Investment in the future is always a good decision, because you will profit for sure.

Growth as a constant

Financial statements 2006 together with Independent Auditors' Report

Ericsson Nikola Tesla d.d.

Company profile

History and incorporation

Ericsson Nikola Tesla d.d. Zagreb (the Company) is a Croatian company with fifty-seven 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 2006, 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 0.85% and other shareholders own the remaining 49.19% 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 customers in Central and Eastern Europe, Middle East and Africa as well as companies within the Ericsson Group.

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 executive management

The Supervisory Board

The Supervisory Board members during 2006 and up to the release of these statements were:

Jan Campbell	Appointed on 1 June 2006	Chairperson
Ragnar Bäck	Appointed on 18 May 2004	
	Resigned 1 June 2006	Chairperson up to 1 June 2006
Ignac Lovrek	Appointed on 8 May 2003	Member; from 18 May 2004 Vice-Chairperson
Carita Jönsson	Appointed on 18 May 2004	Member
Zvonimir Jelić	Appointed on 5 June 2006	Member and employees' representative
Darko Marinac	Appointed on 8 May 2003	Member

The Management Board

The Management Board has one member:

Gordana Kovačević	Appointed on 1 January 2005	President

Company profile (continued)

Executive management

As at 31 December 2006, the Company's executive management comprised:

Gordana Kovačević	Company 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
Alessandro Pane	Director, Research and Development Center
Maria Radtke	Director, Finance & Sourcing
Snježana Bahtijari	Director, Communication
Ana Jožinec	Director, HR and Organization (including Legal Affairs)
Alen Ludaš	Director, Sales and Marketing for VIPnet and Si.mobil
Miroslav Kantolić	Director, Sales and Marketing for TELE 2 and Alternative Operators
Snježana Ivezić-Torbarina	Director, Sales and Marketing for Enterprise
Davor Rogić	Acting Director, Sales and Marketing for B&H, Montenegro
Damir Bušić	Director, System Integration (including e-systems)
Srećko Lepri	Director, Services
Mathias Danielsson	Director, Global Service Delivery Center
Branko Dronjić	Director, Business Ericsson Test Environment
Siniša Krajnović	Manager, CPP
Vlatka Maričić	Manager, AXE Signaling, Design/Test & Capability Manager
Vjeran Radatović	Deputy Manager, AXE Signaling, System Management & Capability Manager
Lorenco Damjanić	Manager, DCNE I&V

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

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

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

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

The financial statements set out on pages 58 to 106 were authorised by the Management Board on 1 March 2007 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 financial statements of Ericsson Nikola Tesla d.d. (the Company), which comprise the balance sheet as at 31 December 2006 and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' Responsibility

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

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

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

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

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Company as at 31 December 2006 and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

KPMG

KPMG Croatia d.o.o. za reviziju
Croatian Certified Auditors
Eurotower, 17th floor
Ivana Lučića 2a
10000 Zagreb
Croatia

1 March 2007

For and on behalf of KPMG Croatia d.o.o. za reviziju:

Tony Ilijanić
Director, Croatian Certified Auditor

Ivana Matovina
Croatian Certified Auditor

Ericsson Nikola Tesla income statement

for the year ended 31 December 2006

	Notes	2006 HRK '000	2005 HRK '000
Sales revenue	3	1,634,141	1,624,515
Cost of sales		(1,347,875)	(1,300,964)
Gross profit		286,266	323,551
Other operating income	5	75,112	96,739
Distribution expenses		(67,900)	(70,141)
Administrative expenses		(42,120)	(43,452)
Other operating expenses	6	(52,902)	(90,554)
Results from operating activities		198,456	216,143
Interest income and other financial income	8	93,505	64,506
Net foreign exchange losses	9	(25,690)	(12,057)
Profit before financial cost and income tax expense		266,271	268,592
Financial cost (including interest expense and excluding net foreign exchange losses)	9	(1,751)	(190)
Profit before tax		264,520	268,402
Income tax expense	10	(30,747)	(32,714)
Profit for the year		233,773	235,688
Earnings per share (HRK)	11	177.06	178.82

The notes set out on pages 64 to 106 form an integral part of these financial statements.

Ericsson Nikola Tesla balance sheet

as at 31 December 2006

	Notes	2006 HRK '000	2005 HRK '000
Assets			
Non-current assets			
Property, plant and equipment	12	200,333	206,150
Intangible assets	13	3,888	2,894
Non-current loans and receivables	14	389,140	247,719
Equity securities	15	45	45
Deferred tax assets	16	14,181	20,176
Total non-current assets		607,587	476,984
Current assets			
Inventories	17	30,608	30,934
Trade receivables	18	490,334	621,313
Receivables from related parties	28(c)	70,192	48,278
Income tax receivable		872	8,739
Other receivables	19	24,269	28,324
Other current financial assets	20	436,952	492,146
Prepayments and accrued income		1,249	2,730
Cash and cash equivalents	21	280,767	192,320
Total current assets		1,335,243	1,424,784
Total assets		1,942,830	1,901,768

The notes set out on pages 64 to 106 form an integral part of these financial statements.

Ericsson Nikola Tesla balance sheet (continued)

as at 31 December 2006

	Notes	2006 HRK '000	2005 HRK '000
Equity and liabilities			
Equity			
Share capital	22(a)	133,165	266,330
Treasury shares	22(b)	(3,119)	(4,561)
Legal reserves	22(d)	20,110	20,110
Retained earnings		1,422,337	1,208,681
Total equity		1,572,493	1,490,560
Non-current liabilities			
Interest-bearing borrowings	23	1,415	3,109
Employee benefits	24	4,331	4,054
Total non-current liabilities		5,746	7,163
Current liabilities			
Payables to related parties	28(c)	70,083	112,732
Interest-bearing borrowings	23	586	307
Trade and other payables	25	122,754	107,233
Provisions	26	14,734	11,735
Accrued charges and deferred revenue	27	156,434	172,038
Total current liabilities		364,591	404,045
Total liabilities		370,337	411,208
Total equity and liabilities		1,942,830	1,901,768

The notes set out on pages 64 to 106 form an integral part of these financial statements.

Ericsson Nikola Tesla statement of cash flows

for the year ended 31 December 2006

	Notes	2006 HRK '000	2005 HRK '000
Cash flows from operating activities			
Profit before tax		264,520	268,402
Adjustments for:			
Depreciation and amortisation	12,13	73,286	53,912
Impairment losses and reversal		(5,695)	(24,719)
Change in provisions	26	5,339	3,560
Net loss on sale of property, plant and equipment	6	918	85
Net gains on financial assets at fair value through profit or loss	8	(9,187)	(17,263)
Amortisation of discount	8	(59,698)	(18,773)
Interest income	8	(24,620)	(28,470)
Interest expense	9	1,751	190
Foreign exchange gains		(6,091)	(19,321)
Equity-settled transactions		5,800	2,097
		246,323	219,700
Increase in non-current loans and receivables		(129,091)	(210,779)
Decrease in inventories and receipt from insurance company		37,272	17,596
Decrease in receivables		114,905	46,703
(Decrease)/increase in payables		(32,004)	29,329
(Decrease)/increase in other operating assets and liabilities		–	(977)
Cash generated from operations		237,405	101,572
Interest paid		(1,751)	(190)
Income taxes paid		(18,045)	(54,596)
Net cash from operating activities		217,609	46,786
Cash flows from investing activities			
Interest received		24,316	28,650
Purchases of property, plant and equipment, and intangible assets		(69,381)	(109,968)
Increase in non-current deposits		3,326	449
Net disposal/(acquisition) of other non-trading financial assets		64,029	(163,706)
Net cash from investing activities		22,290	(244,575)

The notes set out on pages 64 to 106 form an integral part of these financial statements.

Ericsson Nikola Tesla statement of cash flows (continued)

for the year ended 31 December 2006

	Note	2006 HRK '000	2005 HRK '000
Cash flows from financing activities			
Repayment of interest-bearing borrowings		(1,430)	(415)
Dividends paid		(25,077)	(23,652)
Capital redemption		(131,403)	–
Net cash used in financing activities		(157,910)	(24,067)
Effects of exchange rate changes on cash and cash equivalents		6,458	19,321
Net increase/(decrease) in cash and cash equivalents		88,447	(202,535)
Cash and cash equivalents at the beginning of the year	21	192,320	394,855
Cash and cash equivalents at the end of the year	21	280,767	192,320

The notes set out on pages 64 to 106 form an integral part of these financial statements.

Ericsson Nikola Tesla statement of changes in equity

for the year ended 31 December 2006

	Share capital HRK '000	Treasury shares HRK '000	Legal reserves HRK '000	Retained earnings HRK '000	Total HRK '000
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	–	–	–	(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
As at 1 January 2006	266,330	(4,561)	20,110	1,208,681	1,490,560
Changes in equity for 2006					
Profit for the year	–	–	–	233,773	233,773
Total recognised income for 2006	–	–	–	233,773	233,773
Dividend distribution for 2005, Note 22	–	–	–	(25,077)	(25,077)
Capital redemption, Note 22 (c)	(133,165)	–	–	1,762	(131,403)
Treasury shares, Note 22 (b)	–	1,442	–	(1,442)	–
Equity-settled transactions, Note 24 (b)	–	–	–	5,800	5,800
Deferred tax related to equity increase	–	–	–	(1,160)	(1,160)
As at 31 December 2006	133,165	(3,119)	20,110	1,422,337	1,572,493

The notes set out on pages 64 to 106 form an integral part of these financial statements.

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 on the Public Joint Stock Company listing on the Zagreb Stock Exchange. The shares are also traded on the free market of the Varaždin Stock Exchange. These financial statements were authorised for issue by the Management Board on 1 March 2007 for approval by the Supervisory Board. A summary of the Company's principal accounting policies is set out below.

Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and their 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.

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 are discussed in Note 2.

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 2007 or later periods but which the Company has not early adopted, as follows:

_ IFRS 7, Financial Instruments: Disclosures, and a complementary amendment to IAS 1, Presentation of Financial Statements – Capital Disclosures (effective from 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.

_ IFRS 8, Operating Segments (effective from 1 January 2009). The Standard requires segment disclosure based on the components of the entity that management monitors in making decisions about operating matters. Operating segments are components of an entity about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. Management is currently assessing the impact of IFRS 8 on the presentation and disclosure of its operating segments. The Company will apply IFRS 8 from annual periods beginning 1 January 2009.

_ IFRIC 7, Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies (effective for annual periods beginning on or after 1 March 2006). IFRIC 7 is not relevant to the Company's operations.

_ IFRIC 8, Scope of IFRS 2 (effective for annual periods beginning on or after 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. IFRIC 8 is not relevant to the Company's operations as the Company has not entered into any share-based payments arrangements for apparently nil or inadequate consideration.

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

- IFRIC 9, Reassessment of Embedded Derivatives (effective for annual periods beginning on or after 1 June 2006). The Interpretation requires that a reassessment of whether an embedded derivative should be separated from the underlying host contract should be made only when there are changes in the terms of the contract that significantly modify the cash flows that otherwise would be required under the contract. The Company is analysing the impact of the new Interpretation.

- IFRIC 10, Interim Financial Reporting and Impairment (effective for annual periods beginning on or after 1 November 2006). The Interpretation prohibits the reversal of an impairment loss recognised in a previous interim period in respect of *goodwill*, investments in equity instruments or financial assets carried at cost. The Company does not expect the Interpretation to have significant impact on the financial statements.

- IFRIC 11, IFRS 2 – Group and Treasury Share Transactions (effective for annual periods beginning on or after 1 March 2007). The Interpretation requires a share-based payment arrangement in which an entity receives goods or services as consideration for its own equity instruments to be accounted for as an equity-settled share-based payment transaction, regardless of how the equity instruments needed are obtained. It also provides guidance on whether share-based payment arrangements, in which suppliers of goods or services of an entity are provided with equity instruments of the entity's parent, should be accounted for as cash-settled or equity-settled in the entity's financial statements. The Company is analysing the impact of the new Interpretation.

- IFRIC 12, Service Concession Arrangements (effective from 1 January 2008). The Interpretation provides guidance to private sector entities on certain recognition and measurement issues that arise in accounting for public-to-private service concession arrangements. The Company is analysing the impact of the new Interpretation.

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 exchange rate as at 31 December 2006 was HRK 5.5784 per 1 United States dollar (2005: HRK 6.2336) and HRK 7.3451 per 1 euro (2005: HRK 7.3756).

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. For the purpose of disclosing profit before financial cost and income tax expense and amortisation of discount on non-current loans and receivables, as disclosed in Note 8, the Company has changed the format of the income statement and accordingly reclassified prior year figures.

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	
	2006	2005
Buildings	5 – 30 years	5 – 30 years
Technical equipment	3 – 10 years	3 – 10 years
Other (vehicles, tools, furniture and fixtures)	3 – 7 years	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 licence and computer software, which are amortised on a straight-line basis over useful life of 2-4 years (2005: 3 years). Cost associated with developing or maintaining computer software is 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 or 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, 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 securities 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 acquired. 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 expensed 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 financial 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 its quoted price at the balance sheet date, being the present value of the quoted forward price.

Trade and other receivables

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

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

Notes to the financial statements (continued)

2 Critical accounting estimates and judgements

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

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 tax

The Company is subject to income tax 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)

2 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.

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

Under certain service contracts the Company offers 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.

3 Sales revenue

	2006 HRK '000	2005 HRK '000
Sales revenue in Croatia	482,591	475,947
Sales revenue in Russia, Belarus, Kazakhstan, Ukraine, Kyrgyzstan, Moldova and neighbouring countries	539,795	530,425
Sales revenue to the European Union	357,826	296,546
Sales revenue in Bosnia and Herzegovina, Montenegro and Macedonia	233,944	274,515
Other export sales revenue	19,985	47,082
	1,634,141	1,624,515

Out of total sales revenue of HRK 1,634 million, sales of products amounted to HRK 857 million (2005: HRK 944 million) and sales of services amounted to HRK 777 million (2005: HRK 681 million).

Notes to the financial statements (continued)

4 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 decisions 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

	2006 HRK '000	2005 HRK '000
Systems	1,506,538	1,435,382
Mobile Networks	770,353	684,416
Fixed Networks	219,380	360,558
Professional Services	516,805	390,408
Other business operations	202,715	285,872
	1,709,253	1,721,254

Geographical segments

Segments are managed in Europe, Middle East and Africa. Revenues determined based on the geographic location of customers are disclosed in Note 3. All the Company's assets are located in Croatia.

Notes to the financial statements (continued)

4 Segment reporting (continued)

	Systems		Other business		Total	
	2006 HRK '000	2005 HRK '000	2006 HRK '000	2005 HRK '000	2006 HRK '000	2005 HRK '000
External sales and other income	1,506,538	1,435,382	202,715	285,872	1,709,253	1,721,254
Total external sales and other income	–	–	–	–	1,709,253	1,721,254
Segment results before financial income	210,779	231,547	30,715	28,133	241,494	259,680
Unallocated Company's expenses	–	–	–	–	(43,038)	(43,537)
Results from operating activities	–	–	–	–	198,456	216,143
Segment financial income	54,855	28,999	17,277	2,049	72,132	31,048
Segment results	265,634	260,546	47,992	30,182	313,626	290,728
Unallocated Company's financial income	–	–	–	–	21,373	33,458
Net foreign exchange losses	–	–	–	–	(25,690)	(12,057)
Profit before financial cost and income tax expense	–	–	–	–	266,271	268,592
Financial cost (including interest expense and excluding net foreign exchange losses)	–	–	–	–	(1,751)	(190)
Profit before tax	–	–	–	–	264,520	268,402
Income tax expense	–	–	–	–	(30,747)	(32,714)
Profit for the year	–	–	–	–	233,773	235,688
Segment assets	933,619	863,357	125,987	173,086	1,059,606	1,036,443
Unallocated Company's assets	–	–	–	–	883,224	865,325
Total Company's assets	–	–	–	–	1,942,830	1,901,768
Segment liabilities	185,456	187,340	25,026	37,558	210,482	224,898
Unallocated Company's liabilities	–	–	–	–	159,855	186,310
Total Company's liabilities	–	–	–	–	370,337	411,208
Capital expenditure	57,850	90,782	7,807	18,200	–	–
Depreciation and amortisation	50,270	23,698	6,784	4,751	–	–
Other non-cash expenses	31,958	43,237	4,313	8,668	–	–

Notes to the financial statements (continued)

5 Other operating income

	2006 HRK '000	2005 HRK '000
Commission income	1,212	5,919
Reversal of unused provisions	1,625	2,723
Rental income	18,354	16,160
Reversal of impairment loss on loans and receivables	717	70,819
Reversal of impairment loss on inventories (i)	37,207	-
Reversal of reserves for YU advances (ii)	12,791	-
Other income	3,206	1,118
	75,112	96,739

(i) 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. During 2006 the Company has finalised all procedures with the insurance company and recognised gains in respect of this claim in the amount of HRK 37,207 thousand.

(ii) The Company has reversed reserves for YU advances in the amount of HRK 12,791 thousand as a result of the fulfilled obligation towards a foreign customer.

6 Other operating expenses

	Note	2006 HRK '000	2005 HRK '000
Net loss on disposal of property, plant and equipment		918	85
Increase in provisions		6,964	6,283
Impairment loss on loans and receivables		44,759	46,090
Impairment loss on inventories	(5i)	261	38,096
		52,902	90,554

Notes to the financial statements (continued)

7 Personnel expenses

	2006 HRK '000	2005 HRK '000
Salaries, net of taxes and contributions	157,688	140,549
Taxes and contributions	152,986	135,830
Other payroll-related costs	11,959	9,431
Equity-settled transactions (Note 24)	5,800	2,097
	328,433	287,907

Personnel costs include HRK 51.6 million (2005: HRK 46.3 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:

	2006 HRK '000	2005 HRK '000
Operations	404	399
Global Service Delivery Center	142	105
Business Ericsson Test Environment	15	-
Research and Development Center	588	567
Sales	66	66
Support functions	148	144
Employees on long-term assignment abroad	10	7
	1,373	1,288

Notes to the financial statements (continued)

8 Interest income and other financial income

	2006 HRK '000	2005 HRK '000
Interest income	24,620	28,470
Financial assets:		
Net gains from disposal of financial assets at fair value through profit or loss (Note 8 a)	705	2,503
Net gains on re-measurement of financial assets at fair value through profit or loss (Note 8 b)	8,482	14,760
Amortization of discount	59,698	18,773
Interest income and other financial income	93,505	64,506

Interest income includes interest income on loans to customers in the amount of HRK 12.4 million (2005: HRK 12.5 million), interest income on debt securities in the amount of HRK 3.9 million (2005: HRK 2.9 million), interest income on term deposits in the amount of HRK 5.6 million (2005: HRK 11.1 million) and interest income on other receivables in the amount of HRK 2.7 million (2005: HRK 1.9 million).

The Company released HRK 59,698 thousand (2005: HRK 18,773 thousand) of impairment reserves into financial income due to amortisation of discount according to the net present value method of impairment.

	2006 HRK '000	2005 HRK '000
8(a)		
Net gains from disposal of financial assets at fair value through profit or loss arise from sale of the following financial instruments:		
– Investment in investment funds	1,012	3,417
– Debt securities	66	(914)
– Old foreign currency savings	(373)	–
8(b)	705	2,503
Net gains/(losses) on re-measurement of financial assets at fair value through profit or loss arise from re-measurement of the following financial instruments:		
– Derivative financial instruments	(358)	(1,078)
– Equity securities	858	633
– Investment in investment funds	9,919	12,655
– Debt securities	(1,937)	2,550
	8,482	14,760

Notes to the financial statements (continued)

9 Financial cost

	2006 HRK '000	2005 HRK '000
Interest expense	(1,751)	(190)
Net foreign exchange losses	(25,690)	(12,057)
	(27,441)	(12,247)

10 Income tax expense

Income tax has been calculated at statutory tax rate of 20% (2005: 20%) of the taxable income of the Company.

Income tax expense recognised in the income statement comprises:

	2006 HRK '000	2005 HRK '000
Current income tax expense	(25,912)	(23,912)
Deferred tax expense relating to the origination and reversal of temporary differences	(4,835)	(8,802)
Total income tax expense in the income statement	(30,747)	(32,714)

Deferred tax recognised directly to equity:

	2006 HRK '000	2005 HRK '000
Relating to equity-settled transactions	(1,160)	580

Notes to the financial statements (continued)

10 Income tax expense (continued)

Reconciliation between tax expense and accounting profit is shown as follows:

	2006 HRK '000	2005 HRK '000
Profit before tax	264,520	268,402
Income tax at 20% (2005: 20%)	52,904	53,680
Non-deductible expenses	2,985	6,457
Tax exempt revenues	–	(633)
Tax incentives	(25,142)	(26,790)
Total tax expense	30,747	32,714
Effective tax rate	11.6%	12.2%

Tax incentives include additional tax allowances (200% deduction) for certain expenditure totalling HRK 20.6 million (2005: HRK 22.7 million) which meets research and development definitions under Croatian tax legislation. The underlying research and development expenditure is included in cost of sales. The remaining part of tax incentives relate to educational costs of employees in the amount of HRK 2.1 million (2005: HRK 2.4 million) and salaries of new employees in the amount of HRK 2.4 million (2005: HRK 1.7 million).

11 Earnings per share

	2006	2005
Profit for the year (HRK '000)	233,773	235,688
Weighted Average Number of Shares Outstanding at the year-end	1,320,336	1,318,001
Earnings per share (HRK)	177.06	178.82

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

2006	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 2006	151,217	346,440	1,484	407	499,548
Additions	–	–	66,561	–	66,561
Transfers	2,655	59,847	(62,506)	4	–
Disposals	–	(81,440)	–	(83)	(81,523)
As at 31 December 2006	153,872	324,847	5,539	328	484,586
Accumulated depreciation					
As at 1 January 2006	79,829	213,380	–	189	293,398
Charge for the year	4,650	66,664	–	10	71,324
Disposals	–	(80,435)	–	(34)	(80,469)
As at 31 December 2006	84,479	199,609	–	165	284,253
Carrying amount					
As at 31 December 2006	69,393	125,238	5,539	163	200,333
As at 31 December 2005	71,388	133,060	1,484	218	206,150

Construction in progress mainly relates to test plants in the amount of HRK 4,090 thousand (2005: HRK 455 thousand), and to Information systems/Information technology (IS/IT) equipment in the amount of HRK 684 thousand (2005: HRK 494 thousand).

Included in cost or deemed cost is HRK 136.1 million (2005: HRK 153.7 million) of fully depreciated property, plant and equipment that are still used by the Company.

As at 31 December 2006 the Company had contracts totalling HRK 7,347 thousand (2005: HRK 14,355 thousand) related to future equipment purchases.

Notes to the financial statements (continued)

12 Property, plant and equipment (continued)

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 and impairment losses					
As at 1 January 2005	75,368	188,559	–	215	264,142
Depreciation 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

Property leased to others with carrying value of HRK 60,455 thousand (2005: HRK 60,242 thousand) is included within the land and buildings. These assets are depreciated at the same depreciated rates as other buildings. HRK 28,413 thousand (2005: 28,241 thousand) of leased assets is leased under non-cancellable period of five years started in year 2005. 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:

	2006 HRK '000	2005 HRK '000
Less than one year	5,225	4,294
Between one and five years	8,306	11,058
More than five years	–	–
	13,531	15,352

Notes to the financial statements (continued)

13 Intangible assets

The movement on intangible assets in the year ended 31 December 2006, may be analysed as follows:

2006	Application software HRK '000
Cost or deemed cost	
As at 1 January 2006	12,437
Additions	2,956
Write-off	(3,036)
As at 31 December 2006	12,357
Accumulated amortisation	
As at 1 January 2006	9,543
Charge for the year	1,962
Write-off	(3,036)
As at 31 December 2006	8,469
Carrying amount	
As at 31 December 2006	3,888
As at 31 December 2005	2,894

Notes to the financial statements (continued)

13 Intangible assets (continued)

2005	Application 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

Included in the cost or deemed cost amount is HRK 5.7 million (2005: HRK 6.1 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

	2006 HRK '000	2005 HRK '000
Deposit with financial institutions, denominated in foreign currency	7,050	10,376
Foreign customers, denominated in foreign currency	382,619	229,271
Domestic customers, denominated in HRK	8,921	9,357
Receivables for sold apartments		
- denominated in foreign currency	6,469	7,077
- denominated in HRK	2,209	3,152
Housing loans to employees, denominated in HRK	662	892
Total non-current loans and receivables	407,930	260,125
Impairment loss on loans and receivables	(18,790)	(12,406)
	389,140	247,719

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 1.26% per annum (2005: 1.14% to 2.49% per annum), and with a remaining maturity of over four years.

The foreign loans and receivables in the amount of HRK 17,953 thousand (2005: HRK 23,953 thousand) are denominated in US dollars and those in the amount of HRK 364,666 thousand 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 2006 in the amount of HRK 75,689 thousand is due in 2008, the amount of HRK 67,194 thousand is due in 2009 and the amount of HRK 46,822 thousand in 2010, the amount of HRK 28,296 thousand is due in 2011, the amount of HRK 29,419 thousand is due in 2012 and the amount of HRK 144,120 thousand is due in the period 2013 - 2020. The non-current loans and receivables bear fixed interest rates in range of 2.2% to 6.75% per annum (2005: 3.8% to 6% per annum).

The non-current portion of foreign and domestic loans and receivables in 2005 was as follows: the amount of HRK 32,846 thousand is due in 2007, HRK 45,408 thousand is due in 2008, the amount of HRK 25,552 thousand is due in 2009, the amount of HRK 19,930 thousand in 2010, the amount of HRK 20,724 in 2011 and the amount of HRK 94,168 thousand is due in the period 2012-2017.

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 three 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 4,287 thousand (2005: HRK 4,732 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)

Notes to the financial statements (continued)

15 Equity securities

	2006 HRK '000	2005 HRK '000
Other equity securities	45	45

16 a) Deferred tax assets

Recognised deferred tax assets and liabilities

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

	2006 Assets HRK '000	2006 Liabilities HRK '000	Credited/(charged) to income statement HRK '000	Credited/(charged) to equity HRK '000	2005 Assets HRK '000	2005 Liabilities HRK '000
Impairment loss on receivables	6,825		(4,540)	–	11,365	–
Impairment loss on obsolete inventory	2,253		52	–	2,201	–
Provision for employee benefits	735		45	–	690	–
Non-current receivables for sold apartments	858		(89)	–	947	–
Negative fair value of financial instruments	1,901		(247)	–	2,148	–
Accrued charges	1,609		(1,216)	–	2,825	–
Increase in equity related to equity-settled transactions	1,579	(1,579)	1,160	(1,160)	419	(419)
	15,760	(1,579)	(4,835)	(1,160)	20,595	(419)
Set-off of tax	(1,579)	1,579	–	–	(419)	419
Net deferred tax assets	14,181	–	(4,835)	(1,160)	20,176	–

16 b) Deferred tax assets (continued)

Recognised deferred tax assets and liabilities

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

	2005 Assets HRK '000	2005 Liabilities HRK '000	Credited/(charged) to income statement HRK '000	Credited/(charged) to equity HRK '000	2004 Assets HRK '000	2004 Liabilities HRK '000
Impairment loss on receivables	11,365	–	(9,806)	–	21,171	–
Impairment loss on obsolete inventory	2,201	–	(799)	–	3,000	–
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	2,825	–	1,216	–	1,609	–
Other temporary differences	–	–	(200)	–	200	–
Increase in equity related to equity-settled transactions	419	(419)	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

	2006 HRK '000	2005 HRK '000
Raw materials	7,411	11,865
Work-in-progress and semi-finished goods	25,410	21,021
Total inventories	32,821	32,886
Impairment loss	(2,213)	(1,952)
	30,608	30,934

18 Trade receivables

	2006 HRK '000	2005 HRK '000
Foreign customers	126,879	391,791
Current portion of non-current loans and receivables	221,986	109,245
Total foreign customers	348,865	501,036
Domestic customers	137,490	167,855
Current portion of non-current loans and receivables	24,817	6,937
Total domestic customers	162,307	174,792
Impairment loss on loans and receivables	(20,838)	(54,515)
	490,334	621,313

Included in trade receivables is HRK 11,558 thousand (2005: HRK 28,403 thousand) of contract work in progress.

19 Other receivables

	2006 HRK '000	2005 HRK '000
Receivables for prepaid VAT	15,979	20,650
Receivables from employees	862	628
Accrued interest receivable	1,769	1,465
Other receivables	5,659	5,581
	24,269	28,324

Notes to the financial statements (continued)

20 Other current financial assets

	2006 HRK '000	2005 HRK '000
Financial assets at fair value through profit or loss, trading assets		
– Positive fair value of derivative instruments	–	358
Financial assets at fair value through profit or loss		
– Debt securities	86,072	78,009
– Equity securities	1,859	1,002
– Investment in open-ended investment funds	349,021	412,777
	436,952	492,146

In 2006 debt securities comprise Ministry of Finance bonds in the total amount of HRK 86,072 thousand (HRK 40,091 thousand denominated in euro and HRK 45,981 are denominated in kuna), consisting of debt securities in the amount of HRK 40,091 thousand maturing in 2007, the amount of HRK 31,965 thousand maturing in 2010, the amount of HRK 4,146 thousand maturing in 2013 and the amount of HRK 9,870 thousand maturing in 2015. These debt securities bear fixed interest rate from 3.875% to 6.75% per annum.

In 2005 debt securities comprise the Ministry of Finance bonds in the amount of HRK 78,009 thousand (HRK 40,712 thousand denominated in euro and the remaining part denominated in kuna) and a fixed interest rate ranging from 3.875% to 6.75% per annum.

Investments in open-ended investment funds in the amount of HRK 311,860 thousand (2005: HRK 358,210 thousand) are denominated in kuna and HRK 37,161 thousand (2005: HRK 54,567 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 2006.

Notes to the financial statements (continued)

21 Cash and cash equivalents

	2006 HRK '000	2005 HRK '000
Cash and demand deposits	44,055	34,446
Time deposits originated by the Company, with original maturity up to 3 months	236,712	157,874
	280,767	192,320

Cash and demand deposits in the amount of HRK 13,997 thousand (2005: HRK 30,622 thousand) are denominated in kuna and the remaining part is denominated in foreign currencies.

Time deposits in the amount of HRK 162,250 thousand (2005: HRK 54,200 thousand) are denominated in kuna and bore fixed interest rates at the year-end ranging from 2.2% to 3.75% per annum (2005: 3.0% to 6.5% per annum). Time deposits in the amount of HRK 49,359 thousand (2005: HRK 92,453 thousand) are denominated in euro and bore fixed interest rates ranging from 2.7% to 5.0% per annum (2005: 2.2% to 4.7% per annum) and those in the amount of HRK 25,103 thousand (2005: HRK 11,221 thousand) are denominated in US dollar and bore fixed interest rates at the year-end ranging from 4.3% to 6.46% per annum (2005: 2.20% to 4.70% per annum).

Notes to the financial statements (continued)

22 Equity

(a) Share capital

As at 31 December 2006, the share capital of the Company is represented by 1,331,650 (2005: 1,331,650) of authorised, issued and fully paid ordinary shares, with a total registered value of HRK 133,165 thousand (2005: HRK 266,330 thousand). The nominal value of one share is HRK 100 (2005: 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.

The Company's shareholders as at 31 December 2006 are:	2006 Number of shares	2006 % Held	2005 Number of shares	2005 % Held
Telefonaktiebolaget LM Ericsson	653,473	49.07	653,473	49.07
Small shareholders	655,015	49.19	652,680	49.01
Croatian Privatisation Fund	11,848	0.89	11,848	0.89
Treasury shares	11,314	0.85	13,649	1.03
	1,331,650	100.00	1,331,650	100.00

(b) Treasury shares

During 1997 and 1998 the Company acquired 17,624 of its own shares. Total amount paid to acquire these shares, net of income tax, amounted to HRK 5.9 million, which 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 31 December 2005, 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.

(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 to legal reserves is required.

22 Equity (continued)

Proposed dividends

Dividends payable are not accounted for until they have been ratified at the General Assembly of shareholders. On 1 June 2006 the General Assembly approved a dividend in respect of 2005 of HRK 19.00 per share totalling HRK 25.1 million. At the meeting which will be held on 21 March 2007 the Management Board will propose a dividend in respect of 2006 in the amount of HRK 320.00 per share.

The dividend will be paid from retained earnings formed up to or as at 31 December 2000 and from retained earnings formed as at 31 December 2005, after approval by the General Assembly, which is scheduled at 31 May 2007.

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

	2006 HRK '000	2005 HRK '000
HRK 19.00 per share for 2005	25,077	–
HRK 18.00 per share for 2004	–	23,652

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 1,189 thousand or EUR 162 thousand (2005: HRK 1,501 thousand or EUR 204 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 812 thousand or EUR 111 thousand (2005: HRK 1,915 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 instalments until July 2009.

	2006 HRK '000	2005 HRK '000
Non-current portion of unsecured loans	1,415	3,109
Current portion of unsecured loans	586	307
	2,001	3,416

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 2006 were a 6% discount rate (2005: 7%) and a 2.73% (2005: 2.57%) rate of average employment turnover.

Movements in long-term service benefits were as follows:

	2006			2005		
	Jubilee awards HRK '000	Retirement HRK '000	Total HRK '000	Jubilee awards HRK '000	Retirement HRK '000	Total HRK '000
As at 1 January	3,451	603	4,054	3,298	528	3,826
Obligation created during the year	233	98	331	153	75	228
Obligation reversed during the year	(9)	(45)	(54)	–	–	–
As at 31 December	3,675	656	4,331	3,451	603	4,054

(b) Share-based payments

During 2004, the Company established its Loyalty program, a share-based scheme under which key management personnel (Executive Management), senior management (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 management and other employees as a bonus arrangement under its Award program.

The treasury shares are distributed to eligible employees upon ratification at the General Assembly and are charged against retained earnings.

Notes to the financial statements (continued)

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 granted shares	Vesting conditions
Loyalty program		
Share grant		
– to key management during 2004	690	Three to five years of service
– to other employees during 2004	8,355	Three to five years of service
– to key management during 2005	–	Three to five years of service
– to other employees during 2005	(125)	Three to five years of service
– to key management during 2006	–	Three to five years of service
– to other employees during 2006	4,575	Three to five years of service
	13,495	
Award program		
Share grant		
– to key management during 2004	1,640	Upon granting
– to other employees during 2004	730	Upon granting
– to key management during 2005	–	Upon granting
– to other employees during 2005	–	Upon granting
– to key management during 2006	1,200	Upon granting
– to other employees during 2006	–	Upon granting
	3,570	

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 granted shares	Weighted average fair value per share
Shares granted in 2004	11,415	HRK 656.68
Shares granted in 2005	(125)	HRK 735.99
Shares granted in 2006	5,775	HRK 2,330.18

During 2006 the Company recognised HRK 5,800 thousand (2005: HRK 2,097 thousand) of expenses in respect of share-based payments, which are included in personnel expenses as disclosed in Note 7. All 1,200 (2005: nil, 2004: 2,370) shares granted under award program were granted during 2006, vested during 2006. Additionally, 2,315 shares granted under loyalty program vested during 2006. During year 2005, 125 shares from loyalty program were returned to treasury shares, since the entitled employees terminated employment with the Company.

25 Trade and other payables

	2006 HRK '000	2005 HRK '000
Trade payables	63,896	54,549
Liabilities to employees	44,052	39,438
Other current liabilities	14,806	13,246
	122,754	107,233

Liabilities to employees include bonus salary of HRK 31.8 million (2005: HRK 28.1 million).

26 Provisions

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

	2006			2005		
	Warranty reserve HRK '000	Penalty reserve HRK '000	Total HRK '000	Warranty reserve HRK '000	Penalty reserve HRK '000	Total HRK '000
As at 1 January	11,436	299	11,735	10,753	1,015	11,768
Provision created during the year	6,741	223	6,964	6,223	60	6,283
Provision reversed during the year	(1,386)	(239)	(1,625)	(1,947)	(776)	(2,723)
Provision used during the year	(2,280)	(60)	(2,340)	(3,593)	–	(3,593)
As at 31 December	14,511	223	14,734	11,436	299	11,735

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

	2006 HRK '000	2005 HRK '000
Advances from domestic customers	457	274
Advances from foreign customers	9,302	24,196
Deferred revenue	51,336	52,703
Accrued severance payment costs	849	10
Accrued charges for unused holidays	8,065	7,013
Accrued charges for court cases	1,533	853
Accrued charges in respect of service contracts	72,196	64,522
Other accrued charges	12,696	22,467
	156,434	172,038

Deferred revenue mainly represents amounts due to customers under contracts for work not performed. Accrued charges in respect of service contracts mainly represent expected future costs of contracts for services 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% (2005: 49.07%) shareholding by Telefonaktiebolaget LM Ericsson, which is also the ultimate parent of the Ericsson Group. As disclosed in Note 22 (a), the remaining 50.93% (2005: 50.93%) of 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:

	Telefonaktiebolaget LM Ericsson		Ericsson Group consolidated companies		Associated Group companies		Total	
	2006 HRK'000	2005 HRK'000	2006 HRK'000	2005 HRK'000	2006 HRK'000	2005 HRK'000	2006 HRK'000	2005 HRK'000
Sales of goods and services								
Sales revenue	–	–	375,546	305,235	–	–	375,546	305,235
Commission income	–	–	–	5,919	–	–	–	5,919
Total sales	–	–	375,546	311,154	–	–	375,546	311,154
Purchases of goods and services								
Licenses	6,482	6,507	38,365	48,632	–	–	44,847	55,139
Management fee	–	–	5,378	6,546	–	–	5,378	6,546
Cost of sales	186	749	628,727	658,976	–	33	628,913	659,758
Total purchases	6,668	7,256	672,470	714,154	–	33	679,138	721,443

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

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 the main organisational units.

	2006 HRK '000	2005 HRK '000
Salaries and other short-term employee benefits	17,216	16,726
Other long-term benefits	18	10
Share-based payments	3,051	137
	20,285	16,873

The members of the executive management and the Supervisory Board held 2,839 ordinary shares at the year-end (2005: 2,674 shares).

Included in the loans and receivables are HRK 234 thousand (2005: HRK 307 thousand) in respect of loans and advances granted to key management. During 2006 the Company collected HRK 18 thousand (2005: HRK 32 thousand) of interest from these loans.

In addition, the Company paid remuneration totalling HRK 300 thousand (2005: HRK 293 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	
	2006 HRK'000	2005 HRK'000	2006 HRK'000	2005 HRK'000
The main shareholder				
Telefonaktiebolaget LM Ericsson (LME)	–	–	582	1,078
Ericsson Group consolidated companies				
Ericsson Enterprise AB (EBC)	1,157	1,019	11,577	15,045
Ericsson AB (EAB)	43,854	30,814	52,388	82,342
Ericsson Telecomunicazioni S.P.A. (TEI)	5,937	1,974	–	–
Ericsson Corporatia AO (ECR)	1,163	4,813	–	–
LM Ericsson Limited (LMI)	79	85	2,386	15
Ericsson SP. Z.O.O. (EPO)	792	48	–	–
Ericsson Network Technologies AB (ECA)	–	–	809	192
Ericsson Global IT services AB (GIS)	–	–	–	8,066
Ericsson Austria A.G. (SEA)	531	150	–	–
Ericsson Sverige AB (ESE)	6	–	–	–
Ericsson South Africa Ltd. (ESA)	126	607	–	–
Ericsson SPOL.S.R.O. (ECZ)	879	154	–	–
Ericsson Egypt Ltd. (EEL)	218	1,327	–	–
Ericsson Test Environments (ETE)	–	–	37	3,591
Ericsson Telecomm. Equipment S.A. (ETG)	1,557	177	–	–
Ericsson Hungary Ltd. (ETH)	46	1,354	–	–
Ericsson Ltd. (ETL)	1,044	251	–	–
Ericsson Telecommunicatia B.V. (ETM)	627	616	1,101	818
Ericsson Denmark A/S (LMD)	–	10	242	122
OY LM Ericsson AB (LMF)	49	–	66	–
Ericsson Slovakia SPOL.S.R.O. (SBB)	86	225	–	–
Ericsson Communications Co. Ltd. (CBC)	118	149	–	–
Ericsson d.o.o. (EBA)	1,355	80	3	590
Ericsson GMBH Group (EDD)	187	–	217	182
Ericsson De Panama S.A. (EDP)	530	148	–	395
Ericsson Espana S.A. (EEM)	288	289	195	8
Ericsson De Honduras Group (EHO)	–	835	–	–
Ericsson Maroc SARL (EMO)	1,201	169	–	–
Ericsson Telekomunikasyon A.S. (ENK)	45	448	–	–
Ericsson Telekomunications Bulgaria EOOD (ETB)	2,013	588	–	–

28 Balances and transactions with related parties (continued)

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

	Receivable		Payable	
	2006 HRK'000	2005 HRK'000	2006 HRK'000	2005 HRK'000
Ericsson Group consolidated companies (continued)				
Ericsson Telekomunications Romania (ETR)	1,278	743	–	–
Ericsson Inc. (EUS)	435	289	–	–
Ericsson d.o.o. (EVN)	106	10	50	98
Ericsson International Services B.V. Group (ISN)	–	–	92	32
LM Ericsson Ltd. (Nigeria) Group (LMN)	50	89	–	–
Nippon Ericsson K.K. Group (NRJ)	203	112	–	–
Ericsson Telecomunicacoes LDA Group (SEP)	231	97	–	–
Ericsson TEMS AB Group (TMS)	–	–	–	156
Ericsson Lab Italy S.P.A. (ERI)	–	–	55	–
Marconi S.P.A. (MCI)	–	–	267	–
Ericsson GmbH Backnang (ED3)	–	–	14	–
Ericsson S.A./N.V. (EBR)	83	–	–	–
Ericsson Australia PTY LTD. (EPA)	306	–	–	–
Ericsson De Colombia S.A. (EDC)	41	–	–	–
Ericsson Ukraine (UKR)	149	–	–	–
Ericsson Eesti AS (EEE)	146	–	–	–
Kuwait Ericsson Telephone Equipment and Services (KET)	956	–	–	–
CIA Anonima Ericsson (CEV)	38	–	–	–
Telefonaktiebolaget LM Ericsson, Abu Dabi Branch (TKU)	12	–	–	–
Telefonaktiebolaget LM Ericsson, Saudi Arabia Branch (TKS)	48	–	–	–
Telefonaktiebolaget LM Ericsson, Tech. Office Oman (TKA)	20	–	–	–
Ericsson AB, Saudi Arabia Branch (BSA)	2,184	–	–	–
Other	18	608	2	2
	70,192	48,278	70,083	112,732

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, 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 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 2006, the five largest customers represent 60% of total net trade receivables (2005: 32%). 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:

	2006 HRK '000			2005 HRK '000		
	Carrying amount	Fair value	Unrecognised gain	Carrying amount	Fair value	Unrecognised gain/(loss)
Non-current loans and receivables	389,140	389,557	417	247,719	248,850	1,131
Trade and other receivables	584,795	584,795	–	697,915	697,915	–
Current financial assets	436,952	436,952	–	492,146	492,146	–
Cash and cash equivalents	280,767	280,767	–	192,320	192,320	–
Interest-bearing borrowings	(2,001)	(1,978)	23	(3,416)	(3,461)	(45)
Trade and other payables	(122,754)	(122,754)	–	(107,233)	(107,233)	–
	1,566,899	1,567,339	440	1,519,451	1,520,537	1,086

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. 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 2005.

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.

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

	2006	2005
Non-current loans and receivables	6%	5%-6%
Interest-bearing borrowings	6%	6%

30 Derivative instruments

Since 2003, the Company 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 nil (2005: HRK 62 million). Their fair values amounted to nil (2005: HRK 358 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 and 2006.

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 and 2006.