



# VIKTORLENAC

**ANNUAL REPORT 2011**

*/April, 2012/*

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FINANCIAL STATEMENTS



## **Foreword**

The Management Board of the Viktor Lenac Shipyard j.s.c. is pleased to present its Annual Report for 2011 to all its shareholders, clients, employees, business partners and the entire public.

The Annual Report 2011 contains a detailed review of the financial results for the year, an assessment of the Company's situation, a review of the Company's business operations, revised consolidated and non-consolidated financial statements and the Auditor's Report. In a separate enclosure to this Report, the corporate governance rules applied by the Company are described.

## **Annual Report in Croatian and English**

The Viktor Lenac Shipyard's Annual Report 2011 has been issued both in Croatian and English. The Annual Report is submitted to the Company's shareholders at the General Assembly and is published on the Company's website.

## **Legal Form**

According to the Companies Act, Article 250.a and 250.b, in this document to the General Assembly the annual financial statements and report on the Company's situation are submitted, while the Supervisory Board's report to the General Assembly is submitted as a separate document.

The annual financial statements have been made in accordance with the Law on Accounting and International Financial Reporting Standards and have been revised according to the International Standards on Auditing.

This Annual Report has been made in accordance with the Law on Accounting and Companies Act and gives an objective assessment of the Company's situation and development with its business results as well as other important information for the Company.

## **Subsidiary Company**

*Viktor Servisi d.o.o. Rijeka* is an entity owned by the Viktor Lenac Shipyard.

## **Consolidation**

The consolidated and non-consolidated financial statements form an integral part of this Report. The difference between the consolidated and the non-consolidated financial statements is not significant in material terms, as the results and assets of the Company's subsidiary company (*Viktor Servisi d.o.o. Rijeka*) participate with less than 1% in the

Group's results and assets. In this Annual Report, the emphasis is, therefore, put on the business results of the mother company - Viktor Lenac Shipyard.

### **Abbreviations**

In this Annual Report, the Viktor Lenac Shipyard j.s.c. is called the "Shipyard" or "Viktor Lenac" or the "Company" respectively, together with its subsidiary company, the "Group".

### **Foreign Exchange Rates**

The following foreign exchange rates were used for converting amounts from one currency to another (from Croatian Kuna to Euros):

1 EUR = HRK 7.530420, representing the midpoint exchange rate by the Croatian National Bank on the 31st day of December 2011 (HRK 7.385173 on 31st December 2010; HRK 7.306199 on 31st December 2009), applied for calculating amounts of assets, liabilities and equity;

1 EUR = HRK 7.441192, representing the annual average of midpoint exchange rates by the Croatian National Bank (HRK 7.292286 for 2010; HRK 7.339664 for 2009), applied for calculating amounts in the profit and loss statement.

## Chairman's Address to Shareholders

Dear Shareholders,



*It is my pleasure to point out that Viktor Lenac shipyard has achieved positive financial results for four years in a row, although modestly lower with respect to the previous year. This is particularly significant, if we know that unfavourable trends are still observed in the world's shipping market.*

*Low freight rates, surplus of shipping capacity, Viktor Lenac's specific geographical position that might be considered as an aggravating circumstance, and increasingly lower sales prices in the shiprepair market have been successfully compensated with measures which are aimed at increasing efficiency and decreasing costs. During 2012, we will further intensify our efforts to maintain and continue the positive trend in turnover and result.*

*The operating revenues in 2011 amounted to 348 million Croatian Kuna or 46.7 million EUR, while operating expenses totalled 345.5 million Croatian Kuna or 46.4 million EUR.*

*The operating revenues and expenses yielded earnings before interest and tax in the amount of 2.5 million Croatian Kuna, significantly lower compared to the previous year as a result of lower sales prices and bigger oscillation in employment of capacity. Thanks to financial incomes that were greater than expenses by 2.8 million Croatian Kuna, the Shipyard generated a profit before tax in the amount of 5.3 million Croatian Kuna. After deducting all expenses like interest, depreciation and tax, the Shipyard realized a net profit in the amount of 4.1 million Croatian Kuna, down by almost one-third compared to the previous year.*

*The first part of the year 2011 production activity was marked by the completion of Seminole project, for the Italian client, which included extensive repairs and building of a completely new superstructure for 250 crew members, worth 15.9 million EUR.*

*The second part of the year was marked by a new contract for the conversion of the vessel SHCV Sampson, worth almost 13 million EUR. The project is expected to be completed in the mid of the current year. A large and complex project of maintenance and overhaul of the US Sixth Fleet Flagship USS Mount Whitney carried out from September to November 2011 was one of the most important projects in the Shipyard's history. In both projects the Shipyard was faced with new requirements and challenges, especially in terms of safety, organisation and planning.*

*The growth and development, knowledge, quality and productivity are an imperative of Viktor Lenac and its relationships with clients, employees, shipowners and other parties, and will remain a pillar of the Company's development strategy for the following years. In September 2011, the Shipyard's Quality Management System was certified by Bureau Veritas according to ISO 9001:2008. It is the*

*Shipyard's objective to eliminate weaknesses in the organisation and continue with development of the quality management system to include health and safety issues.*

*The organization development and business process restructuring continued to focus on the management system at all levels, including intensive upgrade of the IT environment with particular emphasis on business process management.*

*The development of Viktor Lenac is aimed at further shortening delivery times, quick and efficient adjusting to market needs and clients' requests, prompt organising of three-shift work when required and decreasing costs to remain competitive on the market.*

*Continuous investments in development and modernization of technologies and equipment is essential. During 2011, the Shipyard continued its efforts to enlarge its capacity and introduce technology improvements, with investments amounting totally almost 50 million Croatian Kuna.*

*In January 2011, the Shipyard's Dock 5 was completely refurbished, in which process more than 230 tons of steel was renewed, of which 170 tons in the pontoons or underwater hull.*

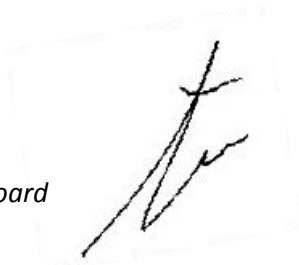
*The first phase of the investment cycle has been started in 2011. Facing severe competition and struggling for every single contract, with increasingly lower prices and shorter delivery times, it is essential to have such production capacity that can enable quick realization of bigger number of vessels in shiprepair. Decreasing of fixed and variable costs per unit of production, aimed at staying competitive in the market under continuous pressures on sales prices, will only be possible through growth in scope of work and advanced technologies and equipment.*

*The following investment phase is based on the purchase of a new floating dock of smaller size, aimed at increasing Shipyard's capacity in shiprepair and conversions, purchase of two new cranes for Dock 11 to speed up work process and enable easier handling of large cargo, renovation of Berth 3, and Berth 9 for accommodating vessels of larger size. The Shipyard's investment plan also includes energy efficiency improvement and thermal energy management, replacing sand-blasting by new environmentally friendly technologies using ultra-high pressure water blasting, purchase of other production equipment, health and safety issues and further upgrading of the IT environment. It is to be noted that a half of the price of the new floating dock was already paid in 2011. The Shipyard also purchased two new work boats.*

*The objective of Viktor Lenac is to maintain the positive trend in turnover and results in 2012 despite increasingly unfavourable trends in the market. The current year will be a year of intensified measures which are aimed at increasing efficiency for the benefit of our shareholders, clients, employees, suppliers and the entire community.*

Robert Škifić

Chairman of the Management Board



## Business Environment

### *Shiprepair*

Exceptionally unfavourable trends are currently observed in the world's shipping market, as a result of a disproportion between supply and demand due to a big number of newbuildings, which were ordered during the years that were characterized with favourable trends. It is expected that this situation may last for a while and no significant signs of recovery are expected in near future, particularly when speaking of the basic ship types where freight rates are currently extremely low (oil tankers, bulk carriers and container ships).

Shipowners are facing hard times and try to postpone dockings as much as possible, or choose to do only the most necessary repair works, or even scrap relatively new ships. Once reputable companies, today start with restructuring or file for bankruptcy.

In such circumstances, the shiprepair market remains under pressure from low prices and lack of contracts. Turkey and the Black Sea shipyards are the biggest competitors to Viktor Lenac, being the cheapest shipyards in the surrounding.

Also, a few shipyards in the Mediterranean have reopened. On the other hand, due to crisis, the largest shipyards in Greece have closed partly or completely.

Viktor Lenac successfully completed the year 2011 when speaking of the shiprepair activity, primarily thanks to entering into cooperation with several large companies what brought to the Shipyard an important number of contracts, and through struggling for every single contract. In near future, no significant changes are expected in this part of the market, neither is likely that Viktor Lenac's market position will change. It is however certain that all shipyards will be faced with exceptional pressures from low prices due to reduced shipowners' budgets resulting from low freight rates during last years.

It is not expected that freight rates will rise in the forthcoming period, except for relative volatility having low average. The biggest impact on freight rates will still be felt from global





economic trends, and the fact that there is still a big number of newbuildings. On the other hand, a decrease in number of newbuilding orders gives us hope that close future may bring a proportion of supply and demand thereby creating the conditions for a significant rise of freight rates.

In the next period, the Shipyard can expect vessels of larger size convenient for its Dock 11. During last years, Dock 11 has successfully positioned in the market and today accommodates mostly large sized ships. Besides having new clients, we also got contracts with larger scope of works, where Viktor Lenac is not always competitive. In order to compensate for lowered unit prices, Viktor Lenac will make efforts to increase the number of vessels in shiprepair annually. The Shipyard is increasing its docking capacity. The third floating dock will be in operative use in the second part of the current year. The new dock will focus on small to medium sized ships, particularly chemical tankers, LPG, ferry boats and cruisers, general cargo and container ships and offshore support vessels conversions.



Having in mind severe competition in the small sized ships market, in the beginning we are expecting lower revenues from the third dock.

### ***Conversions and Offshore***

The ship conversion market relating to merchant ships is very quiet at the moment. This is caused by low freight rates in merchant shipping. There have been observed however small moves in the right direction compared to the previous year. Specifically, a few projects of ship modernization and lengthening have appeared in the European market.

In the following period some projects related to very specific market niches can be expected. It is however very hard to forecast the project locations. After 2012, by ratification of conventions on ballast water treatment and harmful gas emissions, a big number of projects of conversion of existing ships are expected to fulfil new regulations. Such projects won't be large in terms of individual scope of work. On the other hand, considering the number of ships to fulfil new regulations, in total it will be about a big volume of work and an interesting potential source of revenues.

With stable and high oil prices, the market of offshore vessels and platforms involved in the offshore oil and gas industry has took off. It is mostly about ships which do not sail in the Mediterranean as the Mediterranean region is still influenced by disturbances in Egypt, Libya

and other Northern African countries. There are indications however that some ship managers will move part of their fleets to the Mediterranean, what is definitely encouraging.



Of several offshore vessel conversion projects that have recently appeared in the market, Viktor Lenac has contracted conversion of the vessel SHCV *Sampson*. The conversion was started in September 2011. It is expected that this market

segment will be attractive in the forthcoming period as a result of high oil prices, enabling oil companies to explore and exploit oil and gas fields at greater depths and in harder conditions.

Actually, offshore wind farm projects have gone into high gear, especially in the North Europe. After all favourable locations in shallow waters have been used, offshore wind farms are expected to spread to fields that get more and more distant from the shore, with increasing water depth. It is likely that such development will raise demand for construction of jackets. Unfortunately, such projects are mostly located in the North Sea. The transportation costs which make a significant part in total price weaken competitive position for shipyards situated in other locations. As regards the Mediterranean region, a few such projects have actually been in the preparatory stage. It is however not likely that the projects will be launched in near future as preparatory activities are of long duration. Concerning gas field projects in the North Adriatic, where Viktor Lenac earned most of its offshore revenues during the last fifteen years, two gas platforms are planned to be constructed during the current year.



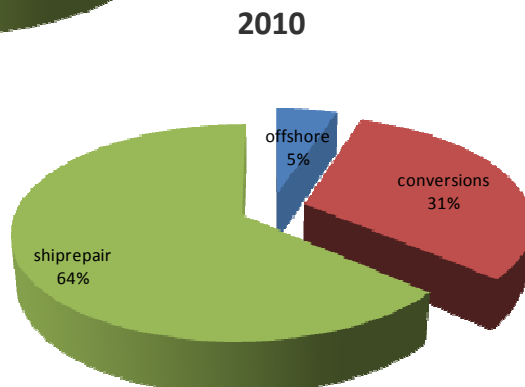
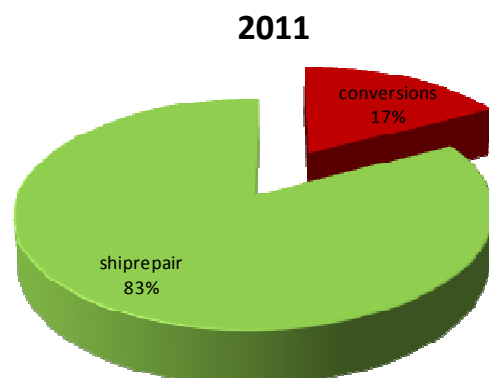
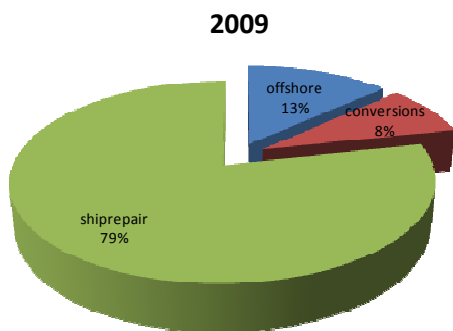
## Business Activities

### Sales

#### Realized revenues

HRK	2009	2010	2011
Shiprepair	222.002.665	190.191.866	275.421.116
Conversions	23.557.569	93.754.850	57.374.612
Offshore	37.217.637	15.328.107	
<b>Realized revenues</b>	<b>282.777.872</b>	<b>299.274.822</b>	<b>332.795.729</b>
Production in progress	4.538.878	-10.385.475	-1.710.526
<b>Realized scope of works</b>	<b>287.316.750</b>	<b>288.889.347</b>	<b>331.085.203</b>

EUR	2009	2010	2011
Shiprepair	30.246.979	26.080.908	37.013.037
Conversions	3.209.625	12.856.552	7.710.406
Offshore	5.070.755	2.101.935	
<b>Realized revenues</b>	<b>38.527.359</b>	<b>41.039.395</b>	<b>44.723.443</b>
Production in progress	618.404	-1.424.155	-229.873
<b>Realized scope of works</b>	<b>39.145.763</b>	<b>39.615.240</b>	<b>44.493.571</b>





In 2011 Viktor Lenac realized most of its revenues from the shiprepair activity. Lack of offshore projects and lower revenues from conversions have been compensated with higher shiprepair revenues, up by 40% compared to the previous year. Shiprepair revenues include repairs of *US Sixth Fleet Flagship USS Mount Whitney* that was the most important project in the year 2011.

The shiprepair revenues derived from 67 repair projects with an average contract value, excluding USS Mount Whitney repairs, amounting to about 413 thousands EUR, significantly higher compared to the previous year when the average contract value amounted to about 300 thousands EUR.

Revenues from conversions include the value of works put in place to complete the construction of the *Seminole* superstructure (completed in March 2011), part of the value of conversion of the vessel *Sampson* based on the milestones completed by the end of 2011 as well as revenues from small conversion of the ferry



*Marko Polo* owned by Croatian shipping company *Jadrolinija*.

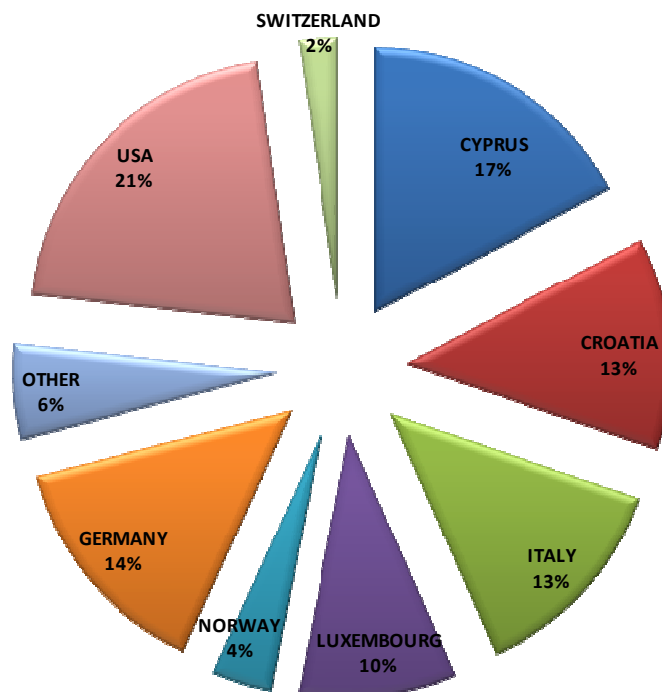
Of total 332.8 million Croatian Kuna (44.7 million EUR) realized from main activities, only 47.5 million Croatian Kuna or 14% derived from the local market. The biggest revenues from the local market or 17.6 million Croatian Kuna were generated from repairs of five ships for the local client *Tankerska plovidba* company, while 16 million Croatian Kuna were earned from repairs and conversion of the ferry *Marko Polo* and repairs of the ferry *Liburnija* for the Croatian shipping company *Jadrolinija*. The remaining revenues related to dry-dockings of newbuildings for local shipyards and other repair jobs of minor value.

In 2011 the American market made the biggest piece of the shiprepair pie deriving from repairs of the US Sixth Fleet Flagship USS Mount Whitney.

During 2011, Viktor Lenac established contact with several large companies in Cyprus, what brought significant volume of contracts for Viktor Lenac and generated revenues in the total amount of 8.2 million EUR or 19% thereby making this market one of the most important for the Shipyard.

The Italian clients traditionally are among the most important clients, participating with the total amount of 8.1 million Euros in 2011.

Of other foreign countries, in 2011 Luxemburg made its mark in terms of realized revenues on the account of the Sampson conversion.



**Sales**

Increasingly severe competition and struggle for every single job, have intensified marketing and sales activities on the shiprepair and conversion market.



The number of covered inquiries and produced quotations is constantly growing, but the percentage of contracting is decreasing during the last few years. This supports the fact that competition is increasingly severe and shipowners increasingly seek to lower prices in shiprepair.

	2008	2009	2010	2011
Number of quotations	140	260	280	332
Number of contracts	47	58	63	67
<b>% contracting</b>	<b>34%</b>	<b>22%</b>	<b>23%</b>	<b>20%</b>

Ambitious sales targets are imposing expectations that more than 70 ships will be contracted in 2012 with

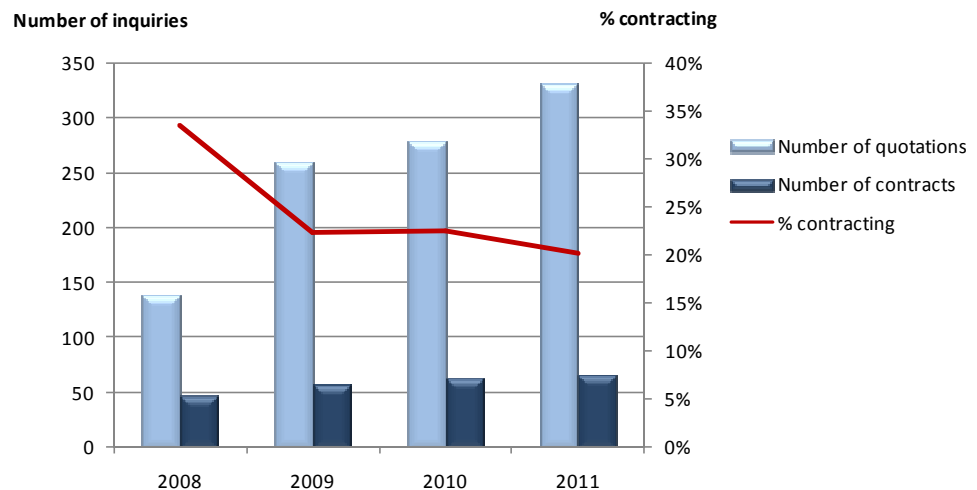
additional number of new contracts in the second half of the year relating to the third dock.

Viktor Lenac's geographical position might be considered as an aggravating circumstance as its distance from the main maritime routes could mean a loss of several days comparing to the main competitors on the Mediterranean market. In fact, this was the main reason for rejecting Viktor Lenac and moreover Viktor Lenac was forced in many cases to adjust its offer in terms of price and redelivery term, in order to be more competitive.

Not rarely, owners postpone repairs or cancel scheduled docking, also

scheduled arrivals often change, which causes problems in planning docking capacity. It happened, therefore, that the shipyard had to refuse a job because of unavailability of capacity at the requested period.

For the same reason, the shipyard did not issue quotation to about 20 inquiries during the year because of unavailability of capacity at the requested period.



## ***Production***

### **Production Activities**

During 2011 Viktor Lenac realized 72 various projects, of which most projects were realized in the shiprepair activity. *Seminole* and *Marko Polo* were the major projects and included both repairs and conversion. In the last quarter of the year, the Shipyard commenced works on the conversion of the vessel SHCV Sampson. There were no offshore projects in 2011.



Repairs carried out on the container ships owned by MSC and Hapag-Lloyd were the most important shiprepair projects primarily consisting of large scope of shipbuilding works carried out on hatch covers, and structural steel renewal. There was a period when a hundred and ten hatch covers, each weighing about 30 tons, were placed all together along Berth 9.

Very complex and comprehensive repairs were carried out on the US Sixth Fleet Flagship USS Mount Whitney from mid September to mid November. For the first time, technology of bolted structural joints was applied in shell plating renewal instead of riveted joints. A complete overhaul of the shaftline and propeller was carried out. Due to dimensions, tailshaft alignment and machining was carried out outside Croatia. In addition, twenty main and auxiliary switchboards were overhauled.

In March 2011, the conversion of the crane-pipe laying vessel *Seminole* was completed. The Shipyard built and outfitted a complete new superstructure weighing some 450 tons, including accommodations for 250 crew members, based on design and workshop drawings produced by the shipyard's design team. It was installed total 1,500 t of steel (main deck, shell plating and tanks), 80,000 meters of cables and about 200 tons of pipes.

In September 2011, the Shipyard commenced works on the complex conversion of the offshore gas and oil field installation vessel *Sampson*. *Sampson* will be converted into a crane

and pipelay vessel. Six new Diesel generators (2200 kW each) will be installed in two independent engine rooms. New ship systems will be installed with more than 40 tons of piping. Two new thrusters will be installed i.w.o. existing fresh water tanks. HiPAP for dynamic positioning will be relocated in newly built structural trunks. New A&R winch room will be built and outfitted i.w.o. existing hold no.1. Complete pipe laying equipment (tensioners, track supports, conveyors, pipe loader etc.) will be installed with hydraulic systems on main deck. A new pipe lay tunnel (300 t) and A-frame structure (276 t) will be built and installed. A new stinger structure (390 t) for laying offshore pipelines will be built.



The existing ship systems will be modified to accommodate new equipment, propulsion and power generation. Two engine rooms, two switchboard rooms and two thruster rooms will be outfitted and HVAC system will be installed in new ship spaces. More than 150 km of cables and 110 tons of pipes will be installed in total. The superstructure will undergo considerable modification including gym, sauna, swimming pool etc. It will be installed total 1,600 tons of steel, of which 62% was prefabricated or 45% assembled by the end of 2011.

Other repair projects consisted of typical works mainly steel renewal, surface preparation and coating and

mechanical works.

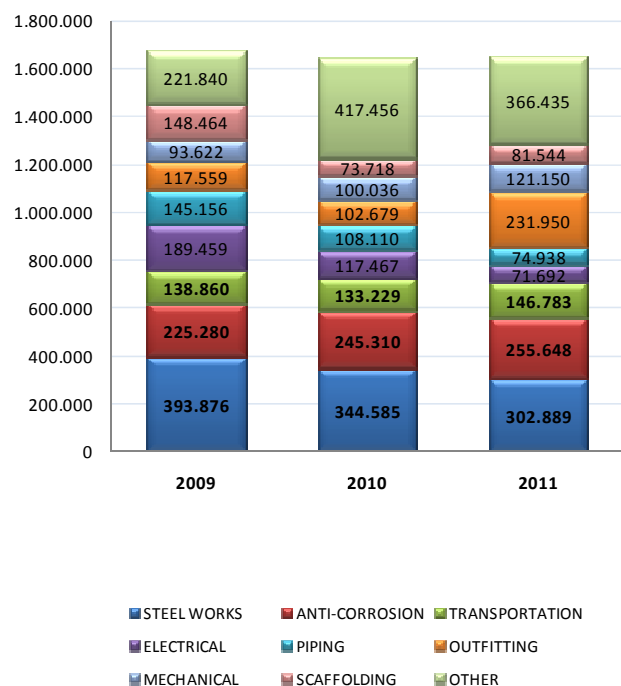
**Structure of Carried out Works**

During 2011 Viktor Lenac produced the total number of 1.65 million effective working hours in the main activities and services, and operative improvements, similar compared to the several previous years.

Total structure of shiprepair works between particular type of work or craft normally has some minor, insignificant oscillation. In a standard manner, in 2011 steel works and anti-corrosion works made the biggest part of the total structure.

Total structure of works depends on participation of projects of larger scope, mostly conversions and offshore, in the total production activity, calling for more or less

**Production Work Structure**



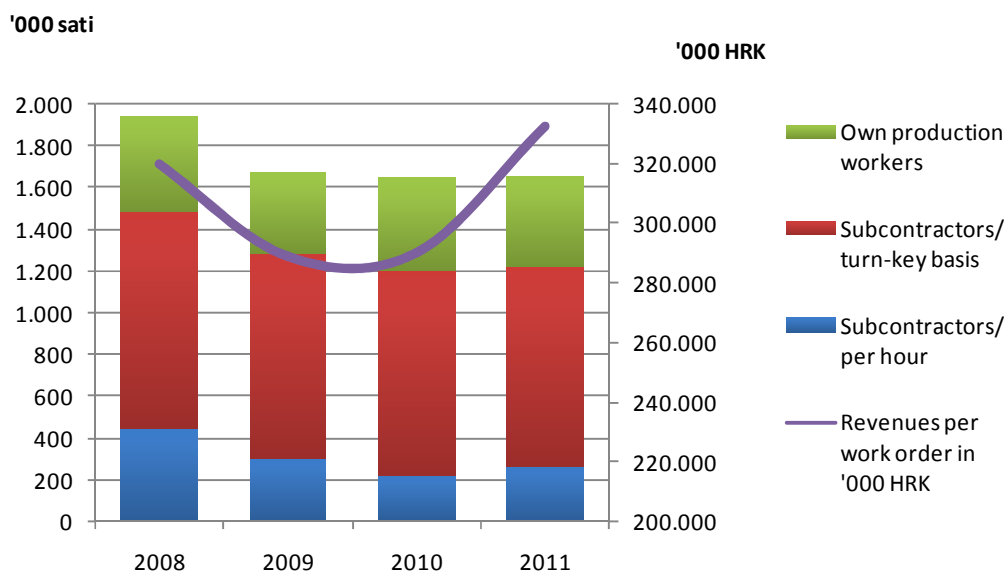
needs for particular type of work or craft. In 2011, a large scope of steel outfitting works was noted, mostly deriving from hatch cover works carried out on the container ships.

	2009	2010	2011	% 2010	% 2011
STEEL WORKS	393.876	344.585	302.889	21,0%	18,3%
ANTI-CORROSION TREATMENT	225.280	245.310	255.648	14,9%	15,5%
TRANSPORTATION WORKS	138.860	133.229	146.783	8,1%	8,9%
ELECTRICAL WORKS	189.459	117.467	71.692	7,2%	4,3%
PIPE WORKS	145.156	108.110	74.938	6,6%	4,5%
OUTFITTING	117.559	102.679	231.950	6,3%	14,0%
MECHANICAL WORKS	93.622	100.036	121.150	6,1%	7,3%
SCAFFOLDING	148.464	73.718	81.544	4,5%	4,9%
OTHER WORKS	221.840	417.456	366.435	25,4%	22,2%
	<b>1.674.116</b>	<b>1.642.591</b>	<b>1.653.029</b>	<b>100,00%</b>	<b>100,00%</b>

### Production Capacity and Costs

The annual production capacity of Viktor Lenac is measured in effective work hours deriving from working orders in main activities, maintenance works and self-investment. Apart from its own permanent production workers, depending on needs, Viktor Lenac uses subcontractors for all its production activities. Subcontractors workers are mainly contracted on turn-key base, and in lesser scope per hour, noticeably during periods of oscillations where own labour is not sufficient.

Effective hours vs. realized revenues from main activities

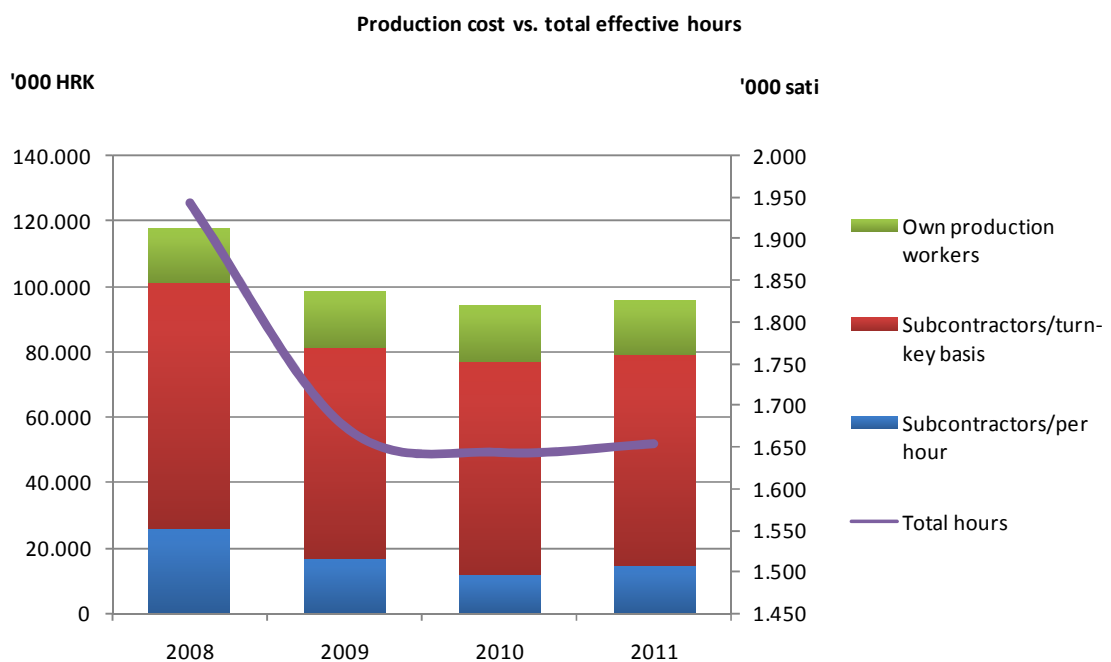


Of 1.65 million effective hours, own production workers, 270 in average, participated with 429 thousands of hours or 26%. During the last two years, a noticeably decreasing trend in total number of effective hours produced with respect to revenues from main activities was observed. Although revenues do not derive from production operations exclusively, but also depend on the value of installed material and equipment, still an increasing trend in efficiency and decreasing trend in number of hours per unit of revenue can be noted. In 2011, a rise in number of subcontracts per hour was noted, which is a result of stronger oscillation in employment of production capacity. Subcontractors engaged per hour produced in total 263 thousands of hours, while turn-key contracts participated with 960 thousands of effective work hours.

In figures, the total cost of production work incorporated in working orders from main, auxiliary and investment activities in 2011 amounted to 95.8 million Croatian Kuna, of which Viktor Lenac's own production workers' salaries made 16.8 million Croatian Kuna.

	2009	2010	2011
Revenues from main activities	282.778	299.275	332.795
Total production work cost	98.340	94.109	95.845
Labour cost as percentage of revenues	35%	31%	29%

The production cost follows the curve of produced hours, but it is evident that the total participation of production cost related to realized revenues is decreasing.





**Employment of Docks and Berths**

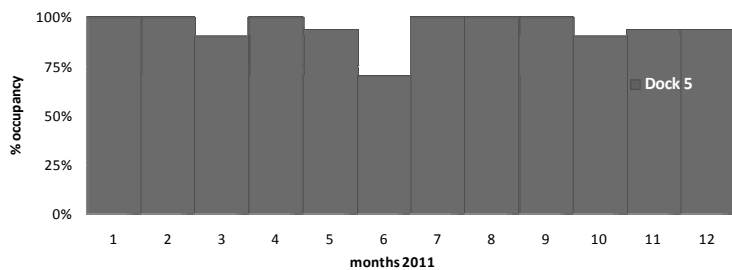
Viktor Lenac disposes of two floating drydocks: Dock 5 and Dock 11.



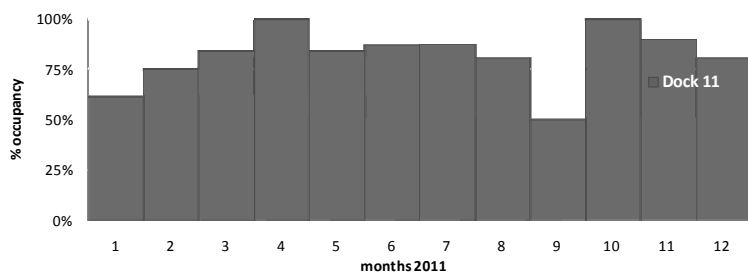
The total number of 31 dockings were completed in Dock 5 during 2011. The total employment of the dock was 346 days, making an occupancy rate of 94.7%. In Dock 11 were completed 32 dockings employing the dock during 302 days, which makes an occupancy rate of 82.6%. Shiprepair activity is characterised by oscillation in capacity utilization, and, therefore, employment of docks varied during the year.

During periods of high employment, when docking capacity represented a limiting factor, it happened four times that there were two ships of smaller size in one dock, and four ships were docked in the nearby shipyards *Kraljevica* and *Lošinj*. In order to maximally use the Shipyard's limited docking capacity, in 2011 for the first time a night docking was carried out, more precisely when a Suezmax tanker was docked in Dock 11 during night hours.

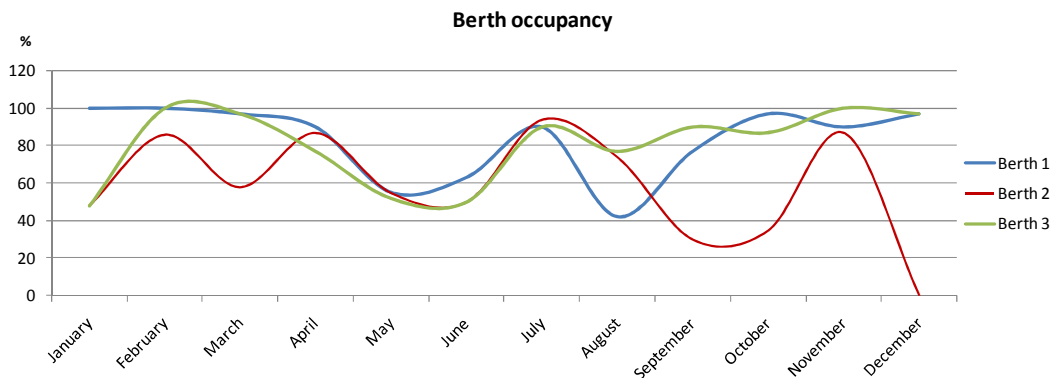
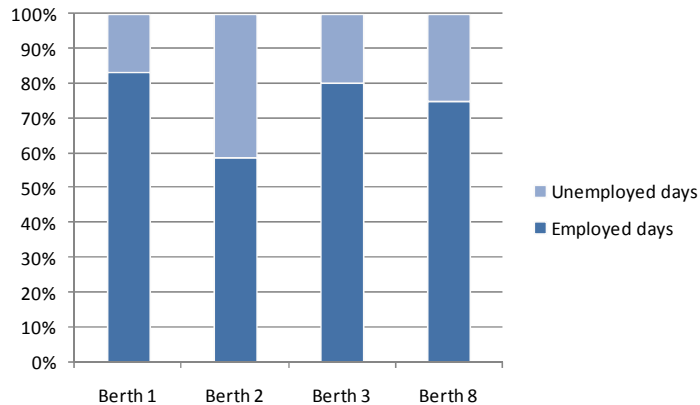
**Dock 5 employment during 2011**



**Dock 11 employment during 2011**



Operative berths also show different percentage of occupancy. Berths 4-7 are not primary operative berths. A higher occupancy rate was noted as regards Berth 8, resulting from USS Sixth Fleet Flagship USS Mount Whitney that was moored at the berth during its repairs period.



**Raw material and energy source cost**

The total cost of material and energy source in main activities in general participate with 20 to 25% in the total operating revenues. The most important material used in production process or built-in on vessel under repairs or alteration during the year, amounting to total 76.2 million Croatian Kuna, were the following:

	in HRK
Material group	2011
IRON, STEEL PLATES, PIPES	28.777.440
ELECTRICAL MATERIAL	6.057.674
CHEMICAL PRODUCTS – PAINTS, COATINGS, GAS, PUTTY	6.162.052
FUEL, OIL, GREASE	5.849.217
CONSTRUCTION MATERIAL - GRIT	5.708.655
EQUIPMENT AND MATERIAL FOR A SPECIFIED PURPOSE	5.644.513

The structure of material costs depends on structure of works carried out for clients.

Viktor Lenac uses significant amounts of energy such as electric power, fresh water, technological water and gas.

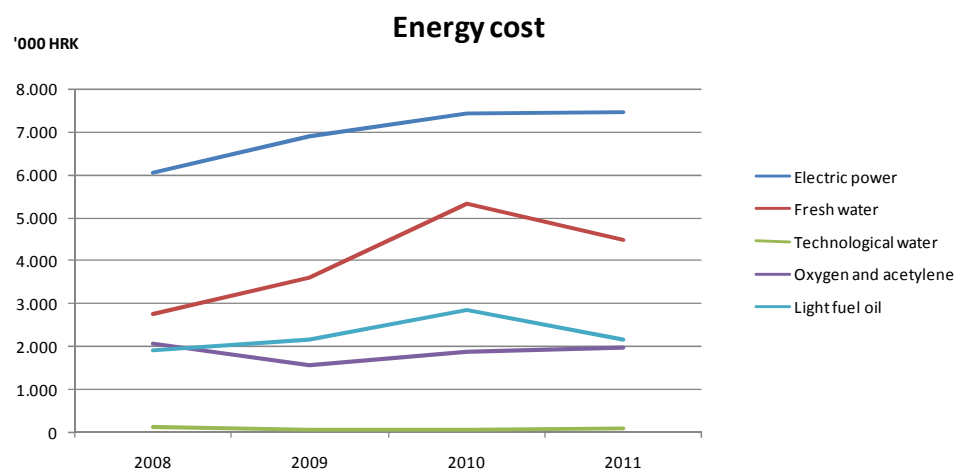
A part of electric energy and fresh water represent fixed costs, while part is calculated as variable production costs that depend on scope of production activity. Technological water which is not used for drinking and technological gas such as liquid oxygen and acetylene are variable costs, which depend in whole on scope of production activity.

Technological water is used in washing and high pressure jetting, steel cutting and assembly. Liquid oxygen and acetylene are used in steel cutting and machining.

Energy source	Unit	2008	2009	2010	2011
Electric power	kWh	11.730.319	11.297.600	11.188.560	13.060.720
Fresh water	m3	295.224	290.289	389.616	293.578
Technological water	m3	253.296	160.002	153.328	176.402
Oxygen and acetylene	kg	751.833	519.140	652.112	651.620
Light fuel oil	kg	611.710	642.400	965.750	589.280

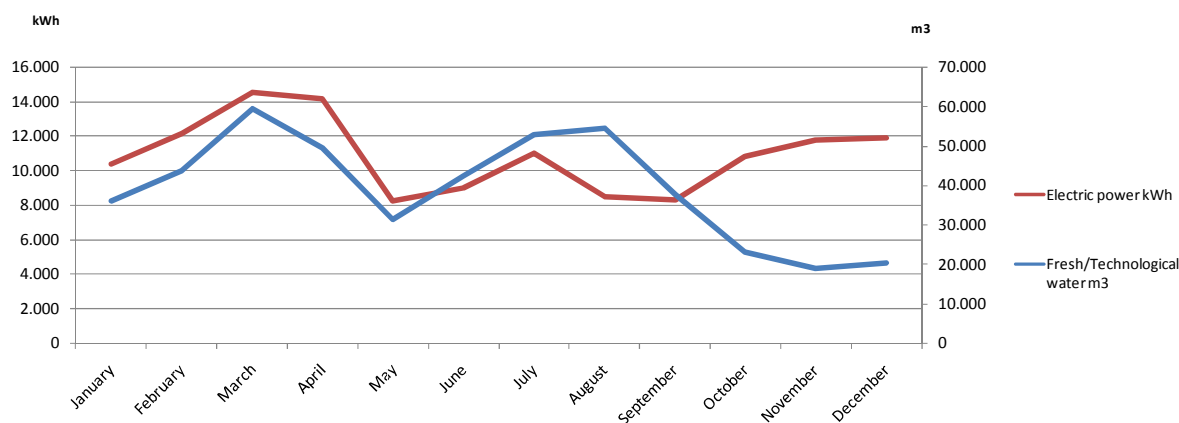
Aimed at decreasing cost of water, in 2011 the Shipyard engaged a specialized company to take severe measures aimed at controlling and monitoring oscillation in consumption and detecting leaking. This resulted in a significant decrease in utilization of expensive water from municipality water supply. More reduction will be achieved by installing additional technological water pipelines aimed at using technological water at larger scope instead of significantly more expensive water from municipality water supply.

Fixed costs of electric power and heating oil will be decreased by increasing energy efficiency, which is planned during the next year. The project will include renewal of boilers, gas



system installation and utilization of waste heat recovered from compressors, and is expected to bring significant reduction in electric power and heating oil.

Oscillation in employment of capacity can also be analyzed through oscillation in consumption of electric power and water. A drop in water consumption as recorded in the second part of the year is the result of the specific measures taken to reduce water consumption and eliminate leaking.



### ***Technological Development and Investment***

The objective of Viktor Lenac is to assure the conditions, through continuous investments, for maintaining and growing its competitive market position and growth in revenues from its main activities, shiprepair and conversions, decreasing costs respectively fixed costs per unit of revenue (product) and increasing overall business efficiency.

The Shipyard's competitiveness is primarily conditioned by its docking capacity for accommodating different ship sizes.

Providing fast service, adaptability to quickly adjusting to clients' needs and responding to frequent changes in work specifications, respecting short delivery times have become the most important factors for the following two main reasons:



- In periods of high ship employment and high freight rates, shipowners give advantage to those shipyards where they expect to spend the least possible time for repairs;
- In periods of oscillation in the shiprepair market, quicker freeing up of docks or production capacity will enable bigger flexibility to be more competitive in today's severe struggle.

Increase in its docking capacity will enable Viktor Lenac to have more flexibility in contracting, and to reinforce its market position, and develop cooperation with new clients in shiprepair and conversions as well as offshore activity.



Conversions and offshore activities are primarily based on technical equipment for fast and efficient steel works, and horizontal and vertical transportation means for handling, assembling and mounting of steel sections. The shipyard has made an investment plan for modernization and improvement of

its production, and development of its activities. The following is the pillar of the plan:

- Purchasing of a new 8500 tlc floating dock aimed at increasing shiprepair and conversion capacity,
- Purchasing and installation of 2 new cranes of larger capacity for Dock 11 aimed at speeding up and improving production activities on the dock and enabling manipulation of large cargo,
- Restoration of Berth 3 and enlarging of Berth 8, in order to provide safe work on operative berths and accommodation of ships of larger size to disengage Dock 11 when possible,
- Replacing sand-blasting by new environmentally friendly technologies using ultra-high pressure water blasting, thereby eliminating most environmental problems,
- Implementation of energy efficiency increase project,
- Investment in horizontal and vertical means of transport aimed at more effective cargo and material manipulation in daily production activities,
- Other investment in production equipment, improvement and modernization of halls and areas, HSE and IT environment.

Planned investment is essential to the realization of the corporate mission: adaptability to quick adjusting to clients' needs in today's ever changing market, continuous investment in human resources development, learning organization and modernization of technologies and equipment, health and safety and environmental protection.



Total investment for this investment phase are planned in the amount of about 23 million EUR and will be realized partly by use of credit funds through Croatian Bank for Reconstruction and Development or 75%, and partly by use of own funds or 25%.

Investments already started. In November 2011, Viktor Lenac signed the contract for the purchase of the new floating drydock with the Ukraine shipyard Kherson State Plant „Pallada“. The new dock will be delivered in May 2012 and towed to Viktor Lenac. It is a composite dock type with concrete pontoons and steel towers having the capacity of 8,500 t, pontoon length of 139.50 m and internal clear between towers of 24.50 m. The dock will be put into operation by the end of June. The total price is 6.83 million EUR, of which an advance payment in the amount of 2.9 million EUR was paid in 2011.

At the end of 2011, one of two planned work boats was purchased having a value of 450 thousands EUR.

In December 2010, the Shipyard's Floating Drydock No.5 entered the other Shipyard's Floating Drydock No.11 to undergo its first docking since it was bought in the Netherlands 40 years ago, when it was towed to the Shipyard in two sections and joined here. The docking was completed in January 2011, in which process it was renewed in total more than 230 tons of steel on the underwater hull and dock towers. It was carried out anti-corrosion treatment and complete overhaul of dock cranes and systems.



The total value of Dock 5 refurbishing amounted to 20.6 million Croatian Kuna, of which 6 million Croatian Kuna was invested in 2011.

Of other important investment, it is to be noted the preparatory activities for building of an open storage space that will comprise of grit, steel and scaffolding warehouse aimed at easier and quicker cargo manipulation. In 2010, a new portal crane was purchased related to this project. The works have continued in 2012. The value of investment realized in 2011 amounted to 1.3 million Croatian Kuna.

## ***Organisational Development***

### **Restructuring the Organisation**

During 2011 continued extensive re-engineering of the shipyard's process with an emphasis on production activities, aimed at an increase in productivity, reduction in overhead staff, and decrease or progress in activities that do not generate additional value.

Diversification of Viktor Lenac's production activities requires that its shiprepair, conversion and offshore projects are executed with a high degree of flexibility and expertness, and the need to increase the productivity level requires accurate planning and rational utilization of resources, particularly considering that Viktor Lenac's activities are project-oriented, often working on multiple simultaneous projects.

The biggest productivity in such project-oriented activities can be achieved in an advanced matrix organisational structure. In spite of the complexity of such structure and an increased risk of conflict due to dual responsibility and conflict of interest between the managing levels, this type of organisation enables transparent measurement of productivity of each individual project and each functional unit.

The major changes in the development of the Company organization are as follows:

- Introducing an integral and detailed project planning system, change control and information system as parts of the overall resource planning process;
- Establishing an efficient control system of project realization by delivery terms, costs and quality as well as stages of business processes;
- Developing functional management and establishing the basis for supervising integral cost and profit units;

The matrix organisation with an adequate information system is a basis for development of the controlling and internal benchmarking, breaking down overall results of company performance by individual organisational units following the company's functional organisational structure. On the other hand, following its project organisational structure, overall results of company performance are divided by individual activities, next by individual projects and at the end by project parts.

By an efficient planning system and planned versus realized strategy, new organization will enable the implementation of the performance measurement system, measured either individually or as part of a group, against overall business objectives or specific job or tasks.

In 2011, a comprehensive analytical evaluation of working posts was continued, aimed at an objective systematization of working posts and defining of roles, responsibilities, authorities and tasks.

### Development of Information System

Comprehensive modernisation and reorganisation of the entire information and communication system, seeking to increase efficiency in planning, management and evaluation based on the matrix organizational structure both project and functional, also continued during 2011.

Aimed at achieving timely and comprehensive business process planning, particularly production sub-processes, the object is to implement computer supported systems to enable automated exchange of information and business data at all stages from bidding, contracting and realization to accounting and analysis.

The new information system has as its goals:

- Increasing efficiency in planning and controlling the realization of tasks;
- Assuring prompt cost control;
- Assuring prompt and effective analysis of cost trends;
- Providing feedback aimed at adjusting inputs and redefining goals;
- Assuring single inputs and additional data upgrade through automatic data transfer to end users;
- Reducing administrative burden in favour of more effective management aspect;
- Enabling performance measurement system;
- Improving accounting and business and financial reporting.

During 2011 the following activities were conducted to improve the shipyard's information system:

- Upgrading application module "Calculation of Effective Hours and Material Cost" as a basis for calculating prime cost in a particular project, directly linking ingoing material price
- Collecting tender documents and contracting subcontractors' services in the module "Subcontracting"
- Planning and following up the realization of steel assembly throughout the application "Installed Steel Records" aimed at obtaining data on installed steel on a real time basis
- Beginning with implementation of Business Intelligence System
- Purchasing and implementing solutions for managing documents, records and processes in quality management – Swing Process Manager
- Beginning with preparation of solutions for Client Management
- Upgrading IT infrastructure, in which process more than 70% of the Shipyard's operative shore has been connected to the local network
- Upgrading IT system with new telephone exchange and IT solutions of new generation.

The following is planned for the next period: purchasing of 3 new servers, disk sub-system for back-up, new equipment for data transfer to server wired/wireless, renewal and upgrading of hardware and software, particularly laptops and notebooks.



### Quality Management System

Since September 2011, the Company's Quality Management System has been certified according to ISO 9001:2008.

The certification was carried out by Bureau Veritas. The first step was to prepare quality management documentation, and organize workshops in order to educate managers and internal auditors aimed at raising awareness on the importance of the system.

Twenty employees have been trained for internal auditors. Some of them will be educated for leading auditors according to ISO 9001:2008 and OHSAS 18001.2007. The objective is to further improve the company's quality management system, and prepare necessary steps for implementing health and safety

management system aimed at raising the quality of relations with the clients and their satisfaction.

The Shipyard's Quality Management System has been improved through the implementation of an application solution for document management – Swing Process Manager (SPM).

SPM enables us to control production, distribution, versioning and filing of documents and records on quality, monitor corrective and preventive activities, plan internal audits, and identify non-conformances in products and processes.

Using SPM we have created the conditions to manage the entire organization and business processes in a successful and efficient way.



The Quality Management System will also include Safety and Environmental Protection. During 2012, the Company will apply for certification of the sub-systems to ISO 14001 and OSHAS 18001.

The following are the key issues to which particular attention will be given aimed at further improving the company's quality management system:

- Implementing corrective and preventive activities, non-conformance management, measuring the cost of non-quality;
- Optimizing main processes in sales, improving purchasing process (both material and service) and technical project preparation. In purchasing, the objective is to establish clear criteria for measuring quality and efficiency of suppliers and subcontractors, and their impact to Viktor Lenac's reputation and cost. Technical preparation improvements are aimed at producing correct, up-dated and timely technical documents using SPM;
- Managing projects under realization.

The Company has established a Board of Quality made of a Member of the Management Board in charge of quality, Quality Manager, line managers and Quality Team made by internal auditors.

Besides internal audits, four key subcontractors have been audited in quality management. The audits were carried out by the Company's auditors in cooperation with BV auditors. In addition, Viktor Lenac's Quality Management System was closely evaluated for the purpose of the Sampson project.

Thirty-two non-conformances have been identified during the internal audits. The analysis indicated that the identified non-conformances had mainly to do with a lack of supervision over measuring and realizing process goals. Accordingly, a series of corrective and preventive activities have been taken.

Thirty-three non-conformed products have been identified during daily controls. The non-conformed products had mainly to do with a lack of respect of the established work procedures. All non-conformances have been eliminated through corrective activities, and preventive activities have been taken as well.

In the forthcoming period, particular attention will be given to improving the non-conformance reporting system, enabling each employee to timely report on any non-conformance observed via electronic mail, aimed at improving the quality of products and processes and raising awareness on the importance of the quality system.

### **Safe Work, Health and Safety at Work and Fire Protection**

Occupational health and safety and protection of property both for own workers and subcontractors, as well as clients, is the Company's highest priority.

The health and safety policy is implemented through the areas of safe work, fire protection and protection of property through corrective and preventive actions and permanent monitoring activities in compliance with laws and regulations.



During 2011, the Shipyard took various activities and measures to improve health and safety, and fire protection:

- A revision of 'Risk Assessment' as the fundamental document for the safety policy was carried out, based on which the Company established rules and measures for each work post with increased level of danger as part of the Risk Management Plan;
- Safety has been integrated into the Quality Management System, enabling revision of work instructions aimed at executing work processes and procedures in a safe way;
- Total number of 219 machines and devices with increased level of danger were tested to establish their conformance with safety rules and regulations, in which process all observed malfunctions and deficiencies were eliminated;
- In workshops and on board vessels under repairs, a series of noise measurement was carried out resulting in reinforcing personal protection measures against harmful noise;
- In all workshops, pre-assembly area, and internal and external communications, measurements of minimum illumination were carried out. In the external areas where illumination level was not satisfactory, the Shipyard installed new lights in accordance with regulations, while other areas will be conformed during 2012;
- The Shipyard engaged a specialized company to measure harmful effects of chemical factors in the work environment, specifically gas products evolved during welding and gas cutting carried out in the workshops. All measured parameters have been conformed with law;
- Work instructions regulating measurement of illumination level in work areas at three-month intervals respectively measurement of harmful effects of chemical factors at monthly intervals have been regulated aimed at monitoring ventilation systems in the workshops. As regards closed or restricted spaces, obligatory measurement of harmful effects of chemical factors both before and after execution of work in such spaces has been ruled;



- Theoretical and practical training of workers for safe work was carried out, also involving new employees and re-assigned workers;
- With purpose of increasing levels of responsibility, a total number of 56 authorized persons, mostly managing staff, have been educated for implementing health and safety, fire protection and environmental protection measures;
- The Shipyard took regular measures aimed at preventing alcohol and drug use involving both Shipyard's and subcontractors' workers. The Shipyard also organized alcohol and drug awareness classes.

Personal protection equipment is provided in accordance with established intervals and real needs. The Shipyard executes regular control over the utilisation of personal protection equipment involving both Shipyard's and subcontractors' workers. An amount of 850 thousands Croatian Kuna was spent in 2011 for personal protection equipment.



A total number of 263 Shipyard's workers employed at posts characterized with special work conditions passed medical examination at the Institute of Occupational Medicine. Thirty-four workers were sent for extraordinary examinations after prolonged sick leave on the account of illness or injury, or as recommended to a worker during his/her mandatory medical check-up.

Aware of the importance of preventive healthcare, Viktor Lenac has renewed its agreement with a reputable medical establishment for four years in a row for annual preventive medical exams and other medical services for the benefit of its employees. In 2011, a total number of 555 employees underwent mandatory medical check-ups and other specialist examinations and tests. An amount of 696 thousands Croatian Kuna was spent for all aspects of healthcare.

Constant efforts in implementing safety procedures have led to a decrease in number of injuries, compared in absolute numbers of injures, or when compared with respect to number of workers. Although the number of injuries in 2011 was higher than in the two previous years, compared in absolute numbers of injures, or when compared with respect to number of workers or frequency index, the work-injury index indicates that the injuries mainly had to do with light injuries such as contusions, wounds, sprains or fractures.

	2007	2008	2009	2010	2011
Effective hours	1.124.347	1.116.833	1.095.324	1.077.765	1.090.191
Number of injuries	34	26	25	25	29
Number of serious injuries	8	9	9	10	
Total lost days due to sick leave	751	822	1024	892	636
<b>Frequency index</b>	<b>30,24</b>	<b>23,28</b>	<b>22,82</b>	<b>23,20</b>	<b>26,60</b>
<b>Work-injury index</b>	<b>66,79</b>	<b>73,60</b>	<b>93,49</b>	<b>89,26</b>	<b>58,34</b>
Number of injuries per 1000 workers	60,61	45,53	42,81	42,30	48,41

The most frequent sources of injury are work areas and communications, and work objects. The most frequent cause of injury is not respecting safety rules, and irregular working areas, specifically obstructed work areas and communications, malfunctions and disturbances in technological process.

During 2011, the Shipyard included subcontractors' workers in its injury management system. Collective analysis will enable us to obtain a whole picture of health and safety and indicate areas where further measures have to be taken in order to improve workers' health and safety.

The Shipyard has also set up a Potentially Dangerous Event Register, which needs to be further upgraded. It is essential to raise awareness of workers on the importance of notification of potentially dangerous event. Through analysis of such events we will be able to define injury prevention measures and activities.

The Shipyard's Fire Protection System integrates a spectrum of preventive measures among which inspecting work sites for issuing of permits for work with open flame, making emergency evacuation plan for each vessel, educating and training new employees, inspecting, maintaining and renewing fire fighting equipment and practicing periodic fire fighting exercises. The shipyard's plan for the following year includes purchase of a new, modern fire-fighting vehicle and special suits.

**Environmental Protection**

By protecting the environment through an environmental protection system, which is based on the world's environmental protection rules and regulations that recognize technological

achievements, branch rules and laws, Viktor Lenac is promoting and supporting the process of sustainable development. The environmental protection system is also a starting point for further development of the company, with purpose to ensure quality common life with the local community.

Environmental Management System will be integrated as sub-system into the Quality Management System. After being certified according to ISO 9001, the sub-system will be integrated into all business aspects.

In cooperation with the Institute of Public Health of the Littoral and Mountain County, Viktor Lenac has been implementing a permanent program of monitoring of the influence of its production activities on the environment. Based on results of measurements of water and air samples, sea water and noise, the Shipyard is undertaking specific corrective measures in its technological processes. In 2011, Viktor Lenac invested 320 thousands Croatian Kuna for this purpose. The objective for 2012 is to intensify noise monitoring activities.

Air samples are continuously taken at locations of the nearby village Vrh Martinšćica and Bay of Žurkovo, as well as at the western border of the city of Rijeka since last year. Based on the results of PM<sub>10</sub> sampling and measurements of sediment concentration of heavy metals, air quality has been given 1st category (clean or insignificantly polluted). Actual data from the monitoring station are available on the web pages of the Public Health of the Littoral and Mountain County <http://www.zzizpgz.hr/zrak>

Anti-corrosion treatment works have been identified as works that negatively affect the environment. With purpose to maintain the stability of the environment, Viktor Lenac applies preventive environmental protection measures such as protection nets and inflatable booms. In 2011, Viktor Lenac spent 550 thousands Croatian Kuna in such equipment.





Aiming at realizing the environmental goals, additional activities intended for protection of air and sea against pollution from sand-blasting have been undertaken. A presentation of application of so called clean technology of surface preparation and anti-corrosion treatment by high pressure water jet was performed. It is planned that new equipment will be purchased in 2012 as part of the Company's development and modernization investments.

In accordance with its obligations from entry negotiations for accession of Croatia to the European Union, Viktor Lenac has made a plan to reduce volatile organic compounds, authorized and approved in the beginning of 2011.



The first steps have been made in reducing volatile organic compounds emissions by using paints with lower content of such compounds.

In January 2010, a noise monitoring station was commissioned in the nearby village Vrh Martinšćica, as part of the Shipyard's Noise Management System. By monitoring noise immission level during 2011 we were able to

carry out successful interventions through corrective activities in the production process to reduce noise level. Continuous monitoring allowed us to identify the main sources of noise, which will be eliminated during the current year.

Entire technological waste accumulated in 2011 in the total quantity of 19,000 tons was disposed through specialized waste treatment companies. In accordance with EU standards, Viktor Lenac has been applying principles of waste management. During the last two years, an increase in waste intended for recycling has been observed, transformed into energy or treated to decrease waste quantity, with respect to waste intended for disposal.



## *Human Resources*

The year 2011 was not marked with a significant increase in number of employees, other than personnel replacement requirements or employing on the real need to complete project on time.

The employment policy during 2011 was, therefore, based on temporary needs. The same applied to engaging subcontractors services. This is also a result of big oscillations in employment of capacity, where own workers become the only fixed costs in periods of low occupancy rate.



The total number of employees has been somewhat decreased based on the management decision to entrust a specialized company with cleaning of Shipyard's works areas and offices. The specialized company re-employed the workers who until then were employed with Viktor Lenac on these specific jobs.

Such decision was made with an objective to establish more realistic proportions between production workers and indirect workers, and overhead workers. Viktor Lenac's human resources policy will be redefined in long term along with reengineering of all processes which is in progress and depending on future development plans.

The human resource policy was in 2011 focused to keeping qualified personnel with specific technical and commercial knowledge being particularly important for the Company and characterised with good skills such as sales engineers, project managers, cost estimators, planners, designers and other technical experts.

### **Number and Structure of Employees**

On the day of 31st December 2011 Viktor Lenac had 581 employees, up by 15 with respect to the previous year.

Of total number of employees, production workers participated with 48.7% or 283 employees, plus 177 indirect workers involving HSE department, Maintenance, QC, foremen in production and other overhead workers.

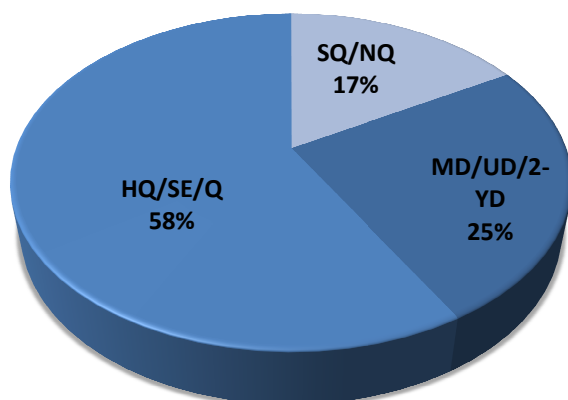
The remaining number of employees included technical and commercial staff and other experts (58 employees or 9.9%), administrative staff (12 employees or 2.1%) and project managers and managers of organisational units of all level (50 employees or 8.6%). At the end of the year, one employee was unassigned.

On 31st December 2011, Viktor Lenac's subsidiary company (Viktor Servisi d.o.o.) had total 17 employees, of which 14 maintenance and repair workers.

Viktor Lenac's personnel structure in terms of qualification and profession is satisfactory. A small number of employees refer to non-qualified workers and those are mostly workers occupied with cleaning works.

Qualification degree	Master's degree	University degree	Two-year degree	High-qualified	Secondary education	Qualified	Semi-qualified	Non-qualified	TOTAL
Number of men	1	47	74	28	165	133	21	76	545
Number of women	0	16	7	0	12	1	0	0	36
<b>Total</b>	<b>1</b>	<b>63</b>	<b>81</b>	<b>28</b>	<b>177</b>	<b>134</b>	<b>21</b>	<b>76</b>	<b>581</b>

**2011**

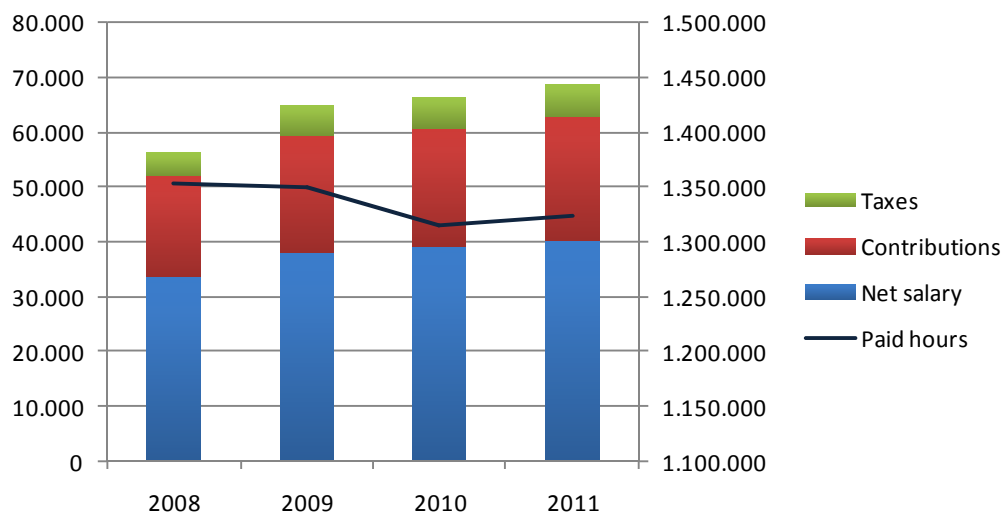


The Company implements rejuvenation policy in all organizational segments. The average age of new-employed in 2011 is 34 years, of which half from 25 to 35 years. The average age of the Shipyard's employees at the end of 2011 was 43.5 years.

**Structure of Effective Work Hours and Salaries**

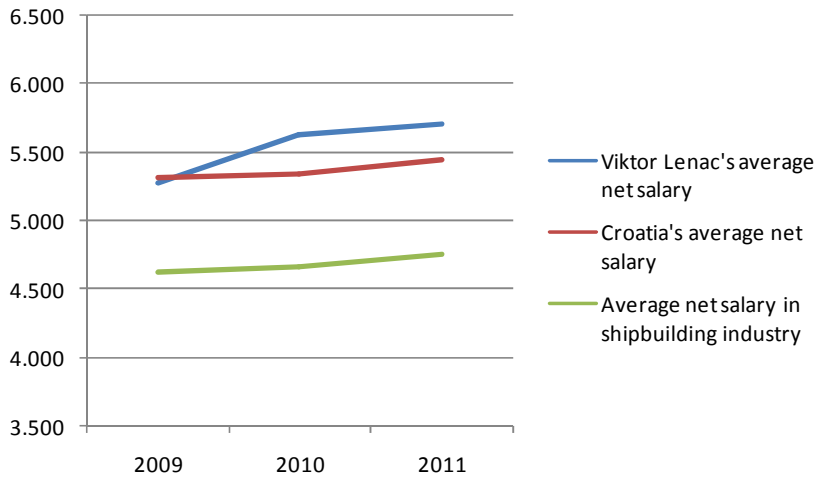
In 2011, Viktor Lenac's employees produced total 1,247,736 work hours in normal working hours, of which 76.1% or 949,700 were effective work hours, while the remaining hours referred to vacation (8.8%), sick leave (5.3%) and national holidays, paid leave and other non-working hours (9.8%). Also, during 2011 Viktor Lenac's employees produced total 52,178 thousands of overtime work hours, down by three times with respect to the year 2009. Such decrease in overtime hours resulted from new company policy on compensation hours as agreed between the Management and Unions in February 2010 in order to obtain bigger flexibility and better utilization of working hours considering oscillation in employment of capacity. Compared to the previous year, the number of overtime work hours has been decreased by 16,500 hours.

In 2011, Viktor Lenac paid total 74.2 million Croatian Kuna on the account of salaries and other employee material rights, of which 68.7 million Croatian Kuna referred to salaries, while 5.5 million Croatian Kuna referred to other material rights to which employees are entitled based on the Collective Agreement and Works Regulations.



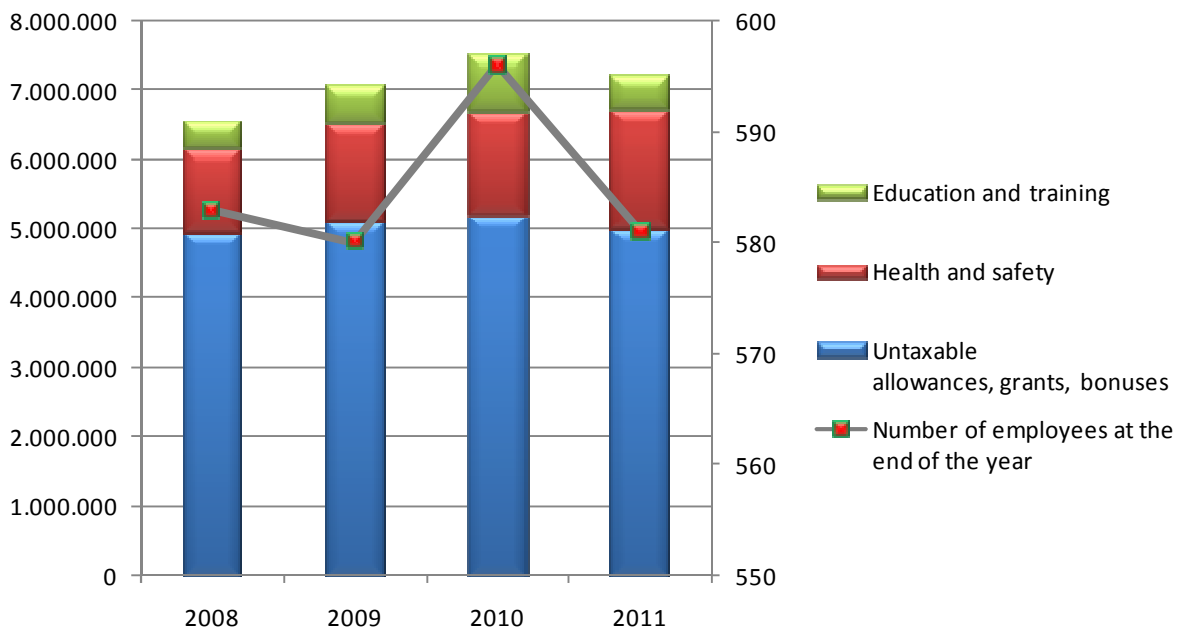
It is evident from the salary chart that a slight increasing trend in net salaries paid in 2011, as compared to the year 2010, was followed by a slight increase in the total paid effective work hours.

Calculated in accordance with the State Statistics Institute's calculation methods, the average net salary per month in 2011, after deduction of contributions and taxes, amounted to HRK 5,714.00, up by 5% compared with the average net salary in Croatia, or up by 20.3% compared with the average net salary in the shipbuilding industry.



Comparing trends in average net salaries in Viktor Lenac with trends in average net salaries in the Republic of Croatia during the last several years, it is noted that Viktor Lenac, where the average net salary in 2008 was almost 10% lower than the average net salary in Croatia, succeeded to reach Croatia's average, moreover go beyond.

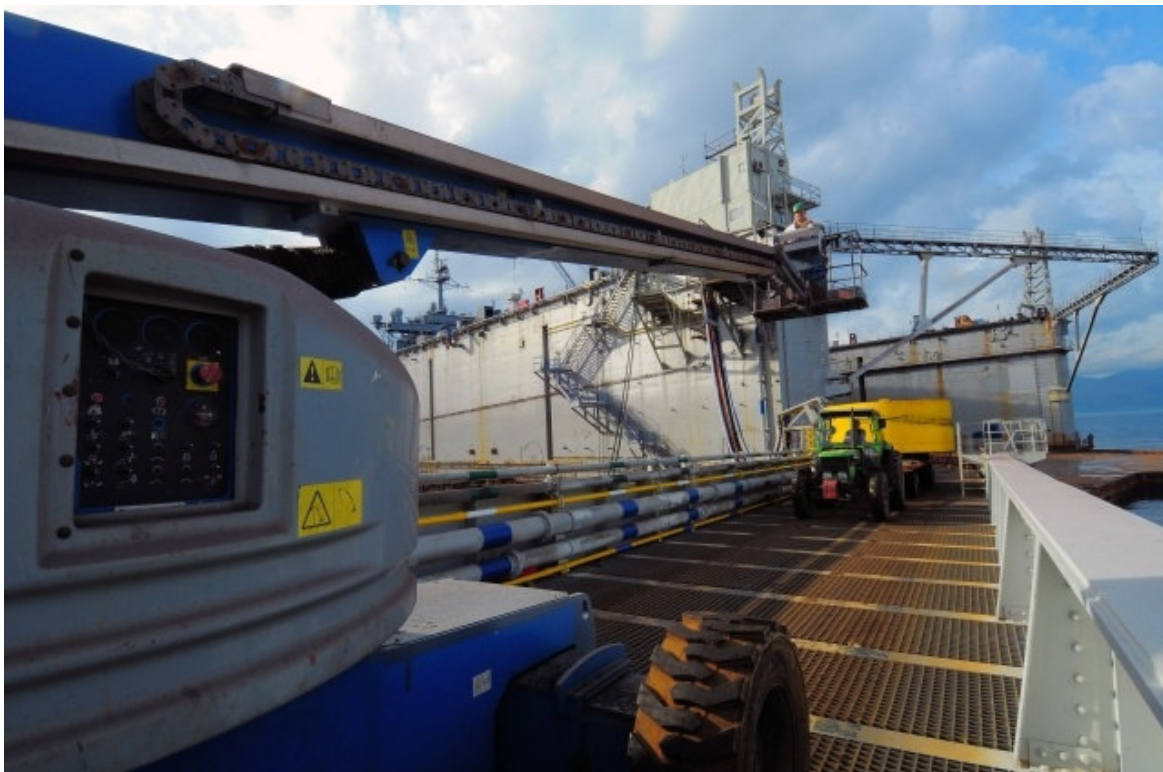
The objective for the following years is to create the conditions through increasing productivity for an increase in net salaries.



### Employee Education

In 2011, the multi-skill approach continued to be one of the core principles of the company's education strategy. Specifically, in order to assure an undisturbed production process, improve organization and increase efficiency, the workers employed in the Docks and Internal Transportation organisational unit were educated and trained in various skills as follows:

- Assistant workers were trained for scaffolders, tractor drivers, and riggers and signalmen
- Scaffolders for E category drivers, and riggers and signalmen
- Crane operators for drivers, shore and construction crane operators, vehicle-mounted crane operators and forklift operators.



The objective of multi-skill training is the rationalization of effective work hours, particularly in periods of oscillation in employment of capacity through filling up with own available workers instead of engaging subcontractors' workers.

The shipyard's employees from Technical Control Department were trained and certified for Visual Control.

Other education activities intended to replace external labour and use own employees in the most rational way consisted of the following: educating managers at all levels in various seminars and courses, foreign language education, HSE seminars, production skills training (particularly, transportation and cargo handling, welding, thermography), and other activities.



Prior to applying for certification of the shipyard's quality management system according to ISO 9001:2008, a few employees were educated for internal auditors. Part of them were further educated for leading auditors.

The total amount of 750 thousands of Croatian Kuna was spent for education activities in 2011, with an average of 1,290 Croatian Kuna per employee.

It is the plan for the year 2012 to develop new education programs for multi-skilled workers in the Production, correlate related professions, carry out additional education and training, and encourage development of supplement skills (active listening, communication, emotional and social skills, stress management etc.).

### **Social Dialogue**

The year 2011 was traditionally marked with a social dialogue of mutual respect between the Viktor Lenac's Management Board and its social partners, the Unions and Workers' Council.

Cooperation between the Workers' Council and the Management Board is maintained at monthly meetings, where the Workers' Council is informed about actual situation and perspectives. The Workers' Council is regularly informed on all issues significant for employee economic and social status. In co-deciding processes, the Workers' Council participates in decision making in accordance with the provisions of the Labour Act.

In addition, on the Company's Intranet site the employees can find all important information about Viktor Lenac, new projects and other news and actualities.

At the Employee Meeting at the end of the year, the Chairman of the Board informed employees on the Company's development plans.

President of the Workers' Council, Mr. Goran Zemljić is also member of the company's Supervisory board, which post he has been holding since March 2011.

Generally, social dialogue between the Management Board and the Unions is made over collective issues. In December 2008 the Management and the Unions concluded the Collective Agreement. The Collective Agreement stipulates all employee rights in terms of working hours, minimal salary, salary structure, health and safety at work and other material rights.

During last year all provisions as adopted by the Collective Agreement were applied to mutual satisfaction of all interested parties.

## Finance

### Key Financial Figures

#### Consolidated Financial Figures

	in thousands of HRK			in thousands of EUR *		
	2011	2010	Index	2011	2010	Index
Total Revenues	352.134	325.291	1,08	47.322	44.607	1,06
Total Expenses	346.149	317.315	1,09	46.518	43.513	1,07
Operating Revenues	348.771	322.445	1,08	46.870	44.217	1,06
Operating Expenses	345.677	316.006	1,09	46.455	43.334	1,07
EBIT	3.094	6.439	0,48	416	883	0,47
Profit and Loss Before Tax	5.985	7.976	0,75	804	1094	0,74
Net Profit and Loss	4.732	6.173	0,77	636	847	0,75
Total Assets	335.581	276.606	1,21	44.563	37.454	1,19
Equity	224.809	195.828	1,15	29.853	26.516	1,13

#### Non-Consolidated Financial Figures

	in thousands of HRK			in thousands of EUR *		
	2011	2010	Index	2011	2010	Index
Total Revenues	351.293	324.762	1,08	47.209	44.534	1,06
Total Expenses	345.988	316.890	1,09	46.496	43.455	1,07
Operating Revenues	348.002	321.955	1,08	46.767	44.150	1,06
Operating Expenses	345.516	315.550	1,09	46.433	43.271	1,07
EBIT	2.486	6.405	0,39	334	878	0,38
Profit and Loss Before Tax	5.305	7.872	0,67	713	1.079	0,66
Net Profit and Loss	4.071	6.069	0,67	547	832	0,66
Total Assets	333.779	275.012	1,21	44.324	37.238	1,19
Equity	222.435	194.117	1,15	29.538	26.285	1,12

\* All amounts expressed in Croatian Kuna, except for assets, share capital and reserves, have been converted into Euros according to the average midpoint exchange rate by the Croatian National Bank for 2011 (HRK 7.44) respectively 2010 (HRK 7.29). Assets, share capital and reserves have been converted into Euros according to the midpoint exchange rate by the Croatian National Bank on 31st December 2011 (HRK 7.53) respectively 31st December 2010 (HRK 7.39).

The consolidated profit and loss statement and other financial statements include Viktor Lenac's subsidiary company Viktor Servisi d.o.o. Rijeka, which, during 2011, realized revenues from its normal business activities consisting in providing specialized services in shipbuilding.

In 2011 Viktor Lenac and Viktor Servisi realized together total revenues in the amount of 352.1 million Croatian Kuna and total expenses in the amount of 346.1 million Croatian Kuna, after annulment of their reciprocal transactions.

Comparing the consolidated financial statements with the non-consolidated ones, it can be concluded that the influence of Viktor Lenac's subsidiary company is irrelevant.

Revenues and expenses of the mother company make more than 99% of revenues respectively expenses of the Group. Moreover, the assets of the mother company make 99% of the Group's assets.

Further in this Report, therefore, the emphasis will be put on the financial results, assets, equity and liabilities of the mother company.

## ***Financial Results***

### **Realized Revenues and Expenses**

In 2011 Viktor Lenac realized total revenues of 351.3 million Croatian Kuna with total expenses in the amount of 346 million Croatian Kuna, thereby making a profit before tax in the amount of 5.3 million Croatian Kuna.

The operating revenues realized in 2011 amounted to 348 million Croatian Kuna, up by 8% with respect to the previous year, and represent 99% of the total revenues.

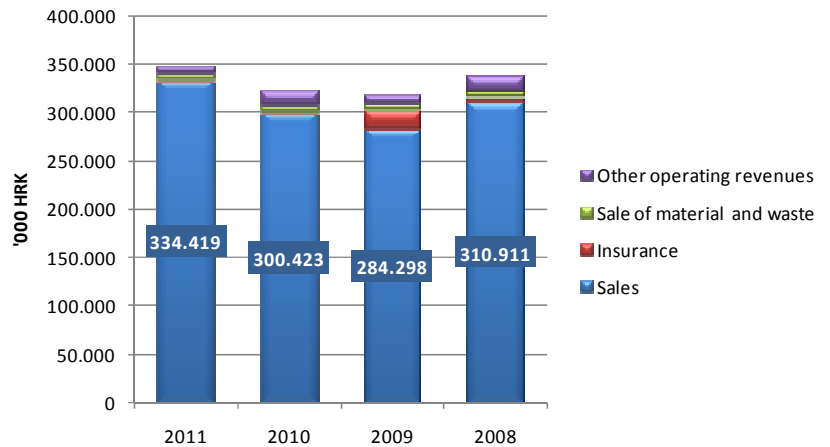
	2011	2010	2009	2008
Sales	334.419	300.423	284.298	310.911
Insurance	292	151	18.681	5.392
Sale of Material and Waste	6.477	6.982	5.880	5.033
Other Operating Revenues	6.814	14.399	8.921	17.013
<b>Total Operating Revenues *</b>	<b>348.002</b>	<b>321.955</b>	<b>317.780</b>	<b>338.349</b>
Material Costs	236.343	206.955	198.169	208.349
Salaries	68.295	66.656	63.825	54.708
Depreciation	16.505	22.460	21.060	22.004
Other Expenses	24.373	19.479	29.147	27.483
<b>Total Operating Expenses *</b>	<b>345.516</b>	<b>315.550</b>	<b>312.201</b>	<b>312.544</b>

\* For purpose of comparison, revenues and expenses related to self-investment and production in progress are excluded.

Compared to the previous two years, revenues from sales increased in 2011. Put in the perspective of the total structure of operating revenues, revenues from sales made 96% .

The remaining operating revenues were made of revenues from rent, sale of material and waste, withdrawal of long-term reservations etc.

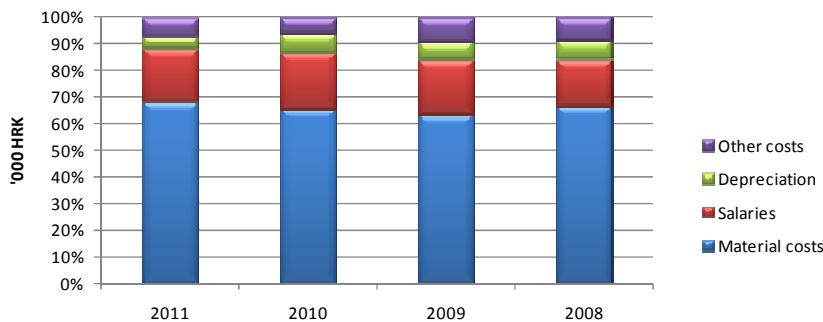
### Operating Revenue Structure



The operating expenses generated in 2011 amounted to 345.5 million Croatian Kuna, up by 9% compared with 2010.

Put in the perspective of the total structure of operating expenses, the material costs were the most important with an average proportion of material costs and outside services of 35:65, depending on structure of contracted jobs.

### Operating Expense Structure



The increase of material costs by approximately 30 million Croatian Kuna compared to the

previous year, of which the most important were the direct variable costs, resulted directly from the increase of operating revenues or revenues from sales, where as well an increase of 34 million Croatian Kuna was recorded.

For 2011 Viktor Lenac recorded and calculated a depreciation cost of its tangible fixed assets and intangible assets in the amount of 16.5 million Croatian Kuna, down by 5.9 million compared with the previous year. This decrease in depreciation cost derived from single rates of depreciation applied in 2011, with respect to the year 2010 where the Company used its legal right to accelerated depreciation.

The remaining operating expenses included value adjustment on customer claims, reservations for risks and costs deriving from guarantees issued to clients for works under warranty and reservations provided for litigations, insurance premiums, bank fees and various utility rates and contributions etc.

A larger growth in operating expenses by 1% with respect to the growth rate in operating revenues, compared to the previous year, resulted in a decrease in earnings before interest and tax by approximately 4 million Croatian Kuna, compared to the previous year. It must be pointed out that the growth in operating revenues is in accordance with growth in revenues from sales. Compared to the previous year, significantly lower other revenues were noted. The biggest difference derives from withdrawal of long-term reservations, down by 7.5 million Croatian Kuna compared to the year 2010.

EBIT for the year 2011 amounted to 2.5 million Croatian Kuna. After calculating net financial income, the profit before tax amounted to 5.3 million Croatian Kuna.

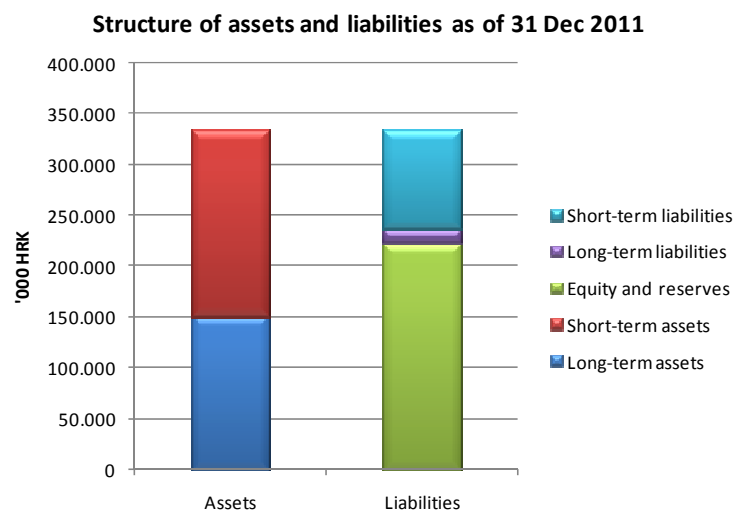
As to financial incomes, an amount of 1.65 million Croatian Kuna was realized on the account of an income deriving from interests earned on time deposits. On the other hand, interest expenses amounted to only 0.47 million Croatian Kuna. Positive exchange rate differences resulted in a net income of 1.2 million Croatian Kuna.

After calculating net financial income, the total profit after tax amounted to 4.1 million Croatian Kuna.

The consolidated profit after tax was slightly higher and amounted to 4.7 million Croatian Kuna.

### **Assets and Liabilities**

The total value of Viktor Lenac's assets on 31st December 2011 amounted to 333.8 million Croatian Kuna, of which 151.6 million Croatian Kuna of long-term assets. Of total long-term assets, tangible fixed assets made 97%, among which the most important being the Shipyard's Floating Drydock No.11.





The short-term assets amounted to 182.2 million Croatian Kuna, mainly structured of liquid assets, of which 34% or 62.3 million of Croatian Kuna consisted of money or its equivalents, while the short-term receivables including not due receivables, made another 86.7 million Croatian Kuna or 48%.

On the day of 31st December 2011, the total inventories amounted to 32.9 million Croatian Kuna or 18% of the short-term assets.

Compared to the situation at the end of the year 2010, put in the perspective of the total structure of short-term assets, a more significant increase can be noted in inventories, deriving from a large conversion project *Sampson*, where a large quantity of material was purchased at the end of 2011 when the project was full speed ahead.

An increase in short-term receivables including not due receivables can be noted, with the biggest impact coming from the USS Mount Whitney project, where a significant part of receivables were collected in the first quarter of the year 2012. Another impact came from uncollected receivables from the Sampson project.

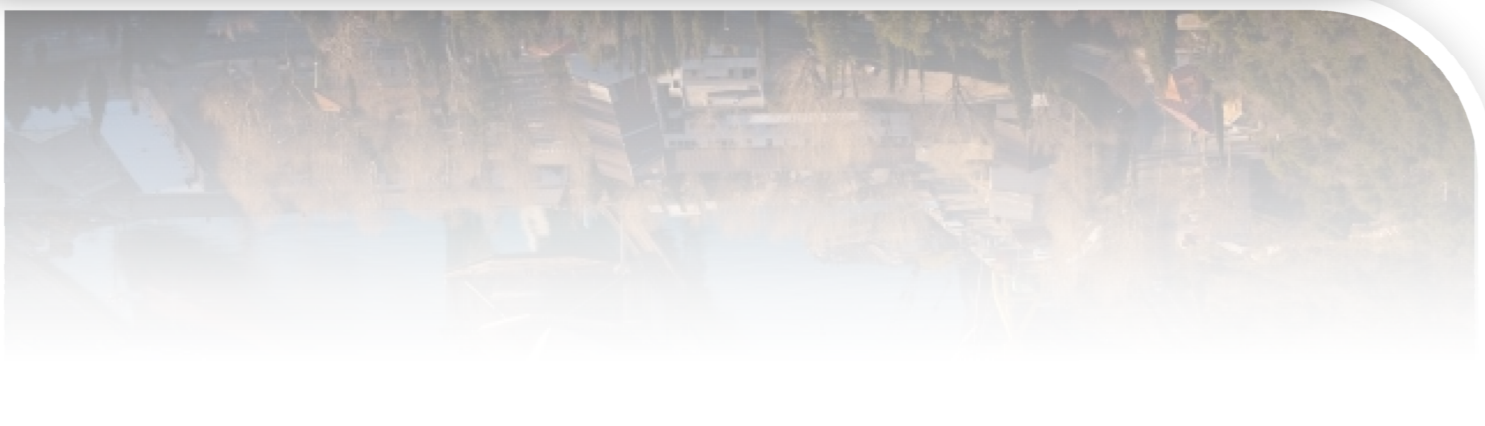
The total short-term assets at the end of 2011 increased by 33.4 million Croatian Kuna with respect to the previous year.

The total Shipyard's liabilities on 31st December 2011 amounted to 111.3 million Croatian Kuna, up by 30.5 million Croatian Kuna compared to the previous year. Of total liabilities, 14.2 million Croatian Kuna are long-term liabilities and reservations, the same as the previous year, while 97.13 million Croatian Kuna are short-term liabilities. This increase in short-term liabilities primarily derived from accounts payable, and was also influenced by the intensity of works carried out on the Seminole conversion at the end of the year 2010 as well as repair works carried out on the US Sixth Fleet Flagship USS Mount Whitney, invoiced upon completion of the repairs in November 2011.

All short-term liabilities have been covered in whole by short-term assets with current ratio 1.87. The total long-term assets have been covered in whole by the Company's equity.

According to the consolidated financial reports, on 31st December 2011 the Group's assets totalled 335.6 million Croatian Kuna, of which 224.8 million Croatian Kuna of share capital and reserves and 96.6 million Croatian Kuna of liabilities, with an almost the same structure as the mother company alone.

More detailed information on Viktor Lenac's financial situation is contained in the financial statements and their associated notes, while information on the Group's business is contained in the consolidated financial statements and their associated notes, accompanied by an auditor's report (the Inženjerski biro – revizija company from Zadar).



## **Main Risks**

Having in mind the nature of Viktor Lenac's activities and its export orientation, the major effect to Viktor Lenac's business comes from the world's maritime market trends. When speaking about its productivity and production costs, it is expected that the entrance of Croatia into the European Union will pose significant challenges to further development of Viktor Lenac. Hence it follows that Viktor Lenac will mostly be exposed to market risk and competitive risk, with associated price risk, while it is believed that its exposure to financial risks will be of minor importance. It is not expected that entering into the European Union will bring significant change in Viktor Lenac's market position, considering that the shipyard already earns more than 80% of its revenues from foreign market, where EU countries make the biggest piece of the pie.

### **Market Risk and Competitive Risk**

The ship repair and conversion market is conditioned by cyclic changes on the shipping market and changes in freight rates. Considering the recovery of the global economy and world shipping trade, it is expected on the long-term that Viktor Lenac will get a sufficient number of vessels sailing within range of Viktor Lenac for ship repair. On the short-term, unfavourable political situation in the Middle East and Northern Africa might negatively affect volumes of shipping trade, which will bring additional pressure to contracting terms and conditions. Issues of market risk and competitive risk with respect to Viktor Lenac's activities, and changes of Viktor Lenac's prices arising therefrom, are elaborated in more details under *Market Expectations*.

### **Price Risk**

Croatia has fulfilled all the preconditions for entering into the European Union mid 2013. The compliance with the European laws has been completed in large part when speaking of environmental protection, health and safety at work, fire protection and safety, causing an increase of overhead workers as well as operative expenses deriving from fulfilment of such requirements.

Viktor Lenac can expect further increase of operative expenses, which will unavoidably lead to a need for increasing productivity and identifying internal resources. In other words, it is not likely to expect that raising prices could compensate for increased costs, having in mind that shipyards are under big pressure to decrease prices if they want to remain competitive.

Global factors, such as constant increase in the world's oil prices during the last few years, have also affected Viktor Lenac in terms of increase in energy costs and consequently material costs. The effect of these factors is not of major importance for Viktor Lenac's competitiveness for the reason that their impact is evenly spread across all Viktor Lenac's competitors.

Seeking to reduce consequences of the increase in energy prices, Viktor Lenac has recently started investments in an integrated energy consumption management, supervision and control system for fresh water, technological water, power supply and technical gases.

Risks connected with changes in prices of raw material and other materials used in shipbuilding industry, such as steel, have no significant impact on Viktor Lenac. Specifically, Viktor Lenac's activities in terms of contracting and production process, particularly concerning ship repair activity, are characterized by short cycles, therefore, Viktor Lenac is not exposed to risk of firm fixed price contracts. Moreover, material cost participates in revenues with less than 15%.

**Personnel Risk and  
Risk of Price of  
Labour**

After Croatia's entrance into the EU, an increase in the price of labour can be expected, though the price of labour in Croatia is already higher than in some EU members. Considerable skilled labour migration to countries of the Western Europe can also be expected. Consequently, more pressure will be felt that price of labour is increased in order to be able



to acquire and maintain skilled workers.

Lack of skilled workers is a problem that has been present in the shipbuilding industry for a long time. Generally, during the last few years, there has been a lack of interest for shipbuilding trades. Seeking to avoid risk of skilled labour migration, reduce consequences of employee fluctuation and provide skilled labour, Viktor Lenac is continuously investing in education and training of human resources. In such circumstances, an increase of the price of labour is inevitable. Viktor Lenac is trying to compensate it through introduction of new technologies, aimed at the rationalization of production, and better performance in production and other business activities.

### **Other Risks**

Other risks affecting Viktor Lenac business include currency, credit, interest, solvency, cash flow, and litigation. Other risks are described in Non-Consolidated Annual Financial Statements and Consolidated Annual Financial Statements.



## Ownership Structure

At the end of the year 2010, the total share capital of the Company amounted to 138,444,470 Croatian Kuna. In July 2011, the total share capital was increased by 29,688,000 Croatian Kuna, based on the Decision on increase of the share capital as adopted by the Company's General Assembly, through payment in cash by Tankerska plovodba j.s.c. Zadar.

On the day of 31 December 2011, the total share capital of the Company amounted to 168,132,470 Croatian Kuna, divided in 16.813.247 registered ordinary shares, with the ticker symbol VLEN-R-B, having a nominal value of 10.00 Croatian Kuna each, registered in the depository of the Central Depository & Clearing Company and included in quotation of public joint-stock companies on the Zagreb Stock Exchange.

During 2011, Viktor Lenac's shares were rarely traded resulting in low transactions of 552.712 shares only with average price of 10.00 Croatian Kuna per share.

On the day of 31 December 2011, ten largest shareholders of Viktor Lenac participated with almost 95% in the company share capital as follows:

	Shareholder	Number of shares	%
1	Tankerska Plovidba j.s.c. Zadar	8.138.460	48,41
2	Uljanik Shipyard j.s.c. Pula	3.904.063	23,22
3	Privredna Bank j.s.c. Zagreb / collective custody account	1.367.268	8,13
4	Croatian State Property Management Agency (AUDIO)	1.243.702	7,40
5	Shipyard Viktor Lenac j.s.c. Rijeka	825.187	4,91
6	Privredna Bank j.s.c. Zagreb	258.751	1,54
7	R.L.E. Ltd. Drniš	105.211	0,63
8	List Gmbh Austria	45.992	0,27
9	Jadranski pomorski servis j.s.c. Rijeka	35.874	0,21
10	Messer Croatia Plin Ltd. Zaprešić	32.987	0,19
	Other	855.752	5,09
	<b>Total</b>	<b>16.813.247</b>	<b>100,00</b>

On the Company's General Assemblies held during 2009, 2010 and 2011 decisions entitling the Company to acquiring of up to 1.054.000 own shares were made. Following the decisions, by the end of 2011 Viktor Lenac acquired total 825.187 own shares, representing 4.91% of the company share capital.

## Corporate Governance

Corporate Governance is a frame for planning, organizing, directing and controlling of the company's business operations. Viktor Lenac's Management and Supervisory Board have been applying the corporate governance principles consistently with its fundamental objectives of successful and growing business and growing of share value for the benefit of its shareholders.

Respecting the principles of corporate governance ensures protection of rights and equal treatment of shareholders, business transparency and responsibility toward all interested parties.

After the termination of the bankruptcy in April 2008, Viktor Lenac has obtained the status of the joint-stock company. On 12 September 2008, Viktor Lenac's shares were included in quotation of public joint-stock companies on the Zagreb Stock Exchange, preceded by issuance of the Short Prospectus approved by the Croatian Agency for Supervision of Financial Services.

Since inclusion of its shares in quotation of public joint-stock companies on the Zagreb Stock Exchange, Viktor Lenac has been voluntarily applying the Corporate Governance Code made by the Croatian Agency for Supervision of Financial Services and Zagreb Stock Exchange. Viktor Lenac has been applying recommendations of the Code, by publishing all information which is in the interest of its shareholders and as stipulated by regulations.

In accordance with the Capital Market Act, obligatory information is displayed to the Croatian Agency for Supervision of Financial Services through the Zagreb Stock Exchange's website and Company's website ([www.lenac.hr](http://www.lenac.hr)). In addition, new information is announced through the Croatian News Agency OTS service.

In 2011, Viktor Lenac's Supervisory Board held six meetings, where its members discussed Viktor Lenac's financial results, its position on the market, business plans and key projects.

The members of the Supervisory Board regularly receive detailed information on the Company's management and business to be allowed to efficiently supervise the Company.

The Company's shareholders execute their rights at the General Assembly, where they decide on profit allocation, amendments to the company statute and appointment and revocation of members of the Supervisory Board. Furthermore, the General Assembly makes decisions over the Management and Supervisory Board performance, appointment of financial auditor and other important issues stipulated by law and company statute.

By implementing the principles of the Corporate Governance Code, Viktor Lenac is seeking to create a quality and long-term relationship with the entire investors' community.

## Supervisory Board and Management Board

### *Supervisory Board*

As of April 7, 2008, members of the Supervisory Board of the Viktor Lenac Shipyard are: Mr. Karlo Radolović, Chairman of the Supervisory Board, Mr. Ive Mustać, Vice-Chairman of the Supervisory Board, Messrs. Anton Brajković and Lenko Milin, members of the Supervisory Board, and workers' representative as the fifth member of the Supervisory Board.

The members of the Supervisory Board have been appointed by the General Assembly Decision of April 7, 2008, the day of the closing of the bankruptcy proceedings, for a term of office of four years.

Mr. Damir Bačinović filled his post of member of the Supervisory Board in his quality of workers' representative until 13<sup>th</sup> of April 2011, when the responsibility was assumed by Mr. Goran Zemljić, in his first term of office as president of the Workers' Council and member of the Supervisory Board for the period of three years.

### Biographies of Members of Supervisory Board

Mr. **Karlo Radolović**, was born in Marčana (Croatia) in 1943. After finishing the Secondary School of Economics in Pula, he continued his education at the Faculty of Economics in Rijeka and graduated in 1966. Following graduation he was employed in the Uljanik Shipyard. After the trial period was expired, he was engaged as economist in the Uljanik Shipyard's Purchasing Department. In 1969 he was appointed Branch Office Manager. In 1973 he became Assistant Purchasing Manager. In 1974 he became Assistant General Manager. In 1980 he was elected Chairman of the Uljanik Shipyard Executive Board. On December 21, 1992 he became Chairman of the Uljanik Shipyard Management Board for the first time and held this position until February 1, 2006. Thereafter, he retained the position of the member of the Management Board, until his retirement in 2011.

Mr. **Ive Mustać**, was born in Privlaka near Zadar (Croatia) in 1945. After finishing primary education in Privlaka and Secondary Maritime School of Zadar, he graduated at the Two-Year Maritime College of Rijeka in 1970, becoming master.

After secondary school, in 1964 he was employed in the Tankerska Plovidba Company as cadet, thereafter as Third, Second and First Officer and finally as master, which position he retained until 1978 when he quit navigation and continued his work in various departments of the Tankerska Plovidba Company. From 1978 to 1979 he was Purchasing Officer in the Commercial Department, thereafter, from 1979 to 1980 he was assigned Manager of

Purchasing Office. From 1980 to 1981 he was Purchasing Manager in the Tankerkomerc Company, while from 1981 to 1983 he was Purchasing Manager in the Tankerska Plovidba Company. From 1983 to 1989 he was appointed General Manager of the Zadar Shipyard, then until 1995 he retained the position of Newbuilding Superintendent in the Technical Department of the Tankerska Plovidba Company. From 1995 to 2004 he held the position of Technical Director. In 2004 he was promoted to Chairman of the Management Board of the Tankerska Plovidba Company, which position he held until his retirement in March 2012.

Mr. **Anton Brajković**, was born in Lovište (Croatia) in 1946. After finishing primary and secondary education in Pula, in 1969 he graduated at the Faculty of Economics in Rijeka. He has been employed in the Uljanik Shipyard since January 1970. In October 1991 he was appointed Vice-Chairman of the Management Board, thereafter, in February 2006 he was promoted to Chairman of the Management Board.

Mr. **Lenko Milin**, was born in Zadar (Croatia) in 1950. After finishing primary and secondary education in Zadar, he was employed in the Tankerska Plovidba Company where he took apprenticeship for mechanical engineer. He graduated at the Maritime Faculty of Split as First Rank Maritime Engineer and was employed in the Tankerska Plovidba Company as Chief Engineer.

After several years of navigation, he was employed as Technical Superintendent in the Technical Department, holding that position during many years. In February 2004 he was appointed Technical Director of the Tankerska Plovidba Company. In March 2012, he was promoted to Chairman of the Management Board.

Mr. **Goran Zemljić**, was born in Rijeka in 1957, where he spent his childhood and completed primary and secondary education. In 1978 he got his first job in the Shipyard 3. Maj. In the period from 1980 to 1985 he sailed with the shipping company Lošinjska plovidba. He has been employed in the Viktor Lenac Shipyard since 1985 holding the position of mechanic leader.

#### **Income and Ownership Interest of the Members of the Supervisory Board**

In accordance with data obtained from the State Statistics Institute, the compensation of the Chairman of the Supervisory Board is established in a net amount equalling one average monthly net salary, while the compensation of the Vice-Chairman of the Supervisory Board is established in a net amount equalling 3/4 of the average monthly net salary in the Republic

of Croatia. In 2011 total compensation in gross amount of 508,427.00 Croatian Kuna was paid to the members of the Supervisory Board.

The members of the Supervisory Board are not shareholders of the Company.

### ***Management Board***

The members of the Viktor Lenac's Management Board are: Mr. Robert Škifić, Chairman of the Board, Mrs. Sandra Uzelac and Mr. Davor Lukeš, members of the Board. The Management Board has been appointed by decision of the Supervisory Board dated April 7, 2008 for a term of office of five years.

### **Biographies of Members of Management Board**

Mr. **Robert Škifić**, B.Sc. in Mechanical Engineering, was born in Zadar (Croatia) in 1956. After finishing primary and secondary education in Zadar, in 1981 he graduated at the Faculty of Mechanical Engineering and Naval Architecture of Zadar.

Upon graduation, in 1982 he was employed in the Rade Končar Institute, working in development of home electrical appliances, where he remained until 1984. From 1984 to 2000 he worked at SAS, a factory for special machine tools in Zadar, where he held various positions of Technologist, Operative Planning Manager, Production Manager and finally became Technical Director. In 1995 he was appointed General Manager of the SAS - Zadar Company and from 2000 to 2006 he held the position of General Manager of the SAS Strojogradnja Company. From 2006 to 2008 he held the position of General Manager of the Crosi Company, a consulting company. In 2008, he was elected Chairman of the Management Board of the Viktor Lenac Shipyard.

In 2008 he passed exam at the Faculty of Economics of Zagreb for corporate governance for members of supervisory and management boards. He speaks fluently English and Italian.

Mrs. **Sandra Uzelac**, B.Sc. in Economics, was born in Rijeka (Croatia) in 1969. After finishing primary and secondary education in Rijeka, in 1994 she graduated at the Faculty of Economics in Rijeka. She has been employed in the Viktor Lenac Shipyard since 1994 at various positions: Office Worker in Salary & Economics of Work Department from 1994 to 1997, Financial Officer and Assistant Accounting Manager in Financial Department from 1997 to 2001 and Manager of Planning and Analysis Department from 2001 to 2004. From 2004 to 2008 she held the position of Manager of Financial Division. After termination of the bankruptcy, she has been appointed member of the Management Board.



During the period from 1997 to 2006, she attended several specialized seminars and upgrading programmes. Since end 2007, she has been studying postgraduate economics (controlling course) at the Faculty of Economics of Rijeka. She speaks fluently English.

Mr. **Davor Lukeš**, B.Sc. in Naval Architecture, was born in Rijeka (Croatia) in 1956. After finishing primary and secondary education in Rijeka, in 1985 he graduated at the Faculty of Engineering of Rijeka. After completing his graduate studies, he was employed in the Brodoprojekt Company, working as Ship Equipment Designer and Project Manager. In 1989 he was employed in the Viktor Lenac Shipyard and until 1991 worked as Conversion and Offshore Sales Specialist. From 1991 to 2001 he held the position of Manager of Project Sales Department, while from 2001 to 2002 he held the position of Manager of Conversion Department. From 2002 to 2004 he worked as Assistant Manager of Commercial and Technical Division. Thereafter, he was Senior Market Advisor in the Commercial and Technical Division until 2007. From 2007 until being appointed member of the Management Board in 2008, he held the position of Deputy General Manager.

He speaks fluently Italian and English and basics of German.

#### **Income and Ownership Interest of the Members of the Management Board**

Each member of the Management Board receives income, which is stipulated by employment contract concluded with each member and approved by the Supervisory Board. Incomes of the members of the Management Board are related to the average income of the Shipyard's employees. Accordingly, the Chairman of the Management Board receives income, which equals five average incomes of the Shipyard's employees, while members of the Management Board each receive income, which equals four and a half average incomes of the Shipyard's employees. Furthermore, the Chairman of the Management Board is entitled to a monthly net amount of 5,000.00 Croatian Kuna for covering his living costs in Rijeka, where the Company's headquarters is located. In 2011 total income in gross amount of 2,132,294 Croatian Kuna was paid to the members of the Management Board.

The Chairman and members of the Management Board have not received any bonus or other income, either in money or in company shares, on the account of good performance results achieved by the Company in 2011 or previous years, as the Company's Stimulation policy has not yet been developed.

As on the day of this Report, members of the Management Board, Mrs. Sandra Uzelac and Mr. Davor Lukeš, own 1038 respectively 2410 company shares, which they, as former bankruptcy creditors, acquired by converting their monetary claims into the company share capital.

The Chairman of the Management Board, Mr. Robert Škifić owns 23586 company shares acquired during the year 2010.

## For Information

### Management

**Marko Domijan**, Marketing and Sales Director

**Dubravko Mataja**, Production Director

**Ljubomir Markulin**, Head of Project Management Department

**Dražen Bevanda**, Safety, Health and Environmental Protection Manager

**Davor Badurina**, Quality Control Manager

**Dolores Kuzmić**, Purchasing Manager

**Anton Dujmović**, Subcontractors Manager

**Alen Karnjuš**, ICT and Quality Assurance Manager

**Ljubica Linardić**, Human Resources Manager

### Auditor

INŽENJERSKI BIRO - REVIZIJA d.o.o. Zadar

### Contact details

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Rijeka, April 2012

On the basis of Article 272.p and with reference to Article 250.a of the Companies Act (Official Gazette No. 113/93, 34/99, 52/00, 118/03, 107/07 and 148/08, hereinafter referred to as 'CA'), the Management Board of the Viktor Lenac Shipyard (hereinafter referred to as 'Company'), on this April 12, 2012, makes the following

## **STATEMENT**

### **on Implementation of the Corporate Governance Code**

1. The Company closed bankruptcy proceedings in April 2008, following which, in accordance with regulations, became the public joint-stock company. After issuance of the Short Prospectus approved by the Croatian Agency for Supervision of Financial Services, on September 12, 2008 the Company's shares were included in quotation of public joint-stock companies.

2. Since inclusion of its shares in quotation of public joint-stock companies, the Company has been voluntarily applying the Corporate Governance Code made by the Croatian Agency for Supervision of Financial Services and Zagreb Stock Exchange. The Code was adopted by the Croatian Agency for Supervision of Financial Services' decision dated April 26, 2007, class 011-02/07-04/28, reg. no. 326-01-07-02 (Official Gazette No. 46/07, hereinafter referred to as 'Code'). The integral version of the Code has been published on the Zagreb Exchange Stock's website.

3. During 2011, the Company was applying recommendations of the Code, by publishing all information which is in the interest of its shareholders and as stipulated by regulations.

During the last year, the Company published all information foreseen by regulations on the Company's website and on the Zagreb Stock Exchange's website, and informed the public on information availability through Croatian News Agency OTS service.

4. Supervision of the Company's business operations has been executed by the Supervisory Board in accordance with the Companies Act. The role of the Supervisory Board is defined by the Company's Statute. Members of the Supervisory Board are provided with detailed information on the Company's management and business operations in order to efficiently fulfil their supervisory role. Supervisory Board's report makes an integral part of the Annual Report submitted to the General Assembly.

The Supervisory Board has not established Committee for Appointment, Committee for Rewarding and Committee for Audit, because the members of the Supervisory Board themselves carry out tasks otherwise being obligation of the mentioned committees.



5. The Company is implementing rules of the accounting policy, which regulate application of methods and techniques in presenting assets, liabilities, capital, revenues, expenses and financial results in financial statements. Annual audit of financial statements is performed by an independent auditor appointed by the General Assembly.

6. As on the day of December 31, 2011, ten largest shareholders are the following ones:

	Shareholder	Number of shares	%
1	Tankerska Plovidba j.s.c. Zadar	8.138.460	48,41
2	Uljanik Shipyard j.s.c. Pula	3.904.063	23,22
3	Privredna Bank j.s.c. Zagreb / collective custody account	1.367.268	8,13
4	Croatian State Property Management Agency (AUDIO)	1.243.702	7,40
5	Shipyard Viktor Lenac j.s.c. Rijeka	825.187	4,91
6	Privredna Bank j.s.c. Zagreb	258.751	1,54
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10	Messer Croatia Plin Ltd. Zaprešić	32.987	0,19
	Other	855.752	5,09
	<b>Total</b>	<b>16.813.247</b>	<b>100,00</b>

The right of the Company's shareholders to vote is not limited to a certain percentage or number of votes. The right to vote is recognized by number of shares registered on shareholder's account at the Central Depository & Clearing Company. Each ordinary share gives the right for one vote at the General Assembly. The Company is entitled to issue registered ordinary shares in accordance with positive legal regulations of the Republic of Croatia and Statute of the Company. In accordance with Article 172 of the Companies Act and Company's Statute, decision on share issue is made by the General Assembly. The Company's rights and obligations originating from acquisition of own shares are realized in accordance with the provisions of the Companies Act, hence it follows that the Company can acquire own shares on the basis of the General Assembly's authority for their acquisition.

Amendments to the Statute of the Company are made in accordance with the Companies Act.

7. The Company's Management Board is consisted of three members, Chairman of the Board and two members of the Board. Mr. Robert Škifić has been elected Chairman of the Board, while Mrs. Sandra Uzelac and Mr. Davor Lukeš hold positions of the members of the Board.

The members of the Management Board represent the Company independently and individually and run Company's business jointly or individually, in accordance with the Statute of the Company and Management Rules of Procedure made by the Supervisory Board. Specific tasks defined by Article 15 of the Company's Statute (acquisition, abalienation or encumbrance to real estate; issuing, abalienation or acquisition of shares; issuing guarantees except for obligations of subsidiary company; taking loans and credits beyond normal business operations of the Company etc.) and in other cases, when required by law, can be undertaken by the Management Board, authorized by the Company's Statute or Supervisory Board's decision, only with previous consent of the Supervisory Board. The Management Board is appointed and revoked by the Supervisory Board for a term of office of five years.

The Supervisory Board of the Company is consisted of five members: Mr. Karlo Radolović has been appointed Chairman of the Supervisory Board, Mr. Ive Mustač is Vice-Chairman of the Supervisory Board and Messrs. Anton Brajković, Lenko Milin and Damir Bačinović are members of the Supervisory Board.

The General Assembly elects and relieves of their office four members of the Supervisory Board, while one member is elected, appointed and revoked by the Company's employees in accordance with positive regulations of the Republic of Croatia.

Mr. Damir Bačinović filled his post of workers' representative in the Supervisory Board until 13<sup>th</sup> of April 2011, when the responsibility was assumed by Mr. Goran Zemljić, in his first term of office as president of the Workers' Council and member of the Supervisory Board for the period of three years.

The Supervisory Board acts as collegial body at sessions, which take place at least once quarterly, where all issues within its competence, as required by the Companies Act and Statute of the Company, are discussed and decided upon. Decisions of the Supervisory Board are made by majority of votes of present members.

8. In accordance with Article 250.a, item 4, and Article 272.p of the Companies Act, this Statement represents a separate section and makes an integral part of the Company's Annual Report 2011.

Robert Škifić

Chairman of the Management Board