HRK 167,589 thousand, transferred loss in the amount of HRK 289,031 thousand, profit for the year in the amount of HRK 14,820 thousand. The non-controlling interest attributable to RWE amounts to HRK 62,847 thousand, of which HRK 11,514 thousand represent dividends attributable to the foreign equity holder.

CAPITAL RESERVES

	31 December 2011	31 December 2010	1 January 2010
	HRK'000	HRK'000	HRK'000
		Restated	Restated
Opening balance of reserves, before restatement	-	(1,889,646)	(2,038,472)
Effect of restatement of opening balance	-	-	147,403
Opening balance of reserves, restated	(874,074)	(1,889,646)	(1,891,069)
Transfer from retained earnings	444,038	1,008,073	-
Other comprehensive income, net before restatement	-	24,853	(2,582)
Effect of restatement	-	(17,354)	4,005
Other comprehensive (loss) / income, net	(8,921)	7,499	1,423
	(438,957)	(874,074)	(1,889,646)

RETAINED EARNINGS

	31 December 2011	31 December 2010	1 January 2010
	HRK'000	HRK'000	HRK'000
		Restated	Restated
Opening balance	816,246	403,018	267,174
Correction of opening balance	(274)	(2)	-
Transfer to reserves	(444,038)	(1,008,073)	-
Dividend paid to the owner	(493,376)	-	-
Profit for the year	(14,820)	1,421,303	135,844
	(136,262)	816,246	403,018

Based on the Decision the General Shareholders' Assembly of HEP d.d. from 27 June 2011 on the Allocation of the 2010 Profits and Retained Earnings, HRK 444,038 thousand were transferred to reserves and HRK 493,376 thousand were distributed to the owner.

Notes to the consolidated financial
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24. LONG-TERM BORROWINGS

	Interest rates	31 December 2011	31 December 2010	1 January 2010
		HRK'000	HRK'000	HRK'000
			Restated	Restated
Domestic bank borrowings	EURIBOR+ (1.00%-6.35%)	1,681,140	1,040,610	1,062,199
Foreign bank borrowings	EURIBOR+ (0.50%-4.74%)	2,042,011	3,010,835	2,929,555
Liabilities to domestic companies	EURIBOR+ 1.95%	-	4,661	13,835
Loan from RWE		8,828	12,369	19,577
Reprogrammed debt		-	-	36,048
Total		3,731,979	4,068,475	4,061,214
Deferred loan origination fees		(22,777)	-	-
Total long-term borrowings		3,709,202	4,068,475	4,061,214
Current portion		(1,174,713)	(1,184,921)	(947,747)
Long-term portion		2,534,489	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 (the EBRD loans in the amount of EUR 4,400,000 and EUR 24,000,000, and a Deutsche Bank loan in the amount of EUR 100,000,000) and the total assets of Plomin.

NEW SOURCES OF FUNDS

For the purpose of financing the investments and operations in 2011, HEP d.d. concluded two long-term loan agreements during 2011, involving a loan of EUR 150 million with a consortium of banks (Privredna banka Zagreb d.d., Raiffeisenbank Austria d.d. and Zagrebačka banka d.d.) and a loan of EUR 20 million with Hrvatska poštanska banka d.d. The maturity of both loans is 7 years. At 31 December 2011 the consortium loan balance was EUR 84 million, whereas the bilateral loan was fully utilised and amounted to EUR 20 million.

In November 2011 a long-term loan agreement was concluded with the European Restructuring and Development Bank and a syndicate of banks for a loan of EUR 123.2 million. The loan funds are intended to finance the construction of Hydro Power Plant Ombla near Dubrovnik. The loan tranches mature in 12 and 15 years, including the utilisation period of 4 years.

Notes to the consolidated financial statements of the HEP Group (continued)
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24. LONG-TERM BORROWINGS (continued)

LOANS IN USE

During 2011 the utilisation of the long-term loan approved by KfW Entwicklungsbank in the amount of EUR 50 million for the financing of the projects of subsidiaries HEP ESCO d.o.o and HEP Obnovljivi izvori energije d.o.o. The key lending terms and conditions are as follows: 5-year utilisation period; quarterly repayment of principal over a period of 10 years following the expiry of the utilisation period. At 31 December 2011 the KfW loan balance was EUR 2.5 million, of which EUR 47.5 million were unutilised. 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 HEP d.d. received a GEF grant in the amount of EUR 0.6 million. The total balance utilized as of 31 December 2011 was EUR 0.58 million.

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

2012	1,174,713
2013	798,638
2014	481,798
2015	383,611
2016	324,188
After 2016	569,031
Total	3,731,979

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. As at 31 December 2011 all the covenants were met.

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

Currency	31 December 2011	31 December 2010	1 January 2010
		Restated	Restated
USD	-	-	7,083
EUR	495,587	549,223	548,245

Notes to the consolidated financial
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25. LONG-TERM LIABILITIES TO THE GOVERNMENT

The long-term debt to the Government in the amount of HRK 30,466 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.

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 of approximately 1.7263 % at 31 December 2011 (2010: approximately 1.2019 %).

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 2011 was EUR 5,113 thousand (2010: EUR 10,226 thousand). The fair value of the interest rate swap contract, representing a future obligation, at 31 December 2011 amounted to HRK 850 thousand (2010: HRK 2,875 thousand). The related deferred tax asset at 31 December 2011 amounted to HRK 170 thousand (2010: HRK 575 thousand).

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

	31 December 2011	31 December 2010	1 January 2010
	HRK'000	HRK'000	HRK'000
		Restated	Restated
Long-term portion (Note 29)	-	672	3,513
Current portion (Note 33)	850	2,203	2,771
	850	2,875	6,284

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27. LONG-TERM PROVISIONS

	31 December 2011	31 December 2010	1 January 2010
	HRK'000	HRK'000	HRK'000
		Restated	Restated
Litigation provision	217,621	162,443	145,335
Provision for retirement bonuses	314,081	302,157	233,949
Provision for jubilee awards	43,551	46,268	53,900
Provision for the de-commissioning of thermal power plants	100,044	93,121	92,280
NPPK - decommission	-	-	4,932
Provision for NPPK decommissioning (long-term)	-	53,838	-
Provision according to damages contract	80,800	80,800	28,621
Provision for electricity purchased from wind power plants	22,532	22,031	-
Provision for investment in HE Lešće	-	39,287	-
	778,629	799,945	559,017

The thermal power plant decommissioning provision in the amount of HRK 100,044 thousand represents a discounted value of the estimated decommissioning costs of the Group's thermal power plants.

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

HRK'000	Legal actions	Retirement bonuses	Jubilee awards	Decommissioning - NPPK	Decommissioning of TPPs	Other	Total
At 1 January 2011	162,443	302,157	46,268	53,838	93,121	142,118	799,945
New provisions made	78,267	31,277	4,287	-	6,923	500	121,985
Decrease in provisions (amounts paid)	(21,906)	(20,023)	(6,977)	-	-	-	(48,906)
Decrease in provision on valuation	(1,183)	670	(758)	(53,838)	-	(39,286)	(94,395)
At 31 December 2011	217,621	314,081	43,551	-	100,044	103,332	778,629

Notes to the consolidated financial statements of the HEP Group (continued)
For the year ended 31 December 2011

27. LONG-TERM PROVISIONS (continued)

LEGAL CASES PROVISION

The provision for legal actions refers to cases where possible outcome has been determined as uncertain or negative and was recognised in the total amount of HRK 217,621 thousand. The most important court case provided against is the one of HEP Proizvodnja d.o.o. for a dispute with Zagrebački Holding (the 2010 provision amounted to HRK 19,075 thousand, while the total provisions were HRK 84,821, and refers to suit for reimbursement of waste water treatment plant).

RETIREMENT BONUSES AND JUBILEE AWARDS

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
		Restated	Restated
At 1 January 2011	302,157	46,268	348,425
Cost of services	10,859	2,237	13,096
Interest expenses	20,418	2,781	23,199
Benefits paid	(20,023)	(6,977)	(27,000)
Actuarial gains/(losses)	670	(758)	(88)
At 31 December 2011	314,081	43,551	357,632

The following assumptions were used in preparing the calculations:

- The termination rate is from 0% to 6.49% percent and is based on the statistical fluctuation rates for the Company in the period from 2005 to 2011.
- The probability of death by age and sex is based on Croatian Mortality Tables 2000 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 grow at 0.7% in other years..
- The present value of the obligation was determined using a 7.3% discount rate for HEP d.d. and HEP Proizvodnja d.o.o., and 7.2% for other companies within the Group.

Notes to the consolidated financial statements of the HEP Group (continued)
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28. ISSUED BONDS

	31 December 2011	31 December 2010	1 January 2010
	HRK'000	HRK'000	HRK'000
		Restated	Restated
Nominal value of bonds	1,200,000	1,200,000	1,200,000
Cumulative repayment	(140,070)	(46,690)	-
Discount value	(1,348)	(1,888)	(2,423)
Current portion of bonds	(93,380)	(93,380)	(46,690)
	965,202	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 installments, commencing three years from the date of issue, and bear interest at a fixed rate of 6.50 percent. The HEP d.d. bonds are listed on the Zagreb Stock Exchange.

29. OTHER NON-CURRENT LIABILITIES

	31 December 2011	31 December 2010	1 January 2010
	HRK'000	HRK'000	HRK'000
		Restated	Restated
Deferred income	4,617,155	4,753,554	4,683,583
Long term liabilities for assets financed by clearing debt	701,012	414,938	239,926
Long-term debt under interest rate swap (Note 26)	850	672	3,513
Other	1,659	1,779	-
	5,320,676	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 connection fee is recognized as income in the amount of funds received from the customer in the period when the customer is connected to the grid or when permanent access to the delivery of the service is given (based on the decision of the Committee on the Interpretation the Financial Reporting Standards in the Republic of Croatia from 11 January 2011 (Official Gazette No. 18/2010).

At 31 December 2011 the Group reported a liability in the amount of HRK 701,012 thousand respect of a clearing debt (2010: HRK 414,938 thousand) regarding a payment under a letter of credit on the basis of the consent of the Ministry of Finance with the use of the funds pursuant to an interbank agreement. As there is no other document that would regulate the relationship between the HEP Group and the Ministry of Finance regarding the clearing debt, it has not been clearly defined as either a loan or a government grant.

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30. SHORT-TERM BORROWINGS

	31 December 2011	31 December 2010	1 January 2010
	HRK'000	HRK'000	HRK'000
		Restated	Restated
Borrowings from domestic banks and foreign banks, denominated in various currencies on the following terms:	592,778	282,252	761,320
Interest rates ranging from EURIBOR + (1.50 – 5.90%)	-	-	-
Interest rates on Ministry of Finance Treasury Bills + (1.00 – 2%)	-	-	-
Secured by bills of exchange	-	-	-
Borrowings from domestic companies on the following terms:	2,806	2,805	2,805
Current portion of RWE loan	7,579	7,436	3,680
	603,163	292,493	767,805

During 2011, the Group used short-term loans from domestic banks for working capital purposes and for the settlement of trade payables. In addition to the prolongation of current loans arranged during 2011, the Group also concluded new credit lines for the purpose of keeping financial stability.

31. LIABILITIES FOR TAXES AND CONTRIBUTIONS

	31 December 2011	31 December 2010	1 January 2010
	HRK'000	HRK'000	HRK'000
		Restated	Restated
Liabilities for income tax	-	357,228	116,563
Utility and other fees	12,680	25,596	28,573
Contributions on salaries	23,205	23,953	24,217
Liabilities for custom	2,239	20,153	5
Contributions and taxes for benefits in kind	1,984	14,880	-
Other	647	3,175	1,722
	40,755	444,985	171,080

Notes to the consolidated financial statements of the HEP Group (continued)
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32. LIABILITIES TO EMPLOYEES

	31 December 2011	31 December 2010	1 January 2010
	HRK'000	HRK'000	HRK'000
		Restated	Restated
Net salaries	78,074	81,133	77,334
Contributions	40,363	41,953	46,614
Other	9,497	11,140	19,184
	127,934	134,226	143,132

33. OTHER PAYABLES

	31 December 2011	31 December 2010	1 January 2010
	HRK'000	HRK'000	HRK'000
		Restated	Restated
Deferred income and received advances for connections	193,125	110,538	-
Deferred income for other advances received	15,538	7,214	7,117
Accrued expenses for unused vacation days	63,900	64,477	-
Deferred income from sale of el. energy to households	10,905	-	-
Liabilities for renewable sources	8,017	16,446	228,351
Decommissioning NPPK accrued expenses	-	5,023	41,645
Other accrued expenses	3,203	9,459	5,464
Current portion of the liability under interest rate swap (Note 26)	850	2,203	2,771
Other payables	51,263	43,968	47,408
	346,801	259,328	332,756

Value adjustment of receivables from Households as at 31 December 2011 was calculated by using logarithmic curve with losses on the supply network of 8.3%, while for the year ended 31 December 2010 the percent of loss was 8.74%. The result is increase of liabilities and decrease of revenue in the amount of HRK 11,285 thousand in the respect to the previous year.

Notes to the consolidated financial statements of the HEP Group (continued)
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34. RELATED PARTY TRANSACTIONS

The Group has a 50% ownership in the capital of NPPK (NE Krško d.o.o.).
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 2011	31 December 2010
	HRK'000	HRK'000
		Restated
NE Krško d.o.o.		
Liabilities for purchased electricity	64,667	61,090
Cost of purchased electricity	737,565	594,612

	Sales revenue		Purchases	
HRK'000	2011	2010	2011	2010
Enterprises controlled by the Government				
Hrvatske Željeznice	108,259	123,627	9,279	16,260
INA-Industrija nafte	121,110	135,772	1,419,311	1,480,394
Prirodni plin	-	134	1,011,225	427,615
Plinacro	1,975	1,102	34,296	38,508
Hrvatske komunikacije	83,937	77,854	27,400	29,382
Croatia osiguranje	6,481	6,181	16,924	15,842
Hrvatska pošta	22,062	21,115	54,523	51,251
Hrvatske šume	5,785	6,572	12,113	13,784
Jadrolinija	727	1,107	787	603
Narodne novine	2,855	2,081	6,236	5,667
Croatian Radio & Television	12,441	12,763	1,079	1,124
Plovput	551	543	230	163
Croatia Airlines	788	807	2	110
Petrokemija Kutina	9,428	8,311	46	133
Ministry of Foreign Affairs	563	621	-	-
Ministry of Defense	17,597	31,172	-	-
Ministry of Interior	24,862	25,621	-	-
Elementary and secondary schools	79,120	78,697	-	-
Judicial institutions	10,506	10,563	-	-
Colleges and universities	30,649	29,715	3,160	4,869
Legislative, executive and other bodies of the Republic of Croatia	29,169	48,470	5,848	7,648
Health institutions and organisations	81,711	92,427	3,502	4,027
Other users	70,472	109,474	15,883	14,202
TOTAL	721,048	824,729	2,621,844	2,111,582

Notes to the consolidated financial statements of the HEP Group (continued)
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34. RELATED PARTY TRANSACTIONS (continued)

HRK'000	Receivables		Payables	
	31 December 2011	31 December 2010	31 December 2011	31 December 2010
Enterprises controlled by the Government				
Hrvatske Željeznice	22,615	34,957	866	3,238
INA-Industrija nafte	14,709	8,483	206,061	210,541
Prirodni Plin	-	7	371,656	76,652
Plinacro	351	32	4,380	9,631
Hrvatske telekomunikacije	8,092	8,761	8,179	8,879
Croatia osiguranje	582	668	-	-
Hrvatska pošta	3,380	3,156	4,568	4,637
Hrvatske šume	1,262	2,017	1,288	925
Jadrolinija	57	242	761	561
Narodne novine	284	246	1,790	1,397
Croatian Radio & Television	2,006	2,233	231	143
Plovput	64	68	49	49
Croatia Airlines	149	150	-	64
Petrokemija Kutina	266	668	-	-
Ministry of Defense	4,209	4,531	-	-
Ministry of Interior	7,286	7,442	-	-
Elementary and secondary schools	15,096	15,135	-	-
Judicial institutions	2,599	2,983	-	-
Colleges and universities	4,136	4,516	-	-
Legislative, executive and other bodies of the Republic of Croatia	5,183	7,038	-	-
Health institutions and organizations	35,810	34,970	-	-
Other users	5,842	16,245	11,008	9,888
TOTAL	133,978	154,548	610,837	326,605

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

Notes to the consolidated financial
statements of the HEP Group (continued)
For the year ended 31 December 2011

35. CONTINGENT LIABILITIES AND COMMITMENTS

LEGAL ACTIONS

In 2011, 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 2011, 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 thousand 1,670,904 thousand (2010: HRK 1,986,175 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

HEP Group monitors and analyses the environmental impact of its business activities on an on-going basis. The key impact indicators comprise emissions of pollutants into air and the quantity of production waste, which HEP reports to the competent institutions, local self-government units and public stakeholders on a regular and timely basis. The staffs engaged in environmental and nature protection undergo training and seminars and workshops where they receive information about the obligations and measures provided in the applicable environmental laws and regulations.

There is an environmental expenditure monitoring system (RETZOK) at the Group which monitors all investments in environmental and nature protection.

The Group is in the process of performing analyses and achieving readiness with respect to compliance with the requirements imposed by EU legislation in terms of more stringent pollutant emission limits and reduced greenhouse gas emissions, the greenhouse gas emission trading scheme, integrated environmental permitting system, as well as the system of ecologically important areas and corridors (the National Ecological Network).

Investments in environmental protection and energy efficiency projects at the level of the entire HEP Group have been substantiated before the Environmental Protection Fund, resulting in a more favourable correction factor and, consequently, reduced fees for pollutant emissions by 50 percent (approximately HRK 15.2 million).

Notes to the consolidated financial statements of the HEP Group (continued)
For the year ended 31 December 2011

36. SUBSIDIARIES

As at 31 December 2011, 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
APO d.o.o., environmental services	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
HEP-Trgovina d.o.o. Brežice	Slovenia	100	Purchase and sale of electrical energy
HEP- Magyarorszag Energia KFT	Hungary	100	Purchase and sale of electrical energy

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

Notes to the consolidated financial statements of the HEP Group (continued)
For the year ended 31 December 2011

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:

<i>(HRK'000)</i>	31 December 2011	31 December 2010
Debt	5,393,724	5,512,390
Cash and cash equivalents	(407,123)	(762,157)
Net debt	4,986,601	4,750,233
Equity	19,279,787	19,811,324
Net debt to equity ratio	25%	23%

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

<i>(HRK'000)</i>	31 December 2011	31 December 2010
Financial assets		
Loans and receivables (including cash and cash equivalents)	2,768,999	3,022,637
Other non-current assets	107,153	111,029
Financial liabilities		
Non-current liabilities	5,524,548	5,672,893
Current liabilities	3,569,029	2,713,686

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.

Notes to the consolidated financial statements of the HEP Group (continued)
For the year ended 31 December 2011

37. FINANCIAL INSTRUMENTS (continued)

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 2011	31 December 2010	31 December 2011	31 December 2010
	(in '000)	(in '000)	(in '000)	(in '000)
European Union (EUR)	16,101	88,390	548,280	573,176
USD	109	34	48,716	75,315

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.

	2011	2010
	HRK'000	HRK'000
EUR change impact		
Profit or loss	400,753	350,872
USD change impact		
Profit or loss	28,288	38,853

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.

Notes to the consolidated financial statements of the HEP Group (continued)
For the year ended 31 December 2011

37. FINANCIAL INSTRUMENTS (continued)

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 2011 would decrease/increase by HRK 19,597 thousand (2010: HRK 21,153 thousand), based on exposure to interest rate risk. This is mainly attributable to the Group's exposure to interest rates on its variable rate borrowings, which accounted for 73% in 2011 (2010: 77%); and
- The Group's sensitivity to interest rates has decreased during the current period mainly due to the reduction in variable rate of debt instruments.

CREDIT RISK MANAGEMENT

Credit risk refers to the risk that 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.

Notes to the consolidated financial statements of the HEP Group (continued)
For the year ended 31 December 2011

37. FINANCIAL INSTRUMENTS (continued)

LIQUIDITY RISK MANAGEMENT (CONTINUED) 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)
2011							
Non-interest bearing		1,242,119	861,593	367,414	399,238	5,788	2,876,152
Variable interest rate instruments	5.00%	22	43	149	-	-	214
Total		1,242,141	861,636	367,563	399,238	5,788	2,876,366
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

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)
2011							
Non-interest bearing		1,436,563	1,082,085	452,560	726,027	2,618	3,699,853
Variable interest rate instruments	4.37%	71,634	395,827	1,367,154	3,547,752	684,184	6,066,551
Fixed interest rate instruments	5.60%	8,437	-	178,950	1,037,917	112,162	1,337,466
Total		1,516,634	1,477,912	1,998,664	5,311,696	798,964	11,103,870
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

The Group has access to financing facilities, the total unused amount of which is HRK 2,090,982 thousand at the reporting date. The Group expects to meet its other obligations from operating cash flows and proceeds of maturing financial assets.

Notes to the consolidated financial statements of the HEP Group (continued)
For the year ended 31 December 2011

37. FINANCIAL INSTRUMENTS (continued)

MATURITY OF DERIVATIVE FINANCIAL LIABILITIES

The Group has an interest rate swap, which it uses to hedge its exposure to variable rate debt. Based on the underlying agreement, the six-month interest rate payable by the Company is fixed at 5.39 %, whereas the swap rate is equal to six-month EURIBOR, or approximated at 1,7263 % at 31 December 2011 (2010: 1.2019 %), 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'000)	(HRK'000)	(HRK'000)	(HRK'000)	(HRK'00)	(HRK'000)
31 December 2011							
Variable interest rate instruments	1.7263%	-	-	698	-	-	698
Fixed interest rate instruments	5.39%	-	-	(2,178)	-	-	(2,178)
Total		-	-	(1,480)	-	-	(1,480)
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)

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.

Notes to the consolidated financial statements of the HEP Group (continued)
For the year ended 31 December 2011

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:

Level 1 observable indicators - indicators of fair value derived from (unadjusted) prices quoted in active markets for identical assets and liabilities are identical

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

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

	1 st level	2 nd level	3 rd level	Total
	HRK'000	HRK'000	HRK'000	HRK'000
2011				
Assets available for sale	120,915	-	-	120,915
Interest swap liability (current and noncurrent portion)	-	850	-	850
2010				
Assets available for sale	162,380	-	-	162,380
Interest swap liability (current and noncurrent portion)	-	2,875	-	2,875

38. APPROVAL OF THE FINANCIAL STATEMENTS

These financial statements were approved by the Board and authorised for issue on 16 April 2012.

Signed on behalf of the Management Board on 16 April 2012:

Zlatko Koračević
President of the Board

Ivan Matasić
Member of the Board

HEP d.d.

Unconsolidated financial statements

Independent Auditor's Report

To the Owner of Hrvatska elektroprivreda d.d.:

We have audited the accompanying unconsolidated financial statements of Hrvatska elektroprivreda d.d. (the 'Company'), which comprise the unconsolidated statement of financial position as at 31 December 2011 and the related unconsolidated income statement, 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 matters affecting opinion 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

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 purchase of electricity facilities located on the Croatian motorways within two years from the date of the advance payment. As of the date of issue of these financial statements, the transfer of the legal title to those facilities to the Company is still pending. 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 Independent customers. As of the date of preparation 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.

MODIFIED OPINION

In our opinion, except for the potential effects of the matter presented in above paragraph, the unconsolidated financial statements present fairly, in all material respects, the financial position of the Company at 31 December 2011, the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

EMPHASIS OF MATTER

A) REVENUE RECOGNITION POLICY

As described in Note 1 to the accompanying unconsolidated financial statements, the Company recognizes revenue based on the invoicing to its subsidiaries HEP Operator distribucijskog sustava d.o.o., HEP Opskrba d.o.o. and HEP Operator prijenosnog sustava d.o.o. who in turn invoice to the final consumers of the Group. However, the receivables from the final customers remain with the subsidiaries. This policy is in accordance with the relevant legislation based on a set 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 to its subsidiaries under finance lease agreements. 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 which are dated 16 April 2012. 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, 16 April 2012

Unconsolidated Income Statement – HEP d.d.

For the year ended 31 December 2011

	2011	2010
	HRK'000	HRK'000
Electricity sales	10,757,193	10,849,131
Service revenues – related companies	1,239,661	1,273,025
Other operating income	238,446	237,666
Total operating income	12,235,300	12,359,822
Purchase of electricity	(3,835,440)	(2,554,853)
Staff costs	(76,014)	(77,678)
Depreciation and amortisation	(68,171)	(68,177)
Electricity generation, transmission and distribution fee from related parties	(7,613,865)	(7,597,287)
Other operating expenses	(528,609)	(701,851)
Total operating expenses	(12,122,099)	(10,999,846)
Profit from operations	113,201	1,359,976
Financial revenue	724,715	255,232
Financial costs	(383,432)	(391,332)
Net financial income/ (loss)	341,283	(136,100)
Profit before tax	454,484	1,223,876
Income tax benefit/expense	15,614	(237,125)
Net profit for the year	470,098	986,751

Signed on behalf of the Company on 16 April 2012 by:

Zlatko Koračević
President of the Board

Ivan Matasić
Member of the Board

Unconsolidated statement of comprehensive income – HEP d.d.

For the year ended 31 December 2011

	2011	2010
	HRK'000	HRK'000
		Restated
Profit for the year	470,098	986,751
Fair valuation adjustment of Janaf shares	(8,922)	7,499
Other comprehensive (loss) / income, net	(8,922)	7,499
Total operating income	461,176	994,250

Signed on behalf of the Company on 16 April 2012 by:

Zlatko Koračević
President of the Board

Ivan Matasić
Member of the Board

Unconsolidated statement of financial position - HEP d.d.

At 31 December 2011

ASSETS	31 December 2011	31 December 2010	1 January 2010
	HRK'000	HRK'000	HRK'000
		Restated	Restated
Property, plant and equipment	217,558	231,808	269,026
Capital work in progress	256,199	270,425	190,970
Intangible assets	13,512	18,466	24,325
Investment properties	8,010	8,010	8,010
Prepayments for tangible assets	327,872	364,965	372,470
Investment in NPP Krško	1,754,419	1,754,419	1,754,419
Investment in and long term receivables from TPP Plomin	441,791	538,046	622,150
Investments in subsidiaries	6,378	6,378	6,398
Investments available for sale and other investments	120,915	162,380	152,997
Long-term loan receivables and deposits	511	815	914
Long-term lease receivables from related companies	18,124,813	17,945,115	17,979,281
Long-term loan receivables from related parties	142,407	158,368	158,569
Receivables from sub loans from related parties	209,001	222,132	182,062
Other receivables	1,209	1,560	1,803
Deferred tax assets	48,603	32,989	8,601
Total non-current assets	21,673,198	21,715,876	21,731,995
Inventories	25,880	26,282	33,751
Trade receivables	20,208	175,172	46,200
Current portion of long-term lease receivables from related companies	1,311,413	1,291,036	1,293,899
Current portion of long-term loan receivables from related parties	45,394	12,337	8,342
Other short-term receivables	161,246	46,211	141,912
Receivables from related companies	4,269,451	3,946,685	3,946,541
Cash and bank balances	268,920	680,306	68,417
Total current assets	6,102,512	6,178,029	5,539,062
TOTAL ASSETS	27,775,710	27,893,905	27,271,057

Signed on behalf of the Company on 16 April 2012 by:
Zlatko Koračević
President of the Board

Ivan Matasić
Member of the Board

Unconsolidated statement of
financial position – HEP d.d. (continued)
At 31 December 2011

EQUITY AND LIABILITIES	31 December 2011	31 December 2010	1 January 2010
	HRK'000	HRK'000	HRK'000
		Restated	Restated
Share capital	19,792,159	19,792,159	19,792,159
Capital reserves	(438,958)	(874,074)	(1,889,646)
Retained earnings	637,682	1,104,997	1,126,319
Total equity	19,990,883	20,023,082	19,028,832
Long term liabilities in respect of Bonds issued	965,202	1,058,042	1,150,887
Long-term borrowings	2,525,661	2,851,424	3,035,239
Long-term liabilities to the state	1,130	1,172	24,211
Other long-term liabilities	707,702	423,900	251,219
Long-term liabilities to related companies	178,980	174,283	122,342
Provisions	40,013	132,764	19,859
Deferred tax liability	-	1,874	-
Total non-current liabilities	4,418,688	4,643,459	4,603,757
Trade payables	503,711	288,927	510,328
Current portion of issued bonds	93,380	93,380	46,690
Current portion of long-term borrowings	1,154,563	1,145,398	894,540
Short-term borrowings	595,584	285,054	764,121
Taxes payable	54,737	236,204	126,770
Interest payable	23,024	27,215	24,161
Liabilities to related companies	913,273	1,123,657	1,210,306
Liabilities to employees	5,229	5,334	5,710
Other payables	22,638	22,195	55,842
Total current liabilities	3,366,139	3,227,364	3,638,468
TOTAL EQUITY AND LIABILITIES	27,775,710	27,893,905	27,271,057

Signed on behalf of the Company on 16 April 2012 by:
Zlatko Koračević
President of the Board

Ivan Matasić
Member of the Board

REPORTS BY HEP GROUP
COMPANIES WITH
FINANCIAL STATEMENTS



HEP – Proizvodnja d.o.o.

In accordance with HEP Group business policy, in 2011 HEP Proizvodnja d.o.o. (HEP Production) paid special attention to its core activities, production of electricity and heat for the needs of customers in Croatia. Special attention was given to improvements in electricity production efficiency and to maintenance of high availability of production units. The level of business and collegial cooperation with HEP Group companies remained high and contacts with the relevant ministries (of the economy and of environmental protection) and energy institutions (HERA, HROTE) intensified.

From the energy viewpoint, 2011 was below average in domestic electricity production. The exceptionally unfavorable hydrological conditions caused very low annual production by HEP's hydro power plants, 4.577 TWh which is 82.8 percent of the planned electricity supply/demand balance. Despite unfavorable hydrological conditions, thanks to specific features and energy abundance of the upper basin of the Drava river, our hydro power plants on the Drava met the production plan at the high 96.2 percent or 1,038 GWh. The production by thermal power plants and cogenerating plants, including the production by TE Plomin d.o.o., in 2011, was 5.147 TWh. It is important to note here that production units A and B of Plomin TPP hit record production. Of the significant business events I single out the obtaining of the operating permit for Lešće hydro power plant.



In 2011, special attention was paid to the optimization of the structure and size of inventories and to the pace of procurement of fuel for HEP's thermal and cogenerating plants, with due regard to the economic and ecological viability of substituting oil with natural gas. Compared to 2010, natural gas consumption increased for a further 10 percent or approximately by 700 million m³ a year and oil consumption decreased to 120,000 tons a year. HEP Proizvodnja in 2011 began preparing hourly plans for natural gas consumption on a daily basis and/or the company established operational cooperation with the supplier company Prirodni plin and with the transport system operator Plinacro.

In 2011, preparations were completed for renewal of Zakučac HPP (486 MW) and Dubrovnik (216 MW) including increase in installed capacity. The beginning of the renewal is expected in the spring of 2012. In Zaučac HPP, a three-phase transformer was installed 220/110 kV 150 MVA in lieu of one-phase transformers of the total capacity of 100 MW. The reconstruction began of the 110 kV switchyard of Varaždin HPP, and the completion of the highly integrated enclosed switchgear is planned for April 2012.

During 2011, primary equipment for Unit C at Sisak TPP was delivered as well as 60 percent of secondary equipment. Major works were carried out (boiler room building, turbine foundations, central and electrical control building, piping foundations), the installation of the boiler plant for unit C was almost fully finished and the permit for a water treatment plant was obtained. HEP Proizvodnja obtained from Plinacro d.o.o. energy connection approvals to connect Unit C to the natural gas transport system.

In the Cetina River Basin Center, computer hardware and specialized software were installed for the needs of operations planning (scheduling) and remote control of hydro power plants in the Cetina River basin. The Center will begin its operational work after testing software applications and training of operators (in 2012).

At the end of 2012 HEP Proizvodnja started the activities to obtain the status of eligible producer for new and renewed small hydro power plants, including biological minimum generating sets. Recertification was successfully carried out for production of green energy from HEP's hydro power plants for 2011 and contacts were established with potential buyers of green electricity.

During 2011, a number of activities were carried out to prepare the application for integrated environmental requirements (individual environmental permits) for HEP's existing thermal power plants, taking into account IPPC and IED directives, i.e. the application of best available techniques and emission limit values taking into account the economic viability of the investments.

In 2011, the number of HEP Proizvodnja employees continued to decrease so that understaffing and high average age have become a growing business problem.

Damir Magić
Director

*Director since April 12, 2012, in the reporting period the director was Nikola Rukavina

GENERATING PLANTS

HYDRO POWER PLANTS	AVAILABLE CAPACITY (MW)	HYDRO POWER PLANTS	AVAILABLE CAPACITY (MW)
Storage		Natural flow	
HE Zakučac	486	HE Varaždin	92.46
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 and Herzegovina

THERMAL POWER PLANTS	NET AVAILABLE CAPACITY (MW)	FUEL
TE-TO Zagreb	422 / 500 MWt	oil/natural gas
TE Sisak	396	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

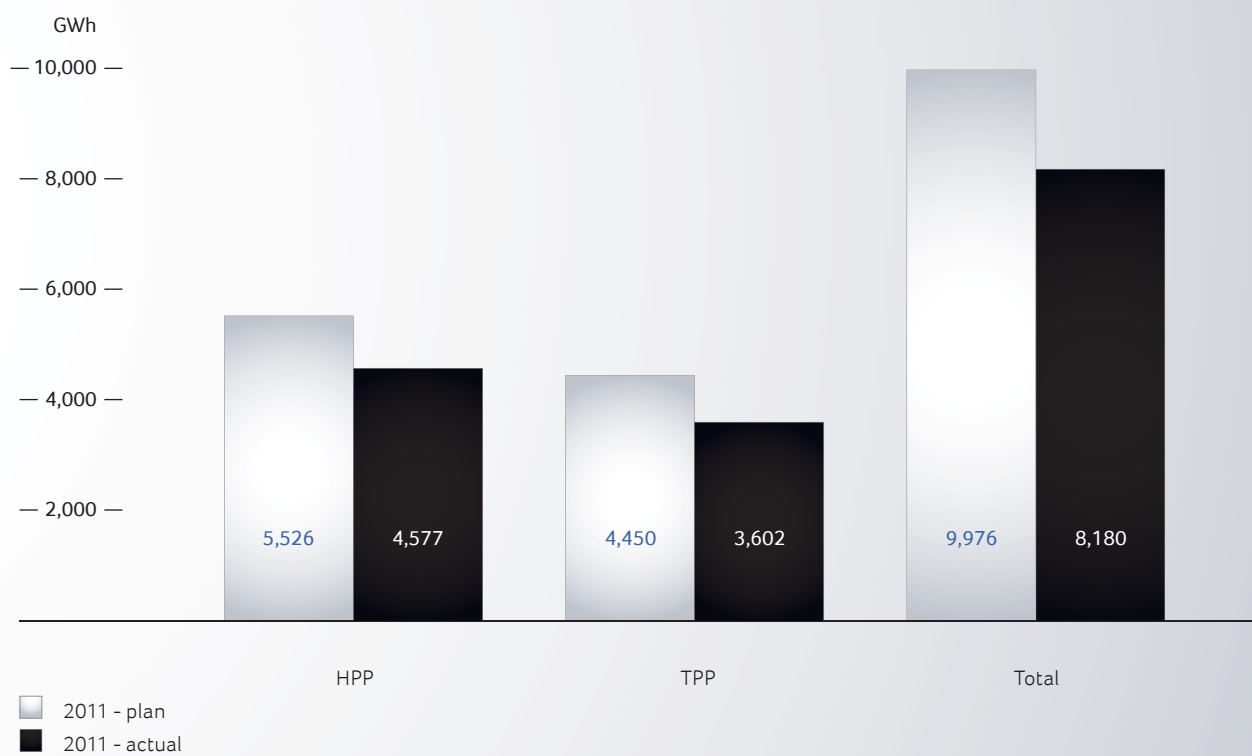
* Owned by TE Plomin d.o.o. (HEP : RWE Power - 50% : 50%); HEP-Proizvodnja d.o.o. – O&M contract

Electricity and heat production in 2011

ELECTRICITY PRODUCTION

In 2011 HEP Proizvodnja power plants generated 8,180 GWh of electricity (4,577 GWh or 56 percent by hydro power plants and 3,602 GWh or 44 percent by thermal power plants) Thus, HEP Proizvodnja's sources covered 43.7 percent of total electricity needs of Croatia.

Compared to the 2011 planned production, the actual production of electricity was lower by 18 percent with hydro power plants producing 17.2 percent less and thermal power plants 19 percent less.



HEAT ENERGY PRODUCTION

In 2011, HEP Proizvodnja combined-cycle plants generated a total of 2,456,455 MWh of heat energy, which is 1.5 percent more than the total planned annual production. Compared to the year before heat production was lower by 1.5 percent.

Process steam production was 874,478 tons which is 2.1 percent more than the total planned production (856,616 t), and 5.5 percent more than the previous year (828.942 t).

Heat production in 2011 was 1,728,015 MWh or 1.2 percent more than the total planned production (1,706,785 MWh) and 4.1 percent less than the heat produced in 2010 (1,802,564 MWh).

HEP Proizvodnja combined-cycle plants in 2011 produced 91.6 percent of the total heat energy generated within HEP.

POWER PLANT AVAILABILITY

The availability of all plants of HEP Proizvodnja in 2011, including TE Plomin d.o.o., measured as the ratio of availability hours (availability hours=operation+reserve in relation to the total number of hours minus planned overhauls) is 97.7 percent which is 0.5 percent lower than the availability level achieved in 2010.

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 2011 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 2011, the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

EMPHASIS OF MATTER

Accounting policy for leases

As described in Note 1 to the accompanying unconsolidated financial statements, the Company has received 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. 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. Our opinion is not modified in respect of this matter.

Deloitte d.o.o.

Branislav Vrtačnik, Certified Auditor

Zagreb, 16 April 2012

HEP-Proizvodnja d.o.o., Income Statement

for the year ended 31 December 2011

	2011	2010
	HRK'000	HRK'000
Electricity generation fee income and other income from related companies	4,030,519	3,931,476
Other operating income	61,456	37,672
	4,091,975	3,969,148
Cost of energy sources, material and spare parts	2,412,777	1,704,769
Service cost	375,529	379,658
Staff costs	347,247	347,686
Depreciation and amortization	447,094	435,907
Administrative expenses – related companies	95,668	102,423
Other operating expenses	371,192	399,608
	4,049,507	3,370,051
Profit from operations	42,468	599,097
Financial income	235	233
Financial expenses	(50,862)	(62,530)
Net financial loss	(50,627)	(62,297)
(Loss) / Profit from operations before tax	(8,159)	536,800
Income tax expense	(87)	(108,046)
(Loss) / profit for the year	(8,246)	428,754

Signed on behalf of the Company on 16 April 2012 by:
Damir Magić
President of the Board

HEP-Proizvodnja d.o.o., Statement of Comprehensive Income for the year ended 31 December 2011

	2011	2010
	HRK'000	HRK'000
(Loss) / Profit for the year	(8,246)	428,754
Other comprehensive income for the year	-	-
Total comprehensive (loss) / income for the year	(8,246)	428,754

Signed on behalf of the Company on 16 April 2012 by:
Damir Magić,
President of the Board

HEP-Proizvodnja d.o.o., Statement of Financial Position at 31 December 2011

ASSETS	31 December 2011	31 December 2010
	HRK'000	HRK'000
Intangible assets	5,178	4,355
Property, plant and equipment	6,986,888	6,424,526
Investment in progress	1,639,259	1,790,818
Investment property	38,866	39,195
Prepayments for property, plant and equipment	98,993	20,871
Investment in subsidiary	7	7
Receivables from the sale of flats	13,872	16,026
Deferred tax assets	56,796	52,682
Total non-current assets	8,839,859	8,348,480
Inventories	619,742	727,079
Other current assets	199,581	15,224
Receivables from related companies	1,008,411	1,168,282
Trade receivables	1,601	1,369
Current portion of long-term receivables	2,474	2,310
Cash and cash equivalents	18,841	5,706
Total current assets	1,850,650	1,919,970
TOTAL ASSETS	10,690,509	10,268,450

Signed on behalf of the Company on 16 April 2012 by:
Damir Magić,
President of the Board

HEP-Proizvodnja d.o.o.,
Statement of Financial Position
at 31 December 2011 (continued)

EQUITY AND LIABILITIES	31 December 2011	31 December 2010
	HRK'000	HRK'000
Share capital	20	20
Accumulated loss	(8,246)	349,390
Total equity	(8,226)	349,410
Long term liabilities to related companies	6,590,781	6,040,962
Long-term provisions	383,447	324,880
Other long-term liabilities	9,816	10,998
Total non-current liabilities	6,984,044	6,376,840
Trade payables	872,407	496,576
Liabilities to related companies	2,334,416	2,414,731
Current portion of long-term debt to related companies	447,094	435,907
Other payables	60,774	194,986
Total current liabilities	3,714,691	3,542,200
TOTAL EQUITY AND LIABILITIES	10,690,509	10,268,450

Signed on behalf of the Company on 16 April 2012 by:
Damir Magić,
President of the Board

HEP – Operator prijenosnog sustava d.o.o.

In accordance with Economic Plan and Investment Plan for 2011 and the legal and regulatory framework, HEP Operator prijenosnog sustava d.o.o. (HEP-OPS, HEP Transmission System Operator), 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 while providing support to the development and functioning of the Croatian electricity market and its interconnections with neighboring electricity markets in the European Union and the Energy Community.

In 2011, total electricity consumption was 17,703 GWh, which is 1.4 percent less compared to 2010, the registered system peak load of 2,970 MW was by 4.8 percent lower than in 2010. Transmission losses amounted to 514 GWh which is in absolute and relative terms (2.17 percent of the 23,642 GWh of total electricity transmitted) lower than in 2010 and in relative terms matches the losses of most other European transmission system operators. In 2011, there were no larger disruption in system operation nor in electricity supply to customers. The availability of the electricity system increased compared to 2010 to 99.998 percent and the amount of non-supplied electricity, estimated at 345,5 MWh or 39.8 percent, was lower than in 2010.

During 2011 new transformer stations were put in regular operation, 110/x kV Zagvozd and Bruška, and a newly built transmission line 2x110 kV Samobor–Rakitje. Also, the activities continued on pre-construction and construction, reconstruction and renewal, among which is the intensified construction



of TS 220/110 kV Plat as part of the Dubrovnik Program, and the implementation of the multi-year project Electricity System Control Functions.

A three-year plan was prepared for the development and construction of the transmission network 2011-2013. A public announcement is now being prepared of the first Indicative Medium Term Plan of the development of the Croatian transmission network.

By signing (with European transmission system operators) a multi-year ITC Agreement for compensation of transit costs, based on the provisions of the Regulation EC 838/2010 HEP OPS continued to participate in the ITC mechanism. In 2011 HEP OPS remained compliant with the Regulation 714/2009/EC ("a successor" to Regulation 1228/2003/EC) and Congestion Management Guidelines (annex to Regulation) concerning the establishment of joint auctions for cross-border transmission capacity at all time levels on Croatian borders, especially those toward EU member states. In this sense, HEP OPS signed Memorandum of Understanding concerning the introduction of a coordinated centrally managed procedure for allocation of cross-border capacity with CAO GmbH which, as a company owned by eight transmission system operators, conducts centrally coordinated direct auctions for cross-border transmission capacity of the region to manage congestion in Central and Eastern Europe. Also, with HROTE and with the Slovenian ELES and BSP the company signed Letter of Intent on common approach to using indirect coordinated procedures for congestion management and signed the support to the establishment of the Croatian power exchange. In order to align with other European transmission system operators HEP OPS initiated the activities towards HERA and HROTE and toward market participants requesting change from a five-day to a seven-day work regime.

HEP OPS employees actively participated and cooperated with the relevant Ministry in the activities concerning the monitoring of the implementation of commitments taken within Croatia's EU accession negotiations and other activities concerning EU requirements and projects (e.g. for north-south interconnection in Central and Eastern Europe) and those of Energy Community.

HEP OPS continued to participate, to the extent of its possibilities, in ENTSO-E and its working bodies (committees and groups), Assembly and Board. For the first time in a wider context, HEP OPS organized and hosted ENTSO-E workshops for South Eastern Europe on the topics relating to the preparation of the second edition of ENTSO-E's Ten-year transmission network development plan and associated regional investment plans, and the first Network rules concerning requirements for connection of generating units in compliance with the requirements of the so-called Third Package of EU energy legislation. Also, HEP OPS became a full member of TSC (Transmission System Operator Security Cooperation), the initiative that gathers 11 transmission system operators of the central part of the mainland Europe. HEP OPS continued in 2011 with the activities directed towards receiving an increased electricity production from wind parks. All obligations relating to environmental and nature protection have been met fully and on time in accordance with Croatia's laws and regulations.

In conclusion, the successful business achievements of HEP-ODS in 2011, in aggravated business conditions and with reduced number of employees, are a result of the continuity of high-quality work of HEP OPS employees. To achieve the Company's business objectives in the coming period, however, it is necessary to significantly improve employees' qualification and age structure.

Dubravko Sabolić
Director

*Director in the reporting period.
Since July 1, 2012, the director is Zdeslav Čerina.

CROATIAN TRANSMISSION SYSTEM CHART

WITH ELECTRICITY EXCHANGE BY BORDER (GWh)



LEGEND

Electricity Exchange by Border (GWh)

SUBSTATIONS

- ⊙ 400 / 220 / 110 kV
- ⊙ 400 / 110 kV
- ⊙ 220 / 110 kV
- ⊙ 220 / 35 kV
- 110 / x kV
- 35 / x kV
- ▲ Railway Traction Substation

POWER PLANTS

- Thermal Power Plant (connected to the transmission network)
- ▣ Hydro Power Plant (connected to the transmission network)
- Industrial Power Plant (connected to the transmission network)
- ▣ Wind Power Plant

TRANSMISSION LINES

- 400 kV
- 220 kV
- 110 kV

TRANSMISSION NETWORK AS AT DECEMBER 31, 2011

	400 kV	220 kV	110 kV	Medium voltage	Total
Line length (km)	1,247	1,210	4,782	198	7,437
Transformer stations	5	6	118	-	129
Installed capacity (MVA)	4,100	2,120	4,900	-	11,120

ELECTRICITY BALANCE 2011 (GWh)

Total production *	9,999
Import (entering Croatia)	14,012
Total procurement	24,011
Export (exiting Croatia)	6,308
Total consumption	17,703
Direct procurement and consumption on distribution network	370
Transmission losses	514
Transmission consumption	16,820
Direct customers	751
Pumping and other auxiliary consumption	227
Delivered to distribution from transmission network	15,843

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

System peak load (January 25, 2011)	2,970 (MWh/h)
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Financial Statements

INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying financial statements of HEP Operator prijenosnog sustava d.o.o. (the "Company"), which comprise the statement of financial position as at 31 December 2011 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 2011, and their financial performance and their cash flows for the year then ended in accordance with International Financial Reporting Standards.

EMPHASIS OF MATTER

Accounting policy for leases

As described in Note 1 to the accompanying financial statements, the Company has received 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. 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.

Our opinion is not modified in respect of this matter.

Deloitte d.o.o.

Branislav Vrtačnik, Certified Auditor

Zagreb, 16 April 2012

HEP Operator prijenosnog sustava d.o.o., Income Statement

for the year ended 31 December 2011

	2011	2010
	000'HRK	000'HRK
Electricity transmission income- related parties	1,140,254	1,154,253
Income from balancing energy-related parties	75,076	61,281
Income from sale of cross-border transmission capacity-related parties	45,606	87,186
Other income - related companies	1,443	1,486
Other operating income	132,306	112,261
	1,394,685	1,416,467
Material and spare parts expenses	(23,832)	(21,823)
Service expenses	(100,817)	(86,560)
Staff expenses	(184,454)	(186,884)
Depreciation and amortisation	(236,562)	(230,465)
Support system services expenses	(234,032)	(235,726)
Transmission grid losses	(219,409)	(260,263)
Purchase of balancing energy	(89,453)	(65,348)
Administrative expenses – related companies	(51,145)	(52,065)
Other operating expenses	(72,473)	(79,549)
	(1,212,177)	(1,218,683)
Profit from operations	182,508	197,784
Financial income	729	806
Financial expenses	(47,887)	(48,795)
Net financial loss	(47,158)	(47,989)
Profit before taxation	135,350	149,795
Income tax	(27,634)	(30,205)
Net profit for the year	107,716	119,590

Signed on behalf of the Company on 16 April 2012 by:

Dubravko Sabolić

Director

HEP Operator prijenosnog sustava d.o.o., Statement of Comprehensive Income

for the year ended 31 December 2011

	2011	2010
	HRK '000	HRK '000
Profit for the year	107,716	119,590
Other comprehensive income	-	-
Total comprehensive income for the year	107,716	119,590

Signed on behalf of the Company on 16 April 2012 by:
Dubravko Sabolić
Director

HEP Operator prijenosnog sustava d.o.o., Statement of Financial Position

As at 31 December 2011

ASSETS	31 December 2011	31 December 2010
	000'HRK	000'HRK
Property, plant and equipment	3,740,068	3,807,668
Capital work in progress	526,403	438,158
Intangible assets	20,249	24,179
Investment properties	11,899	8,751
Prepayments for property, plant and equipment	119	169
Receivables from sale of flats	5,073	5,955
Deferred tax assets	11,432	11,293
Total non-current assets	4,315,243	4,296,173
Inventories	18,027	17,808
Trade receivables	15,822	46,807
Receivables from related companies	358,644	423,908
Other current assets	19,239	23,613
Current portion of long-term receivables	877	673
Cash and cash equivalents	20,196	11,570
Total current assets	432,805	524,379
TOTAL ASSETS	4,748,048	4,820,552
CAPITAL AND LIABILITIES	31 December 2011	31 December 2010
	000'HRK	000'HRK
Subscribed capital	20	20
Reserves	40	40
Retained earnings	107,716	119,590
Total equity	107,776	119,650
Long-term liabilities to related company	3,436,236	3,546,045
Provisions for retirement and jubilee bonuses, and legal actions	48,895	50,852
Other long term liabilities	114,291	94,021
Total non-current liabilities	3,599,422	3,690,918
Liabilities to related companies	584,900	559,622
Trade payables	168,204	162,249
Current portion of long-term liabilities to related company	233,528	229,919
Other current liabilities	54,218	58,194
Total current liabilities	1,040,850	1,009,984
TOTAL CAPITAL AND LIABILITIES	4,748,048	4,820,552

Signed on behalf of the Company on 16 April 2012 by:
Dubravko Sabolić
Director

HEP – Operator distribucijskog sustava d.o.o.

HEP ODS (HEP Distribution System Operator) business operations in 2011 were aimed at meeting its role in the electricity market and achieving business objectives in accordance with HEP Group business policy. In accordance with HEP d.d. Management Board decision concerning the Economic Plan and Investment Plan in 2011 and HEP ODS decision concerning the implementation of business objectives, the trend of reducing operating costs continued.

In 2011 the construction was completed of 15 capital electric power projects of the voltage level 110 kV, 35 kV and 20 kV and construction was launched of 4 transformer stations 110/x kV Ferenščica, Kneginec, Funtana and Srđ.

In addition to capital investments, in 2011 a number of investments were made in MV and LV facilities through the programs; Voltage Restoration, Newly Standardized Voltages and Metering Point Renovation Program. Through these programs, 340 transformer stations 10(20)0.4 kV were constructed as well as 975 km of cable lines 10(20) kV, 72 km of overhead lines 10(20) kV, 644 km of low voltage cable network and 1,150 km of low voltage overhead network.



Mišo Jurković
Director*

In 2011 the activities continued to install remote-communication interval meters and their incorporation into 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). In response to positive results in electricity billing, the pilot project was extended to include additional 1.000 remotely controlled and read meters. Also, as part of the program of connection and metering points, 140 metering points were reconstructed at medium voltage level which had meters with two-system measurements..

The single base of remotely read metering points of customers has been continuously expanding and now contains metering data for 17,000 metering points. Also, the research aimed at monitoring the results of use of the compensation load curves for certain customer categories continued.

During 2011 the interest in getting power plants connected to the distribution network increased significantly compared to the year before. There were 271 preliminary connection approvals issued for power plants of 56,906 kW in total. In 2011 there were 11 power plants of the combined capacity of 267 kW connected to the low voltage network and 3 power plants of 4,200 kW in total to the medium voltage network. The interest in getting small solar plants connected grew significantly.

After the end of the refurbishment cycle of major control centers, the activities continued to prepare the refurbishment of smaller centers aimed at establishing a state-of-the-art architecture of the electricity network remote control and monitoring system. Also, intensive work has been going on in order to increase the automation degree by introducing the growing number of transformer stations and switchgears into the remote control system.

In 2011, intensive activities began to introduce environmental management system under the standard ISO 14001:2004. Seven distribution areas have been prepared for system certification.

Providing quality services to the network users and impartial relationship towards all electricity market participants is the constant obligation of HEP ODS, as reported annually to HERA.

*Director in the reporting period.

Since July 1, 2012, the director is Ljiljana Čule.

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	326	4,175	20,631

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	3,319.5	1,303.6	135.3	3,262.9	3,056.7	2.6
Lines 10 kV (km)			Network 0,4 kV (km)			Household connections (km)		
OHL	Cable	Undersea	OHL-bare	OHL-insulated	Cable	OHL-bare	OHL-insulated	Cable
18,929.6	10,667.7	234.8	22,253.3	24,336.9	16,820.8	4,573.6	16,185.2	10,188.2

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

Description	Number of metering points
High voltage 110 kV	4
Total medium voltage	2,124
Low voltage – commercial (excl. public lighting)	191,182
Low voltage – commercial (public lighting)	21,351
Low voltage - residential	2,130,247
TOTAL	2,344,908

ELECTRICITY SALES BY CUSTOMER CATEGORY IN 2011 (kWh)

Description	Total -Croatia
Commercial - high voltage (HV)	99,760,043
Commercial – medium voltage (MV)	3,541,172,568
TOTAL Commercial HV and MV	3,640,932,611
Commercial – low voltage (LV)	4,236,654,246
Commercial – low voltage (LV) – public lighting	432,871,805
Residential – low voltage (LV)*	6,540,376,066
TOTAL LOW VOLTAGE	11,209,902,117
Public supply service	7,979,884,591
Eligible customers**	6,870,950,137
TOTAL SALES ON DISTRIBUTION NETWORK	14,850,834,729
Sales to customers without supplier on transmission network	70,284,456

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.

Financial Statements

INDEPENDENT AUDITOR'S REPORT

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

We have audited financial statements of HEP – Operator distribucijskog sustava d.o.o (the “Company”), which comprise the statement of financial position as at 31 December 2011 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.

OPINION

In our opinion, financial statements present fairly, in all material respects, the financial position of the Company as at 31 December 2011, the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

EMPHASIS OF MATTER

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, 16 April 2012

HEP Operator distribucijskog sustava d.o.o., Income Statement

for the year ended 31 December 2011

	2011	2010
	HRK '000	HRK '000
Electricity distribution fee income – related companies	3,278,329	3,262,219
Services rendered	300,336	180,367
Other operating income	409,574	332,889
Total operating income	3,988,239	3,775,475
Cost of externally purchased energy	(50,567)	(19,170)
Grid losses and balancing energy purchases	(621,739)	(680,651)
Service expenses	(232,985)	(243,438)
Staff expenses	(1,180,329)	(1,181,872)
Depreciation and amortisation	(780,525)	(768,409)
Administrative expenses – related companies	(185,041)	(161,233)
Other operating expenses	(555,074)	(576,696)
Total operating expenses	(3,606,260)	(3,631,469)
Profit from operations	381,979	144,006
Financial income	2,374	706
Financial expenses	(38,026)	(37,083)
Net financial loss	(35,652)	(36,377)
Profit before tax	346,327	107,629
Income tax expense	(67,824)	(22,499)
Profit for the year	278,503	85,130

Signed on behalf of the Company on 16 April 2012 by:
Mišo Jurković,
Director

HEP Operator distribucijskog sustava d.o.o., Statement of Comprehensive income

for the year ended 31 December 2011

	2011	2010
	HRK '000	HRK '000
Profit before tax	278,503	85,130
Other comprehensive income for the year	-	-
Total comprehensive income for the year	278,503	85,130

Signed on behalf of the Company on 16 April 2012 by:
Mišo Jurković,
Director

HEP Operator distribucijskog sustava d.o.o., Statement of financial position at 31 December 2011

ASSETS	31 December 2011	31 December 2010
	HRK'000	HRK'000
Property, plant and equipment	11,874,752	11,893,722
Capital work in progress	584,479	502,836
Intangible assets	16,974	16,150
Investment properties	66,168	72,143
Receivables from sale of flats	21,675	24,695
Prepayments for tangible assets	37	5
Deferred tax assets	59,908	60,612
Total non-current assets	12,623,993	12,570,163
Inventories	232,611	204,341
Trade receivables	652,581	700,054
Receivables from related companies	1,317,904	1,156,065
Current portion of long-term receivables	3,761	3,451
Other current assets	47,517	38,409
Cash and cash equivalents	53,905	31,630
Total current assets	2,308,279	2,133,950
Total assets	14,932,272	14,704,113

Signed on behalf of the Company on 16 April 2012 by:
Mišo Jurković,
Director

HEP Operator distribucijskog sustava d.o.o.,
Statement of financial position
at 31 December 2011 (continued)

EQUITY AND LIABILITIES	31 December 2011	31 December 2010
	HRK '000	HRK '000
Share capital	20	20
Retained earnings	278,503	71,053
Total equity	278,523	71,073
Long-term liabilities to related companies	7,238,155	7,491,403
Other non-current liabilities	15,430	17,031
Deferred income	4,245,599	4,389,927
Long-term provisions	290,825	279,031
Total non-current liabilities	11,790,009	12,177,392
Trade payables	480,066	351,872
Liabilities to related companies	1,419,633	1,212,123
Current portion of long-term liabilities to related company	570,742	568,842
Other current liabilities	393,299	322,811
Current liabilities	2,863,740	2,455,648
TOTAL CAPITAL AND LIABILITIES	14,932,272	14,704,113

Signed on behalf of the Company on 16 April 2012 by:
Mišo Jurković,
Director

HEP – Toplinarstvo d.o.o.

In 2011, HEP Toplinarstvo d.o.o. (HEP Heating) carried out its main task – reliable and quality supply of heat energy and process steam for 122,764 heat customers, whose satisfaction is at the center of the Company's business interest. The operations of HEP Toplinarstvo d.o.o. in 2011 were aligned with the economic plan and investment plan for 2011.

Considering the objectives set for 2011, the refurbishment of a part of the hot water network in Zagreb was successfully carried out as well as of hot water networks in Samobor, Zaprešić and Velika Gorica. The project to introduce gas in the boiler plant of Galženica III in Velika Gorica and in the boiler plant in the southern town area of Samobor was completed as well as the works to replace condensate return pipelines in the Ciprag area of Sisak, customer consumption increased due to new connections to the hot water system and the exceptionally important project to connect Zagreb's area of Dubrava to the district heating system of the city was begun. Maximum efforts were invested to improve payment collection from heat customers and to enhance communication with customers.

The issue of achieving the adequate level of heat price, which is the key factor for the financial viability of HEP Toplinarstvo and for the ability to invest into the development and expansion of the heating system, remained to be unsolved in 2011. That is, the primary reason why HEP Toplinarstvo operates at a loss is that total costs of heat production, distribution and supply are significantly higher than the



revenues achieved from heat sales. The main reason is an unrealistic ratio between fuel prices (natural gas, light and extra light fuel oil) and the price of procurement of heat energy, as the main input costs, and selling prices of heat energy.

It should be mentioned that since November 2010 there has been a fundamental change in the manner decisions are made on the amount of tariff items for heat energy. That is, in accordance with the Act Amending the Energy Act (NN 127/10), such decisions are no longer made by the Government of the Republic of Croatia but by representative bodies of self-government units which additionally aggravates the possibility of attaining an adequate level of heat prices necessary for the Company's financial viability. In 2011, HEP Toplinarstvo called upon the relevant institutions on several separate occasions pointing to the need to change legal provisions applicable to heat production, distribution and supply, and HEP Toplinarstvo specialists remain willing to actively participate in the legislative process.

In conclusion, I can assert that HEP Toplinarstvo as the largest energy business in the area of district heating in Croatia, with all of its employees working together with dedication is ready for new challenges – new investments, expansion of the heating system and connection of new customers, reduction in heat losses, additional decrease in operating costs, improvement in payment collection for heat supplied, active participation in passing and amending of legislation, continuous rise in the quality of services provided to heat customers, and improvement in public relations.

Robert Krklec
Director

HEP Toplinarstvo d.o.o. in 2011



DISTRICT HEATING SYSTEM ZAGREB

PRODUCTION:	
heat	1,520,892 MWh
steam	602,249 t
SALES:	
heat	1,335,996 MWh
steam	474,054 t
NUMBER OF CUSTOMERS:	
	89,996

LOCAL BOILER PLANTS

PRODUCTION:	
heat	204,269 MWh
PRODAJA:	
heat	189,136 MWh
NUMBER OF CUSTOMERS:	
	16,950

SISAK OPERATIVE AREA

PRODUCTION:	
heat	94,927 MWh
steam	51,629 t
PRODAJA:	
heat	60,094 MWh
steam	40,170 t
NUMBER OF CUSTOMERS:	
	4,106

OSIJEK OPERATIVE AREA

PRODUCTION:	
heat	213,941 MWh
steam	122,696 t
PRODAJA:	
heat	199,028 MWh
steam	86,655 t
NUMBER OF CUSTOMERS:	
	11,712

During 2011 the number of heat energy customers rose by 0.2 percent to a total number of 122,764, of which 116,746 households and 6,018 corporate entities. Due to new customer connection, the contracted load increased by 6.7 MW in the Zagreb area.

In heat consumption (district heat and process steam) households make 59 percent (48 % in income) and corporate entities 41 percent (52% in income). The ratio of delivered heat energy (hot water) to process steam in MWh was 78.3%:21.7%.

In consumption of district heat, the share of Zagreb (including Samobor, Velika Gorica and Zaprešić) was 85.4 percent, Osijek 11.0 percent, and Sisak 3.6 percent. Consumption of steam delivered for industrial processes was 600,879 tons (Zagreb 78.9%, Osijek 14.4%, Sisak 6.7%).

In 2011, heat energy sales decreased by 2.4 percent compared to the year before as a consequence of a somewhat warmer heating season. Taking each of the two main products separately, heat sales decreased by 3.4% whereas steam sales rose by 1.4%.

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 2011 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. 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 at 31 December 2011, 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

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. We draw attention to Note 1 to the financial statements, describing the matters regarding the ability of the Company to continue as a going concern. These conditions indicate the existence of a material uncertainty which may cast significant doubt about the Company's ability to continue as a going concern. Notwithstanding this fact, the Company has adopted the going-concern assumption considering continuous financial support by the Parent as stated in support letter from Parent, in settling the current liabilities from operations and other amounts past due. 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, Certified Auditor

Zagreb, 16 April 2012

HEP Toplinarstvo d.o.o.,

Income Statement

for the year ended 31 December 2011

	2011	2010
	HRK'000	HRK'000
Income from thermal energy sale	582,352	569,784
Income from sale of electric energy to eligible customers	9,016	8,026
Income from thermal energy and other income – related companies	3,906	3,791
Restaurant income	470	530
Other operating income	59,376	47,581
	655,120	629,712
Energy, material and spare parts expenses	(106,740)	(101,517)
Service expenses	(27,783)	(27,791)
Staff expenses	(49,404)	(47,141)
Depreciation and amortisation	(59,929)	(56,240)
Expense in respect of electricity generation and other expenses – related companies	(659,161)	(484,075)
Other operating expenses	(66,841)	(55,540)
	(969,858)	(772,304)
Loss from operations	(314,738)	(142,592)
Financial revenues	7,936	7,567
Financial expenses	(14,114)	(12,171)
Net financial loss	(6,178)	(4,604)
Loss before tax	(320,916)	(147,196)
Income tax	-	-
Loss for the year	(320,916)	(147,196)

Signed on behalf of the Company on 16 April 2012 by:
 Robert Krklec
 Director

HEP Toplinarstvo d.o.o., Statement of Comprehensive Income for the year ended 31 December 2011

	2011	2010
	HRK '000	HRK '000
Loss for the year	(320,916)	(147,196)
Other comprehensive income for the year	-	-
Total comprehensive loss for the year	(320,916)	(147,196)

Signed on behalf of the Company on 16 April 2012 by:
Robert Krklec
Director

HEP Toplinarstvo d.o.o., Statement of Financial Position at 31 December 2011

ASSETS	31 December 2011	31 December 2010
	HRK'000	HRK'000
Property, plant and equipment	839,861	864,816
Assets under construction	71,757	38,494
Intangible assets	717	953
Receivables from the sale of flats	767	705
Advances for property, plant and equipment	-	44
Investment property	824	903
Receivables from related companies	174,283	174,283
Total non-current assets	1,088,209	1,080,198
Inventories	32,285	24,225
Trade receivables	138,195	137,562
Receivables from related companies	644	15,098
Other receivables	47,206	19,934
Current portion of long-term receivables	130	294
Cash and cash equivalents	7,049	9,528
Total current assets	225,509	206,641
TOTAL ASSETS	1,313,718	1,286,839

Signed on behalf of the Company on 16 April 2012 by:
Robert Krklec
Director

HEP Toplinarstvo d.o.o.,
Statement of Financial Position
at 31 December 2011 (continued)

	31 December 2011	31 December 2010
	HRK'000	HRK'000
Share capital	20	20
Reserves	20	20
Accumulated losses	(1,146,249)	(825,333)
Total equity	(1,146,209)	(825,293)
Long-term liabilities to related companies	964,041	1,003,074
Other long-term liabilities	437	477
Long-term provisions	10,652	7,664
Deferred income	150,790	164,248
Total non-current liabilities	1,125,920	1,175,463
Trade payables	71,589	40,889
Liabilities to related companies	1,190,781	832,679
Current portion of long-term debt to related companies	59,929	56,240
Other short-term liabilities	11,708	6,861
Total current liabilities	1,334,007	936,669
TOTAL EQUITY AND LIABILITIES	1,313,718	1,286,839

Signed on behalf of the Company on 16 April 2012 by:
Robert Krklec
Director

HEP – Plin d.o.o.

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 most important fact for the company's operations and state of affairs in 2011 was the continuity of gas supply to customers thanks to our gas wholesale supplier being able to ensure sufficient quantities of gas from domestic production and imports. However, the stagnation of business activities in Croatia continued, reflected as a decrease in gas sales to commercial customers, especially to our large customers. This did not affect much consumption by residential customers since they use the most gas for heating. Nevertheless, due to milder temperatures in the heating season compared to the year before gas consumption by households decreased too.

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.



Finally, one of the most important circumstances for the business in 2011 was that the important regulations governing the gas sector in Croatia, such as the Rules on the Connection Charges and change in the Tariff System for gas distribution and gas supply, and others, which would enable the business to further align with the Gas Market Act, were not passed. The application of the General Conditions and the Rules on the organization of the natural gas market required additional activities to be carried out (entering into the contract for connection to the distribution system, new contracts for supply of end customers with gas and contracts for gas supply to tariff customers, and work relating to the nominating of transport system capacity and ensuring balancing energy for the gas system, etc.).

Current tasks arising from the objectives were successfully carried out in 2011 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.

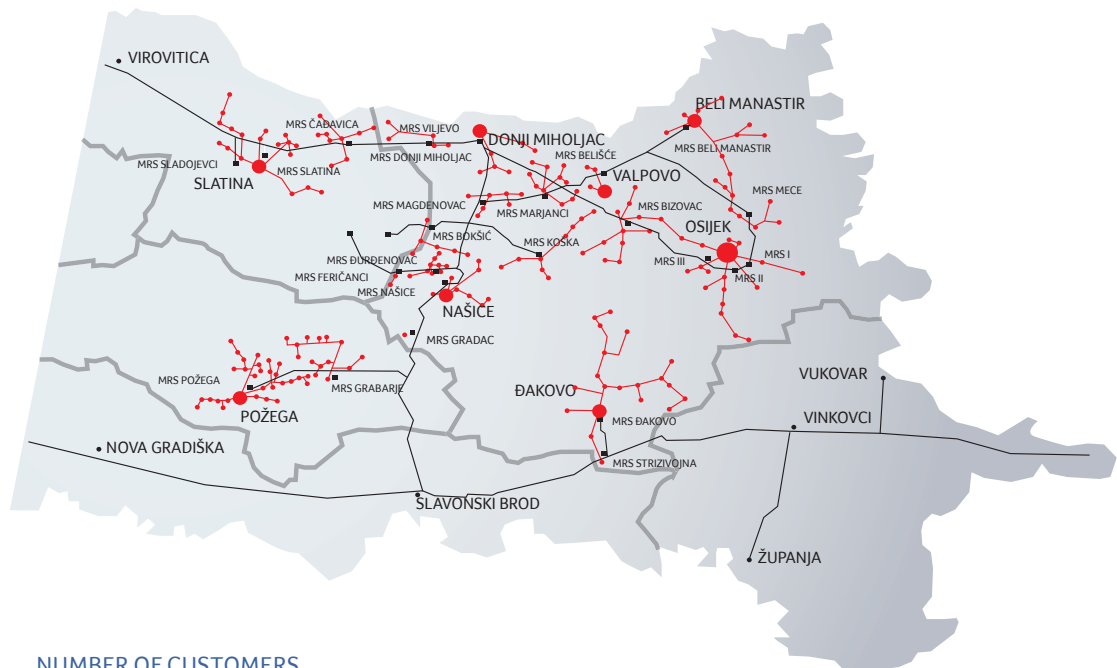
The gas delivered was meter-read and billed in a timely fashion. Because the supply to large majority of gas customers was carried out on the principles of public service, sales were calculated at regulated prices prescribed by the Government. During 2011, the selling price for households did not change, but changed several times for businesses, which aggravated billing for gas delivered.

Payment collection for gas sold, especially from customers in the commercial category, further deteriorated, so that the company's solvency became significantly worse. Despite that, thanks to, among others, the centralized financial function of HEP Group, the worse solvency did not have a more significant effect on our payments for our procured gas.

In the field of development, in 2011, the construction continued of the gas network based on the obligation taken under concession agreements (in the area of Baranja, and the municipality of Satnica Đakovačka), and a part remained to be constructed in 2012. Unfortunately, connecting new customers to the finished network, due to the economic crisis, did not progress as expected. The existing network underwent the necessary modifications and reconstruction in accordance with the reduced investment funds.

Nikola Liović
Director

HEP-Plin d.o.o. in 2011



NUMBER OF CUSTOMERS

Supply area		Customer category	
Osijek-Baranja County	60,476	TM1 - Residential	66,693
Požega-Slavonija County	7,863	TM2 - Commercial (up to 1 mn m ³)	5,349
Virovitica-Podravina County	3,721	TM3 - Commercial (above 1 mn m ³)	18
Total	72,060	Total	72,060

TM – tariff model

GAS NETWORK

	2010	2011	2011/2010 (%)
Gas lines – owned by HEP d.d. (km)	1,781	1,859	4.4
Gas lines – owned by other parties (km)	531	531	0
Gas lines – total	2,312	2,390	3.4
Reducing stations– DRS (number)	52	52	0
Odorizers (number)	27	27	0

ENERGY BALANCE (10³ m³)

	2010	2011	2011/2010 (%)
Procurement(10 ³ m ³)	170,823	157,475	-7.8
Sales (10 ³ m ³)	162,014	149,661	-7.6

GAS SALES STRUCTURE (10³ m³)

Customer category	2010	2011	2011/2010
TM1 - Residential	94,169	88,296	-6.2
TM2 - Commercial (up to 1 mn m ³)	45,229	44,416	-1.8
TM3 - Commercial (above 1 mn m ³)	22,616	16,948	-25.1
Total	162,014	149,661	-7.6

Financial Statements

INDEPENDENT AUDITOR'S REPORT

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

We have audited financial statements of HEP Plin d.o.o. (the "Company"), which comprise of the statement of financial position as at 31 December 2011 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. 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.

OPINION

In our opinion the financial statements present fairly, in all material respects, the financial position of the Company at 31 December 2011, 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, 16 April 2012

HEP Plin d.o.o.,

Income statement

for the year ended 31 December 2011

	2011	2010
	HRK'000	HRK'000
Gas sales	381,177	394,182
Service revenues	7,178	3,970
Income from related companies	3,122	2,264
Other operating income	22,821	22,422
Total operating income	414,298	422,838
Cost of gas purchase and material used	(354,313)	(358,003)
Service expenses	(3,891)	(3,757)
Staff expenses	(18,783)	(18,631)
Depreciation and amortization	(11,192)	(10,929)
Expenses with related parties	(4,550)	(4,765)
Other operating expenses	(19,600)	(29,844)
Total operating expenses	(412,329)	(425,929)
Profit / (Loss) from operations	1,969	(3,091)
Financial income	84	46
Financial expenses	(1,786)	(1,190)
Net financial loss	(1,702)	(1,144)
Profit / (loss) from operations before tax	267	(4,235)
Income tax	(716)	743
Loss for the year	(449)	(3,492)

Signed on behalf of the Company on 16 April 2012 by:
 Nikola Liović
 Director

HEP Plin d.o.o., Statement of comprehensive income for the year ended 31 December 2011

	2011	2010
	HRK'000	HRK'000
Loss for the year	(449)	(3,492)
Other comprehensive income for the year		-
Total comprehensive (loss) for the year	(449)	(3,492)

Signed on behalf of the Company on 16 April 2012 by:
Nikola Liović
Director

HEP Plin d.o.o., Statement of financial position at 31 December 2011

ASSETS	31 December 2011	31 December 2010
	HRK'000	HRK'000
Property, plant and equipment	191,630	188,104
Investment in progress and prepayments	4,200	1,570
Intangible assets	201	210
Prepayments for non-current assets	19	-
Deferred tax assets	621	869
Total non-current assets	196,671	190,753
Inventories	1,844	2,173
Trade receivables	116,534	120,584
Receivables from related companies	4,797	7,903
Other current assets	3,759	4,404
Cash and cash equivalents	3,530	1,422
Total current assets	130,464	136,486
Total assets	327,135	327,239

Signed on behalf of the Company on 16 April 2012 by:
Nikola Liović
Director

HEP Plin d.o.o.,
Statement of financial position
at 31 December 2011 (continued)

SHAREHOLDERS' EQUITY AND LIABILITIES	31 December 2011	31 December 2010
	HRK '000	HRK '000
Share capital	20	20
Accumulated losses	(8,284)	(4,792)
Loss for the year	(449)	(3,492)
Total equity	(8,713)	(8,264)
Long-term liabilities to related companies	92,233	86,236
Deferred income	96,398	100,802
Other non-current liabilities	3,104	3,030
Total non-current liabilities	191,735	190,068
Trade payables	66,640	71,512
Liabilities to related companies	66,585	62,546
Current portion of long-term liabilities to related Companies	6,465	6,376
Other current liabilities	4,423	5,001
Total current liabilities	144,114	145,435
TOTAL CAPITAL AND LIABILITIES	327,135	327,239

Signed on behalf of the Company on 16 April 2012 by:
Nikola Liović
Director

REPORTS BY OTHER
HEP GROUP COMPANIES



HEP – Opskrba d.o.o.

In its operations, HEP Opskrba d.o.o. (HEP Supply) is primarily governed by competitive market principles and seeks to adjust its business operations to customer needs and requirements, all in accordance with HEP Group policies.

Considering the increasing openness of the electricity market and active participation of other suppliers outside HEP Group, the main objectives in 2011 were to strengthen the dominant position of HEP Opskrba as a supplier in the domestic electricity market. Further, the business objectives in 2011 were to reorganize the better to provide quality electricity supply to all the customers in the commercial category, and at the same time provide other services to market-oriented HEP Group members. The new organization would also make it possible to improve business relations, especially with key customers who account for most of the sales of HEP Opskrba. In order to fulfill these tasks, one of the objectives was to further train and develop professional competencies of the employees and to maintain work efficiency and improve our services.

In 2011, HEP Opskrba met its objectives to a large extent on the market. The fact substantiating this is that we ended the year with more than 47,000 customers and more than 116,000 metering points. It should be mentioned that in total sales in 2011 HEP Opskrba realized 83 percent in the commercial category and despite the fall in economic activities in Croatia sold more than 7.8 TWh or 48 percent of the total electricity sales in the Croatian market.

Despite the competition, HEP Opskrba retained its dominant position in the market and kept all of its large and medium customers.



In 2011, more than 3.6 billion kuna was invoiced and collected. Although we ended the year successfully in the financial sphere, payment collection is still one of our important activities.

The increased selling activities and provision of additional services had to be covered by significantly lower number of employees than optimal and planned. Considering the importance and size of our large and medium customers and/or key customers, it is necessary to implement the process of organizing and systemizing and to increase the number of employees. Taking into account the high number of small customers but not neglecting their significantly smaller share in total sales, doing business with them should be further automated. It is important to stress that HEP Opskrba during 2011 responded to more than 640 invitations to tender in the capacity of a tenderer, published by customers who are obligated to conduct public tendering for electricity supply.

In the cost management, very good results were achieved, but the optimization as a day-to-day way of thinking and acting should be further developed and implemented at all levels.

In 2011, we made additional efforts to meet the needs of our customers and provide them with timely information they need to function smoothly. We sought to provide them with additional service, directing them to efficient use of electricity and thereby give our own socially responsible contribution.

Taking into consideration all the circumstances for doing business in 2011, the year which was marked by increasing activities in the electricity market in Croatia, HEP Opskrba fulfilled its main task and achieved the results that guarantee further growth and progress for both HEP Opskrba and HEP Group.

MISSION - to provide customers with a quality electricity supply service

VISION – to be the leading supplier in the region

Tina Jakaša
Director*

*Director since April 16, 2012, in the reporting period the director was Vladimir Kurečić

Number of customers

NUMBER OF METERING POINTS

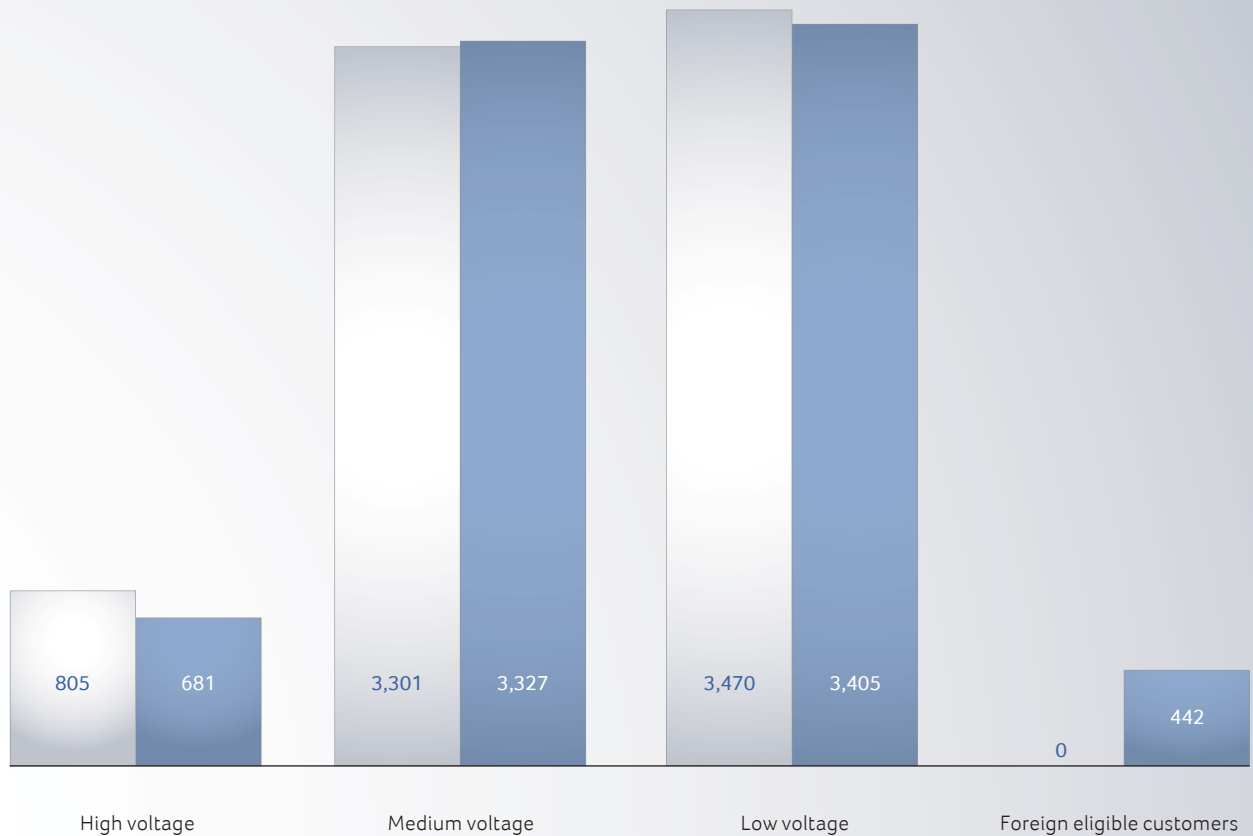
Customer category	2010	2011	11/10 (%)
High voltage	34	35	2.9%
Medium voltage	1,723	1,725	0.1%
Low voltage - commercial	107,610	102,226	-5.0%
Low voltage - public lighting	14,228	11,765	-17.3%
Low voltage - residential	370	350	-5.4%
Total low voltage	122,208	114,341	-6.4%
Total	123,965	116,101	-6.3%

Customer category	2010	2011	%11/10
Number of customers	50,304	47,652	-5.3
Number of metering points per customer	2.5	2.4	-1.1
Electricity sales per customer (MWh/customer)	15.1	16.5	9.4

ELECTRICITY SALES (GWh)

Customer category	2010	2011	%11/10
High voltage	805	681	-15.4
Medium voltage	3,301	3,327	0.8
Low voltage - commercial	3,196	3,165	-1.0
Low voltage - public lighting	270	236	-12.5
Low voltage - residential	3.8	3.7	-1.3
Total low voltage	3,470	3,405	-1.9
Total eligible customers in Croatia	7,576	7,412	-2.2
Foreign eligible customers	0	442	
Total eligible customers	7,576	7,854	

SALES PER VOLTAGE LEVEL (GWh)



■ 2010
■ 2011

HEP – Trgovina d.o.o.

During 2011, by optimizing the operation of HEP Group power plants in combination with purchase and sale of electricity in the electricity market, the company fulfilled all its business tasks, whereby it contributed to the achievement of HEP Group mission. In discharging day-to-day work, it was necessary for us to adjust to the changing conditions in the electricity market, oscillations in electricity consumption, changing hydrologic conditions and to sporadic unavailability of generating plants. The achievement of good business results despite unplanned aggravating circumstances was also due to cooperation with other companies of HEP Group.

During 2011 HEP Trgovina (HEP Trade) continued the activities relating to operations of foreign companies in neighboring countries aimed at increasing profits by achieving lower prices in buying and selling of electricity. The Slovenian company participated in auctions for cross-border transmission capacity at Slovenian/Austrian border, organized by CAO (Central Allocation Office). In this way HEP is able to buy or sell electricity in the liquid market. During 2011 the Hungarian company took an active part in the work of HUPX (Hungarian Power Exchange).

The employees in 2011 participated in national and international conferences for professional improvement and to keep up with trends in the electricity market, thus contributing to achieving HEP Group's vision. The company continued to actively participate in the work of EFET (European Federation of Energy Traders).



Total electricity consumption on the transmission network was 17,667 GWh, a decrease of 1.6 percent compared to 2010 or 2 percent compared to the consumption planned in the electricity balance. Tariff and eligible customers in the consumption structure accounted for 95.8 percent. Consumption by HEP customers was 17,528 GWh and consumption by customers outside HEP Group was 139 GWh.

Due to exceptionally unfavourable hydrological conditions, hydroelectric production was 4,577 GWh or 17 percent lower than planned, so that hydro power plants in covering total consumption contributed only 26 percent. A record low energy value of inflows was recorded, amounting to 3,548 GWh which is 35 percent lower than planned.

Production by thermal power plants was 19 percent lower than planned due to the optimization of variable production costs. The record production was registered for Plomin TPP (786 GWh) and Unit L at TE_TO Zagreb CHP (646 GWh).

Because of these hydrological circumstances, import was 36 percent higher than planned while export was a little higher than planned.

During 2011, the volume of trade was realized in the amount of 6,812 GWh which is 30 percent higher than planned, primarily due to increased import.

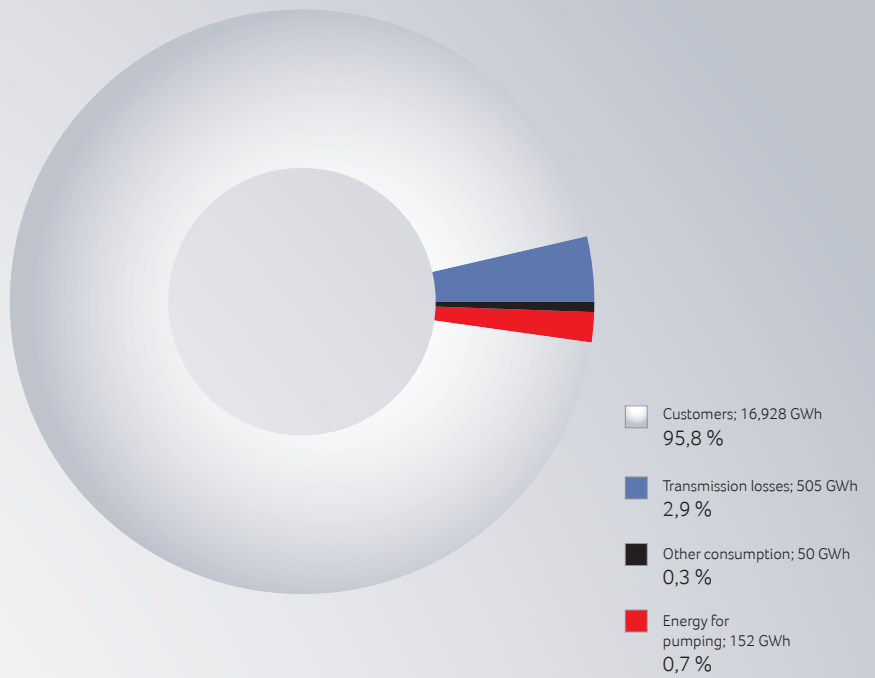
Ante Ćurić
Director

Achievements in 2011 – energy data

ELECTRICITY BALANCE (GWh)

	2010	2011	11/10	2011 (plan)	11/11 (plan)
Total consumption on transmission network	17,947	17,667	-1.6	18,030	-2.0
Production by HPPs	8,309	4,577	-44.9	5,526	-17.2
Production by TPPs	3,276	3,602	9.9	4,450	-19.1
NE Krsko d.o.o.	2,690	2,951	9.7	2,950	0.0
TE Plomin d.o.o.	1,511	1,545	2.3	1,500	3.0
Import	3,902	5,779	48.1	4,242	36.2
Export	-1,917	-1,033	-46.1	-1,007	2.6
Industrial power plants	21	11	-48.8	20	-45.0
Eligible producers	155	234	51.3	350	-33.1
Available electricity	17,947	17,667	-1.6	18,031	-2.0

STRUCTURE OF ELECTRICITY CONSUMPTION IN 2011



TRADE VOLUME



HEP-ESCO d.o.o.

HEP ESCO is the first company in Croatia established to prepare, execute and finance the energy efficiency projects according to Energy Service Company model, in which investments into the project are returned through energy savings achieved after the investment is completed. During the first eight years of our operations, until June 2010, HEP ESCO had been implementing the Energy Efficiency Program of the World Bank and HBOR, with a GEF grant. The main objectives of the Program – promotion of energy efficiency measures, participation in environmental protection, promotion of small and medium sized entrepreneur and encouraging financial institutions for the financing of energy efficiency measures – were fully met, which is reflected as an increased interest by business and public sector in Croatia in energy efficiency.

During 2011, two large energy efficiency projects were completed, the public lighting in Duga Resa worth 1.5 million kuna and in Čakovec worth 6.8 million kuna. HEP ESCO has until now completed almost 50 projects across Croatia and in that way introduced many clients to the concept of ESCO service and investment payback through savings. Because after the implementation of the World Bank projects HEP ESCO was faced with the problem of energy efficiency projects being treated as budget burden, the number of projects for the public sector and local communities has significantly decreased. HEP ESCO reoriented itself therefore to private clients in the hotel sector, food industry, etc. The problem there was inadequate financial capabilities of private clients and general recession. Thus several projects ended early after being started due to clients' financial situation.

In addition to the above, in 2011 a consultancy agreement was signed with the Slovenian company Elektro Maribor, for assistance in establishing an ESCO.



Nearing completion are two large projects which HEP ESCO has been doing for HEP Toplinarstvo. The first is technological and economic optimization of the district heating system in the city of Zagreb, worth 15.4 million kuna with a repayment period of eight years, the purpose being to optimize the operation of Zagreb's district heating system, save energy and reduce greenhouse gas emissions. The second is the project to modernize the heating system in Velika Gorica, worth 16 million kuna with the repayment period of 29 months, the purpose being to install energy efficiency measures and build a connecting gas pipeline and hot water line in the Galženica III boiler plant.

In March 2011, the first energy efficiency project was repaid. It had been implemented jointly by the City of Zagreb and HEP ESCO. It involved the application of modern light bulbs of high efficiency and efficient lighting sources which made it possible to significantly reduce the installed capacity, by more than 270 kW and/or 47 percent, and thereby electricity consumption, which was confirmed by post-installation measurements.

During 2012, due to the growing importance of the position of energy efficiency as a strategic investment field in Croatia, HEP ESCO expects to significantly broaden the scope of and expand the business. As HEP ESCO has confirmed by its activities over almost nine years of existence, energy efficiency has the potential to launch and employ some small and medium sized businesses and contribute added value which is paid back through savings.

Vlasta Zanki
Director*

* Director since May 21, 2012, in the reporting period the director was Ivana Rogulj

APO d.o.o., usluge zaštite okoliša

APO d.o.o. usluge zaštite okoliša (APO Environmental Services) is a consulting and engineering company specializing in environmental protection. The services offered by APO in the market are divided into two groups:

Services in the area of environmental protection, sustainable development, planning, research, project design and management; environmental protection (reports, studies, assessments, monitoring); nature protection (nature protection programs, management plans, action plans, reports on the state of the environment); waste management (waste inventory, disposal, collection); industrial pollution control and risk management (engineering solutions, reports, documentation for integrated environmental requirements); air quality and climate change (report verification, emission calculation) and others (project environmental due diligence, project and program management, consultancy and technical support for projects financed by EU and global funds).

Services in the area of radioactive waste and decommissioning and nuclear materials (Radioactive Waste Management – studies, reports, implementing designs; Nuclear Plant Decommissioning; Nuclear Materials; Clean-up of Nuclear Material Contaminated Locations).

The relevant ministry has issued five new professional licenses so that APO is now authorized for preparation of 22 documents, namely: strategic studies; strategic studies of the main appropriate assessment of acceptability of plans and programs for the ecological network; environmental impact study including preparation and elaboration of the documentation accompanying the request for evaluation of the need



for assessment of the project environmental impact and preparation and elaboration of the documentation accompanying the request for the issuance of instructions on the study contents; preparation of the study on the preliminary assessment of the acceptability of plans and programs for the ecological network; preparation of the study of the preliminary assessment of the acceptability of the project for the ecological network; preparation of studies on the preliminary assessment of the acceptability of the project for the ecological network; preparation and elaboration of the documentation for the procedure of determining the overriding public interest and compensations conditions under special regulations governing nature protection; study on the environmental protection for projects not subject to mandatory environmental assessment including study on environmental remediation; plants' engineering solution relating to integrated environmental permitting requirements (IEPR), including study on engineering solution for the plant as relating to IEPR and preparation and elaboration of the documentation relating to the determination of IEPR including analysis and studies preceding the request; preparation of the proposed measures for product group; preparation of studies on product conformity with measures in the process of eco-labeling; safety report including preparation of internal plans; environmental damage assessments including remediation programs and preparation of studies on environmental damage and existing hazards elimination; environmental action plans and/or action plans for environmental components and pollution protection; preparation of environmental protection programs; preparation of state of the environment reports; preparation of nature protection programs, management plans and action plans and reports on the state of nature protection; preparation of studies of risk assessment for introduction, re-introduction and farming of wild plants; brokerage in organizing the use of and/or managing all types of hazardous and non-hazardous waste; hazardous waste management; transportation and export of hazardous and non-hazardous waste, concessions for collection of waste lubricants in Croatia and collection of waste rechargeable and non-rechargeable batteries.

In 2011 a number of negative business parameters influenced APO business operations. The most important was the worsening of the economic crisis and recession, especially reflected as lack of resources for the financing of services offered by APO in the market, and as decrease in the prices of services almost to the level of non-profitability. In 2011 again there were no contracts, and thereby no revenues, from services within HEP Group. At the same time, there were a significantly fewer in contracts in the external market. During 2011, APO prepared 31 documents in the field of environmental protection and waste management. This included the preparation of strategic documents and programs, from safety reports, integrated environmental requirements, environmental impact studies, environmental protection programs to plans and rules on waste handling. Supervision was carried out of the cleanup of two sites. The amount of waste, mainly hazardous, that was disposed was 467 t.

APO responded to all new needs imposed by legislation on the companies in 2011 and got involved early in the offering and preparing of environmental impact reports for the purpose of IPARD competition. APO's expert team prepared several such studies for the measures 101 and 103 which have been prevalent at competitions for IPARD funds. For Petrokemija Kutina two reports on verification of CO₂ environmental emissions were prepared, a new service for which APO was licensed in 2011.

Mirjana-Čerškov Klika
Director

HEP – Obnovljivi izvori energije d.o.o.

The company HEP Obnovljivi izvori energije d.o.o. (HEP OIE, HEP Renewable Energy Sources) in 2011 continued to develop priority projects – on biomass cogenerating plant Velika Gorica and the solar photovoltaic power plants Concerto Hvar and Konjsko. Also, the company was very active in the development of other renewable energy projects.

At the beginning of 2009, a contract was signed with the German development bank KfW, which secured finance for HEP for the implementation of renewable energy and energy efficiency projects. KfW Bank loan proceeds amounting to 50 million euro were allocated to HEP Obnovljivi izvori energije for power plant projects using renewable energy sources and to HEP ESCO for energy efficiency projects. In addition to the loan, HEP and KfW signed a grant agreement. A smaller portion of the grant was used to purchase specialist software for the assessment of wind potential and staff training, and the greater part was used for consultancy services in the development of wind power plant projects.



Using KfW loan proceeds, three poles were installed to measure wind characteristics of 100 meters in height, and project documentation was prepared for the biomass power plant Velika Gorica. In the further development of biomass power plants, cooperation is expected with other members of HEP Group, primarily HEP Toplinarstvo, HEP Proizvodnja and HEP ESCO.

Also, wind studies were completed based on the wind characteristics measuring campaign on several sites in southern and mainland Croatia. Some sites have shown good quality potential and these are being further developed. The activities to get the sites incorporated in county physical plans continued and would continue into 2012. The company has been in continuous contact with equipment manufacturers and financial institutions which have all shown interest in HEP OIE renewable energy projects. The important contact was established with the Western Balkans Investment Framework (WBIF), for which project applications were prepared. Two project applications successfully passed all evaluation phases, so that HEP OIE was extended a grant of one million euro for the preparation of project documentation for two projects of combined wind power plants and solar power plants and one project of renewal of a small hydro power plant.

Activities relating to European FP7 project of photovoltaic power plant Concerto Hvar continued. The purpose of the Concerto Solution project is to support public and private partners in creating energy self-sufficient communities by applying energy efficiency measures and using renewable energy sources. The project involves 17 partners from Switzerland, Finland, Austria, Slovenia and Croatia, and as the demonstration zone in Croatia the island of Hvar was chosen. The responsibility of HEP OIE in the project is to develop a demonstration solar photovoltaic power plant 2x250 kW on the island of Hvar.

In the field of environmental protection, HEP OIE's plan for the implementation of renewable energy sources was incorporated in HEP Group's Plan for CO₂ emission reduction.

The work on the development of new competencies and raising of awareness of the role of renewable energy sources within and outside HEP Group continued, in professional communities and the general public. For that reason HEP OIE was frequently present in HEP Group internal publications, at professional gatherings and conferences, and on its redesigned website.

Taking the above into consideration, it can be asserted that the successful realization of the objectives have continued, in accordance with the company's mission and vision, further development of quality projects continued and the participation in EU projects has opened the possibilities for further advances and expansion and for the better positioning of HEP OIE in the domestic and foreign markets.

Hubert Bašić
Director*

*Director since May 7, 2013. In the reporting period the director was Goran Slipac.

HEP – Odmor i rekreacija d.o.o.

HEP – Odmor i rekreacija d.o.o. (HEP Leisure and Recreation) was established to provide vacation and recreation services to HEP Group employees.

In 2011, there were 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 the use of vacation houses. The contest for the use of vacation houses is for the period from June 20 to September 8 each year and the 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 2011, there were 39,772 bed nights.

In 2011, the company provided recreation services only to some HEP Group companies. 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 the 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.

The new systematization of the company in 2011 should allow for a new approach and improvement in operations, better organization and above all a more efficient fulfilment of all tasks facing the company. The Hospitality Industry Act requires a new approach in the next period to the use of facilities operated by HEP OIR, primarily commercial operation of our facilities in accordance with the Rules on the categorization of accommodation premises, and the abandonment of the “closed” type of operation.

Karolina Juzbašić
Director

*Director since May 14, 2012. In the reporting period the director was Igor Stankovski.



Ustanova HEP – Nastavno- obrazovni centar

HEP NOC (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 means that all legal preconditions for additional training and acquiring new qualifications have been met.

HEP-NOC offers 16 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 2011 HEP-NOC continued to work as a full member of the Croatian association of laboratories CROLAB, and maintained the 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.

Zdenko Miletić
Head



In 2011, 23 employees of HEP and 11 employees of other companies and 39 employees from Slovenia received live work training and informative course was given to 10 managers of HEP, 9 managers from other companies and 34 employees from Slovenia. For the first time after the transfer of live work technology and verification of new programs in HEP, eight employees were trained in dry cleaning of complete MV/LV substations without switching them off. In addition to the contracts we already have for 2012, we expect the renewal of the 2009 contract for transfer of live work technology to the Slovenian power company. Dispatcher training was given to 24 of HEP employees and to four from other companies, and for switch operator to 109 employees from HEP and to 44 from other companies. Other programs were attended by 252 of HEP employees and 191 from other companies. 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 from Elektra Požega, 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 2011, 1,200 pieces of special insulation tools and protective equipment were inspected and tested, slightly fewer than in 2010.

The most important event for HEP NOC in 2011 was the international conference on live maintenance ICOLIM, held under the auspices of the Ministry of Economy, Labor and Entrepreneurship with the message "Safety First" from May 31 to June 2 in Zagreb. There were 404 participants in the conference from 28 countries, 52 technical papers were presented by speakers from 15 countries, divided into three sections: technology and application requirements, tools and equipment for live work, and live work training. Eight demonstration live works were performed at TS 400/220/110 kV Žerjavinec. The training ground and pylon no.7 at Žerjavinec – Dubec 2 power line were assessed with the highest marks for the functionality, clarity of view and logistic support.

All exhibition spaces were exceptionally well designed and visited. Of the side-events the greatest interest was in the visit to the Technical Museum, especially Nikola Tesla's demonstration cabinet. For the purposes of the conference, the website <http://icolim2011.hep.hr> was created. The conference resonated very well in the power companies in neighboring countries, and was assessed by the users with the highest mark. HEP NOC actively participated in the conference with 6 papers and two practical live work demonstrations on the 20 kV training ground.

I emphasize that the success of HEP NOC Institution depends on a large number of factors. Unfortunately, a large part thereof cannot be influenced such as reduction in the general economic activity and financial liquidity and savings measures in all segments of operations. On the other hand, we expect that with the speedy adoption of a large number of documents, issuance of rules and harmonization of Croatian standards in the process of joining the European Union the education will gain in significance and that the expenses for education will have an appropriate share in the overall economic activities. With its unique and special programs, HEP NOC will certainly acquire the appropriate status and ensure further professional advance of HEP Group employees and the interested users in the region.

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NOTES

TIMEFRAME OF THE REPORTS

This Annual Report gives an overview of the business year 2011 – from January 1 to December 31, 2011.

The data on the events important for HEP Group occurring after December 31 are also given, but no later than June 30, 2012.

FINANCIAL REPORTS OF HEP GROUP COMPANIES

In the financial reports of the companies in the Chapter "Reports by HEP Group Companies with Financial Statements" the authorized auditor gives references to the notes which are an integral part of the financial statements. In this Annual Report, due to its scope, accompanying notes are not given. The full statements with notes are available at headquarters of the companies concerned.

PUBLISHER:

Hrvatska elektroprivreda d.d. (HEP d.d.) Zagreb
Ulica grada Vukovara 37
tel. +385 1 63 22 111
www.hep.hr

FOR THE PUBLISHER:

Zlatko Koračević

PRODUCTION:

Marketing and Corporate Communications Department

DEPARTMENT DIRECTOR:

Mirela Klanac

EDITOR:

Darko Alfirev

PHOTOGRAPHS:

iStockphoto, HEP Files

GRAPHIC DESIGN:

Bestias dizajn

PRINT:

Denona, Zagreb

ISSN 1332-4993

