

 CROATIA AIRLINES

A REGIONAL STAR ALLIANCE MEMBER



## Annual Report on the State of the Company for 2008



April 2009

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## Typical indicators

### Fleet – March 2009

type of aircraft	number	seats	ownership	lease	Ø age (years)	number at the end of 2008	ownership	lease
Airbus A320	4	648	2	2	11,52	4	2	2
Airbus A319	4	528	4	-	10,13	4	4	-
Q-400	2	152	-	2	0,83	2	-	-
<b>TOTAL</b>	<b>10</b>	<b>1328</b>	<b>6</b>	<b>4</b>	<b>8,83</b>	<b>10</b>	<b>6</b>	<b>2</b>

## Traffic indicators

description		2008	2007	2006
flights (km)	DIST 000	16466	15722	15396
departures	FLTS	26013	24349	23732
growth rate	%	7	3	
block hours	BH	35790	33759	32823
growth rate	%	6	3	
passengers carried	RPAX 000	1869	1715	1577
growth rate	%	9	9	
freight&mail carried	CGO T	4393	4608	4243
growth rate	%	-5	9	
passenger km flown	RPKM mln	1372	1303	1220
available seat - km	ASKM mln	2103	2009	1968
<b>passenger load factor</b>	<b>PLF %</b>	<b>65,2</b>	<b>64,9</b>	<b>62</b>
tonne km flown	TKM mln	126	120	113
available tonne-km	ATKM mln	231	220	215
<b>weight load factor</b>	<b>WLF %</b>	<b>54,7</b>	<b>54,6</b>	<b>52,2</b>

## Financial indicators

Indicators		2008	2007	2006	2005
Operating revenues	mIn Kn	1.631	1.464	1.345	1.403
Annual change rate	%	11	9	-4	
Total revenues	mIn Kn	1.729	1.537	1.510	1.465
Annual change rate	%	12	2	3	
Operating expenses	mIn Kn	1.662	1.416	1.361	1.368
Annual change rate	%	17	4	-1	
Total expenses	mIn Kn	1.818	1.536	1.479	1.488
Annual change rate	%	18	4	-1	
Operating expenses without fuel	mIn Kn	1.304	1.169	1.113	1.135
Annual change rate	%	12	5	-2	
Total expenses without fuel	mIn Kn	1.460	1.289	1.231	1.255
Annual change rate	%	13	5	-2	
Operating profit/loss	mIn Kn	-31	48	-16	35
Operating profit/loss (%of operating rev.)	%	-	3,3	-	2,5
Operating profit/loss(% of total revenue)	%	-	3,1	-	2,4
Net profit/loss	mIn Kn	-89	1	32	-23
Net profit/loss (% of operating revenue)	%	-	0,1	2,3	-
Net profit/loss (% of total revenue)	%	-	0,1	2,1	-
EBIT	mIn Kn	-	57	103	58
EBITDA	mIn Kn	139	237	268	220
EBIT margin	%	-	3,9	7,7	4,1
EBITDA margin	%	8,5	16,2	19,9	15,7
Unit operating cost	Kn/ASKM	0,79	0,70	0,69	0,67
Unit operating cost without fuel	Kn/ASKM	0,62	0,58	0,57	0,56
Unit operating revenue	Kn/RPKM	1,19	1,12	1,10	1,17
Passenger yield (total pass.rev.in EUR/RPKM)	€cent/RPKM	13,65	12,66	12,19	12,80
Average number of employees		1.122	1.062	1.049	1.099
Annual change rate		6	1	-5	
Return on total assets	%	-	2,9	4,8	2,7
ROE (return on equity)	%	-	0,2	4,4	-
ROCE (return on capital employed)	%	-	3,5	5,6	3,3
Total asset turnover		0,94	0,77	0,71	0,68
Total asset operating turnover		0,89	0,73	0,63	0,65
Current asset turnover		5,52	6,53	9,03	4,72
Cash ratio		0,14	0,22	0,25	0,19
Quick ratio		0,50	0,57	0,50	0,47
Current ratio		0,62	0,67	0,62	0,54
Financial stability		1,14	1,06	1,07	1,13
Solvency ratio		0,29	0,34	0,33	0,35
Financing ratio (total liabilities/equity)		2,47	1,92	2,00	1,84
Interest cover ratio		-	0,85	-	0,43
Cover ratio I (equity/non-current assets)		0,36	0,40	0,37	0,39
Cover ratio II		0,88	0,94	0,94	0,89
Investment ratio		0,10	0,11	0,06	0,04

## Croatia Airlines in 2008 – introduction

As the national flag carrier, Croatia Airlines has through its operations been realizing the mission of connecting the homeland with the world, and performing a special task of contributing to the Republic of Croatia's tourism development. In nineteen years of its existence and provision of transport services, it has been connecting 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. Croatia Airlines started in 2008 a new investment cycle related to the development of its fleet, by dismissing short-haul ATR aircraft and simultaneously introducing the first two Q-400 aircraft of a greater capacity.

### Ownership structure

Croatia Airlines (the Company) is a joint-stock company. It disposes of the capital stock 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) in the nominal value of 100 Kn, and 4.924,279 refer to regular shares (CRAL-R-A) in the nominal value of 200 Kn.

Review of shareholders and their share in stock capital	Capital (kn)	%
REPUBLIC OF CROATIA	938.175.000	94,77
CROATIAN PRIVATISATION FUND	21.315.200	2,15
HPB D.D./CAPITAL FOND D.D.	14.413.600	1,46
CROATIAN LOTTERY	400.000	0,04
JADRANSKI NAFTAOVOD DD	2.200.000	0,22
AIRPORT ZAGREB	1.302.500	0,13
ENIKON D.D.	735.600	0,08
RATKO ŽURIĆ	676.200	0,07
CONING ENGINEERING	521.400	0,05
CROATIA LLOYD	1.027.000	0,10
OTHERS	9.209.000	0,93
<b>total</b>	<b>989.975.500</b>	<b>100,00</b>

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.

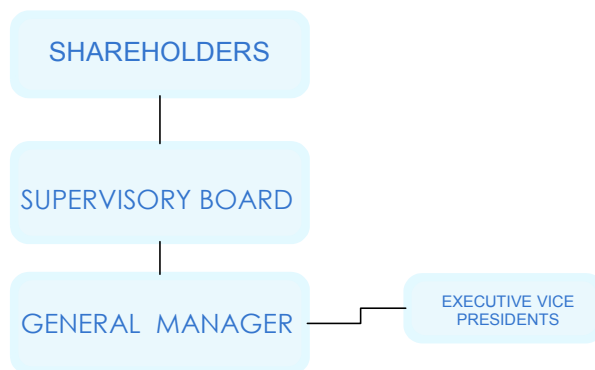
Pleso prijevoz d.o.o. is 50% owned by Croatia Airlines, whereas its other half is owned by Zagreb Airport. Its activity is to transport personnel working at airports in Zagreb and Split, passengers travelling on the route Airports – City, and lost luggage.

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 connecting 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, 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

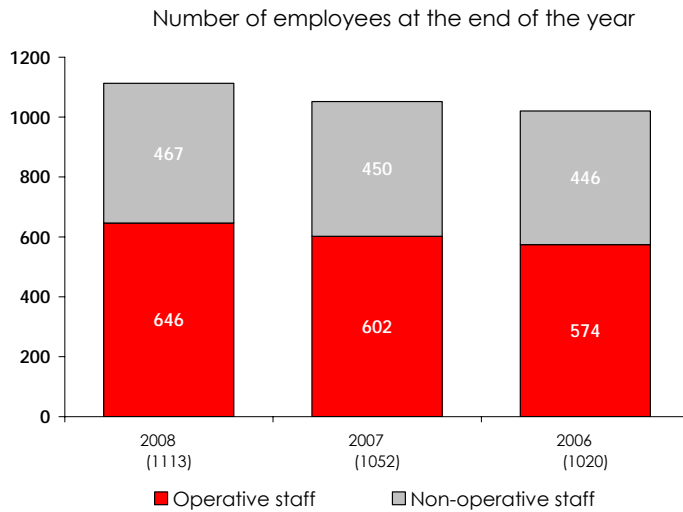


The Company's work organization throughout the year was set up through business functions grouped into six business unities having Executive Vice Presidents and through pivot functions of the Company organized within the President's Office: Management, Corporate Operations Office and Office for Operations Quality and Safety Management.

The business sphere of traffic comprised flight, cabin and ground operations, and the traffic training centre. The business sphere of technical works unifies aircraft maintenance, engineering works, technical support activities and technical training. The business sphere of finances comprises finance, accounting, controlling and revenue accounting. 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 sales used to be a part of a single business sphere, while the business sphere of supply and marketing were unified at the start of the year in a single business sphere.

A new reorganization of the Company came into force in early 2008, aimed at achieving a more efficient personnel management, and increasing labour efficiency by reducing the number of jobs and organizational units. A different elaboration of payment ranks was 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 top quality staff drain.

Human resources



At the end of 2008, the Company had 1,113 employees, including 58 employees in foreign branch offices.

The number of operative staff grew by 7pp during the year, as the result of an increase in the number of operations and the need to employ new pilots and technical staff. The number of

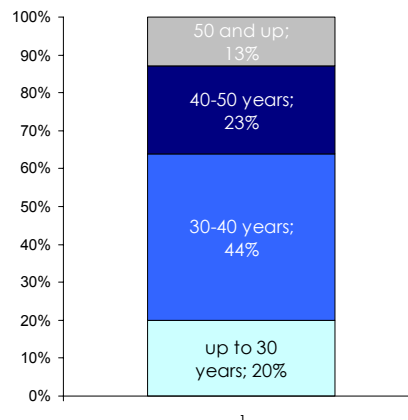
non-operative staff grew by 4pp, primarily due to the need to support the implementation of a large number of new projects.

The introduction of new Q-400 aircraft into the fleet started in the summer period, and in line with this, the current operative personnel was provided training during the year for the new type of aircraft.

Due to the needs of covering the summer flight schedule, the Company seasonally hired some fifty members of the assistant cabin staff.

The opening of a new hangar capacity in 2008 and an increase in the scope of commercial-technical maintenance activities created the need for hiring and training a number of new employees for aircraft maintenance.

Structure by age 2008



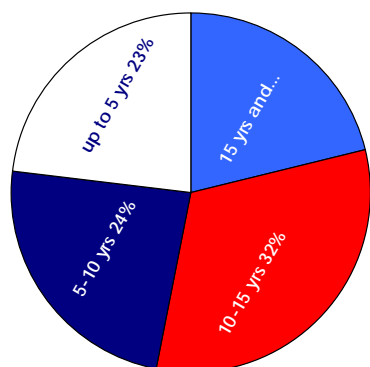
The share of operative staff<sup>1</sup> within the Company is 58% (646 employees), while that of non-operative staff is 42% (467 employees).

The educational structure and the average age of employees (38 years) are exceptionally favourable, and in terms of gender structure, men are somewhat more represented (53%).

Of the total number of employees, 90% are employed for an indefinite period.

<sup>1</sup> Includes pilots, cabin staff, technical staff, traffic and ground operative staff, and excludes catering staff

Structure by employment record

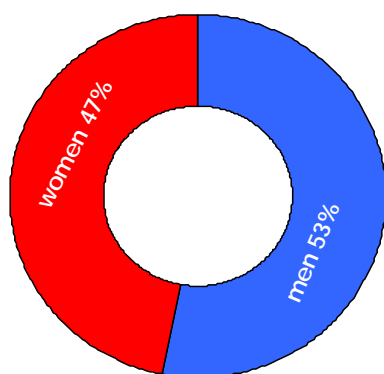


The average employment record of the operative staff was 8 years of service, and of the non-operative staff was 10 years, while the average employment record on the level of the entire Company was 9 years.

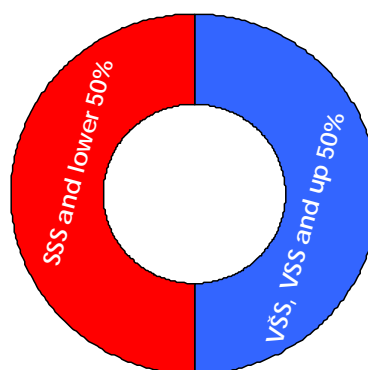
These positive indicators show a low fluctuation in the Company, considering the facts that the Company has been existing for 19 years and that it employed some 200 persons in the first years of its existence. During its later development, the employment rate progressively grew until 1998.

The share of women in the structure of senior and medium management totalled 22pp, whereas this share reached 45pp in the total overall management structure.

Structure by gender



Structure by education



During 2008, the Company for the first time carried out a research of the organizational culture and employee satisfaction, in which all employees participated, and which resulted in further steps aimed at improving individual spheres of human resources management through workshops at which problems and potential improvements were addressed in more details.

Considering that the growth rates of passenger transport 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 measured through the cargo transport has been falling due to pronounced recession tendencies on the goods and mail transport market during the business year.

**Labour productivity**

DESCRIPTION		2008	2007	2006
tonne km per employee	000	113,5	114,3	110,3
Annual change rate	%	-1	4	
passengers carried per employee		1679	1630	1546
Annual change rate	%	3	5	



### Training investments and programmes

Having recognized its activity from day one as intensive both in terms of capital and work, Croatia Airlines has kept developing and strengthening its human resources through continual investments into training.

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

Investment into education (kn)	2008	2007	2006
Operative staff	12.741.691	11.037.487	7.322.515
Annual change rate	15%	51%	-4%
Non-operative staff	1.328.785	974.064	1.139.128
Annual change rate	36%	-14%	28%
<b>Total</b>	<b>14.070.477</b>	<b>12.011.551</b>	<b>8.461.643</b>

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.

Training of Croatia Airlines' employees is simultaneously provided on three levels: training of operative sector employees, technical sector employees and non-operative sector employees.

The year of 2008 was marked by more intensive investments into training of employees of operative and technical sectors due to the introduction of a new type of aircraft into the Croatia Airlines' fleet.

Inicijalni paket teoretskog školovanja za mehaničare na tipu zrakoplova Dash 8 Q400 organizirala je tvrtka *Flight Safety International* u Torontu za grupu instruktora Croatia Airlines, koja je temeljem inicijalne edukacije razvila interne programe školovanja za sve ostale zaposlenike sektora tehnike koji su trebali usvojiti nova relevantna znanja potrebna za servisiranje novog tipa zrakoplova.

The initial package of theoretical training for mechanics for the aircraft type Dash 8 Q400 was organized in Toronto by the company *Flight Safety International*. It was organized for a group of Croatia Airlines' instructors, who, based on the initial education, developed internal training programmes for all other employees of the technical sector who were required to acquire new relevant skills for servicing the new type of aircraft. *On-the-job-training* of mechanics for the same type of aircraft was provided by the airline company *Tyrolean* in Innsbruck.

The initial theoretical training of captains and co-pilots, and the training on the simulator for the new type of aircraft was also organized by the company *Flight Safety International*, while practical training on the new type of aircraft was carried out in several European companies. Canadian instructors trained flight personnel at the Croatia Airlines Training Centre for several months, in order to enable the initial commercial flights on the new type of aircraft.

The cabin personnel attended all relevant training courses related to the new aircraft type at the Croatia Airlines Training Centre in Zagreb.

The training process for the employees of Croatia Airlines relies primarily on internal resources, implying the use of its own authorized instructor staff. In addition to

financial savings realized this way, the nourishment of its own *know-how* results in a lesser dependence on external resources and promotes the Company's cultural and business strategies.

For the types of training that are not required on a permanent basis, Croatia Airlines' employees are, most often individually, referred to the IATA (International Air Transport Association) training centre, while external experts are hired for certain categories of training. Those experts conduct *in-house* programmes, in which a large number of target groups of employees may participate.

As the national flag carrier, Croatia Airlines organizes within its Training Centre a series of training courses needed by travel and commodity agencies for the acquisition of the IATA licence, training courses for airports, freight forwarders and airline companies. In 2008 Croatia Airlines provided training to a large number of flight and cabin staff of the Slovenian company *Adria Airways* in the sphere of safety.

The company concluded last year a cooperation agreement with the Croatian Employment Bureau, based on which a number of unemployed persons were provided training.

**Responsibility to employees**

The Company's employees are in principle hired for an indefinite period, 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 a 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, supports, 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 mandatory schooling.

**Occupational safety**



Organization of occupational safety and fire protection is prescribed by the Company's internal rules. Based on the hazard assessment, revised in 2008, work places with special working conditions are identified, and employees working there are referred to a regular initial or periodical medical examination. The employees trained to work

with special machines and devices are referred to regular medical examinations, too.

Employee training related to working in a safe manner and legally prescribed basic training in fire protection are regularly organized and implemented for all new employees. For those working in places with special conditions, the Company provides practical training and sessions each two years for the purpose of renewing 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 19 such injuries in 2008, of which eight were injuries at the regular place of work, one on an official trip, and 10 while arriving at/leaving the work place.

#### **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 conduct that might jeopardize the employees' dignity, procedural rules were set for the case of 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 pages.

#### **Employees 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 were concluded for 2008.

The first collective agreement with the Independent Croatian Union of Airline Employees was signed in 2008, and talks started at the end of the year on the renewal of the collective agreement with the Independent Professional Union of Croatian Aeromechanics, whose collective agreement was valid to the end of the year.

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.

### **Social responsibility**

#### **Transport and tourism**

As the 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**

As a part of its mission, Croatia Airlines is making efforts to contribute to the overall development of Croatia's tourism and economy. Being aware of a very strong national identification by the passengers, Croatia Airlines serves and promotes Croatian foods and wines in aircraft cabins, and familiarizes its passengers with Croatia's natural beauties, historical values and cultural events during the flights via the Inflight magazine and its video system.

The Company's films on the beauties of the ecologically clean and preserved islands, the sea bed, the coast, the national parks and other Croatian regions are each day shown 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 shown, too.

There are also regular promotions and sponsorships of many cultural events contributing to the advancement of Croatia's tourism – Julian Rachlin and Friends Festival, Split Summer Festival, Dubrovnik Summer Festival, Omiš Festival of Dalmatian Vocal Ensembles ('Klapa'), Knights game 'Sinjska alka', Libertas Film Festival, Motovun Film Festival, as well as cultural and scientific institutions of high importance. The Company also sponsored the Croatian Paralympic Committee in 2008, Youth Sports Games, ACI Match Race Cup, and a series of minor sports events, and it has been continuously and successfully cooperating with the Croatian Olympic Committee for many years.

#### **Support for the community**

Whenever possible, Croatia Airlines strives to support institutions that need humanitarian aid or organize humanitarian projects, and it has been providing direct humanitarian aid by granting 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.

Donations in 2008 included, among the rest, those to the Mediterranean Institute for Life Sciences, to the National Foundation for the Support of Pupil and Student Standard, Children's Clinic Zagreb, and many other supports 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 supports these associations and their activities, and a number 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 1.87 mln passengers in 2008, Croatia Airlines reached a total of nearly 18.7 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 has been developed and maintained for many years was expanded in 2008 with the introduction of new destinations such as Copenhagen, Dusseldorf, Pristina and Podgorica, while another two new destinations are planned for 2009 – Göteborg and Barcelona. The Company's goal is to further expand its destinations network in the next several years, primarily with destinations in the narrower region, but also with more distant European destinations, 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 offer its passengers direct flights from Croatia to the U.S.A. with one stopover only, on joint flights under the logos of both partners. The Code-share Agreement has not been put into force yet due to legislative and legal obstacles on the state level, but the newly founded Civil Aviation Agency will start operating in 2009 and it will be responsible for the control of certificates, operating licences and the implementation of international standards for air traffic; therefore the realization of the agreed cooperation is expected.

Having achieved the significance of the leading 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, 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 overall business operations, the Company is dealing with the issues of the economic policy of tourism development that still does not support the whole-year tourism in the scope that corresponds to the national Company's development plans. By such traffic profiling, the Company is protecting 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 2008, **the replacement of the short-haul fleet started** by the introduction of the first two Dash 8 – Q400 aircraft of the Canadian company Bombardier, via a 10-

year operative lease, and the dismissal of three ATR aircraft from the fleet. Croatia Airlines will continue with the **renewal and development of its fleet** by taking over another two Dash 8 - Q400 aircraft in June 2009, and another two in the spring of 2010. The quality of the Dash 8-Q400 aircraft has, among the rest, been confirmed by the number of the produced turboprop aircraft of this type, i.e. over 650 aircraft and over 13 million hours of flight on this type of aircraft throughout the world. The code 400 stands for the largest aircraft in the family (there are also versions Q300 and Q200), with the capacity of over 70 seats, and the code Q marks the most modern series developed for the purpose of maximum reduction of noise. The design of the interior of the Q400 is a shift towards higher comfort of the business and economy class, with aesthetic improvements of the passenger cabin. Croatia Airlines is also presenting a new company design on new aircraft. Dash 8-Q400 is one of the ecologically most acceptable aircraft among all passenger aircrafts, and its fuel consumption efficiency is 30pp higher compared to jet aircraft, contributing to a reduction in the emission of harmful gases into the atmosphere. Croatia Airlines will strengthen its position of the regional leader with four aircraft, whose performance and capacities correspond to this area and to the basic purpose of connecting cities in the region of the South-East Europe and relatively close airline hubs such as Munich, Zurich and Vienna, and in domestic traffic.

The past practice has shown that the traffic increases with the accession to the European Union, and Croatia Airlines' aim is to get ready for such an increase. In 2008 the Company signed an agreement with Airbus on the intent to purchase four additional A319 aircraft, which would be added to its growing medium-haul fleet. The first two new A319 aircraft in the Croatia Airlines' fleet, which already has eight aircraft from the A320 Family, are expected in 2012, while the third and the fourth ones are expected in 2013.

**Advancement  
and expansion of  
operations**

The opening of **a new hangar capacity** at Zagreb Airport, located opposite the existing hangar, is a significant development step for one of the Company's most important additional activities. Croatia Airlines has gained a huge experience by performing short- and medium-haul aircraft maintenance activities for 15 years. Since 2001, when it received a JAR 145 certificate, i.e. authorization for base and line maintenance of foreign aircraft, Croatia Airlines started providing aircraft maintenance services to foreign companies. In 2004, the JAR 145 certificate was replaced by an EASA Part 145 certificate from the Aviation Safety Agency, representing the basic criterion for the provision of aircraft maintenance services to foreign companies. To the end of 2008, 65 major examinations on aircraft of various European carriers were performed at the technical centre of Croatia Airlines. The Company's technical expertise strongly contributed to its reputation as a safe company. In October 2008, an agreement on the expansion of cooperation between Croatia Airlines and Lufthansa Technik was signed, based on which Lufthansa Technik will increase the number of major examinations (C-checks) on Airbus A319/320 aircraft, which will be carried out in Zagreb, and it will continue using Croatia Airlines' technical support.

In 2008, Croatia Airlines also agreed with Lufthansa Technik the **technical support for the new Dash 8 – Q400 aircraft** in the Croatia Airlines' fleet.

One of the major projects in 2008 is the start of the **implementation of an integral information system** with the help of experts from the company S&T Hrvatska, **based on the SAP ERP solution**, with the specificities of the SAP BI system for providing

support to planning and making business decisions, and the integration of the SAP system with the existing specialized industrial IT systems of Croatia Airlines, based on the mediation of the SAP NetWeaver infrastructure. The selected SAP 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 on Microsoft tools which have certain limitations, felt lately as a bottleneck for the Company's further development. By introducing this system Croatia Airlines expects that it will increase productivity, gain better insight into its business operations and the needed adaptability for a faster fulfilment of its business strategies, and a firmer operative control of all activities parallel with the planning and adapting to the market and technological changes. The implementation is expected to be finished in late 2009.

Through the intensive development of e-ticketing and the establishment of Interline Electronic Ticketing (IET) between Croatia Airlines and Shanghai Airlines on 18 March 2008, Croatia Airlines entirely completed its IET (Interline Electronic Ticketing) connecting with the members of the Star Alliance association, covering altogether 95pp of the inter-company revenue, with the continuation of activities related to the establishment of new connections. Croatia Airlines has been putting efforts into strengthening its status of the regional leader by the exclusive use of electronic tickets, since travelling with them is simpler and carefree, it is impossible for a passenger to lose or forget it, and on the occasion of the check-in it is sufficient to present an identification document, a credit card or a card of the programme Miles & More. The project of the introduction and use of electronic tickets in all Croatia Airlines' domestic destinations was completed during the year, except for the airport on the island of Brač, which did not meet the required conditions. Electronic tickets are today used on the scheduled flights in almost all destinations of Croatia Airlines and on the entire network of flights of Lufthansa and many other airlines. Croatia Airlines has been issuing 98pp of its tickets electronically since 1 June, and since then tickets became available for sale in the travel agencies within the Croatia Airlines' network only by electronic way. Croatia Airlines will completely abandon paper tickets once all of its partner companies are ready to transfer to the new technology. All BSP agents of Croatia Airlines transferred to e-ticketing, while the agents on the American market were issuing 97.82pp of tickets electronically at the end of the year.

The Company worked intensively in 2008 on the further development of its **E-commerce project** by introducing a new Internet service of **Web Check-in** in September, by which passengers are offered a simple and flexible flight check-in via their personal computers at home or in the office, enabling them to avoid crowds at airports and spend their time before the flight in a more useful way. The use of Web Check-in is currently possible in Amsterdam, Brussels, Paris, Frankfurt, Dusseldorf, Munich, London, Vienna and Zagreb. The company plans to continue with the introduction of the Web Check-in in 2009 at other local airports, and those in Zurich, Sarajevo, Skopje, Podgorica and Pristina. As a part of the E-commerce project, the **service of charging and issuing electronic airline tickets via an ATM network** of Privredna banka Zagreb has also been introduced, enabling passengers with a valid reservation a simple payment and issuing of electronic tickets in a safe and familiar technological environment, without the need to make new calls or to go to branch offices.



On 1 October, Croatia Airlines selected and put into operation the **Calidris Booking Integrity system**, which, based on an automated process, checks on a daily basis the reservation system and speculatively booked seats (double reservations, reservations with fake names, etc.), frees and returns them for sale, enables a more precise projection of the number of the booked seats on aircraft, and reduces the distribution costs. The selection of the Calidris system has created a precondition for more successful and efficient business operations, and the value of the new system will particularly be felt in the peak periods of the season, when the demand for flights is the highest.

The Company also worked intensively on the project of replacement of its sales-distributional information system by the **information platform – “Common IT Platform”**. The CITP is a joint project of the Star Alliance carriers that comprises the modules of reservation, inventory and check-in systems and enables significant shifts in the distribution quality of all carriers within the association, and creates prerequisites for a reduction of the distribution costs. The reservation and inventory modules should be implemented by the end of 2009.

One of the projects started in 2008 is the **establishment of the Contact Center** which will provide support to the passengers of Croatia Airlines from the moment of buying a ticket to the realization of the flight, i.e. their entering the plane. This includes the sale of tickets, reservations, informing passengers on the flight schedule changes, and on any events of traffic irregularities, on the flight schedule, ticket prices, products and services, Internet booking, the sale of special services (such as travel insurance, acquisition of co-branding cards) and additional services and products of Croatia Airlines. The activities of the Contact Center will include the takeover of calls from the branch offices during the non-working hours of such offices, post-sale services, dealing with users' claims, user information (general travel conditions, EU regulations, Montreal Convention), telemarketing, outbound marketing campaigns, and other information related to the Company. The Contact Center began operating on 1 March 2009.

#### Anniversaries and Awards

On 1 January 2008 Croatia Airlines marked its tenth anniversary of becoming a fully-fledged member of the Association of European Airlines – AEA. The AEA is a non-profit organization which, in line with its tradition of over 50 years, earned excellent reputation in civil aviation and today it gathers 33 air carriers. Mr. Ivan Mišetić, Chief Executive Officer of Croatia Airlines, was at the annual meeting of the association, held in May 2008, appointed the president of the association for 2009. He will replace Mr. Peter Hartman of KLM in this function.

The Croatian Exporters' Association presented Croatia Airlines in May 2008 the «Golden Key» award as the most successful exporter to the Great Britain.

Mr. Ivan Mišetić, the Chief Executive Officer of Croatia Airlines, was appointed a member of the IATA Nominating Committee on 1 June 2008, and he will take over his duty in 2009. The key function of this body is to select and appoint members of the IATA Board of Governors, IATA's most important body, composed of the leaders of the world's largest airline companies, who strategically run the International Air Transport Association (IATA) through the activities of this body, and directly affect the movements in the airline industry.

In November 2008, Croatia Airlines was for the second year in a row awarded a „**superbrand**“ award, given to Croatia's best trademarks, i.e. to the companies that stand for distinctiveness, reputation, top quality, reliability and long-term consistency.

In December 2008, Croatia Airlines received an E-novation award for the new service of charging and issuing electronic airline tickets via an ATM network: a silver Tesla's egg for the application of the ICT innovation in its operations.

The tenth anniversary of commercial cooperation between Croatia Airlines and Turkish Airlines was marked In December 2008. Over 32,000 passengers were transported in the past 10 years on joint Code-share flights.

### Environmental Protection

As a significant factor of the development of the entire global economy, air traffic also contributes to global climatic changes by emitting greenhouse gases and generating noise, by using non-renewable sources of energy, and to a smaller extent by generating waste.

Amidst the expected long-term growth of traffic, accompanied by an increased emission of carbon dioxide and its effect on the global warming, the inclusion of the air traffic into the emission reduction programme was stipulated on the occasion of defining the Kyoto Protocol. The process ended in 2008 when the final regulation was passed on the inclusion of all airline companies operating in the European Union, and of all of those flying to/from the EU airports, into the European Emission Trading Scheme (EU ETS).

Although airline companies will start participating in the EU ETS in 2012, complex and extensive preparations for the participation should be made in 2009, and the systematic monitoring of fuel, emissions of CO<sub>2</sub> and ton kilometres as the market benchmarking should be set up in more demanding ways and verified for the year of 2010.

As a global industry, the airline industry also actively upholds the establishment of the global ETS, as the only solution that can lead to the realization of the global goals of reducing the aviation emissions and eliminating the situation of an unequal market competition in which airline companies from the territory of the European Union may find themselves if the global agreement is not reached.

Because of the significance of the effect and the financial extent of introducing these economic measures to their operations, airline companies have actively joined the development of regulations through ICAO, a United Nations organization that cares for civil aviation, but also through IATA as an international airlines association and AEA as the association of European airlines.

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 industry<sup>2</sup>, 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 whose implementation is aimed at reducing the CO<sub>2</sub> emission) and economic instruments of ETS (based on offer and demand – the needed rights to emission will be acquired or the excess of such rights sold in line with the needs and the defined rights of the company).

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

<sup>2</sup> Emissions Containment Policy of the European Aviation Industry

actively preparing for the inclusion into the very ETS. It also participates in the activities of coordinating and implementing the European regulations related to the global climatic changes and the Kyoto Agreement for the air traffic in the Republic of Croatia. Croatia Airlines has been continuously participating and working on the creation and application of the environmental regulations and those concerning the sustainable development in the country, coordinating them with the relevant European regulations referring to air traffic and the Company in general, as well as on the advancement of the technology, procedures and processes reducing the negative environmental effects.

Most of the activities within the environmental protection are focused on the sphere of reducing the fuel consumption, reducing the emissions of harmful gases, particularly of carbon dioxide (CO<sub>2</sub>), and reducing the noise level when landing and taking off. The procedures of reduced engine power when taking off are applied, too, by which, in addition to the prolonged engine service life, savings are achieved in fuel consumption and CO<sub>2</sub> emission in this flight stage. The application of the programme for the flight planning and the Fuel Cost Index serves for establishing 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.

The pressure of these additional costs, as well as of the expected long-term and permanent new categories will significantly affect the Company's operations in the financial, operational and broader sense.

## Business environment and operational risks

### Environment in Croatia

In 2008 Croatia's economy was marked by a slowdown of the gross domestic product growth to the estimated 2.4pp. Local effects, with those of the global crisis, almost halved the growth rate of 5.5pp from 2007, and announced the possibility of entering into recession.

The industrial production growth rate amounted to 1.6pp and was the lowest in the past eight years. The average annual inflation totalled 6.1pp, showing a rising inflationary pressure that marked the year of 2008. A high balance-of-payment deficit was present throughout the year, accompanied by an increased foreign debt, whose share in the GDP kept rising.

Tourism recorded good results in 2008, with 11.3 million tourists staying in Croatia during this successful season, or 1pp more than in the year before, with altogether 57 million overnight stays, or 2pp more than in 2007. Most of the foreign tourist overnight stays were realized by the tourists from Germany, Slovenia, Italy, Austria and Czech Republic, while the highest rise in tourist visits refers to those from Japan.

In June 2008, Croatia ratified the Multilateral Agreement on the Establishment of the European Common Aviation Area (ECAA Agreement), officially setting up a free air traffic market between the EU countries and nine adjoined countries in the region.

In such conditions of a completely free market access, Croatia Airlines operated in 2008 in the conditions of growing international competition, i.e. exceptionally strong market competition with foreign scheduled and charter carriers.

Aircraft traffic at the Croatian airports rose by 1.58pp, and passenger traffic rose by 5.14pp in 2008. Of the recorded 5.2 mln passengers at airports, Croatia Airlines transported 1.9 mln passengers, or 36pp of the total number of passengers at the Croatian airports.

Altogether 36 foreign carriers operated within the scheduled air traffic (of which 15 within the network operating model, and 21 low cost carriers), or 20pp more than in 2007, from 48 destinations (+23pp) with 337 flights in the peak traffic weeks. There were altogether 35 foreign carriers in the charter traffic (+75pp) from 36 European destinations (+71pp) with 46 flights in the peak traffic weeks. The share of passengers flying with low-cost companies amounted to 13.5pp at Zagreb Airport, 19.88pp in Dubrovnik, 22.28pp in Split, 41.88pp in Zadar, and as much as 76.99pp in Rijeka.

As a Croatian company representing a significant export potential that is at the centre of the strategic position of the entire economy, the Company has entered 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 difficult its position compared to major competition systems that are either not burdened by such factors, or they 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

The year of 2008 was marked by a slowdown of the global economy growth and all the accompanying risks. The status of the U.S. economy and other major economies in the world was getting worse faster than it was forecast by the leading economists. The worst

credit crunch since the Great Depression in the 1930's pushed the U.S. economy downwards in late 2008, sharply reducing the gross domestic product. The bursting of the greatest credit "bubble" in the history affected the real economy throughout the world, resulting in the closing of construction sites, pushing companies into bankruptcy and leaving millions of people without a job. The extent of difficulties indicates that the states might have to spend billion dollars for incentive packages in order to boost their economies, and that the global recovery will take more time.

A threatening cloud of recession, a slowdown of economies, high fuel prices and a rise in capacities, are, in addition to high indebtedness, the main risks for the global airline industry. The sources of innovation in the efforts to reduce the costs and the possibilities for further thorough changes in the cost structure have been almost completely depleted. A rising number of authorities in the industry testify about tough times for the aviation industry.

The International Air Transport Association IATA announced that the airline industry recorded the loss of \$8.5 billion in 2008, half of which incurred in the fourth quarter only, while the net losses on the level of the industry rose to between 16 and 17 billion dollars, when the losses based on the fuel hedging are included. The international passenger transport decreased by some 3pp, and airlines responded to the fall in the demand for travels by trying to reduce the capacities. The fall of fuel prices in the final months of 2008 brought certain relief for the carriers, but many of them incurred losses anyway, since they had previously undertaken to pay higher fuel prices in order to protect themselves from the risks of higher kerosene prices.

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 continual increase of airport charges, they are draining a significant part of airline companies' financial means and 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 for the entire aviation industry.

Members of the Association of European Airlines AEA transported nearly 356 mln passengers in 2008, or 5.4 mln fewer passengers than in 2007, while recording an increase of passenger kilometres by 1.2pp. Cost-related challenges, the biggest of which is the high and growing oil price, but also a rather high 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 the effects from 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.

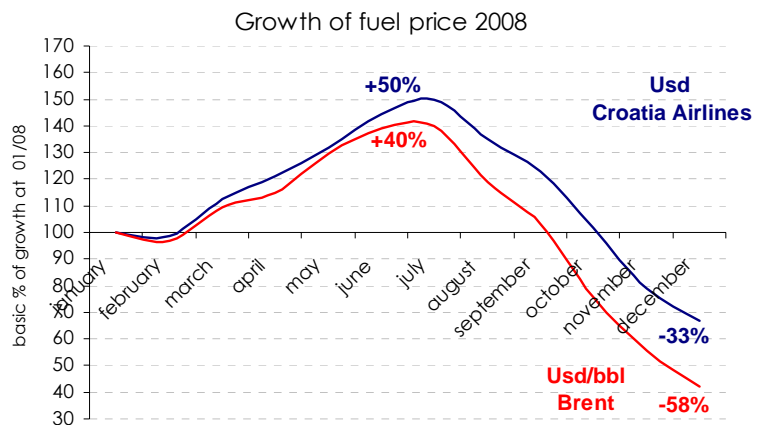
**Fuel**

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.

At the start of the year, the oil price moved around 90 USD/barrel, with a permanent growth tendency, and it reached a record level of some 150 USD/barrel in July. The oil price was in the last quarter characterized by a more prominent fall, having reached some 40 USD/barrel in December.

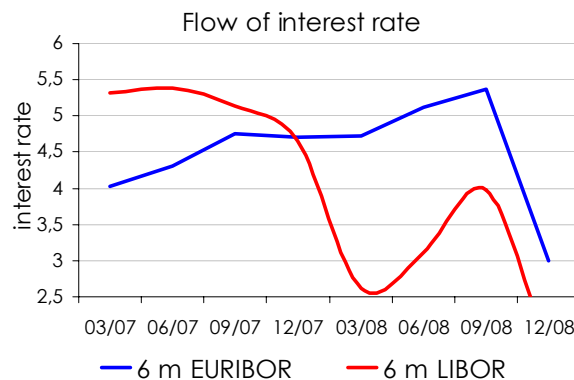
The average price at which Croatia Airlines purchased fuel in 2008 was 49pp higher than that in 2007, amounting to 1,103 USD/t, or 179 USD/t more than the planned price. The effect of this rise in 2008 was partially compensated by a more favourable movement of the USD exchange rate than planned, and by maximal optimization of consumption in accordance with the set flight schedule.

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



**Interest risk**

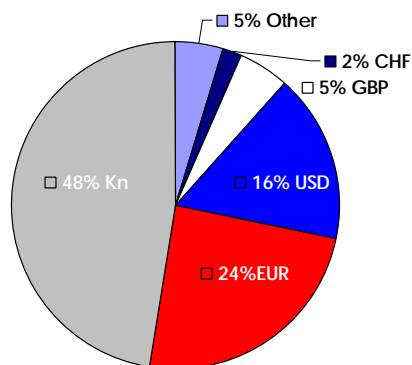
By taking most of the long-term loans with variable interest rate, the Company is exposed to interest-related risk, too. The year of 2008 was characterized by the volatile movement of interest rates. A continual rise of EURIBOR, to which interest costs on loans are tied, was stopped in the last quarter. A rise in interest costs was realized on the basis of a loan for the fleet refinancing, which represented 93pp of the Company's total credit liabilities at the end of 2008.



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

INFLOW CURRENCY STRUCTURE



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 2008, 52pp was realized from the foreign market (24pp in euros), while the share of foreign costs in the total costs was 52pp, showing a satisfactory foreign currency coverage of outflows by inflows.

In August 2008 the Company signed with Privredna banka Zagreb twenty forward agreements worth altogether 9.4 mln USD, becoming due twice a month to June 2009.

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 a 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. 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 and the changes of external effects. 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 basis of transportation 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.

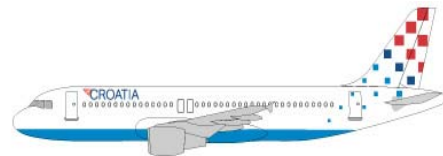


## Fleet and capacities

Croatia Airlines operated until the winter flight schedule with the fleet of altogether 12 aircraft: 8 Airbus aircrafts, one of which is under an operative lease, 2 ATR aircraft and 2 Dash 8-Q400 aircraft, all under an operative lease, altogether representing the capacity of 1,412 available seats.

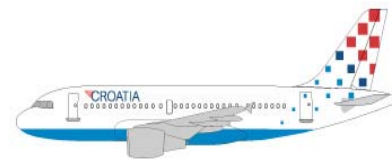
A 320 – 4 aircraft

The aircraft has 162 seats – altogether 648 seats



A 319 – 4 aircraft

The aircraft has 132 seats – altogether 528 seats



Q 400 – 2 aircraft

The aircraft has 76 seats – altogether 152 seats



ATR 42 – 2 aircraft

The aircraft has 42 seats – altogether 84 seats



Croatia Airlines' aircraft realized the **block time of 35,790 block hours** with 26,013 flights. A 6pp rise in the block time is primarily the result of an increase in the scheduled traffic.

Dash 8-Q400 aircraft joined the Croatia Airlines' fleet in May, when the first aircraft of the Canadian producer Bombardier Aerospace arrived, while the second one arrived in July. The delivery of the third and the fourth Dash 8-Q400 aircraft is expected during 2009.

The last two ATR42 aircraft were dismissed from the fleet at the end of the year, and the final flight of the ATR42 aircraft in Croatia Airlines' fleet was flown on 26 October 2008. The entire fleet of ATR aircraft had nearly 88,500 takeoffs and it flew a total distance of 30.375,000 kilometres. Altogether 2,050 tons of goods and 1,800 tons of mail were transported. The ATR aircraft transported over 2.912,500 passengers, of which over 718,000 were transported on domestic scheduled flights, 1.255,500 on international scheduled flights, and almost 219,000 on charter flights.

In the period from May to September, Croatia Airlines additionally leased a Fokker 100 aircraft of the Croatian carrier Trade Air, to bridge over the late delivery of the new Dash Q400 aircraft and due to a stronger demand for travels during the European Football Championship and the tourist season.

During the observed period, Croatia Airlines took into lease *ad hoc* aircraft that flew altogether 69 flights for the purpose of covering the flight schedule in extraordinary situations such as various traffic disturbances, aircraft engine breakdowns, etc.

An Airbus A320 was sold in December 2008, after the leasing was paid out, and it was then taken into an operative lease.

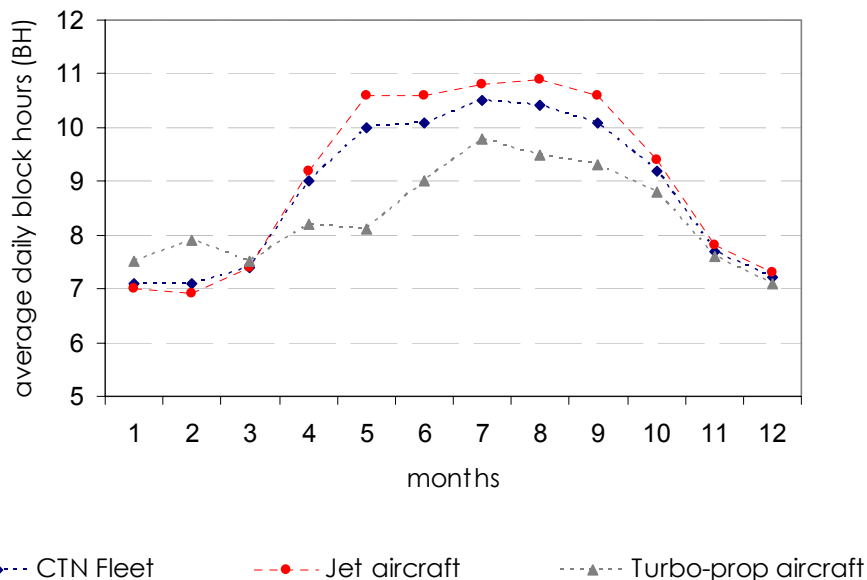
Fleet utilization

type of aircraft	Ø number of aircraft	Ø daily block hours (BH)	Growth of utilisation 08/07
Airbus A320	4	8,9	3%
Airbus A319	4	9,2	3%
ATR 42	1,63	8,7	14%
Q-400	1,03	8,3	
<b>TOTAL</b>	<b>10,66</b>	<b>8,9</b>	<b>6%</b>

Croatia Airlines' fleet flew on average 3,283 block hours per aircraft in 2008, representing a **5.6pp utilization rise** compared to that realized in the previous year.

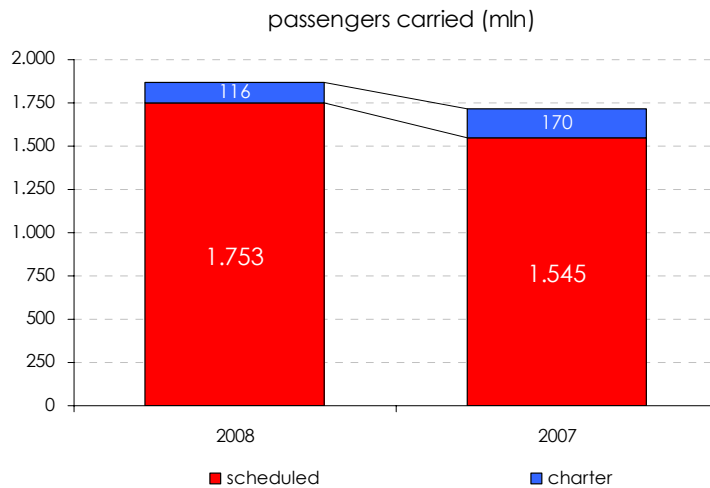
The average number of aircraft at the level of the entire year, i.e. 10.66 aircraft, was 2pp lower than the last year's average. The average was reduced due to one ATR aircraft less since the start of the year, and due to the dismissal of the remaining two in late October, while the fleet renewal with Dash 8-Q400 aircraft started with the delivery of the first aircraft in May, and another one in July. Due to the fleet renewal, the offer of capacities in available seat-kilometres (ASKM) was 5pp higher in 2008, the same as the rise in passenger kilometres.

Fleet utilization by months



## The Market

After the exceptionally successful 2007, in terms of market, Croatia Airlines registered a 9pp rise in passenger transport in 2008. The number of passengers within domestic scheduled traffic rose at the rate of 11pp, and international passenger traffic rose by as much as 15pp.



Croatia Airlines' defined business model of development towards a strong network regular operator resulted in a gradual reduction of the scope and significance of charter traffic in the overall operations in the past few years. Charter traffic registered a 31pp fall in 2008. It can be said that the Company, having proved itself in the previous years as a reliable carrier to the

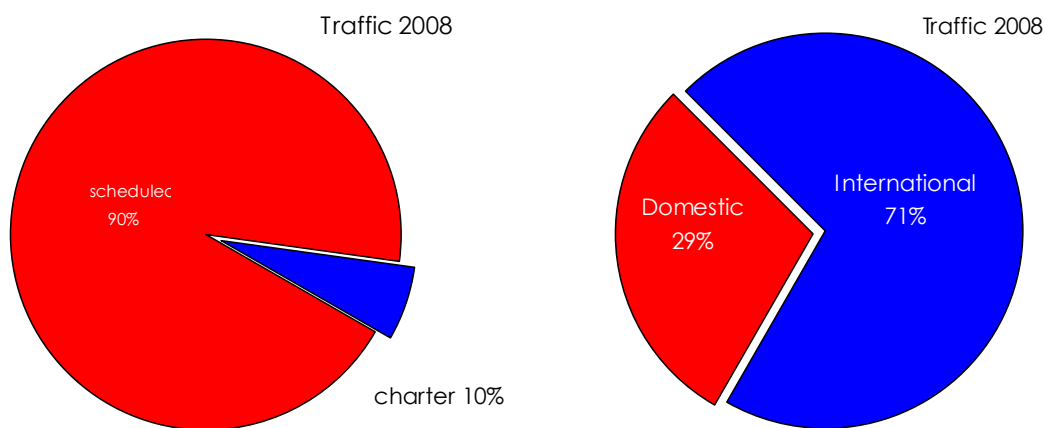
passengers from strong tourist generating countries and in a growingly turbulent competitive environment during 2008, **has preserved and strengthened its market position of a scheduled network carrier.**

Passenger kilometres of the members of the AEA (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 1.2pp on average. Croatia Airlines realized a 12.2pp rise in passenger kilometres in scheduled traffic, the same as the growth of the offered capacities measured in seat-kilometres, while the average of the AEA members was a 3pp growth. When compared, these two data show the realized passenger load factor (PLF) on the level of the last year, while the AEA realized a fall at the average rate of 1.3pp.

**Cargo transport was 5pp lower in 2008 compared to the previous year, but cargo transport revenues were 17pp higher.** Croatia Airlines had an agreed cooperation with the external freight agent Cargo Counts, which took over the sale distribution and management, and the external sale network maintenance. The respective agreement was in 2009 taken over by Lufthansa Cargo, the owner of the freight agent Cargo Counts. Lufthansa Cargo terminated Cargo Counts in early 2009 due to a change of its organizational structure.

In 2008, Croatia Airlines directly connected eight destinations in domestic scheduled traffic and 16 destinations in international Euro-Mediterranean traffic. It developed its destinations network with the help of the existing and new commercial cooperation with the Star Alliance members (Lufthansa, Austrian Airlines, TAP Portugal, SAS, Swiss) and other airline companies (Air One, Turkish Airlines, Brussels Airlines). All comparative advantages of the association membership are used in the strengthening of its market position. Croatia Airlines connected altogether 40 destinations in 2008 in scheduled and charter traffic, and through commercial cooperation.

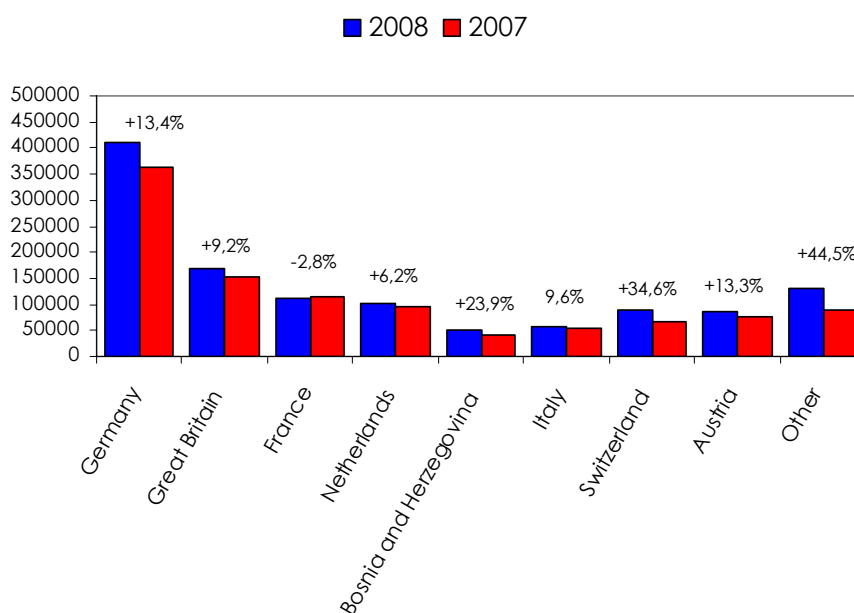
The PLF<sup>3</sup> of 65.2pp rose by 0.4pp, and the WLF<sup>4</sup> of 54.7pp recorded a rise of 0.1pp compared to 2007. The number of passengers has been growing from year to year, with a 9pp rise in the number of the transported passengers in 2008, totalling 1.868,869 passengers, of which 543,192 were transported within the domestic scheduled traffic, 1.209,411 within the international scheduled traffic, and 116,266 within the charter traffic.



Altogether 223,258 passengers were transported in August 2008, which is a record number of passengers transported in a single month since the beginning of commercial flights in 1991, and the millionth passenger was registered as early as on 24 July, the earliest in the Company's history, and 18 days earlier than in the previous year.

Within the international scheduled traffic, 153,970 passengers more were transported, and all foreign markets, except for France, recorded a rise. The highest absolute rise (+48,617 passengers) was recorded on Croatia Airlines' largest market

International scheduled passengers by flights market



– Germany.

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

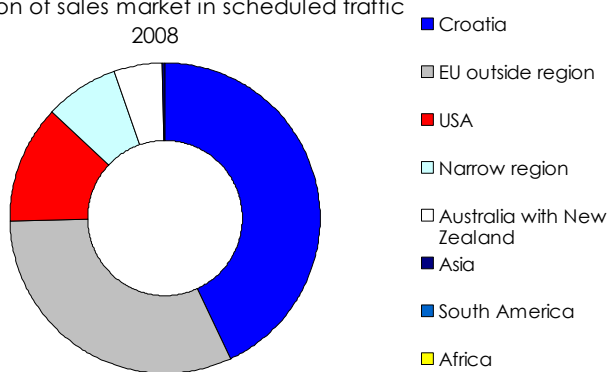
The highest rise of the passenger load factor (PLF) in 2008, i.e. in labour productivity compared to the previous year, was realized on the routes to Germany and Italy, and those to Skopje and Brussels, while the highest passenger load factor (PLF) was recorded on the route to Amsterdam, the same as the year before.

**Croatia Airlines started flying to four new destinations in 2008 – Copenhagen, Dusseldorf, Pristina and Podgorica.** Since 30 March, Croatia Airlines' aircraft flew according to the summer flight schedule, in which flights were adjusted to the passenger needs and to the new fleet structure. The purchase of new aircraft in 2008 enabled the expansion of the network of international destinations of Croatia Airlines, and direct flights from Croatian destinations to Dusseldorf (3 flights a week from Zagreb and 1 flight a week from Split and Dubrovnik), Copenhagen (3 flights a week from Zagreb), Pristina (3 flights a week from Zagreb) and Podgorica (3 flights a week from Zagreb) are a novelty.

Additional flights were introduced on certain routes (from Zagreb to Sarajevo, Brussels and Zurich) and the number of weekly frequencies was increased (from Zagreb to London - Gatwick, Amsterdam and Munich). Additional flights from Dubrovnik to Frankfurt and from Split to Munich and Lyon were also a novelty.

Activities on the **opening of new BSP markets of Estonia and Macedonia** intensified during the year.

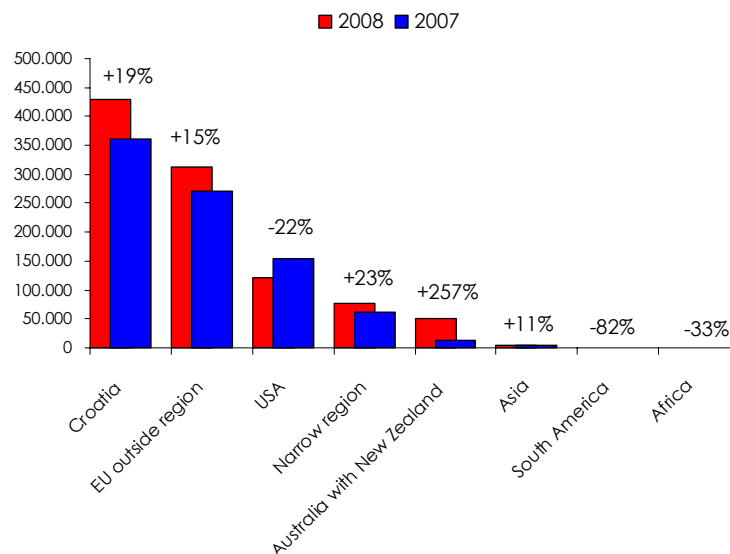
Distribution of sales market in scheduled traffic 2008



The data on the sale on the distribution sale markets in 2008 show that, apart from the Croatian market to which Croatia Airlines belongs, the European countries, and particularly the American market - on which demand historically gravitates toward Croatia - were the most significant for the Company's operations. The markets of Australia and New Zealand are becoming more and

more important, as another historically tourist generating markets whose share in the total distribution of the passenger sale is constantly rising.

Growth by sales market (000 kn)



**A sales rise was recorded via all types of sales channels.** The sale over the Company's own sales channels (branch offices and representative offices) rose by 2pp, the sale via BSP agents rose by 16pp, while the sale via agents outside BSP doubled. The revenues from the capacities sold by other airline companies rose by 5pp.

**The domestic market** kept recording a significant **sale growth of 18pp**, thus continuing a good trend from 2007, while **the foreign market** registered an 11pp rise compared to the last year's sale.

**The European Union market recorded a 15pp growth** and the highest absolute sales growth was recorded on the markets of Germany, Sweden, Denmark, Slovenia, Switzerland and Spain. Outside the European Union, a significant rise was recorded on the markets of Macedonia, Bosnia and Herzegovina, and Montenegro, and a new market of Kosovo was opened. Outside Europe, a significant rise was recorded on the new markets of Australia and New Zealand. Australia has already become the seventh market in terms of sales volume, and a further growth of this market is expected in the upcoming years. The greatest sales fall was recorded on the market of America, amounting to 22pp, mostly as a result of recession on this market and the weaker USD, which additionally devaluated the sales value.

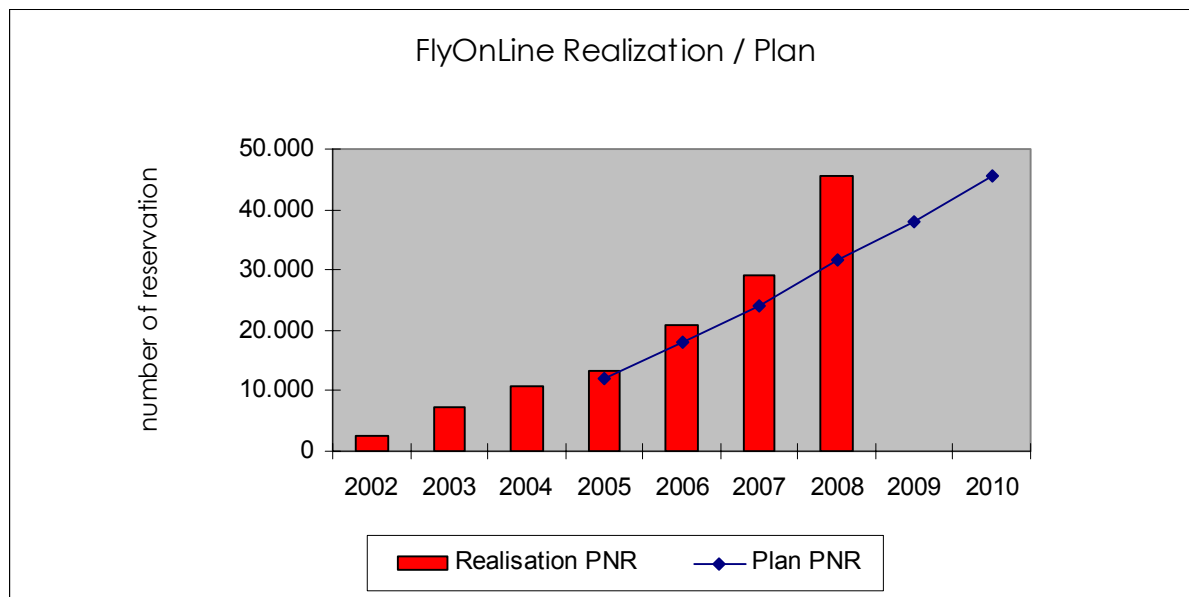
Before the start of the main tourist season and the introduction of the summer flight schedule, Croatia Airlines presented itself at well-known European tourism fairs in Oslo, Vienna, Dusseldorf, Copenhagen, Dresden, Zurich, Hamburg, Munich, at the leading tourism fair ITB in Berlin, and at the largest tourism fair Scandinavia TUR in Göteborg. In November, Croatia Airlines presented itself at the London fair, the World Travel Market, representing the official start of promotion for the 2009 tourist season, and the promotion continued in December at the EIBTM fair in Barcelona where it primarily promoted direct flights from Zagreb to Barcelona, to be introduced within the summer flight schedule in 2009.

A successful marketing action "Europe for 111 Euros" continued on the Croatian and the European market in the first three months of 2008, with the aim of attracting new users and increasing the load factor on international flights in the winter flight schedule. A new promotional campaign "Autumn in Europe" started in October, offering the price of 149 EUR for all international routes on the Croatian market, as

well as in Sarajevo, Skopje, Podgorica and Kosovo, for the purpose of increasing the load factor in the low season. A rise in the number of users and in the spending via co-branded credit cards of Croatia Airlines American Express Premium and Standard was another successfully completed goal in 2008. It was the result of the joint action with the PBZ Card, providing a free return ticket to one of Croatia Airlines' European destinations to all new users of the credit card Croatia Airlines American Express who spent at least 12,000 kuna in the first three months of their membership. The promotional campaign for the first companion Visa card in Croatia was implemented in November and December in cooperation with the Erste Card Club, in an effort to increase the number of users and the spending via co-branded cards.

A large part of the promotional activities during the year referred to the promotion of the network expansion in the summer flight schedule, i.e. to the promotion of four new destinations (Dusseldorf, Copenhagen, Pristina and Podgorica).

For the purpose of increasing visits to the company's web site, and thereby the revenues from online reservations of airline tickets and additional services (hotels, rent-a-car), an online campaign on the Google browser started on 7 May within the E-Commerce project, and it includes the four biggest markets (Great Britain, Germany, the Netherlands and France). The growing trend of ticket sale via Internet continued in 2008. **Online bookings through the Internet service FlyOnLine recorded a 56pp rise, and the Internet sale grew 48pp, in financial terms, compared to the previous year.**



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

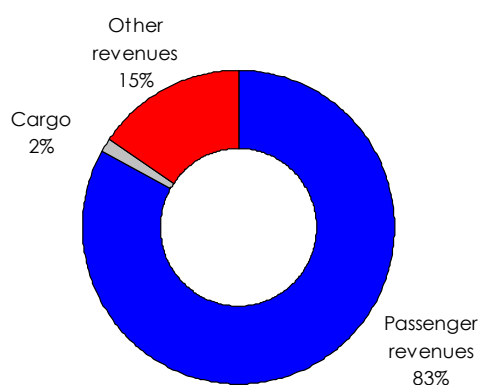
## Financial operations

### Profit and loss account

(000 kn)	2008	2007	Index 08/07	2006
Passenger traffic	1.352.819	1.210.527	112	1.089.236
Cargo traffic	26.348	22.534	117	23.767
Other revenues	252.138	230.873	109	232.163
<b>OPERATING REVENUES</b>	<b>1.631.305</b>	<b>1.463.935</b>	<b>111</b>	<b>1.345.166</b>
Flight operations	533.596	374.563	142	371.322
Maintenance	155.010	143.264	108	130.896
Passenger services	101.259	93.825	108	86.495
Aircraft and traffic services	338.589	317.350	107	301.373
Promotion and sales	225.753	214.424	105	208.441
General and administ. expenses	98.372	87.381	113	78.099
Amortization	172.440	179.346	96	164.592
Other expenses	36.832	5.790	636	19.547
<b>OPERATING EXPENSES</b>	<b>1.661.850</b>	<b>1.415.944</b>	<b>117</b>	<b>1.360.765</b>
<b>PROFIT/LOSS FROM OPERATIONS</b>	<b>-30.546</b>	<b>47.991</b>	<b>-</b>	<b>-15.599</b>
Interest expense	-56.206	-56.140	100	-71.642
Interest revenue	2.995	8.433	36	5.154
Foreign exchange differences, net	-6.542	3.092	-	117.573
Other financial expenses	-4.970	-2.338	213	-5.521
Other financial revenues	6.095	0	-	1.556
<b>NET FINANCIAL EXPENSES</b>	<b>-58.628</b>	<b>-46.953</b>	<b>125</b>	<b>47.120</b>
<b>NET PROFIT</b>	<b>-89.174</b>	<b>1.039</b>	<b>-</b>	<b>31.522</b>

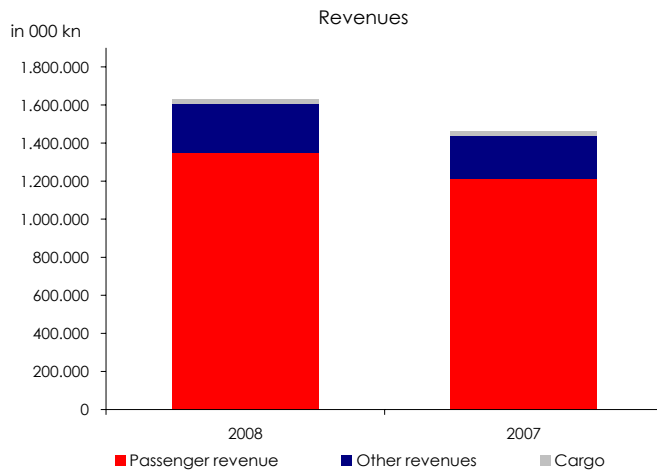
Despite a 9pp growth of passenger traffic and an 11pp growth of operating revenues, operating costs grew by 17pp, which resulted in the **operating loss** of some 31 mln Kn. The inclusion of the still significant costs of financing the fleet, and the unfavourable effects of the exchange rate change, brought the **ultimate net operating loss of 89 mln Kn in 2008**.

Structure of operating revenues 2008





The share of passenger revenues in operating revenues was on the level of the previous year, amounting to 83pp. The revenues from passenger transport rose faster than the high traffic performance and recorded a **12pp** rise despite the non-pecuniary and financial fall of charter traffic. The passenger transport growth and even faster growth of financial revenues from passenger transport show the **continuation of a trend of maintaining the average tariff level from the last year**, by which a years-long fall of the average passenger tariff that follows industrial trends of the yield fall and the pressures on the tariff was stopped.



The revenues from cargo transport were by 17pp higher, despite the fall of the non-pecuniary indicators, and they are the result of the cooperation with the external freight agent Cargo Counts, who took over the sales distribution and management and the maintenance of the external sales network. Due to the termination of the respective freight agent by its owner

Lufthansa Cargo, it is expected that Croatia Airlines will start looking for a new freight agent in 2009; however, great problems are expected in relation to finding such an agent, due to the global situation on the goods and mail transport market, which has been directly affected by the recession.

Other operating revenues were 9pp higher, primarily due to an increased state subsidy for the domestic traffic, higher revenues from the booking systems based on a larger number of passengers and transactions, and higher marketing revenues based on the realized Miles & More miles, that are now being recorded in line with the changed gross method.

**Operating costs were 17pp higher.** An increase in the level of costs was planned due to **the fleet expansion and the growth of traffic and the number of passengers**. Still, **flight costs saw the highest rise, due to increased fuel prices**. **The share of fuel costs** in the total operating costs compared to the same period last year grew by 5pp, **making up 22pp of the total operating costs**. The costs of aircraft lease were higher too, due to the keeping of two ATR aircraft in the operative lease after their sale at the start of the year, due to the costs of the lease of the two new Q400 aircraft and the additional *ad hoc* lease for covering the summer flight schedule until the arrival of the second Q400 aircraft. There was a rise in the personnel costs, after the new collective agreement with the flight personnel came into force on 1 August 2007.

During the year, the costs of services in air traffic grew due to increased block time of the more expensive Airbus aircraft (in terms of costs) and increased traffic. 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 traffic provided by Croatia Airlines at local airports.

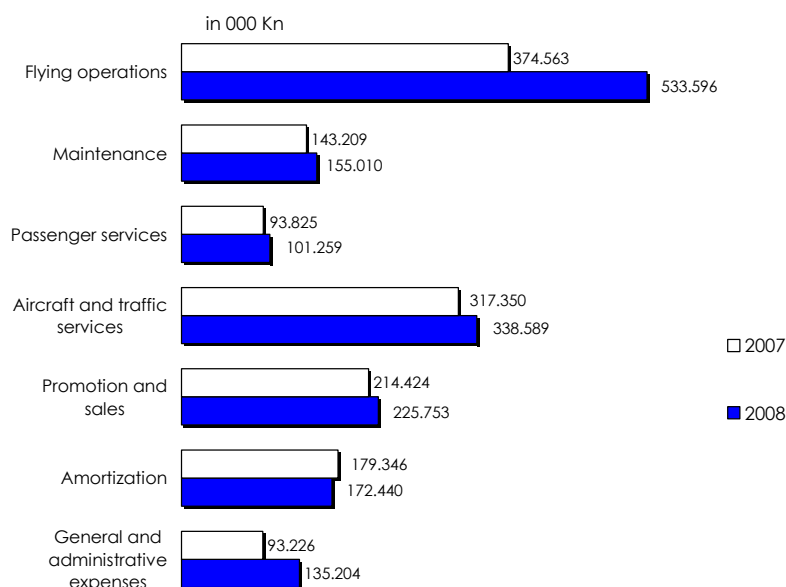
Along with the increase of passenger number, the costs of passenger services rose too, primarily those of waiting the passengers and of traffic disturbances. Also, an increase of the waiting personnel costs was realized on the basis of a new collective agreement with the cabin staff, which came into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

Maintenance costs rose due to increased costs of ATR aircraft maintenance amidst their preparation for sale and dismissal from the fleet, and a part of the increase was caused by higher costs of mostly licensed personnel based on the new collective agreements of 1 May 2007 and 1 January 2008.

Promotion and sales expenses rose due to increased costs of distribution and sales system and costs of promotional activities related to the growth of passenger traffic.

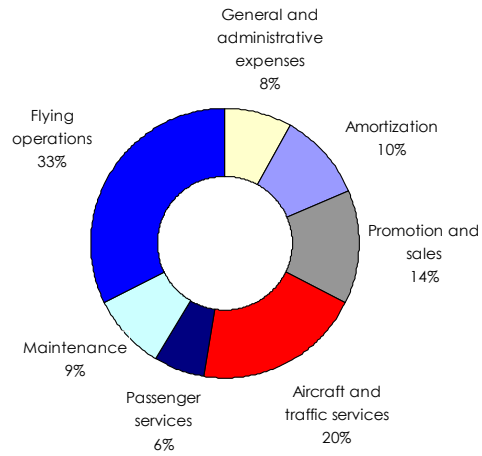
General and administrative expenses rose due to higher costs of personnel income amidst the reorganization of operations since 1 January 2008 and an increase of various and numerous categories of other costs.

Other expenses were higher due to a reduction in the current value of the ATR aircraft amidst the sale of three ATR aircraft, two of which were leased back until the end of the season, and amidst the sale of an Airbus aircraft in late 2008, which was also leased back.



The highest share in the expenses refers to the flying operations and aircraft and traffic services. The share of flying operations expenses in the total expenses rose by 6pp in 2008, due to a significant rise in the fuel costs and aircraft lease costs compared to the previous year.

Structure of operating expenses 2008



## Assets, financing and investments

## Statement of accounts

(000 kn)	end 2008	end 2007	Index	end 2006	Index
<b>ASSETS</b>					
<b>Non-current assets</b>	<b>1.476.098</b>	<b>1.707.793</b>	<b>86</b>	<b>1.898.267</b>	<b>90</b>
Intangible assets	7.388	2.634	280	2.977	88
Property, plant and equipment	1.394.072	1.684.229	83	1.707.056	99
Financial assets and receivables	74.639	20.929	357	188.234	11
<b>Current assets</b>	<b>313.130</b>	<b>232.172</b>	<b>135</b>	<b>167.204</b>	<b>139</b>
Inventories	31.908	29.001	110	24.392	119
Receivables	182.105	123.393	148	68.125	181
Financial assets	29.199	1.937	1508	5.972	32
Cash and cash equivalents	69.918	77.841	90	68.715	113
Prepaid expenses and accrued income	40.429	57.946	70	63.764	91
<b>TOTAL ASSETS</b>	<b>1.829.658</b>	<b>1.997.911</b>	<b>92</b>	<b>2.129.236</b>	<b>94</b>
<b>LIABILITIES</b>					
<b>Capital and reserve</b>	<b>527.133</b>	<b>685.227</b>	<b>77</b>	<b>709.744</b>	<b>97</b>
<b>Non-current liabilities</b>	<b>770.168</b>	<b>931.493</b>	<b>83</b>	<b>1.123.618</b>	<b>83</b>
Obligations under loans and lease	764.785	921.610	83	1.111.492	83
Long-term provision	5.383	9.883	54	12.125	82
<b>Current liabilities</b>	<b>504.454</b>	<b>351.454</b>	<b>144</b>	<b>271.056</b>	<b>130</b>
Obligations under loans and lease	219.509	143.092	153	117.462	122
Accounts payable and others liabilities	284.944	208.362	137	153.594	136
Accrued expenses and defferd income	27.904	29.737	94	24.818	120
<b>TOTAL LIABILITIES</b>	<b>1.829.658</b>	<b>1.997.911</b>	<b>92</b>	<b>2.129.236</b>	<b>94</b>

*Remark Changes in level of assets and liabilities for 2006 and 2007 compared to financial reports for the same period already published arrived from reclassification of some audit reports categories for 2008 according to IAS requests..*

The value of assets (liabilities and capital) was 8pp lower at the end of the year due to a decreased level of loan liabilities and the current value of assets amidst the sale of aircraft. At the end of 2008, credit liabilities with local banks totalled 71.3 mln Kn (8.3 mln Kn refer to long-term liabilities and 63 mln Kn refer to short-term liabilities). A long-term loan taken with the banks' union amounts to 913 mln Kn, and the first installment for the payment of the principal was due in December 2008.

## Investments in 2008

Investments	2008	2007	2006
Investments into aircraft	43.661.671	97.135.032	63.921.759
Investments into spare parts, tools and equip.	33.574.859	6.925.484	5.972.596
Construction investments	13.150.273	11.710.758	2.601.074
Intangible assets	6.861.115	1.172.153	1.894.849
Other equipment	2.922.564	1.439.159	1.340.390
Maintenance Reserve	39.254.966	36.704.562	1.492.844
<b>Total</b>	<b>139.425.448</b>	<b>155.087.148</b>	<b>77.223.512</b>
<b>Financial investments into aircraft (predelivery financing)</b>	<b>29.602.418</b>	<b>1.211.642</b>	
<b>Other financial investments</b>	<b>1.414.976</b>	<b>2.796.209</b>	<b>1.133.939</b>

Within the **investments into aircraft**, 28.3 mln Kn was spent on engine check-ups and works, including one engine check-up on an Airbus and two engine check-ups on an ATR aircraft. A part of the investment in the amount of 15 mln Kn refers to the check-up of the engine on an Airbus aircraft which was completed last year so it was not financially planned for 2008, but the documentation on it was available only at the start of this year after the closing of the business year of 2007, when it was entered into the business books. This created a difference compared to the planned investments into aircraft, but only in terms of time disproportion, while in terms of costs – this investment was included through amortization in the plan for 2008 by regular amortization of this check-up. A 609,000 Kn worth replacement of the engine fan blades on an Airbus and the two planned replacements of the undercarriage on Airbus aircraft worth 3.7 mln Kn were also carried out. The investments also included the planned six-year check-up on an Airbus (CTF), worth 9.6 mln Kn. A part of the investments into aircraft refers to the 1.7 mln Kn worth modifications carried out on Airbus aircraft and to the 10,000 Kn worth modifications performed on ATR aircraft. The amount of 310,000 Kn represents the output from the storage as a preparation of the twelve-year check-ups planned in 2009 on Airbus aircraft (CTG i CTH).

In addition to the above mentioned investments, C checks were carried out in internal construction on six Airbus aircraft (CTI, CTF, CTJ, CTG, CTH i CTI) and on ATR 42 aircraft.

Apart from the investment into the Company's own fleet, a twelve-year check-up was performed on the leased aircraft (Airbus CTM).

**Construction investments** mostly refer to those made into a new mobile hangar, into which 7.8 mln Kn were invested, to 3.3 mln Kn investments into the old hangar, and to those of 2.1 mln Kn made into the preparatory building documentation for the construction of the future business facility.

The overall investment into the new mobile hangar that was put into operation in 2008 amounted to 13.5 mln Kn.

**A part of the investments into intangible assets** in the amount of 5.2 mln Kn refers to investments into the implementation of the new business system. It is an integrated business-information system based on the SAP ERP solution and the SAP BI system for the support of planning and business decision-making. Croatia Airlines in this way continues realizing its corporate plans, advancing the company in terms of technology

and information, adopting the world's best business practices and state-of-the-art solutions.

**Maintenance reserves**, i.e. regular monthly investments into reserves for future aircraft and engine maintenance works amount to 39.3 mln Kn.

**The financial investments into future aircraft purchases** amounted to 29.6 mln Kn in 2008, of which 25.1 mln Kn refer to the predelivery financing of Airbus aircraft by which the medium-haul fleet will be expanded in the upcoming medium-term period, and to the guarantee deposit in the amount of 1.4 mln kn for the two ATR aircraft that Croatia Airlines took into lease at the start of the year, after their sale, and which will be returned after the lease expiry at the end of the year. The financial investments worth 3.5 mln Kn refer to the deposit for the first two Q400 aircraft.

**Other financial investments** were worth 1.4 mln Kn and refer to the deposits given for the employees' housing loans.

### Cash flow movements

Cash flow (000 kn)	2008	2007	Index	The cash flow level (inflow and outflow) rose by 7pp in 2008 compared to the previous year.  Increased inflows from operations are the result of the market expansion, increased traffic, and higher revenues, followed by increased payment of liabilities,
Cash at the beginning of the period	77.841	68.715	113	
Inflow from activities	1.632.192	1.470.839	111	
Inflow from Government	99.922	69.993	143	
Sales of assets	124.728	0	-	
Loans	32.891	241.745	14	
Financial inflow	43.673	32.822	133	
<b>Total inflow</b>	<b>1.933.406</b>	<b>1.815.399</b>	<b>107</b>	
Obligations	1.675.692	1.415.716	118	
Investments	57.965	33.517	173	
Loans	163.715	202.029	81	
Financial outflow	43.956	155.011	28	
<b>Total outflow</b>	<b>1.941.329</b>	<b>1.806.273</b>	<b>107</b>	
<b>Net change for period</b>	<b>-7.923</b>	<b>9.126</b>	<b>-</b>	
Cash at the end of the period	69.918	77.841	90	

primarily due to the rise in fuel prices.

The inflow from the sale of assets came mainly from the sale of an Airbus aircraft and three ATR aircraft within the replacement of the medium-haul fleet.

A short-term borrowing realized at the end of the year amounted to 32.9 mln kn.

The pre-delivery financing of aircraft purchases in the upcoming middle-term period was completed during the year, aside from the regular loan liabilities.

## Review of the Plan realization

### Traffic performance indicators compared to the Plan

description			Realisation 2008	Plan 2008
flights (km)	DIST	000	16466	16730
departure	FLTS		26013	25799
annual change rate		%	1	
block hours	BH		35790	35086
annual change rate		%	2	
passengers carried	RPAX	000	1869	1903
annual change rate		%	-2	
freight&mail carried	CGO	T	4393	4784
annual change rate		%	-8	
passenger km flown	RPKM	mln	1372	1429
available seat -km	ASKM	mln	2103	2160
<b>passenger load factor</b>	<b>PLF</b>	<b>%</b>	<b>65,2</b>	<b>66,2</b>
tonne km flown	TKM	mln	126	132
available tonne - km	ATKM	mln	231	238
<b>weight load factor</b>	<b>WLF</b>	<b>%</b>	<b>54,7</b>	<b>55,3</b>

In 2008, the fleet block time in BH was 2pp higher, and the block time in flights was 1pp higher compared to the planned, while the number of the transported passengers was 2pp lower. The realized traffic results directly affected the level of realized revenues and the level of costs in 2008.

### Profit and loss account

(000 kn)	2008	PLAN 2008	Index
Passenger traffic	1.352.819	1.353.941	100
Cargo traffic	26.348	24.863	106
Other revenues	252.138	275.077	92
<b>OPERATING REVENUES</b>	<b>1.631.305</b>	<b>1.653.882</b>	<b>99</b>
Flyinf operations	533.596	483.381	110
Maintenance	155.010	158.235	98
Passenger services	101.259	105.735	96
Aircraft and traffic services	338.589	351.022	96
Promotions and sales	225.753	234.121	96
General and admi. Services	98.372	101.818	97
Amortisation	172.440	173.245	100
Other expenses	36.832	21.363	172
<b>OPERATING EXPENSES</b>	<b>1.661.850</b>	<b>1.628.920</b>	<b>102</b>
<b>PROFIT/LOSS FROM OPERATIONS</b>	<b>-30.546</b>	<b>24.962</b>	<b>-</b>
Interest expenses	-56.206	-56.404	100
Interes revenues	2.995	7.439	40
Foreign exchange differences, net	-6.542	0	-
Other financial expenses	-4.970	-2.168	229
Other financial revenues	6.095	32.273	19
<b>NET FINANCIAL RESULT</b>	<b>-58.628</b>	<b>-18.860</b>	<b>311</b>
<b>NET PROFIT/LOSS</b>	<b>-89.174</b>	<b>6.102</b>	<b>-</b>

Due to higher operating costs than planned (higher oil price, unplanned additional lease and higher sale expenditure than planned), the operating loss amounted to 31 mln Kn, and after including financial costs (costs of financing the fleet and the costs/revenues based on exchange rate changes), the loss amounted to 89 mln Kn.

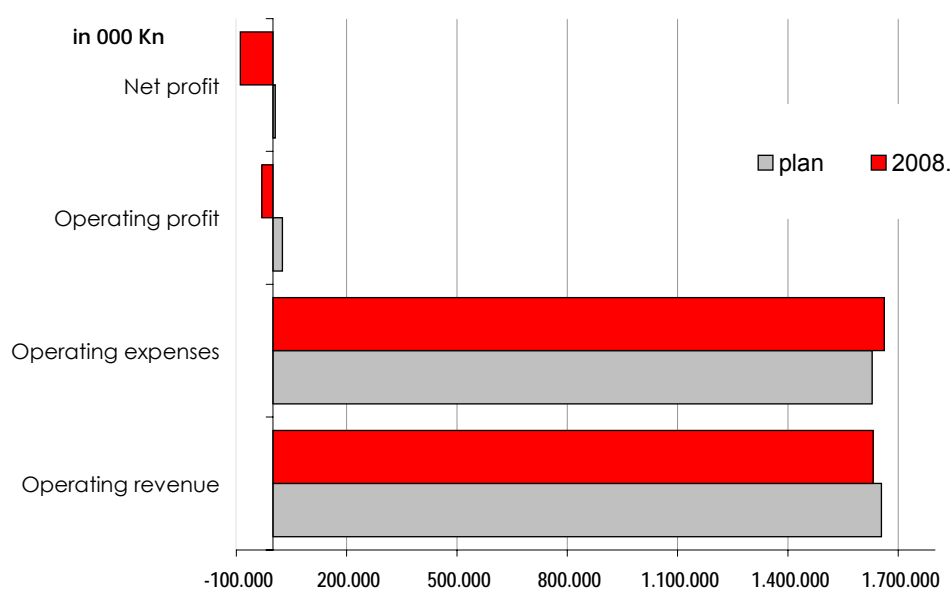
The revenues from passenger transport were close to the planned level, despite lower income from charter passenger traffic and the code share cooperation, and poorer sale on certain markets (America). The financial sales results in 2008

show an overrun of the planned **sale of scheduled traffic on the domestic market by 5pp**, and a **6pp** fall of the **international sale** of scheduled traffic **compared to the plan**. The fall was directly caused by the **fall of sale on the American market**, and one of the factors of the fall is certainly the **decline of the USD exchange rate, devaluating the sales value** on one of the most significant foreign sales markets for Croatia Airlines. These movements were **conditioned by recession weaknesses and the financial problems of the American economy**. The business year was characterized by a higher sale on the existing markets (Germany, Australia, Spain, Sweden and the countries of the narrow region), and by the start of sale on the new market (Kosovo), which partially compensated for the fall on the American market.

**Revenues from cargo transport** were **6pp higher than planned**, based on the successful cooperation with the external cargo agent, which took over the sales distribution and management and the maintenance of the external sales network.

Other operating revenues were 8pp lower than planned, primarily due to a failure to realize all planned sales of fixed assets (the business plan stipulated the sale of shares in the associated companies and the sale of assets in the business premises in Zagreb and Zadar, which was not realized). The sale of the fixed assets was planned for the purpose of directing all Croatia Airlines' resources towards its fundamental activity and its development.

**Operating costs were 2pp higher than planned**, amidst a great overrun of fuel costs due to high costs of fuel in the summer season, when Croatia Airlines performs most of its traffic operations, which could not be compensated by the pronounced fall in the fuel prices in the final quarter. A part of the overruns of the planned operating costs refers to the higher costs of lease of aircraft that Croatia Airlines had to additionally lease due to a late delivery of the new Dash 8-Q400 aircraft. Based on the sale of three ATR aircraft, two of which were kept in the operative lease (leaseback) until the end of the season, and the sale of an Airbus at the end of the year, which was also kept in the operative lease, the reduction of the current value of the aircraft was also in an overrun. All other categories of operating costs were on the same or lower level than planned, contributed by 1.7pp lower EUR exchange rate than projected and 3.3pp lower USD exchange rate than projected.





## Statement of accounts

(000 kn)	end 2008	PLAN	Index
<b>ASSETS</b>			
<b>Non-current assets</b>	<b>1.476.098</b>	<b>1.557.097</b>	<b>95</b>
Intangible assets	7.388	4.560	162
Property, plant and equipment	1.394.072	1.463.034	95
Financial assets and receivables	74.639	89.503	83
<b>Current assets</b>	<b>313.130</b>	<b>247.149</b>	<b>127</b>
Inventories	31.908	30.002	106
Receivables	182.105	125.494	145
Financial assets	29.199	5.296	551
Cash and cash equivalents	69.918	86.358	81
Prepaid expenses and accrued income	40.429	28.927	140
<b>TOTAL ASSETS</b>	<b>1.829.658</b>	<b>1.833.173</b>	<b>100</b>
<b>LIABILITIES</b>			
<b>Capital and reserve</b>	<b>527.133</b>	<b>630.230</b>	<b>84</b>
<b>Non-current liabilities</b>	<b>770.168</b>	<b>788.033</b>	<b>98</b>
Obligations under loans and lease	764.785	783.242	98
Long-term provision	5.383	4.791	112
<b>Current liabilities</b>	<b>504.454</b>	<b>372.272</b>	<b>136</b>
Obligations under loans and lease	219.509	159.380	138
Accounts payable and others liabilities	284.944	212.892	134
Accrued expenses and defferd income	27.904	42.639	65
<b>TOTAL LIABILITIES</b>	<b>1.829.658</b>	<b>1.833.173</b>	<b>100</b>

The value of the assets, i.e. liabilities and capital, was at the end of the year on the level of the planned values, but with a somewhat different structure. The fixed assets were lower due to the sale of an Airbus (CTF) in late 2008, which Croatia Airlines took into lease (leaseback). The current assets were higher than planned due to higher claims, mostly those by the state – on the basis of subsidies and VAT, and amidst increased financial assets after the purchase of currency derivative instruments during the year.

The level of the capital and reserves was lower than planned at the end of 2008, due to a loss compared to the planned profit, while the long-term liabilities were lower due to a lower level of the exchange rates of EUR and USD than projected.

The short-term liabilities were higher than planned due to higher liabilities related to short-term loans (the existing short-term loan of 4 mln EUR was reprogrammed at the end of the year, and an additional one-year short-term loan worth 4.6 mln EUR was taken with Privredna banka Zagreb), and due to liabilities to suppliers and other short-term liabilities.

## Current status – Traffic results I - III 2009

description			realization I-III 2009	plan I-III 2009
flights (km)	DIST	000	2959	2950
departures	FLTS		5252	5203
growth rate		%	1	
block hours	BH		6505	6409
growth rate		%	1	
passengers carried	RPAX	000	300	306
growth rate		%	-2	
freight & mail carried	CGO	T	903	880
growth rate		%	3	
passengers km flown	RPKM	mln	184	191
available seat - km	ASKM	mln	370	375
<b>passenger load factor</b>	<b>PLF</b>	<b>%</b>	<b>49,7</b>	<b>50,9</b>
tonne km flown	TKM	mln	17,2	17,8
available tonne-km	ATKM	mln	41,3	41,9
<b>Weight load factor</b>	<b>WLF</b>	<b>%</b>	<b>41,7</b>	<b>45,7</b>

The year 2009 started for Croatia Airlines, like for the whole airline industry, with a decline in the number of passengers. As the result of the global economic crisis and recession, the number of passengers is decreasing by 3pp compared to the previous year.

The number of passengers in the domestic scheduled traffic has decreased by 4pp and the international traffic results have remained on the same level as in the same period last year.

The passenger load factor (PLF) has been decreasing on all markets. The tendencies in the first three months of this business year show that 2009 will be very difficult for the whole industry and for Croatia Airlines. As a result, we have already started considering options of cutting down expenses during the year so as to diminish the negative financial results of the recession on traffic results as much as possible.

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