

**Ericsson Nikola Tesla d.d.**

**Consolidated Financial Statements and  
Auditor's report  
31 December 2012**

## Contents

	<i>Page</i>
Company profile	1 to 2
Responsibilities of the Management and Supervisory Boards for the preparation and approval of the annual consolidated financial statements	3
Independent Auditors' Report to the shareholders of Ericsson Nikola Tesla d.d.	4
Ericsson Nikola Tesla d.d. consolidated statement of comprehensive income	5
Ericsson Nikola Tesla d.d. consolidated statement of financial position	6 to 7
Ericsson Nikola Tesla d.d. consolidated statement of cash flows	8 to 9
Ericsson Nikola Tesla d.d. consolidated statement of changes in equity	10
Notes to the consolidated financial statements	11 to 64

## 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.

### **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 2012 and up to the release of these consolidated statements were:

Roland Nordgren	Reappointed on 05 June 2012	Chairman
Ignac Lovrek	Reappointed on 31 May 2011	Member; Vice-Chairman
Carita Jönsson	Reappointed on 05 June 2012	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 2012, the Company's executive management comprised:

Gordana Kovačević	Company President
Branko Dronjić	Head, G-ITTE Engineering Services Croatia
Damir Bušić	Director, Commercial Management
Dario Runje	Head, CD RAN & Director, CC & Supply 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
Milan Živković	Director, Strategy and Business Development
Miroslav Kantolić	Director, Sales and Marketing for VIPnet
Patrick Gerard Martin	Director, Research and Development Center
Rafal Rybkowski	Director, Finance
Smiljan Pilipović	Director, Business Innovation and New Opportunities
Snježana Bahtijari	Director, Communication
Tihomir Šicel	Director, Sales & Marketing for Industry and Society

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

The Management Board is required to prepare consolidated financial statements for each financial year which give a true and fair view of the financial position of the Group 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 consolidated 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 Group 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 consolidated financial statements on a going concern basis unless it is inappropriate to presume that the Group 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 Group together with the annual consolidated financial statements, following which the Supervisory Board is required to approve the annual consolidated financial statements which will be presented to the General Assembly of Shareholders.

The consolidated financial statements set out on pages 5 to 64 were authorised by the Management Board on 9 April 2013 for issue to the Supervisory Board and are signed below.

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

**ERICSSON**   
**Ericsson Nikola Tesla d.d.**  
Krapinska 45  
HR-10 000 Zagreb  
**CROATIA**  01



## ***Independent Auditor's Report***

### **To the Shareholders of Ericsson Nikola Tesla d.d.**

We have audited the accompanying consolidated financial statements of Ericsson Nikola Tesla d.d. and its subsidiaries (the "Group"), which comprise the consolidated balance sheet as of 31 December 2012 and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

### **Management's Responsibility for the Consolidated Financial Statements**

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

### **Auditor's Responsibility**

Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated 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 accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2012, 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, 9 April 2013

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., Ulica kneza Ljudevita Posavskog 31, 10000 Zagreb, Croatia*  
*T: +385 (1) 6328 888, F: +385 (1) 6111 556, www.pwc.hr*

Consolidated statement of comprehensive income  
for the year ended 31 December 2012

	<i>Notes</i>	<b>2012</b>	<b>2011</b>
		<b>HRK '000</b>	<b>HRK '000</b>
Sales revenue	3, 4	1,913,304	1,165,830
Cost of sales		<u>(1,701,672)</u>	<u>(1,031,945)</u>
<b>Gross profit</b>		211,632	133,885
Selling expenses		(61,095)	(62,350)
Administrative expenses		(36,080)	(29,019)
Other operating income		3,586	1,194
Other operating expenses	6	<u>(1,432)</u>	<u>(54,910)</u>
<b>Operating profit/(loss)</b>		<u>116,611</u>	<u>(11,200)</u>
Finance income	8	24,487	34,733
Finance expense	8	<u>(80)</u>	<u>(1,166)</u>
Finance income – net		<u>24,407</u>	<u>33,567</u>
<b>Profit before tax</b>		141,018	22,367
Income tax	9	<u>(14,105)</u>	<u>5,626</u>
<b>Profit for the year</b>		<u>126,913</u>	<u>27,993</u>
Other comprehensive income		<u>5</u>	<u>-</u>
<b>Total comprehensive income for the year</b>		<u><b>126,918</b></u>	<u><b>27,993</b></u>
Earnings per share (HRK)	10	<u>95.63</u>	<u>21.15</u>

The notes set out on pages 11 to 64 form an integral part of these consolidated financial statements.

Consolidated statement of financial position  
as at 31 December 2012

	<i>Notes</i>	<b>2012</b> <b>HRK '000</b>	<b>2011</b> <b>HRK '000</b>
<b>ASSETS</b>			
<b>Non-current assets</b>			
Property, plant and equipment	11	117,026	134,179
Intangible assets	12	4,314	3,425
Loans and receivables	13	30,413	45,171
Equity securities		40	48
Deferred tax assets	14	-	13,992
<b>Total non-current assets</b>		<u>151,793</u>	<u>196,815</u>
<b>Current assets</b>			
Inventories	15	33,268	22,705
Trade receivables	16	227,586	273,604
Receivables from related parties	28(c)	81,190	87,491
Other receivables	17	15,169	12,327
Financial assets at fair value through profit or loss	18	145,365	68,249
Prepayments and accrued income		3,655	4,808
Cash and cash equivalents	19	511,639	525,305
<b>Total current assets</b>		<u>1,017,872</u>	<u>994,489</u>
<b>TOTAL ASSETS</b>		<u>1,169,665</u>	<u>1,191,304</u>

The notes set out on pages 11 to 64 form an integral part of these consolidated financial statements.



Consolidated statement of financial position (continued)  
as at 31 December 2012

	<i>Notes</i>	<b>2012</b> <b>HRK '000</b>	<b>2011</b> <b>HRK '000</b>
<b>EQUITY AND LIABILITIES</b>			
<b>Equity</b>			
Share capital	20(a)	133,165	133,165
Treasury shares		(6,928)	(8,443)
Legal reserves	20(c)	20,110	20,110
Retained earnings		608,381	705,878
<b>Total equity</b>		<u>754,728</u>	<u>850,710</u>
<b>Non-current liabilities</b>			
Interest-bearing borrowings	23	12	1,435
Employee benefits	24(a)	4,452	4,530
<b>Total non-current liabilities</b>		<u>4,464</u>	<u>5,965</u>
<b>Current liabilities</b>			
Payables to related parties	28(c)	115,690	50,737
Interest-bearing borrowings	23	1,710	2,047
Trade and other payables	25	123,615	88,679
Provisions	26	18,566	21,968
Accrued charges and deferred revenue	27	150,892	171,198
<b>Total current liabilities</b>		<u>410,473</u>	<u>334,629</u>
<b>Total liabilities</b>		<u>414,937</u>	<u>340,594</u>
<b>TOTAL EQUITY AND LIABILITIES</b>		<u>1,169,665</u>	<u>1,191,304</u>

The notes set out on pages 11 to 64 form an integral part of these consolidated financial statements.

Consolidated statement of changes in equity  
for the year ended 31 December 2012

	Share capital HRK '000	Treasury shares HRK '000 Note 20 (b)	Legal reserves HRK '000	Retained earnings HRK '000	Total HRK '000
<b>As at 1 January 2011</b>	133,165	(16,251)	20,110	933,787	1,070,811
<b>Changes in equity for 2011</b>					
Total comprehensive income	-	-	-	27,993	27,993
Dividend distribution for 2010, Note 21	-	-	-	(251,289)	(251,289)
Share-based payments, Note 24 (b)	-	7,808	-	(7,808)	-
Equity-settled transactions, Note 24 (b)	-	-	-	3,994	3,994
Deferred tax related to equity increase, Note 9	-	-	-	(799)	(799)
Total contributions by and distributions to owners of the parent recognised directly in equity	-	7,808	-	(255,902)	(248,094)
<b>As at 31 December 2011</b>	133,165	(8,443)	20,110	705,878	850,710
<b>As at 1 January 2012</b>	133,165	(8,443)	20,110	705,878	850,710
<b>Changes in equity for 2012</b>					
Total comprehensive income	-	-	-	126,918	126,918
Dividend distribution for 2011, Note 21	-	-	-	(225,695)	(225,695)
Purchases of treasury shares, Note 20 (b)	-	(2,462)	-	-	(2,462)
Share-based payments, Note 24 (b)	-	3,977	-	(3,977)	-
Equity-settled transactions, Note 24 (b)	-	-	-	5,257	5,257
Total contributions by and distributions to owners of the parent recognised directly in equity	-	1,515	-	(224,415)	(222,900)
<b>As at 31 December 2012</b>	133,165	(6,928)	20,110	608,381	754,728

The notes set out on pages 11 to 64 form an integral part of these consolidated financial statements.

Consolidated statement of cash flows  
for the year ended 31 December 2012

	<i>Notes</i>	<b>2012</b>	<b>2011</b>
		<b>HRK '000</b>	<b>HRK '000</b>
<b>Cash flows from operating activities</b>			
<i>Profit before tax</i>		<u>141,018</u>	<u>22,367</u>
Adjustments for:			
Depreciation and amortisation	11, 12	44,619	48,522
Impairment losses and reversals		1,738	68,275
Net increase of provisions		16,837	10,358
(Gain)/loss on sale of property, plant and equipment		(202)	1,638
Net gain on remeasurement of financial assets	8	(2,536)	(1,595)
Amortisation of discount	8	(3,021)	(3,483)
Interest income	8	(20,625)	(19,574)
Interest expense	8	80	1,166
Foreign exchange gains		(3,206)	(10,203)
Equity-settled transactions		<u>5,257</u>	<u>3,994</u>
		179,959	121,465
Decrease in receivables		65,424	22,418
(Increase)/decrease in inventories		(10,563)	12,722
Increase/(decrease) in payables		<u>63,137</u>	<u>(23,673)</u>
<i>Cash generated from operations</i>		<u>297,957</u>	<u>132,932</u>
Interest paid		(80)	(1,166)
Income taxes (paid)/refunded		<u>(113)</u>	<u>3,054</u>
<b><i>Net cash from operating activities</i></b>		<b><u>297,764</u></b>	<b><u>134,820</u></b>
<b>Cash flows from investing activities</b>			
Interest received		22,258	18,768
Proceeds from sale of property, plant and equipment		4,919	89
Purchases of property, plant and equipment, and intangible assets	11, 12	(33,073)	(54,261)
Deposits collected/(placed) with financial institutions - net		594	(1,758)
Purchases of financial assets at fair value through profit and loss		<u>(74,572)</u>	<u>(3,407)</u>
<b><i>Net cash used in investing activities</i></b>		<b><u>(79,874)</u></b>	<b><u>(40,569)</u></b>

The notes set out on pages 11 to 64 form an integral part of these consolidated financial statements.

Consolidated statement of cash flows (continued)  
for the year ended 31 December 2012

	<i>Notes</i>	<b>2012</b>	<b>2011</b>
		<b>HRK '000</b>	<b>HRK '000</b>
<b>Cash flows from financing activities</b>			
Repayment of interest-bearing borrowings		(1,710)	(1,690)
Purchase of treasury shares		(2,462)	-
Dividends paid	21	(225,695)	(251,289)
<b>Net cash used in financing activities</b>		<b><u>(229,867)</u></b>	<b><u>(252,979)</u></b>
Effects of exchange rate changes on cash and cash equivalents		(1,689)	10,081
<b>Net increase in cash and cash equivalents</b>		<b>(13,666)</b>	<b>(148,647)</b>
Cash and cash equivalents at the beginning of the year		<u>525,305</u>	<u>673,952</u>
<b>Cash and cash equivalents at the end of the year</b>	<b>19</b>	<b><u>511,639</u></b>	<b><u>525,305</u></b>

The notes set out on pages 11 to 64 form an integral part of these consolidated financial statements.

# Notes to the consolidated 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. The Company has prepared these consolidated financial statements as at 31 December 2012 and for the year then ended for the Company, two active subsidiaries, of which one is domiciled in Croatia and other in Bosnia and Herzegovina, and two inactive subsidiaries domiciled in Croatia (the Group). These consolidated financial statements were authorised for issue by the Management Board on 9 April 2013 for approval by the Supervisory Board. A summary of the Company's principal accounting policies is set out below.

### ***Statement of compliance***

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

### ***Basis of preparation***

The consolidated 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 consolidated financial statements.

The preparation of consolidated 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 consolidated financial statements and estimates are discussed in Note 2.

### ***Going concern***

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

## Notes to the consolidated financial statements (continued)

### 1 Significant accounting policies (continued)

#### Changes in accounting policies and disclosures

##### *(a) New and amended standards adopted by the Group*

The Group has adopted the following new and amended IFRS and IFRIC interpretations during the year. When the adoption of the standard or interpretation is deemed to have an impact on the financial statements or performance of the Group, its impact is described below.

##### *Amendments to IFRS 7 Financial Instruments: Disclosures on Derecognition (effective for annual periods beginning on or after 1 July 2011)*

This amendment 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. The Group adopted this amendment that affects disclosure only and did not impact on the Group's financial position or performance.

##### *Amendments to IFRS 1 First Time Adoption: Fixed Dates and Hyperinflation (effective for annual periods beginning on or after 1 July 2011)*

These amendments include 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 amendments do not have any impact on the Group's financial position or performance because the Group is not first time adopter.

##### *Amendments to IAS 12 Income Taxes – Deferred Taxes (effective for annual periods beginning on or after 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. Amended IAS 12 does not have an impact on the financial statements of the Group as the Group currently does not have any investment property or non-depreciable asset which is measured using the revaluation model.

## Notes to the consolidated financial statements (continued)

### 1 Significant accounting policies (continued)

#### Changes in accounting policies and disclosures (continued)

##### *(b) Standards and interpretations issued but not yet effective*

A number of new standards and amendments to standards and interpretations are effective for annual periods beginning after 1 January 2012, and have not been applied in preparing these financial statements.

None of these is expected to have an impact on the financial statements of the Group, except the following set out below:

##### *Amendment to IAS 1 Financial Statement Presentation Regarding Other Comprehensive Income (effective for annual periods beginning on or after 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 affects presentation only and therefore is not expected to have an impact on the Group's financial position or performance.

##### *Amendment to IAS 19 Employee Benefits (effective for annual periods beginning on or after 1 January 2013)*

These amendments eliminate the corridor approach and calculate finance costs on a net funding basis. The amendment is not expected to have a material impact on the Group's financial position or performance.

##### *IFRS 10 Consolidated Financial Statements (effective for annual periods beginning on or after 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. It defines the principle of control, and establishes controls as the basis for consolidation. It sets out how to apply the principle of control to identify whether an investor controls an investee and therefore must consolidate the investee. It sets out the accounting requirements for the preparation of consolidated financial statements. The Group is currently assessing the impact that IFRS10 will have on financial statements. The Group plans to adopt this new standard on its effective date.

##### *IFRS 11 Joint Arrangements (effective for annual periods beginning on or after 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 Group expects IFRS 11 could have an impact on the financial statements and is currently assessing the impact. The Group plans to adopt this new standard on its effective date.

## Notes to the consolidated financial statements (continued)

### 1 Significant accounting policies (continued)

#### Changes in accounting policies and disclosures (continued)

##### *(b) Standards and interpretations issued but not yet effective (continued)*

##### *IFRS 12 Disclosures of Interests in Other Entities (effective for annual periods beginning on or after 1 January 2013)*

IFRS 12 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 Group is currently assessing the impact of IFRS 12 on financial statements. The Group plans to adopt this new standard on its effective date.

##### *IFRS 13 Fair Value Measurement (effective for annual periods beginning on or after 1 January 2013)*

IFRS 13 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 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 Group is currently assessing the impact of IFRS 13 on financial statements. The Group plans to adopt this new standard on its effective date.

##### *IAS 27 (revised 2011) Separate Financial Statements (effective for annual periods beginning on or after 1 January 2013)*

IAS 27 (revised 2011) 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 Group is currently assessing the impact of IAS 27 on financial statements. The Group plans to adopt this new standard on its effective date.

##### *IAS 28 (revised 2011) Associates and Joint Ventures (effective for annual periods beginning on or after 1 January 2013)*

IAS 28 (revised 2011) includes the requirements for joint ventures, as well as associates, to be equity accounted following the issue of IFRS 11. The Group is currently assessing the impact of IAS 28 on financial statements. The Group plans to adopt this new standard on its effective date.

##### *IFRIC 20, Stripping Costs in the Production Phase of a Surface Mine (issued in October 2011 and effective for annual periods beginning on or after 1 January 2013)*

The interpretation clarifies that benefits from the stripping activity are accounted for in accordance with the principles of IAS 2, Inventories, to the extent that they are realised in the form of inventory produced. To the extent the benefits represent improved access to ore, the entity should recognise these costs as a 'stripping activity asset' within non-current assets, subject to certain criteria being met. This amendment is not relevant to the Group's operations.



## Notes to the consolidated financial statements (continued)

### 1 Significant accounting policies (continued)

#### Changes in accounting policies and disclosures (continued)

##### *(b) Standards and interpretations issued but not yet effective (continued)*

*Disclosures—Offsetting Financial Assets and Financial Liabilities - Amendments to IFRS 7 (issued in December 2011 and effective for annual periods beginning on or after 1 January 2013).*

The amendment requires disclosures that will enable users of an entity's financial statements to evaluate the effect or potential effect of netting arrangements, including rights of set-off. The amendment will have an impact on disclosures but will have no effect on measurement and recognition of financial instruments. The Group is considering the implications of the amendment and the impact on the Group.

*Amendment to IFRS 1 First time adoption on government loans (effective for annual periods beginning on or after 1 January 2013).*

This amendment addresses how a first-time adopter would account for a government loan with a below-market rate of interest when transitioning to IFRS. It also adds an exception to the retrospective application of IFRS, which provides the same relief to first-time adopters granted to existing preparers of IFRS financial statements when the requirement was incorporated into IAS 20 in 2008. This amendment is not relevant to the Group's operations.

*Amendment to IFRSs 10, 11 and 12 on transition guidance (effective for annual periods beginning on or after 1 January 2013).*

These amendments provide additional transition relief to IFRSs 10, 11 and 12, limiting the requirement to provide adjusted comparative information to only the preceding comparative period. For disclosures related to unconsolidated structured entities, the amendments will remove the requirement to present comparative information for periods before IFRS 12 is first applied. The Group is considering the implications of the amendments and the impact on the Group.

*Offsetting Financial Assets and Financial Liabilities - Amendments to IAS 32 (issued in December 2011 and effective for annual periods beginning on or after 1 January 2014)*

The amendment added application guidance to IAS 32 to address inconsistencies identified in applying some of the offsetting criteria. This includes clarifying the meaning of 'currently has a legally enforceable right of set-off' and that some gross settlement systems may be considered equivalent to net settlement. The Group is considering the implications of the amendment and the impact on the Group.

## Notes to the consolidated financial statements (continued)

### 1 Significant accounting policies (continued)

#### Changes in accounting policies and disclosures (continued)

##### *(b) Standards and interpretations issued but not yet effective (continued)*

##### *IFRS 9 Financial Instruments (effective for annual periods beginning on or after 1 January 2015)*

IFRS 9 is the first standard issued as part of a wider project to replace IAS 39 Financial Instruments: Recognition and Measurement. 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 Group does not expect IFRS 9 to have an impact on the financial statements. The Group plans to adopt this new standard on its effective date.

##### *Amendments to IFRS 10, IFRS 12 and IAS 27 - Investment entities (issued on 31 October 2012 and effective for annual periods beginning 1 January 2014)*

The amendment introduced a definition of an investment entity as an entity that (i) obtains funds from investors for the purpose of providing them with investment management services, (ii) commits to its investors that its business purpose is to invest funds solely for capital appreciation or investment income and (iii) measures and evaluates its investments on a fair value basis. An investment entity will be required to account for its subsidiaries at fair value through profit or loss, and to consolidate only those subsidiaries that provide services that are related to the entity's investment activities. IFRS 12 was amended to introduce new disclosures, including any significant judgements made in determining whether an entity is an investment entity and information about financial or other support to an unconsolidated subsidiary, whether intended or already provided to the subsidiary. The Group is currently assessing the impact of the amendments on its financial statements.

##### *Annual improvements 2011 (effective for annual periods beginning on or after 1 January 2013)*

These annual improvements, address six issues in the 2009-2011 reporting cycle. It includes changes to:

IFRS 1, 'First time adoption'

IAS 1, 'Financial statement presentation'

IAS 16, 'Property plant and equipment'

IAS 32, 'Financial instruments; Presentation'

IAS 34, 'Interim financial reporting'

The Group is considering the implications of the improvements.

There are no other IFRSs or IFRIC interpretations that are not yet effective that would be expected to have a material impact on the Group.

## Notes to the consolidated financial statements (continued)

### 1 Significant accounting policies (continued)

#### Changes in accounting policies and disclosures (continued)

##### Functional and presentational currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment where the entity operates ('the functional currency'). The consolidated financial statements are presented in Croatian kuna (HRK), which is the Company's functional and the Group's presentation currency.

##### **Property, plant and equipment**

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

The Group 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 Group 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:

	<b>Useful lives</b>
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 consolidated statement of comprehensive income.

## Notes to the consolidated 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***

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 consolidated statement of comprehensive income for items of property, plant and equipment, intangible assets, financial instruments and receivables.

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

Evidence of impairment may include indications that the debtors or a group of debtors is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation, and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

## Notes to the consolidated financial statements (continued)

### 1 Significant accounting policies (continued)

#### ***Impairment of assets (continued)***

For loans and receivables category, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced and the amount of the loss is recognised in the consolidated income statement. If a loan or held-to-maturity investment has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. As a practical expedient, the Group may measure impairment on the basis of an instrument's fair value using an observable market price.

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

Short-term receivables are not discounted. The recoverable amount of financial 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 Group 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.

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 Group 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.

## Notes to the consolidated financial statements (continued)

### 1 Significant accounting policies (continued)

#### *Financial instruments (continued)*

Financial instruments with fixed or determinable payments and fixed maturity that the Group 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 Group commits to purchase or sell the instrument. Loans and receivables and other financial liabilities are recognised on the day they are transferred to the Group.

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 consolidated 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 Group 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.

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 Group 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 consolidated 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 consolidated 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 consolidated statement of comprehensive income. Dividends on available-for-sale equity instruments are recognised in the consolidated statement of comprehensive income when the Group's right to receive payments is established.

## Notes to the consolidated financial statements (continued)

### 1 Significant accounting policies (continued)

#### ***Financial instruments (continued)***

A financial asset is derecognised when the Group 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 Group commits to sell the assets. The Group 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 Group. Other financial liabilities are derecognised when the Group's contractual obligations are discharged, cancelled or expire.

The Group 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 consolidated 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.

#### ***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 Group'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.

## Notes to the consolidated financial statements (continued)

### 1 Significant accounting policies (continued)

#### ***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***

Share capital is stated in HRK at nominal value.

Incremental costs directly attributable to the issue of new ordinary shares or options are shown in equity as a deduction, net of tax, from the proceeds. Where the Group 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 Group's equity holders until the shares are cancelled or reissued. Where such ordinary 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 Group's equity holders.

#### ***Income tax***

The tax expense for the period is based on taxable profit for the year and comprises current and deferred tax. Income tax is recognised in the consolidated 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. The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the balance sheet date in the countries where the company and its subsidiaries operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is recognised by using the balance sheet liability method on temporary differences arising between tax basis of assets and liabilities and their carrying amount in the financial statements. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred 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 Group reassesses unrecognised deferred tax assets and the carrying amount of deferred tax assets.



## Notes to the consolidated financial statements (continued)

### 1 Significant accounting policies (continued)

#### ***Income tax (continued)***

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.

#### ***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 consolidated 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.

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment where the entity operates ('the functional currency'). The consolidated financial statements are presented in Croatian kuna (HRK), which is the Company's functional and the Group's presentation currency.

The results and financial position of all Group entities with a functional currency different from the presentation currency are translated into the presentation currency as follows:

- (i) assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;
- (ii) income and expenses for each income statement are translated at average exchange rates; and
- (iii) all resulting exchange differences are recognised in other comprehensive income.

On consolidation, exchange differences arising from the translation of the net investment in foreign operations are taken into other comprehensive income. When a foreign operation is sold, exchange differences that were recorded in equity are reclassified from other comprehensive income to the income statement as part of the gain or loss on sale.

## Notes to the consolidated financial statements (continued)

### 1 Significant accounting policies (continued)

#### **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 Group 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 Group 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 consolidated statement of comprehensive income by recording revenue and related costs in line with contract activity.

- **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 Group'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.

## Notes to the consolidated financial statements (continued)

### 1 Significant accounting policies (continued)

#### **Employee benefits**

##### *a) Long-term service benefits*

The Group 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 Group operates an equity-settled, share-based compensation plan allowing the Group's employees to receive shares. The fair value of the employee services received in exchange for the grant of the Group'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 Group 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 consolidated 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.

#### **Provisions**

A provision is recognised when the Group 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 consolidated 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. The increase in the provision due to passage of time is recognised as interest expense.

#### **Net financial income**

Interest income is recognised using the effective interest method. When a loan and receivable is impaired, the company reduces the carrying amount to its recoverable amount, being the estimated future cash flow discounted at the original effective interest rate of the instrument, and continues unwinding the discount as interest income. Interest income on impaired loan and receivables is recognised using the original effective interest rate.

## Notes to the consolidated financial statements (continued)

### 1 Significant accounting policies (continued)

#### ***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 consolidated statement of comprehensive income over the period of the borrowings using the effective interest method.

#### ***Leases***

Leases on terms in which the Group 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 consolidated statement of comprehensive income on a straight-line basis over the term of the lease.

#### ***Dividend distribution***

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

#### ***Consolidation***

Subsidiaries are all entities (including special purpose entities) over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group and are de-consolidated from the date that control ceases.

The Group applies the acquisition method to account for business combinations. The consideration transferred for the acquisition of a subsidiary is the fair values of the assets transferred, the liabilities incurred and the equity interests issued by the Group. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition related costs are expensed as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. On an acquisition-by-acquisition basis, the Group recognises any non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the recognised amounts of identifiable acquiree's net assets.

## Notes to the consolidated financial statements (continued)

### 1 Significant accounting policies (continued)

#### ***Consolidation (continued)***

Goodwill is initially measured as excess of the aggregate of the consideration transferred and the fair value of non-controlling interest in the acquiree and acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the Group's share of the identifiable net assets acquired. If this is lower than the fair value of the net assets of the subsidiary acquired in the case of a bargain purchase, the difference is recognised directly in profit or loss.

Inter-company transactions, balances and unrealised gains on transactions between Group companies are eliminated. Unrealised losses are also eliminated. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

### 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 Group 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 Group reviews its receivables to assess impairment on a monthly basis. In determining whether an impairment loss should be recorded in the consolidated statement of comprehensive income, the Group 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) Deferred income tax asset recognition*

The net deferred tax asset represents income taxes recoverable through future deductions from taxable profits. Deferred income tax assets are recorded to the extent that realisation of the related tax benefit is probable. In determining future taxable profits and the amount of tax benefits that are probable in the future, management makes judgements and applies estimation based on previous years taxable profits and expectations of future income that are believed to be reasonable under the existing circumstances. Due to the fact that the parent Company utilises research expenditure tax relief which is higher than taxable profits, no deferred tax assets are recognised in the financial statements.

## Notes to the consolidated financial statements (continued)

### 2 Critical accounting estimates and judgements (continued)

#### *Judgements*

The Group 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 Group 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

	<b>2012</b>	<b>2011</b>
	<b>HRK '000</b>	<b>HRK '000</b>
Sales revenue from products	1,131,034	425,581
Sales revenue from services	782,270	740,249
	<u>1,913,304</u>	<u>1,165,830</u>

## Notes to the consolidated financial statements (continued)

### 4 Segment reporting

The Group 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 operating exchange rate differences and administration expenses.

When determining the operating segments, the Group has looked at which market and to what type of customers the Group'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 Group is organised into business units and has three primary reportable operating segments as follows:

- Networks include products and solutions for mobile and fixed broadband access, core networks, and transmission.
- Global Services include managed services, consulting and systems integration, customer support and network rollout services
- Multimedia provides enablers and applications for operators.

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 Group's assets are located in Croatia.

	<b>2012</b>	<b>2011</b>
	<b>HRK '000</b>	<b>HRK '000</b>
Sales revenue in domestic market	268,095	262,861
Sales revenue in Russia, Belarus, Kazakhstan, Georgia, Kyrgyzstan, Moldova, Uzbekistan and Armenia	876,890	133,675
Sales revenue to Ericsson, Note 28 (a)	551,998	484,381
Sales revenue in Bosnia and Herzegovina, Montenegro, Macedonia and Kosovo	204,925	269,631
Other export sales revenue	11,396	15,282
	<u>1,913,304</u>	<u>1,165,830</u>

## Notes to the consolidated financial statements (continued)

### 4 Segment reporting (continued)

	Networks		Professional services		Multimedia		Unallocated		Total	
	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>Sales revenue - gross</b>	1,250,541	620,552	523,312	509,850	146,396	39,948	-	-	1,920,249	1,170,350
<b>Inter-segment sales</b>	(2,170)	(2,260)	(4,771)	(2,260)	(4)	-	-	-	(6,945)	(4,520)
Sales revenue -- net	1,248,371	618,292	518,541	507,590	146,392	39,948	-	-	1,913,304	1,165,830
<b>Operating profit/(loss)</b>	62,642	(17,385)	79,721	37,180	5,479	(1,785)	(31,231)	(29,210)	116,611	(11,200)
Finance income									24,487	34,733
Finance expense									(80)	(1,166)
Profit before tax									141,018	22,367
Income tax									(14,105)	5,626
<b>Profit for the year</b>									<b>126,913</b>	<b>27,993</b>

#### Other segment information:

Segment liabilities	148,075	111,641	69,913	78,024	21,334	6,730	175,615	144,199	414,937	340,594
Segment assets	214,528	237,600	83,914	90,703	22,089	31,625	849,134	831,376	1,169,665	1,191,304

Revenues of approximately HRK 1,349,489 thousand (2011: HRK 736,897 thousand) are derived from external customers whose single revenues are 10 per cent or more of Group's sales revenues, and they are realised in all three segments.

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

	2012	2011
	HRK '000	HRK '000
Segment liabilities	239,322	196,395
<b>Unallocated:</b>		
Non-current liabilities	4,464	5,965
Current liabilities:		
Interest-bearing borrowings	1,710	2,047
Accrued charges and deferred revenue	54,334	80,642
Trade and other payables	96,541	36,414
Provisions	18,566	19,131
Total liabilities per the consolidated statement of financial position	<u>414,937</u>	<u>340,594</u>



## Notes to the consolidated financial statements (continued)

### 4 Segment reporting (continued)

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

	<b>2012</b>	<b>2011</b>
	<b>HRK '000</b>	<b>HRK '000</b>
Segment assets	320,531	359,928
<b>Unallocated:</b>		
Non-current assets	151,793	196,815
Current liabilities:		
Trade receivables	21,513	23,872
Other receivables	15,169	12,327
Financial assets at fair value through profit or loss	145,365	68,249
Prepayments and accrued income	3,655	4,808
Cash and cash equivalents	511,639	525,305
Total assets per the consolidated statement of financial position	<u>1,169,665</u>	<u>1,191,304</u>

### 5 Expenses by nature

	<b>2012</b>	<b>2011</b>
	<b>HRK '000</b>	<b>HRK '000</b>
Changes in contract work in progress (Note 15)	(11,062)	10,147
Material and external services <sup>(1) (2)</sup>	1,300,267	633,393
Personnel expenses (Note 7)	477,263	423,448
Depreciation and amortisation (Notes 11,12)	44,619	48,522
	<u>1,811,087</u>	<u>1,115,510</u>

<sup>1)</sup>Including audit fee expenses of HRK 420 thousand (2011: HRK 420 thousand)

<sup>2)</sup>Material and external services costs do not include the effect of reclassification of other income and other operating expenses to material and external services amounting to HRK 12.240 thousand (2011: HRK 7.804 thousand)

### 6 Other operating expenses

	<b>2012</b>	<b>2011</b>
	<b>HRK '000</b>	<b>HRK '000</b>
Research expenses	2,844	2,954
Impairment reversal gain/(loss) on loans and receivables	(1,412)	50,334
Other expenses	-	1,622
	<u>1,432</u>	<u>54,910</u>

## Notes to the consolidated financial statements (continued)

### 7 Personnel expenses

	<b>2012</b>	<b>2011</b>
	<b>HRK '000</b>	<b>HRK '000</b>
Net salaries	236,339	209,718
Taxes and contributions	209,903	190,637
Other payroll-related costs	25,764	19,099
Equity-settled transactions (Note 24 (b))	5,257	3,994
	<u>477,263</u>	<u>423,448</u>

Personnel expenses include HRK 69,756 thousand (2011: HRK 68,002 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 11,939 thousand (2011: HRK 3,534 thousand) in respect of voluntary redundancy costs. Movements in provision related to these costs are described in Note 26, Provisions.

As at 31 December 2012, total number of employees was 1,621 (2011: 1,664).

## Notes to the consolidated financial statements (continued)

### 8 Finance income and expense

#### *Finance income*

	<b>2012</b>	<b>2011</b>
	<b>HRK '000</b>	<b>HRK '000</b>
Interest income (Note 8 (a))	20,625	19,574
Net gains from remeasurement of financial assets at fair value through profit or loss (Note 8 (c))	2,536	1,595
Amortization of discount (Note 8 (b))	3,021	3,483
Net foreign exchange (loss)/gain	(1,695)	10,081
	<u>24,487</u>	<u>34,733</u>

#### *Finance expense*

	<b>2012</b>	<b>2011</b>
	<b>HRK '000</b>	<b>HRK '000</b>
Interest expense	80	1,166
	<u>80</u>	<u>1,166</u>

#### 8 (a)

	<b>2012</b>	<b>2011</b>
	<b>HRK '000</b>	<b>HRK '000</b>
Interest income		
- on loans to customers	2,806	3,871
- on debt securities	660	660
- on term deposits	15,215	14,436
- on other receivables	1,944	607
	<u>20,625</u>	<u>19,574</u>

#### 8 (b)

The Group released HRK 3.021 thousand (2011: HRK 3,483 thousand) into finance income due to amortisation of discount related to receivables impairment provision.

## Notes to the consolidated financial statements (continued)

### 8 Finance income and expense (continued)

8 (c)

	2012	2011
	HRK '000	HRK '000
Net gains/(losses) from remeasurement of financial assets at fair value through profit or loss		
- Equity securities	(224)	236
- Investment in investment funds	2,050	1,560
- Debt securities	710	(201)
	<u>2,536</u>	<u>1,595</u>

### 9 Income tax expense

Income tax has been calculated on the taxable income at statutory tax rates applicable to profits in the respective countries.

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

	2012	2011
	HRK '000	HRK '000
Current income tax expense	<u>(113)</u>	<u>-</u>
Total deferred tax (expense)/credit relating to the origination and reversal of temporary differences (Note 14)	<u>(13,992)</u>	<u>5,626</u>
Total income tax (expense)/credit	<u>(14,105)</u>	<u>5,626</u>

As disclosed in Note 2, Critical accounting estimates and judgements, due to the fact that the Group utilises research expenditure tax relief which is higher than taxable profits, in 2012 the Group released deferred tax asset of HRK 13,992 thousand. No deferred tax assets are recognised in the consolidated financial statements.

Deferred tax recognised directly as a debit to equity:

	2012	2011
	HRK '000	HRK '000
Relating to equity-settled transactions (Note 14)	<u>-</u>	<u>799</u>

## Notes to the consolidated financial statements (continued)

### 9 Income tax expense (continued)

The tax on the Group's profit before tax differs from the theoretical amount that would arise using the weighted average tax rate applicable to profits of the consolidated entities as follows:

	<b>2012</b>	<b>2011</b>
	<b>HRK '000</b>	<b>HRK '000</b>
Profit before tax	<u>141,018</u>	<u>22,367</u>
Tax calculated at domestic tax rates applicable to profits in the respective countries	28,131	4,479
Tax effects of:	-	-
Expenses not deductible for tax purposes	2,674	8,990
Income not subject to tax	-	663
Tax incentives	(26,939)	(14,123)
Utilisation of tax losses	<u>(3,753)</u>	<u>(9)</u>
Tax charge	<u>113</u>	<u>-</u>
Effective tax rate	<u>0.1%</u>	<u>0.0%</u>

Tax incentives include only part of additional tax allowances for certain expenditure totalling HRK 26,939 thousand (2011: HRK 14,123 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 parent Company's and its subsidiaries 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 Group's management is not aware of any circumstances, which may give rise to a potential material liability in this respect.

### 10 Earnings per share

	<b>2012</b>	<b>2011</b>
Profit for the year (HRK '000)	126,913	27,993
Weighted Average Number of Shares Outstanding at the year-end	<u>1,327,157</u>	<u>1,323,780</u>
Earnings per share (HRK)	<u>95.63</u>	<u>21.15</u>

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

## Notes to the consolidated financial statements (continued)

### 11 Property, plant and equipment

	Land and buildings HRK '000	Plant and equipment HRK '000	Other HRK '000	Total HRK '000
<b>As at 1 January 2011</b>				
Cost or valuation	155,455	295,049	328	450,832
Accumulated depreciation	(99,607)	(222,255)	(197)	(322,059)
Net book amount	<u>55,848</u>	<u>72,794</u>	<u>131</u>	<u>128,773</u>
<b>Year ended 31 December 2011</b>				
Opening net book amount	55,848	72,794	131	128,773
Additions	-	52,748	-	52,748
Disposals	-	(1,728)	-	(1,728)
Depreciation charge	(3,307)	(42,299)	(8)	(45,614)
<b>Closing net book amount</b>	<b><u>52,541</u></b>	<b><u>81,515</u></b>	<b><u>123</u></b>	<b><u>134,179</u></b>
<b>As at 31 December 2011</b>				
Cost or valuation	155,455	312,636	328	468,419
Accumulated depreciation	(102,914)	(231,121)	(205)	(334,240)
Net book amount	<u>52,541</u>	<u>81,515</u>	<u>123</u>	<u>134,179</u>
<b>Year ended 31 December 2012</b>				
Opening net book amount	52,541	81,515	123	134,179
Additions	-	30,354	-	30,354
Disposals	-	(4,718)	-	(4,718)
Depreciation charge	(3,298)	(39,483)	(8)	(42,789)
<b>Closing net book amount</b>	<b><u>49,243</u></b>	<b><u>67,668</u></b>	<b><u>115</u></b>	<b><u>117,026</u></b>
<b>As at 31 December 2012</b>				
Cost or valuation	155,455	305,999	328	461,782
Accumulated depreciation	(106,212)	(238,331)	(213)	(344,756)
Net book amount	<u>49,243</u>	<u>67,668</u>	<u>115</u>	<u>117,026</u>

Included in cost of property, plant and equipment is HRK 187,108 thousand (2011: HRK 166,589 thousand) of fully depreciated property, plant and equipment that is still used by the Group.

As at 31 December 2012, the Group had contracts totalling HRK 3,643 thousand (2011: HRK 2,158 thousand) related to future equipment purchases.

Depreciation expense of HRK 40,478 thousand (2011: HRK 41,904 thousand) has been charged in cost of sales, HRK 1,453 thousand (2011: HRK 2,532 thousand) in selling expenses and HRK 858 thousand (2011: HRK 1,178 thousand) in administrative expenses.

## Notes to the consolidated financial statements (continued)

### 11 Property, plant and equipment (*continued*)

The Group acts as a lessor under operating leases, mainly land and buildings. Property leased to others with a carrying value of HRK 16,580 thousand (2011: HRK 17,490 thousand) is included within land and buildings. These assets are depreciated at the same depreciation rates as other buildings. HRK 16,029 thousand (2011: HRK 18,351 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:

	<b>2012</b>	<b>2011</b>
	<b>HRK '000</b>	<b>HRK '000</b>
Less than one year	3,240	3,164
Between one and five years	1,620	1,582
	<u>4,860</u>	<u>4,746</u>

## Notes to the consolidated financial statements (continued)

### 12 Intangible assets

The movement on intangible assets in the year ended 31 December 2012 may be analysed as follows:

	<b>Application software HRK '000</b>
<b>As at 1 January 2011</b>	
Cost or valuation	19,491
Accumulated amortization	(14,670)
Net book amount	<u>4,821</u>
<b>Year ended 31 December 2011</b>	
Opening net book amount	4,821
Additions	1,513
Amortization charge	(2,909)
<b>Closing net book amount</b>	<u><b>3,425</b></u>
<b>As at 31 December 2011</b>	
Cost or valuation	18,395
Accumulated amortization	(14,970)
Net book amount	<u>3,425</u>
<b>Year ended 31 December 2012</b>	
Opening net book amount	3,425
Additions	2,719
Amortization charge	(1,830)
<b>Closing net book amount</b>	<u><b>4,314</b></u>
<b>As at 31 December 2012</b>	
Cost or valuation	10,855
Accumulated amortization	(6,541)
Net book amount	<u>4,314</u>

Included in cost of intangible assets is HRK 3,250 thousand (2011: HRK 11,956 thousand) of fully amortised intangible assets that are still used by the Group.

Amortisation of HRK 1,731 thousand (2011: HRK 2,672 thousand) has been charged in cost of sales, HRK 62 thousand (2011: HRK 161 thousand) in selling expenses and HRK 37 thousand (2011: HRK 75 thousand) in administrative expenses.



## Notes to the consolidated financial statements (continued)

### 13 Loans and receivables

	<b>2012</b>	<b>2011</b>
	<b>HRK '000</b>	<b>HRK '000</b>
Deposits with financial institutions, denominated in foreign currency	8,241	8,834
Non-current receivables from foreign customers, denominated in foreign currency	20,900	32,717
Non-current receivables from domestic customers, denominated in HRK	49	2,335
Receivables for sold apartments		
- denominated in foreign currency	5,529	5,517
- denominated in HRK	345	628
Total loans and receivables	35,064	50,031
Impairment allowance on loans and receivables	(4,651)	(4,860)
	<u>30,413</u>	<u>45,171</u>

Deposits with financial institutions of HRK 7,230 thousand (2011: HRK 7,293 thousand) are placed as guarantee deposits for housing loans provided to the Group's employees, earning interest at fixed rate 0.37% per annum (2011: 0.37% per annum), and with a remaining maturity of over three years. The remaining amount of HRK 1,011 thousand (2011: HRK 1,541 thousand) 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	<b>2012</b>	<b>2011</b>
	<b>HRK '000</b>	<b>HRK '000</b>
2013	-	18,224
2014	14,667	12,104
2015-2020	6,282	4,724
	<u>20,949</u>	<u>35,052</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 2,209 thousand (2011: HRK 2,272 thousand) is recognised in respect of these loans and amortised through the consolidated statement of comprehensive income, using the effective interest rate method at a rate of 7% per annum (2011: 7% per annum).

## Notes to the consolidated financial statements (continued)

### 14 Deferred tax assets

#### *Recognised deferred tax assets and liabilities*

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

	2012		Credited/ (charged) to consolidated statement of comprehensive income	Credited/ (charged) to equity	2011		Credited/ (charged) to consolidate d statement of comprehen sive income	Credited/ (charged) to equity
	Assets	Liabilities	2012	2012	Assets	Liabilities	2011	2011
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Receivables	-	-	(8,890)	-	8,890	-	2,747	-
Inventories	-	-	(2,260)	-	2,260	-	1,809	-
Employee benefits	-	-	(826)	-	826	-	1	-
Non-current receivables for sold apartments	-	-	(454)	-	454	-	(13)	-
Negative fair value of financial instruments	-	-	(447)	-	447	-	-	-
Accrued charges	-	-	(1,115)	-	1,115	-	283	-
Increase in equity related to equity- settled transactions	-	-	(12,143)	12,143	12,143	(12,143)	799	(799)
			(26,135)	12,143	26,135	(12,143)	5,626	(799)
Set-off of tax	-	-	12,143	(12,143)	(12,143)	12,143	-	-
Deferred tax assets	-	-	(13,992)	-	13,992	-	5,626	(799)

As disclosed in Note 2, Critical accounting estimates and judgements, due to the fact that the Group utilises research expenditure tax relief which is higher than taxable profits, in 2012 the Group released deferred tax asset of HRK 13,992 thousand. No deferred tax assets are recognised in the consolidated financial statements.

## Notes to the consolidated financial statements (continued)

### 14 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 Group did not recognise deferred income tax assets of HRK 53,474 thousand (2011: HRK 57,161 thousand) in respect of tax losses amounting to HRK 267,372 thousand (2011: HRK 285,756 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:

	<b>HRK '000</b>
Tax loss from 2009 – expires 31 December 2014	63,149
Tax loss from 2010 – expires 31 December 2015	151,596
Tax loss from 2011 – expires 31 December 2016	52,481
Tax loss from 2012 – expires 31 December 2017	146
	<u>267,372</u>

### 15 Inventories

	<b>2012</b>	<b>2011</b>
	<b>HRK '000</b>	<b>HRK '000</b>
Raw materials	2,539	3,445
Contract work in progress	40,389	29,327
Total inventories	42,928	32,772
Impairment allowance	(9,660)	(10,067)
	<u>33,268</u>	<u>22,705</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 consolidated statement of comprehensive income.

## Notes to the consolidated financial statements (continued)

### 16 Trade receivables

	<b>2012</b>	<b>2011</b>
	<b>HRK '000</b>	<b>HRK '000</b>
Foreign trade receivables	155,282	164,964
Current portion of non-current foreign receivables	20,406	23,485
Total current foreign receivables	<u>175,688</u>	<u>188,449</u>
Domestic trade receivables	83,038	125,029
Current portion of non-current domestic receivables	3,370	6,622
Total current domestic receivables	<u>86,408</u>	<u>131,651</u>
Impairment allowance on receivables	<u>(34,509)</u>	<u>(46,495)</u>
	<u>227,586</u>	<u>273,604</u>

Included in trade receivables is HRK 2,497 thousand (2011: HRK 4,197 thousand) of contract work in progress.

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

	<b>2012</b>	<b>2011</b>
	<b>HRK '000</b>	<b>HRK '000</b>
As at 1 January (Notes 13, 16)	51,355	33,626
Provision for receivables impaired during the year	7,262	80,227
Receivables written off during the year as uncollectible	(9,607)	(37,655)
Unused amounts reversed	(6,829)	(21,298)
Amortisation of discount	(3,021)	(3,545)
As at 31 December (Notes 13, 16)	<u>39,160</u>	<u>51,355</u>

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

Of the total HRK 39,160 thousand (2011: HRK 51,355 thousand) of impairment allowances as at 31 December 2012, HRK 36,950 thousand (2011: HRK 31,292 thousand) relates to Customer loans and receivables.

## Notes to the consolidated financial statements (continued)

### 17 Other receivables

	<b>2012</b>	<b>2011</b>
	<b>HRK '000</b>	<b>HRK '000</b>
Net receivables for prepaid VAT	13,241	8,746
Receivables from employees	336	318
Accrued interest receivable	671	2,307
Other receivables	921	956
	<u>15,169</u>	<u>12,327</u>

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

### 18 Financial assets at fair value through profit or loss

	<b>2012</b>	<b>2011</b>
	<b>HRK '000</b>	<b>HRK '000</b>
<i>Financial assets at fair value through profit or loss</i>		
- Debt securities, Ministry of Finance	14,195	13,480
- Equity securities	402	630
- Investment in open-ended investment funds	130,768	54,139
	<u>145,365</u>	<u>68,249</u>

### 19 Cash and cash equivalents

	<b>2012</b>	<b>2011</b>
	<b>HRK '000</b>	<b>HRK '000</b>
Cash and demand deposits	301,116	56,949
Term deposits originated by the Group, with original maturity up to 3 months	210,523	468,356
	<u>511,639</u>	<u>525,305</u>

## Notes to the consolidated financial statements (continued)

### 20 Equity

#### (a) Share capital

As at 31 December 2012, the share capital of the Group is represented by 1,331,650 (2011: 1,331,650) of authorised, issued and fully paid ordinary shares, with a total registered value of HRK 133,165 thousand (2011: HRK 133,165 thousand). The nominal value of one share is HRK 100 (2011: 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 Group's shareholders as at 31 December 2012 are:

	<b>2012</b>	<b>2012</b>	<b>2011</b>	<b>2011</b>
	<b>Number of shares</b>	<b>% held</b>	<b>Number of shares</b>	<b>% held</b>
Telefonaktiebolaget LM Ericsson	653,473	49.07	653,473	49.07
Small shareholders	674,769	50.67	670,844	50.38
Croatian Privatisation Fund	-	-	3,096	0.23
Treasury shares	3,408	0.26	4,237	0.32
	<u>1,331,650</u>	<u>100.00</u>	<u>1,331,650</u>	<u>100.00</u>

#### (b) Treasury shares

During 2007, the Group 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 Group 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 and 2012, the Group acquired an additional 8,893 and 2,376 of its own shares, respectively. The amount paid in 2009 was HRK 11,380 thousand and HRK 2,462 thousand in 2012, both out of 2008 net income as decided by the General Assembly held on 26 May 2009. These shares are initially held as "treasury shares" and are regularly granted to key management and other employees as a part of the share-based program established during 2004, as described in Note 23 (b).

Movements in treasury shares are as follows:

	<b>2012</b>	<b>2011</b>
	<b>Number of shares</b>	<b>Number of shares</b>
As at 1 January (Note 20 (a))	4,237	9,288
Purchases during the year	2,376	-
Distributed during the year	(3,205)	(5,051)
As at 31 December (Note 20 (a))	<u>3,408</u>	<u>4,237</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 Group recorded the required level of legal reserves in the year 2000 and no further allocation to legal reserves is required. Legal reserves up to 5% of total share capital are not distributable.

## Notes to the consolidated financial statements (continued)

### 21 Proposed dividends

Dividends payable are not accounted for until they have been ratified at the General Assembly of shareholders. On 5 June 2012, the General Assembly approved a regular dividend in respect of 2011 of HRK 20.00 per share, and additional extraordinary dividend of HRK 150.00 per share, totalling HRK 225.7 million. At a meeting held on 19 February 2013, the Management Board proposed a regular dividend in respect of 2012 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 2003 plus a portion of retained earnings realized in 2004 after approval by the General Assembly, which will be held on 28 May 2013.

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

	<b>2012</b>	<b>2011</b>
	<b>HRK '000</b>	<b>HRK '000</b>
HRK 170.00 per share for 2011	225,695	-
HRK 190.00 per share for 2010	-	251,289
	<u>                    </u>	<u>                    </u>

### 22 Capital management

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

The Group monitors capital using the statutory minimum capital requirement. Shareholders' equity is disclosed in Note 20 to the consolidated financial statements.

## Notes to the consolidated financial statements (continued)

### 23 Interest-bearing borrowings

During 2008, the Group 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 Group on behalf of the customer and, based on the cession agreement between the Group, the customer and the Ministry, the Ministry is obliged to repay the due amounts in favour of the customer directly to HBOR. The Group'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 1,710 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.

	<b>2012</b>	<b>2011</b>
	<b>HRK '000</b>	<b>HRK '000</b>
Non-current portion of borrowings	12	1,435
Current portion of borrowings	1,710	2,047
	<u>1,722</u>	<u>3,482</u>

### 24 Employee benefits

#### *(a) Long-term service benefits*

The Group 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 Group'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 parent Company signed an Annex to the Union Agreement based on which employees are entitled to a benefit upon early retirement.

However, the parent 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 10<sup>th</sup> year and ending in the 40<sup>th</sup> year. The principal actuarial assumptions used to determine retirement and jubilee obligations as at 31 December 2012 were a 6% discount rate (2011: 6%) and a 3,1% (2011: 2.75%) rate of average employment turnover.



## Notes to the consolidated financial statements (continued)

### 24 Employee benefits (continued)

#### (a) Long-term service benefits (continued)

Movements in long-term service benefits were as follows:

	<b>2012</b>	<b>2012</b>	<b>2012</b>	<b>2011</b>	<b>2011</b>	<b>2011</b>
	<b>Jubilee awards</b>	<b>Retirement</b>	<b>Total</b>	<b>Jubilee awards</b>	<b>Retirement</b>	<b>Total</b>
	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>
As at 1 January	4,128	402	4,530	4,123	768	4,891
Obligation created during the year	300	56	356	507	71	578
Obligation fulfilled during the year	(300)	-	(300)	(447)	(8)	(455)
Obligation reversed during the year	(69)	(65)	(134)	(55)	(429)	(484)
As at 31 December	<u>4,059</u>	<u>393</u>	<u>4,452</u>	<u>4,128</u>	<u>402</u>	<u>4,530</u>

#### (b) Share-based payments

During 2004, the parent 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 parent 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 consolidated financial statements (continued)

### 24 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 in previous years (2004 – 2010)	1.140	Three to five years of service
Share grant to other employees in previous years (2004 – 2010)	14.945	Three to five years of service
Share grant to key management during 2011	550	Three to four years of service
Share grant to key management during 2011	6.650	Three to four years of service
Share grant to key management during 2012	290	Up to four years of service
Share grant to other employees during 2012	80	Up to four years of service
	<u>23,655</u>	
<i>Award program</i>		
Share grant to key management in previous years (2004 – 2010)	8,592	Upon granting
Share grant to other employees in previous years (2004 – 2010)	8,746	Upon granting
Share grant to key management during 2011	333	Upon granting
Share grant to other employees during 2011	908	Upon granting
Share grant to key management during 2012	-	Upon granting
Share grant to other employees during 2012	70	Upon granting
	<u>18,649</u>	

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
Shares granted in 2012	440	1,020,46

## Notes to the consolidated financial statements (continued)

### 24 Employee benefits (continued)

During 2012, the Group recognised HRK 5,257 thousand (2011: HRK 3,994 thousand) of expenses in respect of share-based payments, which are included in personnel expenses as disclosed in Note 7. During 2012, there were new Loyalty programs. The Award program for 2012 included "the length of service with the Group component" and the shares granted under this program were distributed during 2012. Shares granted under previous programs to employees who left the Group before vesting date expired.

3,175 of shares granted under the Loyalty programs from previous years vested during 2012. The total weighted average cost of shares exercised during 2012 under the Award and Loyalty programs amounted to HRK 3,977 thousand (2011: HRK 7,808 thousand).

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

	<b>2012</b>	<b>2011</b>
	<b>Number of</b>	<b>Number of</b>
	<b>shares</b>	<b>shares</b>
As at 1 January	9,220	5,900
Granted	440	8,441
Exercised	(3,205)	(5,051)
Expired	(385)	(70)
As at 31 December	<u>6,070</u>	<u>9,220</u>

### 25 Trade and other payables

	<b>2012</b>	<b>2011</b>
	<b>HRK '000</b>	<b>HRK '000</b>
Trade payables	34,076	37,040
Liabilities to employees	76,526	38,412
Other current liabilities	13,013	13,227
	<u>123,615</u>	<u>88,679</u>

## Notes to the consolidated financial statements (continued)

### 26 Provisions

Movements in provisions were as follows:

	<b>2012</b>	<b>2012</b>	<b>2012</b>	<b>2012</b>	<b>2011</b>	<b>2011</b>	<b>2011</b>	<b>2011</b>
	<b>Warranty</b>	<b>Penalty</b>	<b>Voluntary</b>	<b>Total</b>	<b>Warranty</b>	<b>Penalty</b>	<b>Voluntary</b>	<b>Total</b>
	<b>reserve</b>	<b>reserve</b>	<b>redundancy</b>		<b>reserve</b>	<b>reserve</b>	<b>redundancy</b>	
	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK'000</b>	<b>HRK '000</b>
As at 1 January	8,131	11,000	2,837	21,968	10,356	6,347	394	17,097
additional provisions	4,431	940	11,939	17,310	3,861	6,793	3,534	14,188
unused amounts								
reversed	(251)	(221)	-	(472)	(1,608)	(2,140)	-	(3,748)
used during the year	(2,969)	(4,000)	(13,271)	(20,240)	(4,478)	-	(1,091)	(5,569)
As at 31 December	<u>9,342</u>	<u>7,719</u>	<u>1,505</u>	<u>18,566</u>	<u>8,131</u>	<u>11,000</u>	<u>2,837</u>	<u>21,968</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 parent 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 2013 are HRK 1,505 thousand (2011: HRK 2,837 thousand).

### 27 Accrued charges and deferred revenue

	<b>2012</b>	<b>2011</b>
	<b>HRK '000</b>	<b>HRK '000</b>
Advances from domestic customers	2,493	3,044
Advances from foreign customers	8,475	5,340
Deferred revenue	89,187	107,530
Accrued charges for unused holidays	10,945	10,701
Accrued charges for legal claims	971	951
Accrued charges in respect of service contracts	32,246	30,721
Other accrued charges	6,575	12,911
	<u>150,892</u>	<u>171,198</u>

Deferred revenue represents amounts due to customers under contracts for work not performed but invoices issued or cash received.

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 consolidated financial statements (continued)

### 28 Balances and transactions with related parties

For the purposes of these consolidated 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 Group is a related party to the Ericsson Group via the 49.07% (2011: 49.07%) shareholding by Telefonaktiebolaget LM Ericsson, which is also the ultimate parent of the Ericsson Group.

The Group has related-party relationships 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	
	2012	2011	2012	2011	2012	2011
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>Sales of goods and services</b>						
Sales revenue	74	-	551,924	484,381	551,998	484,381
Commission income	-	-	25	863	25	863
Other income	-	-	15,094	11,439	15,094	11,439
	<u>74</u>	<u>-</u>	<u>567,043</u>	<u>496,683</u>	<u>567,117</u>	<u>496,683</u>
<b>Purchases of goods and services</b>						
Licences	6,623	3,343	36,915	17,791	43,538	21,134
Technical cooperation fee		-	5,654	7,202	5,654	7,202
Cost of sales		452	1,039,087	363,100	1,039,087	363,552
	<u>6,623</u>	<u>3,795</u>	<u>1,081,656</u>	<u>388,093</u>	<u>1,088,279</u>	<u>391,888</u>

The sales of goods and services transactions have been directly negotiated between the involved parties and agreed on an individual basis. The Group 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.

## Notes to the consolidated financial statements (continued)

### 28 Balances and transactions with related parties (continued)

#### (b) Key management compensation

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

	<b>2012</b>	<b>2011</b>
	<b>HRK '000</b>	<b>HRK '000</b>
Salaries and other short-term employee benefits	16,636	16,754
Other long-term benefits	14	14
Share-based payments	577	226
	<u>17,227</u>	<u>16,994</u>

The members of the executive management and the Supervisory Board held 4,024 ordinary shares at the year-end (2011: 4,421 shares).

In addition, the Group paid remuneration totalling HRK 321 thousand (2011: HRK 337 thousand) to the Supervisory Board during 2012.

#### (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:

	<b>Receivable</b>		<b>Payable</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>
<b>Main shareholder</b>				
Telefonaktiebolaget LM Ericsson (LME)	37	-	4,119	474
<b>Ericsson Group consolidated companies</b>				
Ericsson AB (EAB)	54,682	57,904	106,818	45,673
Ericsson GMBH Group (EDD)	4,874	6,578	583	-
Ericsson Austria GMBH (SEA)	1,184	2,452	-	-
Ericsson Japan K.K. (NRJ)	2,419	-	-	-
Ericsson Network Services B.V. (ENN)	2,068	232	-	-
LM Ericsson Ltd. (LMI)	1,537	374	1,035	262
Ericsson d.o.o. (EVN)	1,453	-	-	86
Ericsson Ltd. Madrid, Spain (ETL)	2,461	1,414	-	-
Ericsson Corporation, Russia (ECR)	1,849	1,131	96	170
Ericsson Telecommunicatia B.V. (ETM)	1,429	1,462	1,120	1,290
Ericsson SA/NV (EBR)	1,313	565	-	-
Ericsson SP Z.O.O. (EPO)	1,203	169	-	-
Other Ericsson Group companies	4,681	15,210	1,919	2,782
	<u>81,190</u>	<u>87,491</u>	<u>115,690</u>	<u>50,737</u>

## Notes to the consolidated financial statements (continued)

### **29 Financial risk management**

The Group'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 Group'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 Group 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 Group. 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 Group is exposed to US dollars and to the 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 Group may enter into foreign currency forward contracts to hedge economically its exposure to currency risk arising on operating cash flows.

As at 31 December 2012, if the euro had weakened/strengthened by 1.56% (2011: 1.35%) against the Croatian kuna, and if the US dollar had weakened/strengthened by 2.23% (2011: 0.28%), with all other variables held constant, the net result after tax for the reporting period would have been HRK 10,801 thousand lower/higher (2011: HRK 8,440 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 consolidated financial statements (continued)

### 29 Financial risk management (continued)

#### (a) Currency risk (continued)

The tables below present the currency analysis and resulting gap.

#### 2012

	EUR	USD	Other currency	Total foreign currencies	HRK	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Loans and receivables	22,713	7,306	-	30,019	394	30,413
Trade and other receivables	212,962	11,080	13,860	237,902	86,043	323,945
Financial assets at fair value through profit or loss	-	-	-	-	145,365	145,365
Cash and cash equivalents	462,483	9,333	893	472,709	38,930	511,639
	<b>698,158</b>	<b>27,719</b>	<b>14,753</b>	<b>740,630</b>	<b>270,732</b>	<b>1,011,362</b>
Interest-bearing borrowings*	1,958	-	-	1,958	-	1,958
Trade and other payables	122,018	3,766	5,512	131,296	108,009	239,305
	<b>123,976</b>	<b>3,766</b>	<b>5,512</b>	<b>133,254</b>	<b>108,009</b>	<b>241,263</b>
Currency gap	<b>574,182</b>	<b>23,953</b>	<b>9,241</b>	<b>607,376</b>	<b>162,723</b>	<b>770,099</b>

\* include interest payable of HRK 248 thousand

#### 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	10,067	-	42,836	2,335	45,171
Trade and other receivables	211,973	20,732	23	232,728	140,694	373,422
Financial assets at fair value through profit or loss	-	-	-	-	68,249	68,249
Cash and cash equivalents	490,732	13,524	38	504,294	21,011	525,305
	<b>735,474</b>	<b>44,323</b>	<b>61</b>	<b>779,858</b>	<b>232,289</b>	<b>1,012,147</b>
Interest-bearing borrowings*	3,725	-	-	3,725	-	3,725
Trade and other payables	51,017	6,586	1,845	59,448	79,968	139,416
	<b>54,742</b>	<b>6,586</b>	<b>1,845</b>	<b>63,173</b>	<b>79,968</b>	<b>143,141</b>
Currency gap	<b>680,732</b>	<b>37,737</b>	<b>(1,784)</b>	<b>716,685</b>	<b>152,321</b>	<b>869,006</b>

\* include interest payable of HRK 243 thousand



## Notes to the consolidated financial statements (continued)

### 29 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 Group 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 considered low. The Group 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 2012:

- if the effective EUR interest rate on EUR borrowings had increased/decreased by 0.73% (2011: 0.33%) on an annual level, the net result due to changes in EUR credits and borrowings after tax for the reporting period would have been HRK 10 thousand lower/higher (2011: HRK 20 thousand);
- if the effective EUR interest rate on EUR deposits had increased/decreased by 0.08% (2011: 0.48%) on an annual level, the net result due to changes in EUR deposits after tax for the reporting period would have been HRK 5 thousand higher/lower (2011: HRK 28 thousand);
- if the effective HRK interest rate on HRK deposits had increased/decreased by 0.36% (2011: 0.36%) on an annual level, the net result due to changes in investment funds after tax for the reporting period would have been HRK 374 thousand higher/lower (2011: HRK 157 thousand).

The following table presents the annual average interest rates exposure of financial assets and liabilities.

	<b>2012</b>	<b>2011</b>
	<b>Average</b>	<b>Average</b>
	<b>interest rates</b>	<b>interest rates</b>
	<b>%</b>	<b>%</b>
Loans and receivables	4.37	4.99
Trade and other receivables	0.51	0.59
Financial assets at fair value through profit or loss	0.46	0.93
Cash and cash equivalents	1.81	2.67
Interest-bearing borrowings	2.19	3.71

## Notes to the consolidated financial statements (continued)

### 29 Financial risk management (continued)

#### (b) Interest rate risk (continued)

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

#### 2012

	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	-	-	-	383	21,429	8,601	30,413	30,043
Trade and other receivables	300,169	6,907	3,017	13,852	-	-	323,945	10,270
Financial assets at fair value through profit or loss	131,171	-	-	10,082	4,112	-	145,365	14,195
Cash and cash equivalents	186	300,930	210,523	-	-	-	511,639	210,523
	<b>431,526</b>	<b>307,837</b>	<b>213,540</b>	<b>24,317</b>	<b>25,541</b>	<b>8,601</b>	<b>1,011,362</b>	<b>265,031</b>
Interest-bearing borrowings*	-	-	-	1,958	-	-	1,958	1,958
Trade and other payables	239,305	-	-	-	-	-	239,305	-
	<b>239,305</b>	<b>-</b>	<b>-</b>	<b>1,958</b>	<b>-</b>	<b>-</b>	<b>241,263</b>	<b>1,958</b>
Interest rate gap	<b>192,221</b>	<b>307,837</b>	<b>213,540</b>	<b>22,359</b>	<b>25,541</b>	<b>8,601</b>	<b>710,099</b>	<b>263,073</b>

\* include interest payable of HRK 248 thousand

#### 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	(2,588)	-	-	404	38,613	8,742	45,171	42,739
Trade and other receivables	343,315	2,475	6,436	21,196	-	-	373,422	30,147
Financial assets at fair value through profit or loss	54,768	-	-	-	13,481	-	68,249	13,451
Cash and cash equivalents	-	56,949	468,356	-	-	-	525,305	468,356
	<b>395,495</b>	<b>59,424</b>	<b>474,792</b>	<b>21,600</b>	<b>52,094</b>	<b>8,742</b>	<b>1,012,147</b>	<b>554,723-</b>
Interest-bearing borrowings*	70	-	-	2,139	1,516	-	3,725	3,482
Trade and other payables	139,416	-	-	-	-	-	139,416	-
	<b>139,486</b>	<b>-</b>	<b>-</b>	<b>2,139</b>	<b>1,516</b>	<b>-</b>	<b>143,141</b>	<b>3,482</b>
Interest rate gap	<b>256,009</b>	<b>59,424</b>	<b>474,792</b>	<b>19,461</b>	<b>50,578</b>	<b>8,742</b>	<b>869,006</b>	<b>551,241</b>

\* include interest payable of HRK 243 thousand

## Notes to the consolidated financial statements (continued)

### 29 Financial risk management (continued)

#### (c) Price risk

The Group has some exposure to debt securities price risk in spite of low investments and all classified on the balance sheet at fair value through profit or loss (debt securities and investments funds). All the Group' 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 Group's net profit. The analysis is based on the assumption that the CROBEX index had increased/decreased by 16,63% (2011: 5%) and the CROBIS index had increased/decreased by 1,64% (2011: 2%). The effect on profit after tax is as follows:

Index	Impact on post-tax profit	
	2012	2011
	HRK '000	HRK '000
CROBEX	54	23
CROBIS	186	171

## Notes to the consolidated financial statements (continued)

### 29 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.

In 2011 the Group 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 Group will again be in a position of no income tax liability due to other tax reliefs (existing R&D credits 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 Group 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 by discounting of receivables. Additionally, there is credit concentration risk as the Group has a significant portion of receivables outstanding from a small number of customers. As at 31 December 2012, the five largest customers represent 61% of total net trade receivables (2011: 54%). The Group considers that its maximum exposure to credit risk is reflected in the amount of trade receivables (Notes 13 and 16) and other receivables (Note 17), net of provision 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 2012, total outstanding exposure related to customer finance was HRK 45 million (2011: HRK 65 million).

## Notes to the consolidated financial statements (continued)

### 29 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, 2012.

	Due balance	Up to 3 months	3 months to 1 year	1 to 3 years	Total
<b>2012</b>	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>
Foreign receivables	56,880	92,369	26,439	20,900	<b>196,588</b>
Domestic receivables	5,906	77,385	3,117	49	<b>86,457</b>
Receivables from related parties	7,263	73,927	-	-	<b>81,190</b>
	<b>70,049</b>	<b>243,681</b>	<b>29,556</b>	<b>20,949</b>	<b>364,235</b>
<b>2011</b>					
Foreign receivables	42,153	87,900	58,397	32,716	<b>221,166</b>
Domestic receivables	5,293	118,035	8,323	2,335	<b>133,986</b>
Receivables from related parties	19,386	68,105	-	-	<b>87,491</b>
	<b>66,832</b>	<b>274,040</b>	<b>66,720</b>	<b>35,051</b>	<b>442,643</b>

	Up to 3 months	3 months to 1 year	1 to 3 years	Over 3 years	Total
<b>2012</b>	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>
Foreign receivables	32,740	1,165	2,635	20,340	<b>56,880</b>
Domestic receivables	4,756	1,150	-	-	<b>5,906</b>
Receivables from related parties	4,137	1,514	1,612	-	<b>7,263</b>
	<b>41,633</b>	<b>3,829</b>	<b>4,247</b>	<b>20,340</b>	<b>70,049</b>
<b>2011</b>					
Foreign receivables	5,648	13,088	23,367	50	<b>42,153</b>
Domestic receivables	3,726	221	572	774	<b>5,293</b>
Receivables from related parties	7,293	9,716	2,377	-	<b>19,386</b>
	<b>16,667</b>	<b>23,025</b>	<b>26,316</b>	<b>824</b>	<b>66,832</b>

## Notes to the consolidated financial statements (continued)

### 29 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)**

	Due balance	Up to 3 months	3 months to 1 year	1 to 3 years	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>2012</b>					
Foreign receivables	56,880	75,061	15,522	12,724	<b>160,187</b>
Domestic receivables	5,906	27,337	701	-	<b>33,944</b>
Receivables from related parties	7,263	72,599	-	-	<b>79,862</b>
	<b>70,049</b>	<b>174,997</b>	<b>16,223</b>	<b>12,724</b>	<b>273,993</b>
<b>2011</b>					
Foreign receivables	42,139	66,770	42,344	31,759	<b>183,012</b>
Domestic receivables	5,293	53,261	25	-	<b>58,579</b>
Receivables from related parties	19,386	64,852	-	-	<b>84,238</b>
	<b>66,818</b>	<b>184,883</b>	<b>42,369</b>	<b>31,759</b>	<b>325,829</b>

Table 4

**Past due but not impaired customer loans and receivables**

	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
<b>2012</b>					
Foreign receivables	25,137	1,144	-	-	<b>26,281</b>
Domestic receivables	4,756	1,150	-	-	<b>5,906</b>
Receivables from related parties	2,205	3,795	1,062	-	<b>7,062</b>
	<b>32,098</b>	<b>6,089</b>	<b>1,062</b>	<b>-</b>	<b>39,249</b>
<b>2011</b>					
Foreign receivables	4,566	1,815	-	13	<b>6,394</b>
Domestic receivables	3,664	50	209	-	<b>3,923</b>
Receivables from related parties	2,479	5,735	539	-	<b>8,753</b>
	<b>10,709</b>	<b>7,600</b>	<b>748</b>	<b>13</b>	<b>19,070</b>

## Notes to the consolidated financial statements (continued)

### 29 Financial risk management (continued)

#### (d) Credit risk (continued)

As at 31 December 2012, total balance outstanding in respect of customer loans and receivables was HRK 364 million (2011: HRK 443 million), as disclosed in Table 1, of which HRK 343 million (2011: HRK 408 million) is due for payment within one year. As at 31 December 2012, the amount totalling HRK 70 million (2011: HRK 67 million) was overdue (Table 2), of which HRK 45 million (2011: HRK 40 million) was due within one year.

As at 31 December 2012, total balance outstanding in respect of customer overdue receivables as at 31 December 2012 was HRK 274 million (2011: HRK 326 million) as disclosed in Table 3. Of this total, HRK 261 million (2011: HRK 294 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 2012, impairment allowances totalling HRK 41 million (2011: HRK 49 million) were provided in respect of total customer loans and receivables. As disclosed in Table 4, amounts totalling HRK 39 million (2011: HRK 19 million), were past due but not impaired as at 31 December 2012.

## Notes to the consolidated financial statements (continued)

### 29 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 Group has no significant commitments in financial instruments, the risk lies only in its daily operations. The Group has a strong focus on its cash flow with daily updates on actual development and monthly updated forecasts. The Group's maturity profile demonstrates the strong liquidity position of the Group and therefore the risk is considered low. The table below presents the maturity analysis and resulting gap.

2012	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	-	-	383	28,659	1,371	30,413
Trade and other receivables	195,215	87,846	40,884	-	-	323,945
Current financial assets	131,171	-	10,082	4,112	-	145,365
Cash and cash equivalents	301,116	210,523	-	-	-	511,639
	<b>627,502</b>	<b>298,369</b>	<b>51,349</b>	<b>32,771</b>	<b>1,371</b>	<b>1,011,362</b>
Interest-bearing borrowings*	-	-	1,958	-	-	1,958
Trade and other payables	142,277	97,012	16	-	-	239,305
	<b>142,277</b>	<b>97,012</b>	<b>1,974</b>	<b>-</b>	<b>-</b>	<b>241,263</b>
Maturity gap	<b>485,225</b>	<b>201,357</b>	<b>49,374</b>	<b>32,771</b>	<b>1,371</b>	<b>770,099</b>

\* include interest payable of HRK 248 thousand

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
	<b>271,701</b>	<b>637,550</b>	<b>44,403</b>	<b>56,798</b>	<b>1,449</b>	<b>1,011,901</b>
Interest-bearing borrowings*	-	-	2,209	1,516	-	3,725
Trade and other payables	115,603	23,403	-	-	-	139,006
	<b>115,603</b>	<b>23,403</b>	<b>2,209</b>	<b>1,516</b>	<b>-</b>	<b>142,731</b>
Maturity gap	<b>156,098</b>	<b>614,147</b>	<b>42,194</b>	<b>55,282</b>	<b>1,449</b>	<b>869,170</b>

\* include interest payable of HRK 243 thousand



## Notes to the consolidated financial statements (continued)

### 29 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 Group'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 as shown in the balance sheet are as follows:

	Carrying amount		Unrecognised gain/(loss)	Carrying amount		Unrecognised gain/(loss)
	2012	Fair value 2012	2012	2011	Fair value 2011	2011
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Loans and receivables	30,413	30,045	(368)	45,171	45,152	(19)
Trade and other receivables	323,945	323,716	(229)	373,422	373,367	(55)
Financial assets at fair value through profit or loss	145,365	145,365	-	68,249	68,249	-
Cash and cash equivalents	511,639	511,639	-	525,305	525,305	-
Interest-bearing borrowings	(1,722)	(1,652)	70	(3,482)	(3,420)	62
Trade and other payables	<u>(239,305)</u>	<u>(239,305)</u>	<u>-</u>	<u>(139,416)</u>	<u>(139,416)</u>	<u>-</u>
	<u>770,335</u>	<u>769,808</u>	<u>(527)</u>	<u>869,249</u>	<u>869,237</u>	<u>(12)</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 2011. Current financial assets 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 reflect 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 and which are all subject to normal trade credit terms reflect fair values. The following interest rates were used for determining fair values, which are based on available market rates for similar financial instruments:

	2012	2011
Loans and receivables	6.98%	6.28%
Interest-bearing borrowings	6.87%	6.06%

## Notes to the consolidated financial statements (continued)

### **30 Contingent liabilities**

In December 1999 the parent 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 to the date of these statements.