

Ericsson Nikola Tesla d.d.

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

Contents

	<i>Page</i>
Company profile	1 to 2
Responsibilities of the Management and Supervisory Boards for the preparation and approval of the annual financial statements	3
Independent Auditors' Report	4
Statement of comprehensive income	5
Statement of financial position	6 to 7
Statement of changes in equity	8
Statement of cash flows	9 to 10
Notes to the financial statements	11 to 58

Company profile

History and incorporation

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

The 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 2014, Telefonaktiebolaget LM Ericsson (Ericsson) holds 49.07% of the Company's share. Other shareholders own the remaining 50.70% of the Company's shares and 0.23% is held as treasury 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, and Bosnia and Herzegovina, and several customers in Central and Eastern Europe as well as towards companies within the Ericsson Group.

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

Company profile (continued)

Supervisory Board, Management Board and executive management

The Supervisory Board

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

Roland Nordgren	Reappointed on 5 June 2012	Chairman
Ignac Lovrek	Reappointed on 31 May 2011	Member; Vice-Chairman
Carita Jönsson	Reappointed on 5 June 2012	Member
Dubravko Radošević	Reappointed on 27 May 2014	Member
Zvonimir Jelić	Reappointed on 8 July 2014	Member and employees' representative

The Management Board

The Management Board has one member:

Gordana Kovačević	Reappointed on 1 January 2010	President
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Executive management

As at 31 December 2014, the Company's executive management comprised:

Gordana Kovačević	Company President
Branko Dronjić	Head, G-ITTE Engineering Services Croatia
Damir Bušić	Director, Commercial Management
Dario Runje	Head, CD RAN & Director, CC & Supply Croatia
Dragan Fratrić	Manager, General Services
Goran Ožbolt	Director, Sales and Marketing for Tele2 and Alternative Operators
Grga Mrkonjić	Director, Sales and Marketing for HT
Hrvoje Benčić	Director, Engagement Practices and ETK Customer Operations
Ivan Barać	Director, Sales & Marketing for CIS Market
Jagoda Barać	Director, Sales and Marketing for Neighboring Countries
Marijana Đuzel	Head, HR&O and Legal Affairs
Milan Živković	Director, Strategy and Business Development
Miroslav Kantolić	Director, Sales and Marketing for VIPnet
Patrick Gerard Martin	Director, Research and Development Center
Patrik Wahlgren	Director, Finance
Snježana Bahtijari	Director, Communication
Tihomir Šicel	Sales Adviser

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

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

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

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

The financial statements set out on pages 5 to 58 were authorised by the Management Board on 2 April 2015 for issue to the Supervisory Board and are signed below.



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

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

01



Independent Auditor's Report

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

We have audited the accompanying financial statements of Ericsson Nikola Tesla d.d. (the "Company"), which comprise the statement of financial position as at 31 December 2014 and the statement of comprehensive income, statement of changes in equity and cash flows statement for the year then ended, and notes comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as at 31 December 2014, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted in the European Union.


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

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

Statement of comprehensive income
for the year ended 31 December 2014

	<i>Notes</i>	2014	2013
		HRK '000	HRK '000
Sales revenue	3, 4	1,279,279	1,309,461
Cost of sales		<u>(1,108,688)</u>	<u>(1,092,940)</u>
Gross profit		170,591	216,521
Selling expenses		(55,070)	(60,040)
Administrative expenses		(32,850)	(31,924)
Other operating income		3,871	2,049
Other operating expenses		<u>(11,488)</u>	<u>(1,644)</u>
Operating profit		<u>75,054</u>	<u>124,962</u>
Finance income	7	7,698	19,055
Finance expense	7	<u>(2)</u>	<u>(158)</u>
Finance income – net		<u>7,696</u>	<u>18,897</u>
Profit before tax		82,750	143,859
Income tax	8	<u>-</u>	<u>-</u>
Profit for the year		<u>82,750</u>	<u>143,859</u>
Other comprehensive income		<u>-</u>	<u>-</u>
Total comprehensive income for the year		<u>82,750</u>	<u>143,859</u>
Earnings per share (HRK)	9	<u>62.32</u>	<u>108.29</u>

The notes set out on pages 11 to 58 form an integral part of these financial statements.

Ericsson Nikola Tesla d.d.

Statement of financial position
as at 31 December 2014

	<i>Notes</i>	2014 HRK '000	2013 HRK '000
ASSETS			
Non-current assets			
Property, plant and equipment	10	129,752	131,326
Intangible assets	11	1,296	2,112
Loans and receivables	12	19,153	18,801
Investments in subsidiaries	13	73	53
Total non-current assets		<u>150,274</u>	<u>152,292</u>
Current assets			
Inventories	14	21,128	44,679
Trade receivables	15	178,883	242,235
Receivables from related parties	26(c)	84,860	71,604
Other receivables	16	15,119	15,388
Financial assets at fair value through profit or loss	17	44,080	109,845
Prepayments and accrued income		1,932	1,143
Cash and cash equivalents	18	182,106	404,269
Total current assets		<u>528,108</u>	<u>889,163</u>
TOTAL ASSETS		<u>678,382</u>	<u>1,041,455</u>

The notes set out on pages 11 to 58 form an integral part of these financial statements.

Statement of financial position (continued)
as at 31 December 2014

	<i>Notes</i>	2014	2013
		HRK '000	HRK '000
EQUITY AND LIABILITIES			
Equity			
Share capital	19(a)	133,165	133,165
Treasury shares		(8,462)	(9,571)
Legal reserves	19(c)	6,658	6,658
Retained earnings		198,296	539,752
Total equity		<u>329,657</u>	<u>670,004</u>
Non-current liabilities			
Employee benefits	22(a)	5,336	4,697
Other non-current liabilities		4,133	-
Total non-current liabilities		<u>9,469</u>	<u>4,697</u>
Current liabilities			
Payables to related parties	26(c)	62,755	57,941
Trade and other payables	23	126,106	146,796
Provisions	24	10,001	13,458
Accrued charges and deferred revenue	25	140,394	148,559
Total current liabilities		<u>339,256</u>	<u>366,754</u>
Total liabilities		<u>348,725</u>	<u>371,451</u>
TOTAL EQUITY AND LIABILITIES		<u>678,382</u>	<u>1,041,455</u>

The notes set out on pages 11 to 58 form an integral part of these financial statements.

Statement of changes in equity
for the year ended 31 December 2014

	Share capital HRK '000	Treasury shares HRK '000 Note 19 (b)	Legal reserves HRK '000	Retained earnings HRK '000	Total HRK '000
As at 1 January 2013	133,165	(6,928)	20,110	607,758	754,105
Changes in equity for 2013					
Total comprehensive income	-	-	-	143,859	143,859
Dividend distribution for 2012, Note 20	-	-	-	(225,851)	(225,851)
Release of legal reserves, Note 19 (c)	-	-	(13,452)	13,452	-
Purchases of treasury shares, Note 19 (b)	-	(5,754)	-	-	(5,754)
Share-based payments, Note 22 (b)	-	3,111	-	(3,111)	-
Equity-settled transactions, Note 22 (b)	-	-	-	3,645	3,645
Total contributions by and distributions to owners recognised directly in equity	-	(2,643)	(13,452)	(211,865)	(227,960)
As at 31 December 2013	133,165	(9,571)	6,658	539,752	670,004
As at 1 January 2014	133,165	(9,571)	6,658	539,752	670,004
Changes in equity for 2014					
Total comprehensive income	-	-	-	82,750	82,750
Dividend distribution for 2013, Note 20	-	-	-	(424,897)	(424,897)
Purchases of treasury shares, Note 19 (b)	-	(2,768)	-	-	(2,768)
Share-based payments, Note 22 (b)	-	3,877	-	(3,877)	-
Equity-settled transactions, Note 22 (b)	-	-	-	4,568	4,568
Total contributions by and distributions to owners of the parent recognised directly in equity	-	1,109	-	(424,206)	(423,097)
As at 31 December 2014	133,165	(8,462)	6,658	198,296	329,657

The notes set out on pages 11 to 58 form an integral part of these financial statements.

Statement of cash flows
for the year ended 31 December 2014

	<i>Notes</i>	2014	2013
		HRK '000	HRK '000
Cash flows from operating activities			
<i>Profit before tax</i>		<u>82,750</u>	<u>143,859</u>
Adjustments for:			
Depreciation and amortisation	10,11	45,742	40,233
Impairment losses and reversals		16,656	955
Net increase in provisions		2,598	5,178
Gain on sale of property, plant and equipment		(178)	(408)
Net gain on re-measurement of financial assets		(356)	(1,480)
Amortisation of discount		(330)	(2,003)
Interest income		(7,254)	(11,804)
Interest expense	7	2	158
Foreign exchange losses/(gains), net		832	(1,714)
Equity-settled transactions	6	4,568	3,645
		<u>145,030</u>	<u>176,619</u>
Changes in working capital:			
In receivables		33,699	12,323
In inventories		23,551	(16,098)
In payables		<u>(23,773)</u>	<u>(21,130)</u>
<i>Cash generated from operations</i>		<u>178,507</u>	<u>151,714</u>
Interest paid		<u>(2)</u>	<u>(158)</u>
<i>Net cash from operating activities</i>		<u>178,505</u>	<u>151,556</u>
Cash flows from investing activities			
Interest received		5,951	11,799
Proceeds from sale of property, plant and equipment		193	4,917
Purchases of property, plant and equipment, and intangible assets		(45,185)	(63,806)
Deposits collected with financial institutions - net		999	-
Purchases of financial assets at fair value through profit and loss		(45,900)	(103,000)
Proceeds from sale of financial assets at fair value through profit and loss		<u>112,000</u>	<u>140,000</u>
<i>Net cash generated/ (used) in investing activities</i>		<u>28,058</u>	<u>(10,090)</u>

The notes set out on pages 11 to 58 form an integral part of these financial statements.

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

	<i>Notes</i>	2014	2013
		HRK '000	HRK '000
Cash flows from financing activities			
Repayment of interest-bearing borrowings		-	(1,669)
Purchase of treasury shares	19(b)	(2,768)	(5,754)
Dividends paid	20	(424,933)	(225,851)
		<u>(427,701)</u>	<u>(233,274)</u>
Net cash used in financing activities		(427,701)	(233,274)
Effects of exchange rate changes on cash and cash equivalents		(1,026)	1,835
		<u>(222,164)</u>	<u>(89,973)</u>
Net decrease in cash and cash equivalents		(222,164)	(89,973)
Cash and cash equivalents at the beginning of the year		404,269	494,242
		<u>404,269</u>	<u>494,242</u>
Cash and cash equivalents at the end of the year	18	<u>182,106</u>	<u>404,269</u>

The notes set out on pages 11 to 58 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 2 April 2015 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 adopted by the European Union (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 on-going 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 the executive management in the application of IFRSs that have significant effect on the financial statements and estimates are discussed in Note 2.

The Company has issued these separate financial statements in accordance with Croatian regulations. The Company has also prepared consolidated financial statements as at 31 December 2014 and for the year then ended in accordance with IFRS for the Company and its subsidiaries (the Group), which were approved by the Management Board on 2 April 2015. In the consolidated financial statements, subsidiary undertakings (listed in Note 13) and those companies in which the Group indirectly has an interest of more than half of the voting rights or otherwise has power to exercise control over the operations have been fully consolidated. Users of these non-consolidated financial statements should read them together with the Group's consolidated financial statements as at and for the year ended 31 December 2014 in order to obtain full information on the financial position, results of operations and changes in financial position of the Group as a whole.

Going concern

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

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

Changes in accounting policies and disclosures

(a) New and amended standards adopted by the Company

The Company has adopted the following new and amended IFRS and IFRIC (International Financial Reporting Interpretations Committee) interpretations during the year which were endorsed by the EU. When the adoption of the standard or interpretation is deemed to have an impact on the financial statements or performance of the Company, its impact is described below.

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

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

The objective of IFRS 10 is to establish principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. It defines the principle of control, and establishes controls as the basis for consolidation. It sets out how to apply the principle of control to identify whether an investor controls an investee and therefore must consolidate the investee. It also sets out the accounting requirements for the preparation of consolidated financial statements.

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

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

IAS 27 (revised 2011) includes the provisions on separate financial statements that are left after the control provisions of IAS 27 have been included in the new IFRS 10.

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

These amendments provide additional transition relief to IFRSs 10, 11 and 12, limiting the requirement to provide adjusted comparative information to only the preceding comparative period. For disclosures related to unconsolidated structured entities, the amendments will remove the requirement to present comparative information for periods before IFRS 12 is first applied. The amendment did not have a significant impact on the Company's financial position or performance.

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

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

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

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

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

Changes in accounting policies and disclosures (continued)

(b) Standards and interpretations issued but not yet effective

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

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

Earlier application is permitted. If an entity elects to early apply it must apply all of the requirements at the same time with the following exception: Entities with a date of initial application before 1 February 2015 continue to have the option to apply the standard in phases.

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

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

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

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

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

Changes in accounting policies and disclosures (continued)

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

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

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

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

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

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

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

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

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

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

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

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

Changes in accounting policies and disclosures (continued)

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

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

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

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

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

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

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

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

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

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

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

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

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

Changes in accounting policies and disclosures (continued)

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

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

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

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

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

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

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

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

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 2014 was HRK 6.30211 per USD 1 (2013: HRK 5.54900) and HRK 7.66147 per EUR 1 (2013: HRK 7.63764).

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

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

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

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

Intangible assets

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

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

Impairment of assets

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.

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

The recoverable amount of receivables carried at amortised cost is calculated as the present value of expected future cash flows, discounted at the original effective interest rate inherent in the asset. The Company assesses at the end of each reporting period whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

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

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

Impairment of assets (continued)

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

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

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

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

Financial instruments

The 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. Executive management determines the classification of its financial instruments at initial recognition and re-evaluates this at every reporting date.

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

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than those that the 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.

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

Financial instruments (continued)

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.

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.

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

Financial instruments (continued)

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 de-recognition. 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 re-measurement to fair value is recognised immediately in profit or loss. The fair value of a forward exchange contract is its quoted price at the balance sheet date, being the present value of the quoted forward price.

Trade and other receivables

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

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

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

Inventories

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

Share capital

Share capital is stated in HRK at nominal value.

Incremental costs directly attributable to the issue of new ordinary shares or options are shown in equity as a deduction, net of tax, from the proceeds. Where the 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 ordinary shares are subsequently reissued, any consideration received, net of any directly attributable incremental transaction costs and the related income tax effects, is included in equity attributable to the Company's equity holders.

Income tax

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

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

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

Income tax (continued)

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

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

Foreign currencies

Transactions denominated in foreign currencies are translated into HRK at the rate prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currency at the balance sheet date have been translated to HRK at the foreign exchange rate ruling at that date. Foreign exchange differences arising from translation are included in the 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 transfer of risk has occurred, when the revenue amount is fixed or determinable, and when collection is reasonably assured. Specific contractual performance and acceptance criteria may impact the timing and amounts of revenue recognized.

The 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 the contract activity.

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

Recognition of revenues (continued)

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

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

The majority of the Company's products and services are sold under delivery-type contracts including multiple elements, such as base stations, base station controllers, mobile switching centres, 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.

c) Bonus plans

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

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

Provisions

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

Net financial income

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

Segment reporting

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

Borrowings

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

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

Leases

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

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

Dividend distribution

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

Investments in subsidiaries

Investments in subsidiaries in which the Company has an interest of more than one half of the voting rights or otherwise has power to exercise control over the operations are recorded at cost less impairment losses, if any. Impairment is tested annually whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Investments in subsidiaries for which an impairment loss has been recorded are tested at each reporting date for a potential reversal of impairment.

Dividend income is recognised when the right to receive payment is established.

Government grants

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

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

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

Notes to the financial statements (continued)

2 Critical accounting estimates and judgements

Accounting estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The Company makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

(a) Impairment losses on loans and receivables

The Company reviews its receivables 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) Deferred income tax asset recognition

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

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.

Notes to the financial statements (continued)

3 Sales revenue

	2014	2013
	HRK '000	HRK '000
Sales revenue from products	396,417	493,984
Sales revenue from services	882,862	815,477
	<u>1,279,279</u>	<u>1,309,461</u>

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 operating exchange rate differences 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.

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

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

Revenues determined based on the geographic location of customers are disclosed in this note. All the Company's assets are located in Croatia.

	2014	2013
	HRK '000	HRK '000
Sales revenue in domestic market	333,685	340,972
Sales revenue in Russia, Belarus, Kazakhstan, Georgia, Moldova, Uzbekistan and Armenia	138,366	169,101
Sales revenue to Ericsson, Note 26 (a)	628,029	568,749
Sales revenue in Bosnia and Herzegovina, Montenegro and Kosovo	172,023	220,865
Other export sales revenue	7,176	9,774
	<u>1,279,279</u>	<u>1,309,461</u>

Notes to the financial statements (continued)

4 Segment reporting (continued)

	Networks		Professional services		Support solutions		Unallocated		Total	
	2014	2013	2014	2013	2014	2013	2014	2013	2014	2013
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Sales revenue	676,645	737,088	564,935	533,531	37,699	38,842	-	-	1,279,279	1,309,461
Operating profit/(loss)	38,388	49,374	67,896	105,439	763	1,163	(31,993)	(31,014)	75,054	124,962
Finance income									7,698	19,055
Finance expense									(2)	(158)
Profit before tax									82,750	143,859
Income tax									-	-
Profit for the year									82,750	143,859

Revenues of approximately HRK 583,711 thousand (2013: HRK 568,748 thousand) are derived from customers for which revenues from transactions have exceeded 10% of the Company's sales revenues, and they are realised in all three segments.

5 Expenses by nature

	2014	2013
	HRK '000	HRK '000
Changes in contract work in progress (Note 14)	30,214	(15,617)
Material and external services ^{(1) (2)}	598,907	700,365
Personnel expenses (Note 6)	528,710	471,056
Depreciation and amortisation (Notes 10, 11)	45,742	40,233
	<u>1,203,573</u>	<u>1,196,037</u>

¹⁾ Including audit fee expenses of HRK 385 thousand (2013: HRK 455 thousand).

²⁾ Material and external services costs do not include the effect reclassifying other income and other operating expenses to material and external services, amounting to HRK 6,965 thousand (2013: HRK 11,133 thousand).

Notes to the financial statements (continued)

6 Personnel expenses

	2014	2013
	HRK '000	HRK '000
Net salaries	253,128	231,657
Taxes and contributions	248,014	216,371
Other payroll-related costs	23,000	19,383
Equity-settled transactions (Note 22 (b))	4,568	3,645
	<u>528,710</u>	<u>471,056</u>

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

Personnel expenses include HRK 84,972 thousand (2013: HRK 77,255 thousand) of defined pension contributions paid or payable into obligatory pension plans. Contributions are calculated as a percentage of employees' gross salaries (Gross I).

In addition, Personnel expenses include HRK 2,100 thousand (2013: HRK 2,564 thousand) in respect of termination benefit costs. The movements in provisions related to these costs are described in Note 24, Provisions.

As at 31 December 2014, total number of employees was 1,807 (2013: 1,696).

7 Finance income and expense

Finance income

	2014	2013
	HRK '000	HRK '000
Interest income (Note 7 (a))	6,771	11,804
Net gains from re-measurement of financial assets at fair value through profit or loss (Note 7 (c))	374	1,493
Amortization of discount (Note 7 (b))	330	2,003
Net foreign exchange gain	223	3,755
	<u>7,698</u>	<u>19,055</u>

Finance expense

	2014	2013
	HRK '000	HRK '000
Interest expense	2	158
	<u>2</u>	<u>158</u>

Notes to the financial statements (continued)

7 Finance income and expense (continued)

7 (a)

	2014	2013
	HRK '000	HRK '000
Interest income		
- on loans to customers	830	1,511
- on debt securities	210	436
- on term deposits	2,399	4,459
- on other receivables	3,332	5,398
	<u>6,771</u>	<u>11,804</u>

7 (b)

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

7 (c)

	2014	2013
	HRK '000	HRK '000
Net gains from re-measurement of financial assets at fair value through profit or loss		
- Investment in investment funds	551	1,427
- Debt securities	(177)	66
	<u>374</u>	<u>1,493</u>

8 Income tax expense

Income tax has been calculated on the taxable income at statutory tax rate of 20% (2013: 20%). No income tax expense has been recognised in the statement of comprehensive income.

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 57,049 thousand (2013: HRK 52,934 thousand) in respect of tax losses amounting to HRK 285,244 thousand (2013: HRK 264,672 thousand) that can be carried forward against future taxable income.

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

	HRK '000
Tax loss for 2010 – expires 31 December 2015	151,207
Tax loss for 2011 – expires 31 December 2016	9,478
Tax loss for 2012 – expires 31 December 2017	-
Tax loss for 2013 – expires 31 December 2018	39,538
Tax loss for 2014 – expires 31 December 2019	85,021
	<u>285,244</u>

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

Notes to the financial statements (continued)

8 Income tax expense (continued)

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

	2014	2013
	HRK '000	HRK '000
Profit before tax	82,750	143,859
Income tax at 20% (2013: 20%)	16,550	28,772
Tax effects of:		
Expenses not deductible for tax purposes	4,896	3,868
Tax incentives	(21,446)	(32,640)
Tax charge	-	-
Effective tax rate	0.0%	0.0%

Tax incentives include only part of additional tax allowances for certain expenditure totalling HRK 21,446 thousand (2013: HRK 32,640 thousand) which meets research and development incentives definitions under Croatian tax legislation. The underlying research and development expenditure is included in cost of sales.

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

9 Earnings per share

	2014	2013
Profit for the year (HRK '000)	82,750	143,859
Weighted Average Number of Shares Outstanding at the year-end	1,327,917	1,328,428
Earnings per share (HRK)	62.32	108.29

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

Notes to the financial statements (continued)

10 Property, plant and equipment

	Land and buildings HRK '000	Plant and equipment HRK '000	Other HRK '000	Total HRK '000
As at 1 January 2013				
Cost or valuation	155,455	304,667	328	460,450
Accumulated depreciation	(106,212)	(237,028)	(213)	(343,453)
Net book amount	<u>49,243</u>	<u>67,639</u>	<u>115</u>	<u>116,997</u>
Year ended 31 December 2013				
Opening net book amount	49,243	67,639	115	116,997
Additions	2,968	49,381	-	52,349
Disposals	-	(121)	-	(121)
Depreciation charge	(3,356)	(34,535)	(8)	(37,899)
Closing net book amount	<u>48,855</u>	<u>82,364</u>	<u>107</u>	<u>131,326</u>
As at 31 December 2013				
Cost or valuation	158,422	331,951	328	490,701
Accumulated depreciation	(109,567)	(249,587)	(221)	(359,375)
Net book amount	<u>48,855</u>	<u>82,364</u>	<u>107</u>	<u>131,326</u>
Year ended 31 December 2014				
Opening net book amount	48,855	82,364	107	131,326
Additions	175	42,948	-	43,123
Disposals	-	(165)	-	(165)
Depreciation charge	(3,401)	(41,123)	(8)	(44,532)
Closing net book amount	<u>45,629</u>	<u>84,024</u>	<u>99</u>	<u>129,752</u>
As at 31 December 2014				
Cost or valuation	158,598	341,535	328	500,461
Accumulated depreciation	(112,969)	(257,511)	(229)	(370,709)
Net book amount	<u>45,629</u>	<u>84,024</u>	<u>99</u>	<u>129,752</u>

Included in the cost of property, plant and equipment is HRK 251,084 thousand (2013: HRK 190,789 thousand) of fully depreciated property, plant and equipment that is still used by the Company.

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

Depreciation expense of HRK 41,260 thousand (2013: HRK 34,958 thousand) has been charged in cost of sales, HRK 2,049 thousand (2013: HRK 1,920 thousand) in selling expenses and HRK 1,223 thousand (2013: HRK 1,021 thousand) in administrative expenses.

Notes to the financial statements (continued)

10 Property, plant and equipment (*continued*)

The Company acts as a lessor under operating leases, mainly in respect of land and buildings. Property leased to others with a carrying value of HRK 13,528 thousand (2013: HRK 14,515 thousand) is included within land and buildings. These assets are depreciated at the same depreciation rates as other buildings, and are leased for a non-cancellable period of five years which commenced in 2005. Subsequent renewals are negotiated with the lessee. No contingent rents are charged. Portions of the property which is held for rental could not be sold separately or leased out separately under finance lease. Consequently, the IAS 40 criteria for separate investment property recognition are not met.

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

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

Notes to the financial statements (continued)

11 Intangible assets

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

	Application software HRK '000
As at 1 January 2013	
Cost or valuation	10,831
Accumulated amortization	<u>(6,517)</u>
Net book amount	<u>4,314</u>
Year ended 31 December 2013	
Opening net book amount	4,314
Additions	132
Amortization charge	<u>(2,334)</u>
Closing net book amount	<u>2,112</u>
As at 31 December 2013	
Cost or valuation	9,456
Accumulated amortization	<u>(7,344)</u>
Net book amount	<u>2,112</u>
Year ended 31 December 2014	
Opening net book amount	2,112
Additions	394
Amortization charge	<u>(1,210)</u>
Closing net book amount	<u>1,296</u>
As at 31 December 2014	
Cost or valuation	7,932
Accumulated amortization	<u>(6,636)</u>
Net book amount	<u>1,296</u>

Included in cost of intangible assets is HRK 4,685 thousand (2013: HRK 5,003 thousand) of fully amortised intangible assets that are still used by the Company.

Amortisation of HRK 1,121 thousand (2013: HRK 2,153 thousand) has been charged in cost of sales, HRK 56 thousand (2013: HRK 118 thousand) in selling expenses and HRK 33 thousand (2013: HRK 63 thousand) in administrative expenses.

Notes to the financial statements (continued)

12 Loans and receivables

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

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

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

Non-current portion of foreign and domestic loans and receivables

Due	2014	2013
	HRK '000	HRK '000
2015	-	6,274
2016	2,653	-
2017	2,265	-
2018	2,034	-
2019	1,200	-
	<u>8,152</u>	<u>6,274</u>

Receivables for sold apartments are shown net of amounts due to the Croatian state. Housing loans to employees are linked to the counter value of euro, repayments are made by deduction from monthly salary and the loans are secured with mortgages on the house or apartment. Receivables for sold apartments and housing loans provided to a limited number of employees bear fixed interest rates of up to 5% per annum. A discount in the amount of HRK 2,044 thousand (2013: HRK 2,130 thousand) is recognised in respect of these loans and amortised through the statement of comprehensive income, using the effective interest rate method at a rate of 7% per annum (2013: 7% per annum).

Notes to the financial statements (continued)

13 Investments in subsidiaries

	Ownership	2014	2013
		HRK '000	HRK '000
Ericsson Tesla SoftLab d.o.o.	100%	20	20
ETK poslovna rješenja d.o.o.	100%	20	20
Ericsson Nikola Tesla Servisi d.o.o.	100%	20	-
Libratel d.o.o	100%	5	5
Ericsson Nikola Tesla BH d.o.o	100%	7	7
Ericsson Nikola Tesla d.d. – Branch office of Kosovo	100%	1	1
		<u>73</u>	<u>53</u>

The subsidiaries Ericsson Tesla SoftLab d.o.o. and ETK poslovna rješenja d.o.o. are inactive, while others listed above are active and fully consolidated in the consolidated financial statements.

The new subsidiary Ericsson Nikola Tesla Servisi d.o.o. was founded in 2014 as a result of the transfer of the managed services segment from the company Hrvatski Telekom (HT). The subsidiary provides maintenance services of the HT fixed and mobile network over a five-year contract.

14 Inventories

	2014	2013
	HRK '000	HRK '000
Raw materials	1,176	2,289
Contract work in progress	21,105	51,319
Total inventories	<u>22,281</u>	<u>53,608</u>
Impairment allowance	<u>(1,153)</u>	<u>(8,929)</u>
	<u>21,128</u>	<u>44,679</u>

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

Notes to the financial statements (continued)

15 Trade receivables

	2014	2013
	HRK '000	HRK '000
Foreign trade receivables	63,181	142,998
Current portion of non-current foreign receivables	9,711	15,948
Total current foreign receivables	<u>72,892</u>	<u>158,946</u>
Domestic trade receivables	113,333	113,101
Current portion of non-current domestic receivables	-	883
Total current domestic receivables	<u>113,333</u>	<u>113,984</u>
Impairment allowance on receivables	<u>(7,342)</u>	<u>(30,695)</u>
	<u>178,883</u>	<u>242,235</u>

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

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

	2014	2013
	HRK '000	HRK '000
As at 1 January (Notes 12, 15)	32,824	39,160
Provision for receivables impaired during the year	20,913	7,139
Receivables written off during the year as uncollectible	(29,723)	(5,367)
Unused amounts reversed	(13,717)	(6,185)
Amortisation of discount	(244)	(1,923)
As at 31 December (Notes 12, 15)	<u>10,053</u>	<u>32,824</u>

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

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

Notes to the financial statements (continued)

16 Other receivables

	2014	2013
	HRK '000	HRK '000
Receivables from employees	708	1,622
Accrued interest receivable	986	506
Loans receivable - related parties (Note 26c))	12,519	11,719
Other receivables	906	1,541
	<u>15,119</u>	<u>15,388</u>

Loans receivable relates to loans granted to a subsidiary company Ericsson Nikola Tesla BH d.o.o. in the amount of EUR 1,485 thousand (2013: EUR 1,485 thousand), all due in 2015 and carry interest at 7%.

17 Financial assets at fair value through profit or loss

	2014	2013
	HRK '000	HRK '000
<i>Financial assets at fair value through profit or loss</i>		
- Debt securities, Ministry of Finance	4,129	4,129
- Equity securities	224	402
- Investment in open-ended investment funds	39,727	105,314
	<u>44,080</u>	<u>109,845</u>

18 Cash and cash equivalents

	2014	2013
	HRK '000	HRK '000
Cash and demand deposits	113,153	213,328
Term deposits originated by the Company, with original maturity up to 3 months	68,953	190,941
	<u>182,106</u>	<u>404,269</u>

Notes to the financial statements (continued)

19 Equity

(a) Share capital

As at 31 December 2014, the share capital of the Company is represented by 1,331,650 (2013: 1,331,650) of authorised, issued and fully paid ordinary shares, with a total registered value of HRK 133,165 thousand (2013: HRK 133,165 thousand). The nominal value of one share is HRK 100 (2013: HRK 100). The holders of the ordinary shares are entitled to receive dividends as declared at the General Assembly and are entitled to one vote per share at the General Assembly.

The Company's shareholders as at 31 December 2014 are:

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

(b) Treasury shares

These shares are held initially as "treasury shares" and are regularly granted to key management and other employees as a part of the share-based program established during 2004, as described in Note 22 (b). During 2014, the Company acquired 2,000 (2013: 4,000) of its own shares, for a total amount of HRK 2,768 thousand (2013: HRK 5,754 thousand), paid from the 2008 net income as decided by the General Assembly held on 26 May 2009.

Movements in treasury shares are as follows:

	2014	2013
	Number of shares	Number of shares
As at 1 January (Note 19 (a))	4,808	3,408
Purchased during the year	2,000	4,000
Distributed during the year	<u>(3,728)</u>	<u>(2,600)</u>
As at 31 December (Note 19 (a))	<u>3,080</u>	<u>4,808</u>

(c) Legal reserves

A legal reserve in the amount of 5% of total share capital was formed during previous periods by appropriation of 5% of net profit per annum up to a cap of 5% of share capital. The legal reserve may be used to cover losses if the losses are not covered by current net profit or if other reserves are not available. The Company recorded the required level of legal reserves in 2000 and no further allocation to legal reserves is required. Legal reserves up to 5% of total share capital are not distributable. During 2013, the Company released legal reserves of HRK 13,452 thousand representing reserves in excess of the prescribed 5% of share capital.

Notes to the financial statements (continued)

20 Proposed dividends

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

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

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

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

The 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 19 to the financial statements.

Notes to the financial statements (continued)

22 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 2014 were a 6% discount rate (2013: 6%) and a 3,5% (2013: 3.4%) rate of average employment turnover.

Movements in long-term service benefits were as follows:

	2014	2014	2014	2013	2013	2013
	Jubilee awards	Retirement	Total	Jubilee awards	Retirement	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
As at 1 January	4,377	320	4,697	4,059	393	4,452
Obligation created during the year	976	86	1,062	560	62	622
Obligation fulfilled during the year	(407)	(16)	(423)	(242)	(40)	(282)
Obligation reversed during the year	-	-	-	-	(95)	(95)
As at 31 December	<u>4,946</u>	<u>390</u>	<u>5,336</u>	<u>4,377</u>	<u>320</u>	<u>4,697</u>

(b) Share-based payments

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

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

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

Notes to the financial statements (continued)

22 Employee benefits (continued)

(b) Share-based payments (continued)

The terms and conditions of the grants are as follows:

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

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

	Number of granted shares	Weighted average fair value per share HRK
Shares granted in 2013	11,145	1,443.39
Reversal of shares granted in 2011-2013	(3,529)	1,373.20

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

3,728 of shares granted under the Loyalty programs from previous years vested during 2014. The total weighted average cost of shares exercised during 2014 under the Award and Loyalty programs amounted to HRK 3,877 thousand (2013: HRK 3,111 thousand).

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

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

Notes to the financial statements (continued)

23 Trade and other payables

	2014	2013
	HRK '000	HRK '000
Trade payables	35,194	54,653
Liabilities to employees	67,949	73,109
Other current liabilities	15,513	12,990
Net liability for VAT	7,450	6,044
	<u>126,106</u>	<u>146,796</u>

24 Provisions

Movements in provisions were as follows:

	2014	2014	2014	2014	2013	2013	2013	2013
	Warranty	Penalty	Termination	Total	Warranty	Penalty	Termination	Total
	reserve	reserve	benefits	HRK '000	reserve	reserve	benefits	HRK '000
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
As at 1 January	6,507	5,962	989	13,458	9,342	7,719	1,505	18,566
Additional provisions	3,009	1,319	610	4,938	1,682	2,543	960	5,185
Unused provisions								
reversed	(363)	(1,977)	-	(2,340)	(7)	-	-	(7)
Provisions used								
during the year	(4,364)	(672)	(1,019)	(6,055)	(4,510)	(4,300)	(1,476)	(10,286)
As at 31 December	<u>4,789</u>	<u>4,632</u>	<u>580</u>	<u>10,001</u>	<u>6,507</u>	<u>5,962</u>	<u>989</u>	<u>13,458</u>

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

Notes to the financial statements (continued)

25 Accrued charges and deferred revenue

	2014	2013
	HRK '000	HRK '000
Advances from domestic customers	3,504	6,350
Advances from foreign customers	5,816	4,958
Deferred revenue	80,287	90,098
Accrued charges for unused holidays	16,504	12,764
Accrued charges for legal claims	825	801
Accrued charges in respect of service contracts	21,138	23,544
Other accrued charges	12,320	10,044
	<u>140,394</u>	<u>148,559</u>

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

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

26 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% (2013: 49.07%) shareholding by Telefonaktiebolaget LM Ericsson, which is also the ultimate parent of the Ericsson Group.

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

Notes to the financial statements (continued)

26 Balances and transactions with related parties (continued)

(a) Key transactions with the related parties

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

	Telefonaktiebolaget LM Ericsson		Other Ericsson Group consolidated companies		Subsidiaries		Total	
	2014 HRK '000	2013 HRK '000	2014 HRK '000	2013 HRK '000	2014 HRK '000	2013 HRK '000	2014 HRK '000	2013 HRK '000
Sales of goods and services								
Sales revenue	-	-	628,030	568,749	13,536	183	641,566	568,932
Other income	-	-	1,740	8,289	1,666	205	3,406	8,494
			<u>629,770</u>	<u>577,038</u>	<u>15,202</u>	<u>388</u>	<u>644,972</u>	<u>577,426</u>
Purchases of goods and services								
Licences	3,196	3,635	23,111	26,347	-	-	26,307	29,982
Technical cooperation fee	-	-	-	1,958	-	-	-	1,958
Cost of sales	-	-	327,050	407,385	41,085	5,121	368,135	412,506
Other expenses	-	-	-	-	-	5,189	-	5,189
	<u>3,196</u>	<u>3,635</u>	<u>350,161</u>	<u>435,690</u>	<u>41,085</u>	<u>10,310</u>	<u>394,442</u>	<u>449,635</u>

The Company recorded interest income of HRK 799 thousand (2013: HRK 1,774 thousand) relating to loan granted to a subsidiary company Ericsson Nikola Tesla BH d.o.o. disclosed in Note 16.

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.

(b) Key management compensation

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

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

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

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

Notes to the financial statements (continued)

26 Balances and transactions with related parties (continued)

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

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

	Trade receivable		Trade payable	
	2014	2013	2014	2013
	HRK '000	HRK '000	HRK '000	HRK '000
Main shareholder				
Telefonaktiebolaget LM Ericsson (LME)	-	1,342	471	-
Ericsson Group consolidated companies				
Ericsson AB (EAB)	33,513	50,870	33,793	52,667
Ericsson Services d.o.o. (ESK)	20,467	-	-	-
Ericsson Maroc Sarl (EMO)	5,640	2,884	-	-
Ericsson GMBH Group (EDD)	4,762	3,773	1,383	1,575
Ericsson Ltd. Madrid, Spain (ETL)	3,176	527	371	-
Ericsson Telecom S.A.De C.V.(TEM)	1,595	954	-	-
LM Ericsson Ltd. (LMI)	1,427	1,171	434	615
Ericsson Telecommunicatia B.V. (ETM)	1,285	812	681	600
Ericsson Corporation, Russia (ECR)	1,051	1,064	-	-
Ericsson Canada inc. (EMC)	969	-	51	-
Ericsson AG (EAS)	922	375	-	-
Ericsson Austria GMBH (SEA)	595	235	-	15
Ericsson Telecomunicazioni Spa (TEI)	468	75	-	49
Ericsson Korea Limited (EKK)	441	-	-	-
Ericsson Ltd. (EHK)	352	351	-	-
Ericsson AB Bahrain Branch (BBH)	342	141	-	-
Ericsson S.A./N.V. Branch Office Luxembourg (BLU)	324	223	-	-
Ericsson Espana S.A. (EEM)	292	44	-	25
Ericsson Egypt Ltd. (EEL)	257	748	-	-
Other Ericsson Group companies	3,971	6,010	2,406	668
Subsidiaries:				
Ericsson Nikola Tesla BH d.o.o.	2,048	-	589	1,727
Ericsson Nikola Tesla Servisi d.o.o.	958	-	22,576	-
Libratel d.o.o.	5	5	-	-
	<u>84,860</u>	<u>71,604</u>	<u>62,755</u>	<u>57,941</u>

The Company recorded a loan receivable in the amount of HRK 12,519 thousand (2013: HRK 11,719 thousand) relating to the loan granted to the subsidiary company Ericsson Nikola Tesla BH d.o.o. disclosed in Note 16.

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

Notes to the financial statements (continued)

27 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 the euro, as a substantial proportion of receivables and foreign revenues are denominated in these currencies. Risk management relies on attempts to match, as much as possible, revenues in each currency with the same currency expenditure. The Company may enter into foreign currency forward contracts to hedge economically its exposure to currency risk arising on operating cash flows.

As at 31 December 2014, if the euro and US dollars had weakened/strengthened by 1% (2013: 1%) against the Croatian kuna, with all other variables held constant, the net result after tax for the reporting period would have been HRK 1,521 thousand lower/higher for the Company (2013: HRK 4,095 thousand), mainly as a result of foreign exchange losses/gains on translation of significant cash, cash equivalents, deposits, trade payables, customer receivables and customer financing denominated in euro.

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

Notes to the financial statements (continued)

27 Financial risk management (continued)

(a) Currency risk (continued)

The tables below present the currency analysis and resulting gap.

2014

	EUR	USD	Other currency	Total foreign currencies	HRK	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Loans and receivables	11,645	2,541	-	14,186	4,967	19,153
Trade and other receivables	132,308	11,727	(7)	144,028	134,834	278,862
Financial assets at fair value through profit or loss	-	-	-	-	44,080	44,080
Cash and cash equivalents	157,527	4,103	2,436	164,066	18,040	182,106
	301,480	18,371	2,429	322,280	201,921	524,201
Trade and other payables	42,606	18,076	115	60,797	128,064	188,861
	42,606	18,076	115	60,797	128,064	188,861
Currency gap	258,874	295	2,314	261,483	73,857	335,340

2013

	EUR	USD	Other currency	Total foreign currencies	HRK	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Loans and receivables	15,594	2,463	-	18,057	744	18,801
Trade and other receivables	195,217	13,271	7,217	215,705	113,522	329,227
Financial assets at fair value through profit or loss	-	-	-	-	109,845	109,845
Cash and cash equivalents	358,721	2,250	537	361,508	42,761	404,269
	569,532	17,984	7,754	595,270	266,872	862,142
Trade and other payables	68,649	3,665	(32)	72,282	132,455	204,737
	68,649	3,665	(32)	72,282	132,455	204,737
Currency gap	500,883	14,319	7,786	522,988	134,417	657,405

Notes to the financial statements (continued)

27 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 considered low. The Company also has borrowings and deposits in financial institutions at a variable interest rate, as well as investments in money investment funds that are sensitive to market interest rate movements on short-term deposits and treasury bills.

As at 31 December 2014:

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

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

	2014	2013
	Average	Average
	interest rates	interest rates
	%	%
Loans and receivables	2.44	2.16
Trade and other receivables	0.57	0.32
Financial assets at fair value through profit or loss	0.49	0.20
Cash and cash equivalents	1.32	1.64
Interest-bearing borrowings	-	-

Notes to the financial statements (continued)

27 Financial risk management (continued)

(b) Interest rate risk (continued)

The tables below present the interest rate re-pricing analysis and resulting gap.

2014

	Non-interest-bearing	Up to 1 month	1 - 3 months	3 - 12 months	1 - 5 years	Over 5 years	Total	Fixed interest
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Loans and receivables	4,133	-	-	-	7,656	7,364	19,153	-
Trade and other receivables	257,217	1,041	3,274	16,622	708	-	278,862	8,419
Financial assets at fair value through profit or loss	39,952	-	-	-	4,128	-	44,080	-
Cash and cash equivalents	-	113,153	68,953	-	-	-	182,106	68,953
	301,302	114,194	72,227	16,622	12,492	7,364	524,201	77,372
Trade and other payables	188,861	-	-	-	-	-	188,861	-
	188,861	-	-	-	-	-	188,861	-
Interest rate gap	112,441	114,194	72,227	16,622	12,492	7,364	335,340	77,372

2013

	Non-interest-bearing	Up to 1 month	1 - 3 months	3 - 12 months	1 - 5 years	Over 5 years	Total	Fixed interest
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Loans and receivables	-	-	-	442	9,459	8,900	18,801	7,253
Trade and other receivables	300,610	6,036	1,058	21,523	-	-	329,227	16,898
Financial assets at fair value through profit or loss	105,716	-	-	-	4,129	-	109,845	-
Cash and cash equivalents	-	213,328	190,941	-	-	-	404,269	190,941
	406,326	219,364	191,999	21,965	13,588	8,900	862,142	215,092
Trade and other payables	204,737	-	-	-	-	-	204,737	-
	204,737	-	-	-	-	-	204,737	-
Interest rate gap	201,589	219,364	191,999	21,965	13,588	8,900	657,405	215,092

Notes to the financial statements (continued)

27 Financial risk management (*continued*)

(c) Price risk

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

(d) Credit risk

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. Significant risk is associated with a high level of customer finance receivables.

The tax liability forecasts for the following years showed that the Company will again be in a position of no income tax liability due to other tax reliefs (existing R&D credits as well as considerable tax loss carried forward), and will not be able to use the already approved tax certificates from previous years for the income tax paid abroad.

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

New customers are only accepted on satisfactory completion of a detailed credit check of the customer and a review of the related country risk. Outstanding credit arrangements are monitored frequently. Impairment losses are calculated by discounting of receivables. Additionally, there is credit concentration risk as the Company has a significant portion of receivables outstanding from a small number of customers. As at 31 December 2014, the five largest customers represent 71% of total net trade receivables (2013: 53%). The Company considers that its maximum exposure to credit risk is reflected in the amount of trade receivables (Notes 12 and 15) and other receivables (Note 16), net of provision for doubtful receivables. Ageing analysis of these receivables is within the maturity analysis table shown further in this note.

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

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

Provisions related to customer finance risk exposures are only made when they are reliably measurable and where, after the financing arrangement has become effective, certain events occur which are expected to have a significant adverse impact on the borrower's ability and/or willingness to service the outstanding debt. These events can be political (normally outside the control of the borrower) or commercial, e.g. the borrower's deteriorating creditworthiness. Security arrangements for customer finance facilities normally include pledges of equipment and pledges of certain of the borrower's assets. If available, third-party risk coverage may also be arranged. "Third-party risk coverage" means that a financial payment guarantee covering the credit risk has been issued by a bank, an export credit agency or other financial institution. It may also be a credit risk transfer under a so called "sub-participation arrangement" with a bank, whereby the credit risk and the funding is taken care of by the bank for the part covered by the bank. A credit risk cover from a third party may also be issued by an insurance company.

As at 31 December 2014, total outstanding exposure related to customer finance was HRK 17 million (2013: HRK 23 million).

Notes to the financial statements (continued)

27 Financial risk management (continued)

(d) Credit risk (continued)

The following tables provide an ageing detail of current and overdue amounts in respect of all customer loans and receivables as at 31 December 2014.

	Due balance	Up to 3 months	3 months to 1 year	1 to 3 years	Over 3 years	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
2014						
Foreign receivables	5,556	55,607	11,929	2,318	-	75,410
Domestic receivables	3,627	103,722	4,950	94	1,774	114,167
Receivables from related parties*	16,037	66,124	2,700	2,399	2,400	89,660
	25,220	225,453	19,579	4,811	4,174	279,237

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

2013						
Foreign receivables	35,125	103,806	20,014	6,274	-	165,219
Domestic receivables	12,011	89,291	12,682	-	-	113,984
Receivables from related parties	11,323	60,281	-	-	-	71,604
	58,459	253,378	32,696	6,274	-	350,807

	Up to 3 months	3 months to 1 year	1 to 3 years	Over 3 years	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
2014					
Foreign receivables	3,907	97	1,320	232	5,556
Domestic receivables	1,961	6	775	885	3,627
Receivables from related parties	8,476	3,313	3,187	1,061	16,037
	14,344	3,416	5,282	2,178	25,220
2013					
Foreign receivables	10,220	641	3,924	20,341	35,126
Domestic receivables	7,547	1,411	2,168	884	12,010
Receivables from related parties	4,468	6,423	432	-	11,323
	22,235	8,475	6,524	21,225	58,459

Notes to the financial statements (continued)

27 Financial risk management (continued)

(d) Credit risk (continued)

Table 3

**Payment due date for total customer loans and receivables
(in respect of accounts with any portion falling due)**

	Due balance	Up to 3 months	3 months to 1 year	1 to 3 years	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
2014					
Foreign receivables	5,556	38,504	9,405	2,286	55,751
Domestic receivables	3,627	45,741	-	-	49,368
Receivables from related parties	16,037	62,629	2,700	-	81,366
	<u>25,220</u>	<u>146,874</u>	<u>12,105</u>	<u>2,286</u>	<u>186,485</u>
2013					
Foreign receivables	35,126	75,579	10,238	1,388	122,331
Domestic receivables	12,010	81,087	11,971	-	105,068
Receivables from related parties	11,323	57,983	-	-	69,306
	<u>58,459</u>	<u>214,649</u>	<u>22,209</u>	<u>1,388</u>	<u>296,705</u>

Table 4

Past due but not impaired customer loans and receivables

	Up to 3 months	3 months to 1 year	1 to 3 years	Over 3 years	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
2014					
Foreign receivables	3,660	95	45	-	3,800
Domestic receivables	1,961	6	-	-	1,967
Receivables from related parties	5,691	2	38	64	5,796
	<u>11,312</u>	<u>103</u>	<u>83</u>	<u>64</u>	<u>11,563</u>
2013					
Foreign receivables	6,606	641	101	-	7,348
Domestic receivables	7,455	136	973	-	8,564
Receivables from related parties	747	3,189	2,203	376	6,515
	<u>14,808</u>	<u>3,966</u>	<u>3,277</u>	<u>376</u>	<u>22,427</u>

Notes to the financial statements (continued)

27 Financial risk management (continued)

(d) Credit risk (continued)

As at 31 December 2014, the total balance outstanding in respect of customer loans and receivables was HRK 279 million (2013: HRK 351 million), as disclosed in Table 1, of which HRK 245million (2013: HRK 286 million) is falling due for payment within one year. As at 31 December 2014, the amount totalling HRK 25 million (2013: HRK 58 million) was overdue (Table 2), of which HRK 18 million (2013: HRK 31 million) is up to one year overdue.

As at 31 December 2014, total balance outstanding in respect of customer overdue receivables as at 31 December 2014 was HRK 186 million (2013: HRK 297 million) as disclosed in Table 3. Of this total, HRK 184 million (2013: HRK 237 million) was already due or is due for payment within one year.

In the current economic climate, there is increased risk and uncertainty with regard to the ultimate collectability of some of these balances. As at 31 December 2014, impairment allowances totalling HRK 7 million (2013: HRK 28 million) were provided in respect of total customer loans and receivables. As disclosed in Table 4, amounts totalling HRK 12 million (2013: HRK 22 million), were past due but not impaired as at 31 December 2014.

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

Notes to the financial statements (continued)

27 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.

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

2014	Up to 1 month	1 - 3 months	3 - 12 months	1 - 5 years	Over 5 years	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Loans and receivables	-	-	-	11,812	7,341	19,153
Trade and other receivables	154,983	88,999	33,138	1,742	-	278,862
Current financial assets	39,952	-	-	4,128	-	44,080
Cash and cash equivalents	142,379	39,727	-	-	-	182,106
	337,314	128,726	33,138	17,682	7,341	524,201
Trade and other payables	144,633	40,107	4,121	-	-	188,861
	144,633	40,107	4,121	-	-	188,861
Maturity gap	192,681	88,619	29,017	17,682	7,341	335,340
2013	Up to 1 month	1 - 3 months	3 - 12 months	1 - 5 years	Over 5 years	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Loans and receivables	-	-	442	16,777	1,582	18,801
Trade and other receivables	205,013	92,900	31,314	-	-	329,227
Current financial assets	105,716	-	-	4,129	-	109,845
Cash and cash equivalents	213,328	190,941	-	-	-	404,269
	524,057	283,841	31,756	20,906	1,582	862,142
Trade and other payables	142,902	61,835	-	-	-	204,737
	142,902	61,835	-	-	-	204,737
Maturity gap	381,155	222,006	31,756	20,906	1,582	657,405

Notes to the financial statements (continued)

27 Financial risk management (continued)

(f) Fair value estimation

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

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

The 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 as amounts shown in the balance sheet are as follows:

	Carrying		Unrecognised	Carrying		Unrecognised
	amount	Fair value	gain/(loss)	amount	Fair value	gain/(loss)
	2014	2014	2014	2013	2013	2013
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Loans and receivables	19,153	18,362	(791)	18,801	18,874	73
Trade and other receivables	278,861	278,826	(35)	329,227	328,580	(647)
Financial assets at fair value through profit or loss	44,080	44,080	-	109,845	109,845	-
Cash and cash equivalents	182,106	182,106	-	404,269	404,269	-
Trade and other payables	(188,861)	(188,861)	-	(204,737)	(204,737)	-
	<u>335,339</u>	<u>334,513</u>	<u>(826)</u>	<u>657,405</u>	<u>656,831</u>	<u>(574)</u>

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

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

	2014	2013
Loans and receivables	4,82%	5.31%

Notes to the financial statements (continued)

28 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 to the date of these statements.



ANNUAL REPORT ON GROUP PERFORMANCE

Dear shareholders,

in this report, I will focus on the contribution of Ericsson Nikola Tesla Group to the vision of Networked Society, the situation on the domestic and export markets, key performance indicators and strategic direction.

Our Contribution to the Vision of Networked Society

Information and communication technologies rapidly create new possibilities, and the global process of networking, which has already begun, takes us into the Networked Society of the future. Networked Society positively impacts peoples' lives, business and society, and empowers each individual and every industry to reach their full potential. In such circumstances, ICT sector is recognized as the accelerator of national economies growth, increase of economic competitiveness, export activities and sustainable development.

Ericsson Nikola Tesla actively contributes to the global technological development and drives change through innovative ICT products, services and solutions. The key factor of sustainable development is the collaboration and mutual trust of all stakeholders involved (customers/partners, employees, society, shareholders). Respecting the high standards set in all activities and processes, and a new way of thinking encourages and opens new perspectives and new strategic partnerships.

Business Situation in Major Markets

Ericsson Nikola Tesla business results in 2014 show a continuous stable business performance. Sales revenues decreased by 2% year-over-year. Ericsson market records a significant increase in sales revenues, while the revenues are stable in the domestic market, thus neutralizing the revenue decrease in CIS and Southeast Europe markets. We have maintained our position among the Croatian leading exporters, especially when it comes to the export of knowledge/services.

A significant part of our activities relates to research & development and professional services in Ericsson market. This business segment records a continuous growth, and accounts for 48% of sales revenues. In 2014, our Research and Development Center was highly evaluated in comparison to other Research & Development Centers in the Ericsson Group. The evaluation of the collaboration so far, and the results achieved, represent an excellent foundation for further partnership, increased responsibility and sales growth. During 2014, we employed 174 new professionals, primarily in this segment.

In the domestic market, a stable sales trend was realized, despite an unfavorable economic situation. The operators' capital expenditure were focused on core network modernization and optimization, 3G and 4G radio access network expansion, fixed access network modernization, as well as investments in additional radio spectrum. The operators' focus on increased efficiency in business



performance indicates a trend of outsourcing construction and maintenance of telecommunications network (managed services). As one of the main activities in 2014, I would like to highlight the successfully completed negotiations with Hrvatski Telekom (HT) on collaboration in managed services segment. Ericsson Nikola Tesla Servisi d.o.o. (EHR), a newly founded Ericsson Nikola Tesla subsidiary, provides maintenance of HT fixed and mobile network. After the transfer of 638 employees from HT to the newly established company, the Ericsson Nikola Tesla Group now employs 2,500 employees. During 2014, a successful collaboration with the strategic partner Vipnet continued, primarily in the segment of mobile telecom network expansion and modernization, including the fourth generation of mobile networks (LTE). Vipnet and Ericsson Nikola Tesla are the winners of the Global Telecom Business Innovation Award 2014 for introducing PSI coverage energy efficient solution in the radio access network segment.

In ICT solutions for Industry and Society segment, I would also like to highlight activities on upgrading the national ICT healthcare system. Ericsson Nikola Tesla experts completed the migration of the Central Healthcare Information System of the Republic of Croatia (CEZIH) to new system software, which will enable a faster and an easier integration of all applications related to e-health system. Furthermore, we completed One Stop Shop project for Joint Information System of Land Registry and Cadaster, financed by the European Union IPA programs.

Despite unfavorable economic and political developments in our major export markets, we have managed to recognize new business opportunities. I would like to highlight the continued quality collaboration with the customers in Bosnia and Herzegovina market, in the field of upgrading fixed and mobile networks, the transformation of operational support systems (OSS) and in the services segment. In 2014 we continued with the projects of modernization and construction of a mobile network in Belarus with our longtime customer Velcom.

Considering the demanding market environment, operational risks, that marked the previous year, are still present. By assessing Ericsson Nikola Tesla operational risks, I here list the following:

- › the impact of negative economic developments on the demand and prices of our products and services;
- › dependence on telecom market trends (number of subscribers, the use of new services);
- › industry consolidation;
- › strong competition and the entry of new IT companies in the telecommunications market;
- › continuation of political uncertainty in some markets.

Key Performance Indicators

Net profit amounting to MHRK 87.4 was realized, representing 6.6% return on sales. The gross margin of 13.7% decreased year-over-year, as a result of change in business mix of products and services, and continuous price pressure. The sales and administrative expenses decreased year-over-year. We adhered to business and financial goals, focused on improving working capital, cash



conversion and risk management. Pursuant to that, we finalized the year with a solid balance sheet and strong cash flow from operating activities.

In 2014, the annual Employee Engagement Survey (Dialog) confirmed the Company's motivating culture and strong employee engagement. Furthermore, the annual Customer Satisfaction Survey confirmed a high level of satisfaction among our main customers/partners.

Sustainability and corporate responsibility remained important during 2014. We focus our efforts on projects in telecom segment and Industry and Society segment (such as e-health, e-government, e-utilities, traffic information systems) where we can make the biggest contribution to positive economic, environmental and social growth.

Strategic Direction

Ericsson Nikola Tesla is focused on further strengthening our position in four areas of interest. We want to be the leading ICT transformation partner for our customers, recognised as a company that attracts, develops and retains talented employees, leads and drives positive change in the society and creates value for shareholders. Our Networked Society strategy builds on a combination of excelling in our core business (Radio, Core and Transmission, Telecom Services) and establishing leadership in targeted growth areas (IP Networks, Cloud, TV and Media, OSS and BSS, and selected areas in Industry and Society segment). We have initiated several strategic initiatives for 2015, focused on business development in all markets and improvement of profitability through cost efficiency and business excellence. We set up a model of strong compliance between innovative ideas and strategic initiatives, with the aim of business growth and improvement of ways of working.

Our Industry long term foundations remain attractive, and with the constant adjustment to technological, market and competitive conditions, we are well positioned to further support our customers in their transformation processes.

All other data, pursuant to Article 250a of the Company Act, which are required to be an integral part of the company annual report, can be found in the enclosed 2014 Annual Report, encompassing General Report, Social Report and Consolidated Financial Statements as at December 31, 2014.

Gordana Kovačević

President

Ericsson Nikola Tesla d.d.


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

THE REPORT OF THE SUPERVISORY BOARD OF ERICSSON NIKOLA TESLA ON THE SUPERVISION PERFORMED ON THE COMPANY'S OPERATIONS IN 2014

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, taking respective decisions in four regular and three extraordinary board meetings held during 2014.

The Company Management regularly informed the Supervisory Board on all important business activities and the course of the Company business performance. At the board meetings the Supervisory Board reviewed the financial results, business plans, market conditions and ICT industry trends. Further topics of discussions were as follows: strategic projects, investments, business risks, innovations and issues relating to human resources. The Supervisory Board continuously monitored the business development and responsibilities of the Research & Development Centre, Operations & Competence Center, Engagement Practices and IT & Test Environment (ITTE) Croatia. The Supervisory Board analyzed and approved the Company's Business Strategy 2014–2017, as well as strategic direction and initiatives necessary for further business development. Profitability improvement program, through cost efficiency and operational excellence, has been approved and will be followed up regularly together with other strategic initiatives on Supervisory Board meetings during 2015.

At extraordinary Board meetings, the members discussed dividend payment, 2013 annual financial reports, targets for 2014, as well as entering into the new business segment "managed services".

For purpose of the realization of a Managed Services contract with Hrvatski Telekom, the Ericsson Nikola Tesla subsidiary, Ericsson Nikola Tesla Servisi d.o.o. (EHR), was founded. The primary activity of the subsidiary is construction and maintenance of telecommunications infrastructure.

Ericsson Nikola Tesla is a dynamic company, operating in an exciting and challenging market environment with good long-term perspectives. By analyzing the Managing Director reports and key financial indicators, our conclusion is that the company achieved solid financial performance.

At the meeting held on December 11, 2014, the Supervisory Board re-elected the Managing Director, Mrs. Gordana Kovačević for a new mandate, effective January 1, 2015. During 2014 there was no change in the Supervisory Board composition. As his mandate has expired, Mr. Dubravko Radošević was re-elected as Supervisory Board member with the mandate renewed for a further four years at the Annual General Meeting held on May 27, 2014.

The Audit Committee held four sessions in 2014. During these sessions, the Audit Committee discussed financial performance during the year, the annual financial statements, 2014 audit plan, audit findings,

internal control and risk management system and performed other tasks defined by the Audit Law. The Audit Committee regularly informed other Supervisory Board members of its findings and recommendations. On the day of this report issuance, the Audit Committee is comprised of Mr. Ignac Lovrek, Chairman and Mrs. Carita Jönsson, Member.

Based on the review of financial and other relevant business documents, the Managing Director's report 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 consolidated and non-consolidated annual financial statements;
2. Decision by the Supervisory Board on the established consolidated and non-consolidated annual financial statements;

For the Supervisory Board



Roland Nordgren, Chairman

Ericsson Nikola Tesla d.d. Zagreb
Krapinska 45

OIB: 84214771175

Matični br.: 03272699

Zagreb, 02. travnja 2015.

Predmet: Odluka Uprave Društva

Subject: Managing Director Decision

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

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

- Utvrđuju se godišnja financijska izvješća Društva za 2014.g.
- Utvrđuju se godišnja konsolidirana financijska izvješća Društva i njegovih podružnica („Grupa“) za 2014.g.

- The Annual Financial Reports of the Company for 2014 have been submitted and approved.
- The Annual Consolidated Financial Statements of the Company and its subsidiaries (the “Group“) for 2014 have been submitted and approved.

Ericsson Nikola Tesla d.d. Zagreb
Uprava

Ericsson Nikola Tesla d.d. Zagreb
Managing Director

Gordana Kovačević


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

Gordana Kovačević


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

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

Zagreb, 02. travnja 2015.

Predmet: Odluka Nadzornog odbora Društva

Subject: Supervisory Board Decision

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

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

- Utvrđuju se godišnja financijska izvješća Društva za 2014.g.
- Utvrđuju se godišnja konsolidirana financijska izvješća Društva i njegovih podružnica („Grupa“) za 2014. godinu.

- The Annual Financial Reports of the Company for 2014 have been submitted and approved.
- The Annual Consolidated Financial Statements of the Company and its subsidiaries (the “Group“) for 2014 have been approved.

Ericsson Nikola Tesla d.d. Zagreb

Za Nadzorni odbor



Roland Nordgren
Predsjednik

Ericsson Nikola Tesla d.d. Zagreb

For Supervisory Board



Roland Nordgren
Chairman