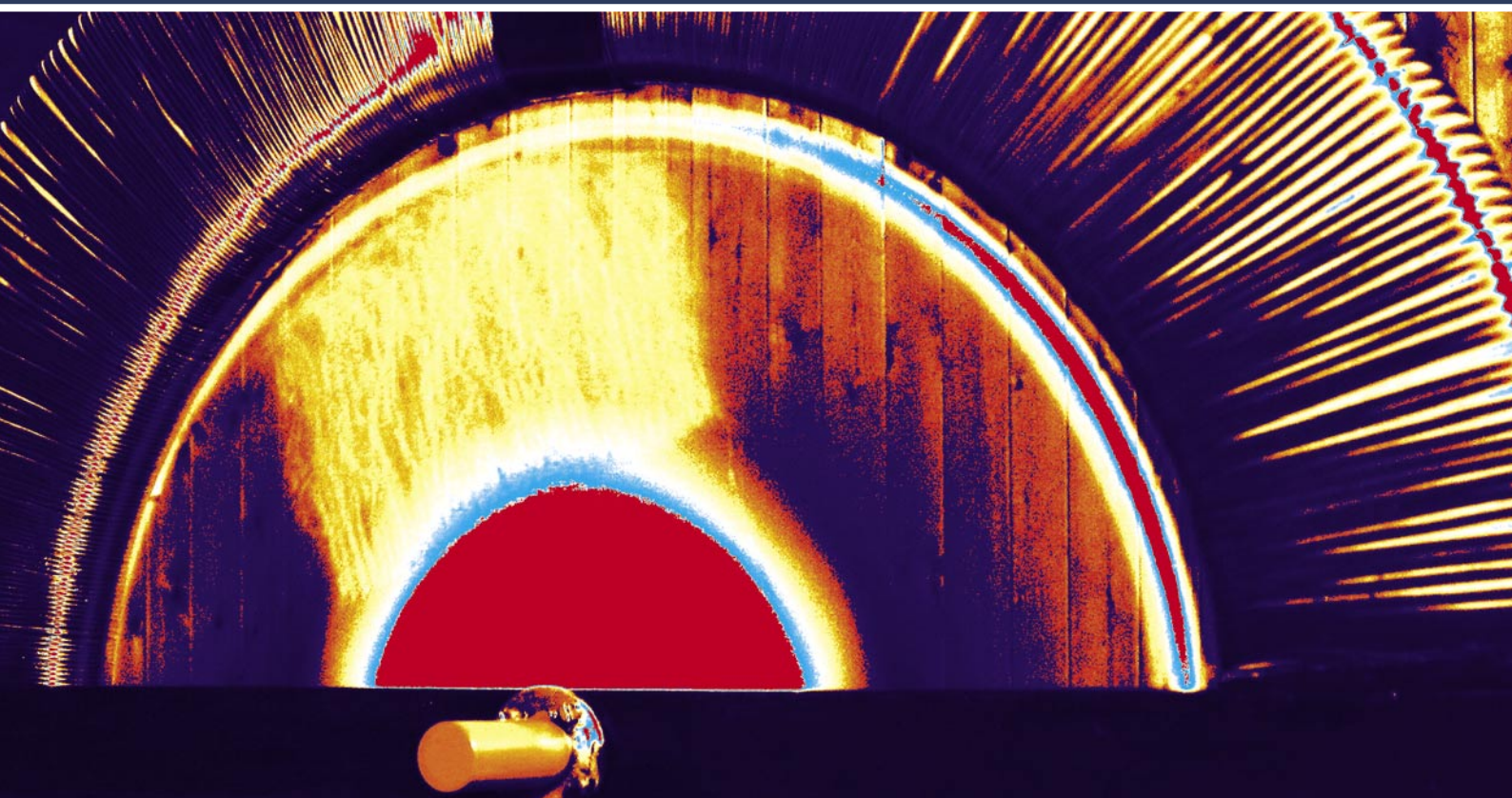


Financial statements



**Financial statements as at 31 December 2005
together with auditors' report**

COMPANY PROFILE

History and incorporation

Ericsson Nikola Tesla d.d. Zagreb (the Company) is a Croatian company with fifty-six years of continuous operations. It has always been a leading specialized supplier and exporter of telecommunications equipment, and software solutions and services in Central and Eastern Europe.

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

According to the ownership structure as at 31 December 2005, Telefonaktiebolaget LM Ericsson (Ericsson) holds 49.07% of the shares. The Croatian Privatisation Fund owns 0.89% of the Company's shares, treasury shares amount to 1.03% and other shareholders own the remaining 49.01% of the Company's shares.

Principal activities

The principal activities of the Company are the following: research and development of telecommunications software and services, design and integration of total communications solutions for operators and enterprises as well as testing, sales and maintenance of communications solutions and systems in the Republic of Croatia, selected countries of Central and Eastern Europe, Middle East and Africa as well as within the Ericsson Group companies.

Ericsson Nikola Tesla d.d. Zagreb 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 directors

The Supervisory Board

The Supervisory Board members during 2005 and up to the release of these statements were:

Ragnar Bäck	<i>Appointed on 18 May 2004</i>	Chairman
Ignac Lovrek	<i>Appointed on 8 May 2003</i>	Member; from 18 May 2004 Vice-Chairman
Carita Jönsson	<i>Appointed on 18 May 2004</i>	Member
Zvonimir Jelić	<i>Appointed on 4 June 2002</i>	Member
Darko Marinac	<i>Appointed on 8 May 2003</i>	Member

The Management Board

The Management Board has one member:

Gordana Kovačević	<i>Appointed on 1 January 2005</i>	President
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COMPANY PROFILE (continued)

Executive management

As at 31 December 2005, the Company's executive management comprised:

Gordana Kovačević	President
Milivoj Pejković	Senior Adviser to the Company President for Sales and Marketing
Milan Živković	Director, Business Development
Josip Jakovac	Director, Sales and Marketing for CIS
Tihomir Šicel	Director, Sales and Marketing for T-HT
Hrvoje Benčić	Director, Marketing, Customer Solutions and Sales Support
Björn Dellås	Director, Research and Development Center
Maria Radtke	Director, Finance (including Sourcing)
Snježana Bahtijari	Director, Communication
Ana Jožinec	Director, HR and Organization (including Legal and Operational Development)
Alen Ludaš	Director, Sales and Marketing for VIPnet and Si.mobil
Miroslav Kantolić	Director, Sales and Marketing for Alternative Operators
Snježana Ivezić-Torbarina	Director, Sales and Marketing for Enterprise
Jagoda Carić	Director, Sales and Marketing for B&H, Montenegro
Zvonko Bićanić	Account Manager, Sales and Marketing for Belarus and Moldova
Damir Bušić	Director, System Integration (including e-systems)
Srećko Lepri	Director, Services
Dario Runje	Director, Global Service Delivery Center
Branko Dronjić	Program Manager, Multiple Job Areas
Siniša Krajnović	Deputy Director, Research and Development Center
Vlatka Maričić	Assistant R&D Center Director, PU CPP products
Vjeran Radatović	Assistant R&D Center Director, PU Call Control and Signalling

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

The financial statements set out on pages 52 to 100 were authorised by the Management Board on 6 March 2006 for issue to the Supervisory Board and are signed below.

Gordana Kovačević
Director



Ericsson Nikola Tesla d.d. Zagreb
Krapinska 45
10000 Zagreb
Croatia



Independent Auditors' Report to the shareholders of Ericsson Nikola Tesla d.d. Zagreb

We have audited the accompanying balance sheet of Ericsson Nikola Tesla d.d. Zagreb ("the Company") as of 31 December 2005, and the related statements of income, changes in equity and cash flows for the year then ended. These financial statements are the responsibility of the Company's Management Board. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements give a true and fair view of the financial position of the Company as of 31 December 2005 and of the results of its operations and cash flows for the year then ended in accordance with International Financial Reporting Standards.

KPMG Croatia d.o.o. za reviziju

Croatian Registered Auditors

Centar Kaptol

Nova Ves 11

10000 Zagreb

Croatia

6 March 2006

Ericsson Nikola Tesla income statement

For the year ended 31 December 2005

		<i>Restated</i>	
	<i>Notes</i>	2005	2004
		HRK '000	HRK '000
Sales revenue	4	1,624,515	1,551,661
Cost of sales		(1,300,964)	(1,187,416)
		-----	-----
Gross profit		323,551	364,245
Other operating income	6	115,512	93,368
Distribution expenses		(70,141)	(66,815)
Administrative expenses		(43,452)	(47,323)
Other operating expenses	7	(90,554)	(125,732)
		-----	-----
Operating profit before net financial income		234,916	217,743
		-----	-----
Financial income	9	45,733	48,827
Financial expenses	9	(12,247)	(20,314)
		-----	-----
Net financial income	9	33,486	28,513
		-----	-----
Profit before tax		268,402	246,256
Income tax expense	10	(32,714)	(28,863)
		-----	-----
Profit for the year		235,688	217,393
		-----	-----
Earnings per share (HRK)	11	178.82	165.44
		-----	-----

The notes set out on pages 58 to 100 form an integral part of these financial statements.

Ericsson Nikola Tesla balance sheet As at 31 December 2005

		<i>Restated</i>	
	<i>Notes</i>	2005	2004
		HRK '000	HRK '000
ASSETS			
Non-current assets			
Property, plant and equipment	12	206,150	150,354
Intangible assets	13	2,894	2,719
Non-current loans and receivables	14	247,719	107,138
Equity securities	15	45	45
Deferred tax assets	16	20,176	28,398
		-----	-----
Total non-current assets		476,984	288,654
		-----	-----
Current assets			
Inventories	17	30,934	48,530
Trade receivables	18	621,313	572,288
Receivables from related parties	28(c)	48,278	31,226
Income tax receivable		8,739	-
Other receivables	19	28,324	30,864
Other current financial assets	20	492,146	310,716
Prepayments and accrued income		2,730	894
Cash and cash equivalents	21	192,320	394,855
		-----	-----
Total current assets		1,424,784	1,389,373
		-----	-----
TOTAL ASSETS		1,901,768	1,678,027
		-----	-----

The notes set out on pages 58 to 100 form an integral part of these financial statements.

Ericsson Nikola Tesla balance sheet (continued)
As at 31 December 2005

		<i>Restated</i>	
	<i>Notes</i>	2005	2004
		HRK '000	HRK '000
EQUITY AND LIABILITIES			
Equity			
Share capital	22(a)	266,330	266,330
Treasury shares	22(b)	(4,561)	(4,219)
Legal reserves	22(d)	20,110	20,110
Retained earnings		1,208,681	994,625
Total equity		1,490,560	1,276,846
Non-current liabilities			
Interest-bearing borrowings	23	3,109	3,559
Employee benefits	24	4,054	3,826
Total non-current liabilities		7,163	7,385
Current liabilities			
Payables to related parties	28(c)	112,732	108,898
Interest-bearing borrowings	23	307	272
Income tax payable		-	21,945
Trade and other payables	25	107,233	93,057
Provisions	26	11,735	11,768
Accrued charges and deferred revenue	27	172,038	157,856
Total current liabilities		404,045	393,796
Total liabilities		411,208	401,181
TOTAL EQUITY AND LIABILITIES		1,901,768	1,678,027

The notes set out on pages 58 to 100 form an integral part of these financial statements.

Ericsson Nikola Tesla statement of cash flows

For the year ended 31 December 2005

	<i>Restated</i>	
	2005	2004
	HRK'000	HRK'000
Cash flows from operating activities		
<i>Profit before tax</i>	268,402	246,256
Adjustments for:		
Depreciation and amortisation	53,912	44,799
Impairment losses and reversal	(43,492)	56,483
Change in provisions	3,560	1,912
Net loss on sale of property, plant and equipment	85	9,235
Net gains on non-trading financial assets	(17,263)	6,977
Interest income	(28,470)	(46,412)
Interest expense	190	152
Foreign exchange gains	(19,321)	(10,099)
Reversal of impairment losses on buildings	-	(14,575)
Equity-settled transactions	2,097	4,995
	219,700	299,723
Increase in non-current loans and receivables	(210,779)	(18,467)
Decrease in inventories	17,596	24,853
Decrease/(increase) in receivables	46,703	(261,515)
Increase in payables	29,329	101,272
(Decrease)/increase in other operating assets and liabilities	(977)	703
<i>Cash generated from operations</i>	101,572	146,569
Interest paid	(190)	(152)
Income taxes paid	(54,596)	(5,507)
Net cash from operating activities	46,786	140,910
Cash flows from investing activities		
Interest received	28,650	44,224
Purchases of property, plant and equipment, and intangible assets	(109,968)	(40,809)
Decrease/(increase) in non-current deposits	449	(755)
Net acquisition of other non-trading financial assets	(163,706)	(194,313)
Net cash used in investing activities	(244,575)	(191,653)

The notes set out on pages 58 to 100 form an integral part of these financial statements.

Ericsson Nikola Tesla statement of cash flows (continued)
For the year ended 31 December 2005

		<i>Restated</i>	
	<i>Note</i>	2005	2004
		HRK'000	HRK'000
Cash flows from financing activities			
Repayment of interest-bearing borrowings		(415)	(228)
Dividends paid		(23,652)	(22,338)
Capital redemption		-	(131,403)
		-----	-----
Net cash used in financing activities		(24,067)	(153,969)
		-----	-----
Effects of exchange rate changes on cash and cash equivalents		19,321	9,668
Net decrease in cash and cash equivalents		(202,535)	(195,044)
		-----	-----
Cash and cash equivalents at the beginning of the year	21	394,855	589,899
		-----	-----
Cash and cash equivalents at the end of the year	21	192,320	394,855
		-----	-----

The notes set out on pages 58 to 100 form an integral part of these financial statements.

Ericsson Nikola Tesla statement of changes in equity

For the year ended 31 December 2005

	Share capital HRK '000	Treasury shares HRK '000	Legal reserves HRK '000	Retained earnings HRK '000	Total HRK '000
As at 1 January 2004 as previously reported	399,495	(5,890)	20,110	795,483	1,209,198
Changes in equity for 2004					
Profit for the year (restated), Note 2	-	-	-	217,393	217,393
Total recognised income for 2004	-	-	-	217,393	217,393
Dividend distribution for 2003, Note 22	-	-	-	(22,338)	(22,338)
Capital redemption, Note 22(c)	(133,165)	-	-	1,762	(131,403)
Treasury shares, Note 22(b)	-	1,671	-	(1,671)	-
Equity-settled transactions (restated), Note 2	-	-	-	4,995	4,995
Deferred tax related to equity increase (restated), Note 2	-	-	-	(999)	(999)
As at 31 December 2004 (restated), Note 2	266,330	(4,219)	20,110	994,625	1,276,846
As at 1 January 2005	266,330	(4,219)	20,110	994,625	1,276,846
Changes in equity for 2005					
Profit for the year	-	-	-	235,688	235,688
Total recognised income for 2005	-	-	-	235,688	235,688
Dividend distribution for 2004, Note 22	-	-	-	(23,652)	(23,652)
Treasury shares, Note 22(b)	-	(342)	-	342	-
Equity-settled transactions, Note 24(b)	-	-	-	2,097	2,097
Deferred tax related to equity increase	-	-	-	(419)	(419)
As at 31 December 2005	266,330	(4,561)	20,110	1,208,681	1,490,560

Notes to the financial statements

1 Significant accounting policies

Ericsson Nikola Tesla d.d. Zagreb (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 at the Quotation of the Public Joint Stock Companies on the Zagreb Stock Exchange and Varaždin 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 (IFRS) and its interpretations adopted by International Accounting Standards Board (IASB).

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 instruments and financial instruments with fair values 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, except as a result of change in accounting policies resulting from amendments to existing IFRSs and the introduction of new IFRSs applicable as of 1 January 2005 which are described in Note 2.

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

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of revision and future periods if the revision affects both current and future periods.

Judgements made by management in the application of IFRSs that have significant effect on the financial statements and estimates with a significant risk of material adjustments in the next year are discussed in Note 3.

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

Standards, interpretations and amendments to published standards that are not yet effective

Certain new standards, amendments and interpretations to existing standards have been published that are mandatory for the Company's accounting periods beginning on or after 1 January 2006 or later periods but which the Company has not early adopted, as follows:

- IAS 19 (Amendment) *Employee Benefits* (effective as of 1 January 2006). This amendment introduces the option of an alternative recognition approach for actuarial gains and losses. It may impose additional recognition requirements for multi-employer plans where insufficient information is available to apply defined benefit accounting. It also adds new disclosure requirements. As the Company does not intend to change the accounting policy adopted for recognition of actuarial gains and losses and does not participate in any multi-employer plans, adoption of this amendment will only impact the format and extent of disclosures presented in the statements. The Company will apply this amendment from annual periods beginning 1 January 2006.

- IAS 21 (Amendment) *The Effects of Changes in Foreign Exchange Rates – Net Investment in a Foreign Operation* (effective as of 1 January 2006). Management considered this amendment to IAS 21 and concluded that it is not relevant to the Company.

- IAS 39 (Amendment) *Cash Flow Hedge Accounting of Forecast Intragroup Transactions* (effective as of 1 January 2006). Management considered this amendment to IAS 39 and concluded that it is not relevant to the Company.

- IAS 39 (Amendment) *The Fair Value Option* (effective as of 1 January 2006). This amendment changes the definition of financial instruments classified at fair value through profit or loss and restricts the ability to designate financial instruments as a part of this category. The Company believes that this amendment should not have a significant impact on the classification of financial instruments, as the Company should be able to comply with the amended criteria for the designation of financial instruments at fair value through profit or loss. The Company will apply this amendment from annual periods beginning 1 January 2006.

- IAS 39 and IFRS 4 (Amendment) *Financial Guarantee Contracts* (effective as of 1 January 2006). Management considered this amendment to IAS 39 and concluded that it is not relevant to the Company.

- IFRS 1 (Amendment) *First-Time Adoption of International Financial Reporting Standards* and IFRS 6 (Amendment) *Exploration for and Evaluation of Mineral Resources* (effective as of 1 January 2006). These amendments are not relevant to the Company's operations as the Company is not a first-time adopter of IFRS and does not carry out exploration for and evaluation of mineral resources.

- IFRS 6 *Exploration for and Evaluation of Mineral Resources* (effective as of 1 January 2006). IFRS 6 is not relevant to the Company's operations.

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

– IFRS 7 *Financial Instruments: Disclosures*, and a complementary amendment to IAS 1 *Presentation of Financial Statements – Capital Disclosures* (effective as of 1 January 2007). IFRS 7 introduces new disclosures to improve the information about financial instruments. It requires the disclosure of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk, including sensitivity analysis to market risk. It replaces IAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions*, and disclosure requirements in IAS 32 *Financial Instruments: Disclosure and Presentation*. It is applicable to all entities that report under IFRS. The amendment to IAS 1 introduces disclosures about the level of an entity's capital and how it manages capital. Management is currently assessing the impact of IFRS 7 and amendment to IAS 1 on the Company's operations. The Company will apply IFRS 7 and the amendment to IAS 1 from annual periods beginning 1 January 2007.

– IFRIC 4 *Determining whether an Arrangement contains a Lease* (effective as of 1 January 2006). IFRIC 4 requires the determination of whether an arrangement is or contains a lease to be based on the substance of the arrangement. It requires an assessment of whether: (a) fulfilment of the arrangement is dependent on the use of a specific asset or assets (the asset); and (b) the arrangement conveys a right to use the asset. Management is currently assessing the impact of IFRIC 4 on the Company's operations.

– IFRIC 5 *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds* (effective as of 1 January 2006). IFRIC 5 is not relevant to the Company's operations.

– IFRIC 6 *Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment* (effective as of 1 December 2005). The interpretation deals with obligations arising from the European Union Directive regulating the collection, treatment, recovery and environmentally sound disposal of waste equipment. Management is currently assessing the impact of IFRIC 6 on the Company's operations.

– IFRIC 7 *Applying the Restatement Approach under IAS 29, Financial Reporting in Hyperinflationary Economies* (effective as of 1 March 2006). IFRIC 7 is not relevant to the Company's operations.

– IFRIC 8 *Scope of IFRS 2* (effective as of 1 May 2006). The Interpretation clarifies that the accounting standard IFRS 2 *Share-based Payment* applies to arrangements where an entity makes share-based payments for apparently nil or inadequate consideration. Management is currently assessing the impact of IFRIC 8 on the Company's operations.

Reporting currency

The Company's financial statements have been prepared in Croatian kuna (HRK), which is the currency of primary economic environment in which the entity operates ("the functional currency") and the presentation currency, and are rounded to the nearest thousand. The effective exchange rate as at 31 December 2005 was HRK 6.2336 per 1 United States dollar (2004: HRK 5.6368) and HRK 7.3756 per 1 euro (2004: HRK 7.6712).

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

Changes in presentation or classification of items in the financial statements

Certain amounts of income and expenses and balance sheet items have been reclassified in comparison with last year and reclassifications have also been made to the corresponding figures to conform to the current year's presentation.

Property, plant and equipment

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

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

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

	Useful lives
Buildings	5 – 30 years
Tehanical equipment	3 – 10 years
Other (vehicles, tools, furniture, and fixtures)	3 – 7 years

The assets' residual values, depreciation method and useful lives 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 income statement.

Intangible assets

Intangible assets are stated on initial recognition at cost and subsequently at cost less accumulated amortisation and impairment losses. All expenditure on research and development activities is recognised in the income statement as an expense as incurred. Expenditure on development activities, whereby research findings are applied to a plan or design for the production of new or substantially improved products and processes, is capitalised if the product or process is technically and commercially feasible and the Company has sufficient resources to complete development. Other development expenditure is recognised in the income statement as an expense as incurred.

Amortisation is provided on a straight-line basis over the estimated useful lives of intangible assets. Intangible assets include acquired computer software (SAP, SOFTPRO) which are amortised on a straight-line basis over useful life of 4 years. Cost associated with developing or maintaining computer software programmes are recognised as an expense as incurred.

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

Impairment of assets

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

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

The recoverable amount of held-to-maturity financial assets and receivables carried at amortised cost is calculated as the present value of expected future cash flows, discounted at the original effective interest rate inherent in the asset. Receivables with short duration are not discounted. The recoverable amount of other assets is the higher of the asset's net selling price and its value in use.

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

Financial instruments

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

Financial assets at fair value through profit or loss category have two sub-categories: "financial assets held for trading", and those designated by management at fair value through profit or loss at inception. Financial assets acquired principally for the purpose of generating a short-term profit are classified as held for trading and included in current assets. These include derivative instruments, which do not qualify for hedge accounting. Financial assets at fair value through profit or loss include debt and equity securities and investments in investment funds and are classified as current assets if they are expected to be realized within 12 months of the balance sheet date.

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

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

Financial instruments with fixed or determinable payments and fixed maturity that the Company has positive intent and ability to hold to maturity are classified as held-to-maturity financial assets. All other financial instruments are classified as available for sale.

All financial assets at fair value through profit or loss, held-to-maturity and available-for-sale are recognised on the trade date, which is the date that the Company commits to purchase or sell the asset. Loans and receivables are recognised on the day they are transferred to the Company.

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

The fair value of financial instruments at fair value through profit or loss or available for sale is based on their quoted market price at the balance sheet date, without any deduction for transaction costs. The fair value of derivatives that are not exchange-traded is estimated at the amount that the Company would receive or pay to terminate the contract at the balance sheet date.

Realised and unrealised gains and losses arising from changes in the fair value of financial assets at fair value through profit or loss are recognised in the income statement in the period in which they arise.

Changes in the fair value of monetary securities denominated in a foreign currency and classified as available for sale are analysed between translation differences resulting from changes in amortised cost of the security and other changes in the carrying amount of the security. The translation differences are recognised in profit or loss, and other changes in carrying amount are recognised in equity. Changes in the fair value of other monetary securities classified as available for sale and non-monetary securities classified as available for sale are recognised in equity.

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

When securities classified as available-for-sale are sold or impaired, the accumulated fair value adjustments recognised in equity are included in the income statement as 'gains and losses from available-for-sale securities'. Interest on available-for-sale securities calculated using the effective interest method is recognised in the income statement. Dividends on available-for-sale equity instruments are recognised in the income statement when the Company's right to receive payments is established.

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

Derivative instruments

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

Trade and other receivables

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

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.

Inventories

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

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

Cash and cash equivalents

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

Share capital and reserves

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

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

Trade and other payables

Trade and other payables are measured at amortised cost using the effective interest rate.

Income tax

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

Deferred taxes are calculated by using the balance sheet liability method. 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.

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)

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 income statement. 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

Revenue from services rendered is recognised in the income statement in proportion to the stage of completion. The stage of completion is measured by the proportion of contract cost incurred for work performed to date in relation to the estimated total contract costs. If the cost required to complete such contract is estimated to exceed remaining revenues, provision is made for the total estimated loss in the period in which such loss is estimated.

Sales revenue from other activities is recognised in the income statement, excluding value added tax, upon delivery of products, software and/or services when the significant risks and rewards of ownership have been transferred to the buyer.

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 a 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 compensation

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 income statement, with a corresponding adjustment to equity. When distributed upon vesting date treasury shares are credited at average purchase cost and recorded against retained earnings.

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

Provisions

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

Net financial income

Net financial income comprises interest receivable on non-current loans, interest receivable on funds invested, foreign exchange gains and losses, gains and losses on financial assets at fair value through profit and loss, and gains and losses on hedging instruments that are recognised in the income statement. Interest income is recognised in the income statement as it accrues, using the effective interest method.

Segment reporting

A segment is a distinguishable component of the Company that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

2 Change in accounting policies

In late 2003 the IASB published a revised version of IAS 32 *Financial Instruments: Disclosure and Presentation*, a revised version of IAS 39 *Financial Instruments: Recognition and Measurement*, and Improvements to International Accounting Standards, which made changes to 14 existing standards. In the first quarter of 2004 the IASB published IFRS 2 *Share-based Payments*, IFRS 3 *Business Combinations*, IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, and further amendments to IAS 39. In mid-2005 the IASB issued a further revision to IAS 39 regarding the Fair Value Option. Revised IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, amongst other matters, requires that changes in accounting policies that arise from the application of new or revised standards and interpretations are applied retrospectively, unless otherwise specified in the transitional requirements of the particular standard or interpretation. The Company adopted these effective as of 1 January 2005.

Notes to the financial statements (continued)

2 Change in accounting policies (continued)

Share-based payment

IFRS 2 *Share-based Payments*, which became effective as of 1 January 2005, requires the fair value of equity instruments granted to employees to be recognized as an expense. Under the Company's previous accounting policy to 31 December 2004, no expenses were recorded, and consequently, no charge to the gross profit was recognised in the Company's financial statements. As required by IFRS 2, the Company has restated the prior-period comparative information to reflect the cost of grants awarded during 2004 and which remain unvested at 1 January 2005 (for equity-settled share-based payments) and the cost of grants awarded in 2004 which vested in 2004. Deferred tax asset in respect of expense was recognised in income statement and deferred tax liabilities in respect of equity increase were recognised in retained earnings.

Financial instruments

In accordance with IAS 39 requirements, the Company has reviewed its portfolio of financial instruments held at 1 January 2005 and has performed re-designation of these financial instruments into categories as defined by the revised IAS 39. Standard requires retrospective application. In the corresponding financial statements at 31 December 2004 the Company's financial instruments were classified into following categories:

- All derivative instruments were classified as trading instruments within current assets and measured at fair value with changes in fair values recognised in income statement. As of 1 January 2005 all derivative instruments were designated as trading instruments within financial assets at fair value through income statement and included in current assets. There was no impact on net income or equity from this re-designation.
- All debt securities, investments in investment funds and equity securities other than investments in subsidiaries and associates were classified as available-for-sale instruments and measured at fair value with changes in fair value recognised in income statement. Equity securities available for sale were classified as non-current assets. Other available-for-sale financial instruments were classified as current financial assets. As of 1 January 2005 all available-for-sale instruments were designated as financial assets at fair value through income statement and included in current assets. There was no impact on net income or equity from this re-designation.
- All loans and receivables, deposits and guarantee deposits originated by the Company were classified as loans and receivables originated by the Company and measured at amortised cost. As of 1 January 2005 all originated loans and receivables were designated as loans and receivables and measured at amortised cost. Current portion of non-current loans and receivables is included in current assets based on remaining maturity at the balance sheet date. There was no impact on net income or equity from this re-designation.
- The Company did not have any held-to-maturity financial instruments at 31 December 2004.

Presentation of financial statements

The new and revised standards result in significant changes to the format and content of the financial statements. In addition, the Company has made certain presentational changes to further improve comparability of its financial position and results to those of other companies.

Notes to the financial statements (continued)

2 Change in accounting policies (continued)

Changes that resulted from retrospective application of the new or revised standards and interpretations and their effect on the financial statements are summarised in the table below.

	2004 as previously reported HRK '000	Effects of IFRS 2 HRK '000	Effects of IAS 39 HRK '000	2004 <i>restated</i> HRK '000
Income statement				
Cost of sales	(1,182,421)	(4,995)	-	(1,187,416)
Gross profit	369,240	(4,995)	-	364,245
Operating profit before net financial income	222,738	(4,995)	-	217,743
Profit before tax	251,251	(4,995)	-	246,256
Income tax expense	(29,862)	999	-	(28,863)
Profit for the year	221,389	(3,996)	-	217,393
Earnings per share	168.48	(3.04)	-	165.44
Assets				
Non-current loans and receivables	107,507	-	(369)	107,138
Total non-current assets	289,023	-	(369)	288,654
Other current financial assets	310,347	-	369	310,716
Total current assets	1,389,004	-	369	1,389,373
Total assets	1,678,027	-	-	1,678,027
Equity and liabilities				
Profit for the year	221,389	(3,996)	-	217,393
Equity-settled transactions, net of tax	-	3,996	-	3,996
Retained earnings	994,625	-	-	994,625
Total equity	1,276,846	-	-	1,276,846
Total liabilities	401,181	-	-	401,181
Total equity and liabilities	1,678,027	-	-	1,678,027

Notes to the financial statements (continued)

3 Critical accounting estimates and judgements

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.

Critical accounting estimates and assumptions

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) Income taxes

The Company is subject to income taxes in Croatia. There are certain transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business. The Company recognises liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income tax and deferred tax provisions in the period in which such determination is made. These calculations that support the tax return may be subjected to review and approval by the local tax authorities.

(b) Revenue recognition

The Company uses the percentage-of-completion method in accounting for its sales of services. Use of the percentage-of-completion method requires the Company to estimate the services performed to date as a proportion of the total services to be performed.

(c) Impairment losses on non-current loans and receivables

The Company reviews its loan portfolios to assess impairment at least on a quarterly basis. In determining whether an impairment loss should be recorded in the income statement, 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.

Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce differences between loss estimates and actual loss experience.

Notes to the financial statements (continued)

3 Critical accounting estimates and judgements (continued)

Judgements

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

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

Under certain service contracts the Company offered to its customers the additional deliveries of its goods or services, provided certain criteria are fulfilled. These additional deliveries are treated as adjustment to the sales margin of the original contract and recognised as an obligation when the customer fulfils the criteria.

4 Sales revenue

	2005	<i>Restated</i> 2004
	HRK '000	HRK '000
Sales revenue in Croatia	475,947	381,060
Sales revenue in Russia, Belarus, Kazakhstan, Ukraine, Kyrgyzstan, Moldova and neighbouring countries	530,425	572,128
Sales revenue to the European Union	296,546	226,452
Sales revenue in Bosnia and Herzegovina, Montenegro and Macedonia	274,515	330,015
Other export sales revenue	47,082	42,006
	<u>1,624,515</u>	<u>1,551,661</u>

Out of total sales revenue of HRK 1,625 million, sales of products amounted to HRK 944 million (2004: HRK 1,009 million) and sales of services amounted to HRK 681 million (2004: HRK 543 million).

Notes to the financial statements (continued)

5 Segment reporting

Segment information is presented in respect of the Company's business segments, which is the primary format, and is based on the Company's management and internal reporting structure. Segment results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items comprise mainly financial assets and related revenue, non-current liabilities and related expenses, and corporate assets and related expenses. Segment capital expenditure is the total cost incurred during the period to acquire segment assets that are expected to be used for more than one period.

Business segments

The Company comprises the following main business segments:

Systems

This segment provides:

- System solutions/networks and products for mobile network operators
- System solutions/networks and products for fixed network operators
- Professional services.

Other business operations

This segment includes enterprise systems and services, dedicated networks, cables and components, defence communications, transmission and transport networks and power modules.

External sales and other income

	2005	<i>Restated</i>
	HRK '000	2004
		HRK '000
Systems	1,454,155	1,420,935
Mobile Networks	702,809	490,987
Fixed Networks	360,938	619,447
Professional Services	390,408	310,501
Other business operations	285,872	209,519
	-----	-----
	1,740,027	1,630,454
	-----	-----

Geographical segments

Segments are managed in Europe, Middle East and Africa. Revenues determined based on the geographic location of customers are disclosed in Note 4. All the Company's assets are located in Croatia.

Notes to the financial statements (continued)

5 Segment reporting (continued)

	Systems			Other business		Total
	<i>Restated</i>			<i>Restated</i>		<i>Restated</i>
	2005	2004	2005	2004	2005	2004
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
External sales and other income	1,454,155	1,420,935	285,872	209,519	1,740,027	1,630,454
Unallocated other income					-	14,575
Total external sales and other income					1,740,027	1,645,029
Segment results	260,546	263,245	30,182	14,828	290,728	278,073
Segment results before financial income	250,320	242,003	28,133	11,711	278,453	253,714
Unallocated Company's expenses					(43,537)	(35,971)
Operating profit before financial income					234,916	217,743
Financial income					45,733	48,827
Financial expenses					(12,247)	(20,314)
Net financial income					33,486	28,513
Profit before tax					268,402	246,256
Income tax expense					(32,714)	(28,863)
Profit for the year					235,688	217,393
Segment assets	863,357	712,267	173,086	106,431	1,036,443	818,698
Unallocated Company's assets					865,325	859,329
Total Company's assets					1,901,768	1,678,027
Segment liabilities	187,340	144,755	37,558	21,630	224,898	166,385
Unallocated Company's liabilities					186,310	234,796
Total Company's liabilities					411,208	401,181
Capital expenditure	90,782	53,447	18,200	7,986	-	-
Depreciation and amortisation	23,698	17,345	4,751	2,592	-	-
Other non-cash expenses	43,237	94,790	8,668	14,164	-	-

Notes to the financial statements (continued)

6 Other operating income

	<i>Restated</i>	
	2005	2004
	HRK '000	HRK'000
Commission income	5,919	7,741
Reversal of unused provisions	2,723	3,691
Rental income	16,160	10,539
Reversal of impairment loss on loans and receivables	89,592	54,411
Reversal of impairment loss on buildings	-	14,575
Other	1,118	2,411
	-----	-----
	115,512	93,368
	-----	-----

During 2004 the Company provided HRK 104,961 thousand in respect of significant impairment losses expected to occur as a result of potential resale of a large non-current exposure to a customer from a high-risk country. However, during 2005 the Company managed to restructure the payment terms to ensure regular repayment of the exposure. As a result, the Company released HRK 88,068 thousand of impairment losses in respect of this exposure and in accordance with IAS 39 has retained HRK 16,893 thousand in respect of impairment losses due to restructuring of original exposure terms.

7 Other operating expenses

	<i>Restated</i>	
	2005	2004
	HRK '000	HRK'000
Net loss on disposal of property, plant and equipment	85	9,235
Increase in provisions	6,283	5,603
Impairment loss on loans and receivables	46,090	109,853
Impairment loss on inventories	38,096	1,041
	-----	-----
	90,554	125,732
	-----	-----

During 2005 the Company suffered losses on its inventories due to fire in the warehouse. As a result, impairment loss on inventories was recognised in the amount of HRK 38,096 thousand. The inventories were insured and the Company has placed a claim to an insurance company. Up to date of these financial statements the Company has not finalised all procedures with the insurance company and has not recognised any gains in respect of this claim.

Notes to the financial statements (continued)

8 Personnel expenses

		<i>Restated</i>
	2005	2004
	HRK '000	HRK '000
Salaries, net of taxes and contributions	140,549	129,526
Taxes and contributions	135,830	120,524
Other payroll-related costs	9,431	8,581
Equity-settled transactions (Note 24)	2,097	4,995
	-----	-----
	287,907	263,626
	-----	-----

Personnel costs include HRK 46.3 million (2004: HRK 39.6 million) of defined pension contributions paid or payable into obligatory pension plans. Contributions are calculated as a percentage of employees' gross salaries (Gross II).

At the year-end the Company employed the following personnel:

	2005	2004
Operations	504	480
Research and Development Center	567	408
Sales	66	69
Support functions	144	137
Employees on long-term assignment abroad	7	6
	-----	-----
	1,288	1,100
	-----	-----

Notes to the financial statements (continued)

9 Net financial income

	2005	<i>Restated</i> 2004
	HRK '000	HRK '000
Interest income	28,470	46,412
Financial assets		
Net gains from disposal of financial assets at fair value through profit or loss	2,503	2,415
Net gains on re-measurement of financial assets at fair value through profit or loss	14,760	-
Financial income	<u>45,733</u>	<u>48,827</u>
Net losses on foreign exchange differences	(12,057)	(10,770)
Interest expense	(190)	(152)
Financial assets		
Net gains on re-measurement of financial assets at fair value through profit or loss	-	(9,392)
Financial expenses	<u>(12,247)</u>	<u>(20,314)</u>
Net financial income	<u>33,486</u>	<u>28,513</u>

Interest income includes HRK 25,509 thousand (2004: HRK 42,117 thousand) of interest income earned from financial instruments not at fair value through profit or loss.

	2005	<i>Restated</i> 2004
	HRK '000	HRK '000
Net gains from disposal of financial assets at fair value through profit or loss arises from sale of the following financial instruments:		
- Investment in investment funds	3,417	978
- Debt securities	(914)	1,437
	<u>2,503</u>	<u>2,415</u>
Net gains/(losses) on re-measurement of financial assets at fair value through profit or loss arises from re-measurement of the following financial instruments:		
- Derivative financial instruments	(1,078)	(13,120)
- Equity securities	633	(2,739)
- Investment in investment funds	12,655	8,469
- Debt securities	2,550	(2,002)
	<u>14,760</u>	<u>(9,392)</u>

Notes to the financial statements (continued)

10 Income tax expense

Income tax has been calculated at statutory tax rate of 20% (2004: 20%) of the taxable income of the Company.

Income tax expense recognised in the income statement comprises:

	2005	<i>Restated</i> 2004
	HRK '000	HRK '000
Current income tax expense	(23,912)	(43,573)
Deferred tax income/(expense) relating to the origination and reversal of temporary differences	(8,802)	14,710
Total income tax expense in the income statement	(32,714)	(28,863)

Deferred tax recognised directly to equity comprises:

	2005	<i>Restated</i> 2004
	HRK '000	HRK '000
Relating to increase resulted from equity-settled transactions	580	999

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

	2005	<i>Restated</i> 2004
	HRK '000	HRK '000
Profit before tax	268,402	246,256
Income tax at 20% (2004: 20%)	53,680	49,251
Non-deductible expenses	6,457	2,348
Tax exempt revenues	(633)	(184)
Tax incentives	(26,790)	(22,552)
Total tax expense	32,714	28,863
Effective tax rate	12.2%	11.7%

Tax incentives include additional tax allowances (200% deduction) for research and development expenditure totalling HRK 22.7 million (2004: HRK 20.5 million). The underlying research and development expenditure is included in cost of sales.

Notes to the financial statements (continued)

11 Earnings per share

	2005	<i>Restated</i> 2004
Profit for the year (HRK `000)	235,688	217,393
Weighted Average Number of Shares Outstanding at the year-end	1,318,001	1,314,026
Earnings per share (HRK)	<u>178.82</u>	<u>165.44</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)

12 Property, plant and equipment

2005	Land and buildings HRK `000	Plant and equipment HRK `000	Construction in progress HRK `000	Other HRK `000	Total HRK `000
Cost or deemed cost					
As at 1 January 2005	144,636	264,407	4,979	474	414,496
Additions	-	-	108,325	-	108,325
Transfers	7,068	104,752	(111,820)	-	-
Disposals	(487)	(22,719)	-	(67)	(23,273)
As at 31 December 2005	151,217	346,440	1,484	407	499,548
Accumulated depreciation					
As at 1 January 2005	75,368	188,559	-	215	264,142
Charge for the year	4,836	47,597	-	11	52,444
Disposals	(375)	(22,776)	-	(37)	(23,188)
As at 31 December 2005	79,829	213,380	-	189	293,398
Carrying amount					
As at 31 December 2005	71,388	133,060	1,484	218	206,150
As at 31 December 2004	69,268	75,848	4,979	259	150,354

Construction in progress mainly relates to test plants in the amount of HRK 455 thousand (2004: HRK 3,956 thousand), and to IS/IT equipment in the amount of HRK 494 thousand (2004: HRK 158 thousand).

Included in cost or deemed cost is HRK 153.7 million (2004: HRK 140.7 million) of fully depreciated property, plant and equipment that are still used by the Company.

As at 31 December 2005 the Company had contracts totalling HRK 14,355 thousand (2004: HRK 20,561 thousand) related to future equipment purchases.

Notes to the financial statements (continued)

12 Property, plant and equipment (continued)

<i>Restated</i> 2004	Land and buildings	Plant and equipment	Construction in progress	Other	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Cost or deemed cost					
As at 1 January 2004	172,320	272,430	121	482	445,353
Additions	-	-	61,433	-	61,433
Transfers	27,894	28,681	(56,575)	-	-
Disposals	(55,578)	(36,704)	-	(8)	(92,290)
As at 31 December 2004	144,636	264,407	4,979	474	414,496
Accumulated depreciation and impairment losses					
As at 1 January 2004	110,043	186,257	-	204	296,504
Depreciation charge for the year	4,297	38,613	-	11	42,921
Reversal of impairment losses	(14,575)	-	-	-	(14,575)
Disposals	(24,397)	(36,311)	-	-	(60,708)
As at 31 December 2004	75,368	188,559	-	215	264,142
Carrying amount					
As at 31 December 2004	69,268	75,848	4,979	259	150,354
As at 31 December 2003	62,277	86,173	121	278	148,849

Property leased to others with carrying value of HRK 60,242 thousand (2004: HRK 59,152 thousand) is included within the land and buildings. These assets are depreciated at the same depreciated rates as other buildings. HRK 28,241 of leased assets is leased under non-cancellable period of five years started in year 2004. Subsequent renewals are negotiated with the lessee. No contingent rents are charged. Future minimum lease payments under non-cancellable operating leases in the aggregate and for each of the following periods are:

	<i>Restated</i>	
	2005	2004
	HRK '000	HRK '000
Less than one year	4,294	4,386
Between one and five years	11,058	15,352
More than five years	-	-
	15,352	19,738

Notes to the financial statements (continued)

13 Intangible assets

The movement on intangible assets in the year ended 31 December 2005, may be analysed as follows:

2005	Application software software HRK '000
Cost or deemed cost	
As at 1 January 2005	13,895
Additions	1,643
Disposals	(3,101)
As at 31 December 2005	12,437
Accumulated amortisation	
As at 1 January 2005	11,176
Charge for the year	1,468
Disposals	(3,101)
As at 31 December 2005	9,543
Carrying amount	
As at 31 December 2005	2,894
As at 31 December 2004	2,719

Notes to the financial statements (continued)

13 Intangible assets (continued)

<i>Restated</i> 2004	Application software HRK '000
Cost or deemed cost	
As at 1 January 2004	12,450
Additions	1,723
Disposals	(278)
As at 31 December 2004	13,895
Accumulated amortisation	
As at 1 January 2004	9,576
Charge for the year	1,878
Disposals	(278)
As at 31 December 2004	11,176
Carrying amount	
As at 31 December 2004	2,719
As at 31 December 2003	2,874

Included in the cost or deemed cost amount is HRK 6.1 million (2004: HRK 8.2 million) of fully amortised intangible assets that are still used by the Company.

Notes to the financial statements (continued)

14 Non-current loans and receivables

		<i>Restated</i>
	2005	2004
	HRK '000	HRK '000
Deposit with financial institutions, denominated in foreign currency	10,376	10,825
Foreign customers, denominated in foreign currency	229,271	116,017
Domestic customers, denominated in HRK	9,357	-
Receivables for sold apartments		
- denominated in foreign currency	7,077	7,800
- denominated in HRK	3,152	3,278
Housing loans to employees, denominated in HRK	892	1,217
	-----	-----
Total non-current loans and receivables	260,125	139,137
Impairment loss on loans and receivables	(12,406)	(31,999)
	-----	-----
	247,719	107,138
	-----	-----

Deposits with financial institutions are placed as guarantee deposits for housing loans provided to the Company's employees, earning interest at variable rates ranging from 1.14% to 2.49% per annum (2004: 1.14% to 2.49% per annum), and with a remaining maturity of over five years.

The foreign loans and receivables in the amount of HRK 23,953 thousand (2004: HRK 77,384 thousand) are denominated in US dollars and other foreign loans and receivables are denominated in euros. 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. The non-current portion of foreign and domestic loans and receivables in 2005 in the amount of HRK 32,846 thousand is due in 2007, the amount of HRK 45,408 thousand is due in 2008 and the amount of HRK 25,552 thousand in 2009, the amount of HRK 19,930 thousand is due in 2010, the amount of HRK 20,724 thousand is due in 2011 and the amounts of HRK 94,168 thousand are due in period 2012 - 2017. The non-current loans and receivables bear fixed interest rates in range of 3.8% to 6% per annum (2004: 4.5% to 6% per annum).

The non-current portion of foreign and domestic loans and receivables in 2004 was as follows: the amount of HRK 26,856 thousand is due in 2005, HRK 69,157 thousand is due in 2006, the amount of HRK 13,883 thousand is due in 2007 and the amount of HRK 6,121 thousand in 2008. Receivables for sold apartments are shown net of amounts due to the Croatian State. Housing loans to employees are linked to the countervalue of euro, repayments are made by deduction from monthly salary and the loans are secured with collateral on the house or apartment. Remaining maturity of these receivables is four years. Receivables for sold apartments and housing loans provided to a limited number of employees bear fixed interest rates of 1% to 5% per annum that are more favourable in comparison to the market interest rates. A discount in the amount of HRK 4,732 thousand (2004: HRK 5,143 thousand) is recognised in respect of these loans and amortised to the income statement, using the effective interest rate method of 7% per annum.

Notes to the financial statements (continued)

15 Equity securities

	2005	<i>Restated</i> 2004
	HRK '000	HRK '000
Other equity securities	45	45
	-----	-----

16 Deferred tax assets

Recognised deferred tax assets and liabilities

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

	2005		Credited/ (charged) to income statement	Credited/ (charged) to equity	<i>Restated</i> 2004	
	Assets	Liabilities	HRK'000	HRK'000	Assets	Liabilities
	HRK'000	HRK'000			HRK'000	HRK'000
Impairment loss on receivables	11,365	-	(9,806)	-	21,171	-
Impairment loss on obsolete inventory	390	-	(799)	-	1,189	-
Provision for employee benefits	690	-	31	-	659	-
Non-current receivables for sold apartments	947	-	(82)	-	1,029	-
Negative fair value of financial instruments	2,148	-	419	-	1,729	-
Accrued charges	4,636	-	1,216	-	3,420	-
Other temporary differences	419	-	219	-	200	-
Increase in equity related to equity-settled transactions	-	(419)	-	580	-	(999)
	-----	-----	-----	-----	-----	-----
	20,595	(419)	(8,802)	580	29,397	(999)
Set-off of tax	(419)	419	-	-	(999)	999
	-----	-----	-----	-----	-----	-----
Net deferred tax assets	20,176	-	(8,802)	580	28,398	-
	-----	-----	-----	-----	-----	-----

Notes to the financial statements (continued)

17 Inventories

	2005	<i>Restated</i> 2004
	HRK '000	HRK '000
Raw materials	11,865	14,877
Work-in-progress and semi-finished goods	21,021	39,335
Finished goods	-	264
	-----	-----
Total inventories	32,886	54,476
Impairment loss	(1,952)	(5,946)
	-----	-----
	30,934	48,530
	-----	-----

Movement in the impairment loss in the amount of HRK 42,090 thousand (2004: nil) relates to used impairment losses.

18 Trade receivables

	2005	<i>Restated</i> 2004
	HRK '000	HRK '000
Foreign customers	391,791	291,412
Current portion of non-current loans and receivables	109,245	181,757
	-----	-----
Total foreign customers	501,036	473,169
	-----	-----
Domestic customers	167,855	186,467
Current portion of non-current loans and receivables	6,937	4,589
	-----	-----
Total domestic customers	174,792	191,056
	-----	-----
Impairment loss on loans and receivables	(54,515)	(91,937)
	-----	-----
	621,313	572,288
	-----	-----

Included in trade receivables is HRK 28,403 thousand (2004: HRK 8,453 thousand) of contract work in progress.

Notes to the financial statements (continued)

19 Other receivables

	2005	<i>Restated</i> 2004
	HRK '000	HRK '000
Receivables for prepaid VAT	20,650	25,117
Receivables from employees	628	1,134
Accrued interest receivable	1,465	1,645
Other receivables	5,581	2,968
	<u>28,324</u>	<u>30,864</u>

20 Other current financial assets

	2005	<i>Restated</i> 2004
	HRK '000	HRK '000
<i>Financial assets at fair value through profit or loss, trading assets</i>		
- Positive fair value of derivative instruments	358	1,436
<i>Financial assets at fair value through profit or loss</i>		
- Debt securities	78,009	89,459
- Equity securities	1,002	369
- Investment in open-ended investment funds	412,777	218,991
<i>Other loans and receivables</i>		
- Loans, deposits and guarantee deposits	-	461
	<u>492,146</u>	<u>310,716</u>

In 2005 debt securities comprise Ministry of Finance bonds in the total amount of HRK 78,009 thousand (HRK 40,712 thousand denominated in euro and the remaining part denominated in kuna), consisting of debt securities in the amount of HRK 40,712 thousand maturing in 2007, the amount of HRK 33,051 thousand maturing in 2010, and the amount of HRK 4,246 thousand maturing in 2015. These debt securities bear fixed interest rate from 3.875% to 6.75% per annum. In 2004 debt securities comprise the Ministry of Finance bonds in the amount of HRK 41,981 thousand (denominated in euro) with maturity in 2007 and a fixed interest rate of 3.875% per annum, and the Ministry of Finance Treasury bills, denominated in kuna, in the amount of HRK 47,478 thousand with maturity in 2005 and fixed interest rate in range of 4.90% to 6.65% per annum. Investments in open-ended investment funds in the amount of HRK 358,210 thousand (2004: HRK 149,226 thousand) are denominated in kuna and HRK 54,567 thousand (2004: HRK 69,765 thousand) are denominated in euro. The fair value of financial assets at fair value through profit or loss at the balance sheet date was determined by reference to quoted prices on the Zagreb stock exchange on 31 December 2005.

Notes to the financial statements (continued)

21 Cash and cash equivalents

	2005	<i>Restated</i> 2004
	HRK '000	HRK '000
Cash and demand deposits	34,446	30,244
Time deposits originated by the Company, with original maturity up to 3 months	157,874	364,611
	<u>192,320</u>	<u>394,855</u>

Cash and demand deposits in the amount of HRK 30,622 thousand (2004: HRK 12,295 thousand) are denominated in kuna and the remaining part is denominated in foreign currencies. Time deposits in the amount of HRK 54,200 thousand (2004: HRK 111,460 thousand) are denominated in kuna and bore fixed interest rates at the year-end ranging from 3.0% to 6.5% per annum (2004: 5.0% to 7.0% per annum), HRK 92,453 thousand (2004: HRK 253,151 thousand) are denominated in euro and bore fixed interest rates ranging from 2.2% to 4.7% per annum (2004: 2.19% to 2.60% per annum) and the amount of HRK 11,221 thousand (2004: nil) are denominated in US dollar and bore fixed interest rates at the year-end ranging from 2.2% to 4.7% per annum (2004: nil).

Notes to the financial statements (continued)

22 Equity

(a) Share capital

As at 31 December 2005, the share capital of the Company is represented by 1,331,650 (2004: 1,331,650) of authorised, issued and fully paid ordinary shares, with a total registered value of HRK 266,330 thousand (2004: HRK 266,330 thousand). The nominal value of one share is HRK 200 (2004: HRK 200). 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.

<i>The Company's shareholders as at 31 December 2005 are:</i>	2005	2005	2004	2004
	Number of shares	% Held	Number of shares	% Held
Telefonaktiebolaget LM Ericsson	653,473	49.07%	653,473	49.07%
Small shareholders	652,680	49.01%	648,892	48.73%
Croatian Privatisation Fund	11,848	0.89%	11,661	0.88%
Treasury shares	13,649	1.03%	17,624	1.32%
	<u>1,331,650</u>	<u>100.00%</u>	<u>1,331,650</u>	<u>100.00%</u>

(b) Treasury shares

During 1997 and 1998 the Company acquired 17,624 of its own shares. Total amount of HRK 5.9 million paid to acquire these shares, net of income tax, was deducted from shareholders' equity. These shares are held as "treasury shares" and will be granted to key management and other employees as a part of the share-based program established during 2004, as described in Note 24(b).

(c) Capital redemption

A decrease in share capital was approved by the General Assembly at its meeting in May 2005, resulting from a decrease in the nominal value of shares from HRK 200 to HRK 100 and became unconditional after the year-end, following the statutory six-month period as required by the Commercial Court. The official Commercial Court approval was received in January 2006 and the obligation for redemption was recognised in January 2006. The share capital was repaid on 15 February 2006 (Note 32). Repayment in respect of capital redemption in 2004 relates to decrease in share capital that was approved by the General Assembly at its meeting in May 2003, resulting from decrease in the nominal value of shares from HRK 300 to HRK 200 and became unconditional after 31 December 2003, following the statutory six-month period as required by the Commercial Court. The Commercial Court approval was received in January 2004 and the obligation for redemption was recognised in January 2004 and repaid in January 2004.

(d) 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 for covering of losses if the losses are not covered by current net profit or if other reserves are not available. The Company recorded the required level of legal reserves in the year 2000 and no further allocation of legal reserves is required.

Notes to the financial statements (continued)

22 Equity (continued)

Proposed dividends

Dividends payable are not accounted for until they have been ratified at the General Assembly of shareholders. On 12 May 2005 the General Assembly approved a dividend in respect of 2004 of HRK 18.00 per share totalling HRK 23.7 million. At the meeting held on 6 March 2006 the Management Board proposed a dividend in respect of 2005 in the amount of HRK 19.00 per share. The dividend will be paid from retained earnings formed up to 31 December 2005, after approval by the General Assembly, which is scheduled for 1 June 2006. Dividends paid out of profits realised in the years preceding 2001 are generally not subject to withholding tax or dividend tax. Dividends paid out of profits realised in the years 2001 to 2005 are generally subject to withholding tax. Dividend payments to foreign individuals and foreign entities are generally subject to 15% withholding tax.

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

	2005	<i>Restated</i> 2004
	HRK '000	HRK '000
HRK 18.00 per share for 2004	23,652	-
HRK 17.00 per share for 2003	-	22,338
	-----	-----

23 Interest-bearing borrowings

Borrowings are represented by debt due to financial institutions, the settlement of which is pending the definition of debt deriving from the former Yugoslavia. The amount of HRK 1,501 thousand or EUR 204 thousand (2004: HRK 1,802 thousand or EUR 239 thousand) (current portion included) to Hermes Kreditversicherungs, A.G. (Germany) is repayable in the period from 2006 to 2009. This loan bears a fixed interest rate of 7.9% per annum.

The remaining amount of HRK 1,915 thousand (2004: HRK 2,029 thousand) (current portion included) relates to two loans from Crediop and Centrobanca Italy that bear interest at rates declared by the Treasury of Italy plus a margin of 0.4% per annum. These two loans are repayable in semi-annual installments until July 2009.

	2005	<i>Restated</i> 2004
	HRK '000	HRK '000
Non-current portion of unsecured loans	3,109	3,559
Current portion of unsecured loans	307	272
	-----	-----
	3,416	3,831
	-----	-----

Notes to the financial statements (continued)

24 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 national pension fund to the Croatian employees upon their retirement. Additionally, during 2001 the Company signed an Annex to the Union Agreement with benefit regarding early retirement of employees.

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 2005 were a 7% discount rate (2004: 7%) and a 2.57% (2004: 2.56%) rate of average employment turnover.

(b) Share-based payments

During 2004, the Company established its Loyalty program, a share-based scheme under which key management personnel (Executive Management), senior employees (Top 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 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 and are charged against retained earnings.

Notes to the financial statements (continued)

24 Employee benefits (continued)

The terms and conditions of the grants are as follows:

Employees entitled/grant date	Number of shares granted	Vesting conditions
<i>Loyalty program</i>		
Share grant to key management during 2004	690	Three to five years of service
Share grant to other employees during 2004	8,355	Three to five years of service
Share grant to key management during 2005	-	Three to five years of service
Share grant to other employees during 2005	-	Three to five years of service
	9,045	
<i>Award program</i>		
Share grant to key management during 2004	1,640	Upon granting
Share grant to other employees during 2004	730	Upon granting
Share grant to key management during 2005	-	Upon granting
Share grant to other employees during 2005	-	Upon granting
	2,370	

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. Dividends that will not be receivable by the employees during the vesting period are not incorporated into the measurement of fair value, as the impact of this is not considered material.

	Number of shares granted	Weighted average fair value per share
Shares granted in 2004	11,415	HRK 656.68
Shares granted in 2005	-	-

During 2005 the Company recognised HRK 2,097 thousand (2004: HRK 4,995 thousand) of expenses in respect of share-based payments, which are included in personnel expenses as disclosed in Note 8. All shares under award program granted during 2004 vested during 2004 and were distributed upon ratification at the General Assembly. Additionally, 1,605 shares granted under loyalty program vested during 2005.

Notes to the financial statements (continued)

25 Trade and other payables

	2005	<i>Restated</i> 2004
	HRK '000	HRK '000
Trade payables	54,549	42,488
Liabilities to employees	39,438	39,820
Other current liabilities	13,246	10,749
	<u>107,233</u>	<u>93,057</u>

Liabilities to employees include bonus salary of HRK 28.1 million (2004: HRK 30.0 million).

26 Provisions

Provisions relate to current provisions for penalty costs and warranty costs. Movements in provisions were as follows:

	2005	2005	2005	<i>Restated</i> 2004	<i>Restated</i> 2004	<i>Restated</i> 2004
	Warranty reserve	Penalty reserve	Total	Warranty reserve	Penalty reserve	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
As at 1 January	10,753	1,015	11,768	15,891	997	16,888
Provision created during the year	6,223	60	6,283	5,537	66	5,603
Provision reversed during the year	(1,947)	(776)	(2,723)	(3,643)	(48)	(3,691)
Provision used during the year	(3,593)	-	(3,593)	(7,032)	-	(7,032)
As at 31 December	<u>11,436</u>	<u>299</u>	<u>11,735</u>	<u>10,753</u>	<u>1,015</u>	<u>11,768</u>

The warranty reserve is established to cover the expected warranty claims on products sold during the year. The penalty reserve is created to cover the expected claims from customers in respect of delays in deliveries of products and services having occurred during the year. These provisions have not been discounted, as the effect of discounting is not considered material. Warranty and penalty costs are expected to be incurred in the next financial 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)

27 Accrued charges and deferred revenue

		<i>Restated</i>
	2005	2004
	HRK '000	HRK '000
Advances from domestic customers	274	77
Advances from foreign customers	24,196	32,911
Deferred revenue	52,703	65,970
Accrued severance payment costs	10	10
Accrued charges for unused holidays	7,013	6,061
Accrued charges in respect of service contracts	64,522	34,765
Other accrued charges	23,320	18,062
	-----	-----
	172,038	157,856
	-----	-----

Advances from foreign customers include HRK 14 million received during the years 1989-1992 from the post and telegraph companies of the former Yugoslavia. These advances are carried at cost, as there is significant uncertainty as to when they will be utilised. Deferred revenue mainly represents amounts due to customers under contracts for work not performed.

Notes to the financial statements (continued)

28 Balances and transactions with related parties

The Company is a related party to the Ericsson Group via the 49.07% (2004: 49.07%) shareholding by Telefonaktiebolaget LM Ericsson, which is also the ultimate parent of the Ericsson Group. As disclosed in Note 22(a), remaining 50.93% (2004: 50.93%) of the shares are widely held.

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

(a) Key transactions with the related parties

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

	Ericsson Group							
	Telefonaktiebolaget LM Ericsson		Consolidated companies		Associated companies		Total	
	2005	2004	2005	2004	2005	2004	2005	2004
	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000
Sales of goods and services								
Sales revenue	-	-	305,235	229,019	-	238	305,235	229,257
Commission income	-	-	5,919	7,741	-	-	5,919	7,741
	-----	-----	-----	-----	-----	-----	-----	-----
Total sales	-	-	311,154	236,760	-	238	311,154	236,998
	-----	-----	-----	-----	-----	-----	-----	-----
Purchases of goods and services								
Licenses	6,507	6,625	48,632	96,018	-	-	55,139	102,643
Management fee	-	-	6,546	5,722	-	-	6,546	5,722
Cost of sales	749	739	658,976	544,130	33	55	659,758	544,924
	-----	-----	-----	-----	-----	-----	-----	-----
Total purchases	7,256	7,364	714,154	645,870	33	55	721,443	653,289
	-----	-----	-----	-----	-----	-----	-----	-----

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

Notes to the financial statements (continued)

28 Balances and transactions with related parties (continued)

(b) Key management compensation

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

	<i>Restated</i>	
	2005	2004
	HRK '000	HRK '000
Salaries and other short-term employee benefits	16,726	15,290
Other long-term benefits	10	3
Share-based payments	137	2,486
	<u>16,873</u>	<u>17,779</u>

The members of the executive management and the Supervisory Board held 2,674 ordinary shares at the year-end (2004: 683 shares).

Included in the loans and receivables are HRK 307 thousand (2004: HRK 766 thousand) in respect of loans and advances granted to key management. During 2005 the Company collected HRK 32 thousand (2004: HRK 99 thousand) of interest from these loans.

In addition, the Company paid remuneration totalling HRK 293 thousand (2004: HRK 294 thousand) to the Supervisory Board.

Notes to the financial statements (continued)

28 Balances and transactions with related parties (continued)

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

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

	Receivable		Payable	
	<i>Restated</i>		<i>Restated</i>	
	2005	2004	2005	2004
	HRK'000	HRK'000	HRK'000	HRK'000
The main shareholder				
Ericsson Telefonaktiebolaget LM (LME)	-	-	1,078	31
Ericsson Group consolidated companies				
Ericsson Enterprise AB (EBC)	1,019	-	15,045	2,345
Ericsson AB (EAB)	30,814	23,934	82,342	100,403
Ericsson Telecomunicazioni S.P.A. (TEI)	1,974	65	-	-
Ericsson Corporatia AO (ECR)	4,813	639	-	-
LM Ericsson Limited (LMI)	85	155	15	372
Ericsson SP. Z.O.O. (EPO)	48	102	-	6
Ericsson Network Technologies AB (ECA)	-	-	192	452
Ericsson Global IT services AB (GIS)	-	32	8,066	1,015
Ericsson Austria A.G. (SEA)	150	379	-	-
Ericsson Sverige AB (ESE)	-	142	-	-
Ericsson South Africa Ltd. (ESA)	607	30	-	-
Ericsson SPOL.S.R.O. (ECZ)	154	172	-	-
Ericsson Egypt Ltd. (EEL)	1,327	292	-	-
Ericsson Test Environments (ETE)	-	-	3,591	2,146
Ericsson Telecomm. Equipment S.A. (ETG)	177	898	-	-
Ericsson Hungary Ltd. (ETH)	1,354	646	-	12
Ericsson Ltd. (ETL)	251	459	-	-
Ericsson Telecommunicatia B.V. (ETM)	616	531	818	1,326
Ericsson Denmark A/S (LMD)	10	159	122	147
OY LM Ericsson AB (LMF)	-	279	-	168
Ericsson Slovakia SPOL.S.R.O. (SBB)	225	524	-	-
Ericsson Communications Co. Ltd. (CBC)	149	-	-	-
Ericsson d.o.o. (EBA)	80	-	590	-
Ericsson GMBH Group (EDD)	-	-	182	-
Ericsson De Panama S.A. (EDP)	148	-	395	-
Ericsson Espana S.A. (EEM)	289	-	8	-
Ericsson De Honduras Group (EHO)	835	-	-	-
Ericsson Maroc SARL (EMO)	169	-	-	-
Ericsson Telekomunikasyon A.S. (ENK)	448	-	-	-
Ericsson Telekomunikations Bulgaria EOOD (ETB)	588	-	-	-
Ericsson Telekomunikations Romania (ETR)	743	-	-	-
Ericsson Inc. (EUS)	289	-	-	-
Ericsson d.o.o. (EVN)	10	-	98	-
Ericsson International Services B.V. Group (ISN)	-	-	32	-
LM Ericsson Ltd. (Nigeria) Group (LMN)	89	-	-	-
Nippon Ericsson K.K. Group (NRJ)	112	-	-	-
Ericsson Telecomunicacoes LDA Group (SEP)	97	-	-	-
Ericsson TEMS AB Group (TMS)	-	-	156	-
Other	608	1,788	2	475
	48,278	31,226	112,732	108,898

Notes to the financial statements (continued)

29 Financial instruments

Exposure to currency, interest rate and credit risk arises in the normal course of the Company's business. 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 exposed to US dollars and to euro, as a substantial proportion of receivables and foreign revenues are denominated in these currencies. Risk management relies on attempts to match, as much as possible, revenues in each currency with the same currency expenditure. Additionally, the Company entered into foreign currency forward contracts to hedge economically its exposure to currency risk arising on operating cash flows. The Company hedges at least 75% of its estimated foreign currency exposure in respect of forecast sales and purchases over the following 12 months. All derivative contracts have maturities of less than one year after the balance sheet date.

Interest rate price risk

Interest rate price 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 mainly on short-term notice, the risk is limited to investments in the Ministry of Finance bonds, as well as non-current deposits in financial institutions (Note 14).

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 for projects. Therefore, the Company is financing customers to a certain extent, which exposes 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. Impairment losses are calculated using the net present value method. Additionally, there is credit concentration risk as the Company has a significant portion of receivables from some customers. As at 31 December 2005, the five largest customers represent 32% of total net trade receivables (2004: 28%). 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 banks. Management of this risk is focused on dealing with banks in foreign ownership or with banks that are listed on the international financial markets and on contacts with the banks on a daily basis. Therefore, the Company considers that its maximum exposure to credit risk is reflected in the amount of trade receivables (Notes 14 and 18) and other receivables (Note 19), net of impairment loss for doubtful receivables.

Notes to the financial statements (continued)

29 Financial instruments (continued)

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 considered low.

Fair value estimation

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

The fair values of financial instruments together with carrying amounts shown in the balance sheet are as follows:

				<i>Restated</i>	<i>Restated</i>	<i>Restated</i>
	Carrying amount	Fair value	Unrecognised gain/(loss)	Carrying amount	Fair value	Unrecognised gain/(loss)
	2005	2005	2005	2004	2004	2004
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Non-current loans and receivables	247,719	248,850	1,131	107,138	107,138	-
Trade and other receivables	697,915	697,915	-	633,379	633,379	-
Current financial assets	492,146	492,146	-	310,716	310,716	-
Cash and cash equivalents	192,320	192,320	-	394,855	394,855	-
Interest-bearing borrowings	(3,416)	(3,461)	(45)	(3,831)	(3,831)	-
Trade and other payables	(107,233)	(107,233)	-	(93,057)	(93,057)	-
	1,519,451	1,520,537	1,086	1,349,200	1,349,200	-

Fair value of non-current loans and receivables and 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. The Company has set up the model for calculation in 2005 and consequently it was not practicable to calculate the fair values of non-current loans and receivables in 2004. However, 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 2004.

Notes to the financial statements (continued)

29 Financial instruments (continued)

Current financial assets, including derivatives are stated at fair value that is based on quoted prices at the balance sheet date without any deduction for transaction costs.

The carrying amount of cash and cash equivalents and of bank deposits deemed to reflect the fair value due to the short-term maturity of these financial instruments. Similarly, the amortised cost carrying amounts of trade receivables and payables with remaining life of less than one year which are all subject to normal trade credit terms deemed to reflect the fair values.

It is not practicable to determine the fair value of advances received from post and telegraph companies of the former Yugoslavia due to the uncertainty of timing of their utilisation (Note 27).

The following interest rates were used for determining fair values, which are based on available market rates for similar financial instruments:

Non-current loans and receivables	5% - 6%
Interest-bearing borrowings	6%

30 Derivative instruments

Since 2003 the Company has entered into foreign currency forward agreements to hedge economically its operating cash flows denominated in foreign currency, predominately USD and EUR. As these hedges do not qualify for hedge accounting, these are accounted for as trading instruments, with all gains and losses on fair value being recognised in the income statement.

The contractual notional amount of these derivatives (over the counter) at the year-end amounted to HRK 62 million (2004: HRK 60 million), while their fair values amounted to HRK 358 thousand (assets) (2004: HRK 1,436 thousand (assets)). These derivatives have remaining periods to maturity of less than one year.

Majority of the Company's purchases and sales contracts are denominated in foreign currency. The embedded derivative component of these contracts is not measured and presented separately as derivatives. Market for forward EUR:HRK or USD:HRK currency agreements in excess of six months in Croatia is undeveloped and market rates are not easy to obtain. Consequently, the Company is not able to determine reliably the fair value of the embedded option and any gains and losses on derivative component of the contracts is recognised in the income statement upon recognition of sales revenue or cost of purchases.

Notes to the financial statements (continued)

31 Contingent liabilities

In December 1999 the Company received a notification of a lawsuit brought against it by a number of small shareholders. According to this lawsuit, the Zagreb Commercial Court was required to declare certain decisions of the General Assembly, held on 18 June 1998, null and void. The Company has submitted its response to the Court. In January 2004 the Zagreb Commercial Court published the 1st instance judgement in which the plaintiffs' requests have been refused.

On 2 March 2004 the plaintiffs appealed and the Appeal Court (Croatian High Commercial Court) has still not made a decision on appeal. The Company's Management Board is of the opinion that no material liabilities for the Company can result from this lawsuit. No developments occurred in the case during 2005.

In September 2004 the Croatian Privatisation Fund made a request towards the Company to increase its share capital by HRK 2 million due to the increased value of buildings held in countries of the former Yugoslavia, included in privatisation during 1995. The Company disagrees with the basis and method of the valuation made by the Croatian Privatisation Fund. Accordingly, the Company commenced legal proceedings during October 2004 to resolve the matter. The Company's Management Board believes the matter will be resolved with no material liabilities for the Company. No developments occurred in the case during 2005.

32 Subsequent events

On 24 February 2005, the Supervisory Board accepted the Management Board's proposal to decrease the nominal value of shares from HRK 200 to HRK 100. The proposal was approved at the General Assembly meeting held on 12 May 2005. The official Commercial Court approval was received in January 2006 and the obligation for redemption was recognised in January 2006. Share capital in the total amount of HRK 133.2 million was repaid on 15 February 2006 (Note 22(c)).