

Ericsson Nikola Tesla d.d.

**Consolidated Financial Statements and
Auditor's report
31 December 2014**

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Profile of the parent company and its subsidiaries (the Group)

History and incorporation

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

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

Ericsson Nikola Tesla d.d. has prepared these consolidated financial statements for the Parent Company, its four active subsidiaries (of which two are domiciled in Croatia, one in Bosnia and Herzegovina and one in Kosovo), and two inactive subsidiaries domiciled in Croatia.

Principal activities

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

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

Profile of the parent company and its subsidiaries (the Group) (continued)

Supervisory Board, Management Board and executive management

The Supervisory Board

The Supervisory Board members during 2014 and up to the release of these consolidated statements were:

| | | |
|--------------------|----------------------------|--------------------------------------|
| Roland Nordgren | Reappointed on 5 June 2012 | Chairman |
| Ignac Lovrek | Reappointed on 31 May 2011 | Member; Vice-Chairman |
| Carita Jönsson | Reappointed on 5 June 2012 | Member |
| Dubravko Radošević | Reappointed on 27 May 2014 | Member |
| Zvonimir Jelić | Reappointed on 8 July 2014 | 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 2014, the executive management comprised:

| | |
|-----------------------|---|
| Gordana Kovačević | 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 |
| Patrik Wahlgren | Director, Finance |
| Snježana Bahtijari | Director, Communication |
| Tihomir Šicel | Sales Adviser |

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 60 were authorised by the Management Board on 2 April 2015 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 



Independent Auditor's Report

To the Shareholders and Management 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 statement of financial position as at 31 December 2014 and the consolidated statement of comprehensive income, statement of changes in equity and cash flows statement for the year then ended, and notes comprising 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 as adopted in the European Union, 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 consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2014, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted in the European Union.


PricewaterhouseCoopers d.o.o.
Zagreb, 2 April 2015

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Consolidated statement of comprehensive income
for the year ended 31 December 2014

| | <i>Notes</i> | 2014 | 2013 |
|---|--------------|----------------------|-----------------------|
| | | HRK '000 | HRK '000 |
| Sales revenue | 3, 4 | 1,314,868 | 1,345,226 |
| Cost of sales | | <u>(1,135,261)</u> | <u>(1,125,093)</u> |
| Gross profit | | 179,607 | 220,133 |
| Selling expenses | | (56,330) | (60,694) |
| Administrative expenses | | (34,125) | (32,676) |
| Other operating income | | 3,772 | 2,120 |
| Other operating expenses | | <u>(11,488)</u> | <u>(1,644)</u> |
| Operating profit | | <u>81,436</u> | <u>127,239</u> |
| Finance income | 7 | 6,903 | 17,284 |
| Finance expense | 7 | <u>(8)</u> | <u>(163)</u> |
| Finance income – net | | <u>6,895</u> | <u>17,121</u> |
| Profit before tax | | 88,331 | 144,360 |
| Income tax | 8 | <u>(981)</u> | <u>(5)</u> |
| Profit for the year | | <u>87,350</u> | <u>144,355</u> |
| Other comprehensive income - items that may be subsequently reclassified to profit or loss: | | | |
| Currency translation differences | | <u>78</u> | <u>13</u> |
| Total comprehensive income for the year | | <u>87,428</u> | <u>144,368</u> |
| Earnings per share (HRK) | 9 | <u>65.78</u> | <u>108.67</u> |

The notes set out on pages 11 to 60 form an integral part of these consolidated financial statements.

Consolidated statement of financial position
as at 31 December 2014

| | <i>Notes</i> | 2014 HRK '000 | 2013 HRK '000 |
|---|--------------|--------------------------------|--------------------------------|
| ASSETS | | | |
| Non-current assets | | | |
| Property, plant and equipment | <i>10</i> | 135,715 | 131,616 |
| Intangible assets | <i>11</i> | 5,481 | 2,112 |
| Loans and receivables | <i>12</i> | 19,153 | 18,801 |
| Other non-current assets | | 40 | 40 |
| Total non-current assets | | <u>160,389</u> | <u>152,569</u> |
| Current assets | | | |
| Inventories | <i>13</i> | 30,946 | 51,506 |
| Trade receivables | <i>14</i> | 190,572 | 246,152 |
| Receivables from related parties | <i>25(c)</i> | 81,849 | 71,819 |
| Other receivables | <i>15</i> | 2,820 | 3,715 |
| Income tax receivables | | 8 | - |
| Financial assets at fair value through profit or loss | <i>16</i> | 44,081 | 109,845 |
| Prepayments and accrued income | | 1,956 | 1,156 |
| Cash and cash equivalents | <i>17</i> | 186,963 | 411,328 |
| Total current assets | | <u>539,195</u> | <u>895,521</u> |
| TOTAL ASSETS | | <u>699,584</u> | <u>1,048,090</u> |

The notes set out on pages 11 to 60 form an integral part of these consolidated financial statements.

Consolidated statement of financial position (continued)
as at 31 December 2014

| | <i>Notes</i> | 2014 | 2013 |
|--------------------------------------|--------------|-----------------|------------------|
| | | HRK '000 | HRK '000 |
| EQUITY AND LIABILITIES | | | |
| Equity | | | |
| Share capital | 18(a) | 133,165 | 133,165 |
| Treasury shares | | (8,462) | (9,571) |
| Legal reserves | 18(c) | 6,658 | 6,658 |
| Retained earnings | | 204,106 | 540,884 |
| Total equity | | <u>335,467</u> | <u>671,136</u> |
| Non-current liabilities | | | |
| Interest-bearing borrowings | | 32 | 69 |
| Employee benefits | 21(a) | 5,622 | 4,697 |
| Other non-current liabilities | | 8,933 | - |
| Total non-current liabilities | | <u>14,587</u> | <u>4,766</u> |
| Current liabilities | | | |
| Payables to related parties | 25(c) | 41,661 | 60,936 |
| Interest-bearing borrowings | | 356 | 309 |
| Trade and other payables | 22 | 147,559 | 148,426 |
| Provisions | 23 | 11,073 | 13,458 |
| Accrued charges and deferred revenue | 24 | 148,881 | 149,059 |
| Total current liabilities | | <u>349,530</u> | <u>372,188</u> |
| Total liabilities | | <u>364,117</u> | <u>376,954</u> |
| TOTAL EQUITY AND LIABILITIES | | <u>699,584</u> | <u>1,048,090</u> |

The notes set out on pages 11 to 60 form an integral part of these consolidated financial statements.

Consolidated statement of changes in equity
for the year ended 31 December 2014

| | Share capital HRK '000 | Treasury shares HRK '000 Note 18 (b) | Legal reserves HRK '000 | Retained earnings HRK '000 | Total HRK '000 |
|--|------------------------------|---|-------------------------------|----------------------------------|-------------------|
| As at 1 January 2013 | 133,165 | (6,928) | 20,110 | 608,381 | 754,728 |
| Changes in equity for 2013 | | | | | |
| Total comprehensive income | - | - | - | 144,368 | 144,368 |
| Dividend distribution for 2012, Note 19 | - | - | - | (225,851) | (225,851) |
| Release of legal reserves, Note 19 (c) | - | - | (13,452) | 13,452 | - |
| Purchases of treasury shares, Note 18 (b) | - | (5,754) | - | - | (5,754) |
| Share-based payments, Note 21 (b) | - | 3,111 | - | (3,111) | - |
| Equity-settled transactions, Note 21 (b) | - | - | - | 3,645 | 3,645 |
| Total contributions by and distributions to owners of the parent recognised directly in equity | - | (2,643) | (13,452) | (211,865) | (227,960) |
| As at 31 December 2013 | 133,165 | (9,571) | 6,658 | 540,884 | 671,136 |
| As at 1 January 2014 | 133,165 | (9,571) | 6,658 | 540,884 | 671,136 |
| Changes in equity for 2014 | | | | | |
| Total comprehensive income | - | - | - | 87,428 | 87,428 |
| Dividend distribution for 2013, Note 19 | - | - | - | (424,897) | (424,897) |
| Purchases of treasury shares, Note 18 (b) | - | (2,768) | - | - | (2,768) |
| Share-based payments, Note 21 (b) | - | 3,877 | - | (3,877) | - |
| Equity-settled transactions, Note 21 (b) | - | - | - | 4,568 | 4,568 |
| Total contributions by and distributions to owners of the parent recognised directly in equity | - | 1,109 | - | (424,206) | (423,097) |
| As at 31 December 2014 | 133,165 | (8,462) | 6,658 | 204,106 | 335,467 |

The notes set out on pages 11 to 60 form an integral part of these consolidated financial statements.

Consolidated statement of cash flows
for the year ended 31 December 2014

| | <i>Notes</i> | 2014 | 2013 |
|--|--------------|-----------------------|------------------------|
| | | HRK '000 | HRK '000 |
| Cash flows from operating activities | | | |
| <i>Profit before tax</i> | | <u>88,331</u> | <u>144,360</u> |
| Adjustments for: | | | |
| Depreciation and amortisation | 10,11 | 46,280 | 40,282 |
| Impairment losses and reversals | | 13,971 | 955 |
| Net increase in provisions | | 3,670 | 5,178 |
| Gain on sale of property, plant and equipment | | (53) | (448) |
| Net gain on remeasurement of financial assets | | (336) | (1,479) |
| Amortisation of discount | | (330) | (2,003) |
| Interest income | | (6,459) | (10,036) |
| Interest expense | 7 | 8 | 163 |
| Foreign exchange losses/(gains), net | | 768 | (1,332) |
| Equity-settled transactions | 6 | <u>4,568</u> | <u>3,645</u> |
| | | 150,418 | 179,285 |
| Changes in working capital: | | | |
| In receivables | | 31,403 | 10,632 |
| In inventories | | 20,560 | (18,238) |
| In payables | | <u>(25,889)</u> | <u>(30,333)</u> |
| <i>Cash generated from operations</i> | | <u>176,492</u> | <u>141,346</u> |
| Interest paid | | (8) | (163) |
| Income taxes paid | | <u>(100)</u> | <u>(5)</u> |
| <i>Net cash from operating activities</i> | | <u>176,384</u> | <u>141,178</u> |
| Cash flows from investing activities | | | |
| Interest received | | 5,951 | 11,800 |
| Proceeds from sale of property, plant and equipment | | 193 | 4,957 |
| Purchases of property, plant and equipment, and intangible assets | | (45,259) | (63,806) |
| Deposits collected with financial institutions - net | | 999 | - |
| Purchases of financial assets at fair value through profit and loss | | (45,900) | (103,000) |
| Proceeds from sale of financial assets at fair value through profit and loss | | <u>112,000</u> | <u>140,000</u> |
| <i>Net cash generated/(used) in investing activities</i> | | <u>27,984</u> | <u>(10,049)</u> |

The notes set out on pages 11 to 60 form an integral part of these consolidated financial statements.

Consolidated statement of cash flows (continued)
for the year ended 31 December 2014

| | <i>Notes</i> | 2014 | 2013 |
|---|--------------|-----------------------|-----------------------|
| | | HRK '000 | HRK '000 |
| Cash flows from financing activities | | | |
| Repayment of interest-bearing borrowings | | - | (1,669) |
| Purchase of treasury shares | <i>18(b)</i> | (2,768) | (5,754) |
| Dividends paid | <i>19</i> | (424,933) | (225,851) |
| | | <u>(427,701)</u> | <u>(233,274)</u> |
| Net cash used in financing activities | | (427,701) | (233,274) |
| Effects of exchange rate changes on cash and cash equivalents | | (1,032) | 1,835 |
| | | <u>(224,365)</u> | <u>(100,311)</u> |
| Net decrease in cash and cash equivalents | | (224,365) | (100,311) |
| Cash and cash equivalents at the beginning of the year | | 411,328 | 511,639 |
| | | <u>411,328</u> | <u>511,639</u> |
| Cash and cash equivalents at the end of the year | <i>17</i> | <u>186,963</u> | <u>411,328</u> |

The notes set out on pages 11 to 60 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 Parent 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 Parent Company's shares are listed on the Public Joint Stock Company listing on the Zagreb Stock Exchange. Ericsson Nikola Tesla d.d. has prepared these consolidated financial statements as at 31 December 2014 and for the year then ended for the Parent Company, its four active subsidiaries (of which two are domiciled in Croatia, one in Bosnia and Herzegovina and one in Kosovo), and two inactive subsidiaries domiciled in Croatia (the Group). These consolidated financial statements were authorised for issue by the Management Board on 2 April 2015 for approval by the Supervisory Board. A summary of the Group'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 adopted by the European Union (IFRS). 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 executive 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 executive management 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 (International Financial Reporting Interpretations Committee) interpretations during the year which were endorsed by the EU. 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.

Below is a list of standards/interpretations that have been issued and are effective for periods beginning on or after 1 January 2014:

IFRS 10 Consolidated Financial Statements (effective for annual periods beginning on or after 1 January 2014)

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 also sets out the accounting requirements for the preparation of consolidated financial statements.

This standard did not have a significant impact on the Group's financial position or performance.

IAS 27 (revised 2011) Separate Financial Statements (effective for annual periods beginning on or after 1 January 2014) 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.

Amendment to IFRSs 10, 11 and 12 on Transition Guidance (effective for annual periods beginning on or after 1 January 2014)

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 amendment did not have a significant impact on the Group's financial position or performance.

Amendment to IAS 32, 'Financial instruments: Presentation,' on asset and liability offsetting (effective for annual periods beginning on or after 1 January 2014)

These amendments are to the application guidance in IAS 32, 'Financial instruments: Presentation,' and clarify some of the requirements for offsetting financial assets and financial liabilities on the balance sheet. The amendment did not have a significant impact on the Group's financial position or performance.

Amendment to IAS 36, 'Impairment of assets' on recoverable amount disclosures (effective for annual periods beginning on or after 1 January 2014).

This amendment addresses the disclosure of information about the recoverable amount of impaired assets if that amount is based on fair value less costs of disposal. The amendment did not have a significant impact on the Group's financial position or performance.

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

Below is a list of standards/interpretations that have been issued and are not effective for periods starting on 1 January 2014, but will be effective for later periods:

IFRS 9, 'Financial instruments' (effective for annual periods beginning on or after 1 January 2018)

Earlier application is permitted. If an entity elects to early apply it must apply all of the requirements at the same time with the following exception:

Entities with a date of initial application before 1 February 2015 continue to have the option to apply the standard in phases.

The complete version of IFRS 9 replaces most of the guidance in IAS 39. IFRS 9 retains but simplifies the mixed measurement model and establishes three primary measurement categories for financial assets: amortised cost, fair value through OCI and fair value through P&L. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. Investments in equity instruments are required to be measured at fair value through profit or loss with the irrevocable option at inception to present changes in fair value in OCI. There is now a new expected credit losses model that replaces the incurred loss impairment model used in IAS 39.

For financial liabilities there were no changes to classification and measurement except for the recognition of changes in own credit risk in other comprehensive income, for liabilities designated at fair value, through profit or loss.

IFRS 9 relaxes the requirements for hedge effectiveness by replacing the bright line hedge effectiveness tests. It requires an economic relationship between the hedged item and hedging instrument and for the 'hedged ratio' to be the same as the one management actually use for risk management purposes. Contemporaneous documentation is still required but is different to that currently prepared under IAS 39.

The Group plans to adopt this new standard on the effective date as of and when endorsed by EU. The Group is still assessing the impact on this amendment, but it is not expected to have a significant impact on the Group's financial statements.

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 15, 'Revenue from contracts with customers.' (effective for annual periods beginning on or after 1 January 2017)

This is the converged standard on revenue recognition. It replaces IAS 11, 'Construction contracts,' IAS 18, 'Revenue' and related interpretations.

Revenue is recognised when a customer obtains control of a good or service. A customer obtains control when it has the ability to direct the use of and obtain the benefits from the good or service.

The core principle of IFRS 15 is that an entity recognises revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. An entity recognises revenue in accordance with that core principle by applying the following steps:

- Step 1: Identify the contract(s) with a customer
- Step 2: Identify the performance obligations in the contract
- Step 3: Determine the transaction price
- Step 4: Allocate the transaction price to the performance obligations in the contract
- Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation

IFRS 15 also includes a cohesive set of disclosure requirements that will result in an entity providing users of financial statements with comprehensive information about the nature, amount, timing and uncertainty of revenue and cash flows arising from the entity's contracts with customers.

The Group's operations are complex, and the Group has already started the necessary efforts to develop and implement new accounting policies, estimates and processes to comply with this new standard. Such effort is expected to continue until 2016. As a result, at this time, it is not possible to make a reasonable quantitative estimate of the effects of this new standard on the Group's current revenue recognition policies.

IFRIC 21, 'Levies' (effective in EU for annual periods beginning on or after 17 June 2014)

This is an interpretation of IAS 37, 'Provisions, contingent liabilities and contingent assets.' IAS 37 sets out criteria for the recognition of a liability, one of which is the requirement for the entity to have a present obligation as a result of a past event (known as an obligating event). The interpretation addresses what the obligating event is that gives rise to the payment of a levy and when a liability should be recognised.

The Group is still assessing the impact on this interpretation, but it is not expected to have a significant impact on the Group's financial statements.

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)

Amendment to IAS 19, 'Employee benefits' regarding employee or third party contributions to defined benefit plans (effective for annual periods beginning on or after 1 July 2014)

The amendment applies to contributions from employees or third parties to defined benefit plans and clarifies the treatment of such contributions. The amendment distinguishes between contributions that are linked to service only in the period in which they arise and those linked to service in more than one period.

The objective of the amendment is to simplify the accounting for contributions that are independent of the number of years of employee service, for example employee contributions that are calculated according to a fixed percentage of salary.

Entities with plans that require contributions that vary with service will be required to recognise the benefit of those contributions over employee's working lives.

The Group plans to adopt this new amendment on the effective date as of and when endorsed by EU. The Group is still assessing the impact on this amendment, but it is not expected to have a significant impact on the Group's financial statements.

Amendment to IAS 27, 'Separate financial statements' regarding the equity method (effective for annual periods beginning on or after 1 January 2016)

The amendment allows entities to use the equity method to account for investments in subsidiaries, joint ventures and associates in their separate financial statements.

The Group plans to adopt this new amendment on the effective date as of and when endorsed by EU. The Group is still assessing the impact on this amendment, but it is not expected to have a significant impact on the Group's financial statements.

Annual improvements 2012 (effective for annual periods beginning on or after 1 July 2014)

These annual improvements amend standards from the 2010 – 2012 reporting cycle. It includes changes to:

- IFRS 2, 'Share-based payments,' and clarifies the definition of a 'vesting condition' and separately defines 'performance condition' and 'service condition.'
- IFRS 3, 'Business combinations,' and clarifies that an obligation to pay contingent consideration which meets the definition of a financial instrument is classified as a financial liability or equity, on the basis of the definitions in IAS 32, 'Financial instruments: Presentation.' It also clarifies that all non-equity contingent consideration is measured at fair value at each reporting date, with changes in value recognised in profit and loss.
- IFRS 8, 'Operating segments' which is amended to require disclosure of the judgements made by management in aggregating operating segments. It is also amended to require a reconciliation of segment assets to the entity's assets when segment assets are reported.
- IFRS 13, 'Fair value' which amended the basis of conclusions to clarify that it did not intend to remove the ability to measure short term receivables and payables at invoice amounts where the effect of discounting is immaterial.
- IAS 16, 'Property, plant and equipment' and IAS 38, 'Intangible assets' are amended to clarify how the gross carrying amount and the accumulated depreciation are treated where an entity uses 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 (continued)

- IAS 24, 'Related party disclosures' is amended to include, as a related party, an entity that provides key management personnel services to the reporting entity or to the parent of the reporting entity (the 'management entity'). Disclosure of the amounts charged to the reporting entity is required.

The Group plans to adopt this annual improvement on the effective date as of and when endorsed by EU. The Group is still assessing the impact on this amendment, but it is not expected to have a significant impact on the Group's financial statements.

Annual improvements 2014 (effective for annual periods beginning on or after 1 July 2016)

These annual improvements amend standards from the 2012 – 2014 reporting cycle. It includes changes to:

- IFRS 7, 'Financial instruments: Disclosures' – There are two amendments:
 - Servicing contracts – If an entity transfers a financial asset to a third party under conditions which allow the transferor to derecognise the asset, IFRS 7 requires disclosure of all types of continuing involvement that the entity might still have in the transferred assets. The standard provides guidance about what is meant by continuing involvement. The amendment is prospective with an option to apply retrospectively. There is a consequential amendment to IFRS 1 to give the same relief to first time adopters.
 - Interim financial statements – the amendment clarifies that the additional disclosure required by the amendments to IFRS 7, 'Disclosure – Offsetting financial assets and financial liabilities' is not specifically required for all interim periods unless required by IAS 34. This amendment is retrospective.
- IAS 19, 'Employee benefits' – The amendment clarifies that, when determining the discount rate for post-employment benefit obligations, it is the currency that the liabilities are denominated in that is important, not the country where they arise. The assessment of whether there is a deep market in high-quality corporate bonds is based on corporate bonds in that currency, not corporate bonds in a particular country. Similarly, where there is no deep market in high-quality corporate bonds in that currency, government bonds in the relevant currency should be used. The amendment is retrospective but limited to the beginning of the earliest period presented.

The Group plans to adopt this annual improvement on the effective date as of and when endorsed by EU. The Group is still assessing the impact on this amendment, but it is not expected to have a significant impact on the Group's financial statements.

Notes to the consolidated financial statements (continued)

1 Significant accounting policies (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 Parent 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 is not depreciated. Depreciation on other assets is provided on a straight-line basis to allocate their cost over the estimated economic useful life of the assets. The estimated useful lives are as follows:

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

The depreciation method, useful lives and residual values are reviewed, and adjusted if appropriate, at each balance sheet date. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. Gains and losses on disposals are determined by comparing proceeds with carrying amount, and are included in the 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. Executive 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 de-recognition. 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 Parent Company purchases its own equity share capital (treasury shares), the consideration paid, including any directly attributable incremental costs (net of income taxes) is deducted from equity attributable to the 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 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 Parent 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 functional currency 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 functional currency 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 functional currency 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 Parent 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 transfer of risk has occurred, 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 employees to receive shares according to internal policy. The fair value of the employee services received in exchange for the grant of the 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 Parent Company revises its estimates of the number of shares that are expected to become granted. It recognises the impact of the revision of original estimates, if any, in the 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.

c) Bonus plans

The Group recognises a liability and an expense for bonuses as a provision where contractually obliged or where there is past practice that has created a constructive obligation.

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 Group 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.

Government grants

Grants from the government are recognised at their fair value where there is reasonable assurance that the grant will be received and the group will comply with all attached conditions.

Government grants relating to costs are deferred and recognised in the statement of comprehensive income over the period necessary to match them with the costs that they are intended to compensate.

Government grants relating to property, plant and equipment are included in non-current liabilities as deferred government grants and are credited to the statement of comprehensive income on a straight-line basis over the expected lives of the related assets and presented within "other income".

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 shareholders is recognized as a liability in the consolidated financial statements in the period in which the dividends are approved by the shareholders.

Notes to the consolidated financial statements (continued)

1 Significant accounting policies (continued)

Consolidation and Goodwill

Subsidiaries are all entities (including structured entities) over which the Group has control. The Group controls an entity when the group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the 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.

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 the consolidated statement of comprehensive income.

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.

Notes to the consolidated financial statements (continued)

2 Critical accounting estimates and judgements (continued)

(b) Deferred income tax asset recognition

Deferred tax assets represent 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, executive 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.

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 the 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

| | 2014 | 2013 |
|-----------------------------|------------------|------------------|
| | HRK '000 | HRK '000 |
| Sales revenue from products | 427,652 | 528,056 |
| Sales revenue from services | 887,216 | 817,170 |
| | <u>1,314,868</u> | <u>1,345,226</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.

To best reflect the business focus and to facilitate comparability with Ericsson Group, three operating segments are reported:

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

Revenues determined based on the geographic location of customers are disclosed in this note. The Group's assets are located in Croatia and Bosnia & Herzegovina.

| | 2014 | 2013 |
|--|------------------|------------------|
| | HRK '000 | HRK '000 |
| Sales revenue in domestic market | 333,766 | 340,972 |
| Sales revenue in Russia, Belarus, Kazakhstan, Georgia, Moldova, Uzbekistan and Armenia | 138,366 | 169,101 |
| Sales revenue to Ericsson, Note 25 (a) | 628,029 | 568,749 |
| Sales revenue in Bosnia and Herzegovina, Montenegro and Kosovo | 207,530 | 256,630 |
| Other export sales revenue | 7,177 | 9,774 |
| | <u>1,314,868</u> | <u>1,345,226</u> |

Notes to the consolidated financial statements (continued)

4 Segment reporting (continued)

| | Networks | | Professional services | | Support solutions | | Unallocated | | Total | |
|--------------------------------|----------|----------|-----------------------|----------|-------------------|----------|-------------|----------|---------------|----------------|
| | 2014 | 2013 | 2014 | 2013 | 2014 | 2013 | 2014 | 2013 | 2014 | 2013 |
| | HRK '000 | HRK '000 | HRK '000 | HRK '000 | HRK '000 | HRK '000 | HRK '000 | HRK '000 | HRK '000 | HRK '000 |
| Sales revenue - gross | 705,800 | 775,217 | 578,096 | 539,336 | 46,434 | 40,986 | - | - | 1,330,330 | 1,355,539 |
| Inter-segment sales | (5,603) | (6,151) | (8,808) | (4,113) | (1,051) | (49) | - | - | (15,462) | (10,313) |
| Sales revenue -- net | 700,197 | 769,066 | 569,288 | 535,223 | 45,383 | 40,937 | - | - | 1,314,868 | 1,345,226 |
| Operating profit/(loss) | 40,780 | 51,013 | 69,729 | 106,430 | 4,204 | 1,545 | (33,277) | (31,749) | 81,436 | 127,239 |
| Finance income | | | | | | | | | 6,903 | 17,284 |
| Finance expense | | | | | | | | | (8) | (163) |
| Profit before tax | | | | | | | | | 88,331 | 144,360 |
| Income tax | | | | | | | | | (981) | (5) |
| Profit for the year | | | | | | | | | 87,350 | 144,355 |

Revenues of approximately HRK 583,793 thousand (2013: HRK 568,748 thousand) are derived from customers for which revenues from transactions have exceeded 10% of the total revenues and they are realised in all three segments.

5 Expenses by nature

| | 2014 | 2013 |
|---|------------------|------------------|
| | HRK '000 | HRK '000 |
| Changes in contract work in progress (Note 13) | 27,223 | (17,757) |
| Material and external services ^{(1) (2)} | 589,108 | 728,877 |
| Personnel expenses (Note 6) | 570,365 | 478,194 |
| Depreciation and amortisation (Notes 10,11) | 46,280 | 40,282 |
| | <u>1,232,976</u> | <u>1,229,596</u> |

¹⁾ Including audit fee expenses of HRK 485 thousand (2013: HRK 455 thousand).

²⁾ Material and external services costs do not include the effect of reclassifying other income and other operating expenses to material and external services amounting to HRK 7,260 thousand (2013: HRK 11,133 thousand).

Notes to the consolidated financial statements (continued)

6 Personnel expenses

| | 2014 | 2013 |
|---|-----------------|-----------------|
| | HRK '000 | HRK '000 |
| Net salaries | 275,312 | 235,130 |
| Taxes and contributions | 263,132 | 219,262 |
| Other payroll-related costs | 27,353 | 20,157 |
| Equity-settled transactions (Note 21 (b)) | 4,568 | 3,645 |
| | <u>570,365</u> | <u>478,194</u> |

Other payroll-related costs mainly relate to transportation expenses and vacation accrual cost.

Personnel expenses include HRK 91,461 thousand (2013: HRK 78,471 thousand) of defined pension contributions paid or payable into obligatory pension plans. Contributions are calculated as a percentage of employees' gross salaries (Gross I).

In addition, Personnel expenses include HRK 2,267 thousand (2013: HRK 2,564 thousand) in respect of termination benefit costs. The movements in provisions related to these costs are described in Note 23, Provisions.

As at 31 December 2014, the total number of employees was 2,491 (2013: 1,740).

7 Finance income and expense

Finance income

| | 2014 | 2013 |
|--|-----------------|-----------------|
| | HRK '000 | HRK '000 |
| Interest income (Note 7 (a)) | 5,975 | 10,033 |
| Net gains from remeasurement of financial assets at fair value through profit or loss (Note 7 (c)) | 374 | 1,493 |
| Amortization of discount (Note 7 (b)) | 330 | 2,003 |
| Net foreign exchange gain | 224 | 3,755 |
| | <u>6,903</u> | <u>17,284</u> |

Finance expense

| | 2014 | 2013 |
|------------------|-----------------|-----------------|
| | HRK '000 | HRK '000 |
| Interest expense | 8 | 163 |
| | <u>8</u> | <u>163</u> |

Notes to the consolidated financial statements (continued)

7 Finance income and expense (continued)

7 (a)

| | 2014 | 2013 |
|-------------------------|-----------------|-----------------|
| | HRK '000 | HRK '000 |
| Interest income | | |
| - on loans to customers | 830 | 1,511 |
| - on debt securities | 210 | 436 |
| - on term deposits | 2,399 | 4,459 |
| - on other receivables | 2,536 | 3,627 |
| | <u>5,975</u> | <u>10,033</u> |

7 (b)

The Group released HRK 330 thousand (2013: HRK 2,003 thousand) into finance income due to amortisation of discount.

7 (c)

| | 2014 | 2013 |
|---|-----------------|-----------------|
| | HRK '000 | HRK '000 |
| Net gains from remeasurement of financial assets at fair value through profit or loss | | |
| - Investment in investment funds | 551 | 1,559 |
| - Debt securities | (177) | (66) |
| | <u>374</u> | <u>1,493</u> |

Notes to the consolidated financial statements (continued)

8 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:

| | 2014 | 2013 |
|--|-----------------|-----------------|
| | HRK '000 | HRK '000 |
| Current income tax expense | (981) | (5) |
| Total deferred tax expense relating to the origination and reversal of temporary differences | - | - |
| Total income tax expense | <u>(981)</u> | <u>(5)</u> |

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 57,145 thousand (2013: HRK 53,030 thousand) in respect of tax losses amounting to HRK 285,726 thousand (2013: HRK 265,154 thousand) that can be carried forward against future taxable income.

Tax incentives included in the tax return for 2011 were inspected during 2013 by the Ministry of Science, Education and Sports. Out of HRK 151,230 thousand of tax incentives recorded by the Parent Company, HRK 108,629 thousand were approved by the Ministry. Consequently, the Parent Company adjusted its tax loss for 2011 to HRK 9,478 thousand. A tax loss may be carried forward for five years subsequent to the year in which it was incurred. The availability of tax losses against future periods, subject to review by the Ministry of Finance, is as follows:

| | HRK '000 |
|--|-----------------|
| Tax loss for 2010 – expires 31 December 2015 | 151,499 |
| Tax loss for 2011 – expires 31 December 2016 | 9,478 |
| Tax loss for 2012 – expires 31 December 2017 | 190 |
| Tax loss for 2013 – expires 31 December 2018 | 39,538 |
| Tax loss for 2014 – expires 31 December 2019 | 85,021 |
| | <u>285,726</u> |

No deferred tax assets are recognised in the consolidated financial statements for the year ending 31 December 2014 and 2013.

Notes to the consolidated financial statements (continued)

8 Income tax expense (continued)

The tax on the 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:

| | 2014 | 2013 |
|--|-----------------|-----------------|
| | HRK '000 | HRK '000 |
| Profit before tax | <u>88,331</u> | <u>144,360</u> |
| Tax calculated at domestic tax rates applicable to profits in the respective countries | 17,210 | 28,851 |
| Tax effects of: | | |
| Expenses not deductible for tax purposes | 5,227 | 3,875 |
| Tax incentives | (21,446) | (32,640) |
| Utilisation of tax losses | <u>(10)</u> | <u>(81)</u> |
| Tax charge | <u>981</u> | <u>5</u> |
| Effective tax rate | <u>1.1%</u> | <u>0.0%</u> |

Tax incentives include only part of additional tax allowances for certain expenditure totalling HRK 21,446 thousand (2013: HRK 32,640 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 inspect books and records of the Parent Company and its subsidiaries at any time 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 executive management is not aware of any circumstances which may give rise to a potential material liability in this respect.

9 Earnings per share

| | 2014 | 2013 |
|---|------------------|------------------|
| Profit for the year (HRK '000) | 87,350 | 144,355 |
| Weighted Average Number of Shares Outstanding at the year-end | <u>1,327,917</u> | <u>1,328,428</u> |
| Earnings per share (HRK) | <u>65.78</u> | <u>108.67</u> |

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

Notes to the consolidated financial statements (continued)

10 Property, plant and equipment

| | Land and buildings HRK '000 | Plant and equipment HRK '000 | Other HRK '000 | Total HRK '000 |
|--------------------------------------|-----------------------------------|------------------------------------|-------------------|-------------------|
| As at 1 January 2013 | | | | |
| Cost or valuation | 155,455 | 305,999 | 328 | 461,782 |
| Accumulated depreciation | (106,212) | (238,331) | (213) | (344,756) |
| Net book amount | 49,243 | 67,668 | 115 | 117,026 |
| Year ended 31 December 2013 | | | | |
| Opening net book amount | 49,243 | 67,668 | 115 | 117,026 |
| Additions | 2,968 | 49,691 | - | 52,659 |
| Disposals | - | (121) | - | (121) |
| Depreciation charge | (3,355) | (34,585) | (8) | (37,948) |
| Closing net book amount | 48,856 | 82,653 | 107 | 131,616 |
| As at 31 December 2013 | | | | |
| Cost or valuation | 158,423 | 333,364 | 328 | 492,115 |
| Accumulated depreciation | (109,567) | (250,711) | (221) | (360,499) |
| Net book amount | 48,856 | 82,653 | 107 | 131,616 |
| Year ended 31 December 2014 | | | | |
| Opening net book amount | 48,856 | 82,653 | 107 | 131,616 |
| Acquisition of business (Note 11 b)) | - | 5,999 | - | 5,999 |
| Additions | 175 | 43,271 | - | 43,446 |
| Disposals | - | (281) | - | (281) |
| Depreciation charge | (3,401) | (41,656) | (8) | (45,065) |
| Closing net book amount | 45,630 | 89,986 | 99 | 135,715 |
| As at 31 December 2014 | | | | |
| Cost or valuation | 158,598 | 349,148 | 328 | 508,074 |
| Accumulated depreciation | (112,968) | (259,162) | (229) | (372,359) |
| Net book amount | 45,630 | 89,986 | 99 | 135,715 |

Included in the cost of property, plant and equipment is HRK 251,896 thousand (2013: HRK 190,789 thousand) of fully depreciated property, plant and equipment that is still used by the Group.

As at 31 December 2014, the Group had contracts totalling HRK 6,948 thousand (2013: HRK 5,886 thousand) related to future equipment purchases.

Depreciation expense of HRK 42,666 thousand (2013: HRK 35,040 thousand) has been charged in cost of sales, HRK 2,117 thousand (2013: HRK 1,890 thousand) in selling expenses and HRK 1,282 thousand (2013: HRK 1,018 thousand) in administrative expenses.

Notes to the consolidated financial statements (continued)

10 Property, plant and equipment (continued)

The Group acts as a lessor under operating leases, mainly in respect of land and buildings. Property leased to others with a carrying value of HRK 13,528 thousand (2013: HRK 14,515 thousand) is included within land and buildings. These assets are depreciated at the same depreciation rates as other buildings, and are 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:

| | 2014 | 2013 |
|----------------------------|-----------------|-----------------|
| | HRK '000 | HRK '000 |
| Less than one year | 3,518 | 3,419 |
| Between one and five years | 1,759 | 1,709 |
| | <u>5,277</u> | <u>5,128</u> |

Notes to the consolidated financial statements (continued)

11 Intangible assets

The movement on intangible assets in the year ended 31 December 2014 may be analysed as follows:

| | Application Software HRK '000 | Goodwill HRK '000 | Total HRK '000 |
|------------------------------------|--|------------------------------|---------------------------|
| As at 1 January 2013 | | | |
| Cost or valuation | 10,855 | - | 10,855 |
| Accumulated amortization | (6,541) | - | (6,541) |
| Net book amount | <u>4,314</u> | - | <u>4,314</u> |
| Year ended 31 December 2013 | | | |
| Opening net book amount | 4,314 | - | 4,314 |
| Additions | 132 | - | 132 |
| Amortization charge | (2,334) | - | (2,334) |
| Closing net book amount | <u>2,112</u> | - | <u>2,112</u> |
| As at 31 December 2013 | | | |
| Cost or valuation | 9,480 | - | 9,480 |
| Accumulated amortization | (7,368) | - | (7,368) |
| Net book amount | <u>2,112</u> | - | <u>2,112</u> |
| Year ended 31 December 2014 | | | |
| Opening net book amount | 2,112 | - | 2,112 |
| Additions | 411 | 4,173 | 4,584 |
| Amortization charge | (1,215) | - | (1,215) |
| Closing net book amount | <u>1,308</u> | <u>4,173</u> | <u>5,481</u> |
| As at 31 December 2014 | | | |
| Cost or valuation | 7,973 | 4,173 | 12,146 |
| Accumulated amortization | (6,665) | - | (6,665) |
| Net book amount | <u>1,308</u> | <u>4,173</u> | <u>5,481</u> |

(a) Application software

Included in cost of intangible assets is HRK 4,709 thousand (2013: HRK 5,027 thousand) of fully amortised intangible assets that are still used by the Group.

Amortisation of HRK 1,125 thousand (2013: HRK 2,155 thousand) has been charged in cost of sales, HRK 56 thousand (2013: HRK 116 thousand) in selling expenses and HRK 34 thousand (2013: HRK 63 thousand) in administrative expenses.

Notes to the consolidated financial statements (continued)

11 Intangible assets (continued)

(b) Goodwill

In September 2014, Group signed business unit transfer agreements by which the Group acquired a business from Hrvatski telekom d.d. The agreements included transfer of 641 employees, supplier contracts, organisational structure, activities and operational processes. The business comprises of acquired assets and assumed liabilities to employees.

Details of the value of assets and liabilities acquired identified as at 1 September 2014 are as follows:

| | Carrying value |
|--|-----------------------|
| | HRK '000 |
| Property, plant and equipment (Note 10) | 5,999 |
| Long term employee benefits (Note 21 a)) | (287) |
| Accrued charges for unused holidays | (3,886) |
| Total identifiable net assets | <u>1,826</u> |
| Purchase consideration | 5,999 |
| Provisional Goodwill | <u>4,173</u> |

Provisional goodwill is subject to final evaluation which will be completed in 2015.

The business acquired contributed to the consolidated result for the year ended 31 December 2014 with revenue of HRK 44,318 thousand (Note 4). Had the businesses been consolidated from 1 January 2014, the consolidated pro forma revenue for the year ended 31 December 2014 would be HRK 132 million higher, while profit before taxation would not change significantly than currently reported.

Notes to the consolidated financial statements (continued)

12 Loans and receivables

| | 2014 | 2013 |
|---|-----------------|-----------------|
| | HRK '000 | HRK '000 |
| Deposits with financial institutions, denominated in foreign currency | 7,364 | 8,297 |
| Non-current receivables from foreign customers, denominated in foreign currency | 2,518 | 6,274 |
| Non-current receivables from domestic customers, denominated in HRK | 5,634 | - |
| Receivables for sold apartments | | |
| - denominated in foreign currency | 5,634 | 5,615 |
| - denominated in HRK | 714 | 744 |
| Total loans and receivables | <u>21,864</u> | <u>20,930</u> |
| Impairment allowance on loans and receivables | <u>(2,711)</u> | <u>(2,129)</u> |
| | <u>19,153</u> | <u>18,801</u> |

Deposits with financial institutions of HRK 7,341 thousand (2013: HRK 7,318 thousand) are placed as guarantee deposits for housing loans provided to the employees, earning interest at fixed rate 0.37% per annum (2013: 0.37% per annum), and with a remaining maturity of over three years. The remaining amount of HRK 23 thousand (2013: HRK 979 thousand) relates to guarantee deposit for customer financing, bearing interest at twelve-month USD LIBOR plus 0.50 pp per annum and maturing in 2015.

Loans and 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 | 2014 | 2013 |
|------|-----------------|-----------------|
| | HRK '000 | HRK '000 |
| 2015 | - | 6,274 |
| 2016 | 2,653 | - |
| 2017 | 2,265 | - |
| 2018 | 2,034 | - |
| 2019 | 1,200 | - |
| | <u>8,152</u> | <u>6,274</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 2,044 thousand (2013: HRK 2,130 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 (2013: 7% per annum).

Notes to the consolidated financial statements (continued)

13 Inventories

| | 2014 | 2013 |
|---------------------------|-----------------|-----------------|
| | HRK '000 | HRK '000 |
| Raw materials | 1,175 | 2,289 |
| Contract work in progress | 30,923 | 58,146 |
| Total inventories | 32,098 | 60,435 |
| Impairment allowance | (1,152) | (8,929) |
| | <u>30,946</u> | <u>51,506</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.

14 Trade receivables

| | 2014 | 2013 |
|---|-----------------|-----------------|
| | HRK '000 | HRK '000 |
| Foreign trade receivables | 63,181 | 142,998 |
| Current portion of non-current foreign receivables | 9,711 | 15,948 |
| Total current foreign receivables | 72,892 | 158,946 |
| Domestic trade receivables | 125,022 | 117,018 |
| Current portion of non-current domestic receivables | - | 883 |
| Total current domestic receivables | 125,022 | 117,901 |
| Impairment allowance on receivables | (7,342) | (30,695) |
| | <u>190,572</u> | <u>246,152</u> |

Included in trade receivables is HRK 3,845 thousand (2013: HRK 54 thousand) of contract work in progress.

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

| | 2014 | 2013 |
|--|-----------------|-----------------|
| | HRK '000 | HRK '000 |
| As at 1 January (Notes 12, 14) | 32,824 | 39,160 |
| Provision for receivables impaired during the year | 20,913 | 7,139 |
| Receivables written off during the year as uncollectible | (29,723) | (5,367) |
| Unused amounts reversed | (13,717) | (6,185) |
| Amortisation of discount | (244) | (1,923) |
| As at 31 December (Notes 12, 14) | <u>10,053</u> | <u>32,824</u> |

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

Of the total HRK 10,053 thousand (2013: HRK 32,824 thousand) of impairment allowances as at 31 December 2014, HRK 7,342 thousand (2013: HRK 30,695 thousand) relates to customer loans and receivables.

Notes to the consolidated financial statements (continued)

15 Other receivables

| | 2014 | 2013 |
|-----------------------------|-----------------|-----------------|
| | HRK '000 | HRK '000 |
| Receivables from employees | 717 | 1,622 |
| Accrued interest receivable | 1,029 | 553 |
| Other receivables | 1,074 | 1,540 |
| | <u>2,820</u> | <u>3,715</u> |

16 Financial assets at fair value through profit or loss

| | 2014 | 2013 |
|--|-----------------|-----------------|
| | HRK '000 | HRK '000 |
| <i>Financial assets at fair value through profit or loss</i> | | |
| - Debt securities, Ministry of Finance | 4,129 | 4,129 |
| - Equity securities | 224 | 402 |
| - Investment in open-ended investment funds | 39,728 | 105,314 |
| | <u>44,081</u> | <u>109,845</u> |

17 Cash and cash equivalents

| | 2014 | 2013 |
|--|-----------------|-----------------|
| | HRK '000 | HRK '000 |
| Cash and demand deposits | 118,010 | 220,387 |
| Term deposits originated by the Group, with original maturity up to 3 months | 68,953 | 190,941 |
| | <u>186,963</u> | <u>411,328</u> |

Notes to the consolidated financial statements (continued)

18 Equity

(a) Share capital

As at 31 December 2014, the share capital is represented by 1,331,650 (2013: 1,331,650) of authorised, issued and fully paid ordinary shares, with a total registered value of HRK 133,165 thousand (2013: HRK 133,165 thousand). The nominal value of one share is HRK 100 (2013: 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 shareholders as at 31 December 2014 are:

| | 2014 | 2014 | 2013 | 2013 |
|---------------------------------|-----------------------------|---------------|-----------------------------|---------------|
| | Number of shares | % held | Number of shares | % held |
| Telefonaktiebolaget LM Ericsson | 653,473 | 49.07 | 653,473 | 49.07 |
| Small shareholders | 675,097 | 50.70 | 673,369 | 50.57 |
| Treasury shares | 3,080 | 0.23 | 4,808 | 0.36 |
| | <u>1,331,650</u> | <u>100.00</u> | <u>1,331,650</u> | <u>100.00</u> |

(b) Treasury shares

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 21 (b). During 2014, the Parent Company acquired 2,000 (2013: 4,000) of its own shares, for a total amount of HRK 2,768 thousand (2013: HRK 5,754 thousand), paid from the 2008 net income as decided by the General Assembly held on 26 May 2009.

Movements in treasury shares are as follows:

| | 2014 | 2013 |
|---------------------------------|-----------------------------|-----------------------------|
| | Number of shares | Number of shares |
| As at 1 January (Note 18 (a)) | 4,808 | 3,408 |
| Purchased during the year | 2,000 | 4,000 |
| Distributed during the year | <u>(3,728)</u> | <u>(2,600)</u> |
| As at 31 December (Note 18 (a)) | <u>3,080</u> | <u>4,808</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 2000 and no further allocation to legal reserves is required. Legal reserves up to 5% of total share capital are not distributable. During 2013, the Group released legal reserves of HRK 13,452 thousand representing reserves in excess of the prescribed 5% of share capital.

Notes to the consolidated financial statements (continued)

19 Proposed dividends

Dividends payable are not accounted for until they have been ratified at the General Assembly of shareholders. On 27 May 2014, the General Assembly approved a regular dividend in respect of 2013 of HRK 20.00 per share, and additional extraordinary dividend of HRK 300.00 per share, totalling HRK 424.897 thousand. At a meeting held on 12 February 2015, the Management Board proposed a regular dividend in respect of 2014 in the amount of HRK 20.00 per share, and an additional extraordinary dividend of HRK 70 per share. The dividend will be paid from the retained earnings and other reserves as well as a portion of profit realized in 2014, after approval by the General Assembly, which will be held on 2 June 2015.

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

| | 2014 | 2013 |
|-------------------------------|----------------------------|----------------------------|
| | HRK '000 | HRK '000 |
| HRK 320.00 per share for 2013 | 424,897 | - |
| HRK 170.00 per share for 2012 | - | 225,851 |
| Prior year dividend pay out | 36 | - |
| | <hr/> 424,933 <hr/> | <hr/> 225,851 <hr/> |

20 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;
- To maintain a prudent balance sheet with a large component of cash and short-term assets, as well as equity and other investments; and
- To secure adequate back-up financing facilities should need arise.

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 18 to the consolidated financial statements.

Notes to the consolidated financial statements (continued)

21 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 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 Group pays a one-time benefit amounting to HRK 8,000 for each employee who retires. Additionally, the Group pays jubilee awards in respect of each 5 years of service, of an employee, starting from the 10th year and ending in the 40th year. The principal actuarial assumptions used to determine retirement and jubilee obligations as at 31 December 2014 were a 6% discount rate (2013: 6%) and a 3,5% (2013: 3,4%) rate of average employment turnover.

Movements in long-term service benefits were as follows:

| | 2014 | 2014 | 2014 | 2013 | 2013 | 2013 |
|--|-----------------------|-------------------|-----------------|-----------------------|-------------------|-----------------|
| | Jubilee awards | Retirement | Total | Jubilee awards | Retirement | Total |
| | HRK '000 | HRK '000 | HRK '000 | HRK '000 | HRK '000 | HRK '000 |
| As at 1 January | 4,377 | 320 | 4,697 | 4,059 | 393 | 4,452 |
| Obligation created during the year | 975 | 86 | 1,061 | 560 | 62 | 622 |
| Obligation created in business combination (Note 11b)) | - | 287 | 287 | - | - | - |
| Obligation fulfilled during the year | (407) | (16) | (423) | (242) | (40) | (282) |
| Obligation reversed during the year | - | - | - | - | (95) | (95) |
| As at 31 December | <u>4,945</u> | <u>677</u> | <u>5,622</u> | <u>4,377</u> | <u>320</u> | <u>4,697</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 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)

21 Employee benefits (continued)

(b) Share-based payments (continued)

The terms and conditions of the grants are as follows:

| Employees entitled/grant date | Number of granted shares | Vesting conditions |
|---|--------------------------|------------------------------|
| <i>Loyalty program</i> | | |
| Share grant to key management during 2013 | 1,040 | Two to four years of service |
| Share grant to other employees during 2013 | 9,165 | Two to five years of service |
| Reversal in share grants to key management during 2014 | (350) | Two to four years of service |
| Reversal in share grants to other employees during 2014 | (3,179) | Two to five years of service |
| <i>Award program</i> | | |
| Share grant to key management during 2013 | 40 | Upon granting |
| Share grant to other employees during 2013 | 900 | Upon granting |
| Share grant to key management during 2014 | - | Upon granting |
| Share grant to other employees during 2014 | - | Upon granting |

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 2013 | 11,145 | 1,443.39 |
| Reversal of shares granted in 2011-2013 | (3,529) | 1,373.20 |

During 2014, the Group recognised HRK 4,568 thousand (2013: HRK 3,645 thousand) of expenses in respect of share-based payments, which are included in personnel expenses as disclosed in Note 6. During 2014, share-based payment options per Loyalty program was modified with the intention to reduce the share grant liability from the original Loyalty programs. Shares granted under previous programs to employees who left the Parent Company before vesting date expired.

3,728 of shares granted under the Loyalty programs from previous years vested during 2014. The total weighted average cost of shares exercised during 2014 under the Award and Loyalty programs amounted to HRK 3,787 thousand (2013: HRK 3,111 thousand).

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

| | 2014 Number of shares | 2013 Number of shares |
|-------------------|-----------------------------|-----------------------------|
| As at 1 January | 14,510 | 6,070 |
| Granted | - | 11,145 |
| Exercised | (3,728) | (2,600) |
| Expired | (3,529) | (105) |
| As at 31 December | <u>7,253</u> | <u>14,510</u> |

Notes to the consolidated financial statements (continued)

22 Trade and other payables

| | 2014 | 2013 |
|---------------------------|-----------------|-----------------|
| | HRK '000 | HRK '000 |
| Trade payables | 42,311 | 55,175 |
| Liabilities to employees | 73,636 | 73,803 |
| Other current liabilities | 31,612 | 19,448 |
| | <u>147,559</u> | <u>148,426</u> |

23 Provisions

Movements in provisions were as follows:

| | 2014 | 2014 | 2014 | 2014 | 2013 | 2013 | 2013 | 2013 |
|------------------------------------|-----------------|-----------------|--------------------|-----------------|-----------------|-----------------|--------------------|-----------------|
| | Warranty | Penalty | Termination | Total | Warranty | Penalty | Termination | Total |
| | reserve | reserve | benefits | Total | reserve | reserve | benefits | Total |
| | HRK '000 | HRK '000 | HRK '000 | HRK '000 | HRK '000 | HRK '000 | HRK '000 | HRK '000 |
| As at 1 January | 6,507 | 5,962 | 989 | 13,458 | 9,342 | 7,719 | 1,505 | 18,566 |
| Additional provisions | 3,009 | 1,319 | 1,682 | 6,010 | 1,682 | 2,543 | 960 | 5,185 |
| Unused provisions reversed | (363) | (1,977) | - | (2,340) | (7) | - | - | (7) |
| Provisions used during the year | (4,364) | (672) | (1,019) | (6,055) | (4,510) | (4,300) | (1,476) | (10,286) |
| As at 31 December | <u>4,789</u> | <u>4,632</u> | <u>1,652</u> | <u>11,073</u> | <u>6,507</u> | <u>5,962</u> | <u>989</u> | <u>13,458</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.

Notes to the consolidated financial statements (continued)

24 Accrued charges and deferred revenue

| | 2014 | 2013 |
|---|-----------------|-----------------|
| | HRK '000 | HRK '000 |
| Advances from domestic customers | 3,629 | 6,432 |
| Advances from foreign customers | 5,816 | 4,958 |
| Deferred revenue | 80,287 | 90,098 |
| Accrued charges for unused holidays | 20,396 | 12,830 |
| Accrued charges for legal claims | 825 | 801 |
| Accrued charges in respect of service contracts | 21,138 | 23,544 |
| Other accrued charges | 16,790 | 10,396 |
| | <u>148,881</u> | <u>149,059</u> |

Deferred revenue represents amounts due to customers under contracts for work not performed but invoices issued or cash received and thus present a liability to perform a service or delivery material.

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

25 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% (2013: 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.

Notes to the consolidated financial statements (continued)

25 Balances and transactions with related parties (continued)

(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 | |
|--|------------------------------------|------------------|---|------------------|------------------|------------------|
| | 2014 HRK '000 | 2013 HRK '000 | 2014 HRK '000 | 2013 HRK '000 | 2014 HRK '000 | 2013 HRK '000 |
| Sales of goods and services | | | | | | |
| Sales revenue | - | - | 628,029 | 568,749 | 628,030 | 568,749 |
| Other income | - | - | 6,520 | 7,630 | 6,519 | 7,630 |
| | <u>-</u> | <u>-</u> | <u>634,549</u> | <u>576,379</u> | <u>634,549</u> | <u>576,379</u> |
| Purchases of goods and services | | | | | | |
| Licences | 3,405 | 3,805 | 35,701 | 64,704 | 39,106 | 68,509 |
| Technical cooperation fee | - | - | - | 1,958 | - | 1,958 |
| Cost of sales | - | - | 328,747 | 407,216 | 328,747 | 407,216 |
| | <u>3,405</u> | <u>3,805</u> | <u>364,448</u> | <u>473,878</u> | <u>367,853</u> | <u>477,683</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.

(b) Key management compensation

The key management include the executive management listed on page 2, comprising the Management Board member and directors of the main organisational units.

| | 2014 HRK '000 | 2013 HRK '000 |
|---|------------------|------------------|
| Salaries and other short-term employee benefits | 26,905 | 21,308 |
| Other long-term benefits | 8 | 2 |
| Share-based payments | - | 121 |
| | <u>26,913</u> | <u>21,431</u> |

The members of the executive management and the Supervisory Board held 4,342 ordinary shares at the year-end (2013: 4,085 shares).

In addition, the Group paid remuneration totalling HRK 323 thousand (2013: HRK 315 thousand) to the Supervisory Board during 2014.

Notes to the consolidated financial statements (continued)

25 Balances and transactions with related parties (continued)

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

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

| | Receivable | | Payable | |
|---|------------------|------------------|------------------|------------------|
| | 2014 HRK '000 | 2013 HRK '000 | 2014 HRK '000 | 2013 HRK '000 |
| Main shareholder | | | | |
| Telefonaktiebolaget LM Ericsson (LME) | - | 1,342 | 471 | - |
| Ericsson Group consolidated companies | | | | |
| Ericsson AB (EAB) | 33,513 | 50,870 | 35,864 | 57,635 |
| Ericsson Services d.o.o. (ESK) | 20,467 | - | - | - |
| Ericsson Maroc Sarl (EMO) | 5,640 | 2,884 | - | - |
| Ericsson GMBH Group (EDD) | 4,762 | 3,773 | 1,383 | 1,575 |
| Ericsson Ltd. Madrid, Spain (ETL) | 3,176 | 527 | 371 | - |
| Ericsson Telecom S.S.De C.V.(TEM) | 1,595 | 954 | - | - |
| LM Ericsson Ltd. (LMI) | 1,427 | 1,171 | 434 | 615 |
| Ericsson Telecommunicatia B.V. (ETM) | 1,285 | 812 | 681 | 600 |
| Ericsson Corporation, Russia (ECR) | 1,051 | 1,064 | - | - |
| Ericsson Canada inc. (EMC) | 969 | - | 51 | - |
| Ericsson AG (EAS) | 922 | 375 | - | - |
| Ericsson Austria GMBH (SEA) | 595 | 235 | - | 15 |
| Ericsson Telecomunicazioni Spa (TEI) | 468 | 75 | - | 49 |
| Ericsson Korea Limited (EKK) | 441 | - | - | - |
| Ericsson Ltd. (EHK) | 352 | 351 | - | - |
| Ericsson AB Bahrain Branch (BBH) | 342 | 141 | - | - |
| Ericsson S.A./N.V. Branch Office Luxembourg (BLU) | 324 | 223 | - | - |
| Ericsson Espana S.A. (EEM) | 292 | 44 | - | 25 |
| Ericsson Egypt Ltd. (EEL) | 257 | 748 | - | - |
| Other Ericsson Group companies | 3,971 | 6,229 | 2,406 | 422 |
| | <u>81,849</u> | <u>71,818</u> | <u>41,661</u> | <u>60,936</u> |

The Group recorded a non-current receivable (Note 12) and a deferred revenue (within other long term liabilities) of HRK 4,800 thousand (2013: nil) from Ericsson Services d.o.o. (ESK) relating to the five-year managed services contract with Hrvatski Telekom.

Notes to the consolidated financial statements (continued)

26 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 2014, if the euro and US dollar had weakened/strengthened by 1% (2013: 1%) against the Croatian kuna, with all other variables held constant, the net result after tax for the reporting period would have been HRK 1,274 thousand lower/higher (2013: HRK 4,020 thousand), mainly as a result of foreign exchange losses/gains on translation of significant cash, cash equivalents, deposits, trade payables, customer receivables and customer financing denominated in euro.

The Group continues to focus on securing natural hedges and active currency management and to minimise impacts from currency moves. The Group has exposure to the euro, and a limited exposure to US dollars and Swedish Krona as shown in the following table.

Notes to the consolidated financial statements (continued)

26 Financial risk management (continued)

(a) Currency risk (continued)

The tables below present the currency analysis and resulting gap.

2014

| | EUR | USD | Other currency | Total foreign currencies | HRK | Total |
|--|----------------|---------------|-------------------|-----------------------------|----------------|----------------|
| | HRK '000 | HRK '000 | HRK '000 | HRK '000 | HRK '000 | HRK '000 |
| Loans and receivables | 11,645 | 2,541 | - | 14,186 | 4,967 | 19,153 |
| Trade and other receivables | 117,750 | 11,727 | 11,723 | 141,200 | 134,049 | 275,249 |
| Financial assets at fair value through profit or loss | - | - | - | - | 44,081 | 44,081 |
| Cash and cash equivalents | 158,088 | 4,103 | 6,226 | 168,417 | 18,546 | 186,963 |
| | 287,483 | 18,371 | 17,949 | 323,803 | 201,643 | 525,446 |
| Interest-bearing borrowings | 356 | - | - | 356 | 32 | 388 |
| Trade and other payables | 43,498 | 18,076 | 2,089 | 63,663 | 125,557 | 189,220 |
| | 43,854 | 18,076 | 2,089 | 64,019 | 125,589 | 189,608 |
| Currency gap | 243,629 | 295 | 15,860 | 259,784 | 76,054 | 335,838 |

2013

| | EUR | USD | Other currency | Total foreign currencies | HRK | Total |
|--|----------------|---------------|-------------------|-----------------------------|----------------|----------------|
| | HRK '000 | HRK '000 | HRK '000 | HRK '000 | HRK '000 | HRK '000 |
| Loans and receivables | 15,594 | 2,463 | - | 18,057 | 744 | 18,801 |
| Trade and other receivables | 190,242 | 13,230 | 4,694 | 208,166 | 113,520 | 321,686 |
| Financial assets at fair value through profit or loss | - | - | - | - | 109,845 | 109,845 |
| Cash and cash equivalents | 359,314 | 2,250 | 6,511 | 368,075 | 43,253 | 411,328 |
| | 565,150 | 17,943 | 11,205 | 594,298 | 267,362 | 861,660 |
| Interest-bearing borrowings* | 10 | - | - | 10 | 376 | 386 |
| Trade and other payables | 73,347 | 3,723 | 734 | 77,804 | 131,558 | 209,362 |
| | 73,357 | 3,723 | 734 | 77,814 | 131,934 | 209,748 |
| Currency gap | 491,793 | 14,220 | 10,471 | 516,484 | 135,428 | 651,912 |

* include interest payable of HRK 8 thousand

Notes to the consolidated financial statements (continued)

26 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 2014:

- if the effective EUR interest rate on EUR deposits had increased/decreased by 1% (2013: 1%) on an annual level, the net result due to changes in EUR deposits after tax for the reporting period would have been HRK 59 thousand higher/lower (2013: HRK 66 thousand);
- if the effective HRK interest rate on HRK deposits had increased/decreased by 1% (2013: 1%) on an annual level, the net result due to changes in investment funds after tax for the reporting period would have been HRK 552 thousand higher/lower (2013: HRK 843 thousand).

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

| | 2014 | 2013 |
|---|-----------------------|-----------------------|
| | Average | Average |
| | interest rates | interest rates |
| | % | % |
| Loans and receivables | 2.44 | 2.16 |
| Trade and other receivables | 0.26 | 0.33 |
| Financial assets at fair value through profit or loss | 0.49 | 0.20 |
| Cash and cash equivalents | 1.30 | 1.63 |
| Interest-bearing borrowings | - | - |

Notes to the consolidated financial statements (continued)

26 Financial risk management (continued)

(b) Interest rate risk (continued)

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

2014

| | 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 | 4,133 | - | - | - | 7,656 | 7,364 | 19,153 | - |
| Trade and other receivables | 266,122 | 1,041 | 3,274 | 4,104 | 708 | - | 275,249 | 8,419 |
| Financial assets at fair value through profit or loss | 39,953 | - | - | - | 4,128 | - | 44,081 | - |
| Cash and cash equivalents | 4,351 | 113,659 | 68,953 | - | - | - | 186,963 | 68,953 |
| | 314,559 | 114,700 | 72,227 | 4,104 | 12,492 | 7,364 | 525,446 | 77,372 |
| Interest-bearing borrowings* | - | - | - | - | 388 | - | 388 | - |
| Trade and other payables | 189,183 | 37 | - | - | - | - | 189,220 | - |
| | 189,183 | 37 | - | - | 388 | - | 189,608 | - |
| Interest rate gap | 125,376 | 114,663 | 72,227 | 4,104 | 12,104 | 7,364 | 335,838 | 77,372 |

2013

| | 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 | - | - | - | 442 | 9,459 | 8,900 | 18,801 | 7,253 |
| Trade and other receivables | 304,787 | 6,037 | 1,058 | 9,804 | - | - | 321,686 | 16,898 |
| Financial assets at fair value through profit or loss | 105,716 | - | - | - | 4,129 | - | 109,845 | - |
| Cash and cash equivalents | - | 220,387 | 190,941 | - | - | - | 411,328 | 190,941 |
| | 410,503 | 226,424 | 191,999 | 10,246 | 13,588 | 8,900 | 861,660 | 215,092 |
| Interest-bearing borrowings* | - | 34 | 74 | 142 | 136 | - | 386 | - |
| Trade and other payables | 209,362 | - | - | - | - | - | 209,362 | - |
| | 209,362 | 34 | 74 | 142 | 136 | - | 209,748 | - |
| Interest rate gap | 201,141 | 226,390 | 191,925 | 10,104 | 13,452 | 8,900 | 651,912 | 215,092 |

* include interest payable of HRK 8 thousand

Notes to the consolidated financial statements (continued)

26 Financial risk management (*continued*)

(c) Price risk

The Group has insignificant exposure to debt securities price risk due to low investments and all classified on the balance sheet at fair value through profit or loss (debt securities and investments funds). All the securities are actively traded on the Zagreb Stock Exchange and movements of CROBEX and CROBIS indices may have an impact on operating results.

(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.

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 2014, the five largest customers represent 70% of total net trade receivables (2013: 53%). The Group considers that its maximum exposure to credit risk is reflected in the amount of trade receivables (Notes 12 and 14) and other receivables (Note 15), 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 2014, total outstanding exposure related to customer finance was HRK 17 million (2013: HRK 23 million).

Notes to the consolidated financial statements (continued)

26 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 31 December 2014.

| | Due balance | Up to 3 months | 3 months to 1 year | 1 to 3 years | Over 3 years | Total |
|------------------------------------|-----------------|-----------------|--------------------|-----------------|-----------------|-----------------|
| 2014 | HRK '000 | HRK '000 | HRK '000 | HRK '000 | HRK '000 | HRK '000 |
| Foreign receivables | 5,556 | 54,831 | 12,738 | 2,285 | - | 75,410 |
| Domestic receivables | 3,627 | 113,912 | 6,450 | 94 | 1,773 | 125,856 |
| Receivables from related parties * | 14,443 | 66,207 | 1,200 | 2,399 | 2,400 | 86,649 |
| | 23,626 | 234,950 | 20,388 | 4,778 | 4,173 | 287,915 |

*include non-current portion of domestic receivables in the amount of HRK 4,800 thousand

2013

| | | | | | | |
|----------------------------------|---------------|----------------|---------------|--------------|----------|----------------|
| Foreign receivables | 35,126 | 103,806 | 20,014 | 6,274 | - | 165,220 |
| Domestic receivables | 12,010 | 93,207 | 12,682 | - | - | 117,900 |
| Receivables from related parties | 11,323 | 60,496 | - | - | - | 71,819 |
| | 58,459 | 257,509 | 32,696 | 6,274 | - | 354,939 |

Table 2 Ageing of total due customer loans and receivables

| | Up to 3 months | 3 months to 1 year | 1 to 3 years | Over 3 years | Total |
|----------------------------------|-----------------|--------------------|-----------------|-----------------|-----------------|
| 2014 | HRK '000 | HRK '000 | HRK '000 | HRK '000 | HRK '000 |
| Foreign receivables | 3,947 | 95 | 1,288 | 226 | 5,556 |
| Domestic receivables | 1,961 | 6 | 775 | 885 | 3,627 |
| Receivables from related parties | 6,879 | 3,316 | 3,187 | 1,061 | 14,443 |
| | 12,787 | 3,417 | 5,250 | 2,172 | 23,626 |
| 2013 | | | | | |
| Foreign receivables | 10,220 | 641 | 3,924 | 20,341 | 35,126 |
| Domestic receivables | 7,547 | 1,411 | 2,168 | 884 | 12,010 |
| Receivables from related parties | 4,468 | 6,423 | 432 | - | 11,323 |
| | 22,235 | 8,475 | 6,524 | 21,225 | 58,459 |

Notes to the consolidated financial statements (continued)

26 Financial risk management (continued)
(d) Credit risk (continued)

| | Due balance | Up to 3 months | 3 months to 1 year | 1 to 3 years | Over 3 years | Total |
|----------------------------------|---------------|----------------|-----------------------|--------------|--------------|----------------|
| | HRK '000 | HRK '000 | HRK '000 | HRK '000 | HRK '000 | HRK '000 |
| 2014 | | | | | | |
| Foreign receivables | 5,556 | 38,505 | 9,405 | 2,286 | - | 55,752 |
| Domestic receivables | 3,627 | 45,784 | - | - | - | 49,411 |
| Receivables from related parties | 14,443 | 61,629 | 2,700 | - | - | 78,772 |
| | <u>23,626</u> | <u>145,918</u> | <u>12,105</u> | <u>2,286</u> | <u>-</u> | <u>183,935</u> |
| 2013 | | | | | | |
| Foreign receivables | 35,126 | 75,579 | 10,238 | 1,388 | - | 122,331 |
| Domestic receivables | 12,010 | 84,941 | 11,971 | - | - | 108,922 |
| Receivables from related parties | 11,323 | 58,197 | - | - | - | 69,520 |
| | <u>58,459</u> | <u>218,717</u> | <u>22,209</u> | <u>1,388</u> | <u>-</u> | <u>300,773</u> |

| | 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 |
| 2014 | | | | | |
| Foreign receivables | 3,660 | 92 | 45 | - | 3,797 |
| Domestic receivables | 1,961 | 6 | - | - | 1,967 |
| Receivables from related parties | 5,691 | 2 | 38 | 64 | 5,795 |
| | <u>11,312</u> | <u>100</u> | <u>83</u> | <u>64</u> | <u>11,559</u> |
| 2013 | | | | | |
| Foreign receivables | 6,606 | 641 | 101 | - | 7,348 |
| Domestic receivables | 7,455 | 136 | 973 | - | 8,564 |
| Receivables from related parties | 747 | 3,189 | 2,203 | 376 | 6,515 |
| | <u>14,808</u> | <u>3,966</u> | <u>3,277</u> | <u>376</u> | <u>22,427</u> |

Notes to the consolidated financial statements (continued)

26 Financial risk management (*continued*)

(d) Credit risk (*continued*)

As at 31 December 2014, the total balance outstanding in respect of customer loans and receivables was HRK 288 million (2013: HRK 355 million), as disclosed in Table 1, of which HRK 255 million (2013: HRK 290 million) is falling due for payment within one year. As at 31 December 2014, the amount totalling HRK 24 million (2013: HRK 58 million) was overdue (Table 2), of which HRK 16 million (2013: HRK 30 million) is up to one year overdue.

As at 31 December 2014, total balance outstanding in respect of customer overdue receivables as at 31 December 2014 was HRK 184 million (2013: HRK 301 million) as disclosed in Table 3. Of this total, HRK 182 million (2013: HRK 241 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 2014, impairment allowances totalling HRK 7 million (2013: HRK 28 million) were provided in respect of total customer loans and receivables. As disclosed in Table 4, amounts totalling HRK 12 million (2013: HRK 22 million), were past due but not impaired as at 31 December 2014.

During 2014 the internal policies to manage the credit risks continues to be under review to constantly improve the way the Group handles the credit risks. A new Credit Management function within the Group Treasury has been established to further assist the Group in managing its credit risk exposure.

Notes to the consolidated financial statements (continued)

26 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.

The Group has a revolving credit facility with our core banks should an extraordinary liquidity need arise. At 31 December 2014, the facility remained untapped.

| 2014 | 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 | - | - | - | 11,812 | 7,341 | 19,153 |
| Trade and other receivables | 163,888 | 88,999 | 20,620 | 1,742 | - | 275,249 |
| Current financial assets | 39,953 | - | - | 4,128 | - | 44,081 |
| Cash and cash equivalents | 147,236 | 39,727 | - | - | - | 186,963 |
| | 351,077 | 128,726 | 20,620 | 17,682 | 7,341 | 525,446 |
| Interest-bearing borrowings* | - | - | - | 388 | - | 388 |
| Trade and other payables | 148,423 | 39,947 | 850 | - | - | 189,220 |
| | 148,423 | 39,947 | 850 | 388 | - | 189,608 |
| Maturity gap | 202,654 | 88,779 | 19,770 | 17,294 | 7,341 | 335,838 |
| 2013 | 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 | - | - | 442 | 16,777 | 1,582 | 18,801 |
| Trade and other receivables | 197,472 | 92,900 | 31,314 | - | - | 321,686 |
| Current financial assets | 105,716 | - | - | 4,129 | - | 109,845 |
| Cash and cash equivalents | 220,015 | 190,941 | 372 | - | - | 411,328 |
| | 523,203 | 283,841 | 32,128 | 20,906 | 1,582 | 861,660 |
| Interest-bearing borrowings* | 34 | 74 | 210 | 68 | - | 386 |
| Trade and other payables | 146,132 | 63,230 | - | - | - | 209,362 |
| | 146,166 | 63,304 | 210 | 68 | - | 209,748 |
| Maturity gap | 377,037 | 220,537 | 31,918 | 20,838 | 1,582 | 651,912 |

* include interest payable of HRK 8 thousand

Notes to the consolidated financial statements (continued)

26 Financial risk management (continued)

(f) Fair value estimation

Financial assets at fair value of through profit and loss are carried at fair value at the balance sheet date. The fair value is estimated by reference to their quoted active market price at the balance sheet date which represents Level 1 input (Note 17).

A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. The quoted market price used for financial assets held by the Group is the current bid price. There are no financial assets derived from level 2 inputs which represent different valuation techniques based on observable market data or from level 3 inputs which represent different valuation techniques based on no observable market data.

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) |
|---|-----------------|-----------------|--------------------------|-----------------|-----------------|--------------------------|
| | 2014 | Fair value 2014 | 2014 | 2013 | Fair value 2013 | 2013 |
| | HRK '000 | HRK '000 | HRK '000 | HRK '000 | HRK '000 | HRK '000 |
| Loans and receivables | 19,153 | 18,365 | (788) | 18,801 | 18,874 | 73 |
| Trade and other receivables | 275,250 | 275,217 | (33) | 321,686 | 321,040 | (646) |
| Financial assets at fair value through profit or loss | 44,081 | 44,081 | - | 109,845 | 109,845 | - |
| Cash and cash equivalents | 186,963 | 186,963 | - | 411,328 | 411,328 | - |
| Interest-bearing borrowings | (388) | - | - | (308) | (301) | 7 |
| Trade and other payables | (189,220) | (189,220) | - | (209,362) | (209,362) | - |
| | <u>335,839</u> | <u>335,406</u> | <u>(821)</u> | <u>651,990</u> | <u>651,424</u> | <u>(566)</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 the reporting year. 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 reflects 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:

| | 2014 | 2013 |
|-----------------------|-------|-------|
| Loans and receivables | 4.82% | 5.31% |

Notes to the consolidated financial statements (continued)

27 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 Parent 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 Parent Company's Management Board is of the opinion that no material liabilities for the Parent Company will result from this lawsuit. No developments have occurred since 2005 to the date of these statements.