Hit Group

Annual Report 2012

hit
universe of fun

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1 STATEMENT BY THE MANAGEMENT BOARD PRESIDENT

The 2012 business year was extremely demanding for the Hit Group. The Group generated EUR 178.5 million of revenues and incurred EUR 200.9 million of expenses, thus producing a consolidated net loss of EUR 32.4 million.

At year-end 2012, the Hit Group employed 2,390 persons, down by 4 percent compared to a year ago.

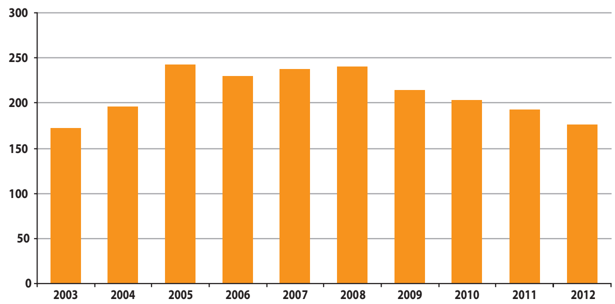
Market conditions have continued to be tight also in 2013. The new management board of Hit I lead has been facing this challenge. I am not afraid of challenges and I therefore believe in the future of the Hit Group and in all its employees!

Mag. Dimitrij Piciga
Management Board President

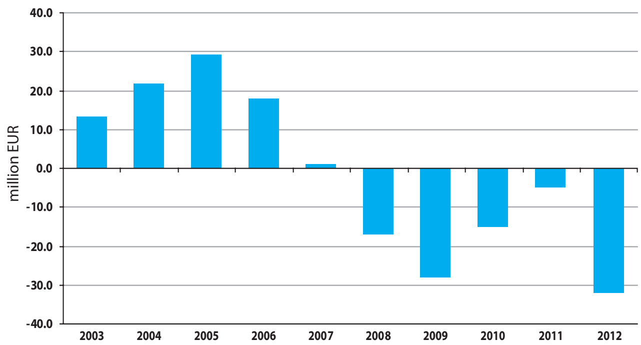
Hit Group in 2012

- EUR 201.9 million in gross operating revenues including gaming tax,
- EUR 176.6 million in gross operating revenues,
- EUR 3.6 million in operating losses,
- EUR 32.4 million in net losses of the Hit Group,
- EUR 31.8 million in net losses of the majority owner,
- EUR 168.7 million in basic gross gaming revenues and casino entrance fees (including gaming tax and output VAT respectively),
- 1.8 million casino visits,
- 448.0 thousand overnight stays,
- 2,390 employees as at year-end 2012,
- a negative 31.3% return on capital

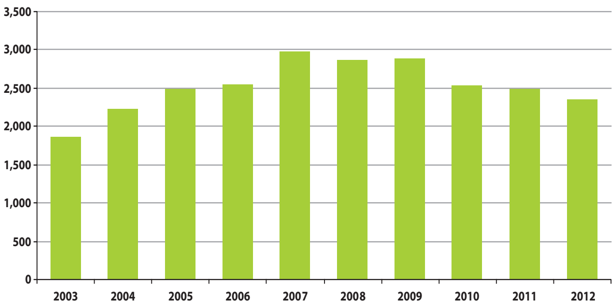
Gross operating revenues



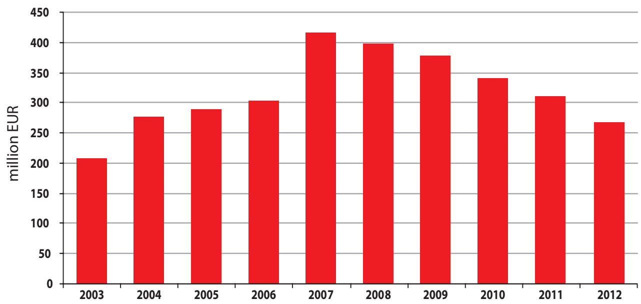
Net profit



Employees at 31 December



Total assets at 31 December



1.1 Hit company profile

1.1.1 Establishment

The establishment of Hit was recorded in the register kept by the Nova Gorica District Court under no. 1/00224/00 on 9 October 1990.

The limited liability company (d.o.o.) later underwent an ownership transformation and became a company limited by shares (d.d.) The transformation was entered into the Nova Gorica District Court register pursuant to decision Srg 98/00076 on 9 February 1998.

The transformation was carried out in accordance with the Ownership Transformation of Companies with Socially-Owned Capital Organising Special Games of Chance and Capital Structure of Companies Organising Special Games of Chance Act (Official Gazette of the RS, no. 40/97, hereinafter ZLPPOD). Hit prepared an opening balance sheet as at 18 June 1994 in accordance with the ZLPPOD, and determined the nominal value of its share capital at SIT 6,788,634,000 (EUR 28,328,467.70). It then issued two classes of shares as follows: 4,073,180 ordinary shares that were not freely transferable and represented 60 percent of its share capital, and 2,715,454 participating preferred shares that were freely transferable and represented 40 percent of its share capital. The nominal value of shares was SIT 1,000 (EUR 4.17).

As its shares are not listed, Hit is not obliged to comply with the Corporate Governance Code applying to companies limited by shares in the Republic of Slovenia, but nevertheless adheres to its provisions as much as possible.

Other company information as entered in the court register:

Registered name: HIT hoteli, igralnice, turizem d.d. Nova GoricaAbbreviated name: HIT d.d. Nova Gorica
Registered office: Delpinova ulica 7a, SI - 5000 Nova Gorica, Slovenia
Company ID no.: 5232058
Share capital: EUR 28,328,467.70
Founders: Republic of Slovenia, entry: 2 September 1997, capital contributed: EUR 28,328,467.70

Representatives:

mag. Dimitrij Piciga, Management Board President since 12 March 2013,
dr. Drago Podobnik, Management Board President from 1 August 2009 to 12 March 2013,
Marjan Zahar, Management Board Member since 30 May 2011,
mag. Stojan Pliberšek, Management Board Member from 1 August 2009 to 12 March 2013 and
Uroš Kravos, Management Board Member from 1 October 2009 to 12 March 2013.

Supervisory Board composition:

Marino Furlan, Chairman since 25 March 2013,
Andrej Cetinski, Chairman from 28 November 2012 to 25 March 2013,
Gorazd Podbevšek, Chairman from 25 August 2010 to 28 November 2012,
Karlo Korče, member since 24 June 2010, Deputy Chairman since 28 March 2013,
Sergej Čujec, member since 21 December 2010,
Silvan Križman, member since 25 April 2013,
Nada Drobne Popovič, member since 10 June 2013,
Miran Lampret, member from 10 June 2013,
Boris Tomašič, member from 5 March 2013 to 25 April 2013,
Tomislav Malnarič, member from 5 March 2009 to 5 March 2013,
Andrej Cetinski, member from 4 May 2011 to 28 November 2012,
Marino Furlan, member from 3 May 2011 to 25 March 2013.

The financial statements for the year ended 31 December 2012 were audited by the company KPMG Slovenija, podjetje za revidiranje, d.o.o., Ljubljana, which expressed an unqualified opinion on these statements on 18 June 2013.

1.1.2 Share capital and ownership structure

Share capital of Hit (SIT 6,788,634 thousand) was determined based on the opening balance sheet as at 18 June 1994, as explained above. Following the changeover to the euro, share capital in an amount of EUR 28,328,467.70 was entered in the court register on 6 March 2007. It is divided into 6,788,634 no-par shares, of which:

- 4,073,180 (60 percent) are ordinary registered shares of no par value that are not freely transferable, and;
- 2,715,454 (40 percent) are participating preferred shares that are non-voting and are freely transferable.

Compared to 2011, the ownership structure did not change.

All shares are fully paid up.

Ordinary shares confer the following rights:

- the right to participate in the management of the company,
- the right to participate in company profits,
- the right to participate in company assets remaining after its liquidation or bankruptcy.

Ordinary shares are transferable subject to prior consent of the Ministry of Finance in accordance with Article 56 of the Gaming Act (official consolidated text 3 published in the Official Gazette of the RS, no. 14/2011). Transfers take effect only upon entry into the share register of Hit kept by the Central Securities Clearing Corporation in accordance with regulations governing dematerialised securities.

Hit ownership structure

	31 December 2012		**31 December 2011**	
Shareholder	Shares (number)	Equity stake (percent)	Shares (number)	Equity stake (percent)
Slovenska odškodninska družba, d. d.	1,357,727	20.00	1,357,727	20.00
Kapitalska družba, d. d.	1,357,727	20.00	1,357,727	20.00
Nova Gorica city municipality	900,309	15.06	1,022,614	15.06
Šempeter-Vrtojba municipality	183,726	2.71	183,726	2.71
Renče - Vogrsko municipality	122,305	1.80	122,305	1.80
Kranjska Gora municipality	131,699	1.94	131,699	1.94
Rogaška Slatina municipality	11,541	0.17	11,541	0.17
Novo mesto municipality	8,146	0.12	8,146	0.12
Total ordinary shares	**4,073,180**	**60.00**	**4,073,180**	**60.00**
Total preferred shares	**2,715,454**	**40.00**	**2,715,454**	**40.00**
Total shares	**6,788,634**	**100.00**	**6,788,634**	**10.00**

Participating preferred shares do not confer the right to company management. Their owners have the right to participate in company profits (based on a resolution adopted by the general meeting of shareholders) and company assets remaining after its liquidation or bankruptcy, as well as the right to a dividend fixed at 1 percent of company book value per share. Preferred shares are freely transferable.

1.1.3 Governance bodies

The governance bodies of Hit are its management and supervisory boards, and the general meeting of shareholders. The management board, which runs the company, is composed of the president and three members, one of whom is an employee representative. Excepting the last one, all members and the president are appointed and recalled by the supervisory board. Since 12 March 2013 and up to the date of this annual report, the management board was composed of the president and the employee representative, while the other two members were not yet appointed.

The supervisory board is composed of six members: two are employee representatives elected by the workers' council, one is appointed by the government, while the remaining three are elected by the general meeting of shareholders.

Mr Gorazd Podbevšek resigned as president of the supervisory board on 5 November 2012 and was replaced by Mr Andrej Cetinski, whose mandate expired on 24 March 2013. On the next day, Mr Marino Furlan was elected president of the supervisory board.

At its session of 28 March 2013, the supervisory board appointed a nomination committee responsible for selection and appointment of supervisory board members. Members of the committee are Mr Simon Černetič, who represents SOD, Ms Vesna Mikuž, who represents the Nova Gorica city municipality, and Mr Marino Furlan as president of the supervisory board.

The supervisory board also appoints a three-member audit committee. In 2012, the audit committee was composed of Mr Andrej Cetinski, Mr Tomislav Malnarič and Mr Marko Ninčevič. As of the date of this annual report, the supervisory board had not yet appointed new members of the audit committee.

1.1.4 Main activities, concessions and concession duties

Hit's main activities are the following:
- organisation of special games of chance,
- hotels,
- restaurants and inns,
- snack bars, sweet shops, coffee houses, canteens, bars
- activities of travel agents and tour operators, tourist assistance nec,
- organisation of exhibitions, fairs and congresses,
- operation of sports arenas and stadiums,
- other recreational activities nec.

no. 14/2011), games of chance may only be organised on the basis of a concession or licence granted by the competent body. Hit obtained five concessions for organising special games of chance in casinos, and concluded relevant concession contracts for the period from 1 July 1999 to 30 June 2004. On 24 June 2004, the Government adopted a resolution on their extension until 30 June 2009. On 24 June 2009, the Government adopted another resolution on extension until 30 June 2014 of the concessions granted for the following casinos:

- Casino Park, Nova Gorica,
- Casino Perla, Nova Gorica,
- Casino Korona, Kranjska Gora,
- Casino Fontana, Rogaška Slatina.
- Hit was also granted a concession for organising special games of chance in slots halls, namely for its Casino Drive-in (Vrtojba).

The concession expires on 5 December 2015. In accordance with the contract on the merger of the company Hit Šentilj, the concession for organising special games of chance granted for its Casino Mond for a period ending on 30 October 2015 was transferred to Hit.

Hit as concessionaire must calculate and pay the concession duty as laid down in the Gaming Tax Act (Official Gazette of the RS, no. 57/99) and the Gaming Act, separately for each concession granted. The basis for calculation is the amount paid in by players to participate at certain special games of chance, as reduced by the winnings paid out to the players and revenues earned by the gaming establishment in the case of games played by players against each other. In the period 2004-2012, Hit accounted for and paid the concession duty at a rate of 5 percent, except for slot machines, in which case a progressive scale applied for casinos and a fixed rate of 20 percent applied for slots halls.

2 BUSINESS REPORT

2.1. Introduction

At year-end 2012, the Hit Group was composed of the parent Hit company and eight subsidiaries, one less than a year ago after merger of the company Hit Šentilj into the parent Hit company. Four subsidiaries were established in Slovenia and four (one of them was dormant) in the area of the former Yugoslavia.

After a positive shift in performance in 2011, which was the result of a consistent implementation of a three-year restructuring programme, the parent Hit company faced very tight conditions in 2012. The renewed tightening of economic and market conditions in its key markets caused a further drop in gross gaming revenues. The significantly changed business conditions required new measures to be adopted by Hit in order to reverse the downward trend in revenues and to reduce costs. The measures adopted were effective and showed results in the second half of 2012. Another important event in 2012 was the merger of the subsidiary Hit Šentilj. This business report shows data for Hit already including Hit Šentilj for both 2012 and 2011.

Hit Larix of Kranjska Gora, Slovenia, was successful in 2012 and earned a profit. Gross revenues increased compared to 2011 due to an increase in the number of casino visitors and their spending, despite the tightened business conditions and the month-long closure of the road via the Korensko sedlo pass in the first half of the year. In order to mitigate said conditions, the company accelerated its marketing activities, which comprised promotions, advertising, additional benefits for members of the players' club and various prize games and other attractive events. They also invested in new slot machines and game conversion. In December 2012, the company rented a restaurant, Bor, to add to its non-gaming activities.

Hit Montenegro of Budva, Montenegro, posted a profit in 2012 and was even more successful than a year before. The good results are mainly explained by the improved performance of gaming operations: the number of casino visitors increased and both slot machines and gaming tables generated more revenues. The company strengthened internal marketing and accelerated its numerous marketing activities to expand its sales network both in the existing and new markets. Hotel operations were slightly less successful due to the general economic crisis, shorter stays of hotels guests and cancellation of two larger poker tournaments. To mitigate such conditions, the company carried out various additional activities, such as promotionckas of various pages and congress services, and enhancement of online sales.

Hit Coloseum of Sarajevo, Bosnia and Herzegovina, did not achieve targets and ended the year 2012 with a loss. The main reasons for its underachievement were the increasingly difficult business conditions in the country, coupled with high unemployment, increased competition from slots halls and obsolescence of the facility and gaming equipment. Marketing activities were aimed at attracting new customers based on co-operation with nearby hotels and new agents, intensive hosting activities, numerous internal marketing activities and promotions in the local and foreign markets. The company replaced certain slot machines, and renovated casino entrance and reception. At the end of September, the casino introduced a player tracking system. To compensate for the drop in operating revenues, the company sold an apartment in the Borak complex and reduced operating expenses. Cost reduction measures comprised reducing the number of employees, labour costs and other operating expenses.

Hit Alpinea of Kranjska Gora, Slovenia, posted a loss in 2012. Revenues were less than planned due to unfavourable winter weather and economic crisis in the company's primary markets. Marketing activities comprised participation at tourism fairs, visits to business partners, establishment of contacts with various agencies and a search for new sales channels. The company emphasised in particular its congress services and sports tourism. Marketing communications focused on developing electronic communications through social networks, as well as online reservations. The company had to work hard in order to ensure financing and thus liquidity, given the drop in revenues, unsold property and rescheduling of its financial and operating liabilities.

Casino Kobarid of Most na Soči, Slovenia, did not achieve the expected results and eventually posted a loss. This was exclusively attributable to elimination of deferred taxes. The drop in revenues is explained by the poor economic situation in the company's primary market, and austerity measures of the Italian government. The company tried to mitigate such conditions by conducting regular sales activities, co-operating with new agents to attract new customers and organised groups, opening new bus lines and improving its internal marketing. Additional activities were aimed at improving customer relationship management. The company inaugurated an open-air casino and replaced certain slot machines and games with new ones.

Hit Bovec of Bovec, Slovenia, posted a loss in 2012, which is explained by the very unfavourable weather conditions on the Kanin mountain early in 2013 and the related cancellations of reservations. The economic crisis and price pressures also contributed to the non-fulfilment of the business plan. The company tried to limit the drop in revenues by using all marketing possibilities within the Hit Group, by increasing promotions, in particular of hotel rooms, and by co-operating with domestic and foreign business partners. Rationalisation was aimed at reducing all cost types, also by closing down the hotel in the low season, that is almost the whole of November and December.

Casino Kristal Umag of Umag, Croatia, did not achieve targets, but its performance improved compared to 2011. The main reason for its underachievement was the economic crisis in Italy, as well as increased competition in the local market and the resulting drop in customer visits and spending. Worst felt was the drop in frequency of visits by the company's best customers. The company consistently carried out all marketing activities specified in the business plan and mainly focused on increasing its own sales network, finding new agents, leasing and replacing slot machines and advertising in various media.

In 2012, the **Hit Group** generated EUR 178.5 million of revenues and incurred EUR 200.9 million of expenses, thus producing a net loss of EUR 32.4 million. At year-end 2012, its assets amounted to EUR 264.3 million, and were financed by its own sources (capital and long-term provisions) in the amount of EUR 80.4 million.

At year-end 2012, the Hit Group employed 2,390 persons, down by 4 percent compared to a year ago.

Altogether, the Hit Group casinos and slots halls had 1,771 thousand visits or 8 percent less than in 2011. All casinos pertaining to the Hit Group saw a drop in the number of visits, the main reason being deteriorated business conditions in the key markets and the resulting drop in customer purchasing power, but also stronger and more developed and aggressive competition. The number of visits to the Larix Slots Hall dropped also due to the closure of the main road from Austria in the first half of 2012.

The Hit Group hotels recorded 448.0 thousand overnight stays or 12 percent (60 thousand) less than in 2011. This drop was seen by all Group hotels other than Maestral, where they managed to maintain the number of overnight stays at the 2011 level. The drop is mainly attributable to the overall saving in the household sector and unfavourable winter weather that ended early the winter season in Kranjska Gora and Bovec.

At year-end 2012, visitors to casinos or slots halls had the choice of 236 gaming tables (11 more than a year ago) and 3,953 slot machines (96 less than in 2011), while hotel guests had at their disposal 1,521 rooms or 2,991 hotel beds (the same as in 2011).

2.2 Games of chance

2.2.1 Gross gaming revenues

Gross revenues from games of chance and casino entrance fees (including gaming tax and output VAT respectively) amounted to EUR 168.7 million in 2012, down 8 percent from 2011. The decrease is mainly attributable to the casinos belonging to the Hit company, which suffered a further drop due to the deepening of the economic crisis and development of competition in the key markets. The company managed to limit the drop by adopting additional measures aimed at strengthening its market position in the primary and more distant markets. Aurora, Coloseum Club and Kristal also saw a drop in the number of visits and gaming revenues due to the difficult business conditions. Larix Slots Hall managed to maintain revenues at the 2011 level, while the Maestral Casino saw an almost 25 percent increase in revenues.

The casinos and slots halls pertaining to the Hit company still accounted for as much as 81.3 percent (EUR 137.2 million) of gross gaming revenues earned by the Group. The subsidiaries established in Slovenia earned 6.3 percent (EUR 10.7 million), while those established abroad earned 12.3 percent (EUR 20.8 million).

Gross gaming revenues from **gaming tables** were EUR 53.5 million, while those from **slot machines** were EUR 114.8 million, down 11 percent and 7 percent from 2011 respectively. **Other gross gaming revenues** (from bingo and sports betting) and **casino entrance fees** were EUR 0.4 million, down 10 percent from 2011.

The **structure of gross gaming revenues and casino entrance fees** changed, as the contribution from slot machines increased by 0.9 percentage points compared to 2011. Slot machines contributed the most to total gross gaming revenues and casino entrance fees (68.0 percent), followed by gaming tables (31.7 percent) and other games and entrance fees (0.2 percent).

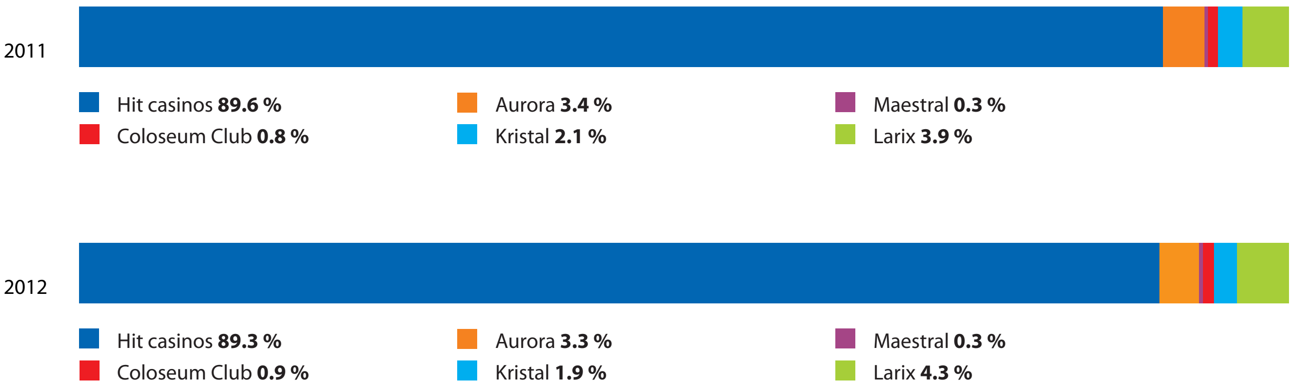
Gross gaming revenues by gaming establishment (million EUR)

	2012	Share	2011	Index 12/11
Hit casinos	137.2	81.3	152.3	90
Aurora	5.4	3.2	5.9	92
Maestral	11.9	7.1	9.6	123
Coloseum Club	3.1	1.8	4.1	76
Kristal	5.8	3.4	7.1	82
Larix	5.2	3.1	5,2	100
Total	**168.7**	**100.0**	**184.3**	**92**

2.2.2 Gaming tax and other duties

In 2012, all Hit Group casinos and slots halls paid EUR 47.0 million of **gaming tax and other duties** (down 9 percent from 2011), which represented 27.8 percent of gross gaming revenues and casino entrance fees (down 0.1 percentage points from 2011). **Gaming tax** was EUR 25.4 million, while **concession and other duties** were EUR 21.6 million. Of total gaming tax and other duties, the casinos and slots halls established in Slovenia paid EUR 45.5 million or 96.8 percent.

Gaming tax and other duties by gaming establishment



Companies established in Slovenia, i.e. Hit and Casino Kobarid, engage not only in games of chance, an activity that is exempt from VAT under the VAT Act, but also in other activities (of which the most important is Food & Beverage). They may deduct input VAT only in a percentage corresponding to the portion that VAT-liable activities contribute to total revenues. In 2012, this portion was 9 percent and 2 percent in Hit and Casino Kobarid respectively. The same applies also to Hit Coloseum of Bosnia and Herzegovina, which was able to deduct input VAT at 6 percent, while Hit Montenegro of Montenegro was able to deduct input VAT at a percent fixed by the local tax administration. This non-deductible input VAT represents an additional tax burden for casinos and thus the entire Group, and increases operating costs.

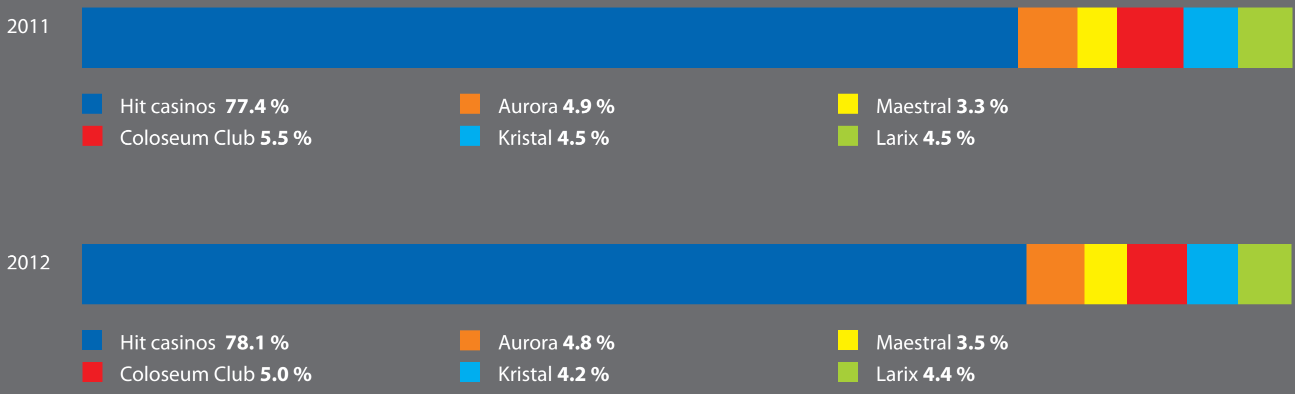
2.2.3 Visits

In 2012, the Hit Group casinos recorded 1,771 thousand of **visits**, down 157 thousand or 8 percent from 2011. The decrease, which was recorded by all casinos, is explained by reduced purchasing power attributable to poor economic conditions, uncertain labour market conditions and thus high unemployment, as well as to austerity measures adopted by certain governments and stronger competition. Competitors accelerated development of online casinos, and opened new casinos with table games and slots halls. Coloseum Club and Kristal saw the largest drop in the number of visits, while Maestral managed to maintain almost the same number of visits as in 2011. Visits to the casinos and slots halls established in Slovenia were 1,547 thousand and accounted for 87.3 percent of the Group's total visits, up by 0.5 percentage points from 2011.

Visits by gaming establishment (thousand)

	2012	Share	2011	Index 2012 / 2011
Hit casinos	1,384	78.1	1,92	93
Aurora	85	4.8	95	89
Maestral	62	3.5	63	98
Coloseum Club	88	5.0	106	84
Kristal	74	4.2	86	86
Larix	78	4.4	86	91
Total	**1,771**	**100.0**	**1,928**	**92**

Visits by gaming establishment



2.3 Hotels and other tourism services

2.3.1 Revenues

In 2012, **gross operating revenues** from rooms sold and other tourism services provided were EUR 27.6 million, down 13 percent from 2011.

2.3.2 Available rooms and occupancy

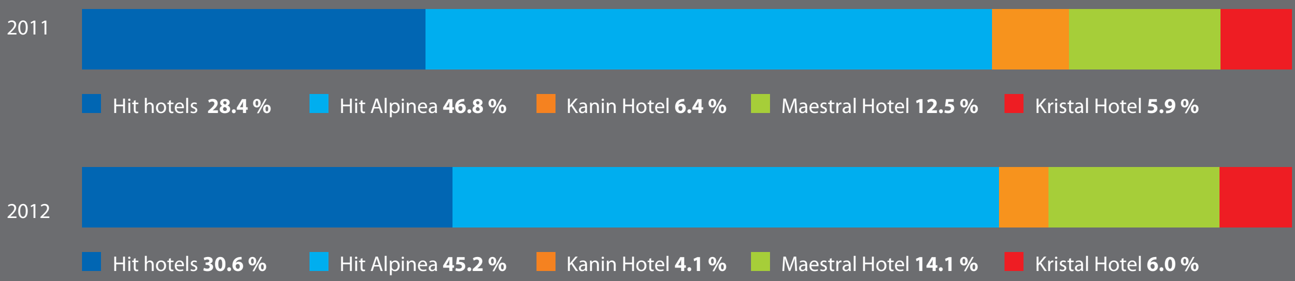
At year-end 2012, there were 1,521 rooms within the Hit Group available to hotel guests, which is the same number as a year ago. The number of **overnight stays** was 448.0 thousand, down 12 percent from 2011. This is explained by the drop in casino customers and in spending by hotel and other customers due to the poor economic situation. Customers searched for bargains and opted for shorter and less expensive vacations. Only the Maestral Hotel saw the same number of overnight stays as in 2011, while other Hit Group hotels all saw a drop. Of the Group's total overnight stays, almost 50 percent was realised by the Hit Alpinea hotels, followed by the five Hit hotels (almost 33 percent), the Maestral Hotel (14.1 percent), the Kanin Hotel (4.1 percent) and the Kristal Hotel (6.0 percent).

In 2012, the Maestral Hotel maintained the same level of **occupancy** as in 2011, while other hotels within the Hit Group saw smaller occupancy rates. The Kristal Hotel of Umag had the highest occupancy rate (49 percent), while the Kanin Hotel had the lowest occupancy rate (20%). Other hotels saw occupancy rates from 42 percent to 43 percent.

Overnight stays and bed occupancy by hotel establishment

	Overnight stays in 2012			Bed occupancy	
	Number	**Share**	**Index 12/11**	**2012**	**2011**
Hit hotels	136,971	30.6 %	95	42 %	45 %
Hit Alpinea hotels	202,606	45.2 %	85	43 %	50 %
Kanin Hotel	18,276	4.1 %	57	20 %	36 %
Maestral Hotel	63,192	14.1 %	100	42 %	42 %
Kristal Hotel	26,937	6.0 %	90	49 %	54 %
Total	**447,982**	**100.0** %	**88**	/	/

Overnight stays by hotel establishment



2.4 Other activities

Other activities pursued within the Hit Group (various services, a tourist agency, wellness centres, etc.) earned **gross operating revenues** of EUR 3.1 million, down 33 percent from 2011.

2.5 Revenue breakdown

The Group's **gross operating revenues** in 2012 were EUR 176.6 and represented 98.9 percent of its total revenues. Of this amount, EUR 148.6 million or 84.2 percent were generated by Group companies established in Slovenia, while the remaining EUR 27.9 million or 15.8 percent were generated by Group companies established abroad. Gross operating revenues fell by 9 percent compared to 2011.

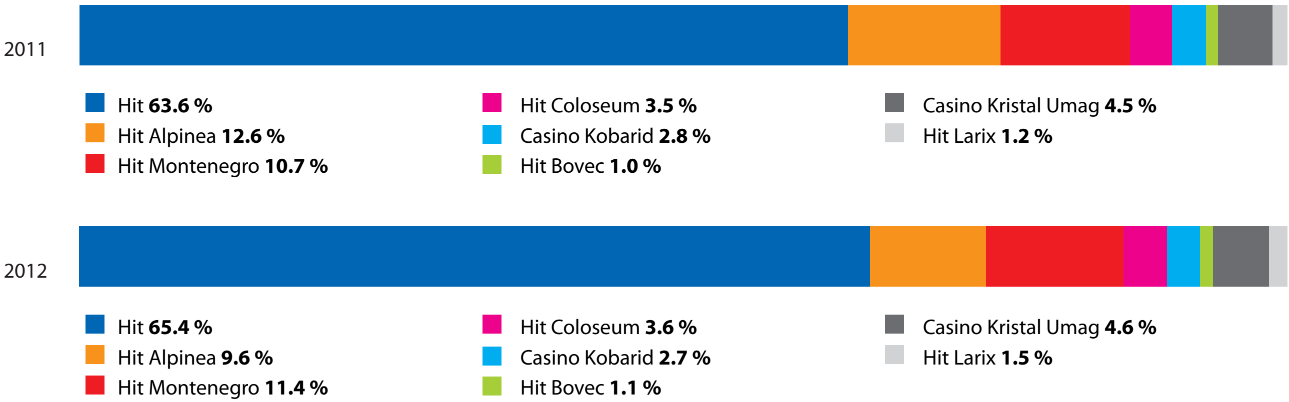
The share of the Group's gross operating revenues generated by games of chance (gaming tax not considered) was 82.6 percent, the share generated by hotels and other tourism activities was 15.6 percent, while the share generated by other activities was 1.8 percent. The share of games of chance increased by 1.4 percentage points, while the shares of hotels and other tourism activities and of other activities decreased by 0.8 and 0.6 percentage points respectively. **Financial revenues** were EUR 1.6 million, while **other revenues** were EUR 0.4 million, representing all together 1.1 percent of total revenues.

The Group's **total revenues** (operating, financial and other) were EUR 178.5 million in 2012, down 8 percent from 2011. The Group's **total expenses** were EUR 200.9 million in 2012, up 1 percent from 2011. The **consolidated net loss** of the Hit Group was thus EUR 32.4 million or 18.1 percent of total revenues.

2.6 Employees

At year-end 2012, the Hit Group had 2,390 **employees**. Compared to the end of 2011, the number of employees decreased by 89 staff members or 4 percent. Due to rationalisation of work processes, Hit Alpinea showed the largest decrease in the number of employees. The Hit company, Hit Coloseum, Casino Kobarid and Casino Kristal Umag also showed a decrease in the number of employees. Hit Larix employed additional staff members due to the rental of the Bor Restaurant, while Hit Montenegro employed additional staff members in high season. Employees of the parent Hit company represented 65.4 percent, up by 1.8 percentage points from 2011.

Employees by Hit Group company as at year-end



The Hit Group follows a recruitment and HR development policy that is based on long-term employee development and key employee maintenance. Training is aimed at achieving said objectives by promoting inner growth and career development. Hit as the parent company aims at ensuring work conditions that encourage employees to be creative and effective. By transferring such knowledge, experience and standards to its subsidiaries, Hit ensures employee motivation throughout the Group.

Employees by Hit Group company as at year-end 2012 (by the highest level of education achieved)

	Primary and vocational (I-IV)	Secondary (V)	Higher (VI)	University or higher (VII)	Total
Hit	331	751	160	322	**1,564**
Hit Alpinea	133	67	16	14	**230**
Hit Montenegro	59	172	26	16	**273**
Hit Coloseum	22	58	1	5	**86**
Casino Kobarid	8	40	5	12	**65**
Hit Bovec	17	4	1	4	**26**
Casino Kristal Umag	27	76	1	6	**110**
Hit Larix	4	20	7	5	**36**
Total Hit Group	**601**	**1,188**	**217**	**384**	**2,390**

2.7 Capital investments and development projects

In 2012, we mainly invested in modernisation of gaming equipment, refreshment of hotel and tourist products, and development of IT support. This allowed Group companies to enhance their products, as well as to offer additional benefits to their existing customers and attract new customers. When the gaming market is shrinking and competition is increasing, capital investments are even more important, as they allow the Group to maintain its market position, competitiveness and effectiveness.

In 2012, the **parent Hit company** invested, in accordance with the restructuring programme, mainly in the enhancement and modernisation of gaming and F&B products, and in strategically important projects, such as development of a balanced scorecard system and a salary system, and process optimisation. The Park gaming and entertainment centre opened a new baccarat room named Lotus to cater to more demanding customers. The Perla gaming and entertainment centre expanded its Oceanis restaurant, while the Sabotin Hotel in Solkan renovated its garden where guests can eat throughout the year. Within the customer relationship management project, the most important project in the last five years, the company continued implementing its loyalty programme also in F&B operations and in the online casino. This increases integration of all products and offers more possibilities for customer relationship development. Within the new tourist complex project, the Hit company revised the preliminary study and concept design, and prepared a study of impacts on the environment and infrastructure, and a study of impacts on the social and economic environment. An internally-developed supervision system for gaming tables was installed also in the Park, Korona and Fontana casinos. For the system, which offers IT support to work processes at gaming tables, the company received in 2012 from the Chamber of Commerce, Regional Chamber Northern Primorska, a silver award for the most innovative idea in 2011. In 2012, the company launched a "family-friendly company" project and continued with the culture of creativity project.

Capital investments of **Hit Montenegro** were mostly directed towards the replacement of outdated equipment, and to a lesser extent also towards the extraordinary maintenance of its facilities.

Hit Larix invested mainly in the modernisation of gaming equipment in order to maintain its competitive advantage, and also in the regular maintenance of fixed assets.

Hit Coloseum invested in new slot machines and in a player tracking system.

Casino Kobarid failed to make all the investments planned, but focused on those ensuring the achievement of objectives, that is new slot machines and game conversion.

Casino Kristal did not have any major capital investment projects. They only carried out urgent maintenance of their facilities and, to a lesser extent, modernised gaming equipment.

Hit Alpinea only carried out urgent maintenance related to the cold water plumbing system, added toilets for the disabled and replaced outdated F&B equipment.

Hit Bovec did not have any major capital investment projects.

2.8 Environmental protection

The Hit Group companies comply with environmental regulations and the Group's social responsibility policy. In this, they follow the example of the parent Hit company. Group companies pursue socially responsible development. They try to eliminate or minimise any negative impact on the environment by implementing appropriate technological solutions, as well as by raising employee awareness and providing relevant employee training. Environmental care and efficient energy use form an integral part of their organisational culture.

Group companies ensure rational energy and water consumption by modernising and automating their energy systems. In this, they rely on an internally-developed computer application for energy (natural gas, heating oil, butane-propane and electricity) and water consumption monitoring. Hit Larix prepared a study of its electricity-consuming devices (air conditioning, lighting, etc.), based on which these were optimised to ensure significant savings over the last four years. In 2012, the company consumed almost 20 percent less energy than in 2008.

The parent company mainly focused, together with external investors, on efficient energy use and renewable energy resources. Based on a ten-year contract with E3, a local electricity supplier, a co-generation facility (generating electricity and heat) was installed in the Perla gaming and entertainment centre in May 2012. The facility features two gas engines with electricity generators. Based on a contract concluded with Topsol in 2011, a photovoltaic system was installed on the roof of the company's Palude service centre. The centre is now self-sufficient, as its annual consumption of electricity equals electricity generated by the photovoltaic system. Both projects brought savings in primary energy sources, thus reducing both costs and carbon emissions. Hit launched another project in 2012, aimed at installing a biomass distant heating system in Kranjska Gora, supplying all its facilities at this location (pertaining to Korona and Hit Alpinea) in 2015. A feasibility study showed that the project was economically viable. The most favourable investor will be selected through a tender system.

2.9 BALANCE SHEET ANALYSIS AND PERFORMANCE INDICATORS

2.9.1 Intangible assets

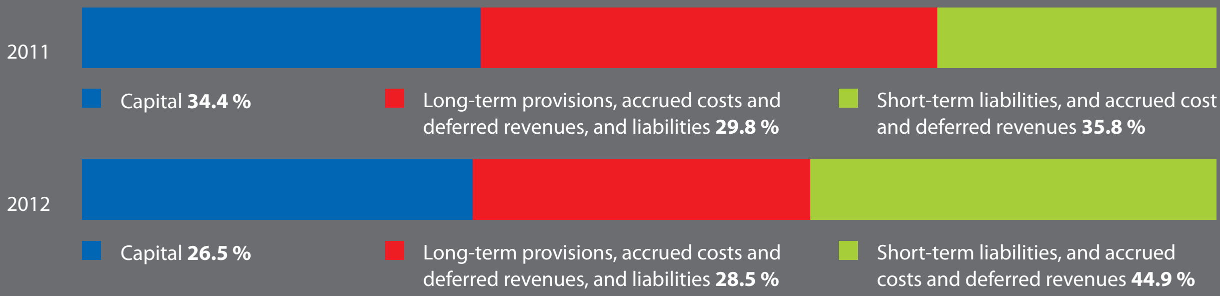
At 31 December 2012, Hit Group's **capital** stood at EUR 70.1 million, down 33 percent from a year ago. Capital represented 26.5 percent of total capital and liabilities, which is 7.8 percentage points less than a year ago.

Long-term provisions, accrued costs and deferred revenues, and liabilities decreased by 17 percent to EUR 75.5 million as at year-end 2012, when they represented 28.5 percent of total capital and liabilities. **Short-term liabilities, and accrued costs and deferred revenues** represented the remaining 44.9 percent of total capital and liabilities (EUR 118.8 million, up by 9 percent from year-end 2011).

Hit Group capital and liabilities as at year-end (thousands EUR)

	2012	Share	2011	Index 12 /11
Capital	70,130	26.5 %	104,768	67
Long-term provisions, accrued costs and deferred revenues, and liabilities	75,454	28.5 %	90,789	83
Short-term liabilities, and accrued costs and deferred revenues	118,754	44.9 %	109,207	109
Total	**264,338**	**100.0 %**	**304,765**	**87**

Hit Group capital and liabilities at year-end



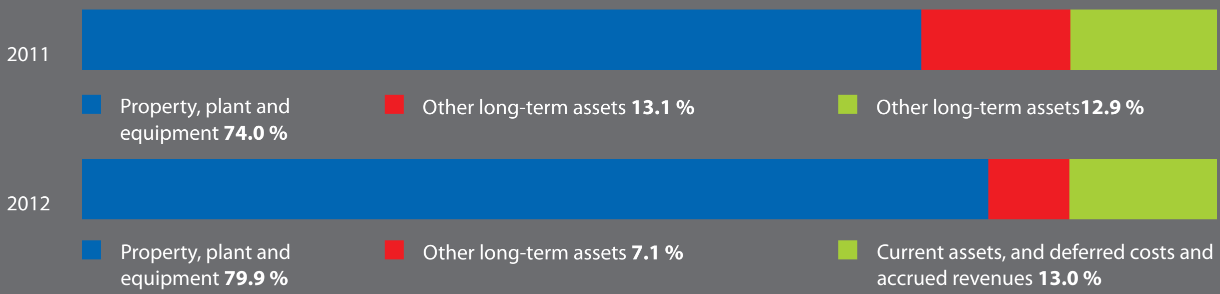
2.9.2 ASSETS

At year-end 2012, Hit Group's **assets** stood at EUR 264.3 million, down 13 percent from a year ago. **Long-term assets** stood at EUR 229.9 million (down 13 percent) and represented 87 percent of total assets (down 0.1 percentage points). **Short-term assets** stood at EUR 34.4 million (down 13 percent) and represented 13 percent of total assets (down 0.1 percentage points).

Hit Group assets at year-end (thousand EUR)

	31. 12. 2012	Share	31. 12. 2011	Index 12 / 11
Property, plant and equipment	211,228	79.9 %	225,510	94
Other long-term assets	18,673	7.1 %	39,832	47
Current assets, and deferred costs and accrued revenues	34,437	13.0 %	39,423	87
Total	**264,338**	**100.0 %**	**304,765**	**87**

Hit Group assets at year-end



2.10 PERFORMANCE INDICATORS*

Hit Group profitability and efficiency ratios

	2012	**2011**
Return on capital	-31.3 %	- 4.9 %
Return on assets	-11.4 %	- 1.8 %
Revenues profitability	-18.1 %	- 2.9 %
Revenues profitability	0.63	0.60
Total efficiency	0.85	0.97

Return on capital, measured as the ratio of net profit / loss to average capital (excluding current year's profit / loss) was minus 31.3 percent (2011: minus 4.9 percent).

Return on assets, measured as the ratio of net profit / loss to average assets, was minus 11.4 percent in 2012 (2011: minus 1.8 percent).

Revenues profitability, measured as the ratio of net profit / loss to total revenues (operating revenues plus financial revenues plus other revenues), was minus 18.1 percent (2011: minus 2.9 percent).

Asset turnover, measured as the ratio of total revenues to average assets, was 0.63 (2011: 0.60).

Total efficiency, measured as the ratio of total revenues to total costs and expenses, was 0.85 (2011: 0.97).

* Profitability indicators were calculated using the Hit Group's total net loss (net loss of the majority owner and net loss of minority owners).

3 MISSION AND STRATEGY

3.1 Mission

The Hit Group **mission** is to satisfy the needs of its stakeholders. This is the main reason for its existence, and at the same time its guiding light and inspiration. A clear and well thought out mission gives its employees the sense that they have a common purpose, direction and opportunity.

From its very beginning the Hit Group has been inseparably connected with hotels, casinos and tourism, and has always contributed to the development of the environment where it operated. The time when merely providing services was sufficient is gone. Now the Group has to put a lot of effort also in attracting and retaining customers, which requires careful customer relationship management. The new mission, vision and slogan all reflect this.

Group management is aware of the importance of understanding customer needs, requirements, wishes and expectations, and of meeting these adequately while at the same time meeting also the needs of all other stakeholders. For this reason, it defined a new mission in the 2012-2020 Group strategy: **Co-creating experiences and opportunities**. With new knowledge, a professional approach and the support of all employees the Group will creatively develop the best tourist product and a broad range of accompanying services for the enjoyment, relaxation and entertainment of its customers in their free time.

3.2 Development strategy

The parent Hit company prepared the 2012-2020 Group strategy with an emphasis on the strategic period 2012-2014. The strategic period focuses on stabilisation and normalisation of operations based on prudent divestment and restructuring, as well as on modernisation of the existing business model to the extent possible. In the period 2012-2014, the Group will also accelerate development of online gaming and entertainment, in line with global trends. Its organisational structure will have to be adjusted to all said changes, and ensure optimal burden sharing among the existing employees, as well as development of new products. In accordance with the "real scenario" of the strategy, Hit will find one or several strategic partners by year-end 2014, and turn around its business model in the period 2015-2020. In addition to successful Group restructuring and improvement in market conditions, the key condition for a successful turnaround will be the following: amendments to the applicable regulations and the resulting ownership consolidation with one or several strategic partners. Capital investments planned in the period 2012-2020 require recapitalisation, as own funds are expected to be insufficient.

The Hit Group will have four pillars or separate strategic units: western, northern, southern and online, all reporting to a top strategic unit. By carrying out all the strategic projects included in the strategy, the Hit Group will become, by the end of this decade, one of the leading European providers of entertainment. It will have a tourist complex in the western Goriška region, a winter pillar in Kranjska Gora in the north, a summer pillar in Montenegro in the south, and a recognisable online product. To put its strategy into action, the parent Hit company defined a set of short- and medium-term measures and started implementing them. It also defined strategic objectives and measures in view of its new values, mission and vision. They form the strategy map created based on the balanced scorecard management system, which is an important management tool.

4 BUSINESS ENVIRONMENT AND COMPETITION

4.1 Applicable regulations

Games of chance are an activity that would usually be subject to special regulation. This is the case in the majority of countries worldwide, Slovenia included. The main acts governing this area in Slovenia are the Gaming Act and the Gaming Tax Act. Development of the gaming & entertainment industry is defined in the Strategy of the Development of Gaming in Slovenia, adopted by the government at year-end 2010.

Difficult business conditions caused by the general economic crisis showed the current fiscal legislation to be unsustainable, hindering the future development of gaming. Being aware of the example of its Italian competitors, Hit favours amendments to legislation that would lessen the tax burden on gaming establishments and allow accumulation of own funds for the future development. Amendments to legislation would require also a new Gaming Act and a new Gaming Tax Act, the adoption of which is a long procedure. In the meantime, in order to survive the crisis, the two acts should be at least amended so as to provide for a reduced basis for concession duties, as well as reduced tax rates.

The competitiveness of Slovenian gaming establishments is further hurt by regulations applying to the implementation of new products. For example, to introduce the latest technologies and innovative solutions, these must undergo a very long procedure for obtaining the required permit from the State Office for Gaming Supervision, despite the fact that gaming devices and software have all the necessary certificates recognised by the majority of Member States (for example Italy and Austria). Manufacturers do not provide certificates especially for Slovenia, given the size of its market. Compared to their direct competitors in the neighbouring countries, Hit companies established in Slovenia thus have a small choice of gaming devices and games. In addition to all this came, in August 2007, the Restriction of the Use of Tobacco Products Act. Similar acts were also introduced in Italy, Austria and Croatia, but are less rigorous as they treat casinos as exceptions and allow smoking there provided certain conditions are met.

In September 2012, the government of Slovenia presented the third package of measures to boost the economy, including gaming. Said measures include adoption of a new Gaming Act which would eliminate administrative barriers and accelerate the procedures that now restrict competitiveness of Slovenian gaming establishments. The new act should, among other things, reduce the prescribed shares of capital of concession holders by the state and local communities, prescribe stricter conditions for awarding concessions, strengthen supervision and modernise the provisions applying to online gaming. In December 2012, the Ministry of Finance invited proposals for a new regulatory framework governing games of chance. Hit responded, emphasising that said framework should be more strategically oriented. The new gaming strategy and regulatory framework should ensure long-term development of the industry, and its short-term defence against new competitors in its primary markets (Italy, Austria), as well as the impacts of the economic crisis. Only by responding appropriately and timely to the difficult business conditions in its key markets and to the opportunities in other more distant markets, will Slovenia's gaming industry be able to avoid the otherwise inevitable stagnation.

New gaming legislation envisaging a tax of 10 percent on gross gaming revenues will be implemented in Montenegro starting in 2014. Amendments to gaming legislation, among them a tax on gross gaming revenues at a rate of 5 percent, are being prepared also in Bosnia and Herzegovina.

In Croatia, the economic policy throughout 2012 focused almost exclusively on the objective of European Union membership, which the country achieved on 1 July 2013. The country made amendments to certain acts, among them those governing corporate profit tax, value added tax, income tax and labour relationships.
meril pri podeljevanju koncesij, krepitve sistema nadzora, posodobitve regulacije spletnih iger na srečo ... Ministrstvo za finance je pripravilo in v mesecu decembru leta 2012 objavilo javni poziv za pošiljanje predlogov za novo sistemsko ureditev iger na srečo. Nanj se je odzvala tudi družba Hit, ki meni, da bi morali biti cilji nove sistemske zakonodaje bolj strateško usmerjeni. Strategija razvoja slovenskega igralništva in s tem nov Zakon o igrah na srečo naj bi tako zagotavljala pogoje za dolgoročni razvoj panoge in kratkoročno izvajanje strategije obrambe pred novo nastajajočo konkurenco na primarnih trgih slovenskega igralništva (Italija, Avstrija) in pred posledicami ekonomske krize. Le z ustreznim in pravočasnim odzivom na zaostrene razmere na ključnih trgih ter priložnosti na oddaljenih trgih se bo namreč mogoče izogniti neizbežni stagnaciji slovenske igralniške panoge.

4.2 Business environment*

Due to a drop in confidence, the already modest recovery of the **world economy** lost momentum during 2012. The impacts of intensification of the euro crisis spread to other economies and caused a synchronised slowing of global economic growth. According to estimates from the International Monetary Fund, global gross domestic product grew at a rate of 3.2 percent in 2012, which is 0.7 percentage points below the 2011 level. Since August 2012, global inflation increased persistently to reach 3.9% at year-end, driven by energy prices. The deteriorated economic environment caused the number of unemployed to increase by 4.2 million to 197.3 million, bringing the global unemployment rate to 5.9 percent.

* All figures in this section are the latest figures published by relevant institutions (Institute of Macroeconomic Analysis and Development of the Republic of Slovenia, national statistical offices and central banks, European Commission, IMF, World Bank, EBRD and others).

The economic environment in the **euro area** deteriorated in 2012, and in the third quarter the region slipped back into recession. Fragile economic activity reflected the negative impact on domestic consumption of low confidence on the part of consumers and investors, as well as of weak external demand. Gross domestic product fell by 0.6 percent in 2012, while in 2011 it grew by 1.4 percent. The annual growth in prices, high since year-end 2010, was dampened in the last months of 2012 by the slowdown in energy prices. Annual inflation decreased to 2.2 percent in December 2012, close to the medium-term inflation target of the European Central Bank, which is below, but close to 2 percent. Average inflation remained at the 2011 level of 2.5 percent. Tightening in labour market conditions continued. Unemployment rate increased by 1 percentage point to 11.7 percent. There were 18.7 million unemployed persons in the European Union. The euro depreciated from February to early September 2012, when it appreciated against most major currencies. At year end, the US dollar / euro exchange rate was 1.2986.

Slovenia's economy, after two years of modest growth, declined by 2.3 percent in 2012. As exports stagnated, a significant contribution to this decline came from lower domestic consumption, both investments and final consumption. Price developments mainly reflected weak economic activity both in the domestic and international environment. Growth in consumer prices in 2012 was 2.7 percent, while the annual average was 2.6 percent. Inflation was 0.7 percentage points above the 2011 level. The situation in the labour market deteriorated significantly towards year-end and led to accelerated growth in the number of unemployed. On 31 December 2012, there were more than 118 thousand persons registered as unemployed, 4.7 percent more than a year ago. Unemployment rate was 13 percent, the highest since the year 2000.

The recession in **Italy**, which started in mid-2011, deepened in 2012. Growth was dampened by a decline in economic activity which was the result of increasing financing costs connected with the increasingly serious sovereign debt crisis, a slowdown in international trade and declining domestic consumption. Gross domestic product fell by 2.2 percent in 2012, while in 2011 it grew by a modest 0.4 percent. The Italian government adopted a series of austerity measures, including among others higher tax burdens, which further reduced household disposable income and consumption. Survey information shows that in 2012, two Italians out of three were struggling to make ends meet, or were even forced to use savings or borrow in order to make ends meet. Together with energy prices, tax changes caused the average inflation rate to rise from 2.8 percent to 3 percent in 2012, the highest level since 2008. After a slowdown in energy prices, annual inflation stopped at 2.3 percent in December 2012, 1 percentage point below the 2011 level. On average, prices rose by 3 percent, 0.2 percentage points more than in 2011. Employment was relatively stable, while the number of unemployed increased and pushed the unemployment rate from 9.4 percent to 11.2 percent. At year-end 2012, there were 2.9 million of unemployed. Consumer confidence dropped to the lowest ever level due to increased concerns about general business conditions and tightening labour market conditions.
Austria saw its economy cool due to the euro sovereign debt crisis and weak global growth in 2012. Gross domestic product grew at a rate of 0.6 percent, compared to 2.7 percent recorded in 2011. Growth in consumer prices, however, also slowed down. On average, prices increased by 2.6 percent, 1 percentage points less than in 2011. In December 2012, annual inflation rate was 2.9 percent. Unemployment rate fell to around 6 percent in the first half of 2012, was relatively stable in the third quarter, and then rose to 8.6 percent by year-end, reflecting deterioration in business

conditions. One year ago, unemployment rate was 8.2 percent. In December 2012, 323 thousand persons were unemployed, 6 percent more than a year ago.

Montenegro saw a slowdown in economic growth in 2012: gross domestic product grew at rate of 0.4 percent, compared to 3.2 percent recorded in 2011. Due to the general economic crisis, exports of goods decreased more rapidly than imports compared to 2011. Unemployment rate rose to 19.7 percent. The number of unemployed increased by 2.7 percent, to 49.4 thousand. Consumer price inflation was at 5.1 percent. The government of Montenegro proposed several new taxes in 2012 in order to increase budget revenues. The main objective of this is budget stabilisation, foreign investment promotion and competitiveness gains.

The economy in **Bosnia and Herzegovina** stagnated in 2012. Gross domestic product shrunk compared to 2011. Unemployment increased and was between 47 percent and 50 percent. Consequently, the purchasing power decreased further, also due to lower public sector salaries, lower social transfers and poor credit conditions. The economy was badly hit by the drop in foreign investments, which represented only 18 percent of those made in 2011. There were almost no new foreign investors, and the existing ones sold their investments. The International Monetary Fund approved a two-year financial arrangement in support of the government's economic programme. The programme is aimed at better policy coordination, fiscal discipline, protection of financial sector's stability and an improved business environment.

After zero growth in 2011, **Croatia** saw its real gross domestic product drop by 2.0 percent in 2012, according to the national central bank. Private consumption and investments provided the main contribution to such negative growth. The government started planning structural reforms in 2012, and adopted numerous austerity measures. Its main short-term objective is to increase the effectiveness of public administration, enhance competitiveness, and reform labour regulations and the market. Consumer price inflation was significantly higher in 2012 due to short-term factors, such as the increased VAT rate, drought and administrative decisions regarding energy prices. Average inflation was 3.4 percent, while year-on-year inflation was 4.7 percent. Negative trends continued also in the labour market, where registered unemployment rate rose by 2.5 percentage points to 21.1 percent. At year-end 2012, there were more than 358 thousand registered unemployed, up 13.6 percent from one year ago.

4.3 Competition

The primary market of the Hit Group continued to shrink in 2012, reflecting the poorer financial condition of its customers due to the deepened economic crisis. The conditions became even tighter with the appearance of new products in Italy, which are cutting into the market share of classic casinos, and with the dispersion and growth of various gaming establishments in Austria and in the area of the former Yugoslavia. The Italian government responded to the crisis and growing competition by introducing tax reliefs to allow local casinos to remain competitive by improving their products despite the crisis.

Italy

The Italian gaming market is undergoing rapid liberalisation, which began even before 2008 and accelerated with the onset of the economic crisis. There are four casinos in the country and a large and increasing number of substitutes to casino gaming. These are above all slot machines outside casinos. Other providers of games of chance, such as online gaming and entertainment and poker tournaments outside casinos, are also becoming increasingly active. All this points to a serious restructuring of the Italian gaming sector. Competition of Italian but also Hit Group casinos increased in December 2012, when Italian online casinos introduced also slot machines.

Italian casinos saw an even greater drop in their gross gaming revenues and visits than in 2011, which was due to the aforementioned liberalisation of the Italian gaming market and deeper economic crisis. Hit's main competitor, Casino di Venezia, saw a 16 percent drop in revenues, followed by the other three casinos which saw their revenues drop by 17 percent to 21 percent. The number of visits to all four casinos declined by 11 percent. The casinos tried to reverse negative trends by modernising their products, organising various tournaments, focusing on new customer segments, offering loyalty programmes and online gaming, etc. They received extraordinary support in their efforts and advantage over competitors when they concluded agreements with local authorities on reduced effective taxation.

Unlike casinos, other games of chance saw a sharp increase in pay-ins, estimated at above 10 percent in 2012. Substitutes to casino gaming, i.e. slot machines outside casinos of the "Comma 6a" and VLT* types, generated the highest level of pay-ins. The number of active VLT-type slot machines has been increasing continuously and reached 45 thousand in 2012. Two important novelties introduced in mid-2011, the so-called cash poker and online casinos (offering slot machines in addition to gaming tables since December 2012), contributed to the increase in pay-ins.

In 2011, Italian tax authorities started to monitor closely the higher pay-outs earned by their citizens in foreign casinos, mainly in poker tournaments.

The Italian government responded to the deepening of economic crisis with austerity measures which are impacting the way of life in Italy – household disposable income and consumption are declining, and together with them revenues of gaming and other establishments.

* Video Lottery Terminals are devices similar to slot machines but linked into a centralised computer system.

Austria

According to unofficial information, Austrian casinos felt the negative impact of the economic crisis in 2012. Hit's main competitors, the casinos in Velden and Graz, saw a drop in their gross gaming revenues. The latter reportedly concluded the 2012 financial year with record-low gross gaming revenues. To mitigate the negative impacts of the economic crisis, the government, at the end of 2011, reduced the tax rate applying to gaming establishment from 40 percent to 45 percent to 30 percent of gross gaming revenues.

There were also certain activities associated with the gaming law adopted in 2010, although this should enter into force only in 2014 for slot machines outside casinos and in 2015 for other gaming establishments. The main change that the law brought about is the number of licences, which was increased from 12 to 15. Licenses were awarded through a public tender published in 2011. Four applicants submitted their proposals, among them also Novomatic, which is expected to play an important role in the Austrian gaming market. The new law brought about also certain changes applying to slots halls and individual slot machines, as well as poker, and an additional gaming tax of 10 percent of gross gaming revenues.

Slovenia

Slots halls in the Goriška region saw their gross gaming revenues decline again, after 2011 also in 2012. They responded by even more aggressive marketing activities, which, however, were short-lived and mainly caused higher operating costs to other gaming establishments. Slots halls Venko and Fortuna saw their gaming revenues decline by an estimated 15 percent to 20 percent. The first one was forced to shorten its operating hours. Casino Portorož is undergoing a compulsory settlement procedure. This notwithstanding, they managed to renovate, during the summer months, the casino in Portorož and the open-air casino in Lipica. In September, however, they had to close the Žusterna slots hall. The performance of Casino Bled was very modest; they had liquidity problems and had practically no effect on Hit casinos. In Styria, where Hit has two casinos, there is a very successful slots hall, Joker, which caters exclusively to local customers. Despite the crisis, two new slots halls opened their doors in Ljubljana and Izola in 2012. The company Alea Iacta tried to obtain a concession in 2012 to develop a slots hall in the area of the former international border crossing in Vrtojba.

Montenegro

Competition in the gaming sector is increasingly fiercer. The main competitors were the casinos located in the Splendid, Avala and Queen of Montenegro casinos. The competitive advantage of these casinos and hotels lies in their wide range of products and services, price flexibility, service quality, luxurious interiors and location. Hit Montenegro continued offering the already established and certain new charter flights from southern Italy. They also offered an attractive entertainment programme and managed to maintain their high reputation in this segment.

The casino, which is located in the Maestral Hotel, maintained a high level of services compared to its competitors and thus recognisability, which was confirmed in 2012 when Business Destination, a British newspaper, presented it the award for the best luxurious hotel in Montenegro.

Bosnia and Herzegovina

The market share of Coloseum, a Hit Group company, fell from 32 percent to only 18 percent in 2012 in the segment of slot machines. The reason for this was the entry of a company named Astra and its three slots halls in the gaming market at the end of 2011. The main competitor of Hit Coloseum remains the national lottery. State-owned and connected with Novotel, a manufacturer of gaming devices, it takes full advantage of its privileged situation. Currently it has 55 slots halls with one thousand slot machines, of which 440 just in the area of Sarajevo. The number of slots halls with 20 to 30 machines also increased. Besides Hit Coloseum, the national lottery is the only official provider of live games, but there are also illegal providers of poker games, representing unfair competition. Also the offer of concerts is increasing, as even larger restaurants are now organising such events.

Croatia

The closest competitor is the Elit slots hall located in the Melia Coral hotel, which took over the majority of customers of the now closed Solei casino. While all other slots halls located in Umag cater to local customers, Elit caters mainly to Italians. In 2013, it should expand its product and introduce gaming tables. Other major competitors of Casino Kristal Umag in 2012 were Casino Mulino, Casino Zefir and three slots clubs in Umag and its surroundings, as well as other smaller slots halls offering slot machines and other games (billiards, sports betting, etc.) Their main advantages are flexibility, a vast range of slot machines, an attractive ambience, an attractive exterior, etc. All casinos and slots halls in Umag refreshed their gaming equipment in 2012 and will continue to do so also in 2013.

5 SOCIAL RESPONSIBILITY POLICY

Socially responsible, despite the tight business conditions

Once again in the **financial year 2012**, which was **one of the most demanding ever**, also due to restructuring of the Hit company and its group subsidiaries, the Hit Group thoughtfully **kept with its vow to act in a socially responsible manner**. It is a fact that our efforts to stabilise operations and our accountability to the owners are inseparably connected with job safety and achievement of social and environmental objectives.

In the third year of restructuring, we were forced to **further limit the funds intended for sponsorships and donations**, and to consider even more prudently various opportunities to offer support. We maintained our support to social, cultural, professional, educational and sports activities, which are an integral part of the local environments where the Group operates.

The Hit Group has long-standing co-operation with **sports associations and clubs**. In 2012, it again sponsored two major sports events in Slovenia – the Golden Fox race in Maribor and the Vitranc race in Kranjska Gora. The support offered by the Hit Group is crucial for the Vitranc sports hall and women's basketball club in Kranjska Gora. The parent Hit company remained an ally of various **educational, cultural and sports institutions in the Goriška region**. Together with the Nova Gorica City Municipality and within its possibilities, it organised several attractive events. In the first half of 2012, Hit managed to support the Nova Gorica football club, female volleyball club, cycling club and chess club, but then limited its support to their young selections due to tightened business conditions. Hit has been a long-standing sponsor of the Young Football Player Club of Nova Gorica, thus enabling young people to be active and to grow safely.

The Hit Group also dedicates funds to **humanitarian ends**, above all to the Stara Gora hospital, but also to other humanitarian associations, institutes and foundations, taking account of their needs and its possibilities. In 2012, it helped launch a newly established **Hit employees retirement club**.

The **Paviljon art gallery in the Hit business centre** launched its 15th exhibition season mainly dedicated to renowned local and foreign artists.

The Hit Group demonstrated its **responsibility towards the natural environment** where its companies operate with many carefully prepared activities. The parent company and its energy experts further improved energy efficiency by completing a project together with the E3 company, a local electricity supplier. The project provided for a **co-generation system**, which emphasises social responsibility and environmental protection, to change the energy supply of Hit's largest gaming and entertainment centre, Perla. Roof space of Hit's technical support centre was used for a **photovoltaic facility** which improved energy supply of the centre.

In the last three years, Hit has been developing a **culture of creativity**. Employees are encouraged to propose improvements: technical, organisational or any other changes that could benefit both the company as a whole and the author(s) of the proposal. In 2013, when further deterioration in social conditions is expected in its broader environment, Hit will remain focused on its restructuring programme and the 2012-2020 Group development strategy. The Hit Group is fully aware of the importance of an efficient performance which demonstrates responsibility towards all stakeholders, including owners, employees and business partners.

6 AUDITOR'S REPORT

Independent Auditor's Report

To the Owners of HIT d.d.

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of the company HIT d.d. and its subsidiaries (the HIT Group), which comprise the consolidated balance sheet as at 31 December 2013, the consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Slovene Accounting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the HIT Group as at 31 December 2013, its financial performance and its cash flows for the year then ended in accordance with Slovene Accounting Standards.

The Independent Auditor's Report hereof is a translation of the original Independent Auditor's Report in Slovene, issued on the financial statements and the notes thereto in Slovene and is not to be signed. This translation is provided for reference purposes only.

Emphasis of Matter

We draw attention to Point 14.1.1 of the Annual Report, which discusses measures for lowering the indebtedness. As at 31 December 2013, Group's short-term liabilities amounted to EUR 105,767 thousand and exceeded short-term assets by EUR 83,781 thousand, whereas the loss for 2013 is recorded at EUR 5,305 thousand. The respective circumstances indicate that significant uncertainty exists as to whether the Group will be able to continue as a going concern.

Our opinion is not adjusted in this respect.

Report on Other Legal and Regulatory Requirements

As required by the Slovenian Companies Act we herewith confirm that the information in the management report is in conformity with the accompanying financial statements.

KPMG SLOVENIJA,
podjetje za revidiranje, d.o.o.

Tomaž Mahnič, ACCA
Certified Auditor

Boris Drobnič
Partner

Ljubljana, 18 April 2014

KPMG Slovenija, d.o.o.
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7 CONSOLIDATED FINANCIAL STATEMENTS

7.1 Consolidated income statement

	2012 (EUR)	2011 (EUR)
Net sales revenues	173,403,014	190,270,463
Change of inventories of products and work in progress		
Capitalised own products and services	1,033,501	1,253,089
Revaluation and other operating revenues	2,133,663	1,827,352
Gross operating revenues	**176,570,178**	**193,350,904**
Operating expenses	**(180,195,545)**	**(190,267,866)**
Costs of goods, materials and services	(61,098,494)	(68,608,577)
Cost of goods sold and materials used	(18,057,525)	(19,444,861)
Cost of services	(43,040,969)	(49,163,716)
Labour costs	(62,563,744)	(65,447,547)
Wages and salaries	(46,375,314)	(48,978,264)
Social insurance costs	(9,314,030)	(8,818,409)
• Pension insurance costs	(6,227,557)	(5,489,797)
• Other social insurance costs	(3,086,473)	(3,328,612)
Other labour costs	(6,874,400)	(7,650,874)
Write-downs in value	(25,449,199)	(28,469,035)
• Depreciation and amortisation expenses, and revaluation operating expenses	(24,698,163)	(28,247,843)
• Revaluation operating expenses associated with operating current assets	(751,036)	(221,192)
Other operating expenses	(31,084,108)	(27,742,707)
Operating profit	**(3,625,367)**	**3,083,038**
Financial revenues	**1,568,589**	**737,009**
Financial revenues from shares and interests	513,453	301,198
Other financial revenues from shares and interests	513,453	301,198
Financial revenues from loans and operating receivables	1,055,136	435,811
Other financial revenues from financial loans and operating receivables	1,055,136	435,811

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	2012 (EUR)	2011 (EUR)
Financial expenses	**(20,407,269)**	**(9,204,573)**
Financial expenses from impairment and write-offs of investments	(11,539,739)	(916,935)
Other revaluation financial expenses	(11,539,739)	(916,935)
Financial expenses for operating and financial liabilities	(8,867,530)	(8,287,638)
Financial expenses for other operating and financial liabilities	(8,176,685)	(7,050,451)
Financial expenses for accounts and notes payable	(13,153)	(110,953)
Other revenues	**388,989**	**770,176**
Other expenses	**(314,198)**	**(376,948)**
Pre-tax profit or loss for the period	**(22,389,256)**	**(4,991,298)**
Income tax	(330,511)	(248,133)
Deferred taxes	(9,668,824)	(438,849)
Net profit or loss for the period	**(32,388,591)**	**(5,678,280)**
Net profit or loss of minority shareholders	(210,314)	(1,129,193)
Net profit or loss of majority shareholders	(32,178,277)	(4,549,087)

7.2 Consolidated statement of comprehensive income for the year ended 31 Dec 2012

	2012 (EUR)	2011 (EUR)
Net profit or loss for the period	(32,388,591)	(5,678,280)
Changes in revaluation surplus from available-for-sale financial assets	(9,352,215)	(9,352,215)
Gains and losses arising from translating the financial statements of foreign operations	573,940	122,595
Total comprehensive income for the period	**(30,409,479)**	**(14,907,900)**
Total comprehensive income of minority shareholders	(40,449)	(1,033,123)
Total comprehensive income of majority shareholders	(30,369,030)	(13,874,777)

7.3 Consolidated balance sheet 31. 12. 2012 in 31. 12. 2012

	2012 (EUR)	2011 (EUR)
ASSETS	**264,338,291**	**304,764,619**
Long-term assets	**229,901,512**	**265,341,992**
Intangible fixed assets and long-term deferred costs and accrued revenues	4,304,232	5,299,465
Long-term property rights	2,104,875	2,863,916
Consolidated goodwill	1,469,937	1,560,114
Other long-term deferred costs and accrued revenues	729,420	875,435
Tangible fixed assets	211,228,443	225,510,227
Land and buildings	184,665,788	196,935,628
• Land	22,916,135	22,981,248
• Buildings	161,749,653	173,954,380
Other plant and equipment	25,093,448	26,981,552
Tangible fixed assets under acquisition	1,469,207	1,593,047
• Advances for tangible fixed assets	94,428	
• Tangible fixed assets under construction	1,374,779	1,593,047
Investment property	3,522,336	3,723,769
Long-term investments	6,958,039	17,088,278
Long-term investments, excluding loans	6,876,132	16,216,377
Other shares and interests	6,621,696	15,676,716
Other long-term investments	254,436	539,661
Long-term loans	81,907	871,901
Long-term loans to others	81,907	871,901
Long-term operating liabilities	1,058,548	1,217,439
Long-term operating liabilities to others	1,058,548	1,217,439
Deferred tax assets	2,829,914	12,502,814
Current assets	**28,797,202**	**33,510,802**
Assets (disposal groups) held for sale	1,225,977	628,570
Assets held for sale	1,225,977	628,570

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	2012 (EUR)	2011 (EUR)
Inventories	1,935,347	2,066,933
Materials	1,816,118	1,911,652
Products and merchandise	119,010	155,273
Advances	219	8
Short-term investments	2,954,772	2,791,425
Short-term investments, excluding loans	2,095,512	2,144,350
Other short-term investments	2,095,512	2,144,350
Short-term loans	859,260	647,075
Short-term loans to others	859,260	647,075
Short-term operating receivables	6,244,181	6,531,209
Short-term trade receivables	2,861,463	3,331,357
Short-term operating receivables due from associates	10,968	10,968
Short-term operating receivables due from others	3,371,750	3,188,884
Cash	16,436,925	21,492,665
Deferred costs and accrued revenues	**5,639,577**	**5,911,825**
CAPITAL AND LIABILITIES	**264,338,291**	**304,764,619**
Capital	**70,129,711**	**104,768,331**
Called-up capital	28,328,468	28,328,468
Share capital	28,328,468	28,328,468
Capital surplus	29,618,361	29,618,361
Revenue reserves	4,248,010	37,623,098
Legal reserves	4,248,010	5,303,159
Other revenue reserves		32,319,939
Revaluation surplus	2,756,099	1,350,927
Capital consolidation adjustment	404,064	143,839
Capital of minority shareholders	4,774,709	7,703,638

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	2012 (EUR)	2011 (EUR)
Provisions, and long-term accrued costs and deferred revenues	**10,286,652**	**7,996,083**
Provisions for termination benefits and similar liabilities	4,193,409	3,726,052
Other provisions	2,801,428	400,000
Long-term accrued costs and deferred revenues	3,291,815	3,870,031
Long-term liabilities	**65,167,485**	**82,793,174**
Long-term financial liabilities	63,888,747	82,237,263
Long-term financial liabilities to banks	49,091,930	69,639,503
Long-term financial liabilities to others	14,796,817	12,597,760
Long-term operating liabilities	707,534	129,494
Long-term operating liabilities to others	703,437	111,742
Dolgoročne poslovne obveznosti do drugih	4,097	17,752
Deferred tax liabilities	571,204	426,417
Short-term liabilities	**109,252,885**	**103,682,907**
Short-term financial liabilities	81,536,180	78,236,646
Short-term financial liabilities to banks	80,722,863	76,905,386
Other short-term financial liabilities	813,317	1,331,260
Short-term operating liabilities	**27,716,705**	**25,446,261**
Short-term operating liabilities from advances	951,793	892,822
Short-term trade payables	11,663,827	11,274,199
Other short-term operating liabilities	15,101,085	13,279,240
Accrued costs and deferred revenues	**9,501,558**	**5,524,124**

7.4 Consolidated cash flow statement for the year ended 31 Dec 2012 (version II)

	2012 (EUR)	2011 (EUR)
A. CASH FLOWS FROM OPERATING ACTIVITIES		
a) Items of income statement	**9,397,446**	**27,908,225**
Operating revenue (except from revaluation) and financial revenues from operating receivables	175,904,557	191,241,908
Operating expenses excluding depreciation or amortisation (except from revaluation) and financial expenses from operating liabilities	(157,893,074)	162,704,895)
Income taxes and other taxes not included in operating expenses	(8,614,037)	(628,788)
b) Changes in net operating assets in balance sheet items (including accruals and deferrals, provisions and deferred tax assets and liabilities)	**17,284,752**	**(3,977,195)**
Opening less closing operating receivables	(58,377)	(636,690)
Opening less closing deferred costs and accrued revenue	235,002	1,313,587
Opening less closing deferred tax assets	8,567,688	483,383
Openin less closing assets (disposal groups) held for sale	(738,227)	
Opening less closing inventories	265,565	(177,627)
Closing less opening operating liabilities	4,394,884	(1,562,038)
Closing less opening accrued costs and deferred revenue, and provisions	4,783,332	(3,309,125)
Closing less opening deferred tax liabilities	(165,115)	(88,685)
c) Net cash from operating activities (a + b)	**26,682,198**	**23,931,030**
B. CASH FLOWS FROM INVESTING ACTIVITIES		
a) Cash receipts from investing activities	**6,037,546**	**9,153,851**
Interest received from investing activities	225,798	376,475
Dividends received from investing activities	513,242	244,786
Cash receipts from disposal of intangible assets	26,618	
Cash receipts from disposal of property, plant and equipment	457,917	1,656,273
Cash receipts from disposal of investment property	707,975	1,787,388
Cash receipts from disposal of long-term investments	17,483	5,088,929
Cash receipts from disposal of short-term of investments	4,088,513	
b) Cash payments from investing activities	**(15,530,601)**	**(11,948,546)**
Cash payments to acquire intangible assets	(138,056)	(492,321)
Cash payments to acquire property, plant and equipment	(9,506,831)	(7,565,498)
Cash payments to acquire investment property	(4,491)	

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	2012 (EUR)	2011 (EUR)
Cash payments to acquire short-term investments	(5,881,223)	(3,890,727)
c) Net cash from investing activities (a + b)	**(9,493,055)**	**(2,794,695)**
C. CASH FLOWS FROM FINANCING ACTIVITIES		
a) Cash receipts from financing activities	**17,116,330**	**14,218,239**
Cash proceeds from increase in short-term financial liabilities	17,116,330	14,218,239
b) Cash payments from financing activities	**(39,358,913)**	**(34,699,851)**
Interest paid on financing activities	(7,692,475)	(7,188,480)
Cash repayments of long-term financial liabilities	(21,117,656)	(20,121,638)
Cash repayments of short-term financial liabilities	(9,644,450)	(6,435,331)
Dividends and other profit shares paid	(904,332)	(954,402)
c) Net cash from financing activities (a + b))	**(22,242,583)**	**(20,481,612)**
D. CLOSING BALANCE OF CASH	**16,436,925**	**21,492,665**
x) Net cash inflow or outflow for the period (sum total of net cash Ac, Bc and Cc)	(5,053,440)	654,723
Exchange rate translation effects	(2,300)	(17,423)
y) Opening balance of cash	21,492,665	20,855,365

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Nova Gorica, 2013