Ericsson Nikola Tesla d.d.

Annual financial report
31 December 2010

Contents

Company profile

History and incorporation

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

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

According to the ownership structure as at 31 December 2010, Telefonaktiebolaget LM Ericsson (Ericsson) holds 49.07% of the Company's share. A further 0.23% is held by The Croatian Privatisation Fund and 0.70% is held as treasury shares. Other shareholders own the remaining 50.00% of the Company's shares.

Principal activities

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

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

Company profile (continued)

Supervisory Board, Management Board and executive management

The Supervisory Board

The Supervisory Board members during 2010 and up to the release of these statements were:

Roland Nordgren	Appointed on 27 May 2008	Chairperson
Ignac Lovrek	Reappointed on 31 May 2007	Member; Vice-Chairperson
Carita Jönsson	Reappointed on 27 May 2008	Member
Dubravko Radošević,	Appointed on 20 May 2010	Member
Zvonimir Jelić	Reappointed on 18 June 2010	Member and employees' representative

The Management Board

The Management Board has one member:

Gordana Kovačević	Reappointed on 1 January 2010	President

Company profile (continued)

Executive management

As at 31 December 2010, the Company's executive management comprised:

ETK Core MT:	
Gordana Kovačević	Company President
Andrew Skelton	Company CFO
Hrvoje Benčić	Director, Engagement Practices and ETK Customer Operations
Lars Olander	Director, Research and Development Center
Milan Živković	Director, Strategy and Business Development
ETK Extended MT:	
Core MT members	
Alen Ludaš	Head, Proposal Management, RWCE
Boris Drilo	Director, ICT for Industry and Society
Branko Dronjić	Regional Manager, BETE
Damir Bušić	Manager, Operations & Competence Centre BSS&OSS Croatia
Dragan Fratrić	Manager, General Services
Franjo Mudrovčić	Acting Director, Sales & Marketing for CIS market
Goran Ožbolt	Director, Sales and Marketing for Tele2 and Alternative Operators
Ivan Barać	Director, Sales and Marketing for T-HT
Jagoda Barać	Director, Sales and Marketing for Neighbouring countries
Marijana Đuzel	Director, HR and Organization (including Legal Affairs)
Mathias Danielsson	Head, Competence Domain Internet Protocol, Broadband & Core, RWCE
Milan Popović	Manager, ETK Project Management Office
Miroslav Kantolić	Director, Sales and Marketing for VIPnet and Si.mobil
Snježana Bahtijari	Director, Marketing and Communication
Snježana Ivezić-Torbarina	Manager, Competence Domain Media and Applications
Tihomir Šicel	Director, Sales & Marketing for Industry and Society

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

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

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

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

The financial statements set out on pages 6 to 65 were authorised by the Management Board on 8 March 2011 for issue to the Supervisory Board and are signed below.

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

pwc

Independent auditor's report

To the Shareholders of Ericsson Nikola Tesla d.d.

We have audited the accompanying financial statements of Ericsson Nikola Tesla d.d., which comprise the statement of financial position as of 31 December 2010 and the statements of comprehensive income, changes in equity and cash flow for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Ericsson Nikola Tesla d.d. as of 31 December 2010 and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers d.o.o.

PricewaterhouseCoopers d.o.o.
Zagreb, 8 March 2011

PRICEWATERHOUSECOOPERS
za reviziju i konzalting d.o.o. 3
ZAGREB, Alexandera von Humboldta 4

This version of our report is a translation from the original, which was prepared in Croatian language. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of our report takes precedence over this translation.

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

Statement of comprehensive income
for the year ended 31 December 2010

	Notes	**2010**	**2009**
		HRK '000	**HRK '000**
Sales revenue	*3*	1,218,863	1,400,011
Cost of sales		(1,012,567)	(1,213,945)
Gross profit		206,296	186,066
Other income	*6*	15,411	17,325
Distribution expenses		(56,973)	(72,894)
Administrative expenses		(34,037)	(37,024)
Other expenses	*7*	(145,946)	(27,793)
Operating profit		(15,249)	65,680
Finance income	*9*	41,408	61,894
Finance expense	*9*	(192)	(757)
Finance income - net		41,216	61,137
Profit before tax		25,967	126,817
Income tax	*10*	(1,905)	1,630
Profit for the year		24,062	128,447
Other comprehensive income		-	-
Total comprehensive income for the year		**24,062**	**128,447**
Earnings per share (HRK)	*11*	18.30	98.09

The notes set out on pages 12 to 65 form an integral part of these financial statements.

Statement of financial position
as at 31 December 2010

	Notes	**2010** **HRK '000**	**2009** **HRK '000**
ASSETS			
Non-current assets			
Property, plant and equipment	*12*	128,643	146,351
Intangible assets	*13*	4,814	4,425
Loans and receivables	*14*	10,358	278,897
Equity securities		45	45
Deferred tax assets	*15*	9,165	12,295
Total non-current assets		153,025	442,013
Current assets			
Inventories	*16*	44,774	24,059
Trade receivables	*17*	346,982	451,247
Receivables from related parties	*29(c)*	75,406	58,905
Income tax receivable		3,054	9,452
Other receivables	*18*	58,232	29,588
Financial assets at fair value through profit or loss	*19*	63,254	120,873
Prepayments and accrued income		6,508	1,371
Cash and cash equivalents	*20*	673,926	414,935
Total current assets		1,272,136	1,110,430
TOTAL ASSETS		1,425,161	1,552,443

The notes set out on pages 12 to 65 form an integral part of these financial statements.

Statement of financial position (continued)
as at 31 December 2010

	Notes	2010 HRK '000	2009 HRK '000
EQUITY AND LIABILITIES			
Equity			
Share capital	*21(a)*	133,165	133,165
Treasury shares	*21(b)*	(16,251)	(34,173)
Legal reserves	*21(c)*	20,110	20,110
Retained earnings		934,000	1,081,121
Total equity		1,071,024	1,200,223
Non-current liabilities			
Interest-bearing borrowings	*24*	3,346	4,965
Employee benefits	*25*	4,891	5,126
Total non-current liabilities		8,237	10,091
Current liabilities			
Payables to related parties	*29(c)*	94,846	67,839
Interest-bearing borrowings	*24*	1,673	1,655
Trade and other payables	*26*	94,380	101,605
Provisions	*27*	17,097	23,730
Accrued charges and deferred revenue	*28*	137,904	147,300
Total current liabilities		345,900	342,129
Total liabilities		354,137	352,220
TOTAL EQUITY AND LIABILITIES		1,425,161	1,552,443

The notes set out on pages 12 to 65 form an integral part of these financial statements.

Statement of cash flows
for the year ended 31 December 2010

	Notes	**2010**	**2009**
		HRK '000	**HRK '000**
Cash flows from operating activities			
Profit before tax		*25,967*	*126,817*
Adjustments for:			
Depreciation and amortisation	*12,13*	56,831	64,787
Impairment losses and reversals		139,850	21,901
Net creation of provisions	*27*	13,853	16,176
Net loss/(gain) on sale of property, plant and equipment	*6,7*	181	(65)
Net gain on remeasurement of financial assets	*9*	(4,026)	(429)
Amortisation of discount	*9*	(6,254)	(15,985)
Interest income	*9*	(23,506)	(39,538)
Interest expense	*9*	192	757
Foreign exchange gains		(6,196)	(5,942)
Equity-settled transactions		6,124	11,129
		203,016	179,608
Decrease in loans and receivables		140,948	78,336
(Increase)/decrease in inventories		(21,022)	28,800
Decrease in receivables		48,256	20,976
Decrease in payables		(11,048)	(10,653)
Cash generated from operations		*360,150*	*297,067*
Interest paid		(192)	(757)
Income taxes refunded/(paid)		6,398	(12,262)
Net cash from operating activities		***366,356***	***284,048***
Cash flows from investing activities			
Interest received		25,369	37,922
Proceeds from sale of property, plant and equipment		43	151
Purchases of property, plant and equipment, and intangible assets	*12,13*	(39,736)	(46,095)
(Decrease)/increase in non-current deposits		(198)	522
Proceeds from disposal/(purchase) of financial assets		61,645	(77,473)
Net cash generated from/(used in) investing activities		***47,123***	***(84,973)***

The notes set out on pages 12 to 65 form an integral part of these financial statements.

Statement of cash flows (continued)
for the year ended 31 December 2010

	Notes	**2010** **HRK '000**	**2009** **HRK '000**
Cash flows from financing activities			
Repayment of interest-bearing borrowings		(1,601)	(2,213)
Purchase of treasury shares	21(b)	-	(11,380)
Dividends paid	22	(158,160)	(91,758)
Net cash used in financing activities		***(159,761)***	***(105,351)***
Effects of exchange rate changes on cash and cash equivalents		5,273	2,908
Net increase in cash and cash equivalents		258,991	96,632
Cash and cash equivalents at the beginning of the year	*20*	414,935	318,303
Cash and cash equivalents at the end of the year	*20*	**673,926**	**414,935**

The notes set out on pages 12 to 65 form an integral part of these financial statements.

Statement of changes in equity
for the year ended 31 December 2010

	Share capital HRK '000	Treasury shares HRK '000	Legal reserves HRK '000	Retained earnings HRK '000	Total HRK '000
As at 1 January 2009	133,165	(46,389)	20,110	1,059,241	1,166,127
Changes in equity for 2009					
Total comprehensive income	-	-	-	128,447	128,447
Dividend distribution for 2008, Note 22	-	-	-	(91,758)	(91,758)
Purchase of treasury shares Note 21 (b)	-	(11,380)	-	-	(11,380)
Share-based payments, Note 25 (b)	-	23,596	-	(23,596)	-
Equity-settled transactions, Note 25 (b)	-	-	-	11,129	11,129
Deferred tax related to equity increase, Note 10	-	-	-	(2,342)	(2,342)
As at 31 December 2009	133,165	(34,173)	20,110	1,081,121	1,200,223
As at 1 January 2010	133,165	(34,173)	20,110	1,081,121	1,200,223
Changes in equity for 2010					
Total comprehensive income	-	-	-	24,062	24,062
Dividend distribution for 2009, Note 22	-	-	-	(158,160)	(158,160)
Share-based payments, Note 25 (b)	-	17,922	-	(17,922)	-
Equity-settled transactions, Note 25 (b)	-	-	-	6,124	6,124
Deferred tax related to equity increase, Note 10	-	-	-	(1,225)	(1,225)
As at 31 December 2010	133,165	(16,251)	20,110	934,000	1,071,024

The notes set out on pages 12 to 65 form an integral part of these financial statements.

Notes to the financial statements

1 Significant accounting policies

Reporting entity

Ericsson Nikola Tesla d.d. (the Company) is a joint stock company incorporated and domiciled in Croatia. The address of its registered office is Krapinska 45, 10000 Zagreb, the Republic of Croatia. The Company's shares are listed on the Public Joint Stock Company listing on the Zagreb Stock Exchange. These financial statements were authorised for issue by the Management Board on 8 March 2011 for approval by the Supervisory Board. A summary of the Company's principal accounting policies is set out below.

Statement of compliance

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

Basis of preparation

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

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

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

Going concern

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

1 Significant accounting policies (continued)

Changes in accounting policies and disclosures

(a) New and amended standards adopted by the Company

The Company has adopted the following new and amended IFRSs as of 1 January 2010:

IFRS 3 (revised), ‘Business combinations’, and consequential amendments to IAS 27, ‘Consolidated and separate financial statements’, IAS 28, ‘Investments in associates’, and IAS 31, ‘Interests in joint ventures’, are effective prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009.

The revised standard continues to apply the acquisition method to business combinations but with some significant changes compared with IFRS 3. For example, all payments to purchase a business are recorded at fair value at the acquisition date, with contingent payments classified as debt subsequently remeasured through the statement of comprehensive income. There is a choice on an acquisition-by-acquisition basis to measure the non-controlling interest in the acquiree either at fair value or at the non-controlling interest’s proportionate share of the acquiree’s net assets. All acquisition-related costs are expensed. The amendment will not have an impact on the Company’s financial statements.

IAS 27 (revised) requires the effects of all transactions with non-controlling interests to be recorded in equity if there is no change in control and these transactions will no longer result in goodwill or gains and losses. The standard also specifies the accounting when control is lost. Any remaining interest in the entity is re-measured to fair value, and a gain or loss is recognised in profit or loss. IAS 27 (revised) has had no impact on the current period, as none of the non-controlling interests have a deficit balance; there have been no transactions whereby an interest in an entity is retained after the loss of control of that entity, and there have been no transactions with non-controlling interests. The revised Standard will not have an impact on the Company’s financial statements.

1 Significant accounting policies (continued)

Changes in accounting policies and disclosures (continued)

(b) New and amended standards, and interpretations mandatory for the first time for the financial year beginning 1 January 2010 but not currently relevant to the Company (although they may affect the accounting for future transactions and events)

The following standards and amendments to existing standards have been published and are mandatory for the Company's accounting periods beginning on or after 1 January 2010 or later periods, but the Company has not early adopted them.

IFRIC 17, 'Distribution of non-cash assets to owners' (effective on or after 1 July 2009). The interpretation was published in November 2008. This interpretation provides guidance on accounting for arrangements whereby an entity distributes non-cash assets to shareholders either as a distribution of reserves or as dividends. IFRS 5 has also been amended to require that assets are classified as held for distribution only when they are available for distribution in their present condition and the distribution is highly probable.

IFRIC 18, 'Transfers of assets from customers', effective for transfer of assets received on or after 1 July 2009. This interpretation clarifies the requirements of IFRSs for agreements in which an entity receives from a customer an item of property, plant and equipment that the entity must then use either to connect the customer to a network or to provide the customer with ongoing access to a supply of goods or services (such as a supply of electricity, gas or water). In some cases, the entity receives cash from a customer that must be used only to acquire or construct the item of property, plant, and equipment in order to connect the customer to a network or provide the customer with ongoing access to a supply of goods or services (or to do both).

IFRIC 9, 'Reassessment of embedded derivatives and IAS 39, Financial instruments: Recognition and measurement', effective 1 July 2009. This amendment to IFRIC 9 requires an entity to assess whether an embedded derivative should be separated from a host contract when the entity reclassifies a hybrid financial asset out of the 'fair value through profit or loss' category. This assessment is to be made based on circumstances that existed on the later of the date the entity first became a party to the contract and the date of any contract amendments that significantly change the cash flows of the contract. If the entity is unable to make this assessment, the hybrid instrument must remain classified as at fair value through profit or loss in its entirety.

1 Significant accounting policies (continued)

Changes in accounting policies and disclosures (continued)

(b) New and amended standards, and interpretations mandatory for the first time for the financial year beginning 1 January 2010 but not currently relevant to the Company (although they may affect the accounting for future transactions and events) (continued)

IFRIC 16, 'Hedges of a net investment in a foreign operation' effective 1 July 2009. This amendment states that, in a hedge of a net investment in a foreign operation, qualifying hedging instruments may be held by any entity or entities within the Group, including the foreign operation itself, as long as the designation, documentation and effectiveness requirements of IAS 39 that relate to a net investment hedge are satisfied. In particular, the Company should clearly document its hedging strategy because of the possibility of different designations at different levels of the Company.

IAS 38 (amendment), 'Intangible assets', effective 1 January 2010. The amendment clarifies guidance in measuring the fair value of an intangible asset acquired in a business combination and permits the grouping of intangible assets as a single asset if each asset has similar useful economic lives.

IAS 1 (amendment), 'Presentation of financial statements'. The amendment clarifies that the potential settlement of a liability by the issue of equity is not relevant to its classification as current or non-current. By amending the definition of current liability, the amendment permits a liability to be classified as non-current (provided that the entity has an unconditional right to defer settlement by transfer of cash or other assets for at least 12 months after the accounting period) notwithstanding the fact that the entity could be required by the counterparty to settle in shares at any time.

IAS 36 (amendment), 'Impairment of assets', effective 1 January 2010. The amendment clarifies that the largest cash-generating unit (or group of units) to which goodwill should be allocated for the purposes of impairment testing is an operating segment, as defined by paragraph 5 of IFRS 8, 'Operating segments' (that is, before the aggregation of segments with similar economic characteristics).

IFRS 2 (amendments), 'Group cash-settled share-based payment transactions', effective form 1 January 2010. In addition to incorporating IFRIC 8, 'Scope of IFRS 2', and IFRIC 11, 'IFRS 2 – Group and treasury share transactions', the amendments expand on the guidance in IFRIC 11 to address the classification of group arrangements that were not covered by that interpretation.

IFRS 5 (amendment), 'Non-current assets held for sale and discontinued operations'. The amendment clarifies that IFRS 5 specifies the disclosures required in respect of non-current assets (or disposal groups) classified as held for sale or discontinued operations. It also clarifies that the general requirement of IAS 1 still apply, in particular paragraph 15 (to achieve a fair presentation) and paragraph 125 (sources of estimation uncertainty) of IAS 1.

1 Significant accounting policies (continued)

Changes in accounting policies and disclosures (continued)

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

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

IFRS 9, 'Financial instruments', issued in November 2009. This standard is the first step in the process to replace IAS 39, 'Financial instruments: recognition and measurement'. IFRS 9 introduces new requirements for classifying and measuring financial assets and is likely to affect the Company's accounting for its financial assets. The standard is not applicable until 1 January 2013 but is available for early adoption. However, the standard has not yet been endorsed by the EU. The Company is yet to assess IFRS 9's full impact.

IAS 24 (revised), 'Related party disclosures', issued in November 2009. It supersedes IAS 24, 'Related party disclosures', issued in 2003. IAS 24 (revised) is mandatory for periods beginning on or after 1 January 2011. Earlier application, in whole or in part, is permitted. However, the standard has not yet been endorsed by the EU.

The revised standard clarifies and simplifies the definition of a related party and removes the requirement for government-related entities to disclose details of all transactions with the government and other government-related entities. The Company will apply the revised standard from 1 January 2011. When the revised standard is applied, the Company will need to disclose any transactions between its subsidiaries and its associates. Since the Company has no material subsidiaries or associates, the revised standard is not expected to have any impact on the financial statements.

'Classification of rights issues' (amendment to IAS 32), issued in October 2009. The amendment applies to annual periods beginning on or after 1 February 2010. Earlier application is permitted. The amendment addresses the accounting for rights issues that are denominated in a currency other than the functional currency of the issuer. Provided certain conditions are met, such rights issues are now classified as equity regardless of the currency in which the exercise price is denominated. Previously, these issues had to be accounted for as derivative liabilities. The amendment applies retrospectively in accordance with IAS 8 'Accounting policies, changes in accounting estimates and errors'. The Company will apply the amended standard from 1 January 2011. The amendment will not have an impact on the Company's financial statements.

1 Significant accounting policies (continued)

Changes in accounting policies and disclosures (continued)

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

IFRIC 19, ‘Extinguishing financial liabilities with equity instruments’, effective 1 July 2010. The interpretation clarifies the accounting by an entity when the terms of a financial liability are renegotiated and result in the entity issuing equity instruments to a creditor of the entity to extinguish all or part of the financial liability (debt for equity swap). It requires a gain or loss to be recognised in profit or loss, which is measured as the difference between the carrying amount of the financial liability and the fair value of the equity instruments issued. If the fair value of the equity instruments issued cannot be reliably measured, the equity instruments should be measured to reflect the fair value of the financial liability extinguished. The Company will apply the interpretation from 1 January 2011, subject to endorsement by the EU. It is not expected to have any impact on the Company’s financial statements.

‘Prepayments of a minimum funding requirement’ (amendments to IFRIC 14). The amendments correct an unintended consequence of IFRIC 14, ‘IAS 19 – The limit on a defined benefit asset, minimum funding requirements and their interaction’. Without the amendments, entities are not permitted to recognise as an asset some voluntary prepayments for minimum funding contributions. This was not intended when IFRIC 14 was issued, and the amendments correct this. The amendments are effective for annual periods beginning 1 January 2011. Earlier application is permitted. The amendments should be applied retrospectively to the earliest comparative period presented. The Company will apply these amendments for the financial reporting period commencing on 1 January 2011.

Functional and presentational currency

The Company’s financial statements have been prepared in Croatian kuna (HRK), which is the currency of the primary economic environment in which the entity operates (the functional currency) and the presentation currency, and are rounded to the nearest thousand. The closing exchange rate as at 31 December 2010 was HRK 5.56825 per USD 1 (2009: HRK 5.08930) and HRK 7.38517 per EUR 1 (2009: HRK 7.30620).

1 Significant accounting policies (continued)

Property, plant and equipment

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

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

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

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

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

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.

1 Significant accounting policies (continued)

Impairment of assets

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

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

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

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

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

Financial instruments

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

1 Significant accounting policies (continued)

Financial instruments (continued)

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

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

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

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

1 Significant accounting policies (continued)

Financial instruments (continued)

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

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

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

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

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

1 Significant accounting policies (continued)

Trade and other receivables

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

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

Cash and cash equivalents

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

Trade and other payables

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

Inventories

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

Share capital and reserves

Share capital is stated in HRK at nominal value. The amount of consideration paid on repurchase of share capital, including directly attributable costs, is recognised as a charge in equity. Repurchased shares are classified as treasury shares and presented as a deduction from total equity.

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

1 Significant accounting policies (continued)

Share capital and reserves (continued)

The result for the year is transferred to retained earnings. Dividends are recognised as a liability in the period in which they are declared. Dividends are paid out of the retained earnings.

Income tax

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

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

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

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

1 Significant accounting policies (continued)

Foreign currencies

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

Recognition of revenues

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

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

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

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

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

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

1 Significant accounting policies (continued)

Recognition of revenues (continued)

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

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

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

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

Employee benefits

a) Long-term service benefits

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

b) Share-based payments

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

1 Significant accounting policies (continued)

Provisions

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

Net financial income

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

Segment reporting

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

Borrowings

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

1 Significant accounting policies (continued)

Leases

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

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

Dividend distribution

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

2 Critical accounting estimates and judgements

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

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

(a) Impairment losses on loans and receivables

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

(b) Financial crisis impact

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

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

2 Critical accounting estimates and judgements (continued)

(b) Financial crisis impact (continued)

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

Judgements

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

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

3 Sales revenue

	2010	**2009**
	HRK '000	**HRK '000**
Sales revenue from products	472,537	619,138
Sales revenue from services	746,326	780,873
	1,218,863	1,400,011

4 Segment reporting

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

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

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

- Networks include products for mobile and fixed broadband access, core networks, transmission and next-generation IP networks. Related network rollout services are also included. In addition, power modules and cables operations are included within Networks.

- Professional services include all service operations, excluding Network rollout reported under Networks. Services related to system integration of IP and core networks are classified as Professional services.

- Multimedia includes multimedia systems, enterprise solutions and mobile platforms.

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

	2010	**2009**
	HRK ‘000	**HRK ‘000**
Sales revenue in domestic market	339,696	481,693
Sales revenue in Russia, Belarus, Kazakhstan, Georgia, Kyrgyzstan, Moldova	222,792	215,237
Sales revenue to Ericsson	444,838	423,155
Sales revenue in Bosnia and Herzegovina, Montenegro, Macedonia and Kosovo	201,662	265,048
Other export sales revenue	9,875	14,878
	1,218,863	1,400,011

Notes to the financial statements (continued)

4 Segment reporting (continued)

	Networks		Professional services		Multimedia		Total	
	2010	2009	2010	2009	2010	2009	2010	2009
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Segment sales revenue	779,021	922,523	393,801	416,321	46,041	61,167	1,218,863	1,400,011
Segment other income	9,850	11,373	4,979	5,133	582	754	15,411	17,260
Segment results from operating activities	58,518	48,476	(31,970)	64,316	(7,579)	(10,153)	18,969	102,639
Segment results from operating activities excluding Kazakhstan write off[1)]	68,463	48,476	84,800	64,316	(7,802)	(10,153)		
Unallocated (loss)/gain on sale of property, plant and equipment							(181)	65
Unallocated expenses[2)]							(34,037)	(37,024)
Operating profit							(15,249)	65,680
Segment finance income	8,206	18,998	4,481	5,832	3,019	9,101	15,706	33,931
Segment results	66,724	67,474	(27,489)	70,148	(4,560)	(1,052)	34,675	136,570
Segment results excluding Kazakhstan write off[1)]	76,669	67,474	89,281	70,148	(4,783)	(1,052)		
Unallocated finance income							25,702	27,963
Finance expense							(192)	(757)
Profit before tax							25,967	126,817
Income tax expense							(1,905)	1,630
Profit for the year							**24,062**	**128,447**
Segment liabilities	143,298	125,320	72,438	56,555	8,469	8,309	224,205	190,184
Other segment information:								
Additions to property, plant and equipment	23,350	29,250	11,803	13,200	1,380	1,940	36,533	44,390
Acquisitions of intangible assets	2,047	1,123	1,035	507	121	75	3,203	1,705
Depreciation and amortisation	29,789	8,028	15,059	3,623	1,760	532		

[1)]Information relating to Kazakhstan write off is disclosed in note 17

[2)]Including audit fee expenses of HRK 420 thousand (2009: HRK 415 thousand)

4 Segment reporting (continued)

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

	2010	2009
	HRK '000	HRK '000
Segment liabilities	224,205	190,184
Unallocated:		
Interest-bearing borrowings	5,019	6,620
Accrued charges and deferred revenue	111,610	147,300
Trade and other payables	8,412	2,990
Employee benefits	4,891	5,126
Total liabilities per the statement of financial position	354,137	352,220

5 Expenses by nature

	2010	2009
	HRK '000	HRK '000
Changes in inventories of finished goods and work in progress (note 16)	(21,817)	27,159
Goods and services	636,144	789,990
Personnel expenses (note 8)	432,419	441,927
Depreciation and amortisation (note12,13)	56,831	64,787
Total cost of sales, distribution and administrative expenses	1,103,577	1,323,863

6 Other income

	2010	2009
	HRK '000	HRK '000
Commission income	251	777
Rental income	14,631	16,159
Net gain on disposal of property, plant and equipment	-	65
Other income	529	324
	15,411	17,325

7 Other expenses

	2010	2009
	HRK '000	HRK '000
Net loss on disposal of property, plant and equipment	181	-
Increase in provisions (Note 27)	5,916	5,892
Impairment loss on loans and receivables (Note 17)	139,543	21,650
Obsolescence allowance on inventories	306	251
	145,946	27,793

8 Personnel expenses

	2010	2009
	HRK '000	HRK '000
Net salaries	210,573	209,381
Taxes and contributions	191,286	195,307
Other payroll-related costs	24,436	25,527
Equity-settled transactions (Note 25 b)	6,124	11,712
	432,419	441,927

Personnel expenses include HRK 68,415 thousand (2009: HRK 70,326 thousand) of defined pension contributions paid or payable into obligatory pension plans. Contributions are calculated as a percentage of employees' gross salaries (Gross II).
In addition, Personnel expenses include HRK 13,868 thousand (2009: HRK 10,284 thousand) in respect of voluntary redundancy costs. Movements in provision related to these costs are described in Note 27, Provisions.

At 31 December 2010, total number of employees was 1,595 (2009: 1,661).

9 Finance income and expense

Finance income

	2010	2009
	HRK '000	HRK '000
Interest income (Note 9 a)	23,506	39,538
Net gains from re-measurement of financial assets at fair value through profit or loss (Note 9 c)	4,026	429
Amortization of discount (Note 9 b)	6,254	15,985
Net foreign exchange gain	7,622	5,942
	41,408	61,894

Finance expense

	2010	2009
	HRK '000	HRK '000
Interest expense	192	757
	192	757

9 (a)

	2010	2009
	HRK '000	HRK '000
Interest income		
- on loans to customers	8,623	17,316
- on debt securities	998	2,720
- on term deposits	12,584	18,079
- on other receivables	1,301	1,423
	23,506	39,538

9 (b)

The Company released HRK 6,254 thousand (2009: HRK 15,985 thousand) into finance income due to amortisation of discount according to the net present value method of impairment.

9 Finance income and expense (continued)

9 (c)

	2010 HRK'000	2009 HRK'000
Net gains/(losses) from re-measurement of financial assets at fair value through profit or loss		
- Derivative financial instruments	-	1,588
- Equity securities	1,388	(385)
- Investment in investment funds	2,671	86
- Debt securities	(33)	(860)
	4,026	429

10 Income tax expense

Income tax has been calculated on the taxable income at statutory tax rate of 20% (2009: 20%).

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

	2010 HRK '000	2009 HRK '000
Current income tax expense	-	-
Total deferred tax (expense)/income relating to the origination and reversal of temporary differences (note 15)	(1,905)	1,630
Total income tax (charge)/credit in the statement of comprehensive income	(1,905)	1,630

Deferred tax recognised directly to equity:

	2010 HRK '000	2009 HRK '000
Relating to equity-settled transactions (note 15)	(1,225)	(2,342)

10 Income tax expense (continued)

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

	2010 HRK '000	2009 HRK '000
Profit before tax	25,967	126,817
Income tax at 20% (2009: 20%)	5,193	25,363
The effects of:		
Non-deductible expenses	1,786	3,338
Tax exempt (revenues)/expenses	(3,338)	300
Tax incentives	(3,641)	(29,001)
Current tax expense	-	-
Effective tax rate	0,0%	0,0%

Tax incentives include only part of additional tax allowances for certain expenditure totalling HRK 3,641 thousand (2009: HRK 29,001 thousand) which meets research and development incentives definitions under Croatian tax legislation. The underlying research and development expenditure is included in cost of sales.

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

11 Earnings per share

	2010	2009
Profit for the year (HRK '000)	24,062	128,447
Weighted Average Number of Shares Outstanding at the year-end	1,314,812	1,309,435
Earnings per share (HRK)	18.30	98.09

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

12 Property, plant and equipment

	Land and buildings HRK '000	Plant and equipment HRK '000	Other HRK '000	Total HRK '000
As at 1 January 2009				
Cost or valuation	155,455	397,620	328	553,403
Accumulated depreciation	(92,476)	(297,457)	(181)	(390,114)
Net book amount	62,979	100,163	147	163,289
Year ended 31 December 2009				
Opening net book amount	62,979	100,163	147	163,289
Additions	-	44,390	-	44,390
Disposals	-	(86)	-	(86)
Depreciation charge	(3,589)	(57,645)	(8)	(61,242)
Closing net book amount	**59,390**	**86,822**	**139**	**146,351**
As at 31 December 2009				
Cost or valuation	155,455	312,094	328	467,877
Accumulated depreciation	(96,065)	(225,272)	(189)	(321,526)
Net book amount	**59,390**	**86,822**	**139**	**146,351**
Year ended 31 December 2010				
Opening net book amount	59,390	86,822	139	146,351
Additions	-	36,533	-	36,533
Disposals	-	(224)	-	(224)
Depreciation charge	(3,542)	(50,467)	(8)	(54,017)
Closing net book amount	**55,848**	**72,664**	**131**	**128,643**
As at 31 December 2010				
Cost or valuation	155,455	293,754	328	449,537
Accumulated depreciation	(99,607)	(221,090)	(197)	(320,894)
Net book amount	**55,848**	**72,664**	**131**	**128,643**

Included in cost is HRK 206,698 thousand (2009: HRK 198,172 thousand) of fully depreciated property, plant and equipment that is still used by the Company.

As at 31 December 2010, the Company had contracts totalling HRK 6,025 thousand (2009: HRK 1,552 thousand) related to future equipment purchases.

12 Property, plant and equipment *(continued)*

The Company acts as a lessor under operating leases, mainly land and buildings. Property leased to others with a carrying value of HRK 22,552 thousand (2009: HRK 23,901 thousand) is included within land and buildings. These assets are depreciated at the same depreciation rates as other buildings. HRK 16,529 thousand (2009: 18,655 thousand) of leased assets is leased for a non-cancellable period of five years which commenced in 2005. Subsequent renewals are negotiated with the lessee. No contingent rents are charged. Portions of the property which is held for rental could not be sold separately or leased out separately under finance lease. Consequently, the IAS 40 criteria for separate investment property recognition are not met.

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

	2010	**2009**
	HRK '000	**HRK '000**
Less than one year	4,058	6,064
Between one and five years	-	-
	4,058	6,064

13 Intangible assets

The movement on intangible assets in the year ended 31 December 2010 may be analysed as follows:

	Application software HRK '000
As at 1 January 2009	
Cost or valuation	16,620
Accumulated amortization	(10,355)
Net book amount	6,265
Year ended 31 December 2009	
Opening net book amount	6,265
Additions	1,705
Amortization charge	(3,545)
Closing net book amount	**4,425**
As at 31 December 2009	
Cost or valuation	16,264
Accumulated amortization	(11,839)
Net book amount	**4,425**
Year ended 31 December 2010	
Opening net book amount	4,425
Additions	3,203
Amortization charge	(2,814)
Closing net book amount	**4,814**
As at 31 December 2010	
Cost or valuation	19,467
Accumulated amortization	(14,653)
Net book amount	**4,814**

Included in the cost amount is HRK 9,641 thousand (2009: HRK 6,365 thousand) of fully amortised intangible assets that are still used by the Company.

14 Loans and receivables

	2010	2009
	HRK '000	HRK '000
Deposits with financial institutions, denominated in foreign currency	7,076	6,878
Non-current receivables from foreign customers, denominated in foreign currency	15,600	260,469
Non-current receivables from domestic customers, denominated in HRK	-	12,445
Receivables for sold apartments		
- denominated in foreign currency	5,430	5,498
- denominated in HRK	1,193	1,415
Housing loans to employees, denominated in HRK	-	7
Total loans and receivables	29,299	286,712
Impairment allowance on loans and receivables (Note 17)	(18,941)	(7,815)
	10,358	278,897

Deposits with financial institutions are placed as guarantee deposits for housing loans provided to the Company's employees, earning interest at variable rates ranging from 1.07% to 1.10% per annum (2009: 1.07% to 1.10% per annum), and with a remaining maturity of over three years.

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	2010	2009
	HRK '000	HRK '000
2011	-	74,978
2012	11,582	42,247
2013	4,018	36,656
2014	-	34,009
2015-2020	-	85,024
	15,600	272,914

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 2,334 thousand (2009: HRK 3,120 thousand) is recognised in respect of these loans and amortised through the statement of comprehensive income, using the effective interest rate method at a rate of 7% per annum.

15 Deferred tax assets

Recognised deferred tax assets and liabilities

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

	2010		Credited/ (charged) to statement of comprehensive income	Credited/ (charged) to equity	2009	
	Assets	**Liabilities**			**Assets**	**Liabilities**
	HRK '000	**HRK '000**	**HRK '000**	**HRK '000**	**HRK '000**	**HRK '000**
Receivables	6,143	-	148	-	5,995	-
Inventories	2,262	-	11	-	2,251	-
Employee benefits	825	-	6	-	819	-
Non-current receivables for sold apartments	467	-	(157)	-	624	-
Negative fair value of financial instruments	447	-	-	-	447	-
Accrued charges	(979)	-	(3,138)	-	2,159	-
Increase in equity related to equity-settled transactions	11,344	(11,344)	1,225	(1,225)	10,119	(10,119)
	20,509	(11,344)	(1,905)	(1,225)	22,414	(10,119)
Set-off of tax	(11,344)	11,344	-	-	(10,119)	10,119
Deferred tax assets	9,165	-	(1,905)	(1,225)	12,295	-

Deferred income tax assets are recognised for tax loss carry-forwards to the extent that the realisation of the related tax benefit through future taxable profits is probable. The Company did not recognise deferred income tax assets of HRK 28,832 thousand (2009: HRK 16,255 thousand) in respect of tax losses amounting to HRK 144,161 thousand (2009: HRK 81,277) that can be carried forward against future taxable income. A tax loss may be carried forward for five years subsequent to the year in which it was incurred. The availability of tax losses against future periods, subject to review by the Ministry of Finance, is as follows:

	HRK '000
Tax loss from 2009 – expires 31 December 2014	81,277
Tax loss from 2010 – expires 31 December 2015	144,161
	225,438

15 Deferred tax assets (continued)

Recognised deferred tax assets and liabilities (continued)

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

	2009		Credited/ (charged) to statement of comprehensive income	Credited/ (charged) to equity	2008	
	Assets	Liabilities			Assets	Liabilities
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Receivables	5,995	-	(1,483)	-	7,478	-
Inventories	2,251	-	(25)	-	2,276	-
Employee benefits	819	-	34	-	785	-
Non-current receivables for sold apartments	624	-	(75)	-	699	-
Negative fair value of financial instruments	447	-	(1,154)	-	1,601	-
Accrued charges	2,159	-	1,991	-	168	-
Increase in equity related to equity-settled transactions	10,119	(10,119)	2,342	(2,342)	7,777	(7,777)
	22,414	(10,119)	1,630	(2,342)	20,784	(7,777)
Set-off of tax	(10,119)	10,119	-	-	(7,777)	7,777
Deferred tax assets	12,295	-	1,630	(2,342)	13,007	-

16 Inventories

	2010	2009
	HRK '000	HRK '000
Raw materials	6,569	7,363
Work-in-progress and semi-finished goods	39,474	17,657
Total inventories	46,043	25,020
Obsolescence allowance	(1,269)	(961)
	44,774	24,059

17 Trade receivables

	2010 HRK ‘000	2009 HRK ‘000
Foreign trade receivables	169,064	193,517
Current portion of non-current foreign receivables	58,104	152,938
Total current foreign receivables	227,168	346,455
Domestic trade receivables	116,397	110,974
Current portion of non-current domestic receivables	18,102	19,273
Total current domestic receivables	134,499	130,247
Impairment allowance on receivables	(14,685)	(25,455)
	346,982	451,247

Included in trade receivables is HRK 31,534 thousand (2009: HRK 15,725 thousand) of contract work in progress.

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

	2010 HRK ‘000	2009 HRK ‘000
As at 1 January (Notes 14,17)	33,270	41,478
Provision for receivables impaired during the year (Note 7)	147,276	22,612
Receivables written off during the year as uncollectible	(132,933)	(13,873)
Unused amounts reversed (Note 7)	(7,733)	(962)
Amortisation of discount (Note 9)	(6,254)	(15,985)
As at 31 December (Notes 14,17)	33,626	33,270

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

Of the total HRK 33,626 thousand of impairment allowances as at 31 December 2010, HRK 31,292 thousand relates to Customer loans and receivables.

18 Other receivables

	2010 HRK ‘000	2009 HRK ‘000
Net receivables for prepaid VAT	19,890	9,456
Receivables for withholding tax	27,031	11,267
Receivables from employees	925	1,039
Accrued interest receivable	1,501	3,364
Other receivables	8,885	4,462
	58,232	29,588

19 Financial assets at fair value through profit or loss

	2010 HRK '000	2009 HRK '000
Financial assets at fair value through profit or loss		
- Debt securities, Ministry of Finance	13,706	43,284
- Equity securities	670	603
- Investment in open-ended investment funds	48,878	76,986
	63,254	120,873

20 Cash and cash equivalents

	2010 HRK '000	2009 HRK '000
Cash and demand deposits	129,622	44,851
Term deposits originated by the Company, with original maturity up to 3 months	544,304	370,084
	673,926	414,935

21 Equity

(a) Share capital

As at 31 December 2010, the share capital of the Company is represented by 1,331,650 (2009: 1,331,650) of authorised, issued and fully paid ordinary shares, with a total registered value of HRK 133,165 thousand (2009: HRK 133,165 thousand). The nominal value of one share is HRK 100 (2009: HRK 100). The holders of the ordinary shares are entitled to receive dividends as declared at the General Assembly and are entitled to one vote per share at the General Assembly.

The Company's shareholders as at 31 December 2010 are:

	2010	2010	2009	2009
	Number of shares	**% held**	**Number of shares**	**% held**
Telefonaktiebolaget LM Ericsson	653,473	49.07	653,473	49.07
Small shareholders	665,793	50.00	651,830	48.95
Croatian Privatisation Fund	3,096	0.23	11,879	0.89
Treasury shares	9,288	0.70	14,468	1.09
	1,331,650	100.00	1,331,650	100.00

(b) Treasury shares

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

Movements in treasury shares are as follows:

	2010 Number of shares	2009 Number of shares
At 1 January (Note 21 (a))	14,468	13,588
Purchases during the year	-	8,893
Distributed during the year	(5,180)	(8,013)
At 31 December (Note 21 (a))	9,288	14,468

(c) Legal reserves

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

22 Proposed dividends

Dividends payable are not accounted for until they have been ratified at the General Assembly of shareholders. On 20 May 2010, the General Assembly approved a regular dividend in respect of 2009 of HRK 20.00 per share, and additional extraordinary dividend of HRK 100.00 per share, totalling HRK 158.2 million. At a meeting held on 10 February 2011, the Management Board proposed a regular dividend in respect of 2010 in the amount of HRK 20 per share, and an additional extraordinary dividend of HRK 170 per share. The dividend will be paid from profit for 2010 and the remaining part of retained earnings realized in 2009 and 2006 plus a portion of retained earnings realized in 2001 after approval by the General Assembly, which will be held on 31 May 2011.

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

	2010	**2009**
	HRK '000	**HRK '000**
HRK 120.00 per share for 2009	158,160	-
HRK 70.00 per share for 2008	-	91,758

23 Capital management

The Company's objectives when managing capital are:

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

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

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

24 Interest-bearing borrowings

During 2008, the Company borrowed the amount of HRK 8,085 thousand from HBOR and delivered information and communication equipment to a customer. The Ministry of Health and Social Welfare ("the Ministry") took over the obligations towards the Company on behalf of the customer and, based on the cession agreement between the Company, the customer and the Ministry, the Ministry is obliged to perform the repayment of the due amounts in favour of the customer directly to HBOR. The Company's liability to HBOR decreases as the Ministry repays. The HBOR borrowing was granted over a 5-year period. The current portion of the borrowing amounts to HRK 1,673 thousand, while the remaining amount is repayable in semi-annual instalments until 2013, bearing an interest rate of six-month EURIBOR plus a margin of 2% per annum. There is no security or pledges in relation to these borrowings. There are no amounts bearing a fixed interest rate.

	2010 HRK '000	2009 HRK '000
Non-current portion of borrowings	3,346	4,965
Current portion of borrowings	1,673	1,655
	5,019	6,620

25 Employee benefits

(a) Long-term service benefits

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

However, the Company pays a one-time benefit amounting to HRK 8,000 for each employee who retires. Additionally, the Company pays jubilee awards in respect of each 5 years of service, of an employee, starting from the 10th year and ending in the 40th year. The principal actuarial assumptions used to determine retirement and jubilee obligations as at 31 December 2010 were a 6% discount rate (2009: 6%) and a 2.91% (2009: 3.01%) rate of average employment turnover.

25 Employee benefits (continued)

(a) Long-term service benefits (continued)

Movements in long-term service benefits were as follows:

	2010 Jubilee awards	2010 Retirement	2010 Total	2009 Jubilee awards	2009 Retirement	2009 Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
As at 1 January	4,095	1,031	5,126	3,927	1,082	5,009
Obligation created during the year	706	514	1,220	657	336	993
Obligation fulfilled during the year	(615)	(88)	(703)	(406)	(48)	(454)
Obligation reversed during the year	(63)	(689)	(752)	(83)	(339)	(422)
As at 31 December	4,123	768	4,891	4,095	1,031	5,126

(b) Share-based payments

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

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

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

25 Employee benefits (continued)

(b) Share-based payments (continued)

The terms and conditions of the grants are as follows:

Employees entitled/grant date	Number of granted shares	Vesting conditions
Loyalty program		
Share grant to key management during 2004	690	Three to five years of service
Share grant to other employees during 2004	8,355	Three to five years of service
Share grant to key management during 2005	-	Three to five years of service
Share grant to other employees during 2005	(125)	Three to five years of service
Share grant to key management during 2006	-	Three to five years of service
Share grant to other employees during 2006	4,575	Three to five years of service
Share grant to key management during 2007	-	Three to five years of service
Share grant to other employees during 2007	(145)	Three to five years of service
Share grant to key management during 2008	450	Three to five years of service
Share grant to other employees during 2008	2,285	Three to five years of service
Share grant to key management during 2009	-	Three to five years of service
Share grant to other employees during 2009	-	Three to five years of service
Share grant to key management during 2010	-	Three to five years of service
Share grant to other employees during 2010	-	Three to five years of service
	16,085	
Award program		
Share grant to key management during 2004	1,640	Upon granting
Share grant to other employees during 2004	730	Upon granting
Share grant to key management during 2005	-	Upon granting
Share grant to other employees during 2005	-	Upon granting
Share grant to key management during 2006	1,200	Upon granting
Share grant to other employees during 2006	-	Upon granting
Share grant to key management during 2007	3,162	Upon granting
Share grant to other employees during 2007	2,577	Upon granting
Share grant to key management during 2008	1,287	Upon granting
Share grant to other employees during 2008	2,430	Upon granting
Share grant to key management during 2009	51	Upon granting
Share grant to other employees during 2009	2,886	Upon granting
Share grant to key management during 2010	1.252	Upon granting
Share grant to other employees during 2010	123	Upon granting
	17,338	

25 Employee benefits (continued)

(b) Share-based payments (continued)

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

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

During 2010, the Company recognised HRK 6,124 thousand (2009: HRK 11,712 thousand) of expenses in respect of share-based payments, which are included in personnel expenses as disclosed in Note 8. During year 2010, there was no decision on new Loyalty programs, only the share distribution according to existing Loyalty programs was executed. The Award program for 2010 included the length of service with the Company component and the shares granted under the program were distributed during 2010, while almost all of 2.937 shares granted under the 2009 Award program were distributed in 2009, only 65 shares being distributed in 2010. Out of 3,717 shares under the 2008 Award program, 1,800 should have been distributed during 2009, but 599 expired.

Shares granted under the previous Loyalty programs vested during 2010. The total weighted average cost of shares granted during 2010 under the Award and Loyalty programs amounted to HRK 17,922 thousand (2009: HRK 23,596 thousand).

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

	2010 Number of shares	2009 Number of shares
As at 1 January	9,705	15,380
Granted	1,375	2,937
Exercised	(5,180)	(8,013)
Expired	-	(599)
As at 31 December	5,900	9,705

26 Trade and other payables

	2010 HRK '000	2009 HRK '000
Trade payables	38,495	43,410
Liabilities to employees	42,612	42,215
Other current liabilities	13,273	15,980
	94,380	101,605

27 Provisions

Movements in provisions were as follows:

	2010 Warranty reserve HRK '000	2010 Penalty reserve HRK '000	2010 Voluntary redundancy HRK '000	2010 Total HRK '000	2009 Warranty reserve HRK '000	2009 Penalty reserve HRK '000	2009 Voluntary redundancy HRK '000	2009 Total HRK '000
As at 1 January	10,002	3,444	10,284	23,730	11,634	843	-	12,477
Provision created during the year	4,968	7,319	13,868	26,155	3,179	5,789	10,284	19,252
Provision reversed during the year	(2,997)	(3,374)	-	(6,371)	(2,355)	(721)	-	(3,076)
Provision used during the year	(1,617)	(1,042)	(23,758)	(26,417)	(2,456)	(2,467)	-	(4,923)
As at 31 December	10,356	6,347	394	17,097	10,002	3,444	10,284	23,730

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

An agreement was reached in 2010 with the local union representatives, which specifies the number of staff involved and the early retirement compensation package offered by the Company, as well as amounts payable to those having accepted the package, before the financial year-end. The estimated staff restructuring costs to be incurred are HRK 394 thousand as at 31 December 2010, and are included in the Note 8, Personnel expenses.

28 Accrued charges and deferred revenue

	2010	2009
	HRK ‘000	HRK ‘000
Advances from domestic customers	376	315
Advances from foreign customers	10,140	16,280
Deferred revenue	67,977	50,722
Accrued charges for unused holidays	10,927	10,548
Accrued charges for legal claims	951	898
Accrued charges in respect of service contracts	24,974	54,067
Other accrued charges	22,559	14,470
	137,904	147,300

Deferred revenue represents amounts due to customers under contracts for work not performed.
Accrued charges in respect of service contracts mainly represent costs incurred for which no invoice has been received at the balance sheet date.

29 Balances and transactions with related parties

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

The Company is a related party to the Ericsson Group via the 49.07% (2009: 49.07%) shareholding by Telefonaktiebolaget LM Ericsson, which is also the ultimate parent of the Ericsson Group.

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

(a) Key transactions with the related parties

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

	Telefonaktiebolaget LM Ericsson		Other Ericsson Group consolidated companies		Total	
	2010	2009	2010	2009	2010	2009
	HRK ‘000	HRK ’000	HRK ’000	HRK ’000	HRK ’000	HRK ’000
Sales of goods and services						
Sales revenue	-	-	444,837	435,610	444,837	435,610
Commission income	-	-	295	777	295	777
Total sales	-	-	445,132	436,387	445,132	436,387
Purchases of goods and services						
Licences	3,798	4,781	25,519	35,666	29,317	40,447
Technical cooperation fee	-	-	14,575	14,153	14,575	14,153
Cost of sales	179	416	373,886	477,261	374,065	477,677
Total purchases	3,977	5,197	413,980	527,080	417,957	532,277

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

29 Balances and transactions with related parties (continued)

(b) Key management compensation

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

	2010	2009
	HRK '000	HRK '000
Salaries and other short-term employee benefits	14,885	16,364
Other long-term benefits	6	4
Share-based payments	1,392	830
	16,283	17,198

The members of the executive management and the Supervisory Board held 4,951 ordinary shares at the year-end (2009: 5,158 shares).
No amounts are included in loans and receivables in respect of loans and advances granted to key management (2009: HRK 14 thousand). During 2010, the Company collected no interest (2009: HRK 7 thousand) from these loans.
In addition, the Company paid remuneration totalling HRK 279 thousand (2009: HRK 319 thousand) to the Supervisory Board.

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

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

	Receivable		Payable	
	2010	2009	2010	2009
	HRK '000	HRK '000	HRK '000	HRK '000
Main shareholder				
Telefonaktiebolaget LM Ericsson (LME)	-	-	(845)	(1,718)
Ericsson Group consolidated companies				
Ericsson AB (EAB)	52,182	42,809	90,364	63,816
Ericsson Telecommunicatia B.V. (ETM)	3,583	2,793	1,383	1,676
Ericsson AB Branch Office Uganda (BUG)	1,847	-	-	-
Ericsson GMBH Group (EDD)	1,645	300	543	89
Ericsson Hungary Ltd. (ETH)	1,160	11	1,004	-
Ericsson NV/SA - Belux (EBR)	1,103	-	-	186
Other Ericsson Group Companies	13,886	12,992	1,552	2,072
	75,406	58,905	94,846	67,839

30 Financial risk management

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

(a) Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Company is exposed to US dollars and to euro, as a substantial proportion of receivables and foreign revenues are denominated in these currencies. Risk management relies on attempts to match, as much as possible, revenues in each currency with the same currency expenditure. Additionally, the Company enters into foreign currency forward contracts to hedge economically its exposure to currency risk arising on operating cash flows. All derivative contracts have maturities of less than one year after the balance sheet date.

As at 31 December 2010, if the euro had weakened/strengthened by 1,14% (2009: 0.43%) against HRK, with all other variables held constant, and if the US dollar had weakened/strengthened by 5,52% (2009: 2.54%), with all other variables held constant, the net result after tax for the reporting period would have been HRK 8,590 thousand (2009: HRK 3,997 thousand) higher/lower for the Company, mainly as a result of foreign exchange gains/losses on translation of significant cash and cash equivalents denominated in euro, and then customer financing denominated in US dollar and foreign payables denominated in euro.

30 Financial risk management (continued)

(a) Currency risk (continued)

The tables below present the currency analysis and resulting gap.

2010

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

* include interest payable of HRK 486 thousand

2009

	EUR	USD	Other currency	Total foreign currencies	HRK	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Loans and receivables	256,171	12,341	-	268,512	10,385	278,897
Trade and other receivables	373,750	27,307	344	401,401	147,791	549,192
Financial assets at fair value through profit or loss	-	-	-	-	120,873	120,873
Cash and cash equivalents	368,980	4,060	98	373,138	41,797	414,935
	998,901	**43,708**	**442**	**1,043,051**	**320,846**	**1,363,897**
Interest-bearing borrowings*	7,505	-	-	7,505	-	7,505
Trade and other payables	83,245	7,300	298	90,843	78,601	169,444
	90,750	**7,300**	**298**	**98,348**	**78,601**	**176,949**
Currency gap	**908,151**	**36,408**	**144**	**944,703**	**242,245**	**1,186,948**

* include interest payable of HRK 885 thousand

30 Financial risk management (continued)

(b) Interest rate risk

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

At 31 December 2010:

- if the effective EUR interest rate on EUR credits and borrowings had increased/decreased by 0.55% (2009: 0.20%) on an annual level, the net result after tax for the reporting period would have been HRK 15 thousand higher/lower for the for the Company (2009: HRK 294 thousand);

- if the effective EUR interest rate on EUR deposits had increased/decreased by 1.61% (2009: 0.39%) on an annual level, the net result after tax for the reporting period would have been HRK 91 thousand higher/lower for the Company (2009: HRK 22 thousand);

- if the effective HRK interest rate on HRK deposits had increased/decreased by 4.97% (2009: 2.27%) on an annual level, the net result of changes in investment funds after tax for the reporting period would have been HRK 1,943 thousand higher/lower for the Company (2009: HRK 1,396 thousand).

The following table presents the average interest rates.

	2010 Average interest rates	**2009 Average interest rates**
	%	**%**
Loans and receivables	1.89	4.54
Trade and other receivables	0.67	1.22
Financial assets at fair value through profit or loss	1.02	1.97
Cash and cash equivalents	2.41	2.94
Interest-bearing borrowings	2.99	3.46

30 Financial risk management (continued)

(b) Interest rate risk (continued)

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

2010

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

* include interest payable of HRK 486 thousand

2009

	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	(3,355)	-	-	-	222,313	59,939	278,897	51,806
Trade and other receivables	391,825	38,689	18,509	100,169	-	-	549,192	84,918
Financial assets at fair value through profit or loss	603	-	107,019	-	13,251	-	120,873	43,284
Cash and cash equivalents	-	221,554	193,381	-	-	-	414,935	414,935
	389,073	**260,243**	**318,909**	**100,169**	**235,564**	**59,939**	**1,363,897**	**594,943**
Interest-bearing borrowings*	-	-	-	2,024	5,481	-	7,505	-
Trade and other payables	169,444	-	-	-	-	-	169,444	-
	169,444	**-**	**-**	**2,024**	**5,481**	**-**	**176,949**	**-**
Interest rate gap	**219,629**	**260,243**	**318,909**	**98,145**	**230,083**	**59,939**	**1,186,948**	**594,943**

* include interest payable of HRK 885 thousand

30 Financial risk management (continued)

(c) Price risk

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

The table below shows the impact of increases/decreases of the index on the Company's net profit. The analysis is based on the assumption that the CROBEX index had increased/decreased by 4% (2009: 39%) and the CROBIS index had increased/decreased by 7% (2009: 5%). The effect on profit after tax is as follows:

	Impact on post-tax profit	
Index	**2010**	**2009**
	HRK '000	**HRK '000**
CROBEX	23	188
CROBIS	(791)	1,633

30 Financial risk management (continued)

(d) Credit risk

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

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

New customers are only accepted on satisfactory completion of a detailed credit check of the customer and a review of the related country risk. Outstanding credit arrangements are monitored frequently. Impairment losses are calculated using the net present value method. Additionally, there is credit concentration risk as the Company has a significant portion of receivables from some customers. As at 31 December 2010, the five largest customers represent 47% of total net trade receivables (2009: 49%). The Company considers that its maximum exposure to credit risk is reflected in the amount of trade receivables (Notes 14 and 17) and other receivables (Note 18), net of impairment loss for doubtful receivables. Ageing analysis of these receivables is within the maturity analysis table shown further in this note.

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

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

Provisions related to customer finance risk exposures are only made when they are reliably measurable and where events occur after the financing arrangement has become effective, 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 2010, total outstanding exposure related to customer finance was HRK 92 million (2009: HRK 445 million).

30 Financial risk management (continued)

(d) Credit risk (continued)

The following tables provide an ageing detail of current and overdue amounts in respect of all customer loans and receivables as at Dec 31, 2010.

Table 1

	Payment due date for total customer loans and receivables					
2010	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**
Foreign receivables	39,344	75,885	111,939	15,600	-	**242,768**
Domestic receivables	9,875	110,053	14,570	-	-	**134,498**
Receivables from related parties	11,771	63,635	-	-	-	**75,406**
Total	**60,990**	**249,573**	**126,509**	**15,600**	**-**	**452,672**

Table 2

	Ageing of total due customer loans and receivables				
2010	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**
Foreign receivables	11,621	4,868	22,855	-	39,344
Domestic receivables	5,868	2,983	1,024	-	9,875
Receivables from related parties	9,703	2,068	-	-	11,771
Total	**27,192**	**9,919**	**23,879**	**-**	**60,990**

Table 3

	Payment due date for total customer loans and receivables (in respect of accounts with any portion falling due)					
2010	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**
Foreign receivables	29,246	41,411	29,379	15,600	-	115,636
Domestic receivables	9,875	30,701	10,187	-	-	50,763
Receivables from related parties	-	-	-	-	-	-
Total	**39,121**	**72,112**	**39,566**	**15,600**	**-**	**166,399**

30 Financial risk management (continued)

(d) Credit risk (continued)

Table 4 — **Past due but not impaired customer loans and receivables**

2010	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**
Foreign receivables	3,413	3,602	240	-	7,255
Domestic receivables	-	-	-	-	-
Receivables from related parties	9,491	2,068	-	-	11,559
Total	**12,904**	**5,670**	**240**	**-**	**18,814**

As at 31 December 2010, total balances outstanding in respect of customer loans and receivables was HRK 453 million (Table 1), of which HRK 437 million is due for payment within 1 year. As at 31 December 2010, amounts totalling HRK 61 million were overdue (Table 2), of which HRK 37 million is less than 1 year overdue.

As at 31 December 2010, total balances outstanding in respect of customers for which any portion of their account was overdue at 31 December 2010 was HRK 166 million (Table 3). Of this total, HRK 151 million is already due or due for payment within the next year.

In the current economic climate, there is increased risk and uncertainty with regards the ultimate collectability of some of these balances. At 31 December 2010, impairment allowances totalling HRK 31 million were provided in respect of total customer loans and receivables. Amounts totalling HRK 19 million (Table 4) are past due but not impaired at 31 December 2010.

30 Financial risk management (continued)

(e) Liquidity risk

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

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

* include interest payable of HRK 486 thousand

2009	**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	-	-	-	218,958	59,939	278,897
Trade and other receivables	291,984	146,661	110,547	-	-	549,192
Financial assets at fair value through profit or loss	-	-	120,873	-	-	120,873
Cash and cash equivalents	61,351	353,584	-	-	-	414,935
	353,335	**500,245**	**231,420**	**218,958**	**59,939**	**1,363,897**
Interest-bearing borrowings*	-	-	2,024	5,481	-	7,505
Trade and other payables	133,444	36,000	-	-	-	169,444
	133,444	**36,000**	**2,024**	**5,481**	**-**	**176,949**
Maturity gap	**219,891**	**464,245**	**229,396**	**213,477**	**59,939**	**1,186,948**

* include interest payable of HRK 885 thousand

30 Financial risk management (continued)

(f) Fair value estimation

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

	Carrying amount 2010 HRK '000	Fair value 2010 HRK '000	Unrecognised gain/(loss) 2010 HRK '000	Carrying amount 2009 HRK '000	Fair value 2009 HRK '000	Unrecognised gain/(loss) 2009 HRK '000
Loans and receivables	10,358	10,389	31	278,897	275,736	(3,161)
Trade and other receivables	483,674	482,019	(1,655)	574,647	575,377	730
Financial assets at fair value through profit or loss	63,254	63,254	-	120,873	120,873	-
Cash and cash equivalents	673,926	673,926	-	414,935	414,935	-
Interest-bearing borrowings	(5,019)	(4,920)	99	(6,620)	(6,614)	(6)
Trade and other payables	(189,226)	(189,226)	-	(169,444)	(169,444)	-
	1,036,967	1,035,442	(1,525)	1,213,288	1,210,863	(2,437)

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

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

	2010	2009
Loans and receivables	5.84%	6.60%
Interest-bearing borrowings	5.93%	6.60%

31 Contingent liabilities

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

COMPANY POSITION REPORT

2010 – STABLE OPERATIONS DESPITE CHALLENGING BUSINESS CONDITIONS

The year 2010 was a particularly demanding and tough one. The ICT industry could not avoid the unfavorable trends present in the wider economy, and the impact of this was manifested in a slower than anticipated realization of planned activities and strategic targets. This was especially evident in a slowdown of capital investments by telecom operators, decreased government investments into infrastructure projects within the ICT segment and decreased budget volumes of our business partners and other customers. A decline in orders during 2010 reflects a decrease in volumes from our domestic market, compensated by extended business activities in our export markets, primarily in Belarus and Bosnia & Herzegovina, as well as exports to Ericsson through R&D and other services. A decline in sales during 2010 further reflects the timing of orders booked and the impact of industry component shortages and Ericsson supply chain bottlenecks.

Despite the challenging environment in which we operated, we managed to maintain a good market position, continued to support our customers in modernization of their networks and in the introduction of new technologies and progressed with investments into new strategic projects and market segments. At the same time, we are able to report improved performance in terms of underlying profitability of operations and cash flow from operating activities and have further improved the strength of our balance sheet.

During 2010, the Company was exposed to additional business risk due to the restructuring of the biggest Kazakhstan bank, BTA, which caused the receivables write-off amounting to MHRK 126.5. Excluding this write-off, the Company result shows a net profit increase of 17 percent year-over-year which, in the given circumstances, is a creditable result. It is important to stress that regardless of the complex situation, we managed to collect approximately 60 percent of receivables, which helped us to further strengthen our financial and cash positions in 2010. At the same time, by solving the given case, the Company risk relating to customer financing was significantly reduced.

Throughout 2010, we responded to the challenging business conditions and increasingly strong competition by adapting the organization for new market and technology requirements, as well as to new organizational models and responsibilities within the wider Ericsson organization. Ericsson Nikola Tesla primarily operates within the Region Western & Central Europe but also retains responsibilities in other Ericsson regions, as well as for those segments of business and products which result from development and activities within the Company. The new organization encourages new and innovative ways of working with a common goal to be closer than ever before to our customers, grow business volumes in existing and new segments and drive improved profitability and cash flow.

In cooperation with our strategic customers, a series of ICT projects in Croatia and in our export markets were completed, thus showing that information and communication technologies are a driving force of economic recovery and development of the society as a whole. Let me just underline our activities on existing networks transformation into new generation networks, as well as taking part in preparations for implementing the state-of-the-art technologies in all our markets. We are also witnessing the operators' interest in the 4G mobile communication systems that will provide higher transmission speeds and extended range of services. During the year, we achieved significant results in terms of our responsibilities assigned in the global organization in the areas of Research and Development, Service Delivery Center and other centers of expertise. This segment is constantly growing and today represents 36 percent of the Company's sales revenue.

ICT technology implementation continues also in a non-operator segment, both in business systems and government administration. ICT solutions, such as e-health, Intelligent Transport Systems (ITS) and National Security/Public Safety (NS/PS), have a positive impact on operations, human lives and the environment. The best illustration for this is e-Health solution, our recognizable high-tech product. As of informatization of the Croatian health care system, another step forward in 2010 was implementation of new functionalities such as ePrescription, eReferral and eBooking. Moreover, Ericsson Mobile Health (EMH), a product aimed at remote patient medical monitoring, won the best innovation award and is ready for commercial operation.

In my last year's Company position report I emphasized that innovativeness in everything we do is the key to our future stable operations; only work aimed at creating new values may raise the stakeholders' satisfaction level and contribute to overall progress in the community. Concerning this, I would like to mention our Innovation Management program, implemented in all Company units, which resulted in almost 1000 various innovative proposals submitted during 2010. Some of the innovative solutions have already been implemented even at the global level. In 2010, we organized Innovation Day in Zagreb and Split, and the most prominent innovators and their best innovations were presented there.

We also marked the tenth anniversary of Ericsson Nikola Tesla Summer Camp, so far attended by almost 300 students, assisted by mentors from the Faculty of Electrical Engineering and Computing at the University of Zagreb and the Faculty of Electrical Engineering, Mechanical Engineering and Naval Architecture at the University of Split as well as from our Company. Their work resulted in 162 student projects and 82 prototypes.

In 2010, Ericsson Nikola Tesla yielded the following business results (2009 figures in brackets):

- Orders booked MHRK 1,311.3 (MHRK 1,386.2)
- Sales revenues MHRK 1,218.9 (MHRK 1,400.0)
- Net profit MHRK 24 (MHRK 128.4)
- Cash flow from operating activities MHRK 366.4 (MHRK 284)
- Motivational Company culture, confirmed by the annual employee survey Dialog
- Customer satisfaction, confirmed by the annual customer satisfaction questionnaire

- Satisfaction of shareholders, investors and the general public expressed by the award for transparent business operations and relations with investors offered by the Zagreb Stock Exchange and Poslovni dnevnik, and by the annual Grand Prix by the Croatian Public Relations Association for the Company's 60th anniversary project.

In brief, in 2010 we achieved solid net income and sound cash flow from operating activities. We continued to invest into development projects, preserved our jobs and held our market position primarily as Croatia's leading knowledge exporter.

OUTLOOK

We are approaching a new business cycle aware of the complex and dynamic trends in the ICT industry and e-business.

The telecom market shows a tendency of core network transformation towards the next generation network with introduction of IMS architecture, as well as with the strong development and implementation of mobile broadband networks and next generation of optic access networks. Transformation of the current network will enable further development, delivery and growth of advanced services (such as IPTV, positioning services, etc.), with requirements for advanced convergent billing and charging services and complex network management systems.

Mobile technology broadband access will continue the intensive development primarily due to the growth in number of smart phones and tablets but also due to M2M networking trends. A significant growth of mobile network traffic will demand further extension of HSPA and introduction of LTE technology. By implementation of a broadband access based on HSPA+ (42 Mbps) and LTE trial network, Croatia joined the most developed countries in the world, where already today convergence of fixed and mobile network and achievements of the 4G mobile communication networks are present.

There is no doubt that our operating environment will remain challenging in 2011, so we should focus on further development of our business operations and risk management.

Having assessed operational risks for Ericsson Nikola Tesla in 2011, I would like to point out the following:

- Serious disturbances in the financial market and their negative impact; operators' investment slowdown regarding network development and decrease in non-operator investments regarding ICT projects;
- Consolidation among our customers and largest competitors with further impact on product and service prices;
- Increasing demand for customer financing;
- Negative impact of a strong HRK and changes in EUR and USD exchange rates;
- Shortage of industrial components in the world market and supply chain bottlenecks;

- Natural disaster that hamper production, supply and transport
- Continued political uncertainty and instability in some markets.

Ericsson Nikola Tesla is operating in line with the current corporate policies and directives, the Croatian legislative regulations, as well as principles of corporate governance and business ethics. In the forthcoming period we shall strengthen our position in all business segments and in all Company markets, focusing on new customers and strategic projects. The mission and strategy of Ericsson Nikola Tesla are directed towards key stakeholders: customers, employees and shareholders. It is all about value creation, understanding the needs, sharing knowledge and the partnership among those included in various processes and activities. We shall focus on the three strategic goals: profitable sales growth, healthy margins and cash flow, as well as sales within the Ericsson group.

Innovativeness and a proactive approach towards users of our products and services, constant technology shifts, adjustment to market and competitive conditions are the imperative of our future business development. Ericsson Nikola Tesla is fully focused on achieving long-term, profitable growth whilst ensuring short-term stability and will endeavor to achieve this by making strategic business moves, by fully analyzing and reacting to all business risks, by ensuring optimal utilization and continual development of all its resources.

All other data, which need to be an integral part of the annual Company report pursuant to Article 250 (a) of the Company Act can be found in the enclosed 2010 Annual report, comprising the General Report, Social Report and Financial Statements as of December 31, 2010.

Gordana Kovačević

President

Ericsson Nikola Tesla d.d.

Zagreb, March 8, 2011

THE REPORT OF THE SUPERVISORY BOARD OF ERICSSON NIKOLA TESLA ON THE SUPERVISION PERFORMED ON THE COMPANY'S OPERATIONS IN 2010

In accordance with the provisions of the Croatian Company Law and Ericsson Nikola Tesla Statute, the Supervisory Board of Ericsson Nikola Tesla has reviewed the Company's operations, making respective decisions in four regular and two extraordinary meetings held during 2010.

The Company management regularly informed the Supervisory Board on all important business activities and the course of the Company business performance. At the meetings the Supervisory Board reviewed the financial results, the domestic and export markets status, market conditions and trends in ICT industry. Further topics of discussions were as follows: business plans and strategic projects, business risks and issues relating to human resources. Besides, the Supervisory Board continuously monitored the business development and responsibilities of the Research and Development Centre, Service Supply Centre and Business Ericsson Test Environment unit (BETE).
At extraordinary Board meetings, the members discussed dividend payment and impairment of receivables in Kazakhstan.

The Supervisory Board analyzed and approved the Company's Business Strategy 2011 –2015 and the focus areas and strategic programs necessary for further business development. The Company management determined the key objectives for 2011 with explicitly defined tasks and ways of measurements and the Supervisory Board approved them, correspondingly.

During 2010, the Company business performance was impacted by the deterioration in market conditions marked by cautious customer investments, problems with collection of outstanding debts in the Kazakhstan market, as well as the shortage in industrial components and bottleneck in supply. Despite of the above, we consider that the Company has managed to maintain a good position in the markets and achieved good financial results with a healthy balance sheet and a solid cash position.

In the course of the year the Board composition changed as follows: A new member to the Supervisory Board is Dubravko Radošević, who was elected at the Annual Assembly of the Company held on May 20, 2010.

The Audit Committee held five sessions in 2010, where it discussed financial performance during the year and annual financial statements, audit plan for 2010, internal control and risk management system, and performed other tasks defined by the Audit Law. The Audit Committee

Zagreb, March 8, 2011

regularly informed other Supervisory Board members of its findings and recommendations. On the day of this report issuance, the Audit Committee is comprised of Mr. Ignac Lovrek, Chairman and Mrs. Carita Jönsson, Member.

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

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

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

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

For the Supervisory Board

Roland Nordgren, Chairman

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

Zagreb, 08. ožujka 2011.

Predmet: **Odluka Uprave Društva**

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

- Utvrđuju se godišnja financijska izvješća za 2010.g.

Ericsson Nikola Tesla d.d. Zagreb
Uprava

Gordana Kovačević

Subject: **Managing Director Decision**

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

- The Annual Financial Reports for 2010 have been submitted and approved.

Ericsson Nikola Tesla d.d. Zagreb
Managing Director

Gordana Kovačević

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

Zagreb, 08. ožujka 2011.

Predmet: **Odluka Nadzornog odbora Društva**

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

- Utvrđuju se godišnja financijska izvješća za 2010.g.

Ericsson Nikola Tesla d.d. Zagreb
Za Nadzorni odbor

Roland Nordgren
Predsjednik

Subject: **Supervisory Board Decision**

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

- The Annual Financial Reports for 2010 have been submitted and approved.

Ericsson Nikola Tesla d.d. Zagreb
For Supervisory Board

Roland Nordgren
Chairman