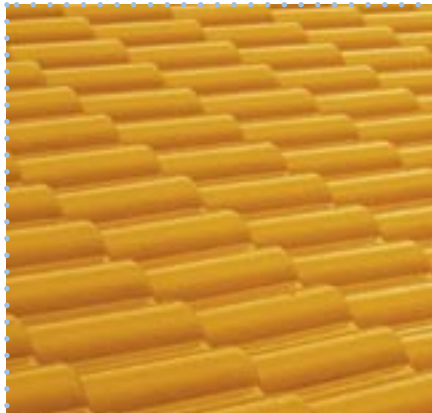
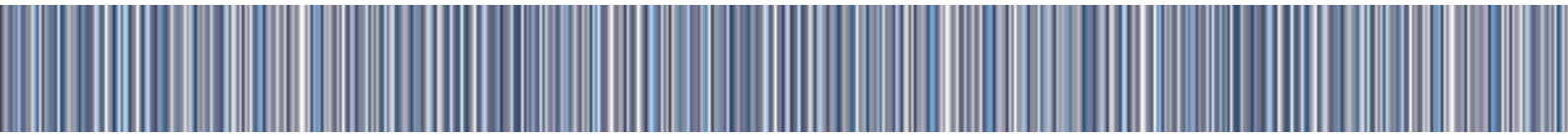




Ericsson Nikola Tesla d.d.

**2003**  
*Annual Report*



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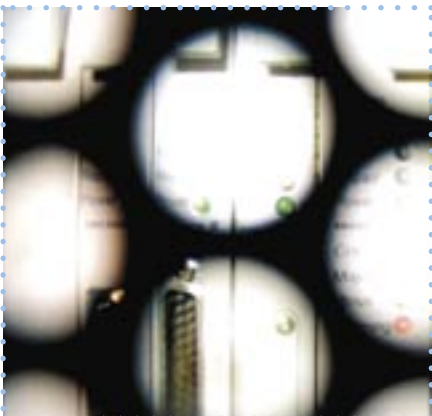
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The joint stock company Ericsson Nikola Tesla:  
*»Brainware« production*  
*Competent, creative and motivated specialists*  
*Socially responsible company*

## The joint stock company Ericsson Nikola Tesla

Ericsson Nikola Tesla (ETK) can trace its roots back to the enterprise »Nikola Tesla« founded in 1949. Over the years the company has successfully adopted new technologies and adjusted its ways of doing business in the telecommunications market. For many years it has been the largest specialized supplier of telecommunications equipment in Central and Eastern Europe. Continuous business success of the company results from work, commitment, knowledge, expertise and experience of present and former employees.

Ericsson's systems have been manufactured in Croatia since 1953 when the enterprise »Nikola Tesla« signed the first licensing agreement with LM Ericsson. A new dimension was added to the partnership between these two companies on May 13, 1995 when Ericsson became the largest stockholder of the just established joint stock company Ericsson Nikola Tesla. The company name unifies the names of two great men – Nikola Tesla, a great scientist and world-renowned inventor, and Lars Magnus Ericsson, the founder and the first owner of Ericsson. Today the Ericsson Group owns 49.07 percent of the Company stock, small shareholders 48.73 percent, the Croatian Privatization Fund holds 0.88 percent of stock and there are 1.32 percent treasury shares.

In its mission Ericsson Nikola Tesla emphasizes that they wish to understand the customers' needs, to create business opportunities for them and to offer to them communications solutions by being faster and better than any competitor, and by being the best partner for software solutions and services in the internal Ericsson market. In doing so Ericsson Nikola Tesla will generate profit and prosperity for all its shareholders.

### Total communication solutions

Over the last several years – since its incorporation into Ericsson - ETK transformed into a modern company that primarily produces »brainware«, i.e. designs software and services and provides total communication solutions for global operators of fixed and mobile telephony and for large businesses worldwide. The company is fully oriented to the new world of communications that features solutions and services for the mobile Internet and multi-service networks. As a member of the Ericsson Group the company offers to its customers the entire Ericsson portfolio of telecommunications products, solutions and services.

Within Ericsson the company Ericsson Nikola Tesla belongs to the market unit Central Europe (MUCE). The company performed well during all the years of its existence and by its business results it occupies a position among the top ranking Croatian companies. Ericsson Nikola Tesla holds the certificate »Recognized for Excellence« for 2003. The company obtained this certificate from the European Foundation for Quality Management, EFQM, as the first company in Croatia and in the Ericsson Group.

### »Brainware« production



## The intellectual capital – the most valuable asset

Ericsson Nikola Tesla employs round one thousand specialists. The intellectual capital is the main asset of the company. Over 80 percent of employees are university graduates, most of them being electrical engineers, and 8 percent of them have a master's or a doctor's degree. The strength of the expert teams of Ericsson Nikola Tesla reflects in a balance of the experience and youthful winning spirit. In the total number of employees female associates participate with 30 percent, a number of them occupying managerial positions, an indicator for a high awareness of gender equality.

*Competent, creative and motivated specialists*

Owing to the outstanding competence of specialists, their creativity and way of working in challenging situations Ericsson Nikola Tesla strengthened its position and broadened its responsibilities on the corporate level. During 2003 the company confirmed its standing as the expert center for total communication solutions and services in Central Europe, and in that area it has the status of one of three Business Excellence Centers in the market unit Europe, Middle East and Africa. In addition to the Croatian market the company now has the responsibility for several dozen countries in the regions of Europe, Middle East, Central Asia and Africa.

*Socially responsible company*

## Active role in creating prosperity in Croatia

A leading position in the information and communication technologies carries an obligation. Consequently Ericsson Nikola Tesla has for some years now been actively involved in the creation of the new economy and prosperity in Croatia. The company considers it as its duty to encourage positive social and economic changes and to initiate activities that will create the prerequisites for welfare and better standard of living in Croatia. To provide employment for young, creative people with education, to ensure competitive earning opportunities, to create pleasant work environment and to help them realize their professional ambitions here, in Croatia, are some of the priorities of the company Ericsson Nikola Tesla.





*Address by Åke Enell, the president of  
Ericsson Nikola Tesla,  
to shareholders*



*..We continue on our way to business excellence  
55 years of outstanding performance  
»Recognized for Excellence«  
Achieved business objectives*



## *.:We continue on our way to business excellence*

Ericsson Nikola Tesla finished another in a series of successful years, the 54th in a row. Despite a turbulent and problematic environment within the global telecom industry we held the business level attained before. The European Foundation for Quality Management, EFQM, acknowledged with their "Recognized for Excellence" certificate that Ericsson Nikola Tesla is striving for excellence in all its activities, that for a number of years now the company has had outstanding business results and that being a member of a small group of European companies with this certificate is well-deserved.

*55 years of outstanding performance*

In my address to shareholders last year I emphasized that our goal in 2003 was to stay among the best, which means to be recognized as an efficient and successful company, as the best business partner and provider of communication solutions both home and abroad, as the best employer for whom his employees are the most valuable asset, and as a local and regional leader in the mobile Internet. I am pleased to say that despite all difficulties we achieved our designated objectives. Good performance of Ericsson Nikola Tesla in 2003 is founded on the fulfillment of our prioritized activities that were both in 2003 and in the preceding years the cost savings activities and efficiency boost, competence development and systematic approach to all our markets.

What were the main accomplishments of the company in 2003?

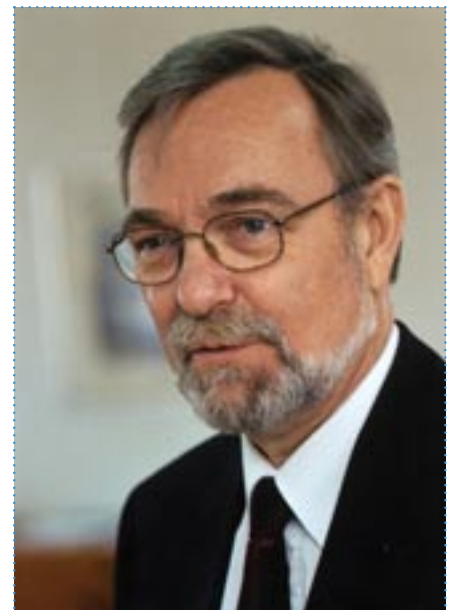
Compared with the preceding year (2002) Ericsson Nikola Tesla achieved in 2003 the following:

- A stable Net Sales level
- Orders Booked down, in accordance with our forecast
- Operating expenses down
- Income before taxes up, better than planned, due to currency deviations, the business result down compared with 2002
- Positive Cash flow for the fifth consecutive year
- Dialog (Employee Survey) result up, the 5th annual survey showed continuous improvement trends in all areas, the Empowerment index up with +4 units and Human Capital index up +41 units.

The overall satisfying result was very much originated from earlier actions (improvements program year 1999 – 2002), in combination with strong sales efforts and cost savings activities.

Ericsson Nikola Tesla as a Regional and Global competence Centre within Ericsson has also been strengthened during the year, mainly due to the competencies and our creativity in urgent situations and our way of working:

- The Mobility World Centre has continued their activities with more associate partners connected and with a number of new mobile applications developed.
- The R&D Centre has secured long-term assignments from Ericsson R&D corporate.
- Customer Solution & Sales Support centres, Centres of Excellence



Åke Enell  
President of Ericsson Nikola Tesla

have during the year received more responsibilities and assignments within the Ericsson Group.

- Global Service Delivery Center (GSDC) for Software Supply & Integration remained in ETK, despite significant reductions in Ericsson.

In 2003 we marked two important anniversaries – 60th anniversary of the death of the great scientist Nikola Tesla and 50 years of the signature to the first licensing agreement between LM Ericsson and “Nikola Tesla”. Also it was a year of awards and recognition, ETK received the Golden Plaque and the Golden Kuna as the most successful large company in Zagreb and in Croatia. The company was 2003 awarded with the EFQM Recognised for Excellence, the first company within the Ericsson sphere and the first company in Croatia. The EFQM award requires a track record (5 years) of sound improvements in all operating areas as well as in business results.

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*»Recognized for Excellence«*

A very important activity during 2003 was listing the ETK shares in the quotation of joint stock companies on the Zagreb Stock Exchange, all in accordance with the Croatian law. In business perspective is our first e-system order, Primary Health Care, the most important one. It is a real break-through into a new important area for the company.

#### Prioritised activities

Our focused areas during year 2003 were the same as in earlier years: Financial, with main focus on cash flow, customer financing and costs optimisation.

Human Resources & Organisation activities with continuous focus on competence shift and restructuring, also on performance management and enhanced action/training to constantly build professional, business and human competencies for all employees. Focused was also the Management Planning process in order to further develop leadership skills of our managers and potential manager candidates, reinforced with ETK Assessment Centre and Leadership Core Curriculum training.

Business, with revitalised focus on the Croatian market and strong focus on our export markets.

Image, with very strong Marketing Communication focus, all different media's involved. We have participated in different exhibitions (in Croatia and abroad) and round table discussions and we have actively participated in different Government initiatives. With its active participation in positive initiatives in the community the company confirmed its mission as a socially responsible entrepreneur, i.e. as a good citizen who takes an active part in the creation of prerequisites for prosperity in Croatia.

#### Business result is in line with our objectives

Net Sales remained in the same level as 2002, 1404 MHRK; the largest markets were Croatia, followed by Russia, Sweden, Montenegro, Belarus and Bosnia and Herzegovina. Orders booked went down, even more than in accordance with forecast due to some cancelled orders on our export markets. Orders booked in level 1108 MHRK are to be compared with 2002 of 1640 MHRK. Cash flow was positive (+148 MHRK) for the fifth consecutive year.



Income before taxes was better than forecasted, there was an increase from 168 MHRK (2002) up to 202 MHRK, and the business result was down compared with 2002. The increase in income is due to positive currency deviations.

### *Achieved business objectives*

Total operating expenses, selling and administrative costs decreased by 10%. Our target was much tougher but due to some non-budgeted costs the level ended up in a 10% reduction.

Highlights in business were the signing of the PZZ contract (e-system for Primary Health Care), we have also signed a number of small and medium contracts with new customers in Russia, which is a good base for further business volumes. Another highlight is the business volume to neighbouring countries, Bosnia and Herzegovina and Montenegro.

### *People are our main assets*

The number of employees decreased from 1109 down to 1020, with 119 leavers and 30 starters (the latter either returned from Military services or are new employees).

People were leaving either with outsourcing, as redundant or by mutual consent. The competence profile shows that 80% of all employees are graduates with university degree. More than 400 employees are under 32 years of age and have their first employment in our company. The division between female and male employees is 30% to 70%.

In our company we are fostering the winning, performance-driven culture, and grooming behaviours that are drivers for our business success like passion to win, dedication to customer success, value added teamwork and fast and urgent creativity.

We constantly measure and focus how to improve the overall capacity of our organisation and our employees to create value for our customers and consequently to our shareholders. One of the measuring tools is Employee Survey – Dialog. The 2003 Dialog result has positioned us within the Best in Class Company in our industrial environment.



We are recognised to be one of the best employers in Croatia; we are providing good working environment, career development and competitive earning opportunities for our employees. Currently we have 169 employees on postgraduate study.

### *Challenges in 2004*

2004 will be another challenging year, we expect a continuous slow down in investments (customers CAPEX, capital investments) and we will also face a new discussion and negotiation with Ericsson corporate, they are in a process to streamline their core operations, also in a process of concentration and downsizing, that will have an impact on our Design and System Integration activities.

Consequently we need to continue our:

- Action programs in order to secure our position within Ericsson and to expand our Business platform.
- Adjustments to the new situation, cost savings actions, rightsizing and efficiency programs

Our prioritised activities for the year 2004 will continue to be our competence shift activity with focused investments in our people (our main asset), we will also continue our strong business orientation towards both Croatia and our Export markets. Our objective is to be the preferred supplier within ICT (Information Communication Technology) concept in Croatia and in our export markets. Another area of priority is to continue our effort in cost optimisation and to increase efficiency; one activity is also to sell or to rent out non-used premises.

### Summary

2003 was a year with a number of positive results despite lower volumes in Orders booked and a lower business income. 2004 brings the 55th anniversary of the company and also new challenges. The outlook for 2004 shows a tough and challenging environment, with challenging business volumes in a number of areas.

Our objectives for 2004 are divided into five areas: Financial, Customer, Productivity and Efficiency, Competitive position & Innovation and Employees.

All objectives are tough and challenging, but we are fully committed and inspired to fulfill all objectives and targets.

Ericsson Nikola Tesla d.d. is a company with excellent workforce and a company culture with passion to win.



A handwritten signature in black ink, appearing to read 'Åke Enell'.

Åke Enell  
President of Ericsson Nikola Tesla



*Address by Lars Jakobsson,  
the Business Support – Finance Director of  
Ericsson Nikola Tesla,  
to shareholders*



*Business performance in 2003::  
Generated profit and cash flow  
Efficient asset management  
Risk management*

## Business performance in 2003

Ericsson Nikola Tesla's main financial objectives – to generate profit and positive business cash flows – were achieved during 2003. We also successfully implemented more tools in the risk management area of currency handling.

### Growth objectives

Ericsson Nikola Tesla has kept its main objective to grow within the potential of the regional financial environment. The overall overcapacity in the telecom sector on the suppliers' side was reduced during 2003 as suppliers streamlined their operations with effect that investments into networks have been stabilised by the majority of operators. Apart from operators there are two additional important segments for us to focus on in order to reach our growth objectives: the business enterprise segment and the governmental sector.

Around the beginning of the new millennium the telecom world experienced an unprecedented upswing. The step towards 3G seemed to herald its imminent entry into the lucrative datatelecom business but soon after the magic was broken and disappointment set in throughout the industry. This was the case everywhere, but not in the markets that Ericsson Nikola Tesla works in. These markets have never seen such an exorbitant growth as Eurozone economies, the USA or Japan but the penetration rates and average revenue per fixed and mobile phone users, initially not at the level of the most developed markets, indicated steady although not so fast growth. Furthermore, the main driver today is not capacity growth to get more subscribers but rather to get higher capacity of the network to be able to handle more services to each subscriber, like ISDN, and broadband in the fixed networks and different types of services using GPRS - like MMS.

This trend will inevitably continue to drive investments due to end-users' demand which is expected to grow further. 3G technology, despite some overly pessimistic predictions, will also soon start to be deployed in the region – Slovenia has been the first to start it already.

As far as the enterprise sector is concerned, we can also see an increasing demand for ICT investments and consequently we have increased our business stake in this area during 2003. This will be the focus of our even greater efforts in this segment in the future. The contract signed with the Ministry of Health demonstrated our commitment and expertise to develop and deliver to this customer SW applications being at the highest technological level demanded, thus indicating further strengthening of our market position and growth potential.

*Generated profit and  
cash flow*



Lars Jakobsson  
Business Support – Finance  
Director  
of Ericsson Nikola Tesla

## Cash flow management

Our objective to generate own business cash flow level was introduced to our financial management in the late '90-ies primarily as a response to the, at that time, shallow credit potential of the financial market and was purposed to provide us with freedom to make our own independent operational decisions. The result was again very successful.

Our liquid position (including current financial assets) has increased by MHRK 148 during the year almost exclusively through business-related activities. This, for example, means that the redemption paid out to our shareholders in January 2004 (HRK 100 per share or MHRK 133 in total), was in full generated during the business year without weakening the Company's financial position.

There is a number of reasons why our cash flow was so good. Let me emphasize just some, the most important of them:

1 Results are better than expected as we have managed to keep margins at the good level and our costs under strict control.

2 Collection rate was closely monitored and managed.

3 We have managed to develop financial set ups with our customers and financial institutions that resulted in unusually high level of cash deals.

4 During 2003 one of the main activities was dealing with currency exposures in order to secure and collateralize the value of the liquid funds. This operation has included hedging, swaps of USD to EUR and fund management. Eventhough the USD has declined much more during 2003 than during 2002 we can report positive effects on currency deviations compared to 2002 big losses. The achievement can be attributed to the long-term co-operation with local financial institutional partners. They have now introduced these tools for corporate entities, which has proven beneficial to all parties involved.

## Efficient asset management

## Capital turnover

Ericsson Nikola Tesla has a strong focus on utilising our assets as efficiently as possible. We are focusing on the following areas with the following targets:

1 Regarding inventory management, we are now targeting less than 20 days as our long-term level goal. During the year it was achieved.

2 Turnover of account receivables shall be at 90 days including all potential financing schemes. The goal is yet to be achieved and for that purpose we are implementing new controlling mechanisms. ETK has initiated new ways of financing customers through risk minimized export credit agencies' financing and through commercial banks in order to provide us with more solutions to meet our needs.

3 Our payment terms and demands on suppliers have been further tightened up and we are continuing to get payment terms up to 60 days. We are also utilising our strong liquidity to offer suppliers quicker payment terms if they offer us discounts. Purchasing unit is now more centralised in order to secure better terms and quality of service from the suppliers.



## Business and financial survey

The financial results and outlook for the year have been kept in line with previously made public statements:

- Orders booked were decreased by 32%
- Net Sales were kept stable
- Cash flow was positive (Net cash inflow) MHRK 148
- Return on sales before taxes was 14.4%, which is above our target of 10%.

**2003**  
*Annual Report*

## Outlook

Although our industry remains one of the most dynamic areas of the economy, any excessive euphoria is misplaced. The year 2004 will actually be a much tougher and more challenging year. Our orders stock at the beginning of the year is lower than last year, markets have not started to grow at the expected level yet and end users' spending on the new telecom services is still lower than expected. Tough competition for market share, high investment costs, and still unresolved issue of enormous costs for licence fees are heavy burdens on the telecommunications sector.

We will, however, strongly focus on getting more business in the enterprise and government-related areas – in the business segment that will be heavily invested by substantial amounts of funds into ICT, both locally and regionally within the next few years.

3G investments, as we firmly believe, will start and will contribute to bring our business to upside curve again in the years to come.

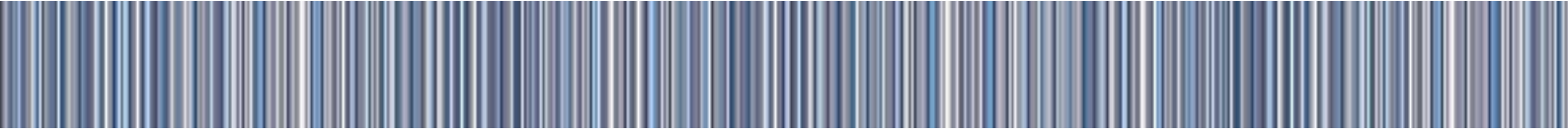
All that is given, despite all odds, will challenge the entrepreneurial spirit of our Company to meet the needs of our customers, shareholders, employees and wider communities we are working in. We devote ourselves to infuse a spirit of teamwork throughout the organization, so that we can cut across all boundaries to meet our dreams ahead.

## Risk management



A handwritten signature in black ink, appearing to read 'Lars Jakobsson'. The signature is stylized and fluid.

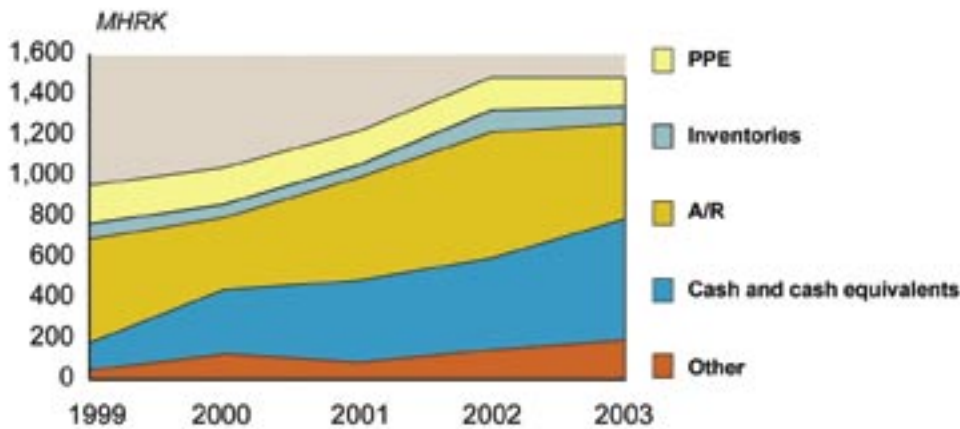
Lars Jakobsson  
Business Support – Finance Director  
of Ericsson Nikola Tesla



...Financial highlights in 2003

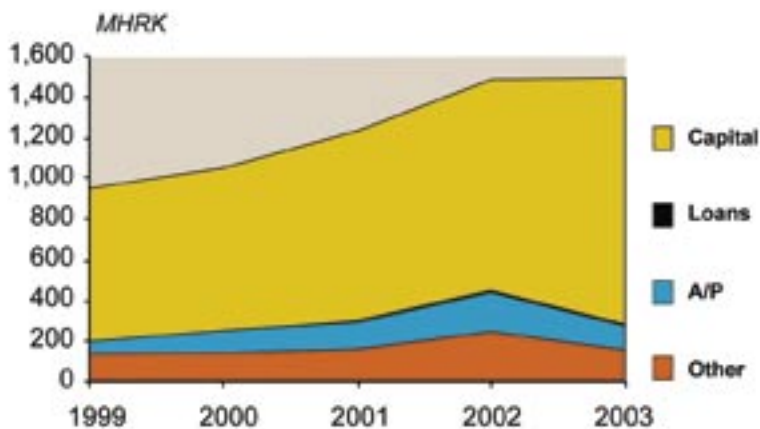
FINANCIAL HIGHLIGHTS IN 2003

Assets



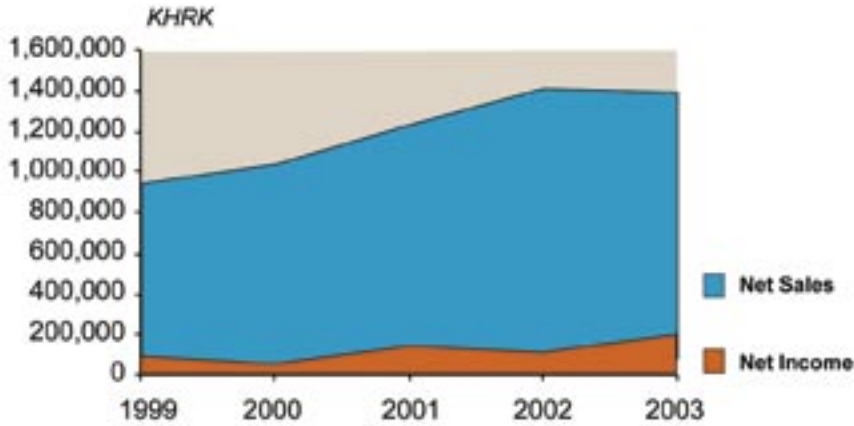
Assets	1999	2000	2001	2002	2003
PPE	190.35	175.37	177.19	168.36	148.85
Inventories	72.77	60.00	41.06	102.93	74.42
A/R	511.89	356.86	516.58	610.53	472.95
Cash and cash equivalents	115.80	317.37	393.56	441.47	589.9
Other	61.91	125.81	91.31	159.76	199.36
<b>TOTAL</b>	<b>952.72</b>	<b>1,035.41</b>	<b>1,219.70</b>	<b>1,483.05</b>	<b>1,485.48</b>

Equity & Liabilities



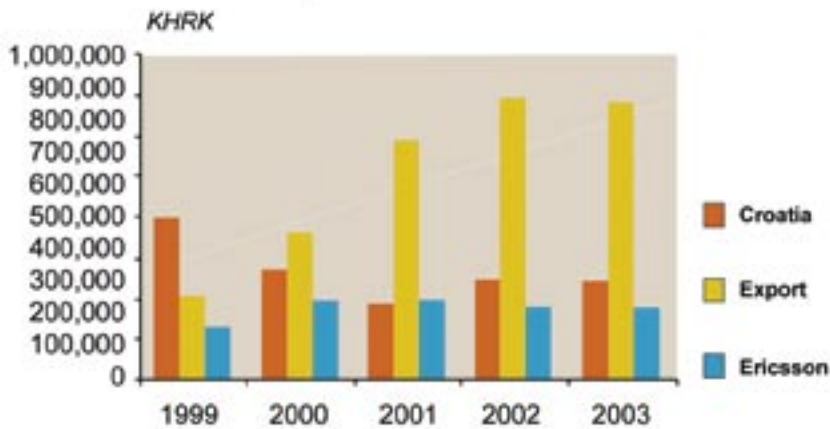
Equity & Liabilities	1999	2000	2001	2002	2003
Capital	738.40	785.67	931.05	1,042.69	1,209.20
Loans	4.70	4.41	8.44	7.50	7.21
A/P	74.44	119.11	106.26	186.80	121.68
Other	135.18	126.22	173.95	246.06	147.39
<b>TOTAL</b>	<b>952.72</b>	<b>1,035.41</b>	<b>1,219.70</b>	<b>1,483.05</b>	<b>1,485.48</b>

### Net Sales & Net Income



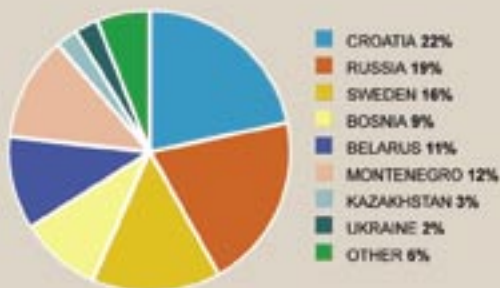
	1999	2000	2001	2002	2003
Net Sales	944,536	1,038,589	1,238,177	1,414,135	1,404,016
Net Income	94,173	61,070	175,908	130,032	184,904

### Net Sales by Market

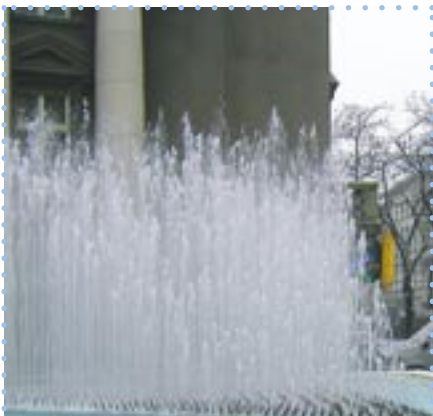


Market	1999	2000	2001	2002	2003
Croatia	509,455	339,114	242,495	312,947	313,642
Export	269,081	453,475	746,682	870,065	866,005
Ericsson	166,000	246,000	249,000	231,123	224,369

### ETK Top Markets 2003



Croatia	313
Russia	273
Sweden	224
Bosnia	126
Belarus	152
Montenegro	168
Kazakhstan	42
Ukraine	28
Other	78
	<b>1404</b>



Good, better, Ericsson Nikola Tesla:::  
*Mind-shift*  
*Integrated strategy of improvements*  
*Appropriate management system*

## Good, better, Ericsson Nikola Tesla

Martin looked at the pile of mail on his desk. He has been in his office for about ten minutes already and he still could not make up his mind whether to join the rest of the "office crowd", as he called his colleagues at work, for an early cup of coffee or whether to skip the routine that day and to get down to his work right away. Tossing these thoughts back and forth in his mind he almost absentmindedly reached for an envelope with four letters at the upper left corner – EFQM. What on earth was that? He run his letter opener through the envelope and it made a swishing sound that he liked a lot. For him it was a sound announcing news contained in the letter he was opening. And Martin liked news, good ones, that is. Somehow he knew that EFQM was good news.

"Dear Representative," the letter started. He read on forgetting all about the coffee, trying to find an explanation for the four letters – EFQM. Scanning the paragraphs that followed the routine introduction he got to it: "The European Foundation for Quality Management helps you improve, brings you recognition and publicity and tells you how good you really are." Martin paused. He looked at the mess on his desk and at the shelves in his office bending under the heavy burden of different binders. He gazed through the window at the big warehouse sheltering stock dated so far back that nobody in the company remembered what they were supposed to be used for. Finally, he turned his eyes towards the doors of his office, now framing the figure of his colleague who dropped in to see why Martin has not yet come for coffee, and asked: "How good do you think we really are?" His friend looked surprised: "What do you mean?" Martin smiled when he replied: "I think it's high time we start an organization-wide improvement program or in a couple of years we shall not exist on the map, and I just might know who could help us with this."

*Mind-shift*

### The mind-shift

A few years later we find Martin in much different circumstances. No, he did not get a bigger office, but it seems bigger because the shelf with dusty binders has been made obsolete and has in the meantime ended up at a scrap yard, neatly sorted and recycled. Martin now keeps all documents stored at the appropriate company disks within the company e-business system, available to all relevant authorized co-workers. The warehouse has been pulled down and now Martin enjoys a view of the company park in which he often joins his colleagues for a chat during the lunch break.



Martin is different, too. A huge mind-shift that was triggered by new knowledge gathered over several past years and a new way of working has altered his perspective. He knows now that regardless of the sector, size, structure or maturity, to be successful, organizations need to establish an appropriate management system. And that is exactly what has been going on in Martin's company over the past few years. The company management has decided to follow the Excellence Model created by the European Foundation for Quality Management, a non-for-profit organization established in 1988 by fourteen leading European businesses with the mission to be a driving force for sustainable excellence in Europe. That is what four letters EFQM stand for – a vision of a world in which European organizations excel. Martin's company wanted to be a part of this world and it set on a journey to business excellence.

Martin was right when he concluded that his organization needed to change. The management of the company he works for had the same views. What is more, they recognized the EFQM Excellence Model as a practical tool to help their organization to measure where it is on the path to excellence. Everyone in the organization tried to understand the gaps and to be a part of the solution, accepting the concepts of EFQM Model.

### *Integrated strategy of improvements*

#### **The focus**

Understanding what excellence actually means was the starting point. It is logical: one cannot reach a goal if it is not clear what the goal actually is. Well, using the internal communications channels the management of Martin's company announced the common view that excellence depended upon balancing and satisfying the needs of all relevant stakeholders. In order to honor this view the company also communicated the change of its strategy to the community it operated in. So, the path to follow was set and each one of about a thousand Martin's colleagues in the company was ready to follow it. They focused.

They focused on satisfying the existing and potential customers' needs and on respecting customers' wishes because they were aware that customers were the final arbiters of the quality of their products and services.

They focused on establishing clear and simple internal operating and business processes, while the company's leaders strove to create the atmosphere of optimism, filled with fighting spirit and mutual trust.

They focused on the planned improvements of the interrelated activities, made by the use of reliable information that included stakeholder perceptions.

They focused on the development of relevant competencies and made sure that the level of the involvement of all employees was maximal. They were aware that organizational performance excels only if it is based on the management and sharing of knowledge within a culture of continuous learning, innovation and improvement.



They focused on partnership development as it became clear that an organization works more effectively when it has mutually beneficial relationship with its partners. What is more, they adopted a view according to which the long-term interest of an organization and its people are best served by adopting an ethical approach towards the public responsibility and by exceeding the expectations of the community at large.

### The tool

When the strategy was set and the goals were known a very important question was raised: How are we going to do it? The European Foundation for Quality Management came up with an answer: RADAR.

### *Appropriate management system*

When Martin first heard of it he was a bit worried. It sounded mysterious and complicated. However, it turned out that by perseverance and professional approach this nut was not too hard to crack. RADAR is the measurement logic that lies at the very heart of the EFQM Model of Excellence. It consists of five elements: Results, Approach, Deployment, Assessment and Review. It is a never-ending circle of activities that makes it possible for an organization to come closer to business excellence. Everyone in Martin's company eagerly got down to realizing all phases in this process within their individual scope of work.

### The outcome

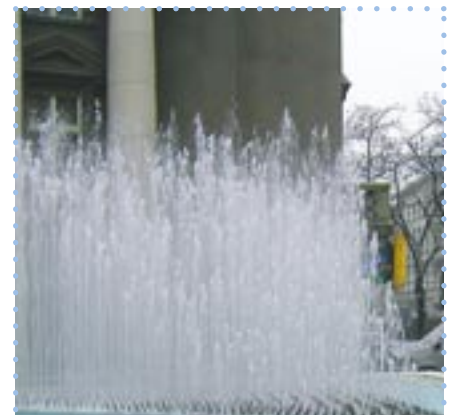
It is easy to realize now why Martin's company has changed so noticeably. The change was not so much about removing the shelf with the binders from Martin's office or about pulling down a warehouse, but it was concerned more with establishing a systematic approach that correlates different aspects of excellence, resulting in the integrated strategy of improvements. This approach connects adopted vision, mission, strategy and company policies with operational activities, result management, benchmarking and the concept of management by objectives.

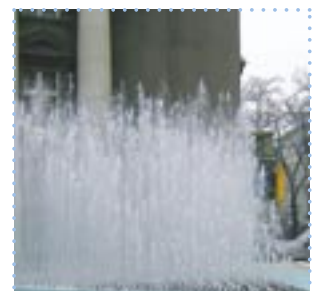
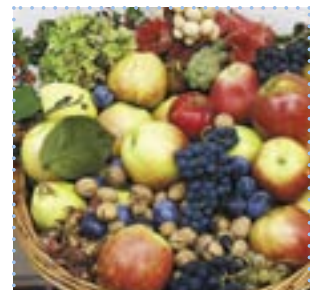
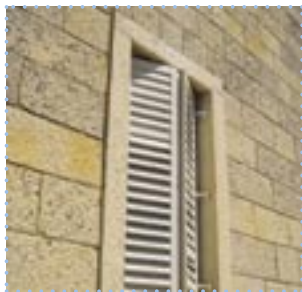
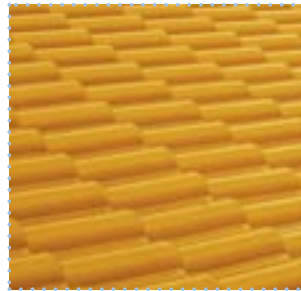
By embracing the fundamental EFQM concepts of excellence and by applying them in practice Martin's company turned into a modern, dynamic, adoptive organization that employs professionals able to satisfy the requirements of the demanding market.

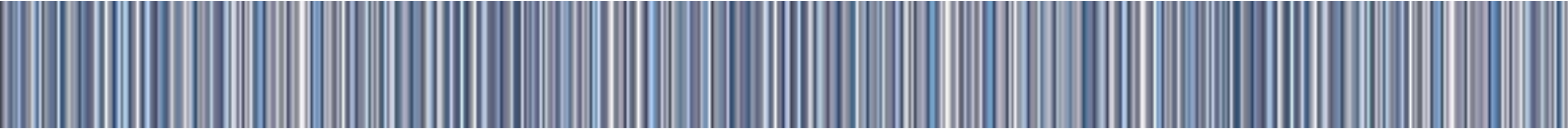
Finally, there is one question that needs to be answered: What is the company that Martin works for? We guess you knew it all along: Ericsson Nikola Tesla – a company consistently striving for excellence in all segments of its activities and also daring to challenge its capabilities in new business areas, a company that in 2003 was granted the certificate Recognized for Excellence by the European Foundation for Quality Management. Ericsson Nikola Tesla is the first company in Croatia and the first company in the Ericsson Group to have received this recognition.

As for Martin, he is now packing to go to Bruxelles, to EFQM headquarters, to attend a workshop in which he will learn what a company needs to do in order to apply for the European Quality Award, Europe's most prestigious and rigorous award for organizational excellence.

You know, on the way to excellence there's no stopping.







...Financial statements as at 31 December 2003 together with auditors' report

## Company profile

### History and incorporation

Ericsson Nikola Tesla d.d. Zagreb (the Company) is a Croatian company with over fifty 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.

The Company was entered into the Register of Companies of the Commercial Court in Zagreb on 13 June 1995 with an initial share capital of HRK 501,366,225. Following the decision of the General Assembly of the shareholders made on 17 December 1998, the share capital of the Company, amounting to HRK 501,366,225, was reduced by HRK 101,871,225 and now stands at HRK 399,495,000. In November 1999, following the statutory six-month waiting period, the Company paid out HRK 101,067 thousand as a return of capital to shareholders. The remaining balance of HRK 804 thousand relates to the treasury shares that the Company had at that date. The reduction of the share capital was carried out by reduction of the nominal value of the issued shares from DEM 100 to HRK 300 each.

Further decrease in share capital was approved by the General Assembly at its meeting in May 2003, resulting from a decrease in the nominal value of shares from HRK 300 to HRK 200 and became unconditional after the year-end, following the statutory six-month period as required by the Commercial Court.

According to the ownership structure at 31 December 2003, Telefonaktiebolaget LM Ericsson (Ericsson) is the major single shareholder of the Company owning 49.07% of the shares. The Croatian Privatisation Fund owns 0.88% of the Company's shares, treasury shares amount to 1.32% and other shareholders own the remaining 48.73% of the Company's shares.

### Principal activities

The principal activities of the Company are the following: 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, Central and Eastern Europe, the Middle East and Africa as well as other 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)

### Directors and management

#### The Supervisory Board

The Supervisory Board members during 2003 and up to the release of these statements were:

Mats Dahlin	appointed on 4 June 2002	Chairman
Pär Lövgren	appointed on 4 June 2002	Vice-Chairman
Zvonimir Jelić	appointed on 4 June 2002	Member
Ignac Lovrek	appointed on 8 May 2003	Member
Darko Marinac	appointed on 8 May 2003	Member

#### The Management Board

The Management Board has only one member:

Lars Åke Einar Enell	Director
----------------------	----------

#### Executive management

As at 31 December 2003, the Company's executive management comprised:

Lars Åke Einar Enell	Director	
Rajko Pfaff	Deputy Director	
Gordana Kovačević	Vice-Director	Director of Operations
Josip Jakovac	Vice-Director	Director of Export 1
Milan Živković		Director of Business Development
Björn Dellås		Director of Research and Development Centre
Lars Jakobsson		Director of Business Support
Ana Jožinec		Director of People and Culture
Thomas Svane Falk		Director of Export 2
Milivoj Pejković	Vice-Director	Key Account Manager VIPNet
Tihomir Šicel		Key Account Manager HT
Tibor Jerger		Key Account Manager Other
Snježana Bahtijari		Manager of Communication
Jagoda Carić		Key Account Manager B&H, Montenegro

## Statement of the Management Board's responsibilities

Croatian law requires the Management Board 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 result of its operations, changes in equity and cash flows for that year.

In preparing those financial statements, the Management Board is required to:

- >> Select suitable accounting policies to conform with International Financial Reporting Standards and Croatian Accounting Law and then apply them consistently;
- >> Make judgements and estimates that are reasonable and prudent;
- >> State whether applicable accounting standards have been followed; and
- >> Prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Management Board is responsible for maintaining proper accounting records which disclose, with reasonable accuracy, the financial position of the Company at any time as well as for ensuring that the financial statements comply with Croatian law and International Financial Reporting Standards. The Management Board 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.

Signed on behalf of the Management Board:



Lars Åke Einar Enell  
Ericsson Nikola Tesla d.d. Zagreb  
Krapinska 45, 10000 Zagreb  
Croatia  
10 March 2004



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

We have audited the accompanying balance sheet of Ericsson Nikola Tesla d.d. Zagreb (the Company) as of 31 December 2003, and the related statements of income, changes in equity and cash flows for the year then ended. These financial statements are the responsibility of the Company's Management Board. Our responsibility is to express an opinion on these financial statements based on our audit.

The financial statements for the year ended 31 December 2002 were audited by another auditor whose report dated 7 March 2003 expressed unqualified opinion on those financial statements.

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

In our opinion, the financial statements give a true and fair view of the financial position of the Company as of 31 December 2003 and of the results of its operations, changes in equity and cash flows for the year then ended in accordance with International Financial Reporting Standards.

**KPMG Croatia d.o.o. za reviziju**  
Croatian Registered Auditors  
Centar Kaptol  
Nova Ves 11  
10000 Zagreb  
Croatia

10 March 2004



Ericsson Nikola Tesla income statement  
For the year ended 31 December 2003

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	Notes	<b>2003</b> HRK '000	<b>2002</b> HRK '000
Revenue	2	1,404,016	1,414,135
Other operating income	4	38,672	28,586
<b>Total operating income</b>		<u>1,442,688</u>	<u>1,442,721</u>
<i>Operating costs</i>			
Changes in inventories of finished goods and work-in-progress		(13,047)	10,410
Cost of components and raw material		604,999	557,199
Other material costs (services)	5	294,199	298,255
Staff costs	6	248,441	247,423
Depreciation and amortisation	7	46,356	55,188
Other impairment allowances	8	36,747	(17,425)
Provisions	9	4,410	10,394
Other operating expenses	10	49,241	62,124
<b>Total operating costs</b>		<u>1,271,346</u>	<u>1,223,568</u>
<b>Profit from operations</b>		<u>171,342</u>	<u>219,153</u>
Finance income	11	115,653	69,808
Finance expense	12	(84,046)	(120,695)
<b>Net finance income / (expense)</b>		<u>31,607</u>	<u>(50,887)</u>
<b>Profit before tax</b>		202,949	168,266
Income tax expense	13	(18,045)	(38,234)
<b>Net profit for the year</b>		<u>184,904</u>	<u>130,032</u>
Earnings per share (HRK)	14	<u>140.72</u>	<u>98.96</u>

The notes set out on pages 37 to 66 form an integral part of these financial statements.

Ericsson Nikola Tesla balance sheet  
As at 31 December 2003

	Notes	2003 HRK '000	2002 HRK '000
<b>ASSETS</b>			
<b>Non-current assets</b>			
Property, plant and equipment	15	148,849	168,356
Intangible assets	16	2,874	4,560
Investments	17	10,484	10,214
Long-term receivables	18	104,159	78,585
Deferred tax assets	13	14,687	13,179
<b>Total non-current assets</b>		<u>281,053</u>	<u>274,894</u>
<b>Current assets</b>			
Inventories	19	74,424	102,931
Trade receivables	20	353,424	497,526
Receivables from related parties	31	23,919	42,602
Income tax receivable		17,629	-
Other receivables	21	19,954	21,610
Current financial assets	22	122,580	100,152
Prepayments and accrued income		2,596	1,860
Cash and cash equivalents	23	589,899	441,473
<b>Total current assets</b>		<u>1,204,425</u>	<u>1,208,154</u>
<b>TOTAL ASSETS</b>		<u>1,485,478</u>	<u>1,483,048</u>

Ericsson Nikola Tesla balance sheet (continued)  
As at 31 December 2003

**2003**  
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	Notes	2003 HRK '000	2002 HRK '000
<b>EQUITY AND LIABILITIES</b>			
<b>Capital and reserves</b>			
Share capital	24	399,495	399,495
Share premium	24	804	804
Treasury shares	24	(5,890)	(5,890)
Reserves	24	42,848	42,848
Retained earnings	24	771,941	605,433
<b>Total equity</b>	24	<u>1,209,198</u>	<u>1,042,690</u>
<b>Non-current liabilities</b>			
Long-term loans	25	3,817	3,951
Employee benefits obligations	26	3,390	3,544
<b>Total non-current liabilities</b>		<u>7,207</u>	<u>7,495</u>
<b>Current liabilities</b>			
Liabilities toward related parties	31	87,626	158,770
Current financial liabilities	27	242	19,645
Income tax payable		-	5,854
Trade and other payables	28	80,736	64,940
Provisions	29	16,888	26,974
Accruals and deferred income	30	83,581	156,680
<b>Total current liabilities</b>		<u>269,073</u>	<u>432,863</u>
<b>Total liabilities</b>		<u>276,280</u>	<u>440,358</u>
<b>TOTAL EQUITY AND LIABILITIES</b>		<u>1,485,478</u>	<u>1,483,048</u>

The financial statements were approved by the Management Board of Ericsson Nikola Tesla d.d. Zagreb on 10 March 2004 and were signed on its behalf by:



**Lars Åke Einar Enell**  
Director



**Lars Jakobsson**  
Business Support Director

The notes set out on pages 37 to 66 form an integral part of these financial statements.

Ericsson Nikola Tesla cash flow statement  
For the year ended 31 December 2003

	2003 HRK '000	2002 HRK '000
<b>Cash flows from operating activities</b>		
<i>Profit before tax</i>	202,949	168,266
Adjustments for:		
Depreciation and amortisation	46,356	55,188
Other impairment allowances	36,747	29,865
Change in provisions	(8,229)	4,830
Write-offs and losses on disposal of property, plant and equipment	2,911	5,519
Unrealised gains/ (losses) on financial instruments	(26,188)	33,834
Investment income	(24,718)	(24,958)
Interest expense	727	543
Foreign exchange (gain)/loss	(5,371)	35,904
	225,184	308,991
(Increase) / decrease in long-term receivables	(25,574)	38,406
Decrease / (increase) in inventories	26,780	(68,810)
Decrease / (increase) in receivables	129,421	(171,324)
(Decrease) / increase in payables	(55,348)	82,930
(Decrease) / increase in other operating assets and liabilities	(77,354)	36,113
<i>Cash generated from operations</i>	223,109	226,306
Interest paid	(727)	(543)
Income taxes paid	(41,528)	(56,635)
<b>Net cash from operating activities</b>	<b>180,854</b>	<b>169,128</b>
<b>Cash flows from investing activities</b>		
Interest received	24,718	24,958
Purchase of property, plant and equipment, and intangible assets	(28,191)	(51,529)
Increase in long-term deposits	(270)	(420)
Net acquisition of current financial assets	(13,378)	(46,140)
Proceeds from sale of workers' apartments	117	1,053
<b>Net cash used in investing activities</b>	<b>(17,004)</b>	<b>(72,078)</b>

Ericsson Nikola Tesla cash flow statement (continued)  
For the year ended 31 December 2003

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	<b>2003</b>	<b>2002</b>
	<b>HRK '000</b>	<b>HRK '000</b>
<b>Cash flows from financing activities</b>		
Payment of financial liabilities	(93)	(129)
Dividends paid	(18,396)	(18,396)
<b>Net cash used in financing activities</b>	<b>(18,489)</b>	<b>(18,525)</b>
Effects of exchange rate changes on cash and cash equivalents	3,065	(30,614)
<b>Net increase in cash and cash equivalents</b>	<b>148,426</b>	<b>47,911</b>
Cash and cash equivalents at the beginning of the year	441,473	393,562
Cash and cash equivalents at the end of the year	<u>589,899</u>	<u>441,473</u>

The notes set out on pages 37 to 66 form an integral part of these financial statements.

Ericsson Nikola Tesla statement of changes in equity  
For the year ended 31 December 2003

	Share capital HRK '000	Share premium HRK '000	Treasury shares HRK '000	Reserve for treasury shares HRK '000	Transformation reserve HRK '000	Legal reserve HRK '000	Retained earnings HRK '000	Total HRK '000
<b>As at 1 January 2002</b>	399,495	804	(5,890)	5,890	16,848	20,110	493,797	931,054
Dividend distribution for 2001	-	-	-	-	-	-	(18,396)	(18,396)
Net profit for the year	-	-	-	-	-	-	130,032	130,032
<b>As at 31 December 2002</b>	399,495	804	(5,890)	5,890	16,848	20,110	605,433	1,042,690
Dividend distribution for 2002	-	-	-	-	-	-	(18,396)	(18,396)
Net profit for the year	-	-	-	-	-	-	184,904	184,904
<b>As at 31 December 2003</b>	399,495	804	(5,890)	5,890	16,848	20,110	771,941	1,209,198

The notes set out on pages 37 to 66 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 company domiciled in Croatia. A summary of the Company's principal accounting policies is set out below.

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#### Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the International Accounting Standards Board (IASB), currently applicable interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) of the IASB and the Croatian Accounting Law.

#### Basis of preparation

The financial statements are prepared on the historical cost convention, with the exception of financial instruments which are carried at fair value. These comprise derivative instruments and investments available for sale. The accounting policies have been consistently applied and are consistent with those used in the previous year.

#### Reporting currency

The Company's financial statements have been prepared in Croatian Kuna (HRK), which is also the measurement currency, and are rounded to the nearest thousand. The effective exchange rate as at 31 December 2003 was Kuna 6.1185 per 1 United States Dollar (2002: 7.1464) and Kuna 7.6469 per 1 Euro (2002: 7.442).

#### Changes in presentation or classification of items in the financial statements

Current 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 with the current year's presentation.

#### Property, plant and equipment

Property, plant and equipment are shown at historical cost, modified to reflect hyperinflation prior to 31 December 1993 as required by IAS 29, less accumulated depreciation and impairment losses.

Subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the item of property, plant and equipment. All other expenditure on repairs and maintenance is expensed as incurred.

## Notes to the financial statements (continued)

### 1 Significant accounting policies (continued)

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

	<b>Useful lives</b>
Buildings	5 – 30 years
Technical equipment	4 – 10 years
Other (vehicles, tools, furniture and fixtures)	4 – 7 years

#### Intangible assets

Intangible assets are stated 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.

Amortisation is provided on a straight-line basis over the estimated useful lives of intangible assets. Intangible assets include software (SAP, SOFTPRO) which are amortised on a straight-line basis over useful life of 4 years.

#### Impairment of assets

Property, plant and equipment, intangible assets, investments 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 for items of property, plant and equipment, intangible assets, investments and receivables carried at cost.

The recoverable amount of held-to-maturity investments and receivables 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. Impairment loss as to other assets is reversed if there has been a change in the estimates used to determine the recoverable amount. The impairment loss is reversed only 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.

## Notes to the financial statements (continued)

### 1 Significant accounting policies (continued)

#### Investments

Investments acquired principally for the purpose of generating a short-term profit are classified as trading investments and included in current assets. These include derivative instruments, which do not qualify for hedge accounting.

Originated loans and receivables are loans and receivables created by the Company providing money to a debtor other than those created with the intention of short-term profit taking. These include long-term receivables and deposits with financial institutions.

Investments with fixed or determinable payments and fixed maturity that the Company has positive intent and ability to hold to maturity are classified as held-to-maturity investments.

All other investments are classified as available for sale. These include debt and equity securities.

All financial assets held for trading, 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. Originated loans and receivables are recognised on the day they are transferred to the Company.

Investments are initially measured at cost, which is the fair value of the consideration given for them, including transaction costs. All trading instruments and available-for-sale investments 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 investments and loans and receivables originated by the Company are carried at amortised cost less impairment losses. Amortised cost is calculated using the effective interest rate method. Premiums and discounts, 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 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.

## Notes to the financial statements (continued)

### 1 Significant accounting policies (continued)

Realised and unrealised gains and losses arising from changes in the fair value of trading and available-for-sale investments are recognised in the income statement in the period in which they arise.

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. Trading instruments, available-for-sale assets and held-to-maturity instruments that are sold 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. Originated loans and receivables are derecognised on the day they are transferred by the Company.

#### Derivative instruments

The Company uses derivative financial instruments to hedge economically its exposure to foreign exchange risk arising from operational activities. In accordance with its Treasury Policy, the Company is not eligible to hold derivatives for trading purposes. However, derivatives that do not qualify for hedge accounting are accounted for as trading instruments.

#### Trade and other receivables

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

#### Inventories

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.

Other 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. 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 and are paid out of the retained earnings.

#### Trade and other payables

Trade and other payables are stated at their cost.

#### 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 income 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.

#### Recognition of revenues

For long-term contracts, revenue is recognised according to 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 upon delivery of products, software and/or services and represents amounts realised, excluding value added tax.

#### Employee 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.

#### 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.

## Notes to the financial statements (continued)

### 1 Significant accounting policies (continued)

#### 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.

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## Notes to the financial statements (continued)

### 2 Revenue

	2003	2002
	HRK '000	HRK '000
Sales in Croatia	313,642	312,947
Sales in Russia, Belarus, Kazakhstan, Ukraine, Kyrgyzstan, Moldova and neighbouring countries	519,351	583,649
Sales to the European Union	224,369	238,983
Sales in Bosnia and Herzegovina, Montenegro, Slovenia and Macedonia	296,205	245,546
Other export sales	50,449	33,010
	<u>1,404,016</u>	<u>1,414,135</u>

Out of total sales of HRK 1,404 million, sales of products amounted to HRK 878 million (2002: HRK 858 million) and sales of services amounted to HRK 526 million (2002: HRK 556 million). Sales income comprises construction contract revenue recognised as revenue in the amount of HRK 1,016 million (2002: HRK 865 million).

### 3 Segment information

Segment information is presented in respect of the Company's business segments, which is the primary format, and is based on the Company's management and internal reporting structure. Inter-segment pricing is determined on an arm's length basis. 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 income-earning assets and revenue, long-term payables and expenses, and corporate assets and 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:

##### *Mobile Systems*

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

##### *Multi-Service Networks*

This segment provides products and solutions for fixed networks, such as narrowband and broadband access networks.

##### *Other business operations*

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

#### Geographical segments

All three segments are managed in two principal geographical areas, i.e. Europe and Russia with neighbouring countries.

## 3 Segment information (continued)

## Business segments

	Mobile Systems		Multi-Service Networks		Other		Total	
	2003	2002	2003	2002	2003	2002	2003	2002
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
External sales and other income	546,816	558,445	746,946	773,011	148,926	111,265	1,442,688	1,442,721
Segment results	90,409	94,734	110,879	151,001	7,569	9,438	208,857	255,173
Unallocated Company's expenses							(37,515)	(36,020)
<b>Profit from operations</b>							171,342	219,153
Finance income							115,653	69,808
Finance expense							(84,046)	(120,695)
<b>Net finance income / (expense)</b>							31,607	(50,887)
Profit before tax							202,949	168,266
Income tax expense							(18,045)	(38,234)
<b>Net profit for the year</b>							184,904	130,032

## 3 Segment information (continued)

## Business segments

	Mobile Systems		Multi-Service Networks		Other		Total	
	2003	2002	2003	2002	2003	2002	2003	2002
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Segment assets	208,078	276,166	284,738	382,275	54,757	55,023	547,573	713,464
Unallocated Company's assets							937,905	769,584
Total Company's assets	49,905	86,762	68,291	120,098	13,133	17,286	1,485,478	1,483,048
Segment liabilities							131,329	224,146
Unallocated Company's liabilities							144,951	216,212
Total Company's liabilities	8,702	10,587	11,908	14,655	2,290	2,109	276,280	440,358
Depreciation and amortisation	21,975	8,873	30,071	12,282	5,783	1,768	-	-
Other non-cash expenses							-	-

All the Company's assets are located in Croatia.

## 4 Other operating income

	<b>2003</b>	<b>2002</b>
	<b>HRK '000</b>	<b>HRK '000</b>
Commission income	18,230	13,383
Reversal of provisions (note 29)	12,639	5,564
Other	7,803	9,639
	<u>38,672</u>	<u>28,586</u>

## 5 Other material costs (services)

	<b>2003</b>	<b>2002</b>
	<b>HRK '000</b>	<b>HRK '000</b>
Third party suppliers	128,282	126,481
Licence fees	68,265	49,610
Telecommunication and transportation costs	33,419	37,154
Maintenance services	32,758	32,361
IS/IT services and support	4,721	6,583
Other external services	26,754	46,066
	<u>294,199</u>	<u>298,255</u>

Third party suppliers' services include subcontractors on projects, commissions paid to consultants and similar services.

The Company pays licence fees to other Ericsson companies, on sales of wireline and other products. During 2002 the calculation of licence fee was changed and currently the fee is paid as a percentage of sales of wireline products and solutions, rather than as a fixed amount per product sold (note 31). The new calculation is applicable on contracts signed during 2002 and in subsequent periods.

## Notes to the financial statements (continued)

### 6 Staff costs

	<b>2003</b>	<b>2002</b>
	<b>HRK '000</b>	<b>HRK '000</b>
Gross payroll	205,316	197,685
Health and pension contributions	33,471	33,881
Other payroll-related costs	9,654	15,857
	<u>248,441</u>	<u>247,423</u>
<i>Of that:</i>		
Net payroll	128,219	125,300
Taxes and contributions	110,568	106,266
Other payroll-related costs	9,654	15,857
	<u>248,441</u>	<u>247,423</u>

Staff costs include HRK 31.2 million of defined pension contributions paid or payable into obligatory pension plans. Contributions are calculated as a percentage of employees' gross salaries.

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

	<b>2003</b>	<b>2002</b>
Operations	481	416
Research and Development Centre	321	379
Sales	68	71
Support functions	139	228
Employees on long-term assignment abroad	11	15
	<u>1,020</u>	<u>1,109</u>

## 7 Depreciation and amortisation

	<b>2003</b>	<b>2002</b>
	<b>HRK '000</b>	<b>HRK '000</b>
Depreciation of property, plant and equipment	44,402	46,435
Amortisation of intangible assets	1,954	2,853
Impairment losses for property, plant and equipment	-	5,900
	<u>46,356</u>	<u>55,188</u>

The impairment losses noted above have been recognised for certain buildings for which the recoverable amount was below their net book values (note 15).

## 8 Other impairment allowances

	<b>2003</b>	<b>2002</b>
	<b>HRK '000</b>	<b>HRK '000</b>
Impairment allowances for doubtful receivables	57,830	22,923
Recovery of doubtful receivables	(22,810)	(47,290)
Impairment allowances for inventories	1,727	6,942
	<u>36,747</u>	<u>(17,425)</u>

## 9 Provisions

	<b>2003</b>	<b>2002</b>
	<b>HRK '000</b>	<b>HRK '000</b>
Warranty reserve created	3,704	9,390
Penalty reserve created	706	1,004
	<u>4,410</u>	<u>10,394</u>

## 10 Other operating expenses

	<b>2003</b>	<b>2002</b>
	<b>HRK '000</b>	<b>HRK '000</b>
Travel allowances	27,984	32,769
Educational costs	5,025	5,899
Write-offs and losses on disposal of property, plant and equipment	2,911	5,519
Other operating expenses	13,321	17,937
	<u>49,241</u>	<u>62,124</u>

## Notes to the financial statements (continued)

### 11 Finance income

	<b>2003</b>	<b>2002</b>
	<b>HRK '000</b>	<b>HRK '000</b>
Interest income	24,718	24,958
Gains on foreign exchange	64,799	44,850
Available-for-sale investments		
Gain on disposal	2,022	-
Revaluation to fair value	639	-
Net gains derived from trading instruments	23,475	-
	<u>115,653</u>	<u>69,808</u>

### 12 Finance expense

	<b>2003</b>	<b>2002</b>
	<b>HRK '000</b>	<b>HRK '000</b>
Losses on foreign exchange	(83,319)	(114,743)
Interest expense	(727)	(543)
Net losses derived from trading instruments	-	(5,289)
Revaluation to fair value of available-for-sale investments	-	(120)
	<u>(84,046)</u>	<u>(120,695)</u>

## Notes to the financial statements (continued)

### 13 Income tax expense

Income tax has been calculated at statutory tax rate of 20% (2002: 20%) of the taxable income of the Company.

Income tax expense recognised in income statement comprises:

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	<b>2003</b>	<b>2002</b>
	<b>HRK '000</b>	<b>HRK '000</b>
Current income tax expense	(19,553)	(36,163)
Deferred tax income / (expense) relating to the origination and reversal of temporary differences	1,508	(2,071)
Total income tax expense in income statement	<u>(18,045)</u>	<u>(38,234)</u>

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

	<b>2002</b>	<b>Credited / (charged)</b>	<b>2003</b>
	<b>HRK '000</b>	<b>to income</b>	<b>HRK '000</b>
		<b>statement</b>	
		<b>HRK '000</b>	
Impairment allowances for doubtful receivables	3,052	5,841	8,893
Impairment allowances for obsolete stocks	2,182	(683)	1,499
Provision for employee benefits	649	(33)	616
Impairment losses for property, plant and equipment	3,065	(1,127)	1,938
Long-term receivables for sold apartments	1,226	(89)	1,137
Negative fair value of financial instruments	3,005	(2,401)	604
	<u>13,179</u>	<u>1,508</u>	<u>14,687</u>

## Notes to the financial statements (continued)

### 13 Income tax expense (continued)

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

	<b>2003</b>	<b>2002</b>
	<b>HRK '000</b>	<b>HRK '000</b>
Profit before tax	202,949	168,266
Income tax at 20% (2002: 20%)	40,590	33,653
Tax effects of income not taxable in determining taxable profit:		
Recovery of non-deductible impairment allowances	(876)	-
Other allowances	-	(95)
Tax effects of expenses not deductible in determining taxable profit:		
Non-deductible impairment allowances	1,620	3,287
Entertainment expenses	1,129	1,357
Other expenses	(60)	32
Tax effects of tax relief:		
Research and development expenses and education expenses	(24,358)	-
Total tax expense	<u>18,045</u>	<u>38,234</u>

Research and development costs amounted to HRK 115.8 million (2002: HRK 4.2 million) which are included in other material cost (services).

### 14 Earnings per share

	<b>2003</b>	<b>2002</b>
Net profit for the year (HRK '000)	184,904	130,032
Weighted Average Number of Shares Outstanding at the year-end	1,314,026	1,314,026
Earnings per share (HRK)	<u>140.72</u>	<u>98.96</u>

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

## Notes to the financial statements (continued)

### 15 Property, plant and equipment

The movement on property, plant and equipment in the year ended 31 December 2003 may be analysed as follows:

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	At 1 January 2003 HRK '000	Additions HRK '000	Disposals and write-offs HRK '000	Transfers HRK '000	At 31 December 2003 HRK '000
<b>Cost</b>					
Land	18,163	-	-	-	18,163
Buildings	160,441	-	(12,600)	6,316	154,157
Technical equipment	207,336	-	(11,243)	15,973	212,066
Other (vehicles, tools, furniture and fixtures)	56,202	-	(1,346)	5,508	60,364
Construction in progress and advances	19	27,923	-	(27,797)	145
<b>Total</b>	<u>442,161</u>	<u>27,923</u>	<u>(25,189)</u>	<u>-</u>	<u>444,895</u>
	At 1 January 2003 HRK '000	Charge for the year HRK '000	Disposals and write-offs HRK '000		At 31 December 2003 HRK '000
<b>Accumulated depreciation and impairment loss</b>					
Buildings	(111,846)	(3,334)	11,037		(104,143)
Impairment loss on buildings	(5,900)	-	-		(5,900)
Technical equipment	(124,131)	(35,128)	11,091		(148,168)
Other (vehicles, tools, furniture and fixtures)	(33,436)	(5,940)	1,287		(38,089)
<b>Total</b>	<u>(275,313)</u>	<u>(44,402)</u>	<u>23,415</u>		<u>(296,300)</u>
<b>Net book value</b>	<b>166,848</b>				<b>148,595</b>
Net book value of workers' apartments	1,508				254
	<u>168,356</u>				<u>148,849</u>

Additions to property, plant and equipment mainly relate to the acquisition of telecommunications equipment, air conditioning equipment and hardware.

## Notes to the financial statements (continued)

### 15 Property, plant and equipment (continued)

#### Impairment loss

Management has performed an impairment review of certain buildings. The result of the review indicated that a building owned by the Company has been impaired. The impaired building was written down to its recoverable value which is its net selling price assessed by reference to the bids received. The net book value of impaired buildings was HRK 14 million as at 31 December 2003.

#### Capital commitments

During the year ended 31 December 2003 the Company entered into several contracts in the total amount of HRK 871 thousand (2002: HRK 4,581 thousand) for purchase of equipment.

### 16 Intangible assets

The movement on intangible assets in the year ended 31 December 2003, may be analysed as follows:

	At 1 January 2003	Additions	Disposals	At 31 December 2003
	HRK '000	HRK '000	HRK '000	HRK '000
Purchased software (SAP, SOFTPRO), cost	12,184	268	(2)	12,450
Accumulated amortisation	(7,624)	(1,954)	2	(9,576)
<b>Net book value</b>	<b>4,560</b>			<b>2,874</b>

Intangible assets are amortised over 4 years, on average.

## 17 Investments

Non-current investments are analysed as follows:

	<b>2003</b> <b>HRK '000</b>	<b>2002</b> <b>HRK '000</b>
<i>Originated by the Company</i>		
Deposit with financial institutions, denominated in EUR	10,070	9,800
<i>Available for sale</i>		
Shares of Hrvatska poštanska banka	369	369
<i>Investments in subsidiaries</i>		
ETK Enterprise Solutions, Ltd., incorporated in Croatia	20	20
Ericsson Tesla SoftLab, Ltd., incorporated in Croatia	20	20
<i>Investments in associates</i>		
EXi d.o.o., incorporated in Croatia	5	5
	<u>10,484</u>	<u>10,214</u>

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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 3.48% per annum and with a remaining maturity of over five years.

The Company founded two 100% owned subsidiaries during 2002 in order to have them readily available if there is a need for the transfer of a part of the Company's operations to new entities. Up to the year-end, none of these companies started any operations and their balance sheets comprise only paid-in cash by the parent company. Therefore, consolidated financial statements have not been prepared and the Company's investment in these subsidy companies is stated at cost.

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

## Notes to the financial statements (continued)

### 18 Long-term receivables

	<b>2003</b>	<b>2002</b>
	<b>HRK '000</b>	<b>HRK '000</b>
<i>Non-current portion, originated by the Company</i>		
Foreign customers	95,537	66,060
Domestic customers	268	4,344
Receivables for sold apartments	6,032	4,945
Housing loans to employees	2,322	3,236
	<u>104,159</u>	<u>78,585</u>

The foreign receivables are denominated in either US Dollars or Euros.

Domestic receivables and receivables from foreign customers are partially secured with bank guarantees and letters of credit. The current portion of the long-term receivables is classified under current assets.

The long-term portion of domestic and foreign receivables is due in 2005 in the amount of HRK 75,077 thousand and in 2006 in the amount of HRK 20,728 thousand.

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 six years.

Receivables for apartments and housing loans provided to a limited number of employees bear fixed interest rates that are more favourable in comparison to the market interest rates. An impairment allowance is recognised in respect of these loans and amortised to the income statement, using the effective interest rate method.

## Notes to the financial statements (continued)

### 19 Inventories

Inventories comprise the following:

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	Gross		Obsolescence reserve		Net	
	2003 HRK '000	2002 HRK '000	2003 HRK '000	2002 HRK '000	2003 HRK '000	2002 HRK '000
Raw materials	69,347	86,921	(6,808)	(8,922)	62,539	77,999
Work-in-progress and semi-finished goods	11,757	20,198	(257)	(123)	11,500	20,075
Finished goods	817	6,390	(432)	(1,533)	385	4,857
	<u>81,921</u>	<u>113,509</u>	<u>(7,497)</u>	<u>(10,578)</u>	<u>74,424</u>	<u>102,931</u>

### 20 Trade receivables

	2003 HRK '000	2002 HRK '000
Foreign customers	63,724	201,575
Current portion of long-term receivables	<u>249,249</u>	<u>189,193</u>
Total foreign customers	<u>312,973</u>	<u>390,768</u>
Domestic customers	97,365	139,660
Current portion of long-term receivables	<u>7,479</u>	<u>12,025</u>
Total domestic customers	<u>104,844</u>	<u>151,685</u>
Impairment allowances for doubtful receivables	<u>(64,393)</u>	<u>(44,927)</u>
	<u>353,424</u>	<u>497,526</u>

### 21 Other receivables

	2003 HRK '000	2002 HRK '000
Receivables for prepaid VAT	17,841	20,508
Receivables from employees	1,163	80
Other receivables	<u>950</u>	<u>1,022</u>
	<u>19,954</u>	<u>21,610</u>

## Notes to the financial statements (continued)

### 22 Current financial assets

	<b>2003</b>	<b>2002</b>
	<b>HRK '000</b>	<b>HRK '000</b>
Debt securities, available for sale	50,674	59,046
Investment in open-ended investment funds, available for sale	57,241	31,874
Positive fair value of derivative instruments	14,485	8,380
Loans, deposits and guarantee deposits, originated by the Company	180	852
	<u>122,580</u>	<u>100,152</u>

Debt securities comprise Croatian Health Insurance Fund (Hrvatski zavod za zdravstveno osiguranje) bonds in the amount of HRK 19,729 thousand (denominated in Euro) maturing in 2004 and earning a fixed interest rate of 8.5% p.a., and the Ministry of Finance bonds in the amount of HRK 30,945 thousand (denominated in Euro) with maturity in 2004 and a fixed interest rate of 6.875 % p.a.

Investments in open-ended investment funds are denominated in Euro.

The fair value of trading and available-for-sale assets at the balance sheet date was determined by reference to quoted prices on the Zagreb stock exchange on 31 December 2003.

### 23 Cash and cash equivalents

	<b>2003</b>	<b>2002</b>
	<b>HRK '000</b>	<b>HRK '000</b>
Cash and demand deposits	35,224	145,072
Time deposits originated by the Company, with maturity up to 3 months	554,675	296,401
	<u>589,899</u>	<u>441,473</u>

Cash and cash equivalents mainly comprise deposits denominated in foreign currency. Time deposits bear fixed interest rates at the year-end ranging from 1.4% to 9.5% per annum.

## 24 Equity

As at 31 December 2003, the share capital of the Company is represented by 1,331,650 ordinary shares, with a total registered value of HRK 399,495 thousand. The par value of one share is HRK 300.

A decrease in share capital was approved by the General Assembly at its meeting in May 2003, resulting from a decrease in the nominal value of shares from HRK 300 to HRK 200 and became unconditional after the year-end, following the statutory six-month period as required by the Commercial Court (note 35).

The Company's shareholders as at 31 December 2003 are:

	Number of shares	% Held
Telefonaktiebolaget LM Ericsson	653,473	49.07%
Small shareholders	648,892	48.73%
Privatisation Fund	11,661	0.88%
Treasury shares	17,624	1.32%
	<u>1,331,650</u>	<u>100.00%</u>

A reserve for treasury shares was created prior to their repurchase as required by law. Treasury shares were not disposed of within one year from their acquisition as prescribed by law. After taking legal advice the Management Board is of the opinion that no material consequences to the financial statements can arise from this non-compliance.

A legal reserve in the amount of 5% of total share capital was formed during previous periods by appropriation of 5% of net profit per annum up to a cap of 5% of share capital. The legal reserve may be used for covering of losses if the losses are not covered by current net profit or if other reserves are not available. The Company recorded the required level of legal reserves in the year 2000 and no further allocation of legal reserves is required.

The transformation reserve was created as a result of privatisation of the Company in 1995 when a new appraisal of the Company was made.

## Notes to the financial statements (continued)

### 24 Equity (continued)

#### Proposed dividends

Dividends payable are not accounted for until they have been ratified at the General Assembly of shareholders. At the meeting on 18 May 2004, a dividend of HRK 17 per ordinary share is to be proposed. The dividends will be payable from the Company's retained earnings as at 31 December 2000, and as such these dividends are not subject to withholding tax. Dividends payable to foreign investors and domestic individuals from retained earnings formed in periods after 31 December 2000 are subject to 15% withholding tax.

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

	2003	2002
	HRK '000	HRK '000
HRK 14.00 per share for 2002	18,396	-
HRK 14.00 per share for 2001	-	18,396

### 25 Long-term loans

Long-term debt is represented by debt due to financial institutions, the settlement of which is pending the definition of debt deriving from the former Yugoslavia. Consequently, no due dates have yet been established, except for the amount of HRK 2,072 thousand or EUR 271 thousand (current portion included) to Hermes Kreditversicherungs, A.G. (Germany) which will be repaid in the period from 1998 to 2009. This loan bears an interest rate of 7.9% per annum. The remaining amount of HRK 1,987 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.

### 26 Employee benefits obligations

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 2003 were a 7% discount rate and a 2.5% rate of average employment turnover.

## Notes to the financial statements (continued)

### 27 Current financial liabilities

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	<b>2003</b> <b>HRK '000</b>	<b>2002</b> <b>HRK '000</b>
Current portion of long term-loans	242	201
Negative fair value of derivative instruments	-	19,444
	<u>242</u>	<u>19,645</u>

### 28 Trade and other payables

	<b>2003</b> <b>HRK '000</b>	<b>2002</b> <b>HRK '000</b>
Trade payables	34,065	28,033
Liabilities towards employees	43,263	33,399
Liabilities for taxes and contributions	2,872	3,350
Other current liabilities	536	158
	<u>80,736</u>	<u>64,940</u>

Liabilities to employees include a bonus salary of HRK 27 million (2002: HRK 17 million).

### 29 Provisions

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

	<b>Warranty reserve</b> <b>HRK '000</b>	<b>Penalty reserve</b> <b>HRK '000</b>	<b>Total</b> <b>HRK '000</b>
As at 31 December 2002	<u>15,500</u>	<u>11,474</u>	<u>26,974</u>
Provision created during the year	3,704	706	4,410
Provision reversed during the year	(1,456)	(11,183)	(12,639)
Provision used during the year	(1,857)	-	(1,857)
As at 31 December 2003	<u>15,891</u>	<u>997</u>	<u>16,888</u>

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

## Notes to the financial statements (continued)

### 30 Accruals and deferred income

	<b>2003</b>	<b>2002</b>
	<b>HRK '000</b>	<b>HRK '000</b>
Advances from domestic customers	2,093	2,135
Advances from foreign customers	24,180	55,602
Deferred income	17,802	52,125
Accrued restructuring costs	2,210	3,993
Other accrued charges	<u>37,296</u>	<u>42,825</u>
	<u>83,581</u>	<u>156,680</u>

Advances from foreign customers include HRK 14 million received during the years 1989-1992 from the post and telegraph companies of the former Yugoslavia. During 2000 and 2001 new contracts were signed with these companies and deliveries took place. These advances are carried at cost, as there is significant uncertainty as to when they will be utilised. Deferred income mainly represents amounts due to customers under construction contracts for work not performed.

## Notes to the financial statements (continued)

### 31 Balances and transactions with related parties

Balances with Ericsson Group companies may be summarised as follows:

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	<b>Receivable</b>		<b>Payable</b>	
	<b>2003</b>	<b>2002</b>	<b>2003</b>	<b>2002</b>
	<b>HRK'000</b>	<b>HRK'000</b>	<b>HRK'000</b>	<b>HRK'000</b>
Ericsson Telecom (ETX)	-	792	-	7,664
Ericsson Radio System (Access) (ERA)	-	18,395	-	86,587
Ericsson AB (EAB)	14,811	-	69,315	38,898
Ericsson Microwave Systems (EMW)	-	-	-	630
Ericsson Utvecklings Alvsjo (UAB)	-	1,734	-	8
Ericsson Telefonaktiebolaget LM (LME)	1,952	53	4,593	3,417
Ericsson Enterprise AB (EBC)	41	-	6,129	3,942
Ericsson Telecomunicazioni S.P.A. (TEI)	886	1,202	-	-
Ericsson Corporatia AO (ECR)	49	27	1,556	815
LM Ericsson Limited (LMI)	91	10	20	2,106
Ericsson SP. Z.O.O. (EPO)	-	-	10	4,093
Ericsson Network Technologies AB (ECA)	-	-	112	3,352
Ericsson Telecomunicacoes S.A. (EDB)	-	-	-	5,354
Ericsson Global IT services AB (GIS)	63	-	1,092	925
Ericsson Austria A.G. (SEA)	1,038	2,002	-	-
Ericsson Sverige AB (ESE)	96	1,084	-	-
Ericsson SA LTS (ESA)	1,388	11,812	-	-
Other	3,504	5,491	4,799	979
	<u>23,919</u>	<u>42,602</u>	<u>87,626</u>	<u>158,770</u>

Total purchases of goods and services from Ericsson Group companies during 2003 amounted to HRK 639 million (2002: HRK 682 million including licence fees) and sales to Ericsson Group companies amounted to HRK 287 million (2002: HRK 231 million). The 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, corporate trade mark licences and management fees. No other charges are made for the use of the corporate identity and other corporate services.

Total remuneration to executive management in the year amounted to HRK 13,413 thousand (2002: HRK 11,981 thousand) and is included in staff costs (note 6). The members of executive management held 1,228 ordinary shares at the year-end (2002: 1,301 shares).

### 32 Financial instruments

Exposure to currency, interest rate and credit risk arises in the normal course of the Company's business. Risk management policies that relate to short-term and long-term customer financing, cash management and debt and payables can be summarised as follows:

#### Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Company is mainly exposed to US dollars and partly 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, during 2003 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 70% of its estimated foreign currency exposure in respect of forecast sales and purchases over the following 12 months. All contracts have maturities of less than one year after the balance sheet date.

#### Interest rate risk

Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates. As the Company maintains its liquid funds mainly on short-term notice, the risk is limited to investments in bonds of Ministry of Health, Ministry of Finance and investments in open-ended investment funds (note 22), as well as long-term deposits in financial institutions (note 17).

#### 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 the 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. Provisions for doubtful accounts are evaluated monthly and changed if needed. Additionally, there is credit concentration risk as the Company has a significant portion of receivables from some customers. At 31 December 2003, the five biggest customers represent 46% of total net trade receivables (2002: 45%). 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 the risk is focused on dealing with banks in foreign ownership that deal with Ericsson on a world-wide basis or with banks that are listed on the international financial markets and 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 18 and 20) and other receivables (note 21), net of impairment allowances for doubtful receivables.

### 32 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 low.

#### Fair value estimation

The fair value of available-for-sale 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, long-term receivables, trade and other payables and long-term borrowings.

The carrying amount of cash and cash equivalents and of bank deposits approximates their fair value due to the short-term maturity of these financial instruments. Similarly, the historical cost carrying amounts of receivables and payables, including provisions, which are all subject to normal trade credit terms approximate their fair values. It is not practicable to determine the fair value of advances received from post and telegraph companies of the former Yugoslavia due to the uncertainty of timing of their utilisation (note 30).

### 33 Derivative instruments

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

The contractual notional amount of these derivatives (over the counter) at the year-end amounted to HRK 136 million, their fair values amounted to HRK 14,485 thousand (assets). These derivatives have remaining periods to maturity of less than one year.

During the year the Company changed its accounting estimate in respect of fair value measurement of the embedded derivative component included in the majority of its purchase and construction sale contracts denominated in foreign currencies. Since the derivatives market for forward EUR:HRK or USD:HRK currency agreements in excess of six months is undeveloped and market rates are not easy to obtain, the Company is not able to determine reliably the fair value of the embedded option. Accordingly, gains and losses on derivative component of the contracts will be recognised in the income statement upon recognition of income or cost of purchases.

## Notes to the financial statements (continued)

### 34 Contingent liabilities

In December 1999 the Company received a notification of the lawsuit brought against it by a number of small shareholders. According to the 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. After having taken the appropriate legal advice, the Company's Management Board is of the opinion that no material liabilities for the Company can result from this lawsuit.

During 2003 a small shareholder brought the lawsuit against the Company to render certain decisions declared at the General Assembly, held on 8 May 2003, null and void. The Company has submitted its response to the Court. After having taken the appropriate legal advice, the Company's Management Board is of the opinion that no material liabilities for the Company can result from this lawsuit.

### 35 Subsequent events

Based on the General Assembly's decision from May 2003, the Company's share capital has been decreased by HRK 133,165 thousand, as a result of decrease in the nominal value of shares from HRK 300 to HRK 200. Repayment of the difference to the shareholders commenced in January 2004, upon expiry of the statutory six-month period as required by the Commercial Court. Consequently, the decrease in the share capital will be recognised in the Company's accounting records in January 2004.

**Ericsson Nikola Tesla d.d.**

Krapinska 45

P.O.B. 93

HR-10 002 Zagreb

Croatia

phone: +385 1 365 35 35

+385 1 365 45 56

fax +385 1 365 31 56

[www.ericsson.hr](http://www.ericsson.hr)

e-mail: [etk.company@ericsson.com](mailto:etk.company@ericsson.com)

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