

Ericsson Nikola Tesla d.d.

**Annual financial report
31 December 2011**

Contents

	<i>Page</i>
Company profile	1 to 2
Responsibilities of the Management and Supervisory Boards for the preparation and approval of the annual financial statements	3
Independent Auditors' Report to the shareholders of Ericsson Nikola Tesla d.d.	4
Ericsson Nikola Tesla d.d. statement of comprehensive income	5
Ericsson Nikola Tesla d.d. statement of financial position	6 to 7
Ericsson Nikola Tesla d.d. statement of cash flows	8 to 9
Ericsson Nikola Tesla d.d. statement of changes in equity	10
Notes to the financial statements	11 to 65

Company profile

History and incorporation

Ericsson Nikola Tesla d.d. (the Company) is a Croatian company with over sixty years of continuous operations. It is a leading supplier and exporter of specialized telecommunications equipment, software solutions and services in Central and Eastern Europe.

The Company was founded as a result of the privatisation of the enterprise Nikola Tesla - Poduzeće za proizvodnju telekomunikacijskih sistema i uređaja, po.

According to the ownership structure as at 31 December 2011, Telefonaktiebolaget LM Ericsson (Ericsson) holds 49.07% of the Company's share. A further 0.23% is held by The Croatian Privatisation Fund and 0.32% is held as treasury shares. Other shareholders own the remaining 50.38% of the Company's shares.

Principal activities

The principal activities of the Company are: the research and development of telecommunications software and services, design, testing and integration of total communications solutions, and supply and maintenance of communications solutions and systems primarily in the Republic of Croatia, Central and Eastern Europe as well as to companies within the Ericsson Group.

Ericsson Nikola Tesla d.d. is a joint stock company incorporated in Croatia. The headquarters of the Company are in Zagreb, Krapinska 45.

Company profile (continued)

Supervisory Board, Management Board and executive management

The Supervisory Board

The Supervisory Board members during 2011 and up to the release of these statements were:

Roland Nordgren	Appointed on 27 May 2008	Chairperson
Ignac Lovrek	Reappointed on 31 May 2011	Member; Vice-Chairperson
Carita Jönsson	Reappointed on 27 May 2008	Member
Dubravko Radošević,	Appointed on 20 May 2010	Member
Zvonimir Jelić	Reappointed on 18 June 2010	Member and employees' representative

The Management Board

The Management Board has one member:

Gordana Kovačević	Reappointed on 1 January 2010	President
-------------------	-------------------------------	-----------

Executive management

As at 31 December 2011, the Company's executive management comprised:

Gordana Kovačević	Company President
Alen Ludaš	Director, Commercial Management
Boris Drilo	Director, ICT for Industry and Society
Branko Dronjić	Head, G-ITTE Engineering Services Croatia
Dragan Fratrić	Manager, General Services
Goran Ožbolt	Director, Sales and Marketing for Tele2 and Alternative Operators
Grga Mrkonjić	Director, Sales and Marketing for HT
Hrvoje Benčić	Director, Engagement Practices and ETK Customer Operations
Ivan Barać	Director, Sales & Marketing for CIS market
Jagoda Barać	Director, Sales and Marketing for Neighboring countries
Marijana Đuzel	Head, HR&O and Legal Affairs
Mathias Danielsson	Head, Competence Center
Milan Živković	Director, Strategy and Business Development; Acting Finance Director*
Miroslav Kantolić	Director, Sales and Marketing for VIPnet
Patrick Gerard Martin	Director, Research and Development Center
Snježana Bahtijari	Director, Communication
Tihomir Šicel	Director, Sales & Marketing for Industry and Society

*Andrew Skelton held the position of Finance Director until 31 May 2011

Responsibilities of the Management and Supervisory Boards for the preparation and approval of the annual financial statements

The Management Board is required to prepare financial statements for each financial year which give a true and fair view of the financial position of the Company and of the results of its operations and cash flows, in accordance with applicable accounting standards, and is responsible for maintaining proper accounting records to enable the preparation of such financial statements at any time. It has a general responsibility for taking such steps as are reasonably available to it to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

The Management Board is responsible for selecting suitable accounting policies to conform with applicable accounting standards and then apply them consistently; make judgements and estimates that are reasonable and prudent; and prepare the financial statements on a going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Management Board is responsible for the submission to the Supervisory Board of its annual report on the business situation of the Company together with the annual financial statements, following which the Supervisory Board is required to approve the annual financial statements which will be presented to the General Assembly of Shareholders.

The financial statements set out on pages 5 to 65 were authorised by the Management Board on 13 April 2012 for issue to the Supervisory Board and are signed below.



Gordana Kovačević
President
Ericsson Nikola Tesla d.d.
Krapinska 45
10000 Zagreb
Croatia



Independent Auditor's Report

To the Shareholders and the Management Board of Ericsson Nikola Tesla d.d.

We have audited the accompanying financial statements of Ericsson Nikola Tesla d.d. (the "Company"), which comprise the statement of financial position as at 31 December 2011 and the statements of comprehensive income, changes in equity and 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 financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of 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 financial statements present fairly, in all material respects, the financial position of the Company as at 31 December 2011, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers d.o.o.

PricewaterhouseCoopers d.o.o.
Zagreb, 18 April 2012

Our report has been prepared in Croatian and in English languages. In all matters of interpretation of information, views or opinions, the Croatian language version of our report takes precedence over the English language version.

PricewaterhouseCoopers d.o.o., Alexandera von Humboldta 4, 10000 Zagreb, Croatia
T: +385 (1) 6328 888, F: +385 (1) 6111 556, www.pwc.hr

Commercial Court in Zagreb, Tt-99/7257-2, Reg. No.: 080238978; Company ID No.: 81744835353; Founding capital: HRK 1,810,000.00, paid in full; Management Board: F. Mattelaer, President, I. Bijelic, Member; Giro-Account: Raiffeisenbank Austria d.d., Petrinjska 59, Zagreb, giro account no.: 2484008-1105514875.

Statement of comprehensive income
for the year ended 31 December 2011

	<i>Notes</i>	2011	2010
		HRK '000	HRK '000
Sales revenue	3, 4	1,165,660	1,218,863
Cost of sales		<u>(1,023,893)</u>	<u>(1,012,567)</u>
Gross profit		141,767	206,296
Other income	4, 6	14,664	15,411
Distribution expenses		(62,282)	(56,973)
Administrative expenses		(29,363)	(34,037)
Other expenses	7	<u>(76,738)</u>	<u>(145,946)</u>
Operating loss		<u>(11,952)</u>	<u>(15,249)</u>
Finance income	9	34,480	41,408
Finance expense	9	<u>(178)</u>	<u>(192)</u>
Finance income – net		<u>34,302</u>	<u>41,216</u>
Profit before tax		22,350	25,967
Income tax	10	<u>5,626</u>	<u>(1,905)</u>
Profit for the year		<u>27,976</u>	<u>24,062</u>
Other comprehensive income		<u>-</u>	<u>-</u>
Total comprehensive income for the year		<u>27,976</u>	<u>24,062</u>
Earnings per share (HRK)	11	<u>21.13</u>	<u>18.30</u>

The notes set out on pages 11 to 65 form an integral part of these financial statements.

Statement of financial position
as at 31 December 2011

	<i>Notes</i>	2011 HRK '000	2010 HRK '000
ASSETS			
Non-current assets			
Property, plant and equipment	12	134,114	128,643
Intangible assets	13	3,424	4,814
Loans and receivables	14	45,172	10,358
Equity securities		53	45
Deferred tax assets	15	13,992	9,165
Total non-current assets		<u>196,755</u>	<u>153,025</u>
Current assets			
Inventories	16	22,705	44,774
Trade receivables	17	273,465	346,982
Receivables from related parties	29(c)	87,491	75,406
Income tax receivable		-	3,054
Other receivables	18	12,306	58,232
Financial assets at fair value through profit or loss	19	68,249	63,254
Prepayments and accrued income		4,808	6,508
Cash and cash equivalents	20	525,218	673,926
Total current assets		<u>994,242</u>	<u>1,272,136</u>
TOTAL ASSETS		<u>1,190,997</u>	<u>1,425,161</u>

The notes set out on pages 11 to 65 form an integral part of these financial statements.

Statement of financial position (continued)
as at 31 December 2011

	<i>Notes</i>	2011 HRK '000	2010 HRK '000
EQUITY AND LIABILITIES			
Equity			
Share capital	21(a)	133,165	133,165
Treasury shares		(8,443)	(16,251)
Legal reserves	21(c)	20,110	20,110
Retained earnings		706,074	934,000
Total equity		<u>850,906</u>	<u>1,071,024</u>
Non-current liabilities			
Interest-bearing borrowings	24	1,435	3,346
Employee benefits	25	4,530	4,891
Total non-current liabilities		<u>5,965</u>	<u>8,237</u>
Current liabilities			
Payables to related parties	29(c)	50,737	94,846
Interest-bearing borrowings	24	2,047	1,673
Trade and other payables	26	88,269	94,380
Provisions	27	21,968	17,097
Accrued charges and deferred revenue	28	171,105	137,904
Total current liabilities		<u>334,126</u>	<u>345,900</u>
Total liabilities		<u>340,091</u>	<u>354,137</u>
TOTAL EQUITY AND LIABILITIES		<u>1,190,997</u>	<u>1,425,161</u>

The notes set out on pages 11 to 65 form an integral part of these financial statements.

Statement of cash flows
for the year ended 31 December 2011

	<i>Notes</i>	2011	2010
		HRK '000	HRK '000
Cash flows from operating activities			
<i>Profit before tax</i>		<u>22,350</u>	<u>25,967</u>
Adjustments for:			
Depreciation and amortisation	12,13	48,441	56,831
Impairment losses and reversals		68,275	139,850
Net creation of provisions		10,358	13,853
Net loss on sale of property, plant and equipment	7	1,638	181
Net gain on remeasurement of financial assets	9	(1,129)	(4,026)
Amortisation of discount	9	(3,545)	(6,254)
Interest income	9	(19,450)	(23,506)
Interest expense	9	178	192
Foreign exchange gains		(12,310)	(6,196)
Equity-settled transactions		<u>3,994</u>	<u>6,124</u>
		118,800	203,016
(Increase)/Decrease in loans and receivables		(34,671)	140,948
(Decrease)/increase in inventories		12,722	(21,022)
Decrease in receivables		57,255	48,256
Decrease in payables		<u>(21,984)</u>	<u>(11,048)</u>
<i>Cash generated from operations</i>		<u>132,122</u>	<u>360,150</u>
Interest paid		(178)	(192)
Income taxes refunded		<u>3,054</u>	<u>6,398</u>
<i>Net cash from operating activities</i>		<u>134,998</u>	<u>366,356</u>
Cash flows from investing activities			
Interest received		18,644	25,369
Proceeds from sale of property, plant and equipment		89	43
Purchases of property, plant and equipment, and intangible assets	12,13	(54,250)	(39,736)
Increase in non-current deposits		(1,758)	(198)
(Purchases) of/proceeds from financial assets		<u>(3,874)</u>	<u>61,645</u>
<i>Net cash (used in)/generated from investing activities</i>		<u>(41,149)</u>	<u>47,123</u>

The notes set out on pages 11 to 65 form an integral part of these financial statements.

Statement of cash flows (continued)
for the year ended 31 December 2011

	<i>Notes</i>	2011	2010
		HRK '000	HRK '000
Cash flows from financing activities			
Repayment of interest-bearing borrowings		(1,316)	(1,601)
Dividends paid	22	<u>(251,289)</u>	<u>(158,160)</u>
Net cash used in financing activities		<u>(252,605)</u>	<u>(159,761)</u>
Effects of exchange rate changes on cash and cash equivalents		<u>10,048</u>	<u>5,273</u>
Net increase in cash and cash equivalents		(148,708)	258,991
Cash and cash equivalents at the beginning of the year		<u>673,926</u>	<u>414,935</u>
Cash and cash equivalents at the end of the year	20	<u>525,218</u>	<u>673,926</u>

The notes set out on pages 11 to 65 form an integral part of these financial statements.

Statement of changes in equity
for the year ended 31 December 2011

	Share capital	Treasury shares	Legal reserves	Retained earnings	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
		Note 21 (b)			
As at 1 January 2010	133,165	(34,173)	20,110	1,081,121	1,200,223
Changes in equity for 2010					
Total comprehensive income	-	-	-	24,062	24,062
Dividend distribution for 2009, Note 22	-	-	-	(158,160)	(158,160)
Share-based payments, Note 25 (b)	-	17,922	-	(17,922)	-
Equity-settled transactions, Note 25 (b)	-	-	-	6,124	6,124
Deferred tax related to equity increase, Note 10	-	-	-	(1,225)	(1,225)
As at 31 December 2010	133,165	(16,251)	20,110	934,000	1,071,024
As at 1 January 2011	133,165	(16,251)	20,110	934,000	1,071,024
Changes in equity for 2011					
Total comprehensive income	-	-	-	27,976	27,976
Dividend distribution for 2010, Note 22	-	-	-	(251,289)	(251,289)
Share-based payments, Note 25 (b)	-	7,808	-	(7,808)	-
Equity-settled transactions, Note 25 (b)	-	-	-	3,994	3,994
Deferred tax related to equity increase, Note 10	-	-	-	(799)	(799)
As at 31 December 2011	133,165	(8,443)	20,110	706,074	850,906

The notes set out on pages 11 to 65 form an integral part of these financial statements.

Notes to the financial statements

1 Significant accounting policies

Reporting entity

Ericsson Nikola Tesla d.d. (the Company) is a joint stock company incorporated and domiciled in Croatia. The address of its registered office is Krapinska 45, 10000 Zagreb, the Republic of Croatia. The Company's shares are listed on the Public Joint Stock Company listing on the Zagreb Stock Exchange. These financial statements were authorised for issue by the Management Board on 13 April 2012 for approval by the Supervisory Board. A summary of the Company's principal accounting policies is set out below.

Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs). These financial statements also comply with the Croatian Accounting Act in effect on the date of issue of these financial statements. These financial statements are a translation of the official statutory IFRS financial statements.

Basis of preparation

The financial statements are prepared on the historical cost basis, with the exception of financial instruments which are carried at fair value. These comprise derivative financial instruments and financial assets and liabilities at fair value through profit or loss. The accounting policies have been consistently applied to all periods presented in these financial statements and are consistent with those used in the previous year.

The preparation of financial statements in conformity with IFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of revision and future periods if the revision affects both current and future periods. Judgements made by management in the application of IFRSs that have significant effect on the financial statements and estimates are discussed in Note 2.

Going concern

The directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. The Company therefore continues to adopt the going concern basis in preparing its financial statements.

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

Changes in accounting policies and disclosures

(a) New and amended standards adopted by the Company

The Company has adopted the following new and amended IFRSs as of 1 January 2011:

IFRS 7, 'Financial instruments', applied retrospectively, amendment emphasises the interaction between quantitative and qualitative disclosures about the nature and extent of risks associated with financial instruments. This amendment has no significant impact on Company's financial statements.

IAS 24, 'Related party disclosures' (revised 2009), effective from 1 January 2011, amends the definition of a related party and modifies certain related-party disclosure requirements for government-related entities. The revised standard will not have an impact on the Company's financial statements.

Entities subject to rate regulation are allowed to use previous GAAP carrying amounts of property, plant and equipment or intangible assets as deemed cost on an item-by-item basis. Entities that use this exemption are required to test each item for impairment under IAS 36 at the date of transition. Effective date: Applied prospectively. The change does not have an impact on the Company's financial statements.

IFRS 3, 'Business combinations', transition requirements for contingent consideration from a business combination that occurred before the effective date of the revised IFRS, clarifies that the amendments to IFRS 7, 'Financial instruments: Disclosures', IAS 32, 'Financial instruments: Presentation', and IAS 39, 'Financial instruments: Recognition and measurement', that eliminate the exemption for contingent consideration, do not apply to contingent consideration that arose from business combinations whose acquisition dates precede the application of IFRS 3 (as revised in 2008). Effective to annual periods beginning on or after 1 July 2010 and is applied retrospectively. The revised standard will not have an impact on the Company's financial statements.

The choice of measuring non-controlling interests at fair value or at the proportionate share of the acquiree's net assets applies only to instruments that represent present ownership interests and entitle their holders to a proportionate share of the net assets in the event of liquidation. All other components of non-controlling interest are measured at fair value unless another measurement basis is required by IFRS. Effective to annual periods beginning on or after 1 July 2010 and applied prospectively from the date the entity applies IFRS 3. The revised standard will not have an impact on the Company's financial statements.

The application guidance in IFRS 3 on unreplaced and voluntarily replaced share-based payment awards applies to all share-based payment transactions that are part of a business combination, including unreplaced and voluntarily replaced share-based payment awards). This guidance is effective to annual periods beginning on or after 1 July 2010 and applied prospectively. The guidance will not have an impact on the Company's financial statements.

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

Changes in accounting policies and disclosures (continued)

(b) New and amended standards, and interpretations mandatory for the first time for the financial year beginning 1 January 2011 but not currently relevant to the Company (although they may affect the accounting for future transactions and events)

The following standards and amendments to existing standards have been published and are mandatory for the Company's accounting periods beginning on or after 1 January 2011 or later periods.

Amendment to IAS 32, 'Financial instruments: Presentation – Classification of rights issues' (effective from 1 February 2010). This amendment is to allow rights, options or warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency to be classified as equity instruments provided the entity offers the rights, options or warrants pro rata to all of its existing owners of the same class of its own non-derivative equity instruments. The amendment will not have an impact on the Company's financial statements.

IFRIC 19, 'Extinguishing financial liabilities with equity instruments' (effective from 1 July 2010). This amendment clarifies the requirements of IFRSs when an entity renegotiates the terms of a financial liability with its creditor and the creditor agrees to accept the entity's shares or other equity instruments to settle the financial liability fully or partially. The amendment will not have an impact on the Company's financial statements.

Amendment to IFRS 1, 'First-time adoption of IFRS – Limited exemption from comparative IFRS 7 disclosures for first-time adopters' (effective from 1 July 2010). This amendment provides the same relief to first-time adopters as was given to current users of IFRSs upon adoption of the amendments to IFRS 7. Also clarifies the transition provisions of the amendments to IFRS 7. The amendment will not have an impact on the Company's financial statements.

Amendment to IFRIC 14, 'IAS 19 – The limit on a defined benefit assets, minimum funding requirements and their interaction' removes unintended consequences arising from the treatment of pre-payments where there is a minimum funding requirement. Results in pre-payments of contributions in certain circumstances being recognised as an asset rather than an expense. Effective date: 1 January 2011. The amendment will not have an impact on the Company's financial statements.

Amendment to accounting policy changes in the year of adoption clarifies that, if a first-time adopter changes its accounting policies or its use of the exemptions in IFRS 1 after it has published an interim financial report in accordance with IAS 34, 'Interim financial reporting', it should explain those changes and update the reconciliations between previous GAAP and IFRS. Effective date: Applied prospectively. The amendment will not have an impact on the Company's financial statements.

Revaluation basis as deemed cost amendment allows first-time adopters to use an event-driven fair value as deemed cost, even if the event occurs after the date of transition but before the first IFRS financial statements are issued. When such remeasurement occurs after the date of transition to IFRSs but during the period covered by its first IFRS financial statements, any subsequent adjustment to that event-driven fair value is recognised in equity. Effective date: Entities that adopted IFRSs in previous periods are permitted to apply the amendment retrospectively in the first annual period after the amendment is effective, provided the measurement date is within the period covered by the first IFRS financial statements. The amendment will not have an impact on the Company's financial statements.

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

Changes in accounting policies and disclosures (continued)

(b) New and amended standards, and interpretations mandatory for the first time for the financial year beginning 1 January 2011 but not currently relevant to the Company (although they may affect the accounting for future transactions and events) (continued)

IAS 1, 'Presentation of financial statements', applied retrospectively, amendment clarifies that an entity will present an analysis of other comprehensive income for each component of equity, either in the statement of changes in equity or in the notes to the financial statements.

IAS 27, 'Consolidated and separate financial statements', effective to annual periods beginning on or after 1 July 2010 and applied retrospectively. This amendment clarifies that the consequential amendments from IAS 27 made to IAS 21, 'The effect of changes in foreign exchange rates', IAS 28, 'Investments in associates', and IAS 31, 'Interests in joint ventures', apply prospectively for annual periods beginning on or after 1 July 2009, or earlier when IAS 27 is applied earlier.

IAS 34, 'Interim financial reporting', applied retrospectively, amendment provides guidance to illustrate how to apply disclosure principles in IAS 34 and add disclosure requirements around:

- The circumstances likely to affect fair values of financial instruments and their classification;
- Transfers of financial instruments between different levels of the fair value hierarchy;
- Changes in classification of financial assets; and
- Changes in contingent liabilities and assets

IFRIC 13, 'Customer loyalty programmes', the meaning of 'fair value' is clarified in the context of measuring award credits under customer loyalty programmes.

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

Changes in accounting policies and disclosures (continued)

(c) New standards, amendments and interpretations issued but not effective for the financial year beginning 1 January 2011 and not early adopted

The Company's assessment of the impact of these new standards and interpretations is set out below.

Amendments to IFRS 7, 'Financial instruments: Disclosures' on derecognition, effective from 1 July 2011, will promote transparency in the reporting of transfer transactions and improve users' understanding of the risk exposures relating to transfers of financial assets and the effect of those risks on an entity's financial position, particularly those involving securitisation of financial assets. Earlier application subject to EU endorsement is permitted. The amendment will not have an impact on the Company's financial statements.

Amendment to IFRS 1, 'First time adoption', on fixed dates and hyperinflation, effective from 1 July 2011, includes two changes to IFRS 1, 'First-time adoption of IFRS'. The first replaces references to a fixed date of 1 January 2004 with 'the date of transition to IFRSs', thus eliminating the need for entities adopting IFRSs for the first time to restate derecognition transactions that occurred before the date of transition to IFRSs. The second amendment provides guidance on how an entity should resume presenting financial statements in accordance with IFRSs after a period when the entity was unable to comply with IFRSs because its functional currency was subject to severe hyperinflation. The amendment will not have an impact on the Company's financial statements.

Amendment to IAS 12, 'Income taxes' on deferred tax is effective from 1 January 2012. IAS 12, 'Income taxes', currently requires an entity to measure the deferred tax relating to an asset depending on whether the entity expects to recover the carrying amount of the asset through use or sale. It can be difficult and subjective to assess whether recovery will be through use or through sale when the asset is measured using the fair value model in IAS 40, 'Investment property'. This amendment therefore introduces an exception to the existing principle for the measurement of deferred tax assets or liabilities arising on investment property measured at fair value. As a result of the amendments, SIC 21, 'Income taxes - recovery of revalued non-depreciable assets', will no longer apply to investment properties carried at fair value. The amendments also incorporate into IAS 12 the remaining guidance previously contained in SIC 21, which is withdrawn. The amendment will not have an impact on the Company's financial statements.

Amendment to IAS 1, 'Financial statement presentation' regarding other comprehensive income, effective date: 1 July 2012. The main change resulting from these amendments is a requirement for entities to group items presented in 'other comprehensive income' (OCI) on the basis of whether they are potentially reclassifiable to profit or loss subsequently (reclassification adjustments). The amendments do not address which items are presented in OCI. The amendment will not have an impact on the Company's financial statements.

Amendment to IAS 19, 'Employee benefits', effective from 1 January 2013, eliminates the corridor approach and calculates finance costs on a net funding basis. The Company is yet to assess the amendments' full impact.

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

Changes in accounting policies and disclosures (continued)

(c) New standards, amendments and interpretations issued but not effective for the financial year beginning 1 January 2010 and not early adopted (continued)

IFRS 9, 'Financial instruments', effective from 1 January 2013 is the first standard issued as part of a wider project to replace IAS 39. IFRS 9 retains but simplifies the mixed measurement model and establishes two primary measurement categories for) financial assets: amortised cost and fair value. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. The guidance in IAS 39 on impairment of financial assets and hedge accounting continues to apply. The Company is yet to assess IFRS 9's full impact.

IFRS 10, 'Consolidated financial statements' is effective from: 1 January 2013. The objective of IFRS 10 is to establish principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. Defines the principle of control, and establishes controls as the basis for consolidation. Set out how to apply the principle of control to identify whether an investor controls an investee and therefore must consolidate the investee. Sets out the accounting requirements for the preparation of consolidated financial statements. The Company is yet to assess IFRS 10's full impact.

IFRS 11, 'Joint arrangements', effective date: 1 January 2013. IFRS 11 is a more realistic reflection of joint arrangements by focusing on the rights and obligations of the arrangement rather than its legal form. There are two types of joint arrangement: joint operations and joint ventures. Joint operations arise where a joint operator has rights to the assets and obligations relating to the arrangement and hence accounts for its interest in assets, liabilities, revenue and expenses. Joint ventures arise where the joint operator has rights to the net assets of the arrangement and hence equity accounts for its interest. Proportional consolidation of joint ventures is no longer allowed. The amendment will not have an impact on the Company's financial statements.

IFRS 12, 'Disclosures of interests in other entities', effective from 1 January 2013, includes the disclosure requirements for all forms of interests in other entities, including joint arrangements, associates, special purpose vehicles and other off balance sheet vehicles. The Company will apply these as effective.

IFRS 13, 'Fair value measurement', effective from 1 January 2013, aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRSs. The requirements, which are largely aligned between IFRSs and US GAAP, do not extend the use of fair value accounting but provide guidance on how it should be applied where its use is already required or permitted by other standards within IFRSs or US GAAP. The Company will apply these as effective.

IAS 27 (revised 2011), 'Separate financial statements', effective from 1 January 2013, includes the provisions on separate financial statements that are left after the control provisions of IAS 27 have been included in the new IFRS 10. The Company will apply these as effective.

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

Changes in accounting policies and disclosures (continued)

(c) New standards, amendments and interpretations issued but not effective for the financial year beginning 1 January 2010 and not early adopted (continued)

IAS 28 (revised 2011), 'Associates and joint ventures', effective from 1 January 2013, includes the requirements for joint ventures, as well as associates, to be equity accounted following the issue of IFRS 11. The Company will apply these as effective.

Functional and presentational currency

The Company's financial statements have been prepared in Croatian kuna (HRK), which is the currency of the primary economic environment in which the entity operates (the functional currency) and the presentation currency, and are rounded to the nearest thousand. The closing exchange rate as at 31 December 2011 was HRK 5.81994 per USD 1 (2010: HRK 5.56825) and HRK 7.53042 per EUR 1 (2010: HRK 7.38517).

Property, plant and equipment

Items of property, plant and equipment are shown at cost or deemed cost, less accumulated depreciation and impairment losses.

The Company recognises in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if it is probable that the future economic benefits embodied with the item will flow to the Company and the cost of the item can be measured reliably. All other expenditure on repairs and maintenance is expensed as incurred. Where parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items of property, plant and equipment.

Land and assets under construction or development are not depreciated. Depreciation on other assets is provided on a straight-line basis to allocate their cost over the estimated economic useful life of the assets. The estimated useful lives are as follows:

	Useful lives
Buildings	5 - 30 years
Plant and equipment	2 - 10 years
Other	5 - 7 years

The depreciation method, useful lives and residual values are reviewed, and adjusted if appropriate, at each balance sheet date. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. Gains and losses on disposals are determined by comparing proceeds with carrying amount, and are included in the statement of comprehensive income.

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

Intangible assets

Intangible assets are stated on initial recognition at cost and subsequently at cost less accumulated amortisation and impairment losses.

Amortisation is provided on a straight-line basis over the estimated useful lives of intangible assets. Intangible assets include acquired computer software, and are amortised on a straight-line basis over their useful life of 2-4 years. Cost associated with maintaining computer software is recognised as an expense as incurred.

Impairment of assets

Assets that have an indefinite useful life are not amortized but tested annually for impairment. Property, plant and equipment, intangible assets, financial instruments and receivables are reviewed for impairment at each balance sheet date or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Whenever the carrying amount of an asset exceeds its estimated recoverable amount, an impairment loss is recognised in the statement of comprehensive income for items of property, plant and equipment, intangible assets, financial instruments and receivables carried at cost.

The recoverable amount of property, plant and equipment and intangible assets is the higher of an asset's fair value less costs to sell or value in use. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or cash-generating unit. Non-financial assets that suffered impairment are reviewed for possible reversal of the impairment at each reporting date. Impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount and to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation, if no impairment loss had been recognised.

The recoverable amount of held-to-maturity investments and receivables carried at amortised cost is calculated as the present value of expected future cash flows, discounted at the original effective interest rate inherent in the asset.

Short-term receivables are not discounted. The recoverable amount of other assets is the higher of the asset's net selling price and its value in use.

An impairment loss in respect of held-to-maturity investments and receivables is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised.

Financial instruments

The Company classifies its financial instruments in the following categories: financial assets and financial liabilities at fair value through profit or loss, loans and receivables, available-for-sale financial assets or held-to-maturity investments. The classification depends on the purpose for which the financial instruments were acquired. Management determines the classification of its financial instruments at initial recognition and re-evaluates this at every reporting date.

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

Financial instruments (continued)

Financial instruments at fair value through profit or loss category have two sub-categories: “financial instruments held for trading”, and those designated by management at fair value through profit or loss at inception. Financial instruments acquired principally for the purpose of generating a short-term profit are classified as held for trading and included in current assets. These include derivative financial instruments, which do not qualify for hedge accounting. Financial instruments at fair value through profit or loss include debt and equity securities and investments in investment funds.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than those that the Company intends to sell immediately or in the near term, which are designated at fair value through profit or loss or as available for sale. These include non-current receivables and deposits with financial institutions.

Financial instruments with fixed or determinable payments and fixed maturity that the Company has positive intent and ability to hold to maturity are classified as held-to-maturity investments. All other financial instruments are classified as available for sale. Financial instruments at fair value through profit or loss, held-to-maturity investments and available-for-sale financial assets are recognised on the trade date, which is the date that the Company commits to purchase or sell the instrument. Loans and receivables and other financial liabilities are recognised on the day they are transferred to the Company.

Financial assets are initially measured at the fair value of the consideration given for them, including transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets and financial liabilities at fair value through profit or loss are initially recognised at fair value and transaction costs are expensed in the statement of comprehensive income. All financial assets and financial liabilities at fair value through profit or loss and available-for-sale financial assets are subsequently carried at fair value without any deduction for transaction costs that the Company may incur on sale or other disposal. Available-for-sale financial assets for which fair value cannot be reliably measured are stated at cost, including transaction costs, less impairment losses. Held-to-maturity investments and loans and receivables are carried at amortised cost less impairment losses. Amortised cost is calculated using the effective interest rate method. Premiums and discounts on held-to-maturity investments and available-for-sale financial assets, including initial transaction costs, are included in the carrying amount of the related instrument and amortised based on the effective interest rate of the instrument. Other financial liabilities are initially recognised at fair value and subsequently carried at amortised cost.

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

Financial instruments (continued)

The fair value of financial instruments at fair value through profit or loss or available for sale is based on their quoted market price at the balance sheet date, without any deduction for transaction costs. The fair value of derivatives that are not exchange-traded is estimated at the amount that the Company would receive or pay to terminate the contract at the balance sheet date. Realised and unrealised gains and losses arising from changes in the fair value of financial assets at fair value through profit or loss are recognised in the statement of comprehensive income in the period in which they arise.

Changes in the fair value of monetary securities denominated in a foreign currency and classified as available for sale are analysed between translation differences resulting from changes in amortised cost of the security and other changes in the carrying amount of the security. The translation differences are recognised in profit or loss, and other changes in carrying amount are recognised in equity. Changes in the fair value of other monetary securities classified as available for sale and non-monetary securities classified as available for sale are recognised in equity. When securities classified as available-for-sale are sold or impaired, the accumulated fair value adjustments recognised in equity are included in the statement of comprehensive income as 'realised gains and losses from available-for-sale securities'.

Interest on available-for-sale securities calculated using the effective interest method is recognised in the statement of comprehensive income. Dividends on available-for-sale equity instruments are recognised in the statement of comprehensive income when the Company's right to receive payments is established.

A financial asset is derecognised when the Company loses the contractual rights that comprise that asset. This occurs when the rights are realised, expire or are surrendered. A financial liability is derecognised when it is extinguished. Financial instruments at fair value through profit or loss, available-for-sale financial assets and held-to-maturity investments are derecognised and corresponding receivables from the buyer for the payment are recognised as of the date the Company commits to sell the assets. The Company uses the specific identification method to determine the gain or loss on derecognition. Loans and receivables are derecognised on the day they are transferred by the Company. Other financial liabilities are derecognised when the Company's contractual obligations are discharged, cancelled or expire.

The Company uses derivative financial instruments to hedge economically its exposure to foreign exchange risk arising from operational activities. Hedge accounting has not been applied and those derivative instruments are accounted for as financial instruments held for trading. Derivative instruments are measured initially at fair value and the related transaction costs are recognised in the statement of comprehensive income and subsequent to initial recognition, are stated at fair value. The gain or loss on remeasurement to fair value is recognised immediately in profit or loss. The fair value of a forward exchange contract is its quoted price at the balance sheet date, being the present value of the quoted forward price.

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

Trade and other receivables

Receivables are initially recognised at the fair value of consideration given and are carried at amortised cost, using the effective interest rate. Receivables are written down to their estimated realisable value through an impairment allowance.

Service contract work-in-progress is stated at cost plus profit recognised to date less a provision for foreseeable losses and less progress billings on long-term contracts. Cost includes all expenditure related directly to specific projects and an allocation of fixed and variable overheads incurred in the Company's contract activities based on budgeted capacity.

Cash and cash equivalents

Cash comprises cash held at banks and on hand. Cash equivalents include demand deposits and time deposits with maturities up to three months.

Trade and other payables

Trade and other payables are initially recognised at fair value and subsequently measured at amortised cost using the effective interest rate.

Inventories

Inventories are stated at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses. The cost of other inventories is based on the First In First Out (FIFO) principle and includes expenditures incurred in acquiring the inventories and bringing them to their existing location and condition. In case of manufactured inventories the cost includes materials, labour and related overhead, and expenditure incurred in acquiring the inventories and bringing them to their existing location and condition. Slow-moving and obsolete inventories have been written down to their estimated realisable value.

Share capital and reserves

Share capital is stated in HRK at nominal value.

Where the Company purchases its own equity share capital (treasury shares), the consideration paid, including any directly attributable incremental costs (net of income taxes) is deducted from equity attributable to the Company's equity holders until the shares are cancelled or reissued. Where such shares are subsequently reissued, any consideration received, net of any directly attributable incremental transaction costs and the related income tax effects, is included in equity attributable to the Company's equity holders.

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

Income tax

The income tax charge is based on taxable profit for the year and comprises current and deferred tax. Income tax is recognised in the statement of comprehensive income except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity. Current tax is the expected tax payable on the taxable income for the year, using the tax rates enacted or substantially enacted at the balance sheet date, and any adjustments to tax payable in respect of previous years.

Deferred taxes are calculated by using the balance sheet liability method. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred tax assets and liabilities are not discounted and are classified as non-current assets and/or liabilities in the balance sheet. Deferred tax assets are recognised when it is probable that sufficient taxable profits will be available against which the deferred tax assets can be utilised. At each balance sheet date, the Company reassesses unrecognised deferred tax assets and the carrying amount of deferred tax assets.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Deferred tax assets and liabilities are measured by using the tax rates expected to apply to taxable profit in the years in which those temporary differences are expected to be recovered or settled based on tax rates enacted or substantially enacted at the balance sheet date.

The measurement of deferred tax liabilities and deferred tax assets reflects the tax consequences that would follow from the manner in which the enterprise expects, at the balance sheet date, to recover or settle the carrying amount of its assets and liabilities.

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

Foreign currencies

Transactions denominated in foreign currencies are translated into HRK at the rate prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currency at the balance sheet date have been translated to HRK at the foreign exchange rate ruling at that date. Foreign exchange differences arising from translation are included in the statement of comprehensive income. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to HRK at foreign exchange rates ruling at the dates the values were determined. Non-monetary assets and items that are measured in terms of "historical cost of a foreign currency" are not retranslated.

Recognition of revenues

Sales revenue represents the value of goods and services supplied to customers during the period, excluding value added taxes, trade discounts and rebates. Revenue is recognized with reference to all significant contractual terms when the product or service has been delivered, when the revenue amount is fixed or determinable, and when collection is reasonably assured. Specific contractual performance and acceptance criteria may impact the timing and amounts of revenue recognized.

The Company uses 3 main contract types with end customers as follows:

- **Delivery-type contracts:** Contracts for delivery of a product or a combination of products to form a whole or a part of a network as well as delivery of stand-alone products. Medium-size and large delivery type contracts generally include multiple elements. Such elements are normally standardized types of equipment or software as well as services such as network rollout.

Revenue is recognized when risks and rewards have been transferred to the customer, normally stipulated in the contractual terms of trade. For delivery-type contracts that have multiple elements, revenue is allocated to each element based on relative fair values.

- **Construction-type contracts:** Contracts where the Company supplies to a customer a complete network, which to a large extent is based upon new technology or includes major components which are specifically designed for the customer.

Revenues from construction-type contracts are recognized according to the stage of completion, using either the milestone output method or cost incurred method. Long-term construction contracts are assessed on a contract by contract basis and reflected in the statement of comprehensive income by recording revenue and related costs in line with contract activity.

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

Recognition of revenues (continued)

- Service contracts: Contracts for various services such as: training, consulting, engineering, installation, and multi-year managed services.

Revenue is generally recognized when the services have been provided. Revenue for fixed price service contracts covering longer periods is recognized pro rata over the contract period.

The majority of the Company's products and services are sold under delivery-type contracts including multiple elements, such as base stations, base station controllers, mobile switching centers, routers, microwave transmission links, various software products and related installation and integration services. Such contract elements generally have individual item prices in agreed price lists per customer.

The profitability of individual contracts is periodically assessed, and provisions for any estimated losses are made immediately when losses are probable.

Employee benefits

a) Long-term service benefits

The Company provides employees with jubilee and one-off retirement awards. The obligation and costs of these benefits are determined by using the Projected Unit Credit Method. The Projected Unit Credit Method considers each period of service as giving rise to an additional unit of benefit entitlement and measures each unit separately to build up the final obligation. The obligation is measured at the present value of estimated future cash flows using a discount rate that is similar to the interest rate on government bonds where the currency and terms of the government bonds are consistent with the currency and estimated terms of the benefit obligation.

b) Share-based payments

The Company operates an equity-settled, share-based compensation plan allowing the Company's employees to receive shares. The fair value of the employee services received in exchange for the grant of the Company's shares is recognised as an expense with a corresponding increase in equity. The fair value is measured at grant date and spread over the period during which the employees become unconditionally entitled to the shares. The total amount to be expensed over the vesting period is determined by reference to the fair value of the shares granted. At each balance sheet date, the Company revises its estimates of the number of shares that are expected to become granted. It recognises the impact of the revision of original estimates, if any, in the statement of comprehensive income, with a corresponding adjustment to equity. When distributed upon vesting date, treasury shares are credited at average purchase cost and recorded against retained earnings.

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

Provisions

A provision is recognised when the Company has a present obligation (legal or constructive) as a result of a past event and it is probable (i.e. more likely than not) that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. Provisions are reviewed at each balance sheet date and adjusted to reflect the current best estimate. The most significant provisions in the financial statements are provisions for warranty claims, penalty claims and litigation. If the effect is material and if the obligation is expected to be settled in a period of over 12 months, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability. A provision for warranties is recognised when the underlying products or services are sold. The provision is based on historical warranty data and a weighting of all possible outcomes against their associated probabilities.

Net financial income

Net financial income comprises interest receivable on non-current loans, interest receivable on funds invested, foreign exchange gains and losses and gains and losses on financial assets at fair value through profit and loss and any cost related to borrowings. Interest income is recognised in the statement of comprehensive income as it accrues, using the effective interest method.

Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the Management Board that makes strategic decisions.

Borrowings

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

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

Leases

Leases on terms in which the Company assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition, the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that type of asset, although the depreciation period must not exceed the lease term.

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases, and the leased assets under such contracts are not recognized on the balance sheet. Payments made under operating leases (net of any incentives received from the lessor) are recognized in the statement of comprehensive income on a straight-line basis over the term of the lease.

Dividend distribution

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

Notes to the financial statements (continued)

2 Critical accounting estimates and judgements

Accounting estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The Company makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

(a) Impairment losses on loans and receivables

The Company reviews its loan portfolios to assess impairment on a monthly basis. In determining whether an impairment loss should be recorded in the statement of comprehensive income, the Company makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans and receivables before the decrease can be identified with an individual loan or receivable in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with parameters relevant to assets in the group.

(b) Financial crisis impact

The ongoing global liquidity crisis which commenced in the middle of 2007 has resulted in, among other things, a lower level of capital market funding, lower liquidity levels across the banking sector, and, at times, higher interbank lending rates and very high volatility in stock markets. The uncertainties in the global financial markets have also led to bank failures and bank rescues in the United States of America, Western Europe, Russia and elsewhere. Indeed the full extent of the impact of the ongoing financial crisis is proving to be impossible to anticipate or completely guard against.

The customers of the Company may also be affected by the lower liquidity situation which could in turn impact their ability to repay their outstanding debts. Deteriorating operating conditions for borrowers may also have an impact on management's cash flow forecasts and assessment of the impairment of financial and non-financial assets. To the extent that information is available, management has reflected revised estimates of expected future cash flows in their impairment assessments.

Notes to the financial statements (continued)

2 Critical accounting estimates and judgements (continued)

(b) Financial crisis impact (continued)

Management is unable to reliably estimate the effects on the Company's financial position of any further deterioration in the liquidity of the financial markets and the increased volatility in the currency and equity markets. Management believes it is taking all the necessary measures to support the sustainability and growth of the Company's business in the current circumstances.

Judgements

The Company has entered into several service contracts combining features and elements of other contracts for which Management has had to use judgement to determine appropriate accounting treatment.

Certain service contracts under which the Company also provides financing to the contracts are separated into sales revenue and financial income. The financial income is recognised using the effective interest over the life of the contract.

3 Sales revenue

	2011	2010
	HRK '000	HRK '000
Sales revenue from products	425,581	472,537
Sales revenue from services	740,079	746,326
	<u>1,165,660</u>	<u>1,218,863</u>

Notes to the financial statements (continued)

4 Segment reporting

The Company has determined the operating segments based on the reports reviewed by the Management Board that are used to make strategic decisions. The Management Board assesses the performance of the operating segments based on a measure of adjusted Operating profit. The measurement basis excludes the effects of gains/losses on disposal of intangibles, property, plant and equipment and administration expenses.

When determining the operating segments, the Company has looked at which market and to what type of customers the Company's products are aimed, and through what distribution channels they are sold, as well as to commonality regarding technology, research and development. Segment results and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis.

The Company is organised into business units and has three primary reportable operating segments as follows:

- Networks include products for mobile and fixed broadband access, core networks, transmission and next-generation IP networks. Related network rollout services are also included. In addition, power modules and cables operations are included within Networks.
- Professional services include all service operations, excluding Network rollout reported under Networks. Services related to system integration of IP and core networks are classified as Professional services.
- Multimedia includes multimedia systems, enterprise solutions and mobile platforms.

Segments are managed in Europe, the Middle East and Africa. Revenues determined based on the geographic location of customers are disclosed in this note. All the Company's assets are located in Croatia.

	2011	2010
	HRK '000	HRK '000
Sales revenue in domestic market	262,691	333,630
Sales revenue in Russia, Belarus, Kazakhstan, Georgia, Kyrgyzstan, Moldova, Uzbekistan and Armenia	133,675	222,792
Sales revenue to Ericsson, Note 29 (a)	461,247	430,992
Sales revenue in Bosnia and Herzegovina, Montenegro, Macedonia and Kosovo	269,631	206,067
Other export sales revenue	38,416	25,382
	<u>1,165,660</u>	<u>1,218,863</u>

Notes to the financial statements (continued)

4 Segment reporting (continued)

	Networks		Professional services		Multimedia		Total	
	2011	2010	2011	2010	2011	2010	2011	2010
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Segment sales revenue	658,674	779,021	467,037	393,801	39,949	46,041	1,165,660	1,218,863
Segment other income	8,286	9,850	5,875	4,979	503	582	14,664	15,411
Segment results from operating activities	<u>(9,715)</u>	<u>58,518</u>	<u>40,268</u>	<u>(31,970)</u>	<u>(11,504)</u>	<u>(7,579)</u>	<u>19,049</u>	<u>18,969</u>
Unallocated loss on disposal of property, plant and equipment							(1,638)	(181)
Unallocated expenses ¹⁾							<u>(29,363)</u>	<u>(34,037)</u>
Operating loss							<u>(11,952)</u>	<u>(15,249)</u>
Segment finance income	<u>1,858</u>	<u>8,206</u>	<u>2,106</u>	<u>4,481</u>	<u>2,427</u>	<u>3,019</u>	<u>6,391</u>	<u>15,706</u>
Segment results	<u>(7,857)</u>	<u>66,724</u>	<u>42,374</u>	<u>(27,489)</u>	<u>(9,077)</u>	<u>(4,560)</u>	<u>25,440</u>	<u>34,675</u>
Unallocated finance income							28,089	25,702
Finance expense							<u>(178)</u>	<u>(192)</u>
Profit before tax							22,350	25,967
Income tax							5,626	(1,905)
Profit for the year							<u>27,976</u>	<u>24,062</u>
Other segment information:								
Segment liabilities	121,787	143,298	86,353	72,438	7,386	8,469	215,526	224,205
Additions to property, plant and equipment	29,800	23,350	21,130	11,803	1,807	1,380	52,737	36,533
Acquisitions of intangible assets	855	2,047	606	1,035	52	121	1,513	3,203
Depreciation and amortisation	22,745	29,789	16,127	15,059	1,379	1,760		

¹⁾Including audit fee expenses of HRK 420 thousand (2010: HRK 420 thousand)

Revenues of approximately HRK 713,764 thousand (2010: HRK 673,518 thousand) are derived from external customers whose single revenues are 10 per cent or more of Company's sales revenues, and they are realised in all three segments.

Notes to the financial statements (continued)

4 Segment reporting (continued)

Reportable segments' liabilities are reconciled to total liabilities as follows:

	2011	2010
	HRK '000	HRK '000
Segment liabilities	215,526	224,205
Unallocated:		
Interest-bearing borrowings	3,482	5,019
Accrued charges and deferred revenue	80,139	111,610
Trade and other payables	36,414	8,412
Employee benefits	4,530	4,891
Total liabilities per the statement of financial position	<u>340,091</u>	<u>354,137</u>

5 Expenses by nature

	2011	2010
	HRK '000	HRK '000
Changes in contract work in progress (Note 16)	10,147	(21,817)
Goods and services	637,460	636,144
Personnel expenses (Note 8)	419,490	432,419
Depreciation and amortisation (Notes 12,13)	48,441	56,831
Total cost of sales, distribution and administrative expenses	<u>1,115,538</u>	<u>1,103,577</u>

6 Other income

	2011	2010
	HRK '000	HRK '000
Commission income	863	251
Rental income	13,081	14,631
Other income	720	529
	<u>14,664</u>	<u>15,411</u>

Notes to the financial statements (continued)

7 Other expenses

	2011	2010
	HRK '000	HRK '000
Net loss on disposal of property, plant and equipment	1,638	181
Increase in provisions	6,824	5,916
Impairment loss on loans and receivables (Note 17)	58,929	139,543
Obsolescence allowance on inventories	9,347	306
	<u>76,738</u>	<u>145,946</u>

8 Personnel expenses

	2011	2010
	HRK '000	HRK '000
Net salaries	207,741	210,573
Taxes and contributions	189,238	191,286
Other payroll-related costs	18,517	24,436
Equity-settled transactions (Note 25 (b))	3,994	6,124
	<u>419,490</u>	<u>432,419</u>

Personnel expenses include HRK 67,421 thousand (2010: HRK 68,415 thousand) of defined pension contributions paid or payable into obligatory pension plans. Contributions are calculated as a percentage of employees' gross salaries (Gross II).

In addition, Personnel expenses include HRK 3,534 thousand (2010: HRK 13,868 thousand) in respect of voluntary redundancy costs. Movements in provision related to these costs are described in Note 27, Provisions.

As at 31 December 2011, total number of employees was 1,636 (2010: 1,595).

Notes to the financial statements (continued)

9 Finance income and expense

Finance income

	2011	2010
	HRK '000	HRK '000
Interest income (Note 9 (a))	19,450	23,506
Net gains from remeasurement of financial assets at fair value through profit or loss (Note 9 (c))	1,129	4,026
Amortization of discount (Note 9 (b))	3,545	6,254
Net foreign exchange gain	10,356	7,622
	<u>34,480</u>	<u>41,408</u>

Finance expense

	2011	2010
	HRK '000	HRK '000
Interest expense	178	192
	<u>178</u>	<u>192</u>

9 (a)

	2011	2010
	HRK '000	HRK '000
Interest income		
- on loans to customers	3,871	8,623
- on debt securities	660	998
- on term deposits	14,436	12,584
- on other receivables	483	1,301
	<u>19,450</u>	<u>23,506</u>

9 (b)

The Company released HRK 3,545 thousand (2010: HRK 6,254 thousand) into finance income due to amortisation of discount according to the net present value method of impairment.

Notes to the financial statements (continued)

9 Finance income and expense (continued)

9 (c)

	2011	2010
	HRK '000	HRK '000
Net gains/(losses) from remeasurement of financial assets at fair value through profit or loss		
- Derivative financial instruments	(466)	-
- Equity securities	236	1,388
- Investment in investment funds	1,560	2,671
- Debt securities	(201)	(33)
	<u>1,129</u>	<u>4,026</u>

10 Income tax expense

Income tax has been calculated on the taxable income at statutory tax rate of 20% (2010: 20%).

Income tax expense recognised in the statement of comprehensive income comprises:

	2011	2010
	HRK '000	HRK '000
Current income tax expense	<u>-</u>	<u>-</u>
Total deferred tax income/(expense) relating to the origination and reversal of temporary differences (Note 15)	5,626	(1,905)
Total income tax (charge)/credit in the statement of comprehensive income	<u>5,626</u>	<u>(1,905)</u>

Deferred tax recognised directly as a debit to equity:

	2011	2010
	HRK '000	HRK '000
Relating to equity-settled transactions (Note 15)	<u>799</u>	<u>1,225</u>

Notes to the financial statements (continued)

10 Income tax expense (continued)

The reconciliation between tax expense and accounting profit is shown as follows:

	2011	2010
	HRK '000	HRK '000
Profit before tax	22,350	25,967
Income tax at 20% (2010: 20%)	4,470	5,193
Tax effects of:		
Non-deductible expenses	8,990	1,786
Tax exempt (revenues)/expenses	663	(3,338)
Tax incentives	<u>(14,123)</u>	<u>(3,641)</u>
Current tax expense	<u>-</u>	<u>-</u>
Effective tax rate	<u>0.0%</u>	<u>0.0%</u>

Tax incentives include only part of additional tax allowances for certain expenditure totalling HRK 14,123 thousand (2010: HRK 3,641 thousand) which meets research and development incentives definitions under Croatian tax legislation. The underlying research and development expenditure is included in cost of sales.

In accordance with local regulations, the Tax Authority may at any time inspect the Company's books and records within 3 years following the end of the year in which the tax liability is reported and may impose additional tax assessments and penalties. The Company's management is not aware of any circumstances, which may give rise to a potential material liability in this respect.

11 Earnings per share

	2011	2010
Profit for the year (HRK '000)	27,976	24,062
Weighted Average Number of Shares Outstanding at the year-end	<u>1,323,780</u>	<u>1,314,812</u>
Earnings per share (HRK)	<u>21.13</u>	<u>18.30</u>

Basic and fully diluted earnings per share are the same since the Company does not have any dilutive potential ordinary shares.

Notes to the financial statements (continued)

12 Property, plant and equipment

	Land and buildings HRK '000	Plant and equipment HRK '000	Other HRK '000	Total HRK '000
As at 1 January 2010				
Cost or valuation	155,455	312,094	328	467,877
Accumulated depreciation	(96,065)	(225,272)	(189)	(321,526)
Net book amount	<u>59,390</u>	<u>86,822</u>	<u>139</u>	<u>146,351</u>
Year ended 31 December 2010				
Opening net book amount	59,390	86,822	139	146,351
Additions	-	36,533	-	36,533
Disposals	-	(224)	-	(224)
Depreciation charge	(3,542)	(50,467)	(8)	(54,017)
Closing net book amount	<u>55,848</u>	<u>72,664</u>	<u>131</u>	<u>128,643</u>
As at 31 December 2010				
Cost or valuation	155,455	293,754	328	449,537
Accumulated depreciation	(99,607)	(221,090)	(197)	(320,894)
Net book amount	<u>55,848</u>	<u>72,664</u>	<u>131</u>	<u>128,643</u>
Year ended 31 December 2011				
Opening net book amount	55,848	72,664	131	128,643
Additions	-	52,737	-	52,737
Disposals	-	(1,728)	-	(1,728)
Depreciation charge	(3,307)	(42,223)	(8)	(45,538)
Closing net book amount	<u>52,541</u>	<u>81,450</u>	<u>123</u>	<u>134,114</u>
As at 31 December 2011				
Cost or valuation	155,455	311,331	328	467,114
Accumulated depreciation	(102,914)	(229,881)	(205)	(333,000)
Net book amount	<u>52,541</u>	<u>81,450</u>	<u>123</u>	<u>134,114</u>

Included in cost of property, plant and equipment is HRK 165,348 thousand (2010: HRK 206,698 thousand) of fully depreciated property, plant and equipment that is still used by the Company.

As at 31 December 2011, the Company had contracts totalling HRK 2,158 thousand (2010: HRK 6,025 thousand) related to future equipment purchases.

Notes to the financial statements (continued)

12 Property, plant and equipment *(continued)*

The Company acts as a lessor under operating leases, mainly land and buildings. Property leased to others with a carrying value of HRK 17,490 thousand (2010: HRK 22,552 thousand) is included within land and buildings. These assets are depreciated at the same depreciation rates as other buildings. HRK 18,351 thousand (2010: 16,529 thousand) of leased assets is leased for a non-cancellable period of five years which commenced in 2005. Subsequent renewals are negotiated with the lessee. No contingent rents are charged. Portions of the property which is held for rental could not be sold separately or leased out separately under finance lease. Consequently, the IAS 40 criteria for separate investment property recognition are not met.

Future minimum lease payments under non-cancellable operating leases in the aggregate and for each of the following periods are:

	2011	2010
	HRK '000	HRK '000
Less than one year	3,164	4,058
Between one and five years	1,582	-
	<u>4,746</u>	<u>4,058</u>

Notes to the financial statements (continued)

13 Intangible assets

The movement on intangible assets in the year ended 31 December 2011 may be analysed as follows:

	Application software HRK '000
As at 1 January 2010	
Cost or valuation	16,264
Accumulated amortization	(11,839)
Net book amount	<u>4,425</u>
Year ended 31 December 2010	
Opening net book amount	4,425
Additions	3,203
Amortization charge	(2,814)
Closing net book amount	<u>4,814</u>
As at 31 December 2010	
Cost or valuation	19,467
Accumulated amortization	(14,653)
Net book amount	<u>4,814</u>
Year ended 31 December 2011	
Opening net book amount	4,814
Additions	1,513
Amortization charge	(2,903)
Closing net book amount	<u>3,424</u>
As at 31 December 2011	
Cost or valuation	18,371
Accumulated amortization	(14,947)
Net book amount	<u>3,424</u>

Included in cost of intangible assets is HRK 11,933 thousand (2010: HRK 9,641 thousand) of fully amortised intangible assets that are still used by the Company.

Notes to the financial statements (continued)

14 Loans and receivables

	2011	2010
	HRK '000	HRK '000
Deposits with financial institutions, denominated in foreign currency	8,834	7,076
Non-current receivables from foreign customers, denominated in foreign currency	32,717	15,600
Non-current receivables from domestic customers, denominated in HRK	2,335	-
Receivables for sold apartments		
- denominated in foreign currency	5,517	5,430
- denominated in HRK	629	1,193
Total loans and receivables	<u>50,032</u>	<u>29,299</u>
Impairment allowance on loans and receivables	<u>(4,860)</u>	<u>(18,941)</u>
	<u>45,172</u>	<u>10,358</u>

Deposits with financial institutions of HRK 7,293 thousand (2010: 7,076 thousand) are placed as guarantee deposits for housing loans provided to the Company's employees, earning interest at fixed rate 0.37% per annum (2010: 1.07% to 1.10% per annum), and with a remaining maturity of over three years. The remaining amount of HRK 1,541 thousand (2010: nil) relates to guarantee deposit for customer financing, bearing interest at twelve-month USD LIBOR plus 0.50 pp per annum and maturing in 2014.

Receivables from customers are partially secured with bank guarantees and letters of credit. The current portion of the non-current receivables is classified under current assets.

Non-current portion of foreign and domestic loans and receivables

Due	2011	2010
	HRK '000	HRK '000
2012	-	11,582
2013	18,224	4,018
2014	12,104	-
2015-2020	4,723	-
	<u>35,051</u>	<u>15,600</u>

Receivables for sold apartments are shown net of amounts due to the Croatian state. Housing loans to employees are linked to the counter value of euro, repayments are made by deduction from monthly salary and the loans are secured with charges on the house or apartment. Receivables for sold apartments and housing loans provided to a limited number of employees bear fixed interest rates of up to 5% per annum. A discount in the amount of HRK 2,272 thousand (2010: HRK 2,334 thousand) is recognised in respect of these loans and amortised through the statement of comprehensive income, using the effective interest rate method at a rate of 7% per annum (2010: 7% per annum).

Notes to the financial statements (continued)

15 Deferred tax assets

Recognised deferred tax assets and liabilities

Movements in temporary differences and components of deferred tax assets and liabilities are as follows:

	2011		Credited/ (charged) to statement of comprehensive income	Credited/ (charged) to equity	2010		Credited/ (charged) to statement of comprehensive income	Credited/ (charged) to equity
	Assets HRK '000	Liabilities HRK '000	2011 HRK '000	2011 HRK '000	Assets HRK '000	Liabilities HRK '000	2010 HRK '000	2010 HRK '000
Receivables	8,890	-	2,747	-	6,143	-	148	-
Inventories	2,260	-	1,809	-	451	-	11	-
Employee benefits	826	-	1	-	825	-	6	-
Non-current receivables for sold apartments	454	-	(13)	-	467	-	(157)	-
Negative fair value of financial instruments	447	-	-	-	447	-	-	-
Accrued charges	1,115	-	283	-	832	-	(3,138)	-
Increase in equity related to equity- settled transactions	12,143	(12,143)	799	(799)	11,344	(11,344)	1,225	(1,225)
	26,135	(12,143)	5,626	(799)	20,509	(11,344)	(1,905)	(1,225)
Set-off of tax	(12,143)	12,143	-	-	(11,344)	11,344	-	-
Deferred tax assets	13,992	-	5,626	(799)	9,165	-	(1,905)	(1,225)

Notes to the financial statements (continued)

15 Deferred tax assets (continued)

Deferred income tax assets are recognised for tax loss carry-forwards to the extent that the realisation of the related tax benefit through future taxable profits is probable. The Company did not recognise deferred income tax assets of HRK 56,927 thousand (2010: HRK 46,497 thousand) in respect of tax losses amounting to HRK 284,633 thousand (2010: HRK 232,485 thousand) that can be carried forward against future taxable income. A tax loss may be carried forward for five years subsequent to the year in which it was incurred. The availability of tax losses against future periods, subject to review by the Ministry of Finance, is as follows:

	HRK '000
Tax loss from 2009 – expires 31 December 2014	81,277
Tax loss from 2010 – expires 31 December 2015	151,208
Tax loss from 2011 – expires 31 December 2016	52,148
	<u>284,633</u>

16 Inventories

	2011	2010
	HRK '000	HRK '000
Raw materials	3,445	6,569
Contract work in progress	29,327	39,474
Total inventories	32,772	46,043
Obsolescence allowance	(10,067)	(1,269)
	<u>22,705</u>	<u>44,774</u>

Slow-moving or obsolete inventories have been written down to their estimated realisable value through an impairment allowance. The impairment allowance is included within other operating expenses in the statement of comprehensive income.

Notes to the financial statements (continued)

17 Trade receivables

	2011	2010
	HRK '000	HRK '000
Foreign trade receivables	164,964	169,064
Current portion of non-current foreign receivables	23,485	58,104
Total current foreign receivables	<u>188,449</u>	<u>227,168</u>
Domestic trade receivables	124,889	116,397
Current portion of non-current domestic receivables	6,622	18,102
Total current domestic receivables	<u>131,511</u>	<u>134,499</u>
Impairment allowance on receivables	<u>(46,495)</u>	<u>(14,685)</u>
	<u>273,465</u>	<u>346,982</u>

Included in trade receivables is HRK 4,197 thousand (2010: HRK 31,534 thousand) of contract work in progress.

Movements in impairment allowance on loans and receivables were as follows:

	2011	2010
	HRK '000	HRK '000
As at 1 January (Notes 14, 17)	33,626	33,270
Provision for receivables impaired during the year (Note 7)	80,227	147,276
Receivables written off during the year as uncollectible	(37,655)	(132,933)
Unused amounts reversed (Note 7)	(21,298)	(7,733)
Amortisation of discount (Note 9 (b))	(3,545)	(6,254)
As at 31 December (Notes 14, 17)	<u>51,355</u>	<u>33,626</u>

Receivables are written down to their estimated realisable value through an impairment allowance.

During 2010, following the restructuring of JSC BTA Bank, Kazakhstan ("BTA Bank"), the Company has written off HRK 126,492 thousand in respect of balances outstanding relating to a Customer Financing transaction concluded in 2005. The transaction was fully secured by trade finance instruments from BTA Bank.

Of the total HRK 51,355 thousand of impairment allowances as at 31 December 2011, HRK 49,083 thousand relates to Customer loans and receivables.

Notes to the financial statements (continued)

18 Other receivables

	2011	2010
	HRK '000	HRK '000
Net receivables for prepaid VAT	8,725	27,845
Receivables for withholding tax	2	27,031
Receivables from employees	318	925
Accrued interest receivable	2,307	1,501
Other receivables	954	930
	<u>12,306</u>	<u>58,232</u>

Receivables for withholding tax have been written down to their estimated realisable value through an impairment allowance.

19 Financial assets at fair value through profit or loss

	2011	2010
	HRK '000	HRK '000
<i>Financial assets at fair value through profit or loss</i>		
- Debt securities, Ministry of Finance	13,480	13,706
- Equity securities	630	670
- Investment in open-ended investment funds	54,139	48,878
	<u>68,249</u>	<u>63,254</u>

20 Cash and cash equivalents

	2011	2010
	HRK '000	HRK '000
Cash and demand deposits	56,862	129,622
Term deposits originated by the Company, with original maturity up to 3 months	468,356	544,304
	<u>525,218</u>	<u>673,926</u>

Notes to the financial statements (continued)

21 Equity

(a) Share capital

As at 31 December 2011, the share capital of the Company is represented by 1,331,650 (2010: 1,331,650) of authorised, issued and fully paid ordinary shares, with a total registered value of HRK 133,165 thousand (2010: HRK 133,165 thousand). The nominal value of one share is HRK 100 (2010: HRK 100). The holders of the ordinary shares are entitled to receive dividends as declared at the General Assembly and are entitled to one vote per share at the General Assembly.

The Company's shareholders as at 31 December 2011 are:

	2011	2011	2010	2010
	Number of shares	% held	Number of shares	% held
Telefonaktiebolaget LM Ericsson	653,473	49.07	653,473	49.07
Small shareholders	670,844	50.38	665,793	50.00
Croatian Privatisation Fund	3,096	0.23	3,096	0.23
Treasury shares	4,237	0.32	9,288	0.70
	<u>1,331,650</u>	<u>100.00</u>	<u>1,331,650</u>	<u>100.00</u>

(b) Treasury shares

During 2007, the Company acquired 15,000 of its own shares. The amount paid was HRK 52,456 thousand out of 2006 net income as decided by the General Assembly held on 31 May 2007. During 2008, the Company acquired an additional 3,000 of its own shares. The amount paid was HRK 3,895 thousand out of 2006 net income, as decided by the General Assembly held on 31 May 2007. During 2009, the Company acquired an additional 8,893 of its own shares. The amount paid was HRK 11,380 thousand out of 2008 net income as decided by the General Assembly held on 27 May 2008. These shares are held as "treasury shares" and will be granted to key management and other employees as a part of the share-based program established during 2004, as described in Note 25 (b).

Movements in treasury shares are as follows:

	2011	2010
	Number of shares	Number of shares
As at 1 January (Note 21 (a))	9,288	14,468
Purchases during the year	-	-
Distributed during the year	(5,051)	(5,180)
As at 31 December (Note 21 (a))	<u>4,237</u>	<u>9,288</u>

(c) Legal reserves

A legal reserve in the amount of 5% of total share capital was formed during previous periods by appropriation of 5% of net profit per annum up to a cap of 5% of share capital. The legal reserve may be used to cover losses if the losses are not covered by current net profit or if other reserves are not available. The Company recorded the required level of legal reserves in the year 2000 and no further allocation to legal reserves is required.

Notes to the financial statements (continued)

22 Proposed dividends

Dividends payable are not accounted for until they have been ratified at the General Assembly of shareholders. On 31 May 2011, the General Assembly approved a regular dividend in respect of 2010 of HRK 20.00 per share, and additional extraordinary dividend of HRK 170,00 per share, totalling HRK 251,3 million. At a meeting held on 20 February 2012, the Management Board proposed a regular dividend in respect of 2011 in the amount of HRK 20.00 per share, and an additional extraordinary dividend of HRK 150.00 per share. The dividend will be paid from profit for 2001 and 2002 plus a portion of retained earnings realized in 2003 after approval by the General Assembly, which will be held on 5 June 2012.

Cash dividends authorised and paid for previous years were as follows:

	2011	2010
	HRK '000	HRK '000
HRK 190.00 per share for 2010	251,289	-
HRK 120.00 per share for 2009	-	158,160
	<u> </u>	<u> </u>

23 Capital management

The Company's objectives when managing capital are:

- To safeguard the entity's ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders;
- To provide adequate requirements for capital resources, as far as possible, by the retention of profit; and
- To maintain the balance sheet with a large component of cash and short-term assets, as well as equity and other investments.

The Company is generating sufficient cash from operations to fund liabilities as they become due, finance customers and budgeted investments, and pay dividends.

The Company monitors capital using the statutory minimum capital requirement. Shareholders' equity is disclosed in Note 21 to the financial statements.

Notes to the financial statements (continued)

24 Interest-bearing borrowings

During 2008, the Company borrowed HRK 8,085 thousand from HBOR and delivered information and communications equipment to a customer. The Ministry of Health and Social Welfare ("the Ministry") took over the obligations towards the Company on behalf of the customer and, based on the cession agreement between the Company, the customer and the Ministry, the Ministry is obliged to repay the due amounts in favour of the customer directly to HBOR. The Company's liability to HBOR decreases as the Ministry repays. The HBOR borrowing was granted over a 5-year period. The current portion of the borrowing amounts to HRK 2,047 thousand, while the remaining amount is repayable in semi-annual instalments until 2013, bearing an interest rate of six-month EURIBOR plus a margin of 2% per annum. There is no security or pledges in relation to these borrowings. There are no amounts bearing a fixed interest rate.

	2011	2010
	HRK '000	HRK '000
Non-current portion of borrowings	1,435	3,346
Current portion of borrowings	2,047	1,673
	<u>3,482</u>	<u>5,019</u>

25 Employee benefits

(a) Long-term service benefits

The Company does not operate any pension schemes or other retirement benefit schemes for the benefit of any of its employees or management. In respect of all of the Company's personnel, such social payments as required by the authorities are paid. These contributions form the basis of social benefits payable out of the Croatian Pension Insurance Institute to the Croatian employees upon their retirement. Additionally, during 2001 the Company signed an Annex to the Union Agreement based on which employees are entitled to a benefit upon early retirement.

However, the Company pays a one-time benefit amounting to HRK 8,000 for each employee who retires. Additionally, the Company pays jubilee awards in respect of each 5 years of service, of an employee, starting from the 10th year and ending in the 40th year. The principal actuarial assumptions used to determine retirement and jubilee obligations as at 31 December 2011 were a 6% discount rate (2010: 6%) and a 2.75% (2010: 2.91%) rate of average employment turnover.

Notes to the financial statements (continued)

25 Employee benefits (continued)

(a) Long-term service benefits (continued)

Movements in long-term service benefits were as follows:

	2011	2011	2011	2010	2010	2010
	Jubilee awards	Retirement	Total	Jubilee awards	Retirement	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
As at 1 January	4,123	768	4,891	4,095	1,031	5,126
Obligation created during the year	507	71	578	706	514	1,220
Obligation fulfilled during the year	(447)	(8)	(455)	(615)	(88)	(703)
Obligation reversed during the year	(55)	(429)	(484)	(63)	(689)	(752)
As at 31 December	<u>4,128</u>	<u>402</u>	<u>4,530</u>	<u>4,123</u>	<u>768</u>	<u>4,891</u>

(b) Share-based payments

During 2004, the Company established its Loyalty program, a share-based scheme under which management and other employees are entitled to receive the Company's shares conditional on the employee completing certain years of service (the vesting period) from the grant date.

In addition, the Company also grants treasury shares to senior management and other employees as a bonus arrangement under its Award program.

The treasury shares are distributed to eligible employees upon ratification at the General Assembly.

Notes to the financial statements (continued)

25 Employee benefits (continued)

(b) Share-based payments (continued)

The terms and conditions of the grants are as follows:

Employees entitled/grant date	Number of granted shares	Vesting conditions
<i>Loyalty program</i>		
Share grant to key management during 2004	690	Three to five years of service
Share grant to other employees during 2004	8,355	Three to five years of service
Share grant to key management during 2005	-	Three to five years of service
Share grant to other employees during 2005	(125)	Three to five years of service
Share grant to key management during 2006	-	Three to five years of service
Share grant to other employees during 2006	4,575	Three to five years of service
Share grant to key management during 2007	-	Three to five years of service
Share grant to other employees during 2007	(145)	Three to five years of service
Share grant to key management during 2008	450	Three to five years of service
Share grant to other employees during 2008	2,285	Three to five years of service
Share grant to key management during 2009	-	Three to five years of service
Share grant to other employees during 2009	-	Three to five years of service
Share grant to key management during 2010	-	Three to five years of service
Share grant to other employees during 2010	-	Three to five years of service
Share grant to key management during 2011	550	Three to four years of service
Share grant to other employees during 2011	6,650	Three to four years of service
	23,285	
<i>Award program</i>		
Share grant to key management during 2004	1,640	Upon granting
Share grant to other employees during 2004	730	Upon granting
Share grant to key management during 2005	-	Upon granting
Share grant to other employees during 2005	-	Upon granting
Share grant to key management during 2006	1,200	Upon granting
Share grant to other employees during 2006	-	Upon granting
Share grant to key management during 2007	3,162	Upon granting
Share grant to other employees during 2007	2,577	Upon granting
Share grant to key management during 2008	1,287	Upon granting
Share grant to other employees during 2008	2,430	Upon granting
Share grant to key management during 2009	51	Upon granting
Share grant to other employees during 2009	2,886	Upon granting
Share grant to key management during 2010	1,252	Upon granting
Share grant to other employees during 2010	123	Upon granting
Share grant to key management during 2011	333	Upon granting
Share grant to other employees during 2011	908	Upon granting
	18,579	

Notes to the financial statements (continued)

25 Employee benefits (continued)

(b) Share-based payments (continued)

The fair value of service received in return for shares granted is measured by reference to the observable market price of shares at the grant date.

	Number of granted shares	Weighted average fair value per share HRK
Shares granted in 2004	11,415	656.68
Shares granted in 2005	(125)	735.99
Shares granted in 2006	5,775	2,330.18
Shares granted in 2007	5,594	3,387.12
Shares granted in 2008	6,452	1,380.27
Shares granted in 2009	2,937	1,320.34
Shares granted in 2010	1,375	1,382.73
Shares granted in 2011	8,441	1,160.00

During 2011, the Company recognised HRK 3,994 thousand (2010: HRK 6,124 thousand) of expenses in respect of share-based payments, which are included in personnel expenses as disclosed in Note 8. During 2011, there were new Loyalty programs (2010: none). The Award program for 2011 included "the length of service with the Company component" and the shares granted under this program were distributed during 2011. Shares granted under previous programs to employees who left the Company before vesting date expired.

3,745 of shares granted under the Loyalty programs from previous years vested during 2011. The total weighted average cost of shares granted during 2011 under the Award and Loyalty programs amounted to HRK 7,808 thousand (2010: HRK 17,922 thousand).

Movements in shares under the Award and Loyalty programs are as follows:

	2011 Number of shares	2010 Number of shares
As at 1 January	5,900	9,705
Granted	8,441	1,375
Exercised	(5,051)	(5,180)
Expired	(70)	-
As at 31 December	<u>9,220</u>	<u>5,900</u>

Notes to the financial statements (continued)

26 Trade and other payables

	2011	2010
	HRK '000	HRK '000
Trade payables	36,996	38,495
Liabilities to employees	38,231	42,612
Other current liabilities	13,042	13,273
	<u>88,269</u>	<u>94,380</u>

27 Provisions

Movements in provisions were as follows:

	2011	2011	2011	2011	2010	2010	2010	2010
	Warranty	Penalty	Voluntary	Total	Warranty	Penalty	Voluntary	Total
	reserve	reserve	redundancy	HRK	reserve	reserve	redundancy	HRK
	HRK	HRK	HRK '000	'000	HRK	HRK	HRK	'000
	'000	'000		'000	'000	'000	'000	'000
As at 1 January	10,356	6,347	394	17,097	10,002	3,444	10,284	23,730
Provision created during the year	3,861	6,793	3,534	14,188	4,968	7,319	13,868	26,155
Provision reversed during the year	(1,608)	(2,140)	-	(3,748)	(2,997)	(3,374)	-	(6,371)
Provision used during the year	(4,478)	-	(1,091)	(5,569)	(1,617)	(1,042)	(23,758)	(26,417)
As at 31 December	<u>8,131</u>	<u>11,000</u>	<u>2,837</u>	<u>21,968</u>	<u>10,356</u>	<u>6,347</u>	<u>394</u>	<u>17,097</u>

The warranty reserve is established to cover the expected warranty claims on products sold during the year. The penalty reserve is created to cover the expected claims from customers in respect of delays in deliveries of products and services having occurred during the year. Reversal of warranty reserves relates to expired warranties and reversal of penalty reserve relates to waived or expired obligations.

An agreement was reached with the local union representatives, which specifies the number of staff involved and the early retirement compensation package offered by the Company, as well as amounts payable to those having accepted the package, before the financial year-end. The estimated staff restructuring costs to be incurred in 2012 are HRK 2,837 thousand (2010: HRK 394 thousand).

Notes to the financial statements (continued)

28 Accrued charges and deferred revenue

	2011	2010
	HRK '000	HRK '000
Advances from domestic customers	3,044	376
Advances from foreign customers	5,340	10,140
Deferred revenue	107,530	67,977
Accrued charges for unused holidays	10,701	10,927
Accrued charges for legal claims	951	951
Accrued charges in respect of service contracts	30,627	24,974
Other accrued charges	12,912	22,559
	<u>171,105</u>	<u>137,904</u>

Deferred revenue represents amounts due to customers under contracts for work not performed.

Accrued charges in respect of service contracts mainly represent costs incurred for which no invoice has been received at the balance sheet date.

Notes to the financial statements (continued)

29 Balances and transactions with related parties

For the purposes of these financial statements, parties are generally considered to be related if one party has the ability to control the other party, is under common control, or can exercise significant influence over the other party in making financial and operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

The Company is a related party to the Ericsson Group via the 49.07% (2010: 49.07%) shareholding by Telefonaktiebolaget LM Ericsson, which is also the ultimate parent of the Ericsson Group.

The Company has a related-party relationship with Telefonaktiebolaget LM Ericsson, Ericsson Group subsidiaries and associates, the Supervisory Board, the Management Board and other executive management.

(a) Key transactions with the related parties

Major transactions with the Ericsson Group companies may be summarised as follows:

	Telefonaktiebolaget LM Ericsson		Other Ericsson Group consolidated companies		Total	
	2011 HRK '000	2010 HRK '000	2011 HRK '000	2010 HRK '000	2011 HRK '000	2010 HRK '000
Sales of goods and services						
Sales revenue	-	-	461,247	430,992	461,247	430,992
Commission income	-	-	863	295	863	295
Other income			34,573	13,845	34,573	13,845
	<u>-</u>	<u>-</u>	<u>496,683</u>	<u>445,132</u>	<u>496,683</u>	<u>445,132</u>
Purchases of goods and services						
Licences	3,343	3,798	17,791	25,519	21,134	29,317
Technical cooperation fee	-	-	7,202	14,575	7,202	14,575
Cost of sales	452	179	363,100	373,886	363,552	374,065
	<u>3,795</u>	<u>3,977</u>	<u>388,093</u>	<u>413,980</u>	<u>391,888</u>	<u>417,957</u>

The sales of goods and services transactions have been directly negotiated between the involved parties and agreed on an individual basis. The Company pays licence fees on sales of wireline products, sales of services, corporate trade mark licences and technical cooperation fees. The licence fee is paid as a percentage of sales of wireline products and solutions, and sales of services, per product sold. The transactions between related parties are carried out on an arm's length basis.

Notes to the financial statements (continued)

29 Balances and transactions with related parties (continued)

(b) Key management compensation

The Company's key management include the executive management listed on page 3, comprising the Management Board member and directors of the main organisational units.

	2011	2010
	HRK '000	HRK '000
Salaries and other short-term employee benefits	16,754	14,885
Other long-term benefits	14	6
Share-based payments	226	1,392
	<u>16,994</u>	<u>16,283</u>

The members of the executive management and the Supervisory Board held 4,421 ordinary shares at the year-end (2010: 4,951 shares).

In addition, the Company paid remuneration totalling HRK 337 thousand (2010: HRK 279 thousand) to the Supervisory Board.

(c) Year-end balances arising from sales and purchases of goods and services

Year-end balances arising from key transactions with Ericsson Group companies may be summarised as follows:

	Receivable		Payable	
	2011	2010	2011	2010
	HRK '000	HRK '000	HRK '000	HRK '000
Main shareholder				
Telefonaktiebolaget LM Ericsson (LME)	-	-	474	(845)
Ericsson Group consolidated companies				
Ericsson AB (EAB)	57,904	52,182	45,673	90,364
Ericsson GMBH Group (EDD)	6,578	1,645	-	543
Ericsson Austria GMBH (SEA)	2,452	304	-	-
Ericsson LM Nigeria (LMN)	1,813	225	-	-
Ericsson Hungary Ltd. (ETH)	1,806	1,160	704	1,004
Ericsson Spain S.A. (EEM)	1,705	106	82	39
Ericsson Telecommunicatia B.V. (ETM)	1,462	3,583	1,290	1,383
Ericsson Ltd. Madrid, Spain (ETL)	1,414	656	-	-
Ericsson Corporation, Russia (ECR)	1,131	62	170	66
Other Ericsson Group companies	11,226	15,483	2,818	1,447
	<u>87,491</u>	<u>75,406</u>	<u>50,737</u>	<u>94,846</u>

Notes to the financial statements (continued)

30 Financial risk management

The Company's activities expose it to a variety of financial risks: market risk (including currency risk, interest rate risk, and price risk), credit risk and liquidity risk. Exposure to currency, interest rate and credit risk arises in the normal course of the Company's business. Risk management is carried out by a treasury department and its principal role is to actively manage investment of excess liquidity as well as financial assets and liabilities, and to manage and control financial risk exposures. The Company also has a customer finance function with the main objective to find suitable third-party financing solutions for customers and to minimize recourse to the Company. Risk management policies that relate to financial instruments can be summarised as follows:

(a) Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Company is exposed to US dollars and to euro, as a substantial proportion of receivables and foreign revenues are denominated in these currencies. Risk management relies on attempts to match, as much as possible, revenues in each currency with the same currency expenditure. The Company may enter into foreign currency forward contracts to hedge economically its exposure to currency risk arising on operating cash flows.

As at 31 December 2011, if euro had weakened/strengthened by 1.35% (2010: 1.14%) against Croatian kuna, and if the US dollar had weakened/strengthened by 0.28% (2010: 5.52%), with all other variables held constant, the net result after tax for the reporting period would have been HRK 8.440 thousand lower/higher (2010: HRK 8.590 thousand), mainly as a result of foreign exchange gains/losses on translation of significant cash, cash equivalents, deposits, customer receivables and customer financing denominated in euro.

Notes to the financial statements (continued)

30 Financial risk management (continued)

(a) Currency risk (continued)

The tables below present the currency analysis and resulting gap.

2011

	EUR	USD	Other currency	Total foreign currencies	HRK	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Loans and receivables	32,769	10,068	-	42,837	2,335	45,172
Trade and other receivables	211,972	20,731	23	232,726	140,536	373,262
Financial assets at fair value through profit or loss	-	-	-	-	68,249	68,249
Cash and cash equivalents	490,732	13,524	38	504,294	20,924	525,218
	735,473	44,323	61	779,857	232,044	1,011,901
Interest-bearing borrowings*	3,725	-	-	3,725	-	3,725
Trade and other payables	51,018	6,586	1,845	59,449	79,557	139,006
	54,743	6,586	1,845	63,174	79,557	142,731
Currency gap	680,730	37,737	(1,784)	716,683	152,487	869,170

* include interest payable of HRK 243 thousand

2010

	EUR	USD	Other currency	Total foreign currencies	HRK	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Loans and receivables	10,358	-	-	10,358	-	10,358
Trade and other receivables	258,262	38,512	-	296,774	186,900	483,674
Financial assets at fair value through profit or loss	-	-	-	-	63,254	63,254
Cash and cash equivalents	652,110	4,264	-	656,374	17,552	673,926
	920,730	42,776	-	963,506	267,706	1,231,212
Interest-bearing borrowings*	5,505	-	-	5,505	-	5,505
Trade and other payables	104,222	9,545	471	114,238	74,988	189,226
	109,727	9,545	471	119,743	74,988	194,731
Currency gap	811,003	33,231	(471)	843,763	192,718	1,036,481

* include interest payable of HRK 486 thousand

Notes to the financial statements (continued)

30 Financial risk management (continued)

(b) Interest rate risk

Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates. As the Company mainly has its customer financing at a fixed interest rate and only a small portion of customer financing is affected by possible changes in market interest rates, the risk of fluctuating market interest rates is rather low. The Company also has borrowings and deposits in financial institutions at a variable interest rate, as well as investments in money investment funds that are sensitive to market interest rate movements on short-term deposits and treasury bills.

As at 31 December 2011:

- if the effective EUR interest rate on EUR borrowings had increased/decreased by 0.33% (2010: 0.55%) on an annual level, the net result of changes in EUR credits and borrowings after tax for the reporting period would have been HRK 20 thousand lower/higher (2010: HRK 15.2 thousand);
- if the effective EUR interest rate on EUR deposits had increased/decreased by 0.48% (2010: 1.61%) on an annual level, the net result of changes in EUR deposits after tax for the reporting period would have been HRK 28 thousand higher/lower (2010: HRK 91 thousand);
- if the effective HRK interest rate on HRK deposits had increased/decreased by 0.36% (2010: 4.97%) on an annual level, the net result of changes in investment funds after tax for the reporting period would have been HRK 157 thousand higher/lower (2009: HRK 1,943 thousand).

The following table presents the average interest rates.

	2011	2010
	Average	Average
	interest rates	interest rates
	%	%
Loans and receivables	4.99	1.89
Trade and other receivables	0.59	0.67
Financial assets at fair value through profit or loss	0.93	1.02
Cash and cash equivalents	2.67	2.41
Interest-bearing borrowings	3.71	2.99

Notes to the financial statements (continued)

30 Financial risk management (continued)

(b) Interest rate risk (continued)

The tables below present the interest rate repricing analysis and resulting gap.

2011

	Non-interest-bearing	Up to 1 month	1 - 3 months	3 - 12 months	1 - 5 years	Over 5 years	Total	Fixed interest
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Loans and receivables	(2,587)	-	-	405	38,612	8,742	45,172	-
Trade and other receivables	343,154	2,476	6,436	21,196	-	-	373,262	-
Financial assets at fair value through profit or loss	54,768	-	-	-	13,481	-	68,249	-
Cash and cash equivalents	-	56,862	468,356	-	-	-	525,218	-
	395,335	59,338	474,792	21,601	52,093	8,742	1,011,901	-
Interest-bearing borrowings*	70	-	-	2,139	1,516	-	3,725	-
Trade and other payables	139,006	-	-	-	-	-	139,006	-
	139,076	-	-	2,139	1,516	-	142,731	-
Interest rate gap	256,259	59,338	474,792	19,462	50,577	8,742	869,170	-

* include interest payable of HRK 243 thousand

2010

	Non-interest-bearing	Up to 1 month	1 - 3 months	3 - 12 months	1 - 5 years	Over 5 years	Total	Fixed interest
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Loans and receivables	-	-	-	-	10,269	89	10,358	1,193
Trade and other receivables	407,468	35,265	8,595	32,346	-	-	483,674	59,950
Financial assets at fair value through profit or loss	49,548	-	-	-	13,706	-	63,254	13,706
Cash and cash equivalents	-	129,622	544,304	-	-	-	673,926	-
	457,016	164,887	552,899	32,346	23,975	89	1,231,212	74,849
Interest-bearing borrowings*	-	-	-	-	5,505	-	5,505	-
Trade and other payables	189,226	-	-	-	-	-	189,226	-
	189,226	-	-	-	5,505	-	194,731	-
Interest rate gap	267,790	164,887	552,899	32,346	18,470	89	1,036,481	74,849

* include interest payable of HRK 486 thousand

Notes to the financial statements (continued)

30 Financial risk management (continued)

(c) Price risk

The Company has some exposure to debt securities price risk in spite of low investments and all classified on the balance sheet either as available for sale or at fair value through profit or loss (debt securities and investments funds). All the Company' securities are actively traded on the Zagreb Stock Exchange and movements of CROBEX and CROBIS indices may have an impact on operating results.

The table below shows the impact of increases/decreases of the index on the Company's net profit. The analysis is based on the assumption that the CROBEX index had increased/decreased by 5% (2010: 4%) and the CROBIS index had increased/decreased by 2% (2010: 7%). The effect on profit after tax is as follows:

Index	Impact on post-tax profit	
	2011	2010
	HRK '000	HRK '000
CROBEX	(23)	23
CROBIS	171	(791)

Notes to the financial statements (continued)

30 Financial risk management (continued)

(d) Credit risk

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. Significant risk is associated with high level of customer finance receivables. During 2010, the Company's exposure to customer finance receivables was significantly reduced, following the write-off of balances outstanding in respect of Kazakhstan transaction, as disclosed in Note 17.

Furthermore, in 2011 the Company has written off receivables in respect of withholding tax to their estimated realisable value. Namely, the tax liability forecasts for the following years showed that the Company will again be in a position of no income tax liability due to other tax reliefs (existing R&D supports as well as considerable tax loss carried forward), and will not be able to use the already approved tax certificates from previous years for the income tax paid abroad.

The Company has taken further steps in partnership with banks and financial institutions to secure all future significant customer finance risk exposures are managed through these Financial institutions with a significantly reduced level of credit risk exposure.

New customers are only accepted on satisfactory completion of a detailed credit check of the customer and a review of the related country risk. Outstanding credit arrangements are monitored frequently. Impairment losses are calculated using the net present value method. Additionally, there is credit concentration risk as the Company has a significant portion of receivables from some customers. As at 31 December 2011, the five largest customers represent 25% of total net trade receivables (2010: 47%). The Company considers that its maximum exposure to credit risk is reflected in the amount of trade receivables (Notes 14 and 17) and other receivables (Note 18), net of impairment loss for doubtful receivables. Ageing analysis of these receivables is within the maturity analysis table shown further in this note.

Letters of credit are used as a method for securing payments from customers operating in certain markets, in particular in markets with unstable political and/or economic environments. By having banks confirming the letters of credit, the political and commercial credit risk exposures are mitigated.

Prior to the approval of new facilities reported as customer finance, an internal credit risk assessment is conducted in order to assess the credit rating (for political and commercial risk) of each transaction. A reassessment of the credit rating for each customer finance facility is made on a regular basis.

Provisions related to customer finance risk exposures are only made when they are reliably measurable and where, after the financing arrangement has become effective, certain events occur which are expected to have a significant adverse impact on the borrower's ability and/or willingness to service the outstanding debt. These events can be political (normally outside the control of the borrower) or commercial, e.g. the borrower's deteriorating creditworthiness.

Security arrangements for customer finance facilities normally include pledges of equipment and pledges of certain of the borrower's assets. If available, third-party risk coverage may also be arranged. "Third-party risk coverage" means that a financial payment guarantee covering the credit risk has been issued by a bank, an export credit agency or other financial institution. It may also be a credit risk transfer under a so called "sub-participation arrangement" with a bank, whereby the credit risk and the funding is taken care of by the bank for the part covered by the bank. A credit risk cover from a third party may also be issued by an insurance company.

As at 31 December 2011, total outstanding exposure related to customer finance was HRK 65 million (2010: HRK 92 million).

Notes to the financial statements (continued)

30 Financial risk management (continued)

(d) Credit risk (continued)

The following tables provide an ageing detail of current and overdue amounts in respect of all customer loans and receivables as at December 31, 2011.

	Due balance	Up to 3 months	3 months to 1 year	1 to 3 years	Over 3 years	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
2011						
Foreign receivables	42,153	87,900	58,396	32,716	-	221,165
Domestic receivables	5,293	117,895	8,323	2,335	-	133,846
Receivables from related parties	19,386	68,105	-	-	-	87,491
	66,832	273,900	66,719	35,051	-	442,502
2010						
Foreign receivables	39,344	75,885	111,939	15,600	-	242,768
Domestic receivables	9,875	110,053	14,570	-	-	134,498
Receivables from related parties	11,771	63,635	-	-	-	75,406
	60,990	249,573	126,509	15,600	-	452,672

	Up to 3 months	3 months to 1 year	1 to 3 years	Over 3 years	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
2011					
Foreign receivables	5,648	13,088	23,367	50	42,153
Domestic receivables	3,726	221	572	774	5,293
Receivables from related parties	7,293	9,716	2,377	-	19,386
	16,667	23,025	26,316	824	66,832
2010					
Foreign receivables	11,621	4,868	22,855	-	39,344
Domestic receivables	5,868	2,983	1,024	-	9,875
Receivables from related parties	9,703	2,068	-	-	11,771
	27,192	9,919	23,879	-	60,990

Notes to the financial statements (continued)

30 Financial risk management (continued)

(d) Credit risk (continued)

Table 3	Payment due date for total customer loans and receivables (in respect of accounts with any portion falling due)					Total
	Due balance	Up to 3 months	3 months to 1 year	1 to 3 years	Over 3 years	
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
2011						
Foreign receivables	42,139	66,770	42,344	31,759	-	183,012
Domestic receivables	5,293	53,261	25	-	-	58,579
Receivables from related parties	19,386	64,852	-	-	-	84,238
	66,818	184,883	42,369	31,759	-	325,829
2010						
Foreign receivables	29,246	41,411	29,379	15,600	-	115,636
Domestic receivables	9,875	30,701	10,187	-	-	50,763
Receivables from related parties	-	-	-	-	-	-
	39,121	72,112	39,566	15,600	-	166,399

Table 4	Past due but not impaired customer loans and receivables				Total
	Up to 3 months	3 months to 1 year	1 to 3 years	Over 3 years	
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
2011					
Foreign receivables	4,566	1,815	-	13	6,394
Domestic receivables	3,664	50	209	-	3,923
Receivables from related parties	2,479	5,735	539	-	8,753
	10,709	7,600	748	13	19,070
2010					
Foreign receivables	3,413	3,602	240	-	7,255
Domestic receivables	-	-	-	-	-
Receivables from related parties	9,491	2,068	-	-	11,559
	12,904	5,670	240	-	18,814

Notes to the financial statements (continued)

30 Financial risk management (continued)

(d) Credit risk (continued)

As at 31 December 2011, total balance outstanding in respect of customer loans and receivables was HRK 442 million (2010: HRK 453 million), as disclosed in Table 1, of which HRK 407 million (2010: HRK 437 million) is due for payment within one year. As at 31 December 2011, the amount totalling HRK 67 million (2010: HRK 61 million) was overdue (Table 2), of which HRK 40 million (2010: HRK 37 million) was due within one year.

As at 31 December 2011, total balance outstanding in respect of customer overdue receivables as at 31 December 2011 was HRK 326 million (2010: HRK 166 million) as disclosed in Table 3. Of this total, HRK 294 million (2010: HRK 151 million) was already due or is due for payment within one year.

In the current economic climate, there is increased risk and uncertainty with regard to the ultimate collectability of some of these balances. As at 31 December 2011, impairment allowances totalling HRK 49 million (2010: HRK 31 million) were provided in respect of total customer loans and receivables. As disclosed in Table 4, amounts totalling HRK 19 million (2010: HRK 19 million), were past due but not impaired as at 31 December 2011.

Notes to the financial statements (continued)

30 Financial risk management (continued)

(e) Liquidity risk

Liquidity risk, also referred to as funding risk, is the risk that an enterprise will encounter difficulty in raising funds to meet commitments associated with financial instruments. As the Company has no commitments in financial instruments, the risk lies only in its daily operations. The Company has a strong focus on its cash flow with daily updates on actual development and monthly updated forecasts. The Company's maturity profile demonstrates the strong liquidity position of the Company and therefore the risk is considered low. The table below presents the maturity analysis and resulting gap.

2011	Up to 1 month	1 - 3 months	3 - 12 months	1 - 5 years	Over 5 years	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Loans and receivables	-	-	405	43,318	1,449	45,172
Trade and other receivables	160,070	169,194	43,998	-	-	373,262
Current financial assets	54,769	-	-	13,480	-	68,249
Cash and cash equivalents	56,862	468,356	-	-	-	525,218
	271,701	637,550	44,403	56,798	1,449	1,011,901
Interest-bearing borrowings*	-	-	2,209	1,516	-	3,725
Trade and other payables	115,603	23,403	-	-	-	139,006
	115,603	23,403	2,209	1,516	-	142,731
Maturity gap	156,098	614,147	42,194	55,282	1,449	869,170

* include interest payable of HRK 243 thousand

2010	Up to 1 month	1 - 3 months	3 - 12 months	1 - 5 years	Over 5 years	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Loans and receivables	-	-	-	10,269	89	10,358
Trade and other receivables	248,376	97,788	105,164	32,346	-	483,674
Current financial assets	49,548	-	-	13,706	-	63,254
Cash and cash equivalents	129,622	544,304	-	-	-	673,926
	427,546	642,092	105,164	56,321	89	1,231,212
Interest-bearing borrowings*	-	-	1,916	3,589	-	5,505
Trade and other payables	162,348	26,601	277	-	-	189,226
	162,348	26,601	2,193	3,589	-	194,731
Maturity gap	265,198	615,491	102,971	52,732	89	1,036,481

* include interest payable of HRK 486 thousand

Notes to the financial statements (continued)

30 Financial risk management (continued)

(f) Fair value estimation

The fair value of financial assets at fair value through profit or loss is estimated by reference to their quoted market price at the balance sheet date. The Company's principal financial instruments not carried at fair value are cash and cash equivalents, trade receivables, other receivables, non-current loans and receivables, trade and other payables and interest-bearing borrowings. The fair values of financial instruments together with carrying amounts shown in the balance sheet are as follows:

	Carrying amount		Unrecognised gain/(loss)	Carrying amount		Unrecognised gain/(loss)
	2011	Fair value 2011	2011	2010	Fair value 2010	2010
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Loans and receivables	45,172	45,152	(20)	10,358	10,389	31
Trade and other receivables	373,262	373,208	(54)	483,674	482,019	(1,655)
Financial assets at fair value through profit or loss	68,249	68,249	-	63,254	63,254	-
Cash and cash equivalents	525,218	525,218	-	673,926	673,926	-
Interest-bearing borrowings	(3,482)	(3,420)	62	(5,019)	(4,920)	99
Trade and other payables	<u>(139,006)</u>	<u>(139,006)</u>	<u>-</u>	<u>(189,226)</u>	<u>(189,226)</u>	<u>-</u>
	<u>869,413</u>	<u>869,401</u>	<u>(12)</u>	<u>1,036,967</u>	<u>1,035,442</u>	<u>(1,525)</u>

The fair value of loans and receivables and the fair value of interest-bearing borrowings are calculated based on the Management's best estimate of discounted expected future principal and interest cash flows, using the market-related rate for a similar instrument at the balance sheet date as a discount rate. Fair values and carrying amounts are not significantly different as the loans and receivables were granted at market rates, which were not substantially different from market rates at the end of 2009. Current financial assets, including derivatives are stated at fair value that is based on quoted prices at the balance sheet date without any deduction for transaction costs.

The carrying amount of cash and cash equivalents and of bank deposits deemed to reflect the fair value due to the short-term maturity of these financial instruments. Similarly, the amortised cost carrying amounts of trade receivables and payables with remaining life of less than one year which are all subject to normal trade credit terms deemed to reflect the fair values. The following interest rates were used for determining fair values, which are based on available market rates for similar financial instruments:

	2011	2010
Loans and receivables	6.28%	5.84%
Interest-bearing borrowings	6.06%	5.93%

Notes to the financial statements (continued)

31 Contingent liabilities

In December 1999 the Company received notification of a lawsuit brought against it by a number of small shareholders. According to this lawsuit, the Zagreb Commercial Court was required to declare certain decisions of the General Assembly, held on 18 June 1998, null and void. The Company has submitted its response to the Court. In January 2004 the Zagreb Commercial Court published the first instance judgement in which the plaintiffs' requests have been refused. On 2 March 2004 the plaintiffs appealed and the Appeal Court (Croatian High Commercial Court) has still not made a decision on the appeal. The Company's Management Board is of the opinion that no material liabilities for the Company will result from this lawsuit. No developments have occurred since 2005.



COMPANY POSITION REPORT

Dear shareholders,

The telecom industry is facing the most challenging times. Both economy and society expect us, technology and innovation/thought leader, to enter a new communications and networked society era. Our growth and development potential depends on three major forces: broadband, mobility and the cloud. They affect business, people and environment in the best possible way. Ericsson Nikola Tesla supports this agenda.

The year 2011 was yet another demanding and tough one characterized by negative economic trends that considerably affected Ericsson Nikola Tesla's performance and achievements. This was especially evident in the slowdown and decrease in capital investments by telecom operators as well as decreased government investments into infrastructure projects within the ICT segment accompanied by continued price pressure. All this additionally slowed down the realization of our planned activities and strategic goals.

A decline in net sales resulted in the considerable decrease of business volume both in the domestic and CIS markets. This was partly compensated by better situation and results achieved in our export markets, primarily in Bosnia and Herzegovina and Montenegro, as well as Ericsson market. The Ericsson market remains strong despite adjustments to our pricing in order to stay competitive in the demanding global market. In the total sales revenue, the share of domestic market was 23%, and export represented 77% (export to Ericsson market accounted for 39.6% and to other countries 37.8%). Despite the challenging business environment, the Company maintained and in some markets increased its market share.

The gross margin is lower compared to 2010, reflecting continuous price pressure in all markets and investments into export markets aiming at securing new business and strengthening market share. In addition, the gross margin was impacted by the product/service mix, lower margins on certain projects in the Industry and Society segment as well as investments into development projects. It is important to point out that following the impairment of withholding tax receivables as well as impairment of other doubtful receivables, the Company's risk related to collection of receivables has been significantly reduced.

Under such challenging market conditions, our focus on strategic programs/key deals has helped us to somewhat offset the effects of crisis. In partnership with our customers, at home and abroad, we realized a number of significant projects. I would like to underline our activities in transformation and modernization of the existing networks into new generation networks. Along with these activities, Ericsson Nikola Tesla achieved significant results in terms of our responsibilities assigned in the global organization in the areas of Research and Development, Service Delivery Center and other centers of expertise. ICT implementation continued also in a non-operator segment, both in business systems and government administration with strong focus on well-selected areas. The best illustration for this is e-Health solution, our recognizable high-tech-product. However, last year we witnessed the negative impact of crisis, which resulted in reduced volume of business activities and postponement in realization of large ICT

infrastructure projects. Furthermore, in the domestic market the continued recession and 6% tax imposed on mobile services had a negative impact on operators' investments.

In the last few Company reports, I emphasized the importance of innovations not only to our current operations but also to secure our competitiveness in the future. The present industrial and technological revolution that will take us into networked society can be survived, in terms of business operations, only with individuals and teams/organizations that are innovative, motivated and committed to common goals.

In 2011 Ericsson Nikola Tesla yielded the following business results (2010 figures in brackets):

- Orders booked MHRK 1,161.3 (MHRK 1,311.3)
- Sales revenues MHRK 1,165.7 (MHRK 1,218.9)
- Net profit MHRK 28 (MHRK 24)
- Cash flow from operating activities MHRK 135 (MHRK 366.4)
- Motivational Company culture and strong employee engagement- confirmed by the annual employee questionnaire (Dialog)
- Customer satisfaction- confirmed by the annual customer satisfaction questionnaire (Customer satisfaction Survey)
- Satisfaction of shareholders, investors and general public- confirmed by the awards granted by the Zagreb Stock Exchange and Poslovni dnevnik for transparent business operations and best relations with investors in Croatia.

In brief, in 2011 we achieved solid net income, and sound cash flow from operating activities, thus providing the stable balance sheet. This is of strategic importance since it is a firm base on which we continue to invest into market/customers, development projects as well as our employees' knowledge and skills in order to strengthen our market position.

OUTLOOK

We live in extraordinary times, characterized by uncertain economic climate and strong competition, technological innovation and data growth, all happening simultaneously. All of this places particular pressures on the market and our customers, which presents us with both challenges and opportunities.

The telecom and ICT market will continue with dynamic development in 2012. A further strong growth of data traffic, generated by a significant increase in the number of mobile smart devices (smartphone, i-pad, etc.) as well as by increased internet usage, is expected. Consequently, further expansion of fixed broadband access to xDSL technologies and introduction of high-rate technologies based on optics (FTT-x) are expected. The mobile broadband access technology will continue the intensive development by implementation of 3G and 3.5G mobile technologies (HSPA, HSPA+) while in Croatia the first steps in LTE commercial implementation are expected. We also expect a significant modernization of the existing mobile networks applying SRAN concept (Single Radio Access Network), enabling the operators to be more efficient and optimize costs.

As regards edge and core networks, transformation towards „all IP“ Next Generation Convergent Networks based on IMS architecture will be continued.

We also expect, in all our markets, the modernization of Operation Support System (OSS) and Business Support System (BSS), thus enabling operators to offer a wide range of convergent services regardless of the location or the user approach.

ICT implementation should be continued in Industry and Society segment as well, no matter whether enterprise or state administration is in question, taking into account effects and benefits achieved by development, implementation and usage of ICT solutions and services.

Bearing in mind all business challenges and need for quick adaptation, there is no doubt that in 2012 we shall continue to focus on business stability by fully analyzing and reacting to all business risks and by ensuring optimal utilization and continual development of our resources. Having assessed operational risks for Ericsson Nikola Tesla in 2012, I would like to point out the following:

- Challenging global economic conditions may adversely impact the demand and pricing regarding our products and services;
- Operators' and other customers' reduced capital expenditures;
- Intense competition from our existing competitors as well as new entrants, incl. IT companies entering ICT market;
- Customers' and competitors' consolidation may have further impact on product and service prices;
- Continued political uncertainty and instability in some markets;
- If our customers' financial conditions decline, we will be exposed to increased credit and commercial risk;
- Having the majority of our revenues in EUR and USD, our business is exposed to foreign exchange fluctuations;
- In order to remain competitive, we need to retain highly qualified and extraordinary employees.

Ericsson Nikola Tesla operates in line with the current corporate policies and directives, the Croatian legislative regulations as well as principles of corporate governance and business ethics.

In the forthcoming period, respecting all changeable business circumstances, we shall seek to strengthen our position in strategic business segments and strategic Company markets. The mission and strategy of Ericsson Nikola Tesla as well as our wanted position by 2015 are directed towards key stakeholders: customers, employees and shareholders. It is all about value creation, understanding the needs, sharing knowledge and the partnership among those included in various processes and activities in the Company, global organization, our markets and the society as a whole. The key Company programs are strongly focused on growth, business improvement and appropriate cost base, efficiency and wise investments.



On the way towards the networked society, for which it is estimated that some 50 billion devices will be networked by 2020, we are now at the mid point of revolutionary changes that we in Ericsson community describe as follows: "When one person gets connected, their life changes. When everything connects, the world changes. And we are in the midst of this as an industry".

Ericsson Nikola Tesla needs to continue with creating and delivering best-in-class solutions, understanding market and customers' needs, focusing on innovative/thought leadership and knowledge sharing, what will be a firm ground for the Company's future development.

All other data, which is an integral part of the annual Company report, pursuant to Article 250 (a) of the Company Act, can be found in the enclosed 2011 Annual Report, comprising the General Report, Social Report and Financial Statements, as at December 31 2011.

Gordana Kovačević

President

Ericsson Nikola Tesla d.d.

A handwritten signature in black ink, appearing to read "Gordana Kovačević".



Zagreb, April 13, 2012

THE REPORT OF THE SUPERVISORY BOARD OF ERICSSON NIKOLA TESLA ON THE SUPERVISION PERFORMED ON THE COMPANY'S OPERATIONS IN 2011

In accordance with the provisions of the Croatian Company Law and Ericsson Nikola Tesla Statute, the Supervisory Board of Ericsson Nikola Tesla has reviewed the Company's operations, making respective decisions in four regular and two extraordinary meetings held during 2011.

The Company management regularly informed the Supervisory Board on all important business activities and the course of the Company business performance. At the meetings the Supervisory Board reviewed the financial results and business plans, market conditions and trends in ICT industry. Further topics of discussions were as follows: strategic projects, investment management, issues relating to human resources and business risks. Besides, the Supervisory Board continuously monitored the business development and responsibilities of the Research & Development Centre, Operations & Competence Center (OCC) and IT & Test Environment (ITTE) Service delivery Croatia. The Supervisory Board analyzed and approved the Company's Business Strategy 2011–2015 and the focus areas and strategic programs necessary for further business development.

At extraordinary Supervisory Board meetings, the members discussed dividend payment, 2010 annual financial reports and 2011 targets.

During 2011, the Company business performance was impacted by the deterioration in market conditions marked by economic slowdown both in Croatia and the region, cautious customer investments, strong competition and price pressure. Taking into account the above, we believe that the Company had a solid performance.

In the course of the year the Board composition remained the same. As his mandate has expired Prof. Ignac Lovrek, Ph.D. was re-elected as Supervisory Board member with the mandate renewed for a further four years at the Annual Assembly of the Company held on May 31, 2011.

The Audit Committee held five sessions in 2011, where it discussed financial performance during the year and annual financial statements, audit plan for 2011, internal control and risk management system, and performed other tasks defined by the Audit Law. The Audit Committee regularly informed other Supervisory Board members of its findings and recommendations. On the day of this report issuance, the Audit Committee is comprised of Mr. Ignac Lovrek, Chairman and Mrs. Carita Jönsson, Member.


Based on the review of financial and other relevant business documents, the Managing Director's report on the Company's business situation and the report provided by auditors, the Supervisory Board concluded the following:

- To the best of our knowledge Ericsson Nikola Tesla in all material aspects operates in compliance with the laws and Company's enactments and in accordance with the decisions made by the Shareholder's Assembly.
- The annual financial reports have been prepared in accordance with the Company's business records and in all material respects reflect the correct financial and business situation of the Company;
- The Managing Director's proposal relating to net income (profit) allocation is supported and approved;
- There are no objections regarding the Managing Director's report and consequently the report is approved;
- There are no objections regarding the Auditors' report and consequently the report is approved;
- Pursuant to the above stated, the submitted annual financial statements are approved.

Pursuant to the Company Act, art. 300d the following documents are enclosed with this report:

1. Decision by the Managing Director on the established annual financial statements;
2. Decision by the Supervisory Board on the established annual financial statements;

For the Supervisory Board



Roland Nordgren, Chairman

Ericsson Nikola Tesla d.d. Zagreb
Krapinska 45

OIB: 84214771175

Matični br.: 03272699

Zagreb, 13. travnja 2012.

Predmet: **Odluka Uprave Društva**

Subject: **Managing Director Decision**

Temeljem članka 300.d Zakona o trgovačkim društvima, a nakon primitka suglasnosti Nadzornog odbora dioničkog društva Ericsson Nikola Tesla d.d. Zagreb donosim slijedeću ODLUKU:

In accordance with the Company Act, Article 300.d and subsequent to the approval of the Supervisory Board of the Joint Stock Company Ericsson Nikola Tesla d.d. Zagreb, I herewith forward the following DECISION:

- Utvrđuju se godišnja financijska izvješća za 2011.g.

- The Annual Financial Reports for 2011 have been submitted and approved.

Ericsson Nikola Tesla d.d. Zagreb
Uprava


Gordana Kovačević

Ericsson Nikola Tesla d.d. Zagreb
Managing Director


Gordana Kovačević

ERICSSON 

Ericsson Nikola Tesla d.d.

Krapinska 45

HR-10 000 Zagreb

CROATIA

01

Ericsson Nikola Tesla d.d. Zagreb
Krapinska 45
OIB: 84214771175
Matični br.: 03272699

Zagreb, 13. travnja 2012.

Predmet: Odluka Nadzornog odbora Društva

Subject: Supervisory Board Decision

Temeljem članka 300.d Zakona o trgovačkim društvima, Nadzorni odbor dioničkog društva Ericsson Nikola Tesla d.d. Zagreb donosi slijedeće:

Pursuant to the Company Act, Article 300.d the Supervisory Board of the Joint Stock Company Ericsson Nikola Tesla d.d. Zagreb, hereby confirms that:

- Utvrđuju se godišnja financijska izvješća za 2011.g.
- The Annual Financial Reports for 2011 have been submitted and approved.

Ericsson Nikola Tesla d.d. Zagreb
Za Nadzorni odbor



Roland Nordgren
Predsjednik

Ericsson Nikola Tesla d.d. Zagreb
For Supervisory Board



Roland Nordgren
Chairman