ANNUAL REPORT 2006

CONTENTS

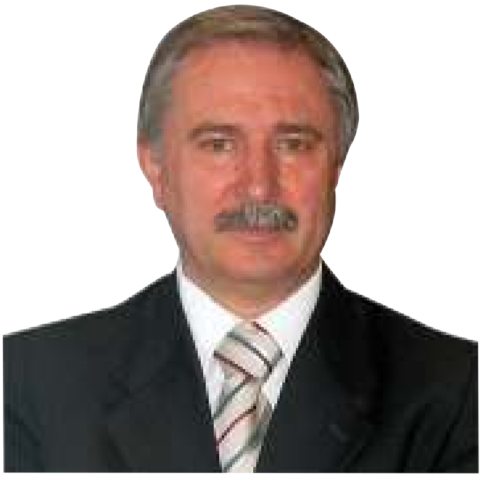
FINANCIAL HIGHLIGHTS

Balance Sheet	in thousands of HRK
Total assets	1,889,603
Total shareholders' equity	158,630

Income Statement	in thousands of HRK
Net operating income	87,933
Profit before tax	27,319
Profit after tax	21,496

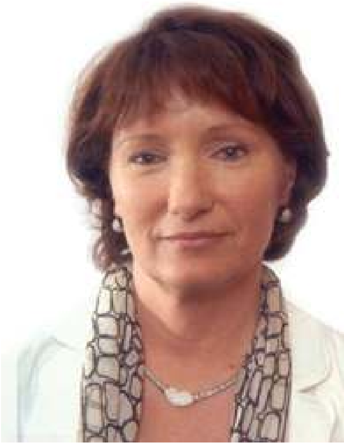
MANAGEMENT BOARD

Chairman



Miro Dodić, B.Econ.

Member



Marina Vidič, B.Econ.

SUPERVISORY BOARD

Chairman	Milan Travan, B.Econ.
Vice Chairman	Edo Ivančić, B.Econ.
Members	Marijan Kovačić, B.Econ.
	Vlatko Reschner, B.Econ.
	Vlado Kraljević

REPORT OF THE MANAGEMENT BOARD

Dear shareholders and business partners,

As the Chairman of the Management Board it is a great pleasure to be able to present to you the successful business operation of Istarska Kreditna Banka Umag in 2006, in which a valuable jubilee was celebrated – the 50th anniversary of a very successful development process in the banking industry.

Among several banks that operated and had their head offices located in the region including the Istarska and Primorsko-Goranska counties, it is only Istarska Kreditna Banka Umag that remained with the domestic ownership structure and the same registered office, being one of the first privatized banks in Croatia.

The Bank's policy and the results accomplished in 2006 have confirmed the achievement of the defined long-term strategic course of the Bank's strengthening as a significant regional banking institution which will be recognized among its customers by its stability and successful performance.

During the year we improved the quality of our services, continued to implement new products and services, achieved a significant increase of our market share and at the same time maintained our high profitability rate. I would like to emphasize that in 2006 the Bank's growth was achieved once again based solely on the increase of our primary sources of funds, i.e. customer deposits, resulting from the longstanding confidence of our customers. This provides acknowledgment to our commitment over many years not to take up foreign borrowings, which makes us one of a few Croatian banks without foreign debt. This is one of our basic principles by means of which we emphasize to our individual and corporate customers our stability and the safety of their funds entrusted to our safekeeping. Because of the high indebtedness rate in Croatia, in the forthcoming period our policy of non-indebtedness will present a significant advantage both for the Bank and the Bank's customers.

Istarska Kreditna Banka Umag has a very good network coverage of the territory of the Istrian County and recently it has been expanding its business network in the region of the Primorsko-Goranska County as well, so that today the Bank operates from four business centres including 21 branches and branch-offices.

Such a relatively large branch network demands quality management in terms of the Bank's profitability and therefore a new organizational structure has been set up. The aim of the new organization of business activities in the Bank's head office and its branch network introduced at mid-year was primarily to come closer to our customers and their needs. The new organizational structure is based on the restructuring made in line with the defined strategic objectives, which will provide the Bank's further development and the realization of targeted strategic projects. According to the new organizational structure the Bank was divided into three major sections: business units i.e. profit centres, support units i.e. cost centres, and management and controlling units.

The performance objectives were determined for the previous year through the annual business plan which formed an integral part in the Bank's Strategic Plan 2006-2010 - a basic document which outlines the long-term policies of the Bank in terms of development, growth, business operation and performance.

The total assets of Istarska Kreditna Banka at year end 2006 amounted to HRK 1,894 million, representing an annual increase of 11.3 percent or HRK 190 million.

The sources of funds, i.e. customer deposits, which represent the basis of the Bank's growth, were increased in every segment and across the branch network. Deposits were increased by 11.6 percent or by more than HRK 175 million as compared to 2005. I want to emphasize quite clearly our satisfaction in terms of the increase in individual customer deposits, as it points out to the continued confidence of our citizens placed in the Bank.

As the Bank's business policy for the financial year 2006 was focused on the increase of lending activities and thereby the increase of profitability itself, we have witnessed a true credit expansion resulting in loans increasing by 34.7 percent in comparison to 2005 and accounting for 52.65 percent of the total assets, as compared to 43.51 percent in 2005. The lending operations increased in all business segments and across the entire branch network, but the profitability of these low exposure loan approvals will be best reflected as early as the current 2007. Lending activities were focused on both corporate and individual customers, with a special emphasis on citizens' housing loans.

It is worth mentioning that we were able to increase the assets within the balance sheet in all business segments and across all business units without any significant increase in staff number.

Despite the fierce competition and the restrictive monetary policy of the Croatian National Bank as well as the decline in interest rate margins, the Bank managed to earn the profit before taxation of HRK 27.32 million in 2006. Thus, with the prevailing trend on the market in terms of declining lending interest rates and bank service charges, Istarska Kreditna Banka managed to increase its profit from operations by 25 percent as compared to the previous year.

Within the income structure we are especially pleased that the interest income increased significantly i.e. by 13.2 percent as a result of an increased number of new loan approvals, which is expected to render full effects in 2007. The increase of operation expenses came as a result of significant investments in the modernisation, expansion and development of the branch network as well as the development of new products and services. However, it should be emphasised that the increase of income in 2006 was higher than the increase in expenses, implying that the reduction of the cost-income ratio as one of the Bank's major strategic goals was achieved.

While during the previous years significant earnings were made from the indexation of securities, in 2006 there was a loss resulting from adjustments as at 31 December 2006 due to the reduced value of state bonds at the securities market, which affected the final profit figure.

Thus, the net profit amounted to HRK 21.5 million, representing a slight increase over the previous year. The net profit will be partly allocated to the Bank's reserves and partly distributed to the shareholders as dividends.

Speaking of business activities carried out in 2006, the most important ones were the implementation and establishment of the new organisational structure in line with the new objectives of the strategic plan until 2010, the adjustment of our products and services to the demands of the marketplace and the design of our own computer applications for the internet based corporate domestic payments as well the internet banking software for individual customers. After the implementation of internet based foreign payment transactions for corporate customers, through this significant step we completed a phase in the development of the service that obtains more and more importance among customers. In 2006 we also completed the process of assumption of payment operation processing from the Financial Agency into the Bank by converting from Model I to Model III of cooperation with the Financial Agency. Thus, we were able to offer our customers a more complete service in terms of payment transactions, which will significantly impact the Bank's profitability in this segment in 2007. The reduction of non-interest expenses is expected along with the increase in non-interest income.

In the years to come it is our goal to make Istarska Kreditna Banka a bank with stronger presence on the regional banking market. We intend to achieve this goal by investing into young skilled and professional employees, strengthening the staff structure, continuing development and an active approach towards customers through creating a quality business environment which corresponds to their requirements.

The main objectives of the 2007 business operations continue to be the investment in the branch network with an equal orientation towards individual customers, small and middle-sized entrepreneurs and the further development of IT systems including considerable investments in both hardware and software. We believe that it is exactly this very approach that will give fresh impetus to the Bank's development through the widening of the product range and further strengthening of the customer base.

Finally, I would like to seize this opportunity to express my gratitude to all of our customers, business partners and shareholders for their trust placed in the Bank. I would specially like to thank the members of the Supervisory Board, the Bank management and staff on their support, efforts and contribution to the achievement of the successful 2006 results.

Chairman of the Management Board
Miro Dodić, B.Econ.

REPORT ON THE ACTIVITIES OF THE SUPERVISORY BOARD OF ISTARSKA KREDITNA BANKA UMAG D.D. UMAG IN 2006

The Supervisory Board of Istarska Kreditna Banka Umag was constituted based on the decision of the Bank's General Meeting of shareholders in April 2003. The Supervisory Board has performed its functions in compliance with legal provisions, especially the Company Law, the Banking Law, the Articles of Incorporation and other internal by-laws of the Bank.

In 2006 Istarska Kreditna Banka has celebrated the 50th anniversary of its business activities, continuing to maintain and strengthen the Bank's position on the financial market of our region. Through the achievement of good business results, our common and unique objectives of further independent development of the Bank have been confirmed, especially by expanding the branch network and introducing new financial services in line with the trends of modern banking, referring mostly to the development of internet banking for both business entities and individual customers.

During the year the Supervisory Board has held 37 meeting, four of them being ordinary meetings, and in 33 cases, when fast and operative decision-making was required, decisions were made by written declaration of opinion by the Board members.

In ordinary meetings the Supervisory Board has reviewed and adopted the Management Board's reports about the Bank's performance and especially in 2006 the Strategic plan for the development of the Bank from 2006 to 2010 was adopted. The new organisation scheme and the reorganization of the Bank were discussed, the 2007 Business Plan was adopted and through the review of different reports the supervison and verification of the Bank's liquidity and the activities of various departments and bodies of the Bank were carried out. The Supervisory Board is also competent for the adoption of certain decisions and the granting of consents according to legal rules, so that in a number of cases necessary decisions were made, which mostly refer to the Bank's lending business, the exposure and the risk management in the Bank's activities.

According to all the reports submitted to us and based on detailed information received from the Management Board, we hereby appraise that the overall business operation throughout 2006 was conducted in line with the business policy and within the legal framework. The Audit of financial statements was performed by the company PriceWaterhouseCoopers, whose report and opinion were fully accepted by the Supervisory Board as a professional and fair view of the financial position and the business results as stated in the Bank's financial records.

The Supervisory Board agrees to the proposal of the Management Board as to the adoption of the annual accounts and the distribution of profits for the current year. The profit earned in 2006 will be distributed partly to the Bank's reserves in order to strengthen the Bank's capital base, and partly to the dividends for shareholders.

This Report will be submitted to the General Meeting of shareholders with the proposal to adopt the same.

Finally, on behalf of the Supervisory Board I would like to express our appreciation to the Bank's clients for their confidence, the shareholders, employees and the management of Istarska Kreditna Banka Umag for the results they have achieved, and especially I would like to thank the members of the Supervisory Board on their engagement and cooperation throughout the year.

Umag, 23 February 2007

Chairman of the Supervisory Board
Milan Travan, B.Econ.

PRICEWATERHOUSECOOPERS

ISTARSKA KREDITNA BANKA UMAG D.D., UMAG

FINANCIAL STATEMENTS
AND INDEPENDENT AUDITORS' REPORT
FOR THE YEAR ENDED 31 DECEMBER 2006

PRICEWATERHOUSECOOPERS

FREE TRANSLATION FROM CROATIAN ORIGINAL

PricewaterhouseCoopers d.o.o.
A. von Humboldta 4
HR-10000 Zagreb
CROATIA
Telephone (385 1) 6328 888
Facsimile (385 1) 6111 556

Independent auditors' report

To the Shareholders of Istarska kreditna banka Umag d.d., Umag

We have audited the accompanying financial statements of Istarska kreditna banka Umag d.d., Umag (the Bank) which comprise the balance sheet as of 31 December 2006 and the income statement, statement of changes in equity and cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory notes.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

PRICEWATERHOUSECOOPERS

Opinion

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position the Bank as of 31 December 2006, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers d.o.o.

PricewaterhouseCoopers d.o.o.
28 February 2007

PRICEWATERHOUSECOOPERS
za reviziju i konzalting d.o.o. 3
ZAGREB, Alexandera von Humboldta 4

Tatjana Rukavina
President of the Management Board

Dušica Madžarac
Certified auditor

Report of the Board of Directors

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

After making enquiries, the Management Board has a reasonable expectation that the Bank has adequate resources to continue in operational existence for the foreseeable future. For this reason, the Management Board continues to adopt the going concern basis in preparing the financial statements.

In preparing those financial statements, the responsibilities of the Management Board include ensuring that:

- suitable accounting policies are selected and then applied consistently;
- judgements and estimates are reasonable and prudent;
- applicable accounting standards are followed, subject to any material departures disclosed and explained in the financial statements; and
- the financial statements are prepared on the going concern basis unless it is inappropriate to presume that the Bank will continue in business.

The Management Board is responsible for keeping proper accounting records, which disclose with reasonable accuracy at any time the financial position of the Bank and must also ensure that the financial statements comply with the Croatian Accounting Law (Official Gazette 146/05). The Board is also responsible for safeguarding the assets of the Bank and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Signed on behalf of the Management Board

Miro Dodić

Istarska kreditna banka Umag d.d., Umag
Ernesta Miloša 1
52470 Umag
Republic of Croatia
28 February 2007

ISTARSKA KREDITNA BANKA D.D., UMAG
INCOME STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2006

(all amounts are expressed in thousands of HRK)	Notes	2006	2005
Interest and similar income		96,722	85,598
Interest expense and similar charges		(35,771)	(32,319)
Net interest income	6	**60,951**	**53,279**
Fee and commission income		20,974	20,070
Fee and commission expense		(8,259)	(8,297)
Net fee and commission income	7	**12,715**	**11,773**
Foreign exchange differences-net	8	12,740	9,398
Result of trading assets	9	(2,686)	4,842
Gains from investment securities	20	298	-
Impairment provisions-net	12	395	700
Other operating income		834	1,312
Administrative expenses	10	(51,030)	(47,871)
Other operating expenses	11	(6,898)	(6,317)
PROFIT BEFORE INCOME TAX		**27,319**	**27,116**
Income tax expense	13	(5,823)	(5,713)
PROFIT FOR THE YEAR		**21,496**	**21,403**
Basic and diluted earnings per shares –ordinary and preference (in HRK)	14	**364,41**	**362,76**

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

ISTARSKA KREDITNA BANKA D.D., UMAG
BALANCE SHEET
AS AT 31 DECEMBER 2006

(all amounts are expressed in thousands of HRK)	Notes	2006	2005
ASSETS			
Cash and balances with Central bank	15	341,193	353,640
Treasury bills and other eligible bills	16	139,630	36,385
Loans and advances to banks	17	290,278	446,839
Loans and advances to customers	18	963,175	706,170
Trading assets	19	37,489	81,971
Investment securities:			
- available for sale	20	47,616	2,226
- held- to- maturity	20	20,108	19,730
Intangible assets	21	3,001	2,261
Property and equipment	22	28,965	31,478
Non-current assets held for sale	23	14,938	15,176
Other assets	23	3,210	2,463
Total assets		**1,889,603**	**1,698,339**
LIABILITIES			
Due to banks	24	26,003	17,556
Due to customers	25	1,692,447	1,515,662
Current income tax liability	13	116	121
Other liabilities	26	12,407	12,499
Total liabilities		**1,730,973**	**1,545,838**
EQUITY			
Share capital	27	65,054	65,080
Retained earnings	29	48,155	42,000
Reserves	29	45,421	45,421
Total equity		**158,630**	**152,501**
Total equity and liabilities		**1,889,603**	**1,698,339**

Signed on behalf of the Management Board of Istarska kreditna banka Umag d.d., Umag, on 28 February 2007:

Miro Dodić
President of the Management Board

Marina Vidič
Member of the Management Board

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

ISTARSKA KREDITNA BANKA D.D., UMAG
STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2006

(in thousands of HRK)	Note	Share capital	Treasury shares	Share premium	Reserves	Retained Earnings	Total
At 1 January 2005		**64.900**	**-**	**163**	**45,421**	**33,459**	**143,943**
Net profit for the year		-	-	-	-	21,403	21,403
Dividend relating to 2004		-	-	-	-	(12,862)	(12,862)
Purchase/sales of treasury shares	27	-	-	17	-	-	17
At 1 January 2006		**64.900**	**-**	**180**	**45,421**	**42,000**	**152,501**
Net profit for the year		-	-	-	-	21,496	21,496
Dividend relating to 2005		-	-	-	-	(15,341)	(15,341)
Purchase of treasury shares	27	-	(13)	(13)	-	-	(26)
At 31 December 2006		**64.900**	**(13)**	**167**	**45,421**	**48,155**	**158,630**

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

ISTARSKA KREDITNA BANKA D.D., UMAG
CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2006

(all amounts expressed in thousands of HRK)	Note	2006	2005
Cash flows from operating activities			
Profit before taxation		27,319	27,116
Income tax	13	(5,707)	(5,592)
Depreciation and amortisation	10	5,529	5,867
Decrease in impairment provisions	12	(395)	(700)
Net gains/(losses) from trading assets	8	(643)	494
Gains from investment securities	20	(298)	-
Change in fair value of trading assets	9	3,329	(5,336)
Other non-cash items		1,721	(2,922)
Cash flows from operating profits before changes in operating assets and liabilities		30,855	18,927
-net increase/(decrease) in assets with the Croatian National Bank		(28,983)	1,217
-net increase in treasury bills and other eligible bills		(83,855)	(9,657)
-net increase in loans and advances to customers		(259,586)	(59,984)
-net increase in other assets		(607)	(1,371)
-net (decrease)/increase in due to banks		(509)	64
-net increase in due to customers		177,807	132,599
-net (decrease)/increase in other liabilities		(440)	130
Net cash (used in)/from operating activities		**(165,318)**	**81,925**
Cash flows from investing activities			
Purchase of intangible assets	21	(1,591)	(1,437)
Purchase of property and equipment	22	(2,165)	(2,876)
Purchase of securities		(19,328)	(85,118)
Proceeds on sale of securities		61,032	83,470
Net cash from/(used in) in investing activities		**37,948**	**(5,961)**
Cash flows from financing activities			
Proceeds from other borrowed funds		20,969	16,718
Repayments of other borrowed funds		(12,013)	(7,401)
Sale of treasury shares	27	-	17
Purchase of treasury shares	27	(26)	-
Dividends paid		(15,341)	(12,862)
Net cash used in financing activities		**(6,411)**	**(3,528)**
Effect of exchange rate changes		180	(1,914)
Net increase in cash and cash equivalents		**(133,601)**	**70,522**
Cash and cash equivalents at beginning of year	31	637,264	566,742
Cash and cash equivalents at end of year	31	503,663	637,264

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

ISTARSKA KREDITNA BANKA D.D., UMAG
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2006

NOTE 1 – GENERAL INFORMATION

HISTORY AND INCORPORATION

Istarska kreditna banka Umag d.d., Umag (the "Bank") was registered as a joint stock company on 19 December 1989. The address of the Bank's registered office is Ernesta Miloša 1, Umag, Croatia.

Principal activities of the Bank

1. accepting and placing of deposits,
2. providing current and term deposit accounts;
3. granting short and long-term loans and guarantees to the Ministry of Finance, local municipalities, corporate customers, private individuals and other credit institutions dealing with finance lease and foreign exchange transactions,
4. treasury operations in the interbank market,
5. trust management and investment banking services,
6. performing local and international payments,
7. providing banking services through an extensive branch network in the Republic of Croatia.

GOVERNANCE AND MANAGEMENT

GENERAL ASSEMBLY

Marijan Kovačić	President

SUPERVISORY BOARD

Milan Travan	President
Edo Ivančić	Vice president
Marijan Kovačić	Member
Vlatko Reschner	Member
Vlado Kraljević	Member

MANAGEMENT BOARD

Miro Dodić	President
Marina Vidič	Member

The shareholders of the Bank as at 31 December 2006 and 2005 are disclosed in note 27.

The Bank has its primary listing on the Zagreb Stock Exchange.

The Bank is subject to the regulatory requirements of the Croatian National Bank. These regulations include limits and other restrictions pertaining to minimum capital adequacy requirements, classification of loans and off-balance sheet commitments and provisioning to cover credit risk, liquidity, interest rate and foreign currency position. At year-end, the Bank was substantially in compliance with all regulatory requirements.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

2.1 Basis of presentation

These financial statements are prepared in accordance with International Financial Reporting Standards ('IFRS') as published by the International Accounting Standards Board. The financial statements have been prepared under the historical cost basis, except for the revaluation of certain financial instruments at fair value.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Bank's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements, are disclosed in Note 4.

(a) Amendments to published standards and interpretations effective 1 January 2006

The application of the amendments and interpretations listed below did not result in substantial changes to the Bank's accounting policies:

IAS 19 Amendment – Actuarial Gains and Losses, Bank Plans and Disclosures;
IAS 21 Amendment – Net Investment in a Foreign Operation;
IAS 39 Amendment – Cash Flow Hedge Accounting of Forecast IntraBank Transactions;
IAS 39 Amendment – The Fair Value Option;
IAS 39 and IFRS 4 Amendment – Financial Guarantee Contracts;
IFRS 1 (Amendment), First-time Adoption of International Financial Reporting Standards, and IFRS 6 (Amendment), Exploration for and Evaluation of Mineral Resources;
IFRS 6, Exploration for and Evaluation of Mineral Resources;
IFRIC 4, Determining whether an Arrangement contains a Lease;
IFRIC 5, Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds; and
IFRIC 6, Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment.

- IAS 19 Amendment, IAS 21 Amendment, IAS 39 Amendment – Cash flow hedge accounting of forecasted intraBank transactions, IFRS 1, IFRS 6, IFRIC 4 and IFRIC 5 are not relevant to the Bank's operating activities and therefore have no material effect on the Bank's policies.
- IAS 39 Amendment – The Fair Value Option. Prior to the amendment, the Bank applied the unrestricted version of the fair value option in IAS 39. The Bank meets the new criteria in the amendment and therefore continues to designate certain financial assets and financial liabilities at fair value through profit and loss.
- IAS 39 and IFRS 4 Amendment – Financial Guarantee Contracts. These types of contract are now accounted for under IAS 39 and no longer accounted for under IFRS 4, as previously required under IFRS. The measurement and disclosure requirements under IAS 39 have not resulted in a material change to the Bank's policies.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.1 Basis of presentation (continued)

(b) Early adoption of standards

No standards were early adopted by the Bank.

(c) Standards and interpretations to existing standards that are not yet effective and have not been early adopted by the Bank

The following standards, amendments and interpretations to existing standards are mandatory for the Bank's accounting period beginning on or after the effective date, but have not been early adopted by the Bank:

– *IFRS 7, Financial Instruments: Disclosures (effective from 1 January 2007).* IFRS 7 introduces new disclosures to improve the information about financial instruments. It requires the disclosure of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk, including sensitivity analysis to market risk. It replaces disclosure requirements in IAS 32, Financial Instruments: Disclosure and Presentation. The Bank assessed the impact of IFRS 7, and concluded that the main additional disclosures will be the sensitivity analysis to market risk. The Bank will apply IFRS 7 beginning 1 January 2007.

– *Amendment to IAS 1, Presentation of Financial Statements – Capital Disclosures (effective from 1 January 2007).* The amendment to IAS 1 introduces disclosures about the level of an entity's capital and how it manages capital. The Bank assessed the impact of the amendment to IAS 1, and concluded that certain additional disclosures will be required related to capital management.

(d) Interpretations issued but not yet effective

– IFRS 8, Operating Segments (effective 1 January 2009);
– IFRIC 7, Applying the Restatement Approach under IAS 29 (effective 1 March 2006);
– IFRIC 8, Scope of IFRS 2 (effective 1 January 2009);
– IFRIC 9, Reassessment of embedded derivative (effective 1 June 2006);
– IFRIC 10, Interim Financial Reporting and Impairment (effective 1 November 2006);
– IFRIC 11, IFRS 2 – Bank Treasury Share Transactions (effective 1 March 2007); and
– IFRIC 12, Service Concession Arrangements (effective 1 January 2009).

The application of these new interpretations will not have a material impact on the Bank's financial statements in the period of initial application.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.2 Investment in subsidiaries

Subsidiary companies are companies in which the Bank, directly or indirectly, has more than one half of voting rights or otherwise controls the operations of the companies.

The Bank has one fully owned subsidiary undertaking - FIDUCIA d.o.o., Umag (see Note 20), which is carried at cost and has not been consolidated in these financial statements. The effect of not consolidating the entity is not significant to the financial statements.

2.3 Segment reporting

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and returns different from those of segments operating in other economic environments.

2.4 Foreign currency translation

(a) Functional and presentation currency

Items included in the financial statements of the Bank are measured using the currency of the primary economic environment in which the Bank operates ('the functional currency').

The financial statements are presented in Croatian kuna (HRK), which is the Bank's functional and presentation currency. As at 31 December 2006, the conversion rate was HRK 5.578 to USD 1 and HRK 7.345 to EUR 1 (31 December 2005: HRK 6.234 to USD 1 and HRK 7.376 to EUR 1).

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

2.5 Financial assets

The Bank classifies its financial assets in the following categories: financial assets at fair value through profit or loss, loans and receivables, investment securities available for sale and held to maturity. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its investments at initial recognition.

(a) Financial assets at fair value through profit or loss

This category has two sub-categories: financial assets held for trading, and those designated at fair value through profit or loss at inception. A financial asset is classified as held for trading if it is acquired or incurred principally for the purpose of selling or repurchasing in the near term or if it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.5 Financial assets (continued)

(b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than: (a) those that the entity intends to sell immediately or in the short term, which are classified as held for trading, and those that the entity upon initial recognition designates as at fair value through profit or loss; (b) those that the entity upon initial recognition designates as available for sale; or (c) those for which the holder may not recover substantially all of its initial investment, other than because of credit deterioration.

(c) Held-to-maturity financial assets

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Bank's management has the positive intention and ability to hold to maturity. If the Bank were to sell other than an insignificant amount of held-to-maturity assets, the entire category would be reclassified as available for sale.

d) Available-for-sale financial assets

Available-for-sale investments are those intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices. Regular-way purchases and sales of financial assets at fair value through profit or loss, held to maturity and available for sale are recognised on trade-date – the date on which the Bank commits to purchase or sell the asset.

Financial assets are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets carried at fair value through profit and loss are initially recognised at fair value, and transaction costs are expensed in the income statement. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Bank has transferred substantially all risks and rewards of ownership. Financial liabilities are derecognised when they are extinguished – that is, when the obligation is discharged, cancelled or expires.

Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables and held-to-maturity investments are carried at amortised cost using the effective interest method. Gains and losses arising from changes in the fair value of the 'financial assets at fair value through profit or loss' category are included in the income statement in the period in which they arise. Gains and losses arising from changes in the fair value of available-for-sale financial assets are recognised directly in equity, until the financial asset is derecognised or impaired. At this time, the cumulative gain or loss previously recognised in equity is recognised in profit or loss. However, interest calculated using the effective interest method and foreign currency gains and losses on monetary assets classified as available for sale are recognised in the income statement. Dividends on available-for-sale equity instruments are recognised in the income statement when the entity's right to receive payment is established.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.5 Financial assets (continued)

The fair values of quoted investments in active markets are based on current bid prices. If there is no active market for a financial asset, the Bank establishes fair value using valuation techniques. These include the use of recent arm's length transactions, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants.

2.6 Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis or realise the asset and settle the liability simultaneously.

2.7 Derivative financial instruments

Derivative financial instruments include foreign exchange rate forward contracts and are initially recognised in the balance sheet at fair value and subsequently re-measured at their fair value. Fair values are obtained from quoted market prices or pricing models as appropriate. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

The Bank's derivative instruments do not qualify for hedge accounting. Changes in the fair value of any derivative instrument that does not qualify for hedge accounting are recognised immediately in the income statement under net trading income. However, the gains and losses arising from changes in the fair value of derivatives that are managed in conjunction with designated financial assets or financial liabilities are included in 'net income from financial instruments designated at fair value'.

2.8 Interest income and expense

Interest income and expense for all interest-bearing financial instruments, except for those classified as held for trading or designated at fair value through profit or loss, are recognised within 'interest income' and 'interest expense' in the income statement using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument (for example, prepayment options) but does not consider future credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.9 Fee and commission income

Fees and commissions are recognized on an accrual basis. Loan origination fees for loans which are probable of being drawn down are deferred (together with related direct costs) and recognized as an adjustment to the effective yield of the loan. Commission and fees arising from negotiating, or participating in the negotiation of a transaction for a third party, such as the acquisition of loans, shares or other securities or the purchase or sale of businesses, are recognised on completion of the underlying transaction.

Fees and commissions consist mainly of fees received from foreign currency transactions, guarantees, letters of credit and other services that the Bank provides.

2.10 Dividend income

Dividends are recognised in the income statement when the entity's right to receive payment is established.

2.11 Impairment of financial assets

a) Assets carried at amortised cost

The Bank assesses at each balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the Bank about the following loss events:

i) significant financial difficulty of the issuer or obligor;
(ii) a breach of contract, such as a default or delinquency in interest or principal payments;
(iii) the Bank granting to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, a concession that the lender would not otherwise consider;
(iv) it becoming probable that the borrower will enter bankruptcy or other financial reorganisation;
(v) the disappearance of an active market for that financial asset because of financial difficulties; or
(vi) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group, including:
– adverse changes in the payment status of borrowers in the group; or
– national or local economic conditions that correlate with defaults on the assets in the group.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.11 Impairment of financial assets (continued)

The Bank first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss on loans and receivables or held-to-maturity investments carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate.

The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement. If a loan or held-to-maturity investment has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. As a practical expedient, the Bank may measure impairment on the basis of an instrument's fair value using an observable market price.

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics (i.e. on the basis of the Bank's grading process that considers asset type, industry, geographical location, collateral type, past-due status and other relevant factors). Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the Bank and historical loss experience for assets with credit risk characteristics similar to those in the Bank. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently.

Estimates of changes in future cash flows for groups of assets should reflect and be directionally consistent with changes in related observable data from period to period (for example, changes in unemployment rates, property prices, payment status, or other factors indicative of changes in the probability of losses in the group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Bank to reduce any differences between loss estimates and actual loss experience.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.11 Impairment of financial assets (continued)

When a loan is uncollectible, it is written off against the related provision for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of the provision for loan impairment in the income statement.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the income statement.

(b) Assets carried at fair value

The Bank assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the assets are impaired. If any such evidence exists for available for- sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in the income statement. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement. If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through the income statement.

2.12 Intangible assets

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised over their estimated useful lives (4 years).

2.13 Property and equipment

Property and equipment are included in the balance sheet at historical cost less accumulated depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Bank and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.13 Property and equipment (continued)

Land is not depreciated. Depreciation of other assets is calculated using the straight-line method to allocate their cost over their estimate useful lives as follows:

Property	33 years
Computers	4 years
Equipment and other	3-10 years

Depreciation is calculated for each asset until the asset is fully depreciated or to its residual value, if significant.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (Note 2.15).

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the income statement.

2.14 Computer software development costs

Generally, costs associated with developing computer software programmes are recognised as an expense as incurred. However, expenditure that enhances and extends the benefits of computer software programmes beyond their original specifications and lives is recognised as a capital improvement and added to the original cost of the software. Computer software development costs recognised as assets are amortised using the straight-line method over their useful lives. Costs associated with the maintenance of existing computer software programmes are expensed as incurred.

2.15 Impairment of non-financial assets

Assets that have an indefinite useful life are not subject to amortisation and depreciation are tested annually for impairment. Assets that are subject to amortisation and depreciation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets other than goodwill that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

2.16 Non-current assets held for sale

Non-current assets (or disposal groups) are classified as assets held for sale and stated at the lower of carrying amount and fair value less costs to sell if their carrying amount is recovered principally through a sale transaction rather than through continuing use.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.17 Leases

The leases entered into by the Bank are primarily operating leases. The total payments made under operating leases are charged to other operating expenses in the income statement on a straight-line basis over the period of the lease.

When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

2.18 Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than 90 days maturity from the date of acquisition including: cash and current accounts with banks, amounts due from other banks and investment securities-available-for-sale and held to maturity.

2.19 Provisions

Provisions are recognised when: the Bank has a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

2.20 Financial guarantee contracts

Financial guarantee contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of a debt instrument. Such financial guarantees are given to banks, financial institutions and other bodies on behalf of customers to secure loans, overdrafts and other banking facilities.

Financial guarantees are initially recognised in the financial statements at fair value on the date the guarantee was given. Subsequent to initial recognition, the bank’s liabilities under such guarantees are measured at the higher of the initial measurement, less amortisation calculated to recognise in the income statement the fee income earned on a straight line basis over the life of the guarantee and the best estimate of the expenditure required to settle any financial obligation arising at the balance sheet date. These estimates are determined based on experience of similar transactions and history of past losses, supplemented by the judgment of Management.

Any increase in the liability relating to guarantees is taken to the income statement under other operating expenses.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.21 Employee benefits

(a) Pension obligations and post-employment benefits

In the normal course of business through salary deductions, the Bank makes payments to mandatory pension funds on behalf of its employees as required by law. All contributions made to the mandatory pension funds are recorded as salary expense when incurred. The Bank does not have any other pension scheme and consequently, has no other obligations in respect of employee pensions. In addition, the Bank is not obliged to provide any other post-employment benefits.

(b) Termination benefits

Termination benefits are payable when employment is terminated by the Bank before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Bank recognises termination benefits when it is demonstrably committed to either: terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal; or providing termination benefits as a result of an offer made to encourage voluntary redundancy. Benefits falling due more than 12 months after the balance sheet date are discounted to present value.

(c) Short-term employee benefits

The Bank recognises a provision for bonuses where contractually obliged or where there is a past practice that has created a constructive obligation. In addition, the Bank recognises a liability for accumulated compensated absences based on unused vacation days at the balance sheet date.

2.22 Deferred income tax

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

2.23 Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

Borrowings are classified as current liabilities unless the Bank has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.24 Share capital

Ordinary and preference shares are classified as equity. Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction, net of tax, from the proceeds. Where the Bank purchases its equity share capital (treasury shares), the consideration paid, including any directly attributable incremental costs (net of income taxes) is deducted from equity attributable to the Bank's equity holders until the shares are cancelled, reissued or disposed of. Where such shares are subsequently sold or reissued, any consideration received, net of any directly attributable incremental transaction costs and the related income tax effects, is included in equity attributable to the Bank's equity holders.

Dividend distribution to the Bank's shareholders is recognised as a liability in the financial statements in the period in which the dividends are approved by the Bank's shareholders.

2.25 Fiduciary activities

The Bank manages assets for and on behalf of legal entities and individuals, and charges a fee for such services. Given that those assets do not represent the assets of the Bank, they have not been included in the balance sheet.

2.26 Comparatives

Certain balances in income statements for 2005 have been reclassified to confirm with changes in presentation in the current year.

– Change in far value in reconstruction bonds has been reclassified from gains from investment securities and is included in Note 6-net interest income in the amount of HRK 514 thousand.

– Net foreign exchange gains from operating activities have been reclassified from fee and commission income and are included in Note 8 - foreign exchange differences in the amount of HRK 4,474 thousand.

– Administrative expenses have been reclassified from Note 11 - other operating expenses and are included in Note 10 - Administritave expenses in the amount of HRK 14,277 thousand.

NOTE 3 – FINANCIAL RISK MANAGEMENT

The most important types of financial risk to which the Bank is exposed are credit risk, liquidity risk and market risk. Market risk includes currency risk, interest rate risk and equity price risk.

An integrated system of risk management has been established by introducing a set of policies and procedures, determining the limits of risk levels acceptable to the Bank. Methodology and models for managing operational risk have been developed.

3.1 Credit risk

The Bank takes on exposure to credit risk, which is the risk that a counter party will be unable to pay amounts in full when due. The Bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical and industry segments. Such risks are monitored on a revolving basis and subject to a quarterly or more frequent review.

Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by changing these lending limits where appropriate. Exposure to credit risk is also managed in part by obtaining collateral and corporate and personal guarantees.

Credit related commitments. The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit, which represent irrevocable assurances that the Bank will make payments in the event that a customer cannot meet its obligations to third parties, carry the same credit risk as loans. Documentary and commercial letters of credit, which are written undertakings by the Bank on behalf of a customer authorising a third party to draw drafts on the Bank up to a stipulated amount under specific terms and conditions, are collateralised by the underlying shipments of goods to which they relate and therefore carry less risk than direct lending.

Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to extend credit, the Bank is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments since most commitments to extend credit are contingent upon customers maintaining specific credit standards. The Bank monitors the term to maturity of credit commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments.

a) Geographic concentrations of assets, liabilities and off-balance sheet items

	2006			2005		
(In thousands of HRK)	**Assets**	**Liabilities**	**Off-balance sheet items**	**Assets**	**Liabilities**	**Off-balance sheet items**
Croatia	1,613,397	1,602,394	111,714	1,269,182	1,443,633	85,108
European Union	276,183	116,545	955	406,152	93,648	443
Other	23	12,034	-	23,001	8,557	-
	1,889,603	**1,730,973**	**112,669**	**1,698,339**	**1,545,838**	**85,851**

NOTE 3 – FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (continued)

b) Industry segmentation of loans and advances:

(In thousands of HRK)	2006	%	2005	%
Industrial segments:				
- Textile and leather industry	2,965	0.30	2,679	0.37
- Food industry	24,062	2.44	8,558	1.18
- Other	34,945	3.55	41,324	5.69
Trading	208,133	21.14	169,531	23.34
Construction	44,832	4.55	31,864	4.39
Traffic and communications	18,256	1.86	9,299	1.28
Housing	40,091	4.07	19.240	2.65
Governmental agencies	36,492	3.71	30,859	4.25
Agriculture	3,147	0.32	16,044	2.21
Individuals	495,415	50.32	365,168	50.29
Other	76,213	7.74	31,604	4.35
Total	**984,551**	**100**	**726,170**	**100**

3.2 Foreign exchange risk

Concentrations of assets, liabilities and off balance sheet items

The Bank is exposed to currency risk through transactions in foreign currencies. Foreign currency exposure arises from credit, deposit, investment and trading activities. It is monitored regularly, in accordance with legislation and internally set limits, for each currency and for the total balance sheet denominated or linked to foreign currency.

The Bank sets principles and limits for foreign currency exposures which are monitored daily. The Bank directs its business activities trying to minimise the gap between assets and liabilities denominated in or linked to foreign currency, and maintaining the daily business activities within daily potential loss limits. The parameters are regularly reviewed in accordance with fluctuations in foreign currency rates and correlations between currencies.

NOTE 3 – FINANCIAL RISK MANAGEMENT (CONTINUED)

3.2 Foreign exchange risk (continued)

Significant foreign assets, liabilities and off balance sheet items of the Bank have been analyzed as follows:

(In thousands of HRK)	HRK	EUR	USD	Other	Total
At 31 December 2006					
ASSETS					
Cash and balances with Central bank	206,663	126,233	2,675	5,622	341,193
Treasury bills and other eligible bills	139,630	-	-	-	139,630
Loans and advances to banks	14,002	226,716	49,558	2	290,278
Loans and advances to customers	164,388	763,060	30,025	5,702	963,175
Trading assets	28,156	9,333	-	-	37,489
Investment securities:					
- available for sale	47,604	12	-	-	47,616
- held to maturity	20,108	-	-	-	20,108
Intangible assets	3,001	-	-	-	3,001
Property and equipment	28,965	-	-	-	28,965
Non-current assets held for sale	14,938	-	-	-	14,938
Other assets	3,198	12	-	-	3,210
Total assets	**670,653**	**1,125,366**	**82,258**	**11,326**	**1,889,603**
LIABILITIES					
Due to banks	4,802	21,196	5	-	26,003
Due to customers	518,733	1,081,792	81,019	10,903	1,692,447
Income tax liability	116	-	-	-	116
Other liabilities	11,477	883	19	28	12,407
Total liabilities	**535,128**	**1,103,871**	**81,043**	**10,931**	**1,730,973**
Net balance sheet position	**135,525**	**21,495**	**1,215**	**395**	**158,630**
Credit commitments	**6,316**	**46,679**	**-**	**-**	**52,995**

NOTE 3 – FINANCIAL RISK MANAGEMENT (CONTINUED)

3.2 Foreign exchange risk (continued)

(In thousands of HRK)	HRK	EUR	USD	Other currencies	Total
As at 31 December 2005					
ASSETS					
Cash and balances with Central bank	226,783	117,199	3,624	6,034	353,640
Treasury bills and other eligible bills	36,385	-	-	-	36,385
Loans and advances to banks	12,057	337,464	97,047	271	446,839
Loans and advances to customers	214,315	482,397	3,114	6,344	706,170
Trading assets	37,850	44,121	-	-	81,971
Investment securities:					
- available for sale	2,214	12	-	-	2,226
- held to maturity	19,730	-	-	-	19,730
Intangible assets	2,261	-	-	-	2,261
Property and equipment	31,478	-	-	-	31,478
Non-current assets held for sale	15,176	-	-	-	15,176
Other assets	2,390	70	-	3	2,463
Total assets	**600,639**	**981,263**	**103,785**	**12,652**	**1,698,339**
LIABILITIES					
Due to banks	4,225	13,319	12	-	17,556
Due to customers	430,645	971,259	103,400	10,358	1,515,662
Income tax liability	121	-	-	-	121
Other liabilities	11,923	519	22	35	12,499
Total liabilities	**446,914**	**985,097**	**103,434**	**10,393**	**1,545,838**
Net balance sheet position	**153,725**	**(3,834)**	**351**	**2,259**	**152,501**
Credit commitments	**16,027**	**18,333**	**-**	**-**	**34,360**

NOTE 3 – FINANCIAL RISK MANAGEMENT (CONTINUED)

3.3 Interest rate risk

Interest sensitivity of assets, liabilities and off balance sheet items

The Bank is exposed to various risks associated with the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. In the case of floating rate assets and liabilities the Bank is also exposed to basis risk, which is the difference in repricing characteristics of the various floating rate indices, and different types of interest. Risk management activities are aimed at optimising net interest income, given market interest rate levels consistent with the Bank's business strategies.

Exposure to interest rate risk is monitored and measured using repricing maturity gap analysis, net income simulation and economic valuation models.

The table below summarises the Bank's exposure to interest rate risks. Included in the table are the Bank's assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates.

(In thousands of HRK)	Up to 1 month	1-3 months	3-12 months	1-3 years	Over 3 years	Non interest bearing	Total
At 31 December 2006							
ASSETS							
Cash and balances with Central bank	247,159	-	-	-	-	94,034	341,193
Treasury bills and other eligible bills	20,467	25,651	93,512	-	-	-	139,630
Loans and advances to banks	290,278	-	-	-	-	-	290,278
Loans and advances to customers	863,439	5,224	20,956	43,878	29,678	-	963,175
Trading assets	-	-	37,489	-	-	-	37,489
Investment securities:							
- available for sale	45,000	-	-	-	2,596	20	47,616
- held to maturity	-	-	-	-	20,108	-	20,108
Intangible assets	-	-	-	-	-	3,001	3,001
Property and equipment	-	-	-	-	-	28,965	28,965
Non-current assets held for sale	-	-	-	-	-	14,938	14,938
Other assets	-	-	-	-	-	3,210	3,210
Total assets	**1,466,343**	**30,875**	**151,957**	**43,878**	**52,382**	**144,168**	**1,889,603**
LIABILITIES							
Due to banks	1,095	173	2,550	3,376	18,809	-	26,003
Due to customers	1,665,488	76	2,190	942	3,822	19,929	1,692,447
Income tax liability	116	-	-	-	-	-	116
Other liabilities	12,407	-	-	-	-	-	12,407
Total liabilities	**1,679,106**	**249**	**4,740**	**4,318**	**22,631**	**19,929**	**1,730,973**
On balance sheet interest sensitivity gap	**(212,763)**	**30,626**	**147,217**	**39,560**	**29,751**	**124,239**	**158,630**

NOTE 3 – FINANCIAL RISK MANAGEMENT (CONTINUED)

3.3 Interest rate risk (continued)

(In thousands of HRK)	Up to 1 month	1-3 months	3-12 months	1-3 years	Over 3 years	Non interest bearing	Total
At 31 December 2005							
ASSETS							
Cash and balances with Central bank	225,831	-	-	-	-	127,809	353,640
Treasury bills and other eligible bills	612	26,116	9,657	-	-	-	36,385
Loans and advances to banks	446,839	-	-	-	-	-	446,839
Loans and advances to customers	532,658	8,254	40,154	63,078	62,026	-	706,170
Trading assets	-	-	81,971	-	-	-	81,971
Investment securities:							
- available for sale	-	-	-	-	2,206	20	2,226
- held to maturity	-	-	-	-	19,730	-	19,730
Intangible assets	-	-	-	-	-	2,261	2,261
Property and equipment	-	-	-	-	-	31,478	31,478
Non-current assets held for sale	-	-	-	-	-	15,176	15,176
Other assets	-	-	-	-	-	2,463	2,463
Total assets	**1,205,940**	**34,370**	**131,782**	**63,078**	**83,962**	**179,207**	**1,698,339**
LIABILITIES							
Due to banks	1,208	218	2,267	1,428	12,435	-	17,556
Due to customers	1,486,925	147	2,219	1,666	5,265	19,440	1,515,662
Income tax liability	121	-	-	-	-	-	121
Other liabilities	12,499	-	-	-	-	-	12,499
Total liabilities	**1,500,753**	**365**	**4,486**	**3,094**	**17,700**	**19,440**	**1,545,838**
On balance sheet interest sensitivity gap	**(294,813)**	**34,005**	**127,296**	**59,984**	**66,262**	**159,767**	**152,501**

NOTE 3 – FINANCIAL RISK MANAGEMENT (CONTINUED)

3.3 Interest rate risk (continued)

The table below summarises the effective interest rate by major currencies for monetary financial instruments:

	EUR	USD	Other	HRK
	%	%	%	%
At 31 December 2006				
Assets				
Cash and balances with Central bank	1.75	-	-	0.75
Treasury bills and other eligible bills	-	-	-	3.00-9.00
Loans and advances to banks	0.08-4.00	0.08-5.28	2.25	2.00-2.50
Loans and advances to customers	5.86-11.12	5.63-9.04	6.28-8.59	7.57-13.43
Trading assets	7.00	-	-	4.50-6.87
Investment securities:				
- held to maturity	-	-	-	5.00
Liabilities				
Due to banks	-	-	-	0.00-5.00
Due to customers	0.20-4.50	0.10-3.00	0.00-1.30	0.10-6.25
At 31 December 2005				
Assets				
Cash and balances with Central bank	1.12	-	-	1.25
Treasury bills and other eligible bills	-	-	-	3.70-11.00
Loans and advances to banks	0.11-3.00	0.08-4.25	0.05-2.25	1.80
Loans and advances to customers	4.45-11.03	5.63-11.38	6.28-8.59	6.21-12.05
Trading assets	4.62-5.75	-	-	5.50-6.87
Investment securities:				
- held to maturity	-	-	-	5.00
Liabilities				
Due to banks	-	-	-	1.00-5.00
Due to customers	0.20-4.50	0.10-3.60	0.00-1.60	0.00-6.25

NOTE 3 – FINANCIAL RISK MANAGEMENT (CONTINUED)

3.4 Liquidity risk

The Bank is exposed to daily calls on its available cash resources from overnight deposits, current accounts, maturing deposits, loan draw downs, guarantees and from margin and other calls on cash settled derivatives. The Bank does not maintain cash resources to meet all of these needs as experience shows that a minimum level of reinvestment of maturing funds can be predicted with a high level of certainty. Management sets limits on the minimum proportion of maturing funds available to meet such calls and on the minimum level of inter bank and other borrowing facilities that should be in place to cover withdrawals at unexpected levels of demand. The Bank manages liquidity reserves daily, ensuring also accomplishment of all customer needs.

The table below analyses assets and liabilities of the Bank into relevant maturity groupings based on the remaining period at balance sheet date to the contractual maturity date:

(In thousands of HRK)	Up to 1 month	1- 3 months	3-12 months	1-3 years	Over 3 years	Total
At 31 December 2006						
ASSETS						
Cash and balances with Central bank	341,193	-	-	-	-	341,193
Treasury bills and other eligible bills	20,467	25,651	93,512	-	-	139,630
Loans and advances to banks	275,588	14,690	-	-	-	290,278
Loans and advances to customers	59,181	40,709	186,917	244,272	432,096	963,175
Trading assets	-	-	37,489	-	-	37,489
Investment securities:						
- available for sale	45,000	-	-	-	2,616	47,616
- held to maturity	-	-	-	-	20,108	20,108
Intangible assets	-	-	-	-	3,001	3,001
Property and equipment	-	-	-	-	28,965	28,965
Non-current assets held for sale	1,690	13,248	-	-	-	14,938
Other assets	1,094	-	1,824	292	-	3,210
Total assets	**744,213**	**94,298**	**319,742**	**244,564**	**486,786**	**1,889,603**
LIABILITIES						
Due to banks	1,095	173	2,550	3,376	18,809	26,003
Due to customers	892,221	354,272	385,113	42,978	17,863	1,692,447
Income tax liability	116	-	-	-	-	116
Other liabilities	12,328	5	74	-	-	12,407
Total liabilities	**905,760**	**354,450**	**387,737**	**46,354**	**36,672**	**1,730,973**
Net liquidity gap	**(161,547)**	**(260,152)**	**(67,995)**	**198,210**	**450,114**	**158,630**

NOTE 3 – FINANCIAL RISK MANAGEMENT (CONTINUED)

3.4 Liquidity risk (continued)

(In thousands of HRK)	Up to 1 month	1- 3 months	3-12 months	1-3 years	Over 3 years	Total
At 31 December 2005						
ASSETS						
Cash and balances with Central bank	353,640	-	-	-	-	353,640
Treasury bills and other eligible bills	612	26,116	9,657	-	-	36,385
Loans and advances to banks	435,776	11,063	-	-	-	446,839
Loans and advances to customers	79,633	44,523	129,951	177,193	274,870	706,170
Trading assets	-	-	81,971	-	-	81,971
Investment securities:						
- available for sale	-	-	-	-	2,226	2,226
- held to maturity	-	-	-	-	19,730	19,730
Intangible assets	-	-	-	-	2,261	2,261
Property and equipment	-	-	-	-	31,478	31,478
Non-current assets held for sale	392	-	14,784	-	-	15,176
Other assets	2,070	-	-	393	-	2,463
Total assets	**872,123**	**81,702**	**236,363**	**177,586**	**330,565**	**1,698,339**
LIABILITIES						
Due to banks	1,208	218	2,267	1,428	12,435	17,556
Due to customers	834,141	335,422	315,501	14,820	15,778	1,515,662
Income tax liability	121	-	-	-	-	121
Other liabilities	12,499	-	-	-	-	12,499
Total liabilities	**847,969**	**335,640**	**317,768**	**16,248**	**28,213**	**1,545,838**
Net liquidity gap	**24,154**	**(253,938)**	**(81,405)**	**161,338**	**302,352**	**152,501**

NOTE 3 – FINANCIAL RISK MANAGEMENT (CONTINUED)

3.4 Liquidity risk (continued)

The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of the Bank. It is unusual for banks ever to be completely matched since business transacted is often of uncertain term and of different types. An unmatched position potentially enhances profitability, but can also increase the risk of losses.

The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest–bearing liabilities as they mature, are important factors in assessing the liquidity of the Bank and its exposure to changes in interest rates and exchange rates.

Liquidity requirements to support calls under guarantees and standby letters of credit are considerably less than the amount of the commitment because the Bank does not generally expect the third party to draw funds under the agreement. The total outstanding contractual amount of commitments to extend credit does not necessarily represent future cash requirements, since many of these commitments will expire or terminate without being funded.

3.5 Fair values of financial assets and liabilities

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

The following summarises the major methods and assumptions used in estimating the fair values of financial instruments:

Loans and advances

Fair value of loans and advances is calculated based on discounted expected future principal and interest cash flows. For loans that do not have fixed repayment dates or that are subject to prepayment risk, repayments are estimated based on experience in previous periods when interest rates were at levels similar to current levels, adjusted for any differences in interest rate outlook. Expected future cash flows are estimated considering credit risk and any indication of impairment. Expected future cash flows for homogeneous categories of loans are estimated on a portfolio basis and discounted at current rates offered for similar loans to new borrowers with similar credit profiles. The estimated fair values of loans reflect changes in credit status since the loans were made and changes in interest rates in the case of fixed rate loans. As the Bank has a very limited portfolio of loans and advances with fixed rate and longer-term maturity, the fair value of loans and advances is not significantly different from their carrying value.

Bank and customer deposits

For demand deposits and deposits with no defined maturities, fair value is taken to be the amount payable on demand at the balance sheet date. The estimated fair value of fixed-maturity deposits is based on discounted cash flows using rates currently offered for deposits of similar remaining maturities. The value of long-term relationships with depositors is not taken into account in estimating fair values. As most of the Bank's deposits are given with variable rate, being market rate, there is no significant difference between the fair value of these deposits and their carrying value.

NOTE 3 – FINANCIAL RISK MANAGEMENT (CONTINUED)

3.5 Fair values of financial assets and liabilities (continued)

Borrowings

As the majority of the Bank's borrowings bear interest at variable rates, which are paid regularly, there is no significant difference between their carrying and fair value.

Investment securities

Investment securities include only interest-bearing assets held to maturity, as assets available-for-sale are measured at fair value. Fair value for held to maturity asset is based on market prices or broker/dealer price quotations. Where this information is not available, fair value has been estimated using quoted market prices for securities with similar credit, maturity and yield characteristics.

Debt securities in issue

The aggregate fair values are calculated based on quoted market prices. For those notes where quoted market prices are not available, a discounted cash flow model is used based on a current yield curve appropriate for the remaining term to maturity. There is no significant difference between their carrying and fair value.

NOTE 4 – CRITICAL ACCOUNTING ESTIMATES

The Bank makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

(a) Impairment losses on loans and advances

The Bank reviews its loan portfolios to assess impairment at least on a quarterly basis. In determining whether an impairment loss should be recorded in the income statement, the Bank makes judgments as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

To the extent that the net present value of estimated cash flows were to be higher by +2%, the provision would be estimated HRK 348 thousand lower.

NOTE 4 – CRITICAL ACCOUNTING ESTIMATES (CONTINUED)

(b) Impairment of available for-sale equity investments

The Bank determines that available-for-sale equity investments are impaired when there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgment. In making this judgment, the Bank evaluates among other factors, the normal volatility in share price. In addition, impairment may be appropriate when there is evidence of a deterioration in the financial health of the investee, industry and sector performance, changes in technology, and operational and financing cash flows.

Had all the changes in fair value below cost been considered significant or prolonged, the Bank would get an additional HRK 146 thousand gain in its 2006 financial statements.

NOTE 5 – SEGMENT ANALYSIS

(a) By business segment

The Bank is divided into two main business segments:

- Retail banking – incorporating private customer current accounts, savings, deposits, credit and debit cards, consumer loans and mortgages;
- Corporate banking – incorporating direct debit facilities, current accounts, deposits, overdrafts, loan and other credit facilities, foreign currency and derivative products;

Other Bank operations comprise financial instruments trading and fund management, none of which constitutes a separately reportable segment.

NOTE 5 – SEGMENT ANALYSIS (CONTINUED)

(In thousands of HRK)	Retail banking	Corporate banking	Other	Total
At 31 December 2006				
Revenues	48,264	75,289	7,190	130,743
Segment result	12,337	66,185	3,716	82,238
Unallocated costs	-	-	-	(54,919)
Operating profit	-	-	-	27,319
Income tax expense	-	-	-	5,823
Net profit	-	-	-	21,496
Segment assets	310,910	1,008,490	247,408	1,566,808
Unallocated assets	-	-	-	322,795
Total assets	-	-	-	1,889,603
Segment liabilities	1,531,195	85,131	91,279	1,707,605
Unallocated liabilities	-	-	-	23,368
Total liabilities	-	-	-	1,730,973
Other segment items				
Capital expenditure	850	60	2,846	3,756
Depreciation	3,354	2,139	36	5,529
Impairment charge - loans	(978)	1,373	-	395
Other non-cash expenses	4,199	1,564	301	6,064
At 31 December 2005				
Revenues	45,758	64,870	7,219	117,847
Segment result	12,610	55,923	3,978	72,511
Unallocated costs	-	-	-	(45,395)
Operating profit	-	-	-	27,116
Income tax expense	-	-	-	(5,713)
Net profit	-	-	-	21,403
Segment assets	239,912	1,015,602	116,744	1,372,258
Unallocated assets	-	-	-	326,081
Total assets	-	-	-	1,698,339
Segment liabilities	1,340,517	95,107	87,979	1,523,603
Unallocated liabilities	-	-	-	22,235
Total liabilities	-	-	-	1,545,838
Other segment items				
Capital expenditure	1,815	34	3,551	5,400
Depreciation	3,554	2,248	65	5,867
Impairment charge - loans	305	395	-	700
Other non-cash expenses	3,738	1,293	(26)	5,005

(b) The geographical segment is disclosed in Note 3.1.

Revenue from external customers realised over 90% in Croatia.

NOTE 6 – NET INTEREST INCOME

Interest income

	2006	2005
	(in thousands of HRK)	
Loans and advances to :		
- to customers	74,063	67,483
- to banks	782	522
Cash and short-term funds	13,772	11,410
Securities	8,105	6,083
Other	-	100
	96,722	**85,598**

Interest expense

	2006	2005
	(in thousands of HRK)	
Customers deposits	35,219	31,836
Other borrowed funds	446	312
Other	106	171
	35,771	**32,319**

Interest income accrued on impaired financial assets is HRK 3,657 thousand (2005: HRK 2,384 thousand).

NOTE 7 – NET FEE AND COMMISSION INCOME

Fee and commission income

	2006	2005
	(in thousands of HRK)	
Domestic and foreign currency transactions	15,945	15,890
Guarantees and letter of credits given	1,362	1,003
Other	3,667	3,177
	20,974	**20,070**

Fee and commission expense

	2006	2005
	(in thousands of HRK)	
Domestic and foreign currency transactions	8,075	8,119
Other	184	178
	8,259	**8,297**

NOTE 8 – FOREIGN EXCHANGE DIFFERENCES-NET

	2006	2005
	(in thousands of HRK)	
Net foreign exchange differences from operations	12,560	11,381
Gains/(losses) on translation of foreign currency assets and liabilities	180	(1,983)
	12,740	**9,398**

NOTE 9 – RESULT ON TRADING ASSETS

	2006	2005
	(in thousands of HRK)	
Change in fair value of trading assets	(3,329)	5,336
Net gains/(losses) from trading assets	643	(494)
	(2,686)	**4,842**

NOTE 10 – ADMINISTRATIVE EXPENSES

	2006	2005
	(in thousands of HRK)	
Wages and salaries - net	15,570	14,399
Pension contributions	4,607	4,215
Social security contributions	3,458	3,163
Other contributions and taxes on wages and salaries	3,349	2,924
Termination benefits	159	341
Other staff benefits	2,399	2,104
Other administrative expenses	15,959	14,858
Depreciation and amortisation (Note 21 and 22)	5,529	5,867
	51,030	**47,871**

NOTE 11 – OTHER OPERATING EXPENSES

	2006	2005
	(in thousands of HRK)	
Saving deposits insurance charge	3,639	3,409
Rental cost	1,844	1,836
Software development costs	369	374
Taxes and contributions on income	656	532
Other	390	166
	6,898	**6,317**

NOTE 12 – IMPAIRMENT PROVISIONS-NET

	2006	2005
	(in thousands of HRK)	
Loans and advances to banks (Note 17)	(2,104)	2,480
Loans and advances to customers (Note 18)	1,379	(3,527)
Other assets (Note 23)	98	102
Provisions for off-balance items (Note 26)	232	245
	(395)	**(700)**

NOTE 13 – INCOME TAX EXPENSE

	2006	2005
	(in thousands of HRK)	
Profits before tax	27,319	27,116
Non-taxable income	(293)	(340)
Non-deductible expenses	2,091	1,788
Income tax base	29,117	28,564
Income tax rate 20%	5,823	5,713
Tax pre-paid	(5,707)	(5,592)
Income tax liability	116	121

Temporary differences giving rise to deferred taxation are immaterial and accordingly, no provision for deferred taxation is considered necessary.

NOTE 14 – EARNINGS PER SHARE

Basic

Basic earnings per share are calculated by dividing the profit for the year by the weighted average number of existing shares (ordinary and preference) for the period, excluding own shares.

	2006	2005
Profit after tax *(in thousands of HRK)*	21,496	21,403
Weighted average number of shares excluding own shares	58,988	59,000
Basic earnings per share –ordinary and preference (in kuna)	**364,41**	**362,76**

In 2006 and 2005 the dividend declared on ordinary and preference shares was equal (Note 30).

Diluted

Diluted earnings per share for 2006 and 2005 is equal to basic earnings per share, since the Bank did not have any convertible instruments and share options during both years.

NOTE 15 – CASH AND BALANCES WITH CENTRAL BANK

	2006	2005
	(in thousands of HRK)	
Cash in hand	27,952	26,313
Giro account	61,019	91,255
Other money market placements	33,296	46,129
Funds included in cash and cash equivalents (Note 31)	122,267	163,697
Obligatory minimum reserves:		
- In HRK	132,731	121,970
- In foreign currency	86,195	67,973
	218,926	189,943
	341,193	**353,640**

The obligatory reserve represents amounts required to be deposited with the Croatian National Bank ('CNB'). The Obligatory reserve requirements consist of two parts, HRK and foreign exchange calculated on a monthly basis.

NOTE 16 – TREASURY BILLS AND OTHER ELIGIBLE BILLS

	2006	2005
	(in thousands of HRK)	
Ministry of Finance bills	106,995	24,903
Commercial bills	16,923	-
Bills of exchange	15,712	11,482
	139,630	**36,385**

Treasury bills and bills of exchange are debt securities. Treasury bills are issued by Ministry of Finance of the Republic of Croatia for terms of three and six months. Commercial bills and bills of exchange are issued by several enterprises for terms of three, six months or a year.

NOTE 17 – LOANS AND ADVANCES TO BANKS

	2006	2005
	(in thousands of HRK)	
Deposits in banks	276,233	434,858
Loans to banks	19,003	18,003
Items in course of collection from other banks	476	1,516
	295,712	454,377
Less: Allowance for impairment	(5,434)	(7,538)
	290,278	**446,839**
Current	**290,278**	**446,839**

Reconciliation of allowance account for losses on loans and advances to other banks:

	2006	2005
	(in thousands of HRK)	
Balance at 1 January	**7,538**	**5,058**
Provision for loan	-	2,480
Amounts recovered during the year	**(2,104)**	-
Balance at 31 December	**5,434**	**7,538**

NOTE 18 – LOANS AND ADVANCES TO CUSTOMERS

	2006	2005
	(in thousands of HRK)	
Retail customers:		
Overdrafts	12,052	11,367
Housing loans	128,063	61,986
Mortgages	20,058	10,438
Credit card	5,119	3,574
Other loans and advances	331,310	278,739
	496,602	366,104
Corporate entities:		
-Large corporate customers	33,021	21,878
-SME-s	425,326	314,290
	458,347	336,168
Other	29,602	23,895
Gross loans and advances	984,551	726,167
Less: Allowance for impairment	(21,376)	(19,997)
Net	**963,175**	**706,170**
Current	**286,807**	**254,107**
Non-current	**676,368**	**452,063**

Loans with variable rates amount to HRK 897,597 thousand (2005: HRK 563,835 thousand) and fixed rates amount to HRK 80,738 thousand (2005: HRK 158,575 thousand).

Reconciliation of allowance account for losses on loans and advances to customers:

	2006	2005
	(in thousands of HRK)	
Balance at 1 January	**19,997**	**23,524**
Provision for loan	1,370	-
Amounts recovered during the year	-	(3,551)
Foreign exchange differences	9	24
Balance at 31 December	**21,376**	**19,997**

NOTE 19 – TRADING ASSETS

	2006	2005
	(in thousands of HRK)	
Debt securities-listed	35,333	79,879
Equity securities-listed	2,156	2,092
	37,489	**81,971**

NOTE 20 – INVESTMENT SECURITIES

	2006	2005
	(in thousands of HRK)	
Securities available for sale		
Debt securities at fair value:		
-unlisted	45,000	-
Equity securities at fair value		
-unlisted	2,616	2,226
Total securities available for sale	**47,616**	**2,226**
Securities held to maturity		
Reconstruction bonds	20,108	19,730
Total securities held to maturity	**20,108**	**19,730**
Total investment securities	**67,724**	**21,956**
Current	**45,000**	**-**
Non-current	**22,724**	**21,956**

The reconstruction bonds of the Republic of Croatia were accepted in lieu of repayments from certain borrowers in 1991 and were non-transferable. The bonds were issued with 20 years maturity period and were revalued by applying the industrial product price index. No market exists for such instruments nor were there any publicly traded instruments with similar characteristics. On 6 April 2000, the Croatian Government made a Decision on replacing these Reconstruction Bonds with bonds bearing an interest rate of 5% as of 1 July 2000. These bonds are revalued in conformity to the rise in prices of industrial products. Given that the bonds are of high credit quality and the return approximates current market rates, management believes that the fair value is not materially different from their carrying value.

NOTE 20 – INVESTMENT SECURITIES (CONTINUED)

Investment in subsidiary is included among securities available-for-sale:

(in thousands of HRK)	Principal activity	Country of incorporation	Proportion of ownership interest	2006 Investment Cost	2005 Investment Cost
Fiducia d.o.o.	Wholesale trade	Croatia	100%	20	20

The Bank has one wholly owned subsidiary – FIDUCIA d.o.o., Umag, which was dormant during 2006 and 2005 and has not been consolidated in these financial statements due to its immaterial nature.

Movements in investment securities may be summarised as follows:

(in thousands of HRK)	Available for sale	Held to maturity	Total
Balance at 1 January 2006	2,226	19,730	21,956
Additions	45,450	693	46,143
Sales	(60)	(315)	(375)
Balance at 31 December 2006	**47,616**	**20,108**	**67,724**
Balance at 1 January 2005	2,226	19,654	21,880
Additions	-	514	514
Sales	-	(438)	(438)
Balance at 31 December 2005	**2,226**	**19,730**	**21,956**

Gains from investment securities:

	2006	2005
	(in thousands of HRK)	
Sale of available-for-sale financial assets	298	-
	298	**-**

NOTE 21 – INTANGIBLE ASSETS

	Software
	(in thousands of HRK)
At 1 January 2005	
Cost	6,984
Accumulated amortisation	(4,325)
Net book amount	2,659
Year ended 31 December 2005	
Opening net book amount	1,572
Additions	1,437
Amortisation charge (Note 10)	(748)
Closing net book amount	2,261
At 31 December 2005	
Cost	7,334
Accumulated amortisation	(5,073)
Net book amount	**2,261**
Year ended 31 December 2006	
Opening net book amount	2,261
Additions	1,591
Amortisation charge (Note 10)	(851)
Closing net book amount	3,001
At 31 December 2006	
Cost	8,925
Accumulated amortisation	(5,924)
Net book amount	**3,001**

NOTE 22 – PROPERTY AND EQUIPMENT

(in thousands of HRK)	Land and buildings	Computer equipment	Furniture and equipment	Vehicles	Leasehold improvements	Construction in progress	Total
At 1 January 2005							
Cost	26,157	12,770	12,316	1,626	4,020	1,803	58,692
Accumulated depreciation	(8,231)	(9,566)	(6,775)	(902)	(584)	-	(26,058)
Net book amount	**17,926**	**3,204**	**5,541**	**724**	**3,436**	**1,803**	**32,634**
Year ended December 2005							
Opening net book amount	17,926	3,204	5,541	724	3,436	1,803	32,634
Additions	107	2,595	636	154	123	348	3,963
Depreciation charge (Note 10)	(754)	(1,957)	(1,097)	(289)	(1,022)	-	(5,119)
Closing net book amount	**17,279**	**3,842**	**5,080**	**589**	**2,537**	**2,151**	**31,478**
At 31 December 2005							
Cost	26,264	14,578	12,801	1,680	4,143	2,151	61,617
Accumulated depreciation	(8,985)	(10,736)	(7,721)	(1,091)	(1,606)	-	(30,139)
Net book amount	**17,279**	**3,842**	**5,080**	**589**	**2,537**	**2,151**	**31,478**
Year ended December 2006							
Opening net book amount	17,279	3,842	5,080	589	2,537	2,151	31,478
Additions	-	341	223	-	-	1,601	2,165
Depreciation charge (Note 10)	(754)	(1,645)	(1,025)	(218)	(1,036)	-	(4,678)
Closing net book amount	**16,525**	**2,538**	**4,278**	**371**	**1,501**	**3,752**	**28,965**
At 31 December 2006							
Cost	26,264	14,838	12,717	1,680	4,143	3,754	63,396
Accumulated depreciation	(9,740)	(12,300)	(8,439)	(1,309)	(2,643)	-	(34,431)
Net book amount	**16,524**	**2,538**	**4,278**	**371**	**1,500**	**3,754**	**28,965**

As of 31 December 2006 and 2005, the Bank had no contracted capital commitments for any projects.

NOTE 23 – OTHER ASSETS

	2006	2005
	(in thousands of HRK)	
Non-current assets held for sale	14,938	15,176
Pre-payments	483	380
Fees receivable	1,197	1,118
Small inventory	1,081	277
Other	856	997
Less: Allowance for impairment losses on other assets	(407)	(309)
	18,148	**17,639**
Current	**17,856**	**17,246**
Non-current	**292**	**393**

The movement in the allowance for impairment losses on other assets is as follows:

	2006	2005
	(in thousands of HRK)	
Balance at 1 January	309	207
Increase in impairment loss	98	102
Balance at 31 December	**407**	**309**

NOTE 24 – DUE TO BANKS

	2006	2005
	(in thousands of HRK)	
Deposits of banks	831	908
Borrowings from HBOR	25,172	16,648
	26,003	**17,556**
Current	**3,818**	**3,693**
Non-current	**22,185**	**13,863**

NOTE 24 – DUE TO BANKS (CONTINUED)

All deposits from banks carry variable rates.

	2006	2005
	(in thousands of HRK)	
Borrowings comprise:		
Current portion of long-term borrowings	3,071	2,698
Long-term borrowings	22,101	13,950
	25,172	**16,648**

NOTE 25 – DUE TO CUSTOMERS

	2006	2005
	(in thousands of HRK)	
Large corporate enterprises		
– current accounts	381	3,564
SME-s:		
– current accounts	200,909	176,942
– time deposits	107,643	119,074
Citizens		
– current /demand accounts	455,735	404,638
– time deposits	927,779	811,444
	1,692,447	**1,515,662**
Current	**1,362,935**	**1,281,521**
Non - current	**329,492**	**234,141**

All customer deposits carry variable rates.

NOTE 26 – OTHER LIABILITIES

	2006	2005
	(in thousands of HRK)	
Sundry creditors	1,266	1,435
Employee payables	2,212	2,165
Items in transfer	5,744	5,782
Saving deposits insurance payable	947	880
Dividends payable	710	674
Other	560	827
Provisions for off-balance sheet items (Note 28)	968	736
	12,407	**12,499**

The movement in provisions for off-balance sheet items was as follows:

	2006	2005
	(in thousands of HRK)	
Balance at 1 January	**736**	**491**
Increase in provision	232	245
Balance at 31 December	**968**	**736**

NOTE 27 – SHARE CAPITAL

(in thousands of HRK)	Number of shares	Ordinary shares	Preference shares	Share premium	Treasury shares	Total
At 1 January 2005	59,000	63,236	1,664	163	-	65,063
Purchase/sale of treasury shares	-	-	-	17	-	17
At 31 December 2005 /1 January 2006	59,000	63,236	1,664	180	-	65,080
Purchase of treasury shares	-	-	-	(13)	(13)	(26)
At 31 December 2006	59,000	63,236	1,664	167	(13)	65,054

As at 31 December 2006 and 2005 the nominal registered, subscribed and fully paid capital comprises 57,487 ordinary shares and 1,513 preference shares with a nominal value of HRK 1,100.00 per share. Preference shares have no voting rights and the related dividend is at least at the level of the interest rate that the Bank calculates and pays on 36-month term deposits from citizens plus 1%. However a preference dividend is only payable if a dividend on ordinary shares is also approved by the Annual General Meeting of Shareholders and does not exceed the amount of dividend per ordinary share for the current year. Preference shares obtain voting rights for the period until the next Annual General Meeting of Shareholders if no ordinary dividend is declared. Preference dividends are not cumulative if not paid for a given year.

The Bank buys and sells its own shares in the normal course of its equity trading and market activities. These shares are treated as a deduction from the shareholders' equity. Gains and losses on sales or redemption of own shares are credited or charged to share premium. The total number of treasury shares at the end of 2006 was 12 (2005: -).

The Bank's main shareholders as of 31 December can be shown as follows:

	2006			2005		
Shareholder	**Number of shares**	**% in share capital**	**% in voting rights**	**Number of shares**	**% in share capital**	**% in voting rights**
Intercommerce Umag	9,947	16.86	17.30	9,947	16.86	17.30
Tvornica cementa Umag	8,874	15.04	15.44	8,874	15.04	15.44
Hempel Umag	8,851	15.00	15.40	8,851	15.00	15.40
Serfin d.o.o.	5,701	9.66	9.92	5,701	9.66	9.92
Assicurazioni Generali s.p.a.	3,000	5.08	5.22	-	-	-
Plava laguna Poreč	2,106	3.57	3.66	2,106	3.57	3.66
KB 1909 s.p.a.	1,500	2.54	2.61	4,500	7.63	7.83
Treasury shares	12	0.02	-	-	-	-
Other	19,009	32.23	30.45	19,021	32.24	30.45
Total	**59,000**	**100**	**100**	**59,000**	**100**	**100**

NOTE 28 – CONTINGENT LIABILITIES AND COMMITMENTS

Legal Proceedings. At 31 December 2006 and 2005, there were no legal proceedings outstanding against the Bank.

Capital commitments. At 31 December 2006 and 2005, the Bank had no capital commitments in respect of buildings and equipment purchases.

The following table indicates the contractual amounts of the Bank's off-balance sheet financial instruments:

	2006	2005
	(in thousands of HRK)	
Guarantees	25,860	20,748
Letters of credit	10,040	12,509
Undrawn portion of loans on approved overdrafts	24,742	18,970
Commitments to lend	52,995	34,360
Less: Provision for off-balance sheet items (Note 26)	(968)	(736)
Total	**112,669**	**85,851**

The primary purpose for commitments to lend from guarantees and letters of credit is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit, which represent irrevocable assurances that the Bank will make payments in the event that a customer cannot meet its obligations to third parties, carry the same credit risks as loans.

Commitments to lend represent unused portions of authorisations to lend in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to lend, the Bank is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments since most commitments to lend are contingent upon customers maintaining specific credit standards.

Guarantees, irrevocable letters of credit and undrawn loan commitments are subject to similar credit risk monitoring and credit policies as utilised in the extension of loans. The management of the Bank believes the market risk associated with guarantees, irrevocable letters of credit and undrawn loan commitments to be minimal.

NOTE 29 – RESERVES AND RETAINED EARNINGS

	2006	2005
	(in thousands of HRK)	
Statutory reserves	22,764	17,264
Other reserves	22,657	28,157
Retained earnings	48,155	42,000
	93,576	**87,421**
Movements in reserves:		
Statutory reserve		
At beginning of the year	17,264	17,264
Transfer from other reserves	5,500	-
At end of the year	**22,764**	**17,264**
Other reserves		
At beginning of the year	28,157	28,157
Transfer to statutory reserves	(5,500)	-
At end of the year	**22,657**	**28,157**
Retained earnings		
At beginning of the year	42,000	33,459
Net profit for the year	21,496	21,403
Dividend for the previous year	(15,341)	(12,862)
At the end of the year	**48,155**	**42,000**

In accordance with national legislation, a portion of the net profit of the Bank is required to be transferred to a non-distributable statutory reserve until this reserve represents 5% of the share capital of the Bank.

Other reserves can only be distributed upon approval at the Annual General Meeting.

NOTE 30 – DIVIDENDS PER SHARE

Dividends payable are not accounted for until they have been ratified at the Annual General Meeting.

At the General Meeting that will be held on 20 April 2007, a dividend for 2006 of HRK 206,00 will be proposed (2005: HRK 260,00). The financial statements for the year ending 31 December 2006 do not reflect this resolution, which will be accounted for in shareholder' equity as an appropriation at retained earnings in the year ending 31 December 2007.

NOTE 31 – CASH AND CASH EQUIVALENTS

For the purposes of the cash flow statement, cash and cash equivalents comprise the following balances with less than 90 days maturity:

	Notes	2006	2005
		(in thousands of HRK)	
Cash and current accounts with banks	15	122,267	163,697
Treasury bills and other eligible bills	16	46,118	26,728
Due from other banks	17	290,278	446,839
Investment securities available-for-sale	20	45,000	-
		503,663	**637,264**

NOTE 32 – RELATED-PARTY TRANSACTIONS

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions. A number of banking transactions are entered into with related parties in the normal course of business. These transactions were carried out under commercial terms and conditions and at market rates.

The volumes of related party transactions outstanding balances at the year-end are:

	Directors and other key personell		Others*	
	2006	2005	2006	2005
	(in thousands of HRK)		*(in thousands of HRK)*	
Loans				
At beginning of the year	172	238	7,794	8,849
Increase	879	47	11,061	8,230
Decrease	(145)	(113)	(9,989)	(9,285)
At 31 December	**906**	**172**	**8,866**	**7,794**
Interest income	10	6	378	259
Deposits				
At beginning of the year	471	140	46,496	49,468
Increase	716	331	46,473	42,057
Decrease	-	-	49,128	45,029
At 31 December	**1,187**	**471**	**43,841**	**46,496**
Interest expense	16	11	1,185	1,800

Directors and other key personnel

	2006	2005
Gross salaries and other short-term benefits	2,215	2,602

* Under 'Other' are disclosed entities which have representatives in the Bank's Supervisory Board.

NOTE 33 – MANAGED FUNDS – AGENCY BUSINESS

The Bank manages funds on behalf of individuals and other institutions. The risk and rewards associated with these assets remain with those third parties and accordingly the assets are not included in the balance sheet of the Bank.

The net assets and liabilities managed on behalf of third parties may be summarized as follows:

	2006	**2005**
	(in thousands of HRK)	
Assets		
- Loans to citizens	2,396	2,423
- Loans to companies	6	7
- Cash	162	162
- Other	592	552
Total assets	**3,156**	**3,144**
Liabilities		
- Companies	7	7
- Financial institutions	2,396	2,423
- Other	753	714
Total liabilities	**3,156**	**3,144**

CORRESPONDENT BANKS

AUSTRIA		
Adria Bank AG	Vienna	ABAG AT WW
Bank Austria-Creditanstalt AG	Vienna	BKAU AT WW
Bank Styria AG	Graz	STSP AT 2G
Zveza Bank RZZOJ	Klagenfurt	VSGK AT 2K
BELGIUM		
Fortis Bank S.A.	Brussels	GEBA BE BB 36A
BOSNIA AND HERZEGOVINA		
Unicredit Zagrebačka banka dd	Mostar	ZABA BA 22
DENMARK		
Danske Bank A/S	Copenhagen	DABA DK KK
FRANCE		
Société Générale	Paris	SOGE FR PP
GERMANY		
Bayerische Hypo-und Vereinsbank AG	Munich	HYVE DE MM
Bayerische Landesbank Girozentrale	Munich	BYLA DE MM
Commerzbank AG	Frankfurt a/M	COBA DE FF
LHB Internationale Handelsbank AG	Frankfurt a/M	LHBI DE FF
ITALY		
Banca Antonveneta SpA	Padova	ANTB IT 2P 480
Banca di Cividale SpA	Cividale	CIVI IT 2C
Banca di Roma	Rome	BROM IT RD
Banca Intesa SpA	Milan	BCIT IT MM
Nova Ljubljanska banka Trieste	Trieste	LJBA IT 2T
UniCredito Italiano	Milan	UNCR IT MM
NETHERLANDS		
ING Bank NV	Amsterdam	INGB NL 2A
SLOVENIA		
Banka Koper dd	Koper	BAKO SI 2X
Nova Ljubljanska banka dd	Ljubljana	LJBA SI 2X
SWEDEN		
Svenska Handelsbanken AB	Stockholm	HAND SE SS
SWITZERLAND		
UBS AG	Zurich	UBSW CH ZH
UNITED STATES		
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Credit Products Support and Development	phone	52/702 317
Retail Deposit and Payment Products Support and Development	phone	52/702 351
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Supply and Technical Services Department	phone	52/702 329
INFORMATION TECHNOLOGY DEPARTMENT	phone	52/702 320
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Central and Network Information Systems Department	phone	52/702 325
Informatics Engineering Department	phone	52/702 319

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Bašanija bb, 52475 Savudrija		
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Trg J.B.Tita 1, 52460 Buje	fax	52/772 431
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Retail Operations Department	phone	51/213 360
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