

Ericsson Nikola Tesla d.d.

**Financial Statements and
Auditor's report
31 December 2016**

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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 2016, Telefonaktiebolaget LM Ericsson (Ericsson) holds 49.07% of the Company's share. Other shareholders own the remaining 50.81% of the Company's shares and 0.12% 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 2016 and up to the release of these statements were:

Roland Nordgren	Reappointed on 31 May 2016	Chairman
Ignac Lovrek	Reappointed on 2 June 2015	Member; Vice-Chairman
Vidar Mohammar	Appointed on 2 June 2015	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 2015	President
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Executive management

As at 31 December 2016, the Company's executive management comprised:

Gordana Kovačević	Company President
Branko Dronjić	Head, ITTE OPS Croatia
Damir Bušić	Director, Commercial Management (including Legal)
Dario Runje	Head, RAN Competence Domain
Dragan Fratrić	Director, 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	Director, HR
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	Business Excellence Manager

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 10 to 61 were authorised by the Management Board on 21 April 2017 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

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Independent Auditor's Report

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

Our opinion

In our opinion, the separate financial statements present fairly, in all material respects, the financial position of Ericsson Nikola Tesla d.d. (the "Company") as at 31 December 2016, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted in European Union ("IFRS").

What we have audited

The Company's separate financial statements comprise:

- the statement of financial position as at 31 December 2016;
 - the statement of comprehensive income for the year then ended;
 - the statement of changes in equity for the year then ended;
 - the statement of cash flows for the year then ended; and
 - the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.
-

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Separate Financial Statements* section of our report.

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

Independence

We are independent of the Company in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code). We have fulfilled our other ethical responsibilities in accordance with the IESBA Code.

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

Our audit approach

Overview

Materiality

- Overall materiality for separate financial statements as a whole: HRK 12 million, which represents 0.75% of total revenue.

Key audit matters

- Revenue recognition from sale of goods
 - De-recognition of receivables with off balance sheet financing
-

How we tailored our audit scope

We designed our audit by determining materiality and assessing the risks of material misstatement in the separate financial statements. In particular, we considered where management made subjective judgements; for example, in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. We also addressed the risk of management override of internal controls, including among other matters consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

We tailored the scope of our audit in order to perform sufficient work to enable us to provide an opinion on the separate financial statements as a whole, taking into account the structure of the Company, the accounting processes and controls, and the industry in which the Company operates.

Materiality

The scope of our audit was influenced by our application of materiality. An audit is designed to obtain reasonable assurance whether the separate financial statements are free from material misstatement. Misstatements may arise due to fraud or error. They are considered material if individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the separate financial statements.

Based on our professional judgement, we determined certain quantitative thresholds for materiality, including the overall Company materiality for the separate financial statements as a whole as set out in the table below. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, if any, both individually and in aggregate on the separate financial statements as a whole.



Overall materiality for separate financial statements as a whole

HRK 12 million (2015: HRK 8.5 million)

How we determined it

0.75% of total revenues

Rationale for the materiality benchmark applied

We consider revenue to be the benchmark against which the performance of the Company is most commonly measured by the shareholders. In addition, majority of the sales and purchases are realised from internal Ericsson Group transactions and are subject to transfer pricing arrangements.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the separate financial statements of the current period. These matters were addressed in the context of our audit of the separate financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key audit matter	How our audit addressed the Key audit matter
<p><i>Recognition of revenue from sale of goods</i></p> <p>Refer to Note 1 of the financial statements under heading “Recognition of revenues” and Note 24 (Accrued charges and deferred revenue).</p> <p>We focused on revenue recognition because the customer payments set in the contracts usually do not align with timing of revenue recognition criteria. Revenue from delivery of goods is mostly recognised upon approved acceptance test by a customer.</p>	<p>We assessed the consistency of the application of the revenue recognition policy by performing following procedures:</p> <ul style="list-style-type: none"> - We tested the design and operating effectiveness of the controls (including IT controls) over revenue systems across the Company to determine the extent of reliance on the automated controls and overall IT environment. - We checked that revenue had been recognised at the correct time by testing a sample of transactions and contracts, and comparing the timing of revenue recognition to approved client acceptance tests. - We also tested on a sample basis the appropriateness of deferred revenue transactions by reference to the delivery status of the related contracts and timing of invoices. <p>No exceptions were noted from our testing.</p>

Key audit matter

De-recognition of receivables with off balance sheet financing

See note 2(b) of the financial statements under heading “De-recognition of receivables with off-balance sheet financing”

In 2016, the Company entered into several new customer contracts in the foreign market with total revenue amount of HRK 141 million.

We focused on this area because of the significance and complexity of these contracts. The contracts include long-term payment terms, securing related receivable through a separate insurance contract, and a supplier credit financing structure. As part of such contracts, the Company also issued guarantees to the financing bank for risk of non-performance by the insurance company.

Based on a detail analysis of the related accounting criteria, management of the Company concluded it was appropriate to de-recognize a portion of related receivables, and reflect the financing component as an off-balance sheet transaction.

How our audit addressed the Key audit matter

We performed the following testing in respect of these transactions:

- We considered each transaction separately by carefully reading the specific contract terms.
- We obtained external confirmations on a sample basis from the customer and the financing bank related to the Company’s initial receivables and the de-recognised proportion which confirmed the outstanding receivables and payables arising from these transactions.
- We assessed and formed our own view on management’s analysis of the de-recognition criteria of financial assets. We considered whether there was transfer to third parties of contractual rights to receive cash flows and transfer of risk (primarily consisting of late payment risk and credit risk). We determined that these transactions were recorded and presented consistently with the related requirements of the accounting standards (IFRS).

Other information

Management is responsible for the other information. The other information comprises the Separate Annual Report of the Company, which includes the General Report and Social Report, comprising Corporate Governance Statement, but does not include the separate financial statements and our independent auditor’s report thereon.

Our opinion on the separate financial statements does not cover the other information, including the General Report and Social Report, comprising Corporate Governance Statement.

In connection with our audit of the separate financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the separate financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

With respect to the General Report and Social Report, comprising Corporate Governance Statement, we also performed procedures required by the Accounting Act in Croatia. Those procedures include considering whether the General Report and Social Report include the disclosures required by Article 21 and 24 of the Accounting Act, and whether the Corporate Governance Statement includes the information specified in Article 22 of the Accounting Act.



Based on the work undertaken in the course of our audit, in our opinion:

- the information given in the General Report and Social Report, comprising Corporate Governance Statement, for the financial year for which the separate financial statements are prepared is consistent, in all material respects, with the separate financial statements;
- the General Report and Social Report have been prepared in accordance with the requirements of Article 21 and 24 of the Accounting Act; and
- the Corporate Governance Statement includes the information specified in Article 22 of the Accounting Act.

In addition, in light of the knowledge and understanding of the Company and its environment obtained in the course of the audit, we are also required to report if we have identified material misstatements in the General Report and Social Report, comprising Corporate Governance Statement. We have nothing to report in this respect.

Responsibilities of management and those charged with governance for the separate financial statements

Management is responsible for the preparation and fair presentation of the separate 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 separate financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the separate financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditor's responsibilities for the audit of the separate financial statements

Our objectives are to obtain reasonable assurance about whether the separate financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an independent auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these separate financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the separate financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.



- Obtain an understanding of internal control relevant to the audit 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 Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our independent auditor's report to the related disclosures in the separate financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our independent auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the separate financial statements, including the disclosures, and whether the separate financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the separate financial statements of the current period and are therefore the key audit matters. We describe these matters in our independent auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this independent auditor's report is Tamara Maćašović.

PricewaterhouseCoopers d.o.o.

PricewaterhouseCoopers d.o.o.
Ulica kneza Ljudevita Posavskog 31, Zagreb
21 April 2017

Statement of comprehensive income
for the year ended 31 December 2016

	<i>Notes</i>	2016	2015
		HRK '000	HRK '000
Sales revenue	3, 4	1,575,862	1,329,114
Cost of sales		(1,389,129)	(1,157,127)
Gross profit		<u>186,733</u>	<u>171,987</u>
Selling expenses		(43,420)	(48,298)
Administrative expenses		(32,525)	(32,119)
Other operating income		4,809	4,666
Other operating expenses		(3,179)	(8,168)
Operating profit		<u>112,418</u>	<u>88,068</u>
Finance income	7	5,813	1,738
Finance expense	7	(563)	(166)
Finance income – net		<u>5,250</u>	<u>1,572</u>
Profit before tax		117,668	89,640
Income tax	8	(8,101)	-
Profit for the year		<u>109,567</u>	<u>89,640</u>
Other comprehensive income		-	-
Total comprehensive income for the year		<u>109,567</u>	<u>89,640</u>
Earnings per share (HRK)	9	<u>82,45</u>	<u>67.46</u>

The notes set out on pages 16 to 61 form an integral part of these financial statements.

Ericsson Nikola Tesla d.d.

Statement of financial position
as at 31 December 2016

	<i>Notes</i>	2016 HRK '000	2015 HRK '000
ASSETS			
Non-current assets			
Property, plant and equipment	<i>10</i>	107,933	126,282
Intangible assets	<i>11</i>	1,912	814
Loans and receivables	<i>12</i>	81,160	19,235
Deferred tax assets	<i>8</i>	13,558	-
Investments in subsidiaries	<i>13</i>	73	73
Total non-current assets		<u>204,636</u>	<u>146,404</u>
Current assets			
Inventories	<i>14</i>	9,188	19,761
Trade receivables	<i>15</i>	173,363	130,219
Receivables from related parties	<i>26(c)</i>	90,141	117,472
Other receivables	<i>16</i>	14,040	3,062
Financial assets at fair value through profit or loss	<i>17</i>	62,993	53,917
Prepayments and accrued income		4,422	1,837
Cash and cash equivalents	<i>18</i>	213,375	218,499
Total current assets		<u>567,522</u>	<u>544,767</u>
TOTAL ASSETS		<u>772,158</u>	<u>691,171</u>

The notes set out on pages 16 to 61 form an integral part of these financial statements.

Statement of financial position (continued)
as at 31 December 2016

	<i>Notes</i>	2016	2015
		HRK '000	HRK '000
EQUITY AND LIABILITIES			
Equity			
Share capital	19(a)	133,165	133,165
Treasury shares		(1,630)	(3,434)
Legal reserves	19(c)	6,658	6,658
Retained earnings		140,057	164,038
Total equity		<u>278,250</u>	<u>300,427</u>
Non-current liabilities			
Interest-bearing borrowings	20	8,954	-
Other non-current liabilities	21	9,946	3,087
Employee benefits	22(a)	5,487	5,623
Total non-current liabilities		<u>24,387</u>	<u>8,710</u>
Current liabilities			
Payables to related parties	26(c)	96,211	74,544
Trade and other payables	23	130,460	130,508
Income tax payable		21,658	-
Provisions	24	15,967	9,783
Accrued charges and deferred revenue	25	205,225	167,199
Total current liabilities		<u>469,521</u>	<u>382,034</u>
Total liabilities		<u>493,908</u>	<u>390,744</u>
TOTAL EQUITY AND LIABILITIES		<u>772,158</u>	<u>691,171</u>

The notes set out on pages 16 to 61 form an integral part of these financial statements.

Statement of changes in equity
for the year ended 31 December 2016

	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 2015	133,165	(8,462)	6,658	198,296	329,657
Changes in equity for 2015					
Total comprehensive income	-	-	-	89,640	89,640
Dividend distribution for 2014, Note 19 (d)	-	-	-	(119,593)	(119,593)
Purchases of treasury shares, Note 19 (b)	-	(4,062)	-	-	(4,062)
Share-based payments, Note 22 (b)	-	6,840	-	(6,840)	-
Sale of treasury shares, Note 22 (b)	-	2,250	-	(398)	1,852
Equity-settled transactions, Note 22 (b)	-	-	-	2,933	2,933
Total contributions by and distributions to owners recognised directly in equity	-	5,028	-	(123,898)	(118,870)
As at 31 December 2015	133,165	(3,434)	6,658	164,038	300,427
As at 1 January 2016	133,165	(3,434)	6,658	164,038	300,427
Changes in equity for 2016					
Total comprehensive income	-	-	-	109,567	109,567
Dividend distribution for 2015, Note 19 (d)	-	-	-	(132,846)	(132,846)
Purchases of treasury shares, Note 19 (b)	-	(1,140)	-	-	(1,140)
Share-based payments, Note 22 (b)	-	2,087	-	(2,087)	-
Sale of treasury shares, Note 22 (b)	-	857	-	123	980
Equity-settled transactions, Note 22 (b)	-	-	-	1,262	1,262
Total contributions by and distributions to owners of the parent recognised directly in equity	-	1,804	-	(133,548)	(131,744)
As at 31 December 2016	133,165	(1,630)	6,658	140,057	278,250

The notes set out on pages 16 to 61 form an integral part of these financial statements.

Statement of cash flows
for the year ended 31 December 2016

	<i>Notes</i>	2016	2015
		HRK '000	HRK '000
Cash flows from operating activities			
<i>Profit before tax</i>		<u>117,668</u>	<u>89,640</u>
Adjustments for:			
Depreciation and amortisation	5, 10, 11	44,235	49,528
Impairment losses and reversals		16,359	2,739
Net increase in provisions	24	12,421	3,916
Gain on sale of property, plant and equipment		(65)	(231)
Net (gain)/loss on re-measurement of financial assets		(2,033)	21
Amortisation of discount		(657)	(69)
Interest income		(3,332)	(3,811)
Interest expense	7	563	166
Unrealised foreign exchange (gains)/losses, net		(5,274)	2,446
Equity-settled transactions	6	1,262	2,933
		<u>181,147</u>	<u>147,278</u>
Changes in working capital:			
In receivables		(71,803)	25,670
In inventories		10,571	1,367
In payables		61,775	45,684
<i>Cash generated from operations</i>		<u>181,690</u>	<u>219,999</u>
Interest paid		(563)	(165)
<i>Net cash from operating activities</i>		<u>181,127</u>	<u>219,834</u>
Cash flows from investing activities			
Interest received		2,745	2,936
Dividends received		212	-
Proceeds from sale of property, plant and equipment		83	355
Purchases of property, plant and equipment, and intangible assets		(28,224)	(50,729)
Deposits with financial institutions - net		(19,846)	66
Purchases of financial assets at fair value through profit and loss		(89,000)	(92,000)
Proceeds from sale of financial assets at fair value through profit and loss		81,745	82,142
<i>Net cash used in investing activities</i>		<u>(52,285)</u>	<u>(57,230)</u>

The notes set out on pages 16 to 61 form an integral part of these financial statements.

Statement of cash flows (continued)
for the year ended 31 December 2016

	<i>Notes</i>	2016	2015
		HRK '000	HRK '000
Cash flows from financing activities			
Purchase of treasury shares	<i>19(b)</i>	(1,140)	(4,062)
Dividends paid	<i>19(d)</i>	<u>(132,846)</u>	<u>(119,715)</u>
<i>Net cash used in financing activities</i>		<u>(133,986)</u>	<u>(123,777)</u>
Effects of exchange rate changes on cash and cash equivalents		<u>20</u>	<u>(2,434)</u>
Net (decrease)/increase in cash and cash equivalents		(5,124)	36,393
Cash and cash equivalents at the beginning of the year		<u>218,499</u>	<u>182,106</u>
Cash and cash equivalents at the end of the year	<i>18</i>	<u>213,375</u>	<u>218,499</u>

The notes set out on pages 16 to 61 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. 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 2016 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 21 April 2017. 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 2016 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 amended standards for their annual reporting period commencing 1 January 2016 which were endorsed by the European Union and which are relevant for the Company's financial statements:

- Clarification of Acceptable Methods of Depreciation and Amortisation – Amendments to IAS 16 and IAS 38.
- Disclosure Initiative - Amendments to IAS 1.
- Annual Improvements to IFRSs 2012-2014 Cycle comprising changes to four standards (IFRS 5, IFRS 7, IFRS 19, IAS 34).

The adoption of the improvements did not have any impact on the current period or any prior period and is not likely to affect future periods.

(b) Standards and interpretations issued but not yet effective

Certain new standards and interpretations have been published that are not mandatory for 31 December 2016 reporting periods and have not been early adopted by the Company. None of these is expected to have a significant effect on the Company's financial statements, except for the following standards:

IFRS 9 Financial instruments and associated amendments to various other standards (effective for annual periods beginning on or after 1 January 2018)

IFRS 9 addresses the classification, measurement and derecognition of financial assets and financial liabilities and introduces new rules for hedge accounting.

The Management Board of the Company assessed the impact of the new standard IFRS 9 on its financial statements as follows:

- Following the changes approved by IASB in July 2014, the Company does not expect any impact from the new classification, measurement and derecognition rules on its financial assets and financial liabilities.
- There will also be no impact on the Company's accounting for financial liabilities, as the new requirements only affect the accounting for financial liabilities that are designated at fair value through profit or loss and the Company does not have any such liabilities.
- The new impairment model is an expected credit loss (ECL) model which may result in earlier recognition of credit losses.
- The Company has not yet assessed how the new rules would affect its impairment provisions.

The Management Board plans to adopt the standard on its effective date.

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 and associated amendments to various other standards (effective for annual periods beginning on or after 1 January 2018)

The IASB has issued a new standard for the recognition of revenue. This will replace IAS 18 which covers contracts for goods and services and IAS 11 which covers construction contracts.

The new standard is based on the principle that revenue is recognised when control of a good or service transfers to a customer – so the notion of control replaces the existing notion of risks and rewards.

Key changes to current practice are:

- Any bundled goods or services that are distinct must be separately recognised, and any discounts or rebates on the contract price must generally be allocated to the separate elements.
- Revenue may be recognised earlier than under current standards if the consideration varies for any reasons (such as for incentives, rebates, performance fees, royalties, success of an outcome, etc.) – minimum amounts must be recognised if they are not at significant risk of reversal.
- The point at which revenue can be recognised may shift: some revenue which is currently recognised at a point in time at the end of a contract may have to be recognised over the contract term and vice versa.
- There are new specific rules on licenses, warranties, non-refundable upfront fees and consignment arrangements, to name a few; and
- As with any new standard, there are also increased disclosures.

Entities will have a choice of full retrospective application, or prospective application with additional disclosures.

At this stage, the Company is not able to estimate the impact of the new rules on the Company's financial statements; it will make more detailed assessments of the impact over the next twelve months. The Management Board plans to adopt the standard on its effective date.

IFRS 16 Leases (effective for annual periods beginning on or after 1 January 2019, early adoption is permitted only if IFRS 15 is adopted at the same time)

IFRS 16 will affect primarily lessee accounting and will result in the recognition of almost all leases on the balance sheet. The standard removes the current distinction between operating and financing leases and requires recognition of an asset (the right to use the leased item) and a financial liability to pay rentals for virtually all lease contracts. An optional exemption exists for short-term and low-value leases.

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)

The income statement will also be affected because the total expense is typically higher in the earlier years of a lease and lower in later years. Additionally, operating expense will be replaced with interest and depreciation, so key metrics like EBITDA will change.

Operating cash flows will be higher as cash payments for the principal portion of the lease liability are classified within financing activities. Only the part of the payments that reflects interest can continue to be presented as operating cash flows.

Lessor accounting will not change significantly. Some differences may arise as a result of the new guidance on the definition of a lease. In accordance with IFRS 16, a contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

At this stage, the Company is not able to estimate the impact of the new standard on the Company's financial statements; it will make more detailed assessments of the impact over the next twelve months. The Management Board plans to adopt the standard on its effective date and when endorsed by the European Union.

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 2016 was HRK 7.16854 per USD 1 (2015: HRK 6.99180) and HRK 7.55779 per EUR 1 (2015: HRK 7.63505).

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

a) Impairment of non-financial assets

Assets that have an indefinite useful life (such as goodwill) are not subject to amortisation and are tested annually for impairment. Assets that are subject to amortisation and depreciation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

b) Impairment of financial assets

The Company assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. A significant or prolonged decline in the fair value of the security below its cost is considered as an indicator that the securities are impaired.

A provision for impairment of receivables is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy, and default or delinquency in payments are considered indicators that the receivable is impaired. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate.

Financial instruments

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

(a) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the balance

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

Financial instruments (continued)

(a) Loans and receivables (continued)

sheet date. These are classified as non-current assets. The Company's loans and receivables comprise 'trade and other receivables', 'deposits' and 'cash and cash equivalents' in the balance sheet.

Loans and receivables are carried at amortised cost using the effective interest method.

(b) Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss are financial assets held for trading. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term. Derivatives are also categorised as held for trading unless they are categorised as hedges. Assets in this category are classified as current assets if expected to be settled within 12 months; otherwise, they are classified as non-current.

Regular way purchases and sales of financial assets are recognised on trade-date – the date on which the Company commits to purchase or sell the asset. Investments are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets carried at fair value through profit or loss are initially recognised at fair value, and transaction costs are expensed in the income statement. Financial assets are derecognised when the rights to receive cash flows from the investments have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership.

The fair values of quoted investments are based on current bid prices. If the market for a financial asset is not active, the Company establishes fair value by using valuation techniques. These include the use of recent arm's length transactions and references to other instruments that are substantially the same, discounted cash flow analysis and option pricing models, making maximum use of market inputs and relying as little as possible on entity-specific inputs.

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 does not affect either accounting or 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.

Interest 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 Company 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) Derecognition of receivables with off-balance sheet financing

In 2016, the Group entered into several new customer contracts in the foreign market. The contracts include delivery of equipment and sale of services with 15% up-front payment while remaining 85% have deferred payment terms up to 54 months.

The Group financed the sale of equipment through a Supplier credit arrangement. The arrangement includes:

i) matching cash receipts from customer with payments to the bank, ii) assignation of insurance policy to the bank, and iii) ceding future cash receipts from the customer to the bank through special purpose accounts secured by special purpose deposits (Note 12).

By transferring to the bank its contractual right to receive the cash flows, the Group transferred the financial asset to the bank. In terms of de-recognition criteria, the Group analysed transfer of risk and rewards of the receivable, specifically related to credit risk and late payment risk.

Notes to the financial statements (continued)

2 Critical accounting estimates and judgements (continued)

(b) Derecognition of receivables with off-balance sheet financing (continued)

The credit risk is shifted from international customer to the risk from domestic insurance company default which is considered as significant transfer in credit risk. The Group issued guarantees to the financing bank for risk of non-performance by the insurance company which is disclosed in Note 20. The issued guarantee for non-performance of the insurance company is recognized initially at fair value and subsequently at the higher of the unamortized balance of the initial fair value and the best estimate of expenditure required to settle the obligation under the guarantee.

Late payment risk was transferred based on the fact that the special purpose deposit covers the late payment charges and/or history of payments with the customer do not historically evidence late payment risk as substantial to the agreement.

Having transferred the right to cash flows and substantially all the risk and rewards relating to 90% of receivables, management concluded that it was appropriate to de-recognize 90% of the related receivables from the balance sheet. The remaining 10% of the receivables remain on the balance sheet as long term receivables from the customer (Note 12) and a 10% of the related financing liability to the bank is recorded as borrowings (Note 19).

Following de-recognition, the residual difference between interest receivable from the customer and interest payable to the bank represents separate liability recognized at fair value and is disclosed in Note 20.

(c) Revenue recognition

The Group recognises revenues upon delivery of goods or service which may not always align with the timing of issuing invoices to customer since their timing is set in the contract. Revenues are recognised upon approved acceptance test by the customer. Consequently, the Group recognises deferred revenue (Note 24) and unbilled revenue (Note 14).

Notes to the financial statements (continued)

3 Sales revenue

	2016	2015
	HRK '000	HRK '000
Sales revenue from products	396,059	278,901
Sales revenue from services	1,179,803	1,050,213
	<u>1,575,862</u>	<u>1,329,114</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.

The Group management does not monitor assets and liabilities by segments and therefore this information is not disclosed.

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

	2016	2015
	HRK '000	HRK '000
Sales revenue in domestic market	268,689	292,938
Sales revenue in Russia, Belarus, Kazakhstan, Georgia, Moldova and Armenia	283,801	58,173
Sales revenue to Ericsson, Note 26 (a)	873,108	821,946
Sales revenue in Bosnia and Herzegovina, Montenegro and Kosovo	133,012	141,599
Other export sales revenue	17,252	14,458
	<u>1,575,862</u>	<u>1,329,114</u>

Notes to the financial statements (continued)

4 Segment reporting (continued)

	Networks		Professional services		Support solutions		Unallocated		Total	
	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Sales revenue	762,378	590,282	777,490	695,670	35,994	43,162	-	-	1,575,862	1,329,114
Operating profit/(loss)	44,488	32,649	92,024	81,678	1,566	4,654	(25,660)	(30,913)	112,418	88,068
Finance income									5,813	1,738
Finance expense									(563)	(166)
Profit before tax									117,668	89,640
Income tax									(8,101)	-
Profit for the year									109,567	89,640

Revenues of approximately HRK 869,764 thousand (2015: HRK 821,502 thousand) are derived from one customer that individually exceed 10% of the Company's sales revenues, and they are realised in all three segments.

5 Expenses by nature

	2016	2015
	HRK '000	HRK '000
Changes in contract work in progress (Note 14)	10,542	1,379
Material and external services ⁽¹⁾	793,643	641,020
Personnel expenses (Note 6)	609,405	561,736
Depreciation and amortisation (Notes 10, 11)	44,235	49,528
Less reclassifications in material and external services: (Other income)/other operating expenses	7,249	(16,119)
	<u>1,465,074</u>	<u>1,237,544</u>

¹⁾ Including audit fee expenses of HRK 470 thousand (2015: HRK 370 thousand).

Notes to the financial statements (continued)

6 Personnel expenses

	2016	2015
	HRK '000	HRK '000
Net salaries	315,566	290,027
Taxes and contributions	264,303	241,857
Other payroll-related costs	28,274	26,919
Equity-settled transactions (Note 22 (b))	1,262	2,933
	<u>609,405</u>	<u>561,736</u>

Personnel expenses include HRK 95,049 thousand (2015: HRK 87,164 thousand) of defined pension contributions paid or payable into obligatory pension plans. Contributions are calculated as a percentage of employees' gross salaries (Gross I).

Other payroll-related costs mainly relate to termination benefits in the amount of HRK 4,091 thousand (2015: HRK 5,550 thousand), and to transportation expenses and vacation accrual cost

As at 31 December 2016, total number of employees was 2,148 (2015: 1,933).

7 Finance income and expense

Finance income

	2016	2015
	HRK '000	HRK '000
Interest income (Note 7 (a))	3,332	3,811
Net gains from re-measurement of financial assets at fair value through profit or loss (Note 7 (b))	2,283	99
Amortization of discount	-	69
Net foreign exchange gain/(loss)	198	(2,241)
	<u>5,813</u>	<u>1,738</u>

Finance expense

	2016	2015
	HRK '000	HRK '000
Interest expense	563	166
	<u>563</u>	<u>166</u>

Notes to the financial statements (continued)

7 Finance income and expense (continued)

7 (a)

	2016	2015
	HRK '000	HRK '000
Interest income		
- on loans to customers	1,320	665
- on debt securities	-	210
- on term deposits	95	734
- on other receivables	1,917	2,202
	<u>3,332</u>	<u>3,811</u>

7 (b)

	2016	2015
	HRK '000	HRK '000
Net gains from re-measurement of financial assets at fair value through profit or loss		
- Equity securities	1,908	34
- Investment in investment funds	346	201
- Debt securities	29	(136)
	<u>2,283</u>	<u>99</u>

Notes to the financial statements (continued)

8 Income tax expense

Income tax has been calculated on the taxable income at statutory tax rate of 20% (2015: 20%). Income tax expense recognised in the consolidated statement of comprehensive income comprises:

	2016	2015
	HRK '000	HRK '000
Current income tax expense	(21,659)	-
Total deferred tax expense	13,558	-
Total income tax expense	<u>(8,101)</u>	<u>-</u>

Effective tax rate reconciliation

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

	2016	2015
	HRK '000	HRK '000
Profit before tax	117,668	89,640
Income tax at 20% (2015: 20%)	23,534	17,928
Tax effects of:		
Expenses not deductible for tax purposes	7,473	915
Recognition of previously unrecognized temporary differences	(13,558)	-
Tax incentives	(829)	(750)
Utilisation of tax losses	(8,519)	(18,093)
Tax charge	<u>8,101</u>	<u>-</u>
Effective tax rate	<u>6.9%</u>	<u>0.0%</u>

Ministry of Science and Education has not accepted the requests submitted in 2015 for Research and Development Tax incentives, since the legal basis for the allocation of the previous program for Research and Development Tax incentives, expired on 31 December 2014. The new program of Tax incentives for research and development projects for the period up to the year 2020 has not yet entered into force. As soon as the program is approved, the Ministry of Science and Education plans to notify users.

Tax incentives include only part of additional tax allowances for certain expenditure totalling HRK 829 thousand (2015: HRK 750 thousand) which meets research and development incentives definitions under Croatian tax legislation. The underlying research and development expenditure is included in cost of sales.

Notes to the financial statements (continued)

8 Income tax expense (continued)

The Croatian Income Tax Act is subject to different interpretations and changes in respect of certain expenses which reduce the tax base. The Management Board's interpretation of the law relating to these transactions and activities of the Company may be disputed by the relevant authorities. The Tax Authority may take a different view in interpreting the laws and judgments, and it is possible that those transactions and activities that have not been disputed in the past may be disputed now. The Tax Authority may carry out a tax audit within three years from the year in which the income tax liability for a certain financial period was established.

Deferred tax from other temporary differences

During 2016, the Group re-evaluated the potential for utilization of certain existing temporary differences for which deferred tax assets had not been previously recognized based on the uncertainty of their utilization. In view of the changed circumstances, the Group recognized deferred tax assets in the amount of HRK 13,558 thousand relating to temporary differences arising from:

- Accrued interest expenses;
- Impairment of receivables;
- Accrued expenses from contracts;
- Warranty provisions and
- Provisions for jubilee awards and retirement.

	Impairments, provisions and accrued expenses HRK '000
As at 31 December 2015	-
Tax credited to the Income statement	13,558
Tax charged to the Income statement	-
As at 31 December 2016	<u>13,558</u>

9 Earnings per share

	2016	2015
Profit for the year (HRK '000)	109,567	89,640
Weighted Average Number of Shares Outstanding at the year-end	<u>1,328,809</u>	<u>1,328,811</u>
Earnings per share (HRK)	<u>82,45</u>	<u>67.46</u>

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

Notes to the financial statements (continued)

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 2015				
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>
Year ended 31 December 2015				
Opening net book amount	45,629	84,024	99	129,752
Additions	1,769	43,320	-	45,089
Disposals	-	(51)	-	(51)
Depreciation charge	(2,997)	(45,503)	(8)	(48,508)
Closing net book amount	<u>44,401</u>	<u>81,790</u>	<u>91</u>	<u>126,282</u>
As at 31 December 2015				
Cost or valuation	160,367	363,505	328	524,200
Accumulated depreciation	(115,966)	(281,715)	(237)	(397,918)
Net book amount	<u>44,401</u>	<u>81,790</u>	<u>91</u>	<u>126,282</u>
Year ended 31 December 2016				
Opening net book amount	44,401	81,790	91	126,282
Additions	1,797	23,644	-	25,441
Disposals	-	(2)	-	(2)
Depreciation charge	(2,955)	(40,825)	(8)	(43,788)
Closing net book amount	<u>43,243</u>	<u>64,607</u>	<u>83</u>	<u>107,933</u>
As at 31 December 2016				
Cost or valuation	162,164	366,900	328	529,392
Accumulated depreciation	(118,921)	(302,293)	(245)	(421,459)
Net book amount	<u>43,243</u>	<u>64,607</u>	<u>83</u>	<u>107,933</u>

As at 31 December 2016, the Company had contracts totalling HRK 2,567 thousand (2015: HRK 3,391 thousand) related to future equipment purchases.

Depreciation expense of HRK 41,518 thousand (2015: HRK 45,356 thousand) has been charged in cost of sales, HRK 1,298 thousand (2015: HRK 1,893 thousand) in selling expenses and HRK 972 thousand (2015: HRK 1,259 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 12,786 thousand (2015: HRK 14,548 thousand) is included within land and buildings. These assets are depreciated at the same depreciation rates as other buildings. 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:

	2016	2015
	HRK '000	HRK '000
Less than one year	3,271	3,320
Between one and five years	1,635	1,660
	<u>4,906</u>	<u>4,980</u>

Notes to the financial statements (continued)

11 Intangible assets

The movement on intangible assets in the year ended 31 December 2016 may be analysed as follows:

	Application software HRK '000
As at 1 January 2015	
Cost or valuation	7,932
Accumulated amortization	(6,636)
Net book amount	<u>1,296</u>
Year ended 31 December 2015	
Opening net book amount	1,296
Additions	538
Amortization charge	(1,020)
Closing net book amount	<u>814</u>
As at 31 December 2015	
Cost or valuation	8,470
Accumulated amortization	(7,656)
Net book amount	<u>814</u>
Year ended 31 December 2016	
Opening net book amount	814
Additions	1,545
Amortization charge	(447)
Closing net book amount	<u>1,912</u>
As at 31 December 2016	
Cost or valuation	10,014
Accumulated amortization	(8,102)
Net book amount	<u>1,912</u>

Amortisation of HRK 424 thousand (2015: HRK 953 thousand) has been charged in cost of sales, HRK 13 thousand (2015: HRK 40 thousand) in selling expenses and HRK 10 thousand (2015: HRK 26 thousand) in administrative expenses.

Notes to the financial statements (continued)

12 Loans and receivables

	2016	2015
	HRK '000	HRK '000
Deposits with financial institutions, denominated in foreign currency	28,117	7,316
Non-current receivables from foreign customers, denominated in foreign currency	42,889	4,213
Loans given, Note 2b)	10,119	-
Non-current receivables from domestic customers, denominated in HRK	2,922	4,384
Receivables for sold apartments:		
- denominated in foreign currency	-	5,178
- denominated in HRK	606	632
Total loans and receivables	84,653	21,723
Impairment allowance on loans and receivables	(3,493)	(2,488)
	<u>81,160</u>	<u>19,235</u>

Deposits with financial institutions in the amount of HRK 23,959 thousands (2015: nil) are used as a security deposit Supplier credit arrangement disclosed in note 2b), with interest rate from 0.75% to 2% and maturing in year 2022.

The remainder of the deposits with financial institutions in the amount of HRK 4,159 thousand (2015: HRK 7,316 thousand) are placed as guarantee deposits for housing loans provided to the employees, at 25% 12M EUR LIBOR rate, and with a remaining maturity of over three years.

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 from customers

Due	2016	2015
	HRK '000	HRK '000
2017	-	1,200
2018	33,661	5,003
2019	9,214	2,394
2020	8,017	-
2021	5,038	-
	<u>55,930</u>	<u>8,597</u>

Receivables for sold apartments are shown net of amounts due from Croatian state, which was collected in 2016. 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 collateral 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.

Notes to the financial statements (continued)

13 Investments in subsidiaries

	Ownership	2016	2015
		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	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>73</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

	2016	2015
	HRK '000	HRK '000
Raw materials	463	528
Contract work in progress	9,184	19,726
Total inventories	9,647	20,254
Impairment allowance	(459)	(493)
	<u>9,188</u>	<u>19,761</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

	2016	2015
	HRK '000	HRK '000
Foreign trade receivables	102,848	52,114
Current portion of non-current foreign receivables	18,452	4,750
Total current foreign receivables	<u>121,300</u>	<u>56,864</u>
Domestic trade receivables	62,498	76,015
Current portion of non-current domestic receivables	-	-
Total current domestic receivables	<u>62,498</u>	<u>76,015</u>
Impairment allowance on receivables	<u>(10,435)</u>	<u>(2,660)</u>
	<u>173,363</u>	<u>130,219</u>

Included in trade receivables is HRK 7,799 thousand (2015: HRK 9,526 thousand) of unbilled revenue.

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

	2016	2015
	HRK '000	HRK '000
As at 1 January	7,477	10,053
Provision for receivables impaired during the year	21,571	5,438
Impact of discounting non current receivables	3,135	-
Receivables written off during the year as uncollectible	(11,112)	(5,129)
Unused amounts reversed	(4,901)	(2,816)
Amortisation of discount	<u>(657)</u>	<u>(69)</u>
As at 31 December ⁽¹⁾	<u>15,513</u>	<u>7,477</u>

¹⁾ Including impairment provision for receivables from related parties of HRK 1,585 thousand (2015: HRK 2,330 thousand)

Notes to the financial statements (continued)

16 Other receivables

	2016	2015
	HRK '000	HRK '000
Receivables from employees	938	1,172
Accrued interest receivable	99	212
Advances given	11,722	-
Other receivables	1,281	1,678
	<u>14,040</u>	<u>3,062</u>

17 Financial assets at fair value through profit or loss

	2016	2015
	HRK '000	HRK '000
<i>Financial assets at fair value through profit or loss</i>		
- Equity securities	1,952	251
- Investment in open-ended investment funds	61,041	53,666
	<u>62,993</u>	<u>53,917</u>

18 Cash and cash equivalents

	2016	2015
	HRK '000	HRK '000
Cash and demand deposits	213,375	103,974
Term deposits originated by the Company, with original maturity up to 3 months	-	114,525
	<u>213,375</u>	<u>218,499</u>

Notes to the financial statements (continued)

19 Equity

(a) Share capital

As at 31 December 2016, the share capital of the Company is represented by 1,331,650 (2015: 1,331,650) of authorised, issued and fully paid ordinary shares, with a total registered value of HRK 133,165 thousand (2015: HRK 133,165 thousand). The nominal value of one share is HRK 100 (2015: 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 are:

	2016	2016	2015	2015
	Number of shares	% held	Number of shares	% held
Telefonaktiebolaget LM Ericsson	653,473	49.07	653,473	49.07
Small shareholders	676,682	50.81	674,795	50.68
Treasury shares	1,495	0.12	3,382	0.25
	<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 2016, the Company acquired 1,000 (2015: 4,022) of its own shares, for a total amount of HRK 1,140 thousand (2015: HRK 4,062 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:

	2016	2015
	Number of shares	Number of shares
As at 1 January (Note 19 (a))	3,382	3,080
Purchased during the year	1,000	4,022
Distributed during the year	(2,887)	(3,720)
As at 31 December (Note 19 (a))	<u>1,495</u>	<u>3,382</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.

Notes to the financial statements (continued)

19 Equity (continued)

(d) Proposed dividends

Dividends payable are not accounted for until they have been ratified at the General Assembly of shareholders. On 31 May 2016, the General Assembly approved a regular dividend in respect of 2015 of HRK 20.00 per share, and an additional extraordinary dividend of HRK 80.00 per share, totalling HRK 132,846 thousand.

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

	2016	2015
	HRK '000	HRK '000
HRK 100.00 per share for 2015	132,846	-
HRK 90.00 per share for 2014	-	119,593
Prior year dividend pay out	-	122
	<u>132,846</u>	<u>119,715</u>

20 Interest bearing borrowings

	2016	2015
	HRK '000	HRK '000
Borrowings, Note 2 b)	<u>8,954</u>	<u>-</u>

21 Other non-current liabilities

	2016	2015
	HRK '000	HRK '000
Accounts payable	2,400	3,600
NPV discount	(358)	(513)
Total accounts payable /i/	<u>2,042</u>	<u>3,087</u>
Liabilities for issued guarantee, Note 2b)	782	-
Other non-current liabilities, Note 2b)	<u>7,122</u>	<u>-</u>
	<u>9,946</u>	<u>3,087</u>

/i/ non-current payable of HRK 2,042 thousand (2015: HRK 3,087 thousand) to Ericsson Nikola Tesla Servisi d.o.o. (EHR) relates to the five-year managed services contract with Hrvatski Telekom.

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 2016 were a 6% discount rate (2015: 6%) and a 4.17% (2015: 3.97%) rate of average employment turnover.

Movements in long-term service benefits were as follows:

	2016	2016	2016	2015	2015	2015
	Jubilee awards	Retirement	Total	Jubilee awards	Retirement	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
As at 1 January	4,584	1,039	5,623	4,946	390	5,336
Obligation created during the year	649	324	973	944	746	1,690
Obligation fulfilled during the year	(634)	(16)	(650)	(797)	(39)	(836)
Obligation reversed during the year	(144)	(315)	(459)	(509)	(58)	(567)
As at 31 December	<u>4,455</u>	<u>1,032</u>	<u>5,487</u>	<u>4,584</u>	<u>1,039</u>	<u>5,623</u>

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

Part of share based programme from 2014 relate to the right of employee to purchase certain shares, which are settled according to fair value relevant at the date of the purchase. Based on this programme, the Company sold to its employees 841 shares (2015: 1,605 shares) and received compensation in the amount of HRK 980 thousand (2015: HRK 1,852 thousand). The difference between the purchase price of the shares and selling price received from the employee in the amount of HRK 123 thousand (2015: HRK 398 thousand) has been recognised within retained earnings.

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

	2016	2015
	Number of shares	Number of shares
As at 1 January	4,557	9,016
Granted	-	-
Exercised	(2,887)	(4,320)
Expired	(373)	(139)
As at 31 December	<u>1,297</u>	<u>4,557</u>

Vesting conditions for shares granted under Loyalty program are two to five years of service.

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 at grant date
		HRK
Reversal in 2015 of shares granted in 2011-2013	139	1,373.20
Reversal in 2016 of shares granted in 2011-2013	373	1,373.20

During 2016, the Company recognised HRK 1,262 thousand (2015: HRK 2,933 thousand) of expenses in respect of share-based payments, which are included in personnel expenses as disclosed in Note 6.

23 Trade and other payables

	2016	2015
	HRK '000	HRK '000
Trade payables	26,628	29,376
Liabilities to employees	82,422	78,543
Other current liabilities	15,350	13,466
Net liability for VAT	6,060	9,123
	<u>130,460</u>	<u>130,508</u>

Notes to the financial statements (continued)

24 Provisions

Movements in provisions were as follows:

	Warranty reserve	Penalty reserve	Termination benefits	Other provisions	Total	The
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	warr
As at 1 January 2015	4,789	4,632	580	-	10,001	anty
Additional provisions	2,005	520	4,524	-	7,049	reser
Unused provisions reversed	(230)	(2,903)	-	-	(3,133)	ve is
Provisions used during the year	(1,214)	(464)	(2,456)	-	(4,134)	esta
As at 31 December 2015	5,350	1,785	2,648	-	9,783	blish
As at 1 January 2015	5,350	1,785	2,648	-	9,783	ed to
Additional provisions	8,524	-	3,937	497	12,958	cove
Unused provisions reversed	(129)	(408)	-	-	(537)	r the
Provisions used during the year	(2,245)	(902)	(3,090)	-	(6,237)	expe
As at 31 December 2016	11,500	475	3,495	497	15,967	cted

ucts 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

	2016	2015
	HRK '000	HRK '000
Advances from domestic customers	96	3,927
Advances from foreign customers	19,755	12,808
Deferred revenue	104,905	87,928
Accrued charges for unused holidays	17,978	19,026
Accrued charges in respect of service contracts	34,109	21,315
Other accrued charges	28,382	22,195
	<u>205,225</u>	<u>167,199</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.

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.

Notes to the financial statements (continued)

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% (2015: 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.

(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	
	2016 HRK '000	2015 HRK '000	2016 HRK '000	2015 HRK '000	2016 HRK '000	2015 HRK '000	2016 HRK '000	2015 HRK '000
Sales of goods and services								
Sales revenue	-	-	873,108	821,946	2,077	6,092	875,185	828,038
Other income	-	-	38,406	62,544	215	200	38,621	62,744
	-	-	<u>911,514</u>	<u>884,490</u>	<u>2,292</u>	<u>6,292</u>	<u>913,806</u>	<u>890,782</u>
Purchases of goods and services								
Licences	3,448	2,489	20,890	15,687	-	-	24,338	18,176
Technical cooperation fee	-	-	-	-	-	-	-	-
Cost of sales	-	-	369,671	251,007	190,520	196,437	560,191	447,444
Other expenses	-	-	-	-	-	25	-	25
	<u>3,448</u>	<u>2,489</u>	<u>390,561</u>	<u>266,694</u>	<u>190,520</u>	<u>196,462</u>	<u>584,529</u>	<u>465,645</u>

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

Notes to the financial statements (continued)

26 Balances and transactions with related parties (continued)

(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.

	2016	2015
	HRK '000	HRK '000
Salaries and other short-term employee benefits	22,619	22,222
Other long-term benefits	17	4
	<u>22,636</u>	<u>22,226</u>

The members of the executive management and the Supervisory Board held 4,627 ordinary shares at the year-end (2015: 4,540 shares).

In addition, the Company paid remuneration totalling HRK 357 thousand (2015: HRK 337 thousand) to the Supervisory Board during 2016.

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	
	2016	2015	2016	2015
	HRK '000	HRK '000	HRK '000	HRK '000
Main shareholder:				
Telefonaktiebolaget LM Ericsson (LME)	-	-	1,650	-
Ericsson Group consolidated companies:				
Ericsson AB (EAB)	35,648	54,430	62,312	33,132
Ericsson Services d.o.o. (ESK)	23,934	34,130	10	-
Ericsson GMBH Group (EDD)	7,648	2,439	990	1,302
Ericsson Ltd. Madrid, Spain (ETL)	2,805	4,429	-	-
Ericsson AG, Switzerland (EAS)	2,123	394	-	-
Ericsson Communications Co. Ltd., China (CBC)	2,015	173	182	165
Ericsson Inc, USA (EUS)	1,869	834	154	-
Ericsson Telecom S.S.De C.V.(TEM)	1,433	997	-	-
Ericsson AB (ESE)	1,225	1,362	-	-
Ericsson Telecomunicazioni SPA, Italy (TEI)	1,175	474	52	-
Other Ericsson Group companies	8,982	14,286	3,016	3,946
Subsidiaries:				
Ericsson Nikola Tesla BH d.o.o.	64	2,670	353	472
Ericsson Nikola Tesla Servisi d.o.o.	920	760	27,357	35,527
Ericsson Nikola Tesla d.d. – Branch office of Kosovo	293	89	-	-
Libratel d.o.o.	7	5	135	-
	<u>90,141</u>	<u>117,472</u>	<u>96,211</u>	<u>74,544</u>

The Company recorded a non-current receivable (Note 12) and deferred revenue (within other non-current liabilities) of HRK 2,042 thousand (2015: HRK 3,087 thousand) 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 2016, if the euro and US dollar had weakened/strengthened by 1% (2015: +/-1%) against the Croatian kuna, with all other variables held constant, the net result after tax for the reporting period would have been HRK 2,913 thousand higher/lower for the Company (2015: HRK 1,437 thousand), mainly as a result of foreign exchange losses/gains on translation of 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 Company's exposure to foreign currencies is 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.

2016

	EUR	USD	Other currency	Total foreign currencies	HRK	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Loans and receivables	4,159	73,831	-	77,990	3,170	81,160
Trade and other receivables	117,436	72,936	1,876	192,248	85,296	277,544
Financial assets at fair value through profit or loss	-	-	-	-	62,993	62,993
Cash and cash equivalents	115,175	37,844	166	153,185	60,190	213,375
	236,770	184,611	2,042	423,423	211,649	635,072
Interest-bearing borrowings	-	8,954	-	8,954	-	8,954
Trade and other payables	56,666	18,700	284	75,650	182,625	258,275
	56,666	27,654	284	84,604	182,625	267,229
Currency gap	180,104	156,957	1,758	338,819	29,024	367,843

2015

	EUR	USD	Other currency	Total foreign currencies	HRK	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Loans and receivables	11,151	4,213	-	15,364	3,871	19,235
Trade and other receivables	131,723	8,914	62	140,699	110,054	250,753
Financial assets at fair value through profit or loss	-	-	-	-	53,917	53,917
Cash and cash equivalents	155,757	28,116	872	184,745	33,754	218,499
	298,631	41,243	934	340,808	201,596	542,404
Trade and other payables	38,104	7,266	35	45,405	162,734	208,139
	38,104	7,266	35	45,405	162,734	208,139
Currency gap	260,527	33,977	899	295,403	38,862	334,265

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 deposits in financial institutions at a variable interest rate.

As at 31 December 2016:

- if the effective EUR interest rate on EUR deposits had increased/decreased by 1% (2015: 1%) on an annual level, the net result due to changes in EUR deposits after tax for the reporting period would have been HRK 33 thousand higher/lower (2015: HRK 59 thousand);
- if the effective HRK interest rate on HRK deposits had increased/decreased by 1% (2015: 1%) on an annual level, the net result due to changes in investment funds after tax for the reporting period would have been HRK 488 thousand higher/lower (2015: HRK 429 thousand).

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

	2016	2015
	Average	Average
	interest rates	interest rates
	%	%
Loans and receivables	2.59	2.78
Trade and other receivables	-	0.19
Financial assets at fair value through profit or loss	-	-
Cash and cash equivalents	0.21	0.64

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:

2016

	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	48,447	-	1,023	1,812	1,155	4,765	57,202	23,958
Trade and other receivables	277,565	(21)	-	-	-	-	277,544	-
Financial assets at fair value through profit or loss	62,993	-	-	-	-	-	62,993	-
Cash and cash equivalents	-	213,375	-	-	-	-	213,375	-
	389,005	213,354	1,023	1,812	1,155	4,765	611,114	23,958
Interest-bearing borrowings	8,954	-	-	-	-	-	8,954	-
Trade and other payables	258,275	-	-	-	-	-	258,275	-
	267,229	-	-	-	-	-	267,229	-
Interest rate gap	121,776	213,354	1,023	1,812	1,155	4,765	343,885	23,958

2015

	Non-interest-bearing	Up to 1 month	1 - 3 months	3 - 12 months	1 - 5 years	Over 5 years	Total	Fixed interest
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Loans and receivables	3,087	-	-	-	8,832	7,316	19,235	-
Trade and other receivables	245,521	-	1,285	2,828	1,119	-	250,753	3,463
Financial assets at fair value through profit or loss	53,917	-	-	-	-	-	53,917	-
Cash and cash equivalents	-	103,973	114,526	-	-	-	218,499	-
	302,525	103,973	115,811	2,828	9,951	7,316	542,404	3,463
Trade and other payables	208,139	-	-	-	-	-	208,139	-
	208,139	-	-	-	-	-	208,139	-
Interest rate gap	94,386	103,973	115,811	2,828	9,951	7,316	334,265	3,463

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 investments funds.

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 internal directives to manage the credit risks have been tightened during 2015 with the implementation of updated credit management framework and implementation of credit evaluation tools to manage credit risks.

A new Credit Management function within the Treasury has been established to further assist the Company in managing its 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 on a quarterly or annual basis depending on risk category, 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 2016, the five largest customers represent 48% of total net trade receivables (2015: 65%). 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.

The Company defines customer financing as any credit period longer than 179 days. According to Company's policies and directives, the customer financing needs to be approved by the Supervisory Board. The Company is working closely with Croatian Bank for Reconstruction and Development (HBOR) and partnership banks to secure risk mitigation.

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 the 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.

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 2016.

	Due balance	Up to 3 months	3 months to 1 year	1 to 3 years	Over 3 years	Total
2016	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Foreign receivables	2,848	62,407	56,044	43,065	9,943	174,307
Domestic receivables	1,761	57,860	2,877	523	-	63,021
Receivables from related parties*	8,027	78,870	4,827	2,400	-	94,124
	<u>12,636</u>	<u>199,137</u>	<u>63,748</u>	<u>45,988</u>	<u>9,943</u>	<u>331,452</u>

*include non-current portion of domestic receivables in the amount of HRK 2,400 thousand

2015						
Foreign receivables	1,056	49,625	6,182	-	4,213	61,076
Domestic receivables	1,383	64,568	10,064	783	-	76,798
Receivables from related parties	10,324	101,448	8,030	3,600	-	123,402
	<u>12,763</u>	<u>215,641</u>	<u>24,276</u>	<u>4,383</u>	<u>4,213</u>	<u>261,276</u>

*include non-current portion of domestic receivables in the amount of HRK 3,600 thousand

	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
2016					
Foreign receivables	2,656	192	-	-	2,848
Domestic receivables	1,677	84	-	-	1,761
Receivables from related parties	6,750	1,040	120	117	8,027
	<u>11,083</u>	<u>1,316</u>	<u>120</u>	<u>117</u>	<u>12,636</u>
2015					
Foreign receivables	881	164	11	-	1,056
Domestic receivables	384	115	-	884	1,383
Receivables from related parties	7,567	1,838	252	667	10,325
	<u>8,832</u>	<u>2,117</u>	<u>263</u>	<u>1,552</u>	<u>12,764</u>

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
2016					
Foreign receivables	2,848	19,357	624	-	22,829
Domestic receivables	1,761	13,145	2,007	-	16,913
Receivables from related parties	8,027	68,745	4,827	-	81,599
	<u>12,636</u>	<u>101,247</u>	<u>7,458</u>	<u>-</u>	<u>121,341</u>
2015					
Foreign receivables	1,056	28,475	5,875	-	35,406
Domestic receivables	1,383	6,586	-	-	7,969
Receivables from related parties	10,324	92,360	1,200	6,830	110,714
	<u>12,764</u>	<u>127,421</u>	<u>7,075</u>	<u>6,830</u>	<u>154,090</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
2016					
Foreign receivables	2,656	192	-	-	2,848
Domestic receivables	1,677	84	-	-	1,761
Receivables from related parties	3,635	294	84	-	4,013
	<u>7,968</u>	<u>570</u>	<u>84</u>	<u>-</u>	<u>8,622</u>
2015					
Foreign receivables	870	174	-	-	1,044
Domestic receivables	384	115	-	-	499
Receivables from related parties	4,175	924	-	87	5,186
	<u>5,429</u>	<u>1,213</u>	<u>-</u>	<u>87</u>	<u>6,729</u>

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 2016, the facility remained untapped.

2016	Up to 1 month	1 - 3 months	3 - 12 months	1 - 5 years	Over 5 years	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Loans and receivables	10	5,071	13,853	57,946	4,280	81,160
Trade and other receivables	158,995	43,459	74,306	784	-	277,544
Current financial assets	62,993	-	-	-	-	62,993
Cash and cash equivalents	213,375	-	-	-	-	213,375
	435,373	48,530	88,159	58,730	4,280	635,072
Interest bearing borrowings	-	-	-	8,954	-	8,954
Trade and other payables	164,208	79,605	5,719	8,743	-	258,275
	164,208	79,605	5,719	17,697	-	267,229
Maturity gap	271,165	(31,075)	82,440	41,033	4,280	367,843
2015	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	-	-	-	11,919	7,316	19,235
Trade and other receivables	126,754	96,151	25,940	1,908	-	250,753
Current financial assets	53,917	-	-	-	-	53,917
Cash and cash equivalents	218,499	-	-	-	-	218,499
	399,170	96,151	25,940	13,827	7,316	542,404
Trade and other payables	174,793	21,963	9,496	1,887	-	208,139
	174,793	21,963	9,496	1,887	-	208,139
Maturity gap	224,377	74,188	16,444	11,940	7,316	334,265

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)
	2016	2016	2016	2015	2015	2015
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Loans and receivables	81,160	82,617	1,457	19,235	18,290	(945)
Trade and other receivables	277,544	277,472	(32)	250,754	250,663	(91)
Financial assets at fair value through profit or loss	62,993	62,993	-	53,917	53,917	-
Cash and cash equivalents	213,375	213,375	-	218,500	218,500	-
Interest bearing borrowings	(8,954)	(8,954)	-			
Trade and other payables	(258,275)	(258,275)	-	217,922	217,922	-
	<u>367,843</u>	<u>369,228</u>	<u>1,425</u>	<u>324,484</u>	<u>323,448</u>	<u>(1,036)</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:

	2016	2015
Loans and receivables	1,40%	1,50%

Notes to the financial statements (continued)

27 Financial risk management (continued)

g) 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 adequate component of cash and short-term assets, as well as equity and other investments; and
- To secure adequate back-up funding facilities should a need arise,

The Company is generating sufficient cash from operations to fund liabilities as they become due, finance customers when required 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,

ANNUAL REPORT ON GROUP PERFORMANCE Gordana Kovačević,
President of Ericsson Nikola Tesla d.d.

Dear readers,

Information Communication Technology (ICT) continues to contribute to transformation processes in our society more strongly and rapidly than ever. The digital economy, digital society and digital transformation have become common topics for discussion. Digitalization has become the synonym for development, and the Networked Society's potential lies in transformation, primarily through mobility. In its business strategy, Ericsson recognized not only the importance of technological development, but also the need to use it to benefit society at large.

DIGITAL TRANSFORMATION IS GAINING SPEED

The digital infrastructure of modern society implies constant investment in research and development, fast implementation of the fifth generation of mobile networks (5G), connecting everything that benefits from being connected (Internet of things - IoT), and using a large number of data present in digital space (Big Data). The above mentioned infrastructure is the technological foundation required, but it is not the only prerequisite for the Networked Society we are building. More precisely, it is important to combine technology leadership with motivated and creative experts who responsibly contribute to mutual goals.

Ericsson Nikola Tesla Group takes an active part in the technological development and is a relevant partner in the digital transformation of society through innovative ICT products, solutions and services. We apply the highest global standards in our day to day operations, as well as the principles of corporate governance and responsibility. Our sustainable development is based on sound relations, trust and collaboration among all our stakeholders (customers/partners, employees, society and shareholders).

BUSINESS SITUATION IN MAJOR MARKETS

In 2016 Ericsson Nikola Tesla Group continued its series of successful business years. Sales revenue increased by 16.7% year-on-year, due to strong revenue growth in CIS market and continued revenue growth in Ericsson market.

2016 will be particularly remembered by our signing of important contracts in export markets with three new customers: beCloud in Belarus, Ucom in Armenia, and the Ministry of Healthcare in Kazakhstan. All three are demanding projects in the areas of LTE technology and healthcare digitalization. We also continued our collaboration with the operator IDC (Moldova) by signing a contract for LTE network build.

The quality and added value that we deliver have been recognized by the Ericsson Corporation and customers worldwide as demonstrated by newly gained responsibilities in the global organization for our Research and Development Center and the Global and Regional Expert Centers for solutions and services. In line with that, we added 318 experts during 2016. We remain the largest R&D center in Croatia, currently employing over 1200 employees, while Ericsson Nikola Tesla Group has almost 3000 employees. We retained the position as the largest ICT exporter and are surely the largest exporter of knowledge in Croatia.

In the markets of Southeastern Europe, we recorded a decrease in sales revenue, due to negative economic trends and political turmoil slowing down operators' investment dynamics. The main challenges we face in the domestic market are consolidation and centralization of procurement by global customers/operators, postponed strategic investments and growing competition.

I am pleased that we have kept our strong position and our customers' trust in Croatia and the region during 2016, primarily by continuing quality collaboration with our traditional partners, such as Vipnet, Hrvatski Telekom (HT), HT Mostar, BH Telecom, Crnogorski Telekom and Ipko.

Furthermore, I would like to highlight the growth in the business segment ICT Solutions for Industry & Society in the domestic market. Among key projects in this area, we should mention the continuing activities with the Ministry of Healthcare of the Republic of Croatia on implementing new functionalities, such as eHealth Record and the Portal for Patients. We are proud of the Joint Information System of Land Registry and Cadaster project, which was fully



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implemented at the end of 2016, connecting all land-registry and cadaster offices in Croatia into a single information system. A strategically important project in the public safety area was among the last projects that we signed for at the close of 2016. The project concerned the building of the state border control system of the Republic of Croatia and was completed in record time in mid-January 2017.

Our subsidiary, Ericsson Nikola Tesla Servisi d.o.o., records solid business results. In the past two years, the company went through demanding transformation processes, whilst implementing complex projects in network build and maintenance for Hrvatski Telekom.

Risk Management is one of our key priorities, and we consider it an important element of stability of our operations. In order to mitigate business, market and financial risks in the export business, we have successfully expanded cooperation with the Croatian Bank for Reconstruction and Development (HBOR) and commercial banks. In this way, we meet our customers' needs for financing and, at the same time, significantly reduce long-term receivables.

Taking into consideration the above mentioned, we estimate that the Group's main business risks are:

- Impacts of the challenging economic environment and political uncertainty on demand and prices of our products and services
- Reduction and slowdown in operators' capital investments, as well as postponing of strategic investments in the public and private sectors
- Industry convergence and consolidation among suppliers of equipment and services
- Increased competition and new IT companies entering telecommunication market
- Business mix impact on gross margin
- Increased credit and commercial risk exposure in case of deterioration of our customers' financial conditions
- Increased demand for customer financing
- Negative foreign exchange impact on business results given the greater part of our revenue is generated in EUR and USD

- Retaining of highly qualified/top performing employees in order to stay competitive.

KEY PERFORMANCE INDICATORS

Ericsson Nikola Tesla Group business results are as follows (the information in brackets refers to 2015):

- Sales revenue is MHRK 1,591.6 (MHRK 1,364.3), an increase by 16.7% YoY
- Gross profit amounts to MHRK 189.8 (MHRK 177.2), an increase by 7.1% YoY. Gross margin records a slight decrease to 11.9% (13%).
- Sales and administrative costs decreased by 5.5% to MHRK 77.7 (MHRK 82.2).
- Operating profit increased by 24.3% to MHRK 113.6 (MHRK 91.4).
- Net profit increased by 21.2% YoY to MHRK 110.7 (MHRK 91.3).
- Return on Sales (ROS) is 7% (6.7%).
- Cash flow from operating activities is MHRK 187 (MHRK 243.1).

Strong business results were achieved in 2016 primarily due to professionalism and knowledge of our leaders and experts, which is increasingly being recognized as our competitive advantage. A high level of satisfaction among our largest customers/partners was confirmed yet again by our annual survey.

All other key performance indicators grouped in four Scorecard perspectives (Customer, Employee, Society and Shareholder) were excellent.

By opening of the innovation incubator “Ericsson Garage Croatia”, we became one of several global sites for agile and fast innovations oriented towards the needs of both existing and new customers.

STRATEGIC DIRECTION

All business entities, irrespective of industry they belong to, use ICT as their basic infrastructure. Our customers in Croatia, the region, as well as globally, are embarking on digital transformation projects. In the operator segment, these are primarily telecom network virtualization projects and implementation of Cloud solutions. In these projects a special focus is placed on Operations Support Systems (OSS) and Business Support Systems (BSS) transformation, which results in organizational efficiency, as well as in new market and end user approaches.

In the course of 2016, we have started a new strategic planning cycle for the period up to 2019, based on facts that describe the current status in all business and technology segments and on analysis of future trends in the ICT market. Our aim is to strengthen business performance in strategic segments through transformation programs (4G/5G, Managed Services, OSS and BSS, Cloud solutions, Industry & Society) and the Ericsson's internal market. Risk management, effective cost management and efficiency have important roles in our strategy.

Significant transformation is taking place throughout the Ericsson Corporation, our company included. I believe that the results we achieved in 2016, as well as our ongoing strategic transformation initiatives, represent a strong and vital foundation for the Company's future development.

All other data comprising the annual company report pursuant to Article 250a of the Companies Act can be found in the enclosed 2016 Annual Report, consisting of the General Report, the Social Report and Consolidated Financial Statements as at December 31, 2016.

Gordana Kovačević



President

Ericsson Nikola Tesla d.d.

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Ericsson Nikola Tesla d.d.

Krapinska 45

HR-10 000 Zagreb

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April 18, 2017



THE REPORT OF ERICSSON NIKOLA TESLA D.D. SUPERVISORY BOARD ON THE SUPERVISION PERFORMED ON THE COMPANY'S OPERATIONS IN 2016

Pursuant to provisions of the Croatian Companies Act and Ericsson Nikola Tesla d.d. Statute, the Supervisory Board of Ericsson Nikola Tesla d.d. has reviewed the Company's business, taking respective decisions and conclusions in four regular and four extraordinary Board meetings held during 2016.

In 2016, the members of the Supervisory Board were as follows:

Klas Roland Nordgren (Chairman)

Ignac Lovrek (Deputy Chairman)

Vidar Mohammar (Member)

Dubravko Radošević (Member)

Zvonimir Jelić (Member and Employee representative).

The Company Management regularly informed the Supervisory Board on all important business activities and the course of the Company business performance.

At the meetings, the Supervisory Board discussed in detail the financial results, situation in the domestic and export markets and ICT industry trends. Further topics of discussions were as follows: business plans and strategic projects, business risks, investments, and issues regarding human resources and shareholders. Moreover, the Supervisory Board continuously monitored business development and responsibilities of the Research & Development Centre, Solutions& Services Centre and IT & Test Environment Unit (ITTE). The Supervisory Board analyzed and approved the Ericsson Nikola Tesla Group's Business Strategy 2016 – 2019, as well as transformation programs focused on business development.

At extraordinary Board meetings, the members discussed dividend payment, 2015 annual financial reports, 2016 targets and establishment of local company in Belarus.

Analyzing the Managing Director's reports and the key financial indicators, the Supervisory Board evaluated that Ericsson Nikola Tesla Group had a successful business performance in 2016, and achieved excellent financial result, along with a healthy balance sheet and a solid cash position. Ericsson Nikola Tesla Group gained new responsibilities in global corporation, primarily in research and development, and strengthen business in CIS markets. Due to the challenging market environment, the Group continues to be focused on cost and operational effectiveness to enhance profitability, and on addressing customers' needs.

In 2016 there were no changes in the composition of the Supervisory Board. As his mandate expired, Klas Roland Nordgren, the chairman of the Supervisory Board, was re-elected for another term in office, at the Ericsson Nikola Tesla Annual General Meeting held on 31 May 2016.

The Audit Committee held four meetings in 2016. During these meetings, the Audit Committee discussed financial performance during the year, annual financial statements, 2016 audit plan, audit findings, internal control and risk management system, and performed other tasks pursuant to new EU audit regulations. The Audit Committee

April 18, 2017



regularly informed other Supervisory Board members of its findings and recommendations. In 2016, member of the Audit committee where: Ignac Lovrek, Chairman and Vidar Mohammar, 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 d.d. in all material aspects operates in compliance with the laws and Company's enactments and in accordance with the decisions made by the Annual General Meeting;
- The annual financial reports have been prepared in accordance with the business records of Ericsson Nikola Tesla d.d. and its subsidiaries, and in all material respects reflect the correct financial and business situation of Ericsson Nikola Tesla d.d. and its subsidiaries;
- 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 Companies 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

Zagreb, 21. travnja 2017.

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 2016.g.
- Utvrđuju se godišnja konsolidirana financijska izvješća Društva i njegovih podružnica („Grupa“) za 2016.g.

- The Annual Financial Reports of the Company for 2016 have been submitted and approved.
- The Annual Consolidated Financial Statements of the Company and its subsidiaries (the “Group“) for 2016 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

Zagreb, 21. travnja 2017.

Predmet: **Odluka Nadzornog odbora Društva**

Subject: **Supervisory Board Decision**

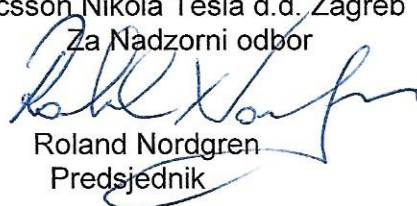
Temeljem članka 300.d Zakona o trgovačkim društvima, Nadzorni odbor dioničkog društva Ericsson Nikola Tesla d.d. Zagreb donosi slijedeće:

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 2016.g.
- Utvrđuju se godišnja konsolidirana financijska izvješća Društva i njegovih podružnica („Grupa“) za 2016. godinu.


- The Annual Financial Reports of the Company for 2016 have been submitted and approved.
- The Annual Consolidated Financial Statements of the Company and its subsidiaries (the “Group“) for 2016 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