

Notes
to the financial statements
as at **31 December 2000**

Notes to the financial statements

1 Sales income

	2000	1999
	HRK '000	HRK '000
Sales in Croatia	339,114	509,455
Sales in CIS and neighbouring countries	250,970	224,298
Sales to the European Union	186,818	160,167
Sales in former Yugoslavia, other than Croatia	143,251	31,920
Other export sales	118,436	18,696
	<u>1,038,589</u>	<u>944,536</u>

Out of total sales of HRK 1,039 million, sale of products amounted to HRK 663 million (1999, HRK 777 million) and services amounted to HRK 376 million (1999, HRK 168 million).

Notes to the financial statements (continued)

2 Segment information

	Mobile systems		Multi service networks		Consumer Products		Other		Total	
	2000 HRK '000	1999 HRK '000	2000 HRK '000	1999 HRK '000	2000 HRK '000	1999 HRK '000	2000 HRK '000	1999 HRK '000	2000 HRK 000	1999 HRK '000
External sales	303,856	98,028	595,347	742,875	582	74	196,108	131,792	1,097,893	972,769
Segment results	41,431	24,562	(20,455)	96,104	311	(4)	26,976	12,195	48,263	132,857
Unallocated Company's expenses									(50,512)	(99,827)
Operating (loss) / profit									<u>(2,249)</u>	<u>33,030</u>

The Company has changed the definition of business segments during the year 2000. As regards new segments, comparative information for the year 1999 is presented.

Mobile systems

This segment provides system solutions/networks mainly for mobile operators.

Multi-Service network

This segment provides products and solutions for fixed networks, such as narrow-band and broadband access networks.

Consumer products

This segment is focused on consumer needs and products. Main products are mobile phones and accessories.

Other business operations

This segment includes enterprise systems, dedicated network, cable and components, defence communications and support unit shared services.

Notes to the financial statements (continued)

2 Segment information (continued)

	Mobile Systems		Multi-Service Networks		Consumer Products		Other		Total company	
	2000	1999	2000	1999	2000	1999	2000	1999	2000	1999
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Segment assets	109,684	60,493	214,904	458,430	210	45	71,511	81,329	396,309	600,297
Unallocated Company's assets									639,101	352,420
Total Company's assets									<u>1,035,410</u>	<u>952,717</u>
Segment liabilities	28,285	8,771	55,418	66,465	54	7	18,441	11,791	102,198	87,034
Unallocated Company's liabilities									933,212	865,683
Total Company's liabilities									<u>1,035,410</u>	<u>952,717</u>
Depreciation and amortisation	8,846	3,699	17,333	28,033	17	3	5,768	4,973	48,951	47,979
Other non cash expenses	8,530	3,631	16,712	27,514	16	3	5,561	4,880	42,885	69,712

All the Company's assets are located in Croatia.

Notes to the financial statements (continued)

3 Other material costs (services)

	2000	1999
	HRK '000	HRK '000
Maintenance services	26,046	9,157
IS/IT services and support	5,687	10,736
Consulting fees	34,283	20,515
Licence fees	105,018	50,767
Telecommunication and transportation costs	26,971	23,367
Other external services	95,370	46,972
	<u>293,375</u>	<u>161,514</u>

4 Staff costs

	2000	1999
	HRK '000	HRK '000
Gross payroll	171,512	187,687
Health and pension contributions	29,248	30,565
	<u>200,760</u>	<u>218,252</u>
<i>Of that</i>		
Net payroll	103,452	116,599
Taxes and contributions	97,308	101,653
	<u>200,760</u>	<u>218,252</u>

Notes to the financial statements (continued)

At the year end the Company employed the following personnel:

	2000	1999
Customer Solutions and Marketing Support	175	169
Customer Services	272	260
Research and Development Centre	361	240
Sales	80	84
Units reorganized in 2000	396	765
Other	33	23
	<u>1,317</u>	<u>1,541</u>

5 Depreciation and amortisation

	2000	1999
	HRK '000	HRK '000
Depreciation of operating fixed assets	47,363	46,536
Amortisation of intangible fixed assets	1,588	1,065
Write off of fixed assets	-	378
	<u>48,951</u>	<u>47,979</u>

6 Provisions against doubtful assets

	2000	1999
	HRK '000	HRK '000
Provision against doubtful receivables	15,810	42,813
Provision against inventories	5,674	13,306
	<u>21,484</u>	<u>56,119</u>

7 Provision against risks and charges

	2000	1999
	HRK '000	HRK '000
Warranty reserve	7,746	7,950
Penalty reserve	13,655	5,643
	<u>21,401</u>	<u>13,593</u>

Notes to the financial statements (continued)

8 Other operating charges

	2000	1999
	HRK '000	HRK '000
Travel allowances	40,690	39,431
Compensation to employees	24,198	30,184
Educational costs	11,220	9,812
Other operating charges	22,713	11,675
	<u>98,821</u>	<u>91,102</u>

9 Financial income

	2000	1999
	HRK '000	HRK '000
Interest income	16,139	8,804
Profit from sale of investments	46,241	-
Dividends received	939	933
Gains on exchange	66,892	105,520
Other	501	953
	<u>130,712</u>	<u>116,210</u>

Profit from sale of investments relates to the gain on sale of shares of Zagrebačka banka.

10 Financial expense

	2000	1999
	HRK '000	HRK '000
Losses on exchange	(65,053)	(41,400)
Interest expense	(1,034)	(323)
	<u>(66,087)</u>	<u>(41,723)</u>

Notes to the financial statements (continued)

11 Taxation

Income tax has been calculated at 35% of the taxable income of the Company.

Taxation expense comprises:

	2000 HRK '000	1999 HRK '000
Current income tax expense	-	(17,956)
Deferred tax benefit relating to the origination and reversal of temporary differences	4,388	4,612
Deferred tax benefit relating to the losses carried forward	9,846	-
Deferred tax expense relating to change in tax rate	(15,540)	-
Taxation	<u>(1,306)</u>	<u>(13,344)</u>

Changes in the deferred taxation consist of the following:

	2000 HRK '000	1999 HRK '000
As of 1 January (at 35%)	22,026	17,414
Deferred tax benefit relating to the origination and reversal of temporary difference	4,388	4,612
Effect of tax loss carried forward	9,846	-
Effect of change in rates	(15,540)	-
As of 31 December (at 20%)	<u>20,720</u>	<u>22,026</u>

The balance at 31 December 2000 is calculated at 20%, the profits tax rate applicable for 2001 and is in respect of

	2000 HRK '000	1999 HRK '000
Provision for bad debts not yet tax deductible	15,094	22,026
Taxes losses carried forward	5,626	-
	<u>20,720</u>	<u>22,026</u>

Utilisation of the deferred tax asset is dependent on the collection of these receivables, possible suing of customers and the existence of taxable profits in the future.

Notes to the financial statements (continued)

The relationship between tax expense and accounting profit can be shown as follows:

	2000 HRK '000	1999 HRK '000
Income before tax	62,376	107,517
Income tax at 35%	21,832	37,631
Tax effects of income not taxable in determining taxable profit:		
Profit on sale of shares	(16,667)	-
Dividends received	(352)	(496)
Tax effects of expenses not deductible in determining taxable profit:		
Provision for bad debts	4,388	4,612
Entertainment expenses	3,036	3,320
Other non deductible expenses	5,681	862
Other		
Protective interest	(27,764)	(26,344)
Protective interest on tax prepayments	-	(1,629)
Current income tax expense	-	17,956
Tax effect of tax loss carried forward (at 35%)	(9,846)	-

12 Earnings per share

	2000	1999
Net profit for the period (HRK '000)	61,07	94,17
Weighted Average Number of Shares Outstanding	1,31	1,31
Earnings per share (HRK)	46.48	71.67

Notes to the financial statements (continued)

12 Earnings per share (continued)

Basic and fully diluted earnings per share are the same, as there are no potentially issued ordinary shares.

13 Intangible fixed assets

Intangible fixed assets represent purchased software (SAP, SOFTPRO). The movement on intangible fixed assets in the year ended 31 December 2000, may be analysed as follows:

	At 1 January 2000	Additions	Disposals	At 31 December 2000
	HRK '000	HRK '000	HRK '000	HRK '000
At cost	13,574	3,562	(6)	17,130
Accumulated amortisation	<u>(9,538)</u>	<u>(1,588)</u>	<u>1</u>	<u>(11,125)</u>
Net book value	<u>4,036</u>	<u>1,974</u>	<u>(5)</u>	<u>6,005</u>

Intangible assets are amortised over 4 years, on average.

Notes to the financial statements (continued)

14 Tangible fixed assets

The movement on tangible fixed assets in the year ended 31 December 2000, may be analysed as follows:

	At 1 January 2000	Additions	Disposals	Transfers	At 31 December 2000
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
COST					
Land	18,163	-	-	-	18,163
Buildings	156,052	-	(72)	947	156,927
Production equipment	271,748		(114,135)	43,850	201,463
Other (vehicles, tools, furniture and fixtures)	68,357		(22,213)	7,482	53,626
Construction in progress	17	52,277		(52,279)	15
Advances to suppliers	8	-	-	-	8
Total	<u>514,345</u>	<u>52,277</u>	<u>(136,420)</u>	<u>-</u>	<u>430,202</u>
ACCUMULATED DEPRECIATION					
Buildings	84,400	7,581	(72)	-	91,909
Production equipment	201,487	35,840	(109,399)	-	127,928
Other (vehicles, tools, Furniture and fixtures)	53,958	3,942	(20,871)	-	37,029
Total	<u>339,845</u>	<u>47,363</u>	<u>(130,342)</u>	<u>-</u>	<u>256,866</u>
Net book value	174,500				173,336
Net book value of workers' apartments	15,851				15,121
	<u>190,351</u>				<u>188,457</u>

Additions to fixed assets mainly relate to acquisition of hardware and telecommunication equipment. Due to refurbishing of the offices in the year 2000, there were also significant additions of furniture.

The Company has outsourced the power supply department. The total net carrying amount of the assets and liabilities sold included fixed assets with a net book value of HRK 1.6 million. Additionally, the Company has sold a production line with a net book value of HRK 1.6 million. The proceeds relating to these transactions amounted to HRK 43 million, and the related gain of HRK 22.4 million is included in other income.

Net book value of apartments includes HRK 13,083 thousands (1999 HRK 13,461 thousands) in respect of long-term receivables for apartments net of amounts due to the Croatian State.

Notes to the financial statements (continued)

Fully depreciated property, plant and equipment

The gross carrying amounts of HRK 98,816 thousands and of HRK 165,432 thousands are fully depreciated as at 31 December 2000 and 1999 respectively, but these items are still in active use.

15 Investments

Investments are analysed as follows:

	2000	1999
	HRK '000	HRK '000
Zagrebačka Banka – shares	-	17,073
Zagrebačka Banka – deposit	1,942	-
Hrvatska Poštanska Banka, net of reserve of HRK 14 thousands	369	369
	<u>2,311</u>	<u>17,442</u>

The Company has sold the Zagrebačka Banka shares for HRK 63,314 thousands (Note 9).

16 Investments in associates

During 1999 the Company entered into a joint venture with EXI Limited, Manchester, England by founding a Company EXI d.o.o. za usluge u telekomunikacijama, Zagreb. The Company's ownership interest is 25%. This investment is carried at cost.

17 Long-term receivables

	2000	1999
	HRK '000	HRK '000
<i>Long-term portion</i>		
Foreign customers	45,487	6,881
Domestic customers	27,256	94
Housing loans to employees	4,423	4,752
	<u>77,166</u>	<u>11,727</u>

The foreign receivables are due in either US Dollars or German Marks.

Domestic receivables and receivables from Bosnian customers are secured primarily by bank guarantees and letters of credit. The current portion of the long-term receivables is classified under current assets, receivables.

During 1999 the Company approved housing loans to a small number of employees in a total amount of HRK 3.9 million. The principal outstanding at the year-end amounted to HRK 3.6 million. Interest rates on these loans are more favourable than the market interest rate. Repayment of each loan is 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.

Notes to the financial statements (continued)

18 Inventories

Inventories comprise the following:

	Gross		Obsolescence Reserve		Net	
	2000 HRK '000	1999 HRK '000	2000 HRK '000	1999 HRK '000	2000 HRK '000	1999 HRK '000
Raw materials	48,732	57,016	(12,756)	(13,543)	35,976	43,473
Work-in-progress and semi-finished goods	18,919	21,378	(2,109)	(3,393)	16,810	17,985
Finished goods	6,899	11,546	(62)	(717)	6,837	10,829
	<u>74,550</u>	<u>89,940</u>	<u>(14,927)</u>	<u>(17,653)</u>	<u>59,623</u>	<u>72,287</u>
Advances to suppliers	372	483	-	-	372	483
	<u>74,922</u>	<u>90,423</u>	<u>(14,927)</u>	<u>(17,653)</u>	<u>59,995</u>	<u>72,770</u>

19 Trade receivables from third parties

	2000 HRK '000	1999 HRK '000
Foreign customers	61,295	62,461
Sale on credit-due in 2001 (2000 respectively)	<u>209,510</u>	<u>219,080</u>
Total foreign customers	<u>270,805</u>	<u>281,541</u>
Domestic customers	71,429	268,805
Sale on credit-due in 2001 (2000 respectively)	<u>591</u>	<u>2,170</u>
Total domestic customers	<u>72,020</u>	<u>270,975</u>
Provisions against doubtful accounts	<u>(108,525)</u>	<u>(93,482)</u>
	<u>234,300</u>	<u>459,034</u>

20 Other receivables

	2000 HRK '000	1999 HRK '000
Receivables from employees	287	953
Receivable for prepaid income tax	20,220	5,422
Receivables for prepaid VAT	17,306	1,317
Other receivables	<u>165</u>	<u>3,432</u>
	<u>37,978</u>	<u>11,124</u>

Notes to the financial statements (continued)

21 Current financial assets

	2000	1999
	HRK '000	HRK '000
Bonds HZZO	19,032	-
Loans, deposits and guarantee deposits	4,419	4,448
Loans to related parties	-	2,000
	<u>23,451</u>	<u>6,448</u>

22 Cash and cash equivalents

	2000	1999
	HRK '000	HRK '000
Cash and demand deposits	97,434	84,153
Time deposits with maturity up to 3 months	219,934	31,642
	<u>317,368</u>	<u>115,795</u>

Cash and cash equivalents comprise deposits in foreign currency 89% (1999, 76 %) and in Croatian Kunas 11% (1999, 24 %). An amount of HRK 5.8 million is pledged as guarantee for quality performance of products and services sold.

23 Accounts payable and other short term liabilities

	2000	1999
	HRK '000	HRK '000
Trade payables	21,226	19,396
Liabilities towards employees	24,203	31,598
Liabilities for taxes and contributions	51	1,086
Other current liabilities	203	93
	<u>45,683</u>	<u>52,173</u>

Liabilities to employees include the bonus salary amounting to HRK 8.5 million.

Notes to the financial statements (continued)

24 Accrued charges and deferred income

	2000	1999
	HRK '000	HRK '000
Advances from domestic customers	3,522	11,607
Advances from foreign customers	41,844	21,366
Deferred income	991	3,901
Accrued restructuring costs	2,855	8,394
Other accrued charges	52,400	26,615
	<u>101,612</u>	<u>71,883</u>

Advances from foreign customers include HRK 19 million of advances received in the years 1989-1992 from the post and telegraph companies of the former Yugoslav Republic. During 1999 and 2000, new contracts have been signed with these companies and deliveries took place. In 1999, these advances were included in reserves for risks and charges.

Restructuring costs represent termination benefits, based on voluntary acceptance.

Other accrued charges mainly relate to provisions for penalty costs HRK 22.7 million (1999 HRK 9.0 million) and warranty costs HRK 14.7 million (1999 HRK 7.9 million).

25 Long-term loans

Long-term debt is represented by debt due to financial institutions, the settlement of which is pending the definition of debt deriving from the former Yugoslavia. Consequently no due dates have yet been established, except for the amount of HRK 2,634 thousand (DEM 678 thousand) relating to Hermes Kreditversicherungs, A.G. (Germany) which will be repaid in the period from 1998 to 2003.

Notes to the financial statements (continued)

26 Balances and transactions with related parties

Balances with Ericsson Group companies may be summarised as follows:

	Receivable		Payable	
	2000 HRK'000	1999 HRK '000	2000 HRK'000	1999 HRK '000
Ericsson Telecom	23,751	6,804	61,165	40,746
Ericsson Radio System (Access)	22,721	14,870	13,401	1,668
Ericsson Telefonaktiebolaget LM	-	-	2,964	-
Ericsson Business Networks	-	-	-	3,220
Ericsson Components	-	54	-	2,948
Ericsson Business Consulting	53	1,215	4,019	721
Ericsson TEI Roma	1,129	2,258	-	12
Ericsson Microwave Systems	-	-	6,238	1,223
Ericsson Corporatia AO	1,135	2,727	-	544
Ericsson Utvecklings Alvsjo	4,628	2,344	-	12
Kongsberg Defence Communication	1,294	-	-	-
Ericsson International Services BV	-	-	2,532	-
LM Ericsson Limited	-	-	2,989	-
Other	6,422	5,016	4,573	3,953
	<u>61,133</u>	<u>35,288</u>	<u>97,881</u>	<u>55,047</u>

Total purchases of goods and services from Ericsson Group companies during 2000 amounted to HRK 493 million (1999, HRK 289 million) (including licence fees) and sales to Ericsson Group companies amounted to HRK 246 million (1999, HRK 165 million). The transactions have been directly negotiated between the involved parties and agreed on an individual basis.

The Company is paying licence fees on sales of AXE and certain other products. No other charges are made for the use of the corporate identity and other corporate services.

Notes to the financial statements (continued)

27 Financial instruments

The Company is not using derivative financial instruments. However, risk management policies that relate to short term and long term customer financing, cash management and debt and payables can be summarised as follows:

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 mainly exposed to US dollars, as a substantial proportion of receivables and foreign revenues are denominated in US dollars. Risk management relies on attempts to match, as much as possible, revenues in each currency with the same currency expenditure.

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 maintains its liquid funds on short-term notice, the risk is not significant.

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 the high level of trade receivables, mainly because of the inability of customers to obtain outside funding of the projects. Therefore, the Company is financing customers to a certain extent, which expose it to a significant risk. 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 at least once a month. Provision for doubtful accounts are evaluated monthly and changed if needed. Additionally, there is credit concentration risk on the Croatian market as the Company has a significant portion of its revenues and receivables from one customer. Management of this risk is concentrated in the diversification of the customer base through new products and services offered to new customers.

Additionally, the Company is exposed to risk through cash deposits in the banks. Management of the risk is focused on dealing with banks in foreign ownership, that deal with Ericsson on a world-wide basis or with banks that are listed on the international financial markets and to contacts with the banks on a daily basis.

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. Due to the strong liquidity position of the Company, the risk is low.

Notes to the financial statements (continued)

28 Shareholders' equity

As of 31 December 2000, the share capital of the Company is represented by 1,331,650 fully paid ordinary shares, with a total registered value of HRK 501,366 thousands. Par value of one share is 376.50 HRK.

At an extraordinary shareholders' meeting held on 17 December 1998, the shareholders made a decision to reduce the share capital of the Company by an amount of HRK 101,871 thousands by decreasing the face value of each share from 100 DEM (376.50 HRK) to 300 HRK. The proposal was registered with the Court on 19 February 1999. In November 1999, the period of six months from submitting the proposal to the court for satisfactory resolution of liabilities to the creditors ended and the Company paid out HRK 101,067 thousands. The remaining balance of HRK 804 thousands relates to the own shares that the Company had at that date. The Court registration of the new share capital of HRK 399,495,000 was obtained at 5 January 2001.

The Company's shareholders as of 31 December 2000 are:

	Number of shares	% Held
Telefonaktiebolaget LM Ericsson	653,473	49.07%
Employees, pensioners and financial institutions	629,449	47.27%
Privatisation Fund	31,104	2.34%
Treasury shares	17,624	1.32%
	<u>1,331,650</u>	<u>100.00%</u>

In the 1999, the Company reclassified HRK 5,890 thousands from current financial assets to equity in order to comply with SIC Interpretation –16 issued by the Standing Interpretations Committee of the International Accounting Standards Committee. A reserve for own shares was created prior to obtaining of own shares as required by Company Law (Zakon o trgovačkim društvima).

Own shares were not disposed off in one year from their acquisition as required by the Company Law.

The legal reserve is formed from 5% of net income per annum and up to 5% of share capital. The legal reserve may be used for covering of losses if the losses are not covered from current net income, or if other reserves are not available.

The transformation reserve was created as a result of privatisation of the Company when a new appraisal of the Company was made.

Notes to the financial statements (continued)

29 Subsequent events

On 18 January 2001, the Company received the claims from the Customs Authorities in respect of important duties on some purchases made in 1998. At the time of the original purchases the Company was relieved from paying import duties and related VAT provided that the same goods were included in exported products and that these products were exported within 12 months. The Company was late with the exports on certain occasions and as a result the Customs Authorities levied customs duty. The total amount of claims received is HRK 1.3 million (inclusive of HRK 0.2 million of input VAT). The total amount of possible claims in respect of other similar instances is estimated at HRK 1.9 million. The Company has appealed in respect of the claims and the Customs Authorities have postponed collection of any duties until the appeal is resolved. The Company believe that the appeals will be settled in their favour and that no liabilities will arise in respect of this matter. Accordingly, no amounts have been provided for these claims in the financial statements.

30 Contingent liabilities

In December 1999 the Company received notification of a claim made by certain small shareholders. The claim requests the Commercial Court in Zagreb to find that certain decisions of the General Assembly held on 18 June 1998 are null and void. The Company has lodged its defence to the claims. After taking appropriate legal advice, the Company's Board is of the opinion that no material liabilities for the Company can result from this lawsuit.

31 Cash flow

	2000	1999
	HRK '000	HRK '000
Cash flows from operating activities		
<i>Net income for the year</i>	61,070	94,173
Adjustments for:		
Depreciation and amortisation	48,951	47,534
Decrease in reserve for risks and charges	(10,459)	(5,210)
Deferred taxation	1,306	(4,612)
Profit on outsourcing activities	(22,442)	-
Net book value of fixed assets disposed	3,671	1,253
Provision for doubtful receivables	25,145	42,813
Provision against inventories	5,674	13,306
Investment income	(65,199)	(10,690)
Unrealised foreign exchange differences	(3,606)	(45,691)
<i>Operating profit before working capital changes</i>	44,111	132,876
Decrease in inventories	2,266	60,363
Decrease / (Increase) in receivables	80,802	(42,221)
Increase in accounts payable	43,030	30,671
Increase in accrued charges and deferred income	9,798	5,403
(Increase)/decrease in prepaid expenses and accrued income	150	(6,417)
Cash generated from operations	180,157	180,675
Income tax paid	(14,798)	(23,377)
<i>Net cash from operating activities</i>	165,359	157,298

Notes to the financial statements (continued)

31 Cash flow (continued)

	HRK '000
Cash and cash equivalents, 1 January 1999	80,173
Net cash inflow	<u>35,622</u>
Cash and cash equivalents, 31 December 1999	115,795
Net cash inflow	<u>201,573</u>
Cash and cash equivalents, 31 December 2000	<u>317,368</u>