



**financial statements as at 31 December 2004
together with independent auditors' report »»**

Company profile

History and incorporation

Ericsson Nikola Tesla d.d. Zagreb (the Company) is a Croatian company with fifty-five 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 101,067,210 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. In January 2004, the Company paid out HRK 131,402,600 as a return of capital to shareholders. The remaining balance of HRK 1,762,400 relates to the treasury shares that the Company had at that date.

According to the ownership structure as at 31 December 2004, 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, 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 2004 and up to the release of these statements were:

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

The Management Board

The Management Board has only one member:

Lars Åke Einar Enell	<i>Until 31 December 2004</i>	Director
Gordana Kovačević	<i>Appointed on 1 January 2005</i>	Director

Company profile (continued)

Executive management

As at 31 December 2004, the Company's executive management comprised:

Lars Åke Einar Enell	Director	
Milivoj Pejković	Senior Adviser to Director of Sales and Marketing	
Gordana Kovačević	Vice-Director	<i>Director, Operations (until 31 December 2004)</i>
Branko Dronjić		<i>Deputy Director, Operations for Services</i>
Josip Jakovac	Vice-Director	<i>Director, Sales and Marketing for CIS</i>
Jagoda Carić		<i>Director, Sales and Marketing for B&H, Montenegro</i>
Tihomir Šicel		<i>Director, Sales and Marketing for T-HT</i>
Alan Ludaš		<i>Director, Sales and Marketing for VIPnet and Si.mobil</i>
Zoran Haniš		<i>Director, Sales and Marketing for Africa and New Markets</i>
Tibor Jerger		<i>Director, Sales and Marketing for Enterprise</i>
Björn Dellås		<i>Director, Research and Development Centre</i>
Siniša Krajnović		<i>Deputy Director, Research and Development Centre</i>
Vlatka Maričić		<i>Assistant R&D Centre Director, Program Unit CPP products</i>
Vjeran Radatović		<i>Assistant R&D Centre Director, PU Call Control and Signalling</i>
Maria Radtke		<i>Director, Finance and Sourcing</i>
Ana Jožinec		<i>Director, HR, Legal and Organization</i>
Snježana Bahtijari		<i>Director, Communication</i>
Milan Živković		<i>Director, Business Development</i>
Dragan Fratrić		<i>Unit Manager, Real Estate and General Services</i>
Hrvoje Benčić		<i>Unit Manager, Customer Solution and Sales Support</i>
Zoran Bojko		<i>Unit Manager, e-systems</i>

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,
- 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
Hrvatska



Gordana Kovačević
Ericsson Nikola Tesla d.d. Zagreb
Krapinska 45
10000 Zagreb
Hrvatska

24 February 2005



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 2004, and the related statements of income, changes in equity and cash flows for the year then ended. These financial statements are the responsibility of the Company's Management Board. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements give a true and fair view of the financial position of the Company as of 31 December 2004 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.

A handwritten signature of the KPMG firm, written in blue ink. The letters are stylized and cursive.

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

24 February 2005

Ericsson Nikola Tesla income statement
For the year ended 31 December 2004

	<i>Notes</i>	2004 HRK '000	2003 HRK '000
Sales revenue	2	1,551,661	1,404,016
Cost of goods sold		(1,182,421)	(1,117,780)
Gross profit		369,240	286,236
Other operating revenue	4	92,369	61,482
Selling expenses		(66,815)	(67,703)
General and administrative expenses		(47,323)	(41,794)
Other operating expenses	5	(125,732)	(66,879)
Operating profit before net financing income		221,739	171,342
Financial income	7	52,124	50,854
Financial expenses	7	(23,611)	(19,247)
Net financing income	7	28,513	31,607
Profit before tax		250,252	202,949
Income tax expense	8	(28,863)	(18,045)
Profit for the year		221,389	184,904
Earnings per share (HRK)	9	168.48	140.72

Ericsson Nikola Tesla balance sheet
For the year ended 31 December 2004

	<i>Notes</i>	2004 HRK '000	2003 HRK '000
ASSETS			
Non-current assets			
Property, plant and equipment	10	150,354	148,849
Intangible assets	11	2,719	2,874
Investments	12	11,239	10,484
Long-term receivables	13	96,313	76,559
Deferred tax assets	8	29,397	14,687
Total non-current assets		290,022	253,453
Current assets			
Inventories	14	48,530	74,424
Trade receivables	15	572,288	380,936
Receivables from related parties	26	31,226	23,919
Income tax receivable		-	17,629
Other receivables	16	29,865	20,042
Current financial assets	17	310,347	122,580
Prepayments and accrued income		894	2,596
Cash and cash equivalents	18	394,855	589,899
Total current assets		1,388,005	1,232,025
TOTAL ASSETS		1,678,027	1,485,478

Ericsson Nikola Tesla balance sheet (continued)

For the year ended 31 December 2004

	Notes	2004 HRK '000	2003 HRK '000
EQUITY AND LIABILITIES			
Capital and reserves			
Share capital	19	266,330	399,495
Share premium	19	2,566	804
Treasury shares	19	(4,219)	(5,890)
Legal reserves	19	20,110	20,110
Retained earnings	19	992,059	794,679
Total equity		1,276,846	1,209,198
Non-current liabilities			
Long-term loans	20	3,559	3,817
Employee benefits	21	3,826	3,390
Total non-current liabilities		7,385	7,207
Current liabilities			
Liabilities to related parties	26	108,898	87,626
Current financial liabilities	22	272	242
Income tax payable		21,945	-
Trade and other payables	23	93,057	80,736
Provisions	24	11,768	16,888
Accruals and deferred income	25	157,856	83,581
Total current liabilities		393,796	269,073
Total liabilities		401,181	276,280
TOTAL EQUITY AND LIABILITIES		1,678,027	1,485,478

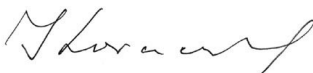
The financial statements were approved by the Management Board of Ericsson Nikola Tesla d.d. Zagreb on 24 February 2005 and were signed on its behalf by:



Lars Åke Einar Enell
Director



Maria Radtke
Finance and Sourcing Director



Gordana Kovačević
Director

Ericsson Nikola Tesla cash flow statement
For the year ended 31 December 2004

	2004 HRK'000	2003 HRK'000
Cash flows from operating activities		
<i>Profit before tax</i>	250,252	202,949
Adjustments for:		
Depreciation and amortisation	44,799	46,356
Other impairment allowances	56,483	36,747
Change in provisions	1,912	(8,229)
Write-offs and losses on disposal of property, plant and equipment	9,235	2,911
Unrealised gains/ (losses) on financial instruments	(4,733)	(26,188)
Investment income	(34,702)	(24,718)
Interest expense	152	727
Foreign exchange (gain)/loss	(10,099)	(5,371)
Reversal of impairment losses on buildings	(14,575)	-
	298,724	225,184
(Increase) / decrease in long-term receivables	(18,467)	(25,574)
Decrease / (increase) in inventories	24,853	26,780
Decrease / (increase) in receivables	(261,515)	129,421
(Decrease) / increase in payables	101,272	(55,348)
(Decrease) / increase in other operating assets and liabilities	1,702	(77,354)
<i>Cash generated from operations</i>	146,569	223,109
Interest paid	(152)	(727)
Income taxes paid	(5,507)	(41,528)
Net cash from operating activities	140,910	180,854
Cash flows from investing activities		
Interest received	44,224	24,718
Net purchase of property, plant and equipment, and intangible assets	(40,809)	(28,074)
Increase in long-term deposits	(755)	(270)
Net acquisition of current financial assets	(194,313)	(13,378)
Net cash used in investing activities	(191,653)	(17,004)

Ericsson Nikola Tesla cash flow statement (continued)

For the year ended 31 December 2004

	2004	2003
	HRK'000	HRK'000
Cash flows from financing activities		
Payment of financial liabilities	(228)	(93)
Dividends paid	(22,338)	(18,396)
Decrease in share capital	(131,403)	-
Net cash used in financing activities	(153,969)	(18,489)
Effects of exchange rate changes on cash and cash equivalents	9,668	3,065
Net increase in cash and cash equivalents	(195,044)	148,426
Cash and cash equivalents at the beginning of the year	589,899	441,473
Cash and cash equivalents at the end of the year	394,855	589,899



Ericsson Nikola Tesla statement of changes in equity

For the year ended 31 December 2004

	Share capital HRK '000	Share premium HRK '000	Treasury shares HRK '000	Legal reserves HRK '000	Retained earnings HRK '000	Total HRK '000
As at 1 January 2003	399,495	804	(5,890)	20,110	628,171	1,042,690
Dividend distribution for 2002	-	-	-	-	(18,396)	(18,396)
Net profit for the year 2003	-	-	-	-	184,904	184,904
As at 31 December 2003	399,495	804	(5,890)	20,110	794,679	1,209,198
Capital redemption	(133,165)	1,762	-	-	-	(131,403)
Dividend distribution for 2003	-	-	-	-	(22,338)	(22,338)
Net profit for the year 2004	-	-	-	-	221,389	221,389
Treasury shares	-	-	1,671	-	(1,671)	-
As at 31 December 2004	266,330	2,566	(4,219)	20,110	992,059	1,276,846

The notes set out on pages 38 to 65 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.

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 2004 was HRK 5.6368 per 1 United States dollar (2003: HRK 6.1185) and HRK 7.6712 per 1 euro (2003: HRK 7.6469).

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:

	Useful lives
Buildings	5 – 30 years
Technical equipment	4 – 10 years
Other (vehicles, tools, furniture and fixtures)	3 – 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.

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.

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

Derivative instruments

The Company uses derivative financial instruments to hedge economically its exposure to foreign exchange risk arising from operational activities. Hedge accounting has not been applied and those derivative instruments are accounted for as 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.

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.

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

Income tax

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

Deferred taxes are calculated by using the balance sheet liability method. Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Deferred tax assets and liabilities are measured by using the tax rates expected to apply to taxable profit in the years in which those temporary differences are expected to be recovered or settled based on tax rates enacted or substantially enacted at the balance sheet date.

The measurement of deferred tax liabilities and deferred tax assets reflects the tax consequences that would follow from the manner in which the enterprise expects, at the balance sheet date, to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are not discounted and are classified as non-current assets and/or liabilities in the balance sheet. Deferred tax assets are recognised when it is probable that sufficient taxable profits will be available against which the deferred tax assets can be utilised. At each balance sheet date, the Company reassesses unrecognised deferred tax assets and the carrying amount of deferred tax assets.

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.

Notes to the financial statements (continued)

1 Significant accounting policies (continued)

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.

Net financing income

Net financing income comprises interest receivable on long-term loans calculated by using the effective interest rate method, interest receivable on funds invested, foreign exchange gains and losses, and gains and losses on hedging instruments that are recognised in the income statement.

Interest income is recognised in the income statement as it accrues, using the effective interest method.

Segment reporting

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

Notes to the financial statements (continued)

2 Sales revenue

	2004 HRK '000	2003 HRK '000
Sales in Croatia	381,060	313,642
Sales in Russia, Belarus, Kazakhstan, Ukraine, Kyrgyzstan, Moldova and neighbouring countries	572,128	519,351
Sales to the European Union	226,452	224,504
Sales in Bosnia and Herzegovina, Montenegro and Macedonia	330,015	296,070
Other export sales	42,006	50,449
	<u>1,551,661</u>	<u>1,404,016</u>

Out of total sales of HRK 1,552 million, sales of products amounted to HRK 1,009 million (2003: HRK 878 million) and sales of services amounted to HRK 543 million (2003: HRK 526 million). Sales income comprises contract revenue recognised as revenue in the amount of HRK 1,209 million (2003: HRK 1,016 million).

3 Segment reporting

Segment information is presented in respect of the Company's business segments, which is the primary format, and is based on the Company's management and internal reporting structure. 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:

Systems

This segment provides:

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

Other business operations

This segment includes enterprise systems, dedicated networks, cables and components, defence communications and support unit shared services. This segment also includes reclassified transmission and transport networks and power modules from Multiservice Networks in 2003.

Notes to the financial statements (continued)

3 Segment reporting (continued)

External sales and other income

	2004 HRK '000	2003 HRK '000
	<i>External sales and other income</i>	<i>External sales and other income</i>
Systems	1,420,935	1,233,321
Mobile Networks	490,987	424,173
Fixed Networks	619,447	505,330
Professional Services	310,501	303,818
Other business operations	208,520	232,177
	<hr/> 1,629,455 <hr/>	<hr/> 1,465,498 <hr/>

Geographical segments

All three segments are managed in Central and Eastern Europe, Middle East and Africa.

Notes to the financial statements (continued)

3 Segment reporting (continued)

	Systems		Other business		Total	
	2004 HRK '000	2003 HRK '000	2004 HRK '000	2003 HRK '000	2004 HRK '000	2003 HRK '000
External sales and other income	1,420,935	1,233,321	208,520	232,177	1,629,455	1,465,498
Segment results	246,365	188,631	11,345	20,226	257,710	208,857
Unallocated Company's expenses					(35,971)	(37,515)
Profit from operations					221,739	171,342
Financial income					52,124	50,854
Financial expenses					(23,611)	(19,247)
Net financing income					28,513	31,607
Profit before tax					250,252	202,949
Income tax expense					(28,863)	(18,045)
Profit for the year					221,389	184,904
Segment assets	646,280	465,437	96,571	82,136	742,851	547,573
Unallocated Company's assets					935,176	937,905
Total Company's assets					1,678,027	1,485,478
Segment liabilities	144,755	111,629	21,630	19,700	166,385	131,329
Unallocated Company's liabilities					234,796	144,951
Total Company's liabilities					401,181	276,280
Depreciation and amortisation	17,345	21,595	2,592	3,641	-	-
Other non-cash expenses	94,790	38,944	14,164	5,783	-	-

All the Company's assets are located in Croatia.

Notes to the financial statements (continued)

4 Other operating revenue

	2004 HRK '000	2003 HRK '000
Commission income	7,741	18,230
Reversal of provisions	3,691	12,639
Rental income	10,539	4,039
Reversal of impairment allowances on receivables	54,411	22,810
Reversal of impairment losses on buildings	14,575	-
Other	1,412	3,764
	<u>92,369</u>	<u>61,482</u>

5 Other operating expenses

	2004 HRK '000	2003 HRK '000
Net loss on disposal of property, plant and equipment	9,235	2,911
Increase in provisions	5,603	4,410
Impairment allowances on receivables	109,853	57,831
Impairment allowances on inventories	1,041	1,727
	<u>125,732</u>	<u>66,879</u>

Notes to the financial statements (continued)

6 Personnel expenses

	2004 HRK '000	2003 HRK '000
Net salaries	129,526	128,219
Taxes and contributions	120,524	110,568
Other payroll-related costs	8,581	9,654
	<u>258,631</u>	<u>248,441</u>

Staff costs include HRK 39.6 million (2003: 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:

	2004	2003
Operations	480	481
Research and Development Centre	408	321
Sales	69	68
Support functions	137	139
Employees on long-term assignment abroad	6	11
	<u>1,100</u>	<u>1,020</u>

Notes to the financial statements (continued)

7 Net financing income

	2004 HRK '000	2003 HRK '000
Interest income	46,412	24,718
Available-for-sale investments		
Gain on disposal	2,415	2,022
Revaluation to fair value	3,297	639
Net gains derived from trading instruments	-	23,475
Financial income	52,124	50,854
Net losses on foreign exchange differences	(10,770)	(18,520)
Interest expense	(152)	(727)
Net losses derived from trading instruments	(12,689)	-
Financial expenses	(23,611)	(19,247)
Net financing income	28,513	31,607

Notes to the financial statements (continued)

8 Income tax expense

Income tax has been calculated at statutory tax rate of 20% (2003: 20%) of the taxable income of the Company.

Income tax expense recognised in income statement comprises:

	2004	2003
	HRK '000	HRK '000
Current income tax expense	(43,573)	(19,553)
Deferred tax income / (expense) relating to the origination and reversal of temporary differences	14,710	1,508
Total income tax expense in income statement	(28,863)	(18,045)

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

	2004	Credited / (charged) to income statement	2003
	HRK '000	HRK '000	HRK '000
Impairment allowances for doubtful receivables	21,171	12,278	8,893
Impairment allowances for obsolete stocks	1,189	(310)	1,499
Provision for employee benefits	659	43	616
Impairment losses for property, plant and equipment	-	(1,938)	1,938
Long-term receivables for sold apartments	1,029	(108)	1,137
Negative fair value of financial instruments	1,729	1,125	604
Customer contract losses	3,420	3,420	-
Other temporary differences	200	200	-
	29,397	14,710	14,687

Notes to the financial statements (continued)

8 Income tax expense (continued)

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

	2004 HRK '000	2003 HRK '000
Profit before tax	250,252	202,949
Income tax at 20% (2003: 20%)	50,050	40,590
Non-deductible expenses	1,549	2,689
Tax exempt revenues	(184)	(876)
Tax incentives not recognised in the income statement	(22,552)	(24,358)
Total tax expense	28,863	18,045

Tax exempt research and development costs amounted to HRK 102.7 million (2003: HRK 115.8 million) which are included in Cost of goods sold. Tax benefit on these costs amounted to HRK 22.6 million (2003: HRK 24.4 million)

9 Earnings per share

	2004	2003
Net profit for the year (HRK '000)	221,389	184,904
Weighted Average Number of Shares Outstanding at the year-end	1,314,026	1,314,026
Earnings per share (HRK)	168.48	140.72

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)

10 Property, plant and equipment

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

Construction in progress mainly relates to test plants in the amount of HRK 3,956 thousand.

Property leased to others with cost value of HRK 59,152 thousand (2003: HRK 22,386 thousand) is included within the land and buildings. These assets are depreciated at the same depreciated rates as other buildings. HRK 28,241 of leased assets is leased under non-cancellable period of five years. Subsequent renewals are negotiated with the lessee. No contingent rents are charged.

Future minimum lease payments under non-cancellable operating leases in the aggregate and for each of the following periods are:

	2004 HRK '000	2003 HRK '000
Less than one year	4,386	-
Between one and five years	15,352	-
More than five years	-	-
	<u>19,738</u>	<u>-</u>

During the year ended 31 December 2004, HRK 2,193 thousand was recognised as rental income in the income statement.

Notes to the financial statements (continued)

10 Property, plant and equipment (continued)

Impairment loss and subsequent reversal

During 2001 and 2002 management has recognised impairment losses over several buildings. Those buildings were subsequently sold during 2004 and previously recognised impairment was reversed.

Capital commitments

During the year ended 31 December 2004 the Company entered into contracts totalling HRK 20,561 thousand (2003: HRK 871 thousand) for equipment purchase.

11 Intangible assets

The movement on intangible assets in the year ended 31 December 2004, may be analysed as follows:

	Application software HRK '000
Cost	
As at 1 January 2004	12,450
Additions	1,723
Disposals	(278)
As at 31 December 2004	<u>13,895</u>
Accumulated amortisation	
As at 1 January 2004	9,576
Charge for the year	1,878
Disposals	(278)
As at 31 December 2004	<u>11,176</u>
Net book value	
As at 31 December 2004	<u>2,719</u>
As at 31 December 2003	<u>2,874</u>

Notes to the financial statements (continued)

12 Investments

Non-current investments are analysed as follows:

	2004	2003
	HRK '000	HRK '000
<i>Originated by the Company</i>		
Deposit with financial institutions, denominated in EUR	10,825	10,070
<i>Available for sale</i>		
Shares of Hrvatska poštanska banka d.d.	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
	11,239	10,484

Deposits with financial institutions are placed as guarantee deposits for housing loans provided to the Company's employees, earning interest at variable rates ranging from 1.14% to 2.49% per annum 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 subsidiary 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. As at 31 December 2004, the Company's stake amounted to 25%. On 1 January 2005 the Company acquired additional 75% of EXi d.o.o. shares for HRK 1. EXi is engaged in implementation of equipment for the Company. In its financial statements for the year ended 31 December 2004, EXi reported loss in the amount of HRK 232 thousand and net assets in the amount of HRK 447 thousand. As at 1 February 2005 EXi changed its name to Libratel d.o.o.

Notes to the financial statements (continued)

13 Long-term receivables

	2004 HRK '000	2003 HRK '000
<i>Non-current portion, originated by the Company</i>		
Foreign customers	116,017	95,537
Domestic customers	-	268
Receivables for sold apartments	11,078	11,718
Housing loans to employees	1,217	2,322
Total long-term receivables	128,312	109,845
Impairment allowances for doubtful receivables and sold apartments	(31,999)	(33,286)
	96,313	76,559

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 in the amount of HRK 69,157 thousand is due in 2006, the amount of HRK 13,883 thousand is due in 2007 and the amount of HRK 6,121 thousand in 2008.

Receivables for sold apartments are shown net of amounts due to the Croatian State. Housing loans to employees are linked to the countervalue of euro, repayments are made by deduction from monthly salary and the loans are secured with collateral on the house or apartment. Remaining maturity of these receivables is five 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 in the amount of HRK 5,143 thousand (2003: 5,686 thousand) 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)

14 Inventories

	2004	2003
	HRK '000	HRK '000
Raw materials	14,877	69,347
Work-in-progress and semi-finished goods	39,335	11,757
Finished goods	264	817
Total inventories	54,476	81,921
Obsolescence provision	(5,946)	(7,497)
	48,530	74,424

15 Trade receivables

	2004	2003
	HRK '000	HRK '000
Foreign customers	291,412	63,724
Current portion of long-term receivables	181,757	249,249
Total foreign customers	473,169	312,973
Domestic customers	186,467	97,277
Current portion of long-term receivables	4,589	7,479
Total domestic customers	191,056	104,756
Impairment allowances for doubtful receivables	(91,937)	(36,793)
	572,288	380,936

16 Other receivables

	2004	2003
	HRK '000	HRK '000
Receivables for prepaid VAT	25,117	17,841
Receivables from employees	1,134	1,163
Accrued interest receivable	1,645	88
Other receivables	1,969	950
	29,865	20,042

Notes to the financial statements (continued)

17 Current financial assets

	2004 HRK '000	2003 HRK '000
Debt securities, available for sale	89,459	50,674
Investment in open-ended investment funds, available for sale	218,991	57,241
Positive fair value of derivative instruments	1,436	14,485
Loans, deposits and guarantee deposits, originated by the Company	461	180
	<u>310,347</u>	<u>122,580</u>

Debt securities comprise the Ministry of Finance bonds in the amount of HRK 41,981 thousand (denominated in euro) with maturity in 2007 and a fixed interest rate of 3.875 % per annum, and the Ministry of Finance Treasury bills in the amount of HRK 47.478 thousand with maturity in 2005 and a fixed interest rate ranging from 4.90 % to 6.65 % per annum.

Investments in open-ended investment funds are denominated in kuna or 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 2004.

18 Cash and cash equivalents

	2004 HRK '000	2003 HRK '000
Cash and demand deposits	30,244	35,224
Time deposits originated by the Company, with maturity up to 3 months	364,611	554,675
	<u>394,855</u>	<u>589,899</u>

Cash and cash equivalents comprise deposits denominated in foreign currency and in kuna. Time deposits in kuna bore fixed interest rates at the year-end ranging from 5.0% to 7.0% per annum and time deposits denominated in foreign currency bore fixed interest rates at the year-end ranging from 2.19% to 2.60% per annum.

Notes to the financial statements (continued)

19 Equity

As at 31 December 2004, the share capital of the Company is represented by 1,331,650 ordinary shares, with a total registered value of HRK 266,330 thousand. The nominal value of one share is HRK 200 (2003: 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 2003, following the statutory six-month period as required by the Commercial Court. In January 2004 the Company redeemed HRK 133 million of its share capital.

The Company's shareholders as at 31 December 2004 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%
	<hr/>	<hr/>
	1,331,650	100.00%
	<hr/>	<hr/>

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.

During 2004, the Company established a share-based scheme under which the eligible employees meeting certain criteria are granted the Company's shares as a form of appropriation of retained earnings. The treasury shares will be distributed from retaining earnings upon ratification at the General Assembly, scheduled for 12 May 2005. As at 31 December 2004 the Company has allocated HRK 1,671 thousand (5,000 shares) of retained earnings in respect of these bonus payments.

Notes to the financial statements (continued)

19 Equity (continued)

Proposed dividends

Dividends payable are not accounted for until they have been ratified at the General Assembly of shareholders. On 18 May 2004 the General Assembly approved a dividend in respect of 2003 of HRK 17.00 per share totalling HRK 22.3 million. On 24 February 2005 the Management Board proposed a dividend in respect of 2004 of HRK 18.00 per share. The dividend will be paid from retained earnings formed up to or as at 31 December 2000, after approval by the General Assembly, which is scheduled for 12 May 2005. Dividends paid out of profits realised in the years preceding 2001 are generally not subject to withholding tax or dividend tax. Dividends paid out of profits realised in the years 2001 to 2004 are generally subject to withholding tax. Dividend payments to foreign individuals and foreign entities are generally subject to 15% withholding tax (subject to double tax treaties) whilst dividend payments to domestic individuals are subject to 15% withholding tax.

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

	2004	2003
	HRK '000	HRK '000
HRK 17.00 per share for 2003	22,338	-
HRK 14.00 per share for 2002	-	18,396

20 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 1,802 thousand or EUR 239 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 2,029 thousand (current portion included) relates to two loans from Crediop and Centrobanca Italy that bear interest at rates declared by the Treasury of Italy plus a margin of 0.4% per annum.

21 Employee benefits

The Company does not operate any pension schemes or other retirement benefit schemes for the benefit of any of its employees or management. In respect of all of the Company's personnel such social payments as required by the authorities are paid. These contributions form the basis of social benefits payable out of the Croatian national pension fund to the Croatian employees upon their retirement. Additionally, during 2001 the Company signed an Annex to the Union Agreement with benefit regarding early retirement of employees.

However, the Company pays a one-time benefit amounting to HRK 8,000 for each employee who retires.

Additionally, the Company pays jubilee awards in respect of each 5 years of service, of an employee, starting from the 10th year and ending in the 40th year.

The principal actuarial assumptions used to determine retirement and jubilee obligations as at 31 December 2004 were a 7% discount rate and a 2.56% rate of average employment turnover.

Notes to the financial statements (continued)

22 Current financial liabilities

	2004 HRK '000	2003 HRK '000
Current portion of long term-loans (refer to note 20)	272	242

23 Trade and other payables

	2004 HRK '000	2003 HRK '000
Trade payables	42,488	34,065
Liabilities to employees	39,820	43,263
Other current liabilities	10,749	3,408
	<u>93,057</u>	<u>80,736</u>

Liabilities to employees include bonus salary of HRK 30 million (2003: HRK 27 million).

24 Provisions

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

	Warranty reserve HRK '000	Penalty reserve HRK '000	Total HRK '000
As at 31 December 2003	15,891	997	16,888
Provision created during the year	5,537	66	5,603
Provision reversed during the year	(3,643)	(48)	(3,691)
Provision used during the year	(7,032)	-	(7,032)
As at 31 December 2004	<u>10,753</u>	<u>1,015</u>	<u>11,768</u>

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

Notes to the financial statements (continued)

25 Accruals and deferred income

	2004 HRK '000	2003 HRK '000
Advances from domestic customers	77	2,093
Advances from foreign customers	32,911	24,180
Deferred income	65,970	17,802
Accrued severance payment costs	10	2,210
Other accrued charges	58,888	37,296
	<u>157,856</u>	<u>83,581</u>

Advances from foreign customers include HRK 13 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 contracts for work not performed.

Notes to the financial statements (continued)

26 Balances and transactions with related parties

The Company has a related party relationship with Ericsson Group companies, associates and with its directors and executive officers.

Balances with Ericsson Group companies may be summarised as follows:

	Receivable		Payable	
	2004 HRK'000	2003 HRK'000	2004 HRK'000	2003 HRK'000
Ericsson AB (EAB)	23,934	14,811	100,403	69,315
Ericsson Telefonaktiebolaget LM (LME)	-	1,952	31	4,593
Ericsson Enterprise AB (EBC)	-	41	2,345	6,129
Ericsson Telecomunicazioni S.P.A. (TEI)	65	886	-	-
Ericsson Corporatia AO (ECR)	639	49	-	1,556
LM Ericsson Limited (LMI)	155	91	372	20
Ericsson SP. Z.O.O. (EPO)	102	-	6	10
Ericsson Network Technologies AB (ECA)	-	-	452	112
Ericsson Global IT Services AB (GIS)	32	63	1,015	1,092
Ericsson Austria A.G. (SEA)	379	1,038	-	-
Ericsson Sverige AB (ESE)	142	96	-	-
Ericsson South Africa Ltd. (ESA)	30	1,388	-	-
Ericsson SPOL.S.R.O. (ECZ)	172	-	-	-
Ericsson Egypt LTD. (EEL)	292	-	-	-
Ericsson Test Environments (ETE)	-	-	2,146	-
Ericsson Telecomm. Equipment S.A. (ETG)	898	-	-	-
Ericsson Hungary LTD. (ETH)	646	-	12	-
Ericsson LTD. (ETL)	459	-	-	-
Ericsson Telecommunicatie B.V. (ETM)	531	-	1,326	-
Ericsson Denmark A/S (LMD)	159	-	147	-
OY LM Ericsson AB (LMF)	279	-	168	-
Ericsson Slovakia SPOL.S.R.O. (SBB)	524	-	-	-
Other	1,788	3,504	475	4,799
	<u>31,226</u>	<u>23,919</u>	<u>108,898</u>	<u>87,626</u>

Total purchases of goods and services from Ericsson Group companies during 2004, including licence fees, amounted to HRK 653 million (2003: HRK 639 million) and sales to Ericsson Group companies amounted to HRK 237 million (2003: HRK 287 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, sales of services, corporate trade mark licences and management fees.

26 Balances and transactions with related parties (continued)

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, and sales of services, rather than as a fixed amount per product sold. The new calculation is applicable on contracts signed during 2002 and in subsequent periods.

Total remuneration to executive management in the year amounted to HRK 15,290 thousand (2003: HRK 13,413 thousand) and is included in staff costs (note 6). The members of executive management held 683 ordinary shares at the year-end (2003: 1,228 shares).

27 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 75% 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 Ministry of Finance bonds, Ministry of Finance Treasury bills and investments in open-ended investment funds (note 17), as well as long-term deposits in financial institutions (note 12).

Credit risk

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. Significant risk is associated with the high level of trade receivables, mainly because of the inability of customers to obtain outside funding for projects. Therefore, the Company is financing customers to a certain extent, which exposes it to a significant risk. New customers are only accepted on satisfactory completion of a detailed credit check of the customer and a review of the related country risk. Outstanding credit arrangements are monitored at least once a month. 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. As at 31 December 2004, the five largest customers represent 28% of total net trade receivables (2003: 46%). Management of this risk is concentrated in the diversification of the customer base through new products and services offered to new customers.

Notes to the financial statements (continued)

27 Financial instruments (continued)

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 13 and 15) and other receivables (note 16), net of impairment allowances for doubtful receivables.

Liquidity risk

Liquidity risk, also referred to as funding risk, is the risk that an enterprise will encounter difficulty in raising funds to meet commitments associated with financial instruments. As the Company has no commitments in financial instruments, the risk lies only in its daily operations. The Company has a strong focus on its cash flow with daily updates on actual development and monthly updated forecasts. Due to the strong liquidity position of the Company, the risk is considered low.

Fair value estimation

The fair value of 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 25).

28 Derivative instruments

During 2003 and 2004 the Company entered into foreign currency forward agreements to hedge economically its operating cash flows denominated in foreign currency, predominately USD and EUR. As these hedges do not qualify for hedge accounting, these are accounted for as trading instruments, with all gains and losses on fair value being recognised in the income statement.

The contractual notional amount of these derivatives (over the counter) at the year-end amounted to HRK 60 million (2003: HRK 136 million), their fair values amounted to HRK 1,436 thousand (assets) (2003: 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.

29 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. In January 2004 the Zagreb Commercial Court published the 1st instance judgement by which plaintiffs' requests have been refused. On 2 March 2004 the plaintiffs appealed and the Appeal Court (Croatian High Commercial Court) has still not made a decision on appeal. The Company's Management Board is of the opinion that no material liabilities for the Company can result from this lawsuit.

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

30 Subsequent events

Effective as of 1 January 2005, Ms Gordana Kovačević has been appointed as a new director of the Company.

On 24 February 2005, the Supervisory Board accepted the Management Board's proposal to decrease the nominal value of shares from HRK 200 to HRK 100. The proposal needs to be approved at the next General Assembly, which is scheduled for 12 May 2005.

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