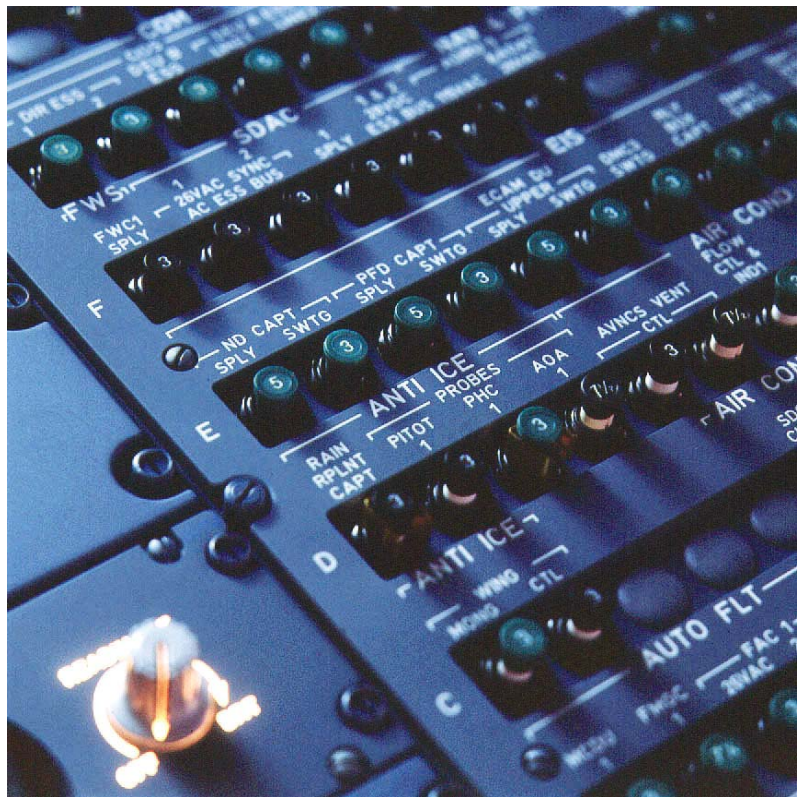


Annual Report on the State of the Company and Business Activities



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Typical Indicators

Fleet – February 2008

type of aircraft	number	seats	ownership	lease	Ø age (years)	number at the end of 2007	ownership	lease
ATR 42	3	126	1	2	14,06	3	3	-
Airbus A320	4	650	3	1	10,455	4	3	1
Airbus A319	4	528	4	-	9,06	4	4	-
total	11	1304	8	3	10,93	11	10	1

Traffic Performance Indicators

description			2007	2006	2005
flights (km)	DIST	000	15722	15396	15936
departures	FLTS		24349	23732	24364
block hours	BH		33759	32823	33523
passengers carried	RPAX	000	1715	1577	1555
freight&mail carried	CGO	T	4608	4243	4544
passenger km flown	RPKM	mln	1303	1220	1199
available seat - km	ASKM	mln	2009	1968	2030
passenger load factor	PLF	%	64,9	62	59,1
tonne km flown	TKM	mln	120	113	111
available tonne-km	ATKM	mln	220	215	222
weight load factor	WLF	%	54,6	52,2	49,9

Financial Indicators

Indicators		2007	2006	2005	2004
Operating revenues	mIn Kn	1.464	1.345	1.403	1.347
Annual change rate	%	9	-4	4	
Total revenues	mIn Kn	1.537	1.510	1.465	1.429
Annual change rate	%	2	3	3	
Operating expenses	mIn Kn	1.416	1.361	1.368	1.243
Annual change rate	%	4	-1	10	
Total expenses	mIn Kn	1.536	1.479	1.488	1.391
Annual change rate	%	4	-1	7	
Operating profit/loss	mIn Kn	48	-16	35	104
Operating profit/loss (%of operating rev.)	%	3,3	-	2,5	7,7
Operating profit/loss(% of total revenue)	%	3,1	-	2,4	7,3
Net profit/loss	mIn Kn	1	31	-23	38
Net profit/loss (% of operating revenue)	%	0,1	2,3	-	2,8
Net profit/loss (% of total revenue)	%	0,1	2,1	-	2,7
EBIT	mIn Kn	57	103	58	121
EBITDA	mIn Kn	237	268	220	275
EBIT margin	%	3,9	7,7	4,1	9,0
EBITDA margin	%	16,2	19,9	15,7	20,4
Unit operating cost	Kn/ASKM	0,70	0,69	0,67	0,67
Unit operating revenue	Kn/RPKM	1,12	1,10	1,17	1,16
Passenger yield (total pass.rev.in EUR/RPKM)	€cent/RPKM	12,66	12,19	12,81	13,20
Average number of employees		1.062	1.049	1.099	1.094
Annual change rate		1	-5	0	
Return on total assets	%	2,9	4,8	2,7	5,2
ROE (return on equity)	%	0,2	4,4	-3,0	4,3
ROCE (return on capital employed)	%	3,5	5,6	3,3	6,0
Total asset turnover		0,77	0,71	0,68	0,62
Total asset operating turnover		0,73	0,63	0,65	0,58
Current asset turnover		6,53	9,03	6,59	5,75
Cash ratio		0,22	0,25	0,19	0,22
Quick ratio		0,57	0,50	0,47	0,57
Current ratio		0,67	0,62	0,54	0,86
Financial stability		1,06	1,07	1,13	1,05
Solvency ratio		0,34	0,33	0,35	0,38
Financing ratio (total liabilities/equity)		1,92	2,00	1,84	1,63
Interest cover ratio		0,85	-0,22	0,43	1,24
Cover ratio I (equity/non-current assets)		0,40	0,37	0,39	0,43
Cover ratio II		0,94	0,94	0,89	0,95
Investment ratio		0,11	0,06	0,04	0,05

Croatia Airlines in 2007 – Introduction

As a national flag carrier, Croatia Airlines has through its operations been realizing a mission of connecting the homeland with the world, and performing a special task of contributing to the Republic of Croatia's tourism development. In over fifteen years of its existence and provision of transport services, it has connected Croatian cities with major European metropolises and thus with the entire world.

Croatia Airlines has entered the new millennium with a completely renewed medium-haul fleet, one of the youngest and most modern in Europe, and it today takes up the position of a medium-size European airline company. With the business year of 2007, Croatia Airlines is at the threshold of a new investment medium-term sweep that will start by dismissing short-haul ATR aircraft and by the parallel introduction of the first Q-400 aircraft during 2008.

Ownership Structure

Croatia Airlines (the Company) is a joint-stock company. It disposes of stock capital in the amount of 989,975.500 Kn, which is divided into 4,975.476 shares. Of the total number of shares, 51,197 refer to preference shares (CRAL-P-A, CRAL-P-A1, CRAL-P-A2, CRAL-P-A3, and CRAL-P-A4) with the nominal value of 100 Kn, and 4,924.279 refer to regular shares (CRAL-R-A) with the nominal value of 200 Kn.

Review of shareholders and their share in stock capital	Capital (kn)	%
REPUBLIC OF CROATIA	938.100.784	94,76
CROATIAN PRIVATISATION FUND	21.383.471	2,16
HPB D.D./CAPITAL FOND D.D.	14.453.642	1,46
CROATIAN LOTTERY	395.990	0,04
JADRANSKI NAFTAOVOD DD	2.177.946	0,22
AIRPORT ZAGREB	1.286.968	0,13
ENIKON D.D.	791.980	0,08
RATKO ŽURIĆ	692.983	0,07
CONING ENGINEERING	494.988	0,05
CROATIA LLOYD	989.976	0,10
OTHERS	9.206.772	0,93
total	989.975.500	100,00

During 2007, minor quantities of the Company's ordinary shares traded on the Zagreb Stock Exchange. The trade reached its peak in October, when the price of the CRAL-R-A share abruptly and unexpectedly hiked after not being traded for five months. On 17 October 2007, there was a daily price fluctuation in the case of 134 transactions of the Company's shares within the range of between 1,100 Kn and 5,000 Kn without a market justification or without the Company announcing any special business decisions that might have affected the change in the stock prices, so the Croatian Agency for Supervision of Financial Services, HANFA, nullified the respective transactions. The highest price that the CRAL-R-A stock reached during 2007 amounted to 1,700 Kn, whereas the lowest one was 360 Kn.

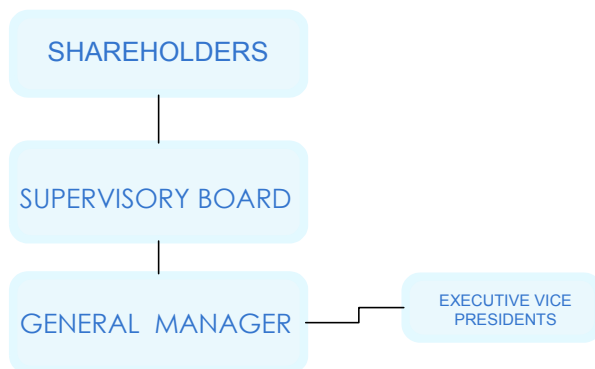
Associated companies owned by Croatia Airlines d.d. are as follows: Amadeus d.d., Pleso prijevoz d.o.o., and Obzor putovanja d.o.o., all of which are independent business entities.

Pleso prijevoz d.o.o. is 50% owned by Croatia Airlines, whereas its other half is owned by Zagreb Airport. Its activity is to transport personnel working at airports in Zagreb and Split, passengers travelling on the route Airports – City, and lost luggage.

Amadeus Croatia d.d. was founded by Croatia Airlines (95% ownership) and Amadeus GDS, a global distribution system with the seat in Madrid. It enables the connecting of travel agencies on the territory of the Republic of Croatia to Amadeus' database located in Erding near Munich, for the needs of booking and issuing passenger tickets in air traffic, maritime and railway transport, and providing hotel accommodation booking services and car rental services.

Obzor putovanja d.o.o. is 100% owned by Croatia Airlines, and its activities include organizing official and tourist travels, counselling, conferences, congresses or incentive trips.

Company's Management Structure and Organization



The Company's work organization was throughout the year set up through business functions grouped into six business unities having the Executive Vice Presidents and through pivot functions of the Company organized within the President's Office: Management, Security/Safety, Facilitation and Fraud Prevention, State and Inter-Company Relations, Internal Audit, Public Relations, Quality, Travel

Organization and Project Management.

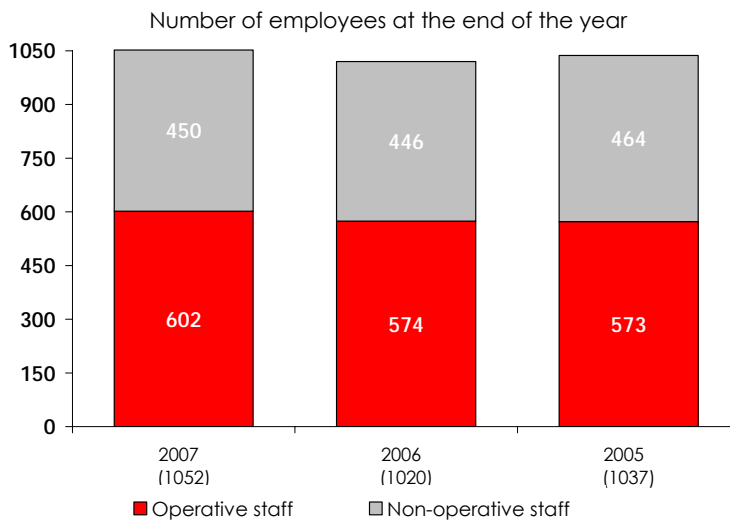
The business sphere of traffic comprised flight, cabin and ground operations, and training and traffic quality. The business sphere of technical works unifies aircraft maintenance, engineering works, technical support activities and technical training, and the quality of technical works. The business sphere of finances comprises finances, accounting, controlling, income calculation and investments. Human resources management, legal affairs management, information technologies management and care for assets and infrastructure are a part of a single business unity. Network and income management and marketing were a part of the business sphere of marketing, while the business sphere of sales unified the sales sector with sales markets.

During 2007 the Company was engaged in the preparation of its reorganization, which came into force at the start of 2008.

The key goals of the reorganization process are a more flexible organizational structure, transparency and simplicity of the structure of evaluating work posts and the coordination of price movements on the labour market and the Company's financial capacities in a high-quality manner.

The reorganization is expected to result in more efficient staff management and increased labour efficiency by reducing the number of jobs and organizational units. A different elaboration of payment ranks has been set up for the purpose of increasing internal mobility of labour force and for the possibility of promoting quality staff, recognizing the market value and the value of certain professions for the Company, as well as for preventing the best quality staff drain.

Human Resources

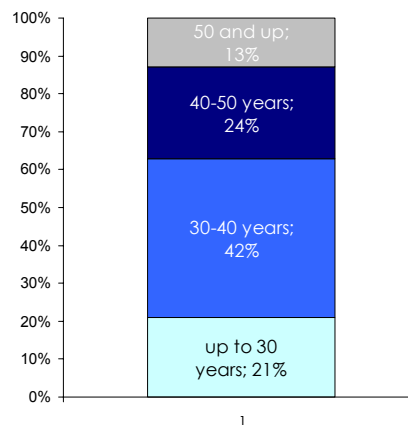


At the end of 2007, the Company had 1,052 employees, including 57 employees at foreign branch offices. The number of operative staff grew by 5pp during the year, as a result of an increase in the number of operations and the need to employ new pilots and technical staff. The number of non-operative staff did not change during the year, by which the trend of reducing the share of

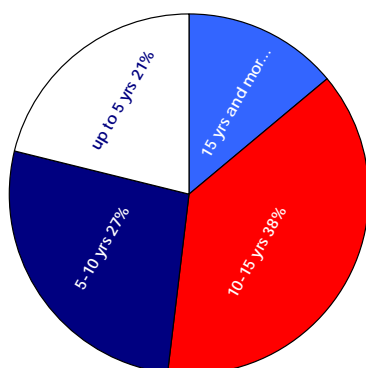
non-operative staff in the total number of employees continued. A part of the new pilots was employed in late 2007, and the other part will be hired during the spring of 2008 through a process of preparation for the introduction of new Q-400 aircraft into the fleet. Due to the needs of covering the summer flight schedule, the Company seasonally hired some fifty members of the assistant cabin staff.

The planned opening of a new hangar capacity at the start of 2008 and an increase in the scope of commercial-technical maintenance activities created a need for hiring and training a larger number of new employees for aircraft maintenance. The qualifications structure and the average age of employees (38 years) are exceptionally favourable, and in terms of gender structure, women are somewhat more represented (51pp). Of the total number of employees, 92% are employed for an indefinite period.

Structure by age 2007



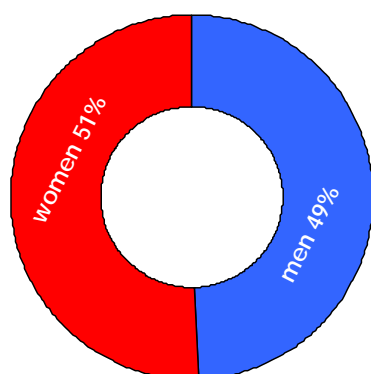
Structure by employment record



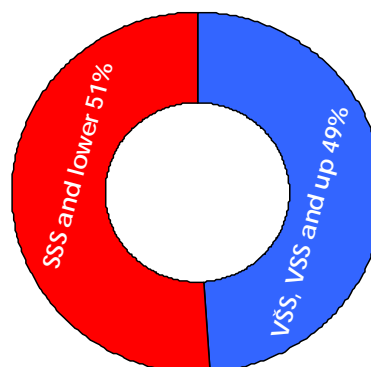
The average employment record of the operative staff was 8 years of service, and of non-operative staff was 10 years, while the average employment record on the level of the entire Company was 9 years.

These positive indicators show a low fluctuation in the Company, considering the facts that the Company has existed for 17 years and that it employed some 200 persons in the first years of its existence. During its later development, the employment rate progressively grew until 1998.

Structure by gender



Structure by education



The share of women in the structure of senior and medium management totalled 14pp, whereas this share rose to 48pp in the total management structure.

Considering that the growth rates of passenger transport, as well as of the transported tonnes of goods, have been significantly higher in the past few years than the growth rates of the number of employees, labour productivity, measured in productivity indicators specific for aviation, has been continuously growing.

Labour Productivity

DESCRIPTION		2007	2006	2005
tonne km by employee	000	114,3	110,3	107,0
Annual change rate	%	4	3	
passengers carried by employee		1630	1546	1500
Annual change rate	%	5	3	

Investments into Education

In line with its fast development, in the conditions lacking qualified human resources in the sphere of aviation activity, the Company kept developing and strengthening human resources parallel with the development of its technological base, having recognized its activity from day one as an intensive one in terms of both capital and work.

Significant financial means are each year invested into employee training, particularly into specialist training and maintaining the readiness of the flight and cabin personnel.

Investment into education	2007	2006	2005
Operative staff	11.037.487	7.322.515	7.656.104
Annual change rate	51%	-4%	N/A
Non-operative staff	974.064	1.139.128	891.635
Annual change rate	-14%	28%	N/A
Total	12.011.551	8.461.643	8.547.739
Annual change rate	42%	-1%	N/A

Exceptionally high investments are made into operative training during certain years when they are required for the purpose of preparation for the introduction of new aircraft or for the planned capacity increase. So was the case in 2007, in which, as a

preparation for 2008 which will bring a change of the fleet structure and capacity growth, investments into operative training rose, which led to reduced investments into non-operative training, with a minor fall compared to the previous year.

Training Policy and Programmes

Operative staff is trained in accordance with the highest global standards at Lufthansa's training centres, and so are engineers and aeromechanics, who regularly undergo specialization at Lufthansa Technik.

The training of the Company employees is performed in various ways. Diverse specialist aviation knowledge is acquired at the training centres of the International Air Transport Association (IATA), but most of the training sessions for which there is a constant need take place at the Croatia Airlines Training Centre, and are carried out by the use of its own internal resources, thus significantly reducing the costs. The purpose of this way of training, in addition to financial benefits and nourishing one's own *know-how* is to eliminate dependence on external sources. Internal training facilitates the implementation of the Company's policy, and helps promoting the Company's culture and business strategy. The Company organized about 100 different kinds of internal training courses in 2007, conducted by its employees qualified for individual spheres.

The services of external experts are used for the needed one-time training courses. They conduct *in-house* seminars for certain target groups, in which a larger number of employees may participate. In 2007, several IATA experts in the sphere of marketing and security trained a rather large number of the Company's employees.

All familiar educational models are used for the training purposes. Due to various benefits, *e-learning* has been practised for several years by participation in various *on-line* seminars, which proved to be practical in business environment. There are also traditional educational models, so the Company financed in 2007 a number of graduate and post-graduate studies, in accordance with its current business needs and strategic projections of its business development.

Knowledge of the current changes in the industry is ensured by the Company employees' participation in various conferences, symposia and work groups organized by the industrially significant institutions, particularly IATA, i.e. by aircraft producers whose technological development the Company must always keep pace with.

Based on IATA authorization, Croatia Airlines traditionally organizes training courses and issuances of authorizations for the sale of airline tickets and goods transport, for the safety aspects of airline operations and the protection of transport documents, and for entities outside the Company (individuals, travel agencies, goods transporters, shipping organizations, airports) on the entire territory of Croatia, Bosnia and Herzegovina, and Macedonia.

Responsibility to Employees

The Company's employees are in principle hired for an indefinite period (on a permanent basis), while a part of the cabin crew is usually employed for a definite period, due to increased needs in the summer season. Only temporary substitutes or vacancies in the periods of peak workload in certain work spheres and processes are settled through employment for a definite period.

Benefits and Supports

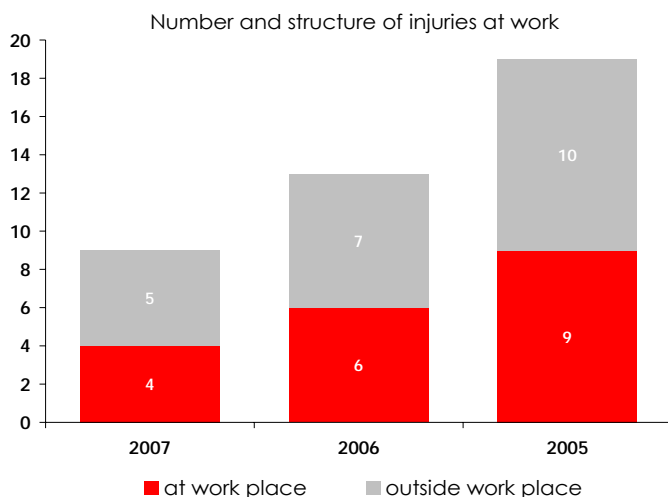
In addition to regular income, the Company offers its employees various benefits. They manifest through the provision of occupational accidents insurance, meal vouchers, jubilee rewards for loyalty to the Company, Christmas

bonuses, Christmas presents for each employee's child up to 15 years of age, local public transportation bonus, severance pay on the occasion of retirement, support in the event of a close family member's death, and support for a continual sick leave longer than 90 days.

In the cases of longer sick leaves, severe illnesses and difficult financial situation, the Company makes efforts to help its employees and their families by providing a support for the purchase of medicines and for the medical treatment costs. It also regularly helps children of the deceased employees through monthly supports during their regular schooling.

Occupational Safety

Organization of occupational safety and fire protection is prescribed by the Company's internal rules. Based on the hazard assessment, which is revised every two years, work places with special working conditions are identified, and employees working at them are referred to a regular initial or periodical medical examination. The employees trained for working with special machines and devices are referred to a regular medical examination, too. Employee training related to



working in a safe manner and legally prescribed basic training in fire protection is regularly organized and implemented for all new employees. For those working in places with special conditions, the Company provides each two years practical training and sessions aimed at the renewal of their fire protection knowledge.

No cases of professional illnesses have been recorded so far, and the data on the number of injuries at work show altogether nine such injuries in 2007, of which four were injuries at work, three while arriving/leaving the work place and two on an official trip. The past three years witnessed a declining trend of injuries at work, and the number of injuries at work reduced as much as 31pp in 2007 compared to the previous year.

Protection of Employees' Dignity

For the purpose of protecting its employees' dignity, the Company appointed a person, immediately after the legal prerequisites were created, for receiving and settling complaints related to the protection of the employees' dignity. In order to provide a work environment free of any behaviour that might jeopardize the employees' dignity, procedural rules were set for the case any kind of harassment or improper behaviour. The very procedures and the procedural data are inviolable and confidential, and the initiation of procedures is easy and fast accessible to all employees via the Company's Intranet sites.

Employee and Management Relations

There are five labour unions within the Company, operating through exceptionally intensive union activity – Croatian Union of Air Traffic Pilots, Union of Engineers and Technicians in Aviation, Independent Professional Union of Croatian Aeromechanics and the Air Cabin Staff Union, with which collective agreements have been concluded,

and the Independent Croatian Union of Airline Employees which is currently negotiating its first collective agreement. Considering the number of unions, the negotiating procedure is exceptionally challenging, long-lasting and burdening, which required a long-term engagement of the Company's management staff in 2007, the year of collective agreements renewal.

Three collective agreements were renewed during the year – with the Independent Professional Union of Croatian Air-Mechanics in May, with the Croatian Union of Air Traffic Pilots in August and with the Air Cabin Staff Union in September, whereas the negotiations with the Independent Croatian Union of Airline Employees, which organizes other Company's employees, lasted throughout the entire 2007 and have continued in 2008. All the renewed collective agreements are valid until the end of 2009, except for the aeromechanics' one, which is valid by the end of 2008.

The renewed collective agreements brought an average increase of income for the pilots of AIRBUS aircraft by 10pp, for the pilots of ATR aircraft by 14pp, for the cabin staff by 10pp, and for the aeromechanics by 9pp.

There is also a Works Council within the Company, founded in 2006, which is composed of 9 members. Through the Works Council, and in a way and under the conditions prescribed by the Labour Act, the Company's employees participate in making decisions related to their economic and social rights and interests. The Company also made investments on two occasions in 2007 into the training of the Works Council members.

Social Responsibility

Transport and Tourism

As a national flag carrier, Croatia Airlines recognizes its social responsibility in connecting the country via air, in international and domestic traffic, but also its great role in contributing to the development of Croatia's tourism. It has been continuously adjusting to the needs of tourism and tourist development by its network of direct flights to the capital Zagreb and to the Adriatic destinations, in cooperation with its airline partners and through coordination with other forms of transport whenever possible.

The Company's significant role in connecting domestic airline destinations and in maintaining traffic within Croatia has also been recognized by the Republic of Croatia, and the Government of the Republic of Croatia reached a decision in late 2006 on the obligation of carrying out domestic airline traffic operations by Croatia Airlines until 2011.

Pursuant to this decision, the Company will be compensated the difference between the unrealized income compared to the costs of domestic airline traffic operations from the state budget for an individual calendar year, in the form of a subsidy for preserving the traffic connectivity between the regions – domestic air traffic. Such a subsidy for the regional traffic maintenance is coordinated with the valid provisions and rules of the European Union.

Croatian Brand

Croatia Airlines has been aware during its entire development process of a very strong national identification with the passengers. Croatian food and wines are served and promoted in aircraft cabins, and the passengers are familiarized during the flight with Croatia's natural beauties, historical values and cultural events via the Inflight magazine and the video system.

The Company's films on the beauties of ecologically clean and preserved islands, the sea bed, coast, national parks and other Croatian regions are each day played within the network of the Company's Airbus flights. Films aimed at raising awareness on the need to protect rare and threatened species by promoting the project of bottlenose dolphins in the local waters of Cres and Lošinj, and a film story on Đakovo Lipizzaner horses, are played, too.

There are also regular promotions and sponsorships of many cultural events contributing to the advancement of Croatia's tourism – Julian Rachlin Concert in Dubrovnik, opera Yevgeny Onegin in Split... – many of which are a part of Croatia's authentic cultural heritage – Dubrovnik Summer Festival, Omiš Festival of Dalmatian Vocal Ensembles ('Klapa'), knights game 'Sinjska alka', as well as cultural and scientific institutions of high importance. The Company also sponsors various sports, and it has been continuously and successfully cooperating with the Croatian Olympic Committee.

Support for the Community

Since the beginning of its business activity, Croatia Airlines has supported institutions that are in need of humanitarian aid or that organize humanitarian projects, and it has been providing direct humanitarian aid by providing cost-free transport for severely ill patients, children or people in need, and has been participating in charity actions by providing free transport and the use of the video system and Inflight magazine services. Rather than organizing big Christmas banquets, the Company has for several years been making donations for charity and humanitarian purposes. In 2007, it made a donation to the Croatian Mountain Rescue Service, for the purpose of purchasing up-to-date equipment.

Humanitarian and donation activities of the business year included, among the rest, donations for the development of the Mediterranean Institute for Life Sciences, training of the personnel of the Umbilical Cord Blood Bank 'Ana Rukavina', supply of medical instruments for the Association of the Blind in Dubrovnik-Neretva County, purchase of the Croatian House in Padova, organization of a scientific gathering under the topic of traffic safety for the Scientific Council for Traffic, as well as many other incentives for the sports events and cultural projects, and supports for the provision of medical aid to severely ill children and disabled persons.

Business Ethics

The Committee for Monitoring the Ethics Code Implementation has been active since 2002. Its purpose is to monitor the enforcement of the provisions of the Code of Ethics in the Company's work, proposing the way of settling problems related to any reported failure to follow the adopted ethical principles or their violation. The Committee's duty is also to improve ethical conduct and behaviour within the Company and to encourage changes and improvements by promoting ethical values in business operations, daily work and human relations. Members of the ethics committee are elected among the employees.

Internal Company Activities

A number of various sports associations practising football, skiing, mountaineering, sailing, basketball and tennis are active within the Company. The Company provides financial support to these associations and their activities, and invests into their further development. Some of them have achieved significant results in international airline competitions and have contributed to the quality of employees' free time.

Development Position

Having transported a record 1.7 mln passengers in 2007, Croatia Airlines reached the total of nearly 17 mln transported passengers in its entire development period since 1993. These traffic development figures show the Company's average annual growth rate of some 10% in this period.

The existing **destinations network** in domestic, European and Euro-Mediterranean traffic that comprised some 20 direct scheduled destinations in 2007 has been developed and maintained for many years. The Company plans to expand it in the next several years, in line with the planned fleet growth, primarily with destinations in the narrower region, but also with more distant European destinations, expanding its network and creating a broader market base and new service products parallel with the restructuring of the fleet capacities.

The Company's development horizons do not stop at European destinations; it has been considering and discussing with numerous partners the issue of making better connections with to the local market particularly interesting destinations in the U.S.A. and Canada. Following the set up of commercial ties with the UA (United Airlines), the establishment of lines between the Airports of Zagreb, Split and Dubrovnik and those of Washington, Chicago, San Francisco and Los Angeles is expected via seven European cities. The Company will in this way enable its passengers direct flights from Croatia to the U.S.A. with one stopover only, on joint flights under the logos of both partners.

Having achieved the significance of the largest airline in the region in terms of traffic scope, Croatia Airlines has set its **strategic focus** on the position of a regional leader, planning to expand to South-East Europe through its middle-term and long-term visions, thus strengthening and expanding its position of the leading regional airline, while at the same time keeping its focus on Zagreb Airport as the hub. The Company sees its membership in the global airline association Star Alliance, which transports a quarter of the world's passengers, as a big comparative advantage.

Croatia Airlines forms its **business model** towards a strong network scheduled operator focused on a single powerful, and in terms of traffic well-connected, 'hub' at Zagreb Airport. Through gradual reduction of the scope and significance of charter traffic for the entire business operations, the Company deals with the issues of the economic policy of tourism development that still does not support whole-year tourism in the scope that corresponds to the national Company's development plans. By such traffic profiling, the Company protects itself from seasonal oscillations that are exceptionally strong in the sphere of charter traffic, and is increasingly focusing on the traffic that keeps the Company's business operations stable during the year.

During 2007, key decisions were made on the **fleet structure and development** and the market positioning. The Company made a decision in early April on the fleet renewal with new aircraft of the Canadian manufacturer Bombardier, Dash-Q400 with 76 seats, belonging to the most modern in their class. This aircraft will bring an additional quality with increased haul and a larger passenger cabin with more seats, and it will provide better effects of income management by covering the current seat capacity gap of 50-130.

Four aircraft (plus two optional) are to be financed via a 10-year operative lease. Parallel with the introduction of new aircraft (two in the spring of 2008, and two a

year later), the current short-haul aircraft ATR42 will be gradually dismissed from the Croatia Airlines' fleet during 2008.

The Company has at the same time been considering a longer middle-term development period, and it has for a rather long period been carrying out analyses and projections of the necessary capacities and market potentials by 2012, on the basis of which decisions will be made during 2008 on the dynamics of the medium-haul fleet expansion and purchase models, and the financing of its future development.

A gradual fleet replacement during 2008 will in the summer season bring one capacity unit more than in the last year's season, which, in addition to the advantage of new and faster aircraft, enables the establishment of new lines and the planning of a significant scheduled traffic rise despite the expected continuation of the rise of the competition from the outside and the increase of the number of foreign carriers. This represents another step towards the strengthening of the Company's business orientation during 2008 towards the model of a network carrier in scheduled traffic, by gradual elimination of the significance of charter transport in total revenues.

The planned opening of a new hangar capacity at Zagreb Airport at the start of the year is one of the key development steps during 2008, which will create conditions for the performance of a wider scope of works on foreign companies' aircraft, but will at the same time provide more flexibility in maintaining the Croatia Airlines' fleet, and increase its availability.

**Advancement
and Expansion
of Operations**

The **construction of a new hangar capacity** at Zagreb Airport started during 2007, in the immediate vicinity of the existing Croatia Airlines' hangar. Its putting into operation is expected at the start of 2008 and will represent a significant development step for one of the most important additional activities of the Company. The new hangar capacity will enable performance of maintenance works on the Airbus A321 family, thus opening new possibilities for an increase in the scope of commercial maintenance. Altogether 10 check-ups were carried out on Lufthansa Airbus aircraft within the commercial maintenance works in 2007, and the agreed scope of works for 2008 shows more than a double increase in maintenance works and check-ups of Airbus aircraft for this renowned European airline company.

Croatia Airlines signed in late 2006 an agreement with Amadeus, Madrid, by which it substituted the sales-distributional information system by the **information platform of Star Alliance – „Common IT Platform“**. After the implementation, which started in 2007, completes, Croatia Airlines will switch to this platform by 2009. This will provide passengers an even more efficient access to a whole range of products, better services, and reduction of distribution costs, and faster introduction of new products onto the market.

Within its distribution channels, Croatia Airlines introduced as of 1 April 2007 a **possibility of paying airline tickets in instalments** via American Express and Maestro cards, by which passengers are given another service benefit.

The introduction and use of **electronic tickets** is extended to almost all of our domestic destinations, as well as to many partner companies' destinations, and the first electronic ticket via the Internet service FlyOnLine was issued in October. **Internet sale** is becoming an increasingly important segment of the Company's operations.

In addition to the existing business cooperations, Croatia Airlines concluded on 17 April 2007 a **commercial cooperation with the Scandinavian air carrier SAS**.

New sales BSP markets were opened (Australia, New Zealand, Ireland, Portugal, Greece and Israel).

Croatia Airlines signed on 29 June 2007 a code share agreement with the United Airlines on the transport of passengers between Croatia and the U.S.A., which represents **the first intercontinental code share agreement in the Company's history**.

An agreement on the expansion of business cooperation with one of the world's leading on-line tour operators Expedia was signed in November 2007, by which Croatia Airlines provided its service users even better access, since information on the services will be available worldwide via Internet site Expedia.com.

In the second half of 2007, the Company began the **selection of suppliers for the future ERP umbrella information system** by inviting to the bid two key suppliers of such systems, both in the world and in the Croatian economy – Oracle and SAP. The procedure of comparative analyses and negotiations with the bidders as regards initial bids was still under way at the end of the year, and a decision was made in early 2008 on the Company's selection of the SAP information system as a better option for its future development.

The project is expected to start in the first half of 2008, and its implementation should finish in about a year and a half. The S&T consultancy firm, which has a licence agreement with SAP, will be the contractor.

The selected ERP solution will replace the existing domestic transaction system Laus in the sphere of finance, accountancy, supply and sales operations, and the sphere of planning and controlling will be improved by the introduction of this integral umbrella information solution whose functionalities will replace the current systems in these spheres, developed in excel, a tool that has certain limitations which have been felt lately as a bottleneck for the Company's further development.

Anniversaries and Awards

Croatia Airlines marked in May 2007 in Frankfurt the **15th anniversary of its first international flight**. The first commercial flight in scheduled international traffic was flown by Aircraft Boeing 737 on the route Zagreb – Frankfurt on 5 April 1992. The anniversary was marked in Zagreb, too, in October 2007.

The abovementioned anniversary was celebrated together with the 10th anniversary of the establishment of the world's leading airline association Star Alliance¹, of which Croatia Airlines is a regional member. Over 30pp of the global traffic is flown on aircraft within the Star Alliance network, connecting people in 962 destinations in 162 countries worldwide.

In May 2007, Croatia Airlines was awarded a prestigious **„superbrand“** award, given to Croatia's best trademarks, i.e. companies representing better quality compared to the competition and offering distinctiveness of their products, thus affecting the consumers' decision.

¹ The Star Alliance Association currently has altogether 20 members (Lufthansa, Air New Zealand, Air Canada, United, Air China, All Nippon Airways, Asiana Airlines, Austrian, BMI, LOT Polish Airlines, SAS, Shanghai Airlines, Singapore Airlines, South African Airlines, Spanair, Swiss, TAP Portugal, Thai Airways, US Airways, Turkish Airlines), 3 associate members (Croatia Airlines, Adria Airways, Blue1) and 2 new entrants (Air India and Egypt Air).

The system of payment via the Internet used by Croatia Airlines was awarded at the international annual e-Commerce conference of airline companies in June in Nice, in the category of the most innovative use of Internet payment.

Environmental Protection

As a significant factor of the entire global economy development, air traffic also contributes to global climatic changes by emitting greenhouse gasses and generating noise, and by using non-renewable sources of energy. A further increase of its effect on global warming is expected amidst higher projected growth rates. During 2007, environmental protection factors significantly moved up on the political scales in terms of significance. Many renowned world politicians support the European Union Emission Trading Scheme (EU ETS) or increasingly promote the significance of climatic changes in certain global institutions.

The Association of European Airlines, AEA, developed a programme setting forth the recommended measures for the reduction of emissions of harmful gases by the aviation industry², based on four key pillars – further technological advancement through scientific-research work, advancement of infrastructure and operating measures (better regulation of air traffic, optimal selection of routes, reduction in circulating above airports, single European sky) and economic instruments of ETS. ETS is envisaged as an efficient and stimulating economic instrument of reducing emissions and as a market mechanism that will not jeopardize the competitiveness and sustainability of airline companies. This mechanism will on the basis of offer and demand serve for acquiring the lack or selling the surplus of rights to emission compared to the Company's needs and defined rights.

As a member of the expert groups of AEA, Croatia Airlines has been active in the process of designing the ETS elements specific for airline companies, and it has been actively preparing for the inclusion into the very ETS. It has at the same time been continuously working on the advancement of technology and of the procedures and processes reducing negative effects on the environment.

Most of the activities within the environmental protection are focused on the sphere of reducing the fuel consumption, reducing the emissions of harmful gasses, particularly of carbon dioxide (CO₂), and reducing the noise level when landing and taking off. Operating procedures for the reduction of noise when taking off, prescribed at airports, are applied in nearly half of the flights network. Those are mostly foreign airports and Dubrovnik Airport, which prescribed them for the purpose of protecting the tourist environment from noise. As regards landing, the procedures are applied at most domestic and foreign airports, whenever possible. Flight operating procedures when landing and taking off that reduce the noise and the fuel consumption, thereby reducing the emission of CO₂, are included in the basic training and work of the pilots. The procedures of reduced engine power when taking off are applied, too, by which, in addition to the prolonged engine service life, savings of up to 25pp are achieved in fuel consumption and CO₂ emission in this flight stage. The application of the programme for the flight planning and the Fuel Cost Index serves to establish an optimal flight plan in terms of fuel consumption. The introduction of the Flight Data Monitoring system has enabled supervision of the noise intensity for each flight, which is necessary due to increasingly demanding regulations in the overcrowded European sky.

² Emissions Containment Policy of the European Aviation Industry

All the activities in the sphere of environmental protection, boosted by the desire of the public to make a difference, have led to the situation in which the regulation of air traffic within the environmental protection is a reality. The involvement of the aviation industry in the emissions trading scheme is to start from 2011/2012. The pressure of these significant additional costs will largely affect the profitability, and on a long-term basis, in addition to the pressures of introducing alternative kinds of transport, it will affect further development of the European Union's aviation industry, which will be in an unequal position in terms of competition until an equal trading scheme is established on the global level. At the same time, within the aviation industry - the entire weight as regards global climatic changes for now rests with airline carriers, which makes their position and development potentials even more difficult.

Business Environment and Operational Risks

Environment in Croatia

Croatia's economy recorded the continuation of a series of positive trends during 2007, but several key negative economic trends intensified, too.

Positive trends manifested through the growth of economic activity, exchange rate stability, low inflation and reduction of the budget deficit. A 5.6pp increase in industrial production positively affected the labour market. The average annual inflation totalled 2.9pp, but, unfortunately, inflation rate totalled 5.8pp on an annual level in December, showing a rising inflationary pressure that marked the end of 2007, and has continued in 2008.

Several problems that the Croatian economy has been faced with for a number of years have deepened, demanding more urgent solutions since they could have a negative long-term effect on the ascending development trend of the entire economy. This primarily refers to the high payment balance deficit and the increased high foreign debt that must be dealt with through increased import and reduced export, together with maintaining the economy growth rates.

Tourism registered records in 2007, with 11.2 million tourists staying in Croatia during the successful season, or 7.5pp more than in the previous year, and altogether 56 million overnight stays, i.e. 5.7pp more than during 2006. Most of the foreign tourist overnight stays were realized by the tourists from Germany, Slovenia, Italy, Czech Republic and Austria.

Aircraft traffic at Croatian airports rose by 1.9pp in 2007, and passenger traffic rose by 11.1pp. Of the recorded 4.9 mln passengers at airports, Croatia Airlines transported 1.7 mln passengers, thus transporting 34.7pp of the total number of passengers at the Croatian airports.

The Company has been exposed to a growing international competition for a number of years. The number of foreign airline companies in scheduled passenger traffic rose to 31 from nine that were present on Croatia's airline market in 1993. In addition to this number of scheduled foreign carriers, some 40 charter companies flew in Croatia in 2007. There has been a rise in the number of low-cost carriers, too, who increased the number of flights to Croatian destinations, and their share rose to over 40pp from 9pp in 2004.

As a Croatian company representing a significant export potential that is at the centre of the strategic position of the entire economy, the Company enters the international market carrying unfavourable factors of the local market and local monopolistic effects integrated in the inputs and price of the system, which often makes its position difficult compared to major competition systems that are either not burdened by them, or are considerably more flexible due to their size and financial power. Therefore, the process of approaching the EU and equalizing external and local initial operating conditions is seen as exceptionally important for the Company's further development.

International Environment

At the international economic scene, the U.S. economy continued displaying weakness signs during 2007, also manifested through a great financial breakdown on the capital market, while the rest of the world's economy recorded good results, with China, India and the Eurozone standing out. A more long-term trend shows a mild downfall of economic activity in the Eurozone, primarily under the influence of the slowdown of the U.S. economy, spreading of the effects of the crisis on the financial

market that bring more restrictive financial circumstances, reduction of business trust and record high oil prices. Owing to the fast economic growth and big investment sweep, it is expected that the Asian emerging economies will continue their current growth, which is largely reflected in the aviation industry through large investments into the development of the airline network and airports, and into infrastructure in those places.

The year of 2007 was a successful one for the global air transport, and the aviation industry is undergoing a full recovery. The constant recovery of the aviation industry and the uprising industrial cycle has been evident since 2003, owing to a strong demand and a broad sphere of realized savings in the costs outside fuel. Tariff fees for fuel, accepted by the passengers when it comes to price, helped these trends, in addition to favourable external economic conditions and discipline in incurring costs, which manifested with the majority of the leading airline companies. Nevertheless, from a long-term perspective, high fuel prices, economies' slowdown and a strong capacity growth with high indebtedness are the main risks for the continuation of favourable trends, so the signs that the breakpoint of the uprising cycle is near are evident. The sources of innovations in making efforts to reduce the costs and the possibilities of further thorough changes of the cost structure are almost completely depleted. A rising number of authorities in the industry testifies about tough times for the aviation industry.

Although it is globally expected that the demand for air transport in all of its segments will continue growing, the factors of environmental protection, with the industry's aim of „zero emission“ by 2050 and infrastructural problems will create additional costs and a rising pressure on the rise of prices. Furthermore, many airports still operate under the monopoly protection, realizing too high EBIT rates compared to airline operators. By the continual increase of airport charges, they are draining a significant part of airline companies' financial means and are creating pressure on the rise of costs and output prices. The additional problem of overcapacity will be intensified with the inauguration of 'large' long-range aircraft. Liberalization of the US-EU traffic based on the signed agreement on free aviation opens up new possibilities, but additional pressure on the cost-effectiveness of the entire industry is expected.

Within the global assessment of the expected cost movements, one should not forget security/safety factors that are becoming more significant from day to day, in the global environment of terrorist threats, and are operating through an increase of the airport and operators' safety, which ultimately brings additional, direct or indirect, costs in the entire aviation industry.

The state and development of air traffic in the EU was in 2007 characterized by a rise in the number of transported passengers, dynamic network development through the opening of new lines, with a further increase of excessive crowdedness at the main EU airports, which led to an increased number of delays and higher costs caused by traffic disturbances. Exceptionally good results were achieved on the lines of long-range traffic, which is in Croatia Airlines' operating framework felt through a sales increase on overseas markets. AEA members increased passenger kilometres in 2007 by 5pp on average. The greatest increase in passenger traffic was realized in traffic within Europe, and in medium-haul flights to destinations outside Europe. Cost-related challenges, the biggest of which is a high and growing oil price, but also a significant labour force price, caused further growth of unit costs despite the continued reduction of indirect and administrative costs, and particularly the costs of sale, promotion and „ticketing“.

Operational Risks

By entering the turbulent international market, Croatia Airlines is exposed to effects from both the local market and to the changing effects from foreign markets. The largest effects are reflected through the changes of input and output prices, interest rates and exchange rates, and the changes of financing conditions. Therefore, the policy of analysing and actively managing the existing risk positions and market trends is applied in these spheres, as well as internal set-off of risk positions to the largest possible extent with the application of adequate financial instruments and methods.

Croatia Airlines is directly most exposed to the conditions on the international market that affect the costs of financing by loans denominated in foreign currencies, and through the supply of fuel – the riskiest good in the near future.

Fuel

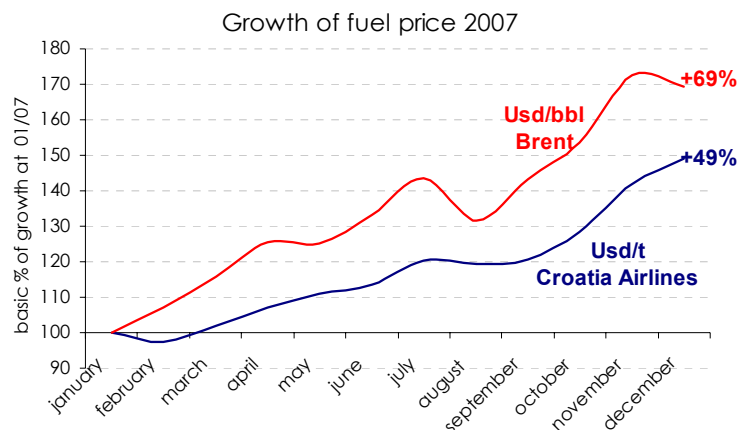
A rise in the fuel prices with direct effect on the fuel costs has in the past several years been one of the most significant risks in the operations of Croatia Airlines, as well as of other airline companies. The price of jet fuel on the market has been exceptionally volatile in the past years. Of the average share of 12-13pp several years ago, the share of fuel costs in airline companies' total costs rose to as much as 30pp.

For the purpose of protection from the rise of the jet fuel price and its influence on the realization of its business results and operating stability, Croatia Airlines applied in 2006 a business-financial strategy of protecting the fuel price via financial derivatives or contracting a fixed delivery price, based on the expected developments on the market for the predefined scope of protection to the predetermined level of exercise price that was assessed as an efficient protection, based on the hedging plan/programme approved by the Management. This kind of fuel price protection was not implemented in 2007, and the oil price recorded hikes, particularly at the end of the year.

At the start of the year, due to above-average temperatures, oil price moved below 60 USD/barrel, and it jumped above 70 USD/barrel in the summer, to pierce 100 USD/barrel at the end of the year for the first time on the New York Stock Exchange.

Daily demand for oil grew 1.8pp in 2007. Despite a growing demand, OPEC reached a decision as late as in September on the increase of production, which did not affect the prices reduction on the market.

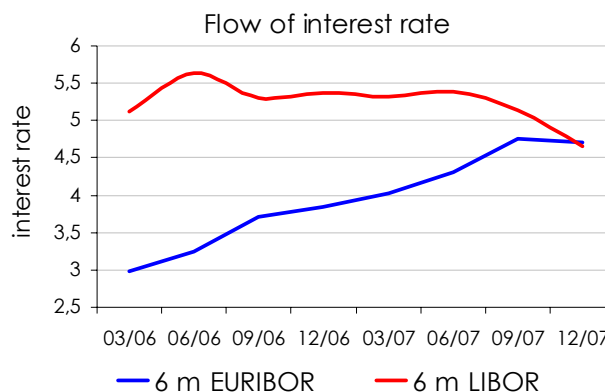
A conclusion can be drawn that OPEC's moves in 2007 enabled the creation of a general impression that the supply will not satisfy the demand, while a very low value of the US dollar and further repercussions as regards the development of Iran's nuclear programme enabled speculators and investors to create a high oil price.



The average price at which Croatia Airlines purchased fuel in 2007 was 6pp higher than that in 2006, amounting to 738 USD/t, which is 28 USD/t more than the planned price, but the effect of this rise in 2007 was compensated by a more favourable movement of the USD exchange rate and more efficient consumption than planned. Therefore, the growth rate of the realized unit price of fuel was somewhat lower than the average oil price growth rate on the global market, and the fuel costs were in line with the planned ones.

Interest Risk

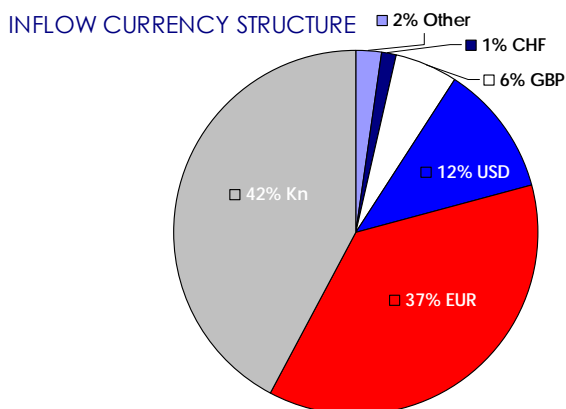
By taking most of the long-term loans with variable interest rate, the Company is exposed to interest-related risk, too. The year of 2007 was characterised by the growth of interest rates, so the costs of interest grew, particularly those of interest of loans tied to EURIBOR, which has been continually rising for the second year. The highest rise of interest costs was realized on the basis of the loan for the fleet refinancing, which represented 93pp of the Company's total credit liabilities at the end of 2007.



The significance of this interest-related risk has been reducing from year to year, parallel with the payment of the taken loans, thus continuously reducing the sum of credit and interest risk exposure.

Currency Risk

The most significant currency-related risk to which the Company is exposed arises from the liabilities that refer to long-term loans and the financial lease of aircraft, which are mostly denominated in euro. Croatia Airlines has been sufficiently and efficiently hedging this exposure and covering it with the yields from the ticket sale abroad. Of the total income inflow in 2007, 58pp (37pp in euro) was realized from the foreign market, while the share of foreign costs in the total ones was 57pp, showing satisfactory foreign currency coverage of outflows by inflows.



Other forms of currency exposure are relatively insignificant, and the continual and efficient short-term management of the currency structure of inflows and outflows is reducing this risk to the minimum.

Liquidity and Sale Crediting Risks

The Company manages the liquidity risk by regularly monitoring the liability maturity and maintaining adequate and sufficient sums of ready cash and deposits for covering unforeseen financial expenses. Cash flows are projected and monitored on an annual, monthly and weekly operating basis.

Within the business year plan, cash flow is planned for each month, by planning all categories of receipts and expenditures in advance. The dynamics of realizing this flow is monitored on a monthly basis, and corrections of the expectations of the cash flow are carried out in line with the changes in its realization. Daily financial operations are implemented on the basis of weekly projections of sizes and categories of inflows and outflows, and the realization of short-term cash flows is also monitored and assessed on a weekly basis.

Credit risk related to agents is relatively low and favourably dispersed since individual sums of claims by any agent are not significant. Credit risk related to business operations with travel agencies, which represent one of the key distribution channels of airline companies, is low, since all IATA-accredited travel agencies are within the system of IATA BSP (Billing & Settlement Plan). This system enables a standardized and controlled way of issuing, charging and paying transport documents that the travel agencies sell on behalf of and for the account of airline companies. In line with IATA standards, all IATA-accredited travel agencies are under the regime of bank guarantees, where the guaranteed sum, depending on the assessed risk of doing business with a certain agency, ranges from 30pp to 100pp of the agency's average monthly turnover. The number of agencies outside the BSP system is not significant for the Company's business.

Unless agreed otherwise in the payment terms, claims and obligations arising from mutual relations of airline companies on the transport basis are usually settled on a net basis via IATA clearing house, which directly reduces the risks of non-payment.

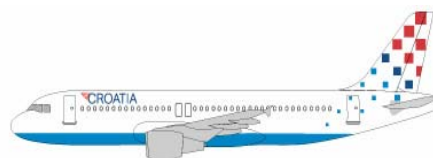
In all other payment relations, solvency and regularity of clients' payments are monitored, and exposure is monitored by applying limits and/or additional payment insurance instruments, if necessary.

Fleet and Capacities

Croatia Airlines operated with the fleet of altogether 11 aircraft: 8 Airbus aircraft, one of which is under an operative lease, and 3 ATR aircraft, altogether representing the capacity of 1,304 available seats.

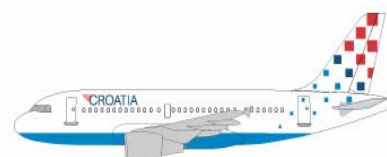
A 320 – 4 aircraft

The aircraft has 162 seats – altogether 648 seats



A 319 – 4 aircraft

The aircraft has 132 seats – altogether 528 seats



ATR 42 – 3 aircraft

The aircraft has 42 seats – altogether 126 seats



Croatia Airlines realized the **block time of 33,759 block hours** with **24,349 flights**. A 3pp rise in block time is primarily the result of an increase in **scheduled traffic**.

Fleet Utilization

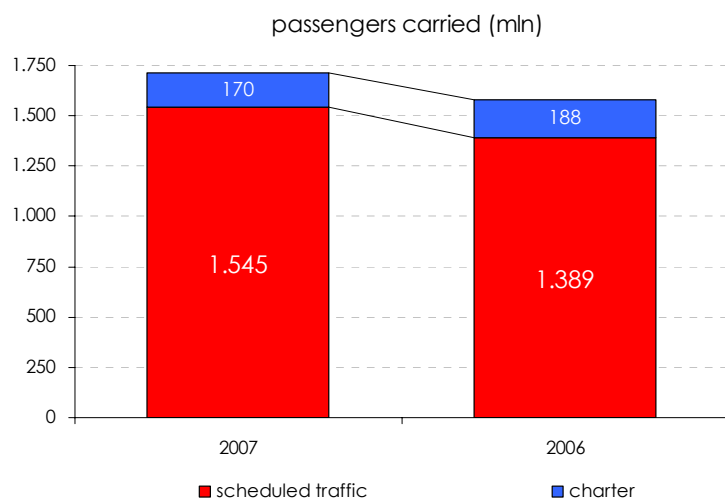
Aircraft type	Ø number of aircraft	Ø daily block hours (BH)	Growth of utilisation 07/06
Airbus A320	4	8,7	1%
Airbus A319	4	8,8	7%
ATR 42	2,91	7,6	1%
TOTAL	10,91	8,5	4%

Croatia Airlines' fleet flew on average 3,108 block hours per aircraft in 2007, representing a **3pp utilization rise** compared to that realized in the previous year.

The average number of aircraft at the level of the entire year, i.e. 10.9 aircraft, is nearly 1pp lower than the last year's average. The average was reduced amid lower utilization of ATR aircraft at the end of the year when the ATR 42 CTU aircraft was withdrawn from traffic due to works and preparations for the planned sale. Since the offer of capacities in available seat-kilometres (ASKM) was at the same time increased by 2pp in 2007, a utilization increase was recorded.

The punctuality of European airline carriers decreased compared to the last year – 78.9pp of departures and 77.7pp arrivals within 15 minutes from the scheduled time were registered in the traffic within Europe. The state of excessive crowdedness of the European air space and airports certainly has a great role in these trends. The punctuality of Croatia Airlines' flights has been following this unfavourable trend by a fall compared to the punctuality in the previous year, having realized 77.5pp departures and 72.8pp arrivals within 15 minutes.

The Market



The year of 2007 was, in terms of market, an exceptionally successful year for Croatia Airlines; it was **the year of strong growth in passenger transport, which rose by 9pp**. The number of passengers within domestic scheduled traffic rose by the rate of 10pp, and international passenger traffic rose by as much as 12pp. By following the Company's

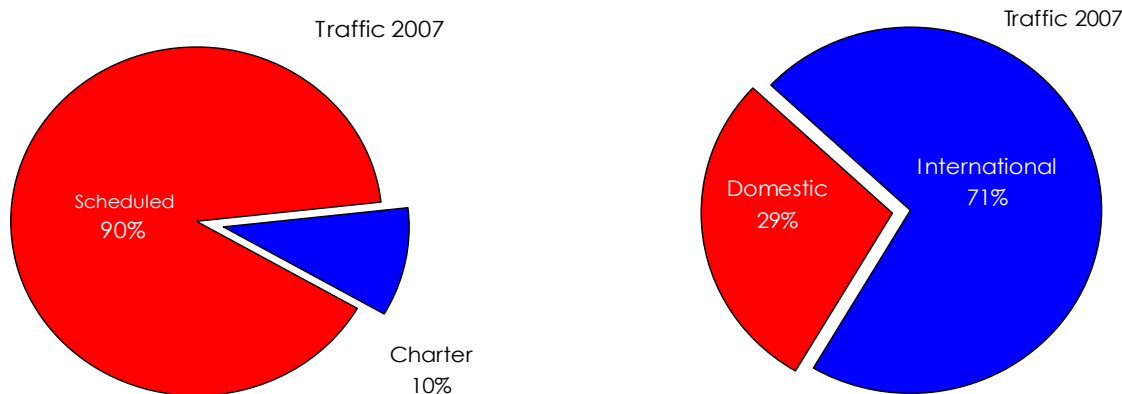
growing orientation towards the network regular operations, **charter traffic is faced with a further decline**, of 10pp. It can be said that the Company, having proved itself in the previous years as a reliable carrier to the passengers from strong tourist generating countries and in a growingly turbulent competitive environment during 2007, **has preserved and strengthened its market position of a scheduled network carrier**.

Passenger kilometres of the AEA Association members (Association of European Airlines), of which the Company is a member and whose collective results are a good external factor of comparison and measurement of the realized scheduled traffic indicators, were growing by 5.1pp on average. Croatia Airlines realized a 7.9pp rise in passenger kilometres in scheduled traffic, but at the same time a significantly smaller growth of the offered capacities measured in seat-kilometres than the Association's average – a rise of 1pp compared to the average rise of 4.2pp. When compared, these two data show a **faster growth rate of passenger load factor (PLF) than the average growth of the AEA group** – the load of the network system of Croatia Airlines' scheduled traffic was growing by the rate of 11.4pp, while the Association's PLF was rising by the average rate of 4.1pp.

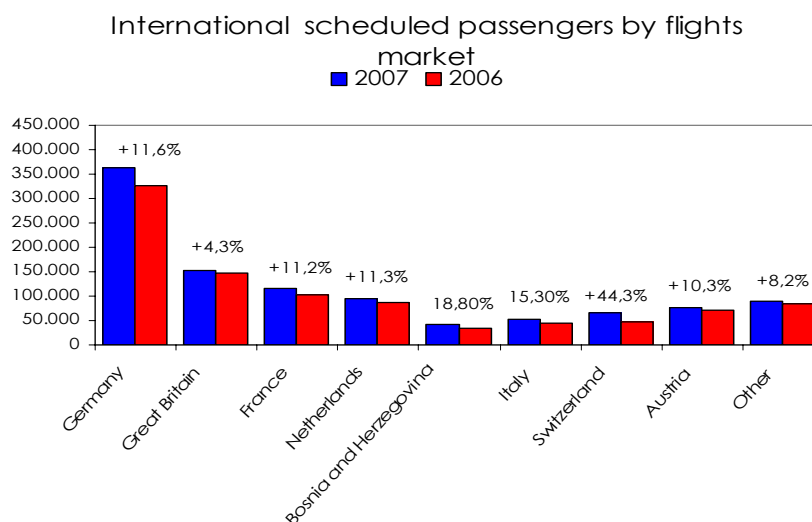
After a longer stagnation period, and based on the change of the sales policy and the assignment of the cargo management for sales abroad to an external partner, expectations as regards increase in the quantities of the transported cargo based on this cooperation, concluded in late 2006, started to realize during 2007. **Goods realized an 8pp rise in tonnes, and mail recorded an 11pp rise compared to the previous year**. Goods transport, measured in tonne kilometres, was rising by the rate of 6.2pp, while the AEA group's results show the average growth of 2.7pp in 2007.

In 2007, Croatia Airlines directly connected 8 destinations in domestic scheduled traffic and 12 destinations in international Euro-Mediterranean traffic. Croatia Airlines developed its destination network with the help of the existing and new commercial cooperations with the Star Alliance members (Lufthansa, Austrian Airlines, TAP Portugal, SAS, and Swiss International Air Lines) and other airline companies (BH Airlines, Air One, Turkish Airlines, Brussels Airlines). All comparative advantages of the association membership are used in the strengthening of the market position.

PLF³ of **64.9pp** rose by 2.9pp, and WLF⁴ of **54.6pp** recorded a rise of 2.4pp compared to 2006. The number of passengers has been growing from year to year, so there was a **9pp rise in the number of the transported passengers in 2007, which totalled 1,715.027**, of which 489,855 were transported in domestic scheduled traffic, 1,055.441 in international scheduled traffic, and 169,731 in charter traffic.



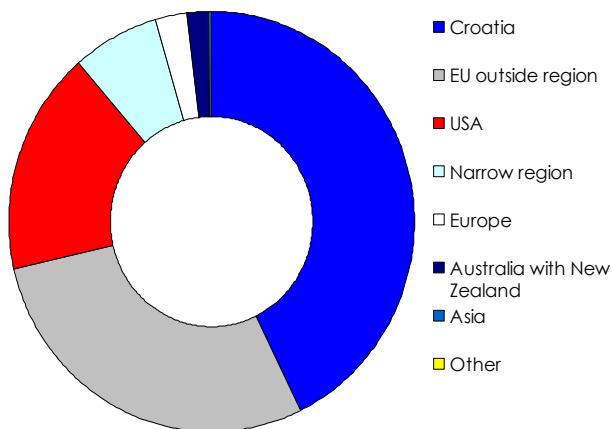
In 2007, a **record number of passengers were transported in a single month since the beginning of commercial flights** in 1991, for the first time in July (201,635 passengers), and then again in August (207,274 passengers). Also, a record average passenger load factor (PLF) in the Company's history was registered in August, totalling 79.5pp. Due to excellent traffic performance indicators, the millionth passenger was recorded as early as on 10 August, the earliest ever since the beginning of the Company's business activity. Altogether 113,371 passengers more were transported in international scheduled traffic and all foreign markets recorded a rise. The highest relative rise was recorded on Switzerland's market, on which Croatia Airlines offered more capacities, since Zurich became the third Star Alliance Hub. A rise in the number of passengers was in line with the rise of capacities on this market. Our largest market – Germany, recorded a rise 11.6pp rise in the number of passengers, resulting from the Star Alliance membership, whose full effect is to be realized by Croatia Airlines during 2007.



³ PLF – Passenger load factor – labour productivity measured by the utilization of passenger capacities
⁴ WLF – Weight load factor – labour productivity measured by the load utilization

The lines to Amsterdam and Paris realized the highest passenger load factor (PLF) in 2007, but all other markets recorded a rise in the passenger load factor (PLF), i.e. in labour productivity compared to the previous year.

Distribution of sales market in scheduled traffic 2007



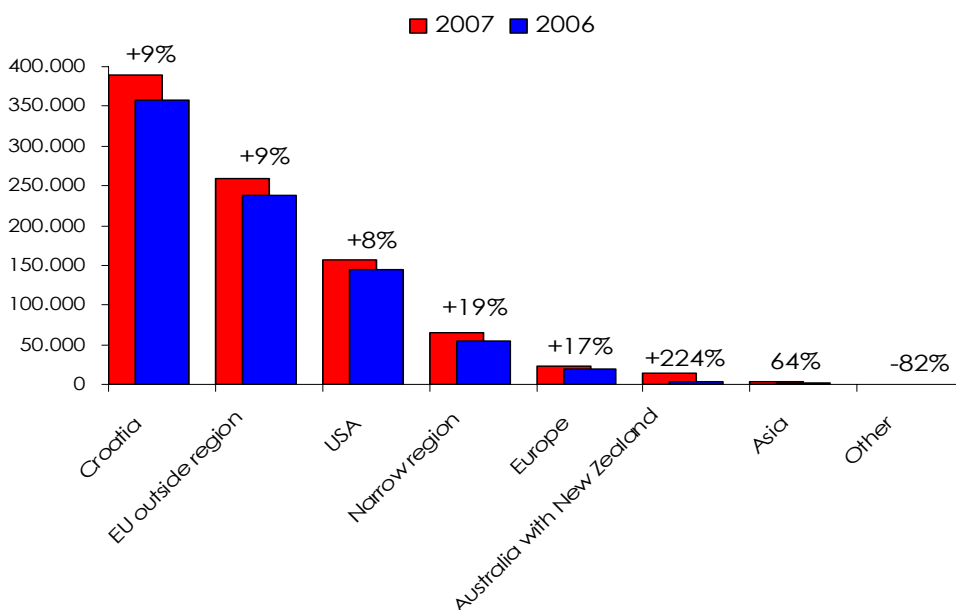
The efforts made into the opening of new BSP markets of Australia, New Zealand, Ireland, Israel, Greece and Portugal intensified during the years.

The real effect of opening these sales markets will be fully felt in 2008. The data on the sale on distributional sales markets realized in 2007 show that the European Union countries, countries in the narrow region and the

particularly important market – the American market, from which the demand historically gravitates to Croatia, have the highest significance for the operations of Croatia Airlines, in addition to the Croatian market to which the Company belongs. **The significance of the markets of Australia and New Zealand has been growing** lately, which is another historically tourist generating market, and these two markets were last year unified within the BSP.

Asian countries, which recorded a high growth in the past couple of years, are still not significant in the total share in the distribution network, but their significance rises from year to year, and after Japan's entry into BSP during 2007, and particularly on a long-term basis, this area is seen as a great future potential in terms of development, by creating products for other Asian markets parallel with the development of the local hub and regional importance of Croatia Airlines.

Growth by sales market (000 kn)



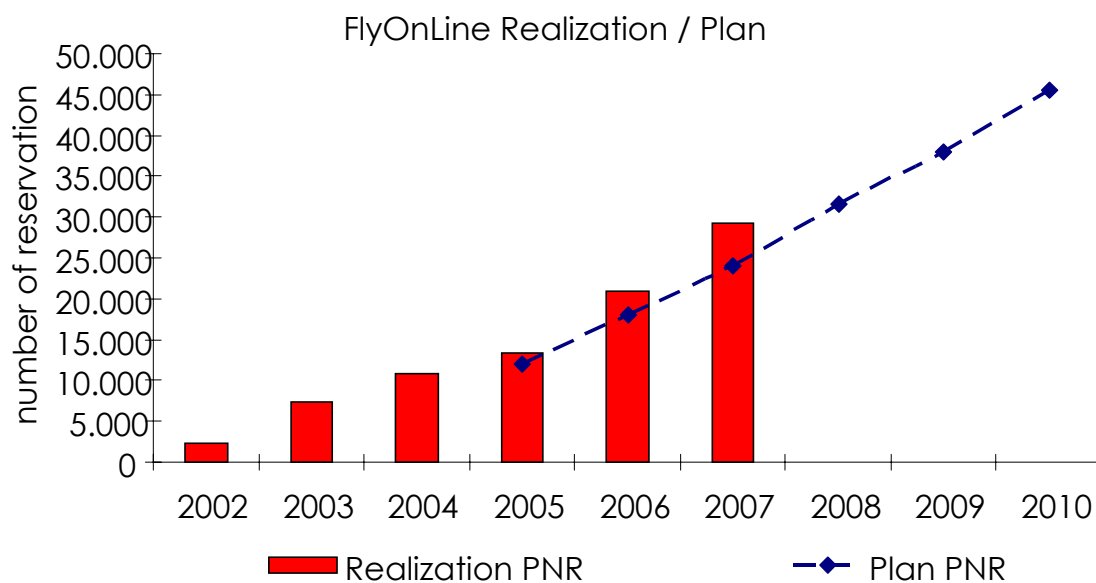
A sales rise has been recorded via all kinds of sales channels. The sale over the Company's own sales channels (branch offices and representative offices) rose by 5pp, while the sale via BSP agents rose by 17pp. Income from capacities sold by other airline companies rose by 8pp. The highest rise realized through the sale by BSP agents is primarily a result of the sale increase on, to us, significant markets of America and the European Union during 2007.

Croatia Airlines realizes over 50pp of the total sales on foreign markets, where the sale rose by 13pp during 2007. The local market recorded a 9pp rise, realized as a result of the actions by which the Company made efforts into motivating local passengers to travel by aircraft instead of by road or some other means of transport to European destinations or from the continent to the sea destinations.

In order to achieve the aimed high sales and income results, Croatia Airlines carried out several successful marketing actions during the year. "Seize the moment" (139 Euros for any European destination) and "Let your friends know" (111 Euros for any European destination) are only some of the actions designed to attract new customers and increase the passenger load of international flights in the winter flight schedule.

The payment of airline tickets in instalments via American Express card, which was introduced during the year, certainly created an additional growth potential realized on the local market.

In addition to other improvements of the approach and availability of the Company's capacities, on-line sale is being popularized through the FlyOnlineClub action, as an integral part of the E-commerce project, aimed at simplifying the purchase of tickets to its customers. **Online bookings recorded a 39pp rise, and the Internet sale grew financially by 66pp** compared to the previous year, by which it was almost four times more financially significant than the Internet sale realized in 2005.



PNR= Passenger Name Record – identification of passengers on the occasion of booking

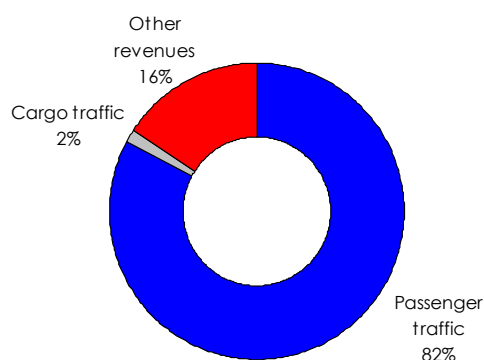
Financial Operations

Profit and Loss Account

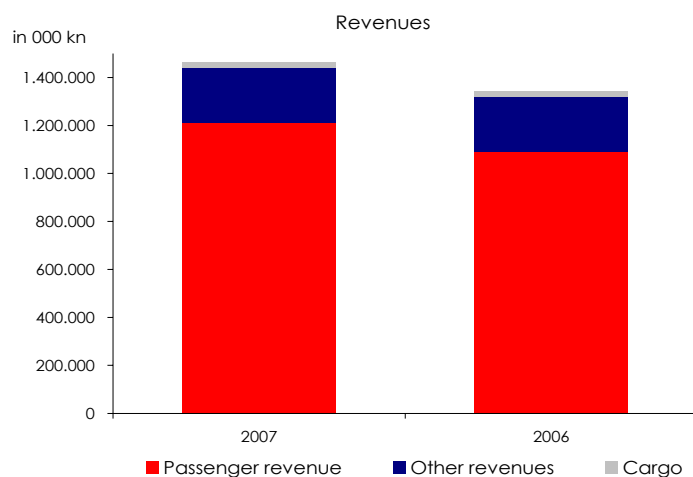
(000 kn)	2007	2006	Index 07/06	2005
Passenger traffic	1.210.527	1.089.236	111	1.136.488
Cargo traffic	22.534	23.767	95	28.756
Other revenues	230.873	232.163	99	237.353
OPERATING REVENUES	1.463.935	1.345.166	109	1.402.597
Flight operations	374.563	371.322	101	371.309
Maintenance	143.264	130.896	109	123.833
Passenger services	93.825	86.495	108	88.744
Aircraft and traffic services	317.350	301.373	105	315.131
Promotion and sales	214.424	208.441	103	186.351
General and administ. expenses	87.381	78.099	112	83.433
Amortization	179.346	164.592	109	162.459
Other expenses	5.790	19.547	30	36.667
OPERATING EXPENSES	1.415.944	1.360.765	104	1.367.926
PROFIT/LOSS FROM OPERATIONS	47.991	-15.599	-	34.671
Interest expense	-56.140	-71.642	78	-80.625
Interest revenue	8.433	5.154	164	5.102
Foreign exchange differences, net	3.092	117.573	3	18.720
Other financial expenses	-2.338	-5.521	42	-761
Other financial revenues	0	1.556	-	117
NET FINANCIAL EXPENSES	-46.953	47.120	-	-57.447
NET PROFIT	1.039	31.522	3	-22.776

Amidst the passenger traffic growth, the growth of operating revenues was higher than the growth of operating costs, resulting in a high operating profit of nearly 50 mln kn. **The posted operating profit**, including the still significant costs of financing the fleet, as well as the favourable effects of the exchange rate change this year, brought the **ultimate net operating profit of 1 mln Kn in 2007**.

Structure of operating revenues 2007



The share of passenger revenues in operating revenues rose by 2pp. The revenues from passenger transport kept pace with the high achieved traffic performance and **rose by 11pp** despite the realized non-pecuniary and financial fall in charter traffic. Almost identical growth rate of passenger transport and financial revenues from passenger transport show **successful maintenance of the average tariff level during the year**, by which a multi-year fall of the average passenger tariff that follows industrial trends of the yield fall and the pressures on the tariff has been stopped.



The revenues from cargo transport in this, still initial, stage of relationship with an external cargo agent, who took over the sale distribution and management and the maintenance of the external sales network, did not follow the good cargo transport performance, and were 5pp lower than those realized in 2006.

Other operating revenues are 1pp lower amid lower state subsidy level and lower various categories of other revenues (revenues from foreign carriers, revenues from DFS and other foreign revenues).

Operating costs followed the traffic increase (block time in BH and flights were 3pp higher, and the number of the transported passengers was 9pp higher) **with a 4pp rise**. Since the year of 2008 is the year of the introduction of the new Q 400 aircraft, **the costs of the business year contain a part of the costs of the short-haul fleet replacement project**, both directly through the financing of deposits or making investments into personnel, and indirectly by employing staff for this project's preparation activities.

The costs of air traffic services rose during the year amid increased costs of flight control and airports' costs, with additional costs incurred by a rise in block time and transport. Since September 2006, Croatian flight control introduced through the enforcement of the European regulations the payment of terminal fee at all Croatian airports. The costs of local airports, which make up a solid part of the costs of the total ground services, do not show a unit tendency of reduction, regardless of the constant rise in the past several years of all forms of Croatia Airlines' traffic at local airports. In exceptionally competitive relations on the sales market, and with the additional pressure of the rise of the fuel prices, to which the Company must adjust by reducing the unit cost in all available operating spheres, this creates an additional pressure on the relations of operators and airports, particularly at the largest airport and the Company's hub – Zagreb.

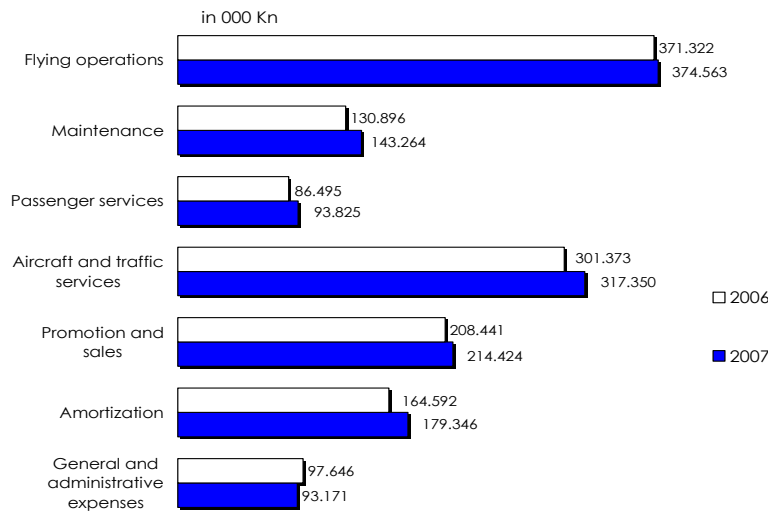
Along with the increase of the passenger number, the costs of passenger services rose, too, primarily those of waiting on the passengers and of traffic disturbances. An increase of the waiting personnel cost was realized on the basis of a new collective agreement with the cabin personnel, which came into force on 1 September 2007.

Maintenance costs rose expectedly due to the fleet's ageing and the stage of maintenance cycles for certain aircraft in the fleet that places them in the period of major works, and a part of the increase was caused by higher personnel costs arising from the new collective agreement. Within these costs there is also an effect of an increase of works for third persons and of commercial maintenance, affecting both the costs and revenues.

Amortization costs were rising primarily due to increased amortization of aircraft, which underwent an exceptionally large number of major engine maintenance works in this business year, thus increasing the fleet's purchase value and the amortization base.

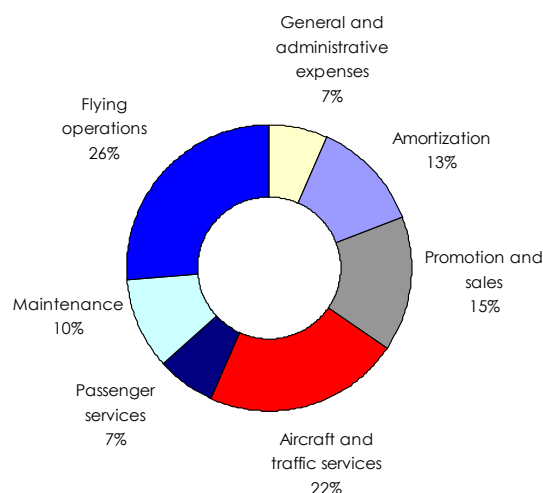
Sales costs rose amid increased corresponding costs of distribution and sales system in the function of supporting and stimulating the traffic growth.

Flight costs rose with an increase of the personnel costs (income and training of pilots), since a new collective agreement with the pilots came into force on 1 August 2007, and although the largest part of the flight costs refer to the costs of fuel, they were, despite the significant rise of the average price of fuel during the year, on the level of the last year due to a more favourable USD exchange rate, which fell during the year, as well as due to a more efficient consumption.



The structure of operating costs did not significantly change in 2007. The largest share in the costs still refers to the flight costs and the air traffic services.

Structure of operating expenses 2007



Assets, Financing and Investments

Statement of Accounts

(000 kn)	end 2007	end 2006	Indeks	end 2005	Indeks
ASSETS					
Non-current assets	1.704.510	1.898.300	90	1.916.893	89
Intangible assets	2.634	2.977	88	3.955	67
Property, plant and equipment	1.684.229	1.707.056	99	1.801.547	93
Financial assets and receivables	17.646	188.267	9	111.392	16
Current assets	235.488	167.204	141	222.289	106
Inventories	29.001	24.392	119	22.987	126
Receivables	123.393	68.125	181	113.108	109
Financial assets	5.252	5.972	88	10.090	52
Cash and cash equivalents	77.841	68.715	113	76.105	102
Prepaid expenses and accrued income	57.946	63.764	91	8.871	653
TOTAL ASSETS	1.997.943	2.129.268	94	2.148.054	93
LIABILITIES					
Capital and reserve	685.260	709.776	97	755.768	91
Non-current liabilities	921.610	1.111.492	83	946.774	97
Obligations under loans and lease	921.610	1.111.492	83	946.774	97
Current liabilities	351.454	271.056	130	408.063	86
Obligations under loans and lease	143.092	117.462	122	261.651	55
Obligations under air traffic services	20.923	17.000	123	13.895	151
Accounts payable and others liabilities	187.439	136.595	137	132.518	141
Accrued expenses and defferd income	39.620	36.944	107	37.449	106
TOTAL LIABILITIES	1.997.943	2.129.268	94	2.148.054	93

The value of assets (liabilities and capital) was 6pp lower at the end of the year since the levels of loan liabilities and long-term deposits for loan insurance were reduced, by ultimately taking a smaller loan for the refinancing.

At the end of 2007, credit liabilities with local banks totalled 41.4 mln Kn (12.1 mln Kn long-term liabilities and 29.3 mln Kn short-term liabilities). The rest of the capital stock of long-term loans with foreign banks totalled 1,020.8 mln Kn – 31.9 mln Kn loans for the financing of A320 (Fox) aircraft, and 988.9 mln Kn for the refinancing, activated in December 2006 for the premature payout of syndicated loans for the purchase of the Airbus fleet and the improvement of financing conditions. In January 2007, the final obligation from the syndicated loan was paid from the refinancing loan.

Investments in 2007

Investments	2007	2006	2005
Investment into aircraft	97.135.032	63.921.759	17.626.861
Investments into spare parts, tools and equip.	6.925.484	5.972.596	5.102.846
Construction investments	11.710.758	2.601.074	1.295.436
Intangible assets	1.172.153	1.894.849	2.805.897
Other equipment	1.439.159	1.340.390	2.697.351
Other financial investments	39.500.771	2.626.783	22.581.255
Total	157.883.357	78.357.452	52.109.646

Within the investments into aircraft, 86.9 mln Kn was spent on the engine check-ups and works, including six Airbus engine check-ups and three ATR engine check-ups.

The planned replacements of the nose landing gear, worth 1.1 mln Kn, were carried out on two ATR aircraft, while 6.3 mln Kn was spent into the two replacements of the main landing gear and the nose landing gear on an Airbus aircraft. Modifications on ATR aircraft were worth 2.1 mln Kn, and those on Airbus aircraft were worth 0.6 mln Kn.

In addition to the abovementioned investments, check-ups were carried out in internal construction on five Airbus aircraft (CTI, CTF, CTJ, CTL and CTK), and on all three ATR 42 aircraft.

Apart from the investment into its own aircraft, a replacement of the main landing gear and the nose landing gear was carried out on the leased aircraft.

Construction investments mostly refer to those made into the modernization and expansion of the existing technical base through the construction of the technical base support facility worth 4.4 mln kn, into the reconstruction of the technics warehouse facility worth 0.5 mln Kn, and into the new mobile hangar, into which 6.8 mln kn was initially invested.

Other financial investmens were worth 39.5 mln Kn through the given deposits for the employees' housing loans, which represent a minor part of the investmens, while the largest part refers to regular monthly investments into maintenance reserves, which are cumulated for the future needs of major maintenance works. The payment of a pre-delivery deposit for the optional Q400 aircraft that will enter the fleet in 2008 was made within these investments, too.

Cash Flow Movements

cash flow (000 kn)	2007	2006	Index
Cash at the beginning of the period	68.715	76.105	90
Inflow from activities	1.461.854	1.332.158	110
Inflow from Government	69.993	103.953	67
Sales of assets	0	7.013	0
Loans	241.745	999.902	24
Financial inflow	41.806	24.945	168
Total inflow	1.815.399	2.467.971	74
Obligations	1.415.716	1.293.584	109
Investments	33.517	16.032	209
Loans	332.351	978.335	34
Financial outflow	24.689	187.410	13
Total outflow	1.806.273	2.475.361	73
Net change for period	9.126	-7.390	-
Cash at the end of the period	77.841	68.715	113

The cash flow level (inflow and outflow) reduced by a quarter in 2007 compared to the previous year that was largely affected by the project of refinancing credit commitments for the purchase of the Airbus fleet through inflows (taking a refinancing loan), as well as through outflows (payment of the existing loans to be closed).

The project was closed in 2007 by the payment of the final instalment of the syndicated loan, i.e. with a significantly lower amount than the amount of payments realized in the refinancing project during the last year.

The increase of inflows from operations amidst the market expansion and increased traffic and income is followed by an increase of payments of obligations, but at a somewhat slower pace due to a slower rise of cost categories.

A short-term loan worth 44 mln kn, taken at Zagrebačka banka, was paid out at the end of the year, and the revolving short-term commitment for the loan taken at PBZ is planned to be paid out in 2008.

Ivan Mišetić
President & C.E.O.