Annual Report 2011

Hrvatski Telekom

Financial Highlights

T-HT GROUP in HRK million	Jan-Dec 2011	Jan-Dec 2010	% of change A11/10
Revenue	8,067	8,372	-3.6%
EBITDA before exceptional items	3,782	3,694	2.4%
Exceptional items	162	32	412.0%
EBITDA after exceptional items	3,619	3,662	-1.2%
EBIT (Operating profit)	2,205	2,246	-1.8%
Net profit after minority interest	1,811	1,831	-1.1%
EBITDA margin before exceptional items	46.9%	44.1%	2.8 p.p.
EBITDA margin after exceptional items	44.9%	43.7%	1.1 p.p.
EBIT margin	27.3%	26.8%	0.5 p.p.
Net profit margin	22.4%	21.9%	0.6 p.p.
Balanca Sheet	**At 31 Dec 2011**	**At 31 Dec 2010**	**% of change A11/10**
Total non current assets	7,461	8,008	-6.8%
Total current assets	5,675	5,521	2.8%
TOTAL ASSETS	**13,136**	**13,529**	**-2.9%**
Total issued capital and reserves	11,019	11,054	-0.3%
Total non current liabilities	473	469	0.7%
Total current liabilities	1,645	2,006	-18.0%
TOTAL EQUITY AND LIABILITIES	**13,136**	**13,529**	**-2.9%**
Cash flow	**Jan-Dec 2011**	**Jan-Dec 2010**	**% of change A11/10**
Net cash flow from operating activities	2,988	3,266	-8.5%
Net cash flow from investing activities	-696	-1,389	49.8%
Net cash flow from financing activities	-1,874	-2,792	32.9%
Net increase/decrease in cash and cash equiv.	422	-912	146.2%
Cash and cash equivalents at the end of period	**3,704**	**3,282**	**12.9%**
CAPEX	877	1,153	-23.9%
CAPEX / Revenue ratio	10.9%	13.8%	-2.9 p.p.
	At 31 Dec 2011	**At 31 Dec 2010**	**% of change A11/10**
ROE	16.4%	15.9%	0.5 p.p.
ROCE	19.2%	19.5%	-0.3 p.p.
Number of employees (FTEs)	6,032	6,322	-4.6%

Operating Statistics

Key operational data	Jan-Dec 2011	Jan-Dec 2010	% of change A11/10
Mobile subscribers in 000			
Number of subscribers	**2,418**	**2,437**	**-0.8%**
- Residential	1,964	2,003	-1.9%
- Business	454	435	4.4%
Number of postpaid subscribers[3]	**1,035**	**1,003**	**3.2%**
- Residential	581	568	2.3%
- Business	454	435	4.4%
Number of prepaid subscribers	**1,383**	**1,434**	**-3.6%**
Minutes of use (MOU) per average subscriber	**134**	**136**	**-1.2%**
- Residential	100	100	0.7%
- Business	285	300	-5.0%
Blended ARPU (monthly average for the year in HRK) [2]	**94**	**104**	**-10.0%**
- Residential	74	83	-11.0%
- Business	184	202	-8.9%
Blended non-voice ARPU (monthly average for the year in HRK) [2]	**23**	**25**	**-7.3%**
SAC per gross add in HRK	**122**	**160**	**-23.7%**
Churn rate (%)	**2.7**	**2.5**	**0.2 p.p.**
Penetration (%) [1]	**119.9**	**117.8**	**2.1 p.p.**
Market share of subscribers (%) [1]	**47.0**	**46.7**	**0.3 p.p.**

[1] Source: published VIPnet's quarterly report for 3Q 2011 and Tele2's quarterly report for 4Q 2010 and 2011. Number of subscribers for VIPnet for 4Q 2011 is internally estimated.

[2] Due to T-Mobile and T-Com merge and within the new segmental reporting explained above, as of Q1 2011 calculation of ARPU was changed to show consolidated mobile revenues rather than unconsolidated mobile revenues.

[3] In September 2011 definition of prepaid subscribers has been changed in order to be aligned with HAKOM definition. According to new definition, only SIM's with traffic or voucher recharge in the last 90 days should be considered as the subscribers. Previous year has been restated with all related KPIs to be aligned with new definition.

Key operational data	Jan-Dec 2011	Jan-Dec 2011	% of change A11/A10
Fixed mainlines in 000			
Total mainlines [1]	**1,267**	**1,438**	**-11.9%**
- Residental	1,074	1,220	-12.0%
- Business	193	217	-11.4%
Total Traffic (mill. of minutes)	**2,790**	**3,177**	**-12.2%**
- Residental	2,083	2,320	-10.2%
- Business	706	856	-17.5%
ARPA voice per access (monthly average for the year in HRK)	**121**	**131**	**-7.3%**
- Residental	101	107	-5.7%
- Business	238	264	-10.0%
IP mainlines/customers in 000			
ADSL mainlines	**651**	**629**	**3.4%**
- Residental	539	524	2.9%
- Business	112	105	6.0%
TV customers [2]	**341**	**303**	**12.3%**
- Residental	321	286	12.3%
- Business	19	17	12.4%
Fixed-line customers	**1**	**1**	**5.1%**
VPN connection points	**4**	**4**	**10.0%**
ADSL mainlines ARPA (monthly average for the year in HRK)	**123**	**127**	**-3.1%**
- Residental	120	124	-3.1%
- Business	134	138	-2.5%
Data lines in 000			
Total data lines	**5**	**6**	**-6.7%**
Wholesale customers in 000			
CPS (Carrier Pre-Selection)	96	221	-56.5%
NP (Number portability) users/number	514	416	23.5%
ULL (Unbundled Local Loop)	148	133	11.7%
WLR (Wholesale Line Rental) [3]	124	0	-

[1] Includes POTS+FGSM+ISDN+Payphones
[2] Includes IPTV, DTH and Cable TV customers
[3] On July 1st HT published new WLR (Wholesale Line Rental) offer according to HAKOM regulation

Presentation of information in the Annual Report

Unless the context otherwise requires, references in this publication to ''T-HT Group'' or ''the Group'' or "T-HT" are to the Company - Hrvatski Telekom d.d., together with its subsidiaries.
References to ''HT'' or the ''Company'' are to the Company - Hrvatski Telekom d.d.
References to ''Iskon'' are to the Company's wholly-owned subsidiary, Iskon Internet d.d.
References to ''Combis" are to the Company's wholly-owned subsidiary, Combis, usluge integracije informatičkih tehnologija d.o.o.
References in this publication to ''Agency'' are to the Croatian National Regulatory Authority, the Agency for Post and Electronic Communications.

Content

I. Introduction

Letter To Shareholders

Dear Shareholders,

T-HT Group generated solid business results in 2011, despite the challenging economic environment. Throughout 2011, Croatia faced a rising unemployment rate, further declines in personal spending and an increase in outstanding debts. Competition in the telecommunications sector grew more intense, while many new regulatory measures were introduced.

In 2011, T-HT Group revenues amounted to HRK 8,067 million, a 3.6% drop compared to the previous year. The decline was largely driven by a 12.5% drop in revenue from voice services, mainly due to price decreases, lower termination fees and reduced revenue at the wholesale level. Last year's acquisition of Combis made a positive contribution of HRK 413 million, as did the 2.2% growth in revenue from non-voice services, thanks to increased broadband services in the fixed and mobile networks.

Throughout this challenging period, the Group remained committed to rigorous cost management, which resulted in EBITDA of HRK 3,619 million, a 1.2% drop compared to 2010.

Customer satisfaction remains the Group's key priority and we are ever responsive to //increasing customers' expectations//, providing continuously improvements in the quality of our services and technologies.

For residential customers, we introduced new tariffs related to mobile broadband services, while T-HT's innovative bonbon mobile brand attracted more than 100,000 customers within one year. Our IPTV services also proved popular, thanks to the launch of new and exclusive content and ADSL customers benefitted from attractive bundled offers of fixed and mobile services.

The Group has seen a decrease in its fixed-telephony customer base, but this is in line with global trends and a consequence of the introduction of Wholesale Line Rental (WLR). The Group has nevertheless maintained its competitive edge through the provision of compelling tariffs and top quality services.

In 2011, T-HT Group became one of the first operators in Europe to deliver cloud services ranging from Software as a Service products, including tCloud Store, tCloud Computing to business application solutions, such as tCloud Human Resources and tCloud Finance and Accounting. These products emphasized our focus on providing cutting edge ICT services as a supplement to the traditional telco services portfolio.

Capital expenditure in 2011 decreased 23.9% to HRK 877 million. Although the Group made no significant investment in the fiber infrastructure, owing to regulatory measures that deter such activity, we continued further development of the network infrastructure by increasing broadband access capacity and setting up a common, fixed and mobile, transport and core network.

The financial crisis also had a negative impact on trends in Croatian capital markets. Croatia's CROBEX index fell 17.56%, while T-HT share were 16.18% lower than the previous year. In 2011, T-HT shares were again the most traded stock on the Zagreb Stock Exchange. In light of the Group's performance and its cash reserves, the Management Board and the Supervisory Board proposed to the General Assembly of Hrvatski Telekom d.d. a dividend of HRK 22.14 per share.

By being aware that the good reputation is dependent on far more than just business results, T-HT Group pays particular attention to the social responsibility.

Commitment to the idea of sustainability in all aspects of our business is constantly in focus. Our goal is a sustainable business in all phases of business processes. Numerous activities in the area of social responsibility are carefully planned and are based on three substantive backbones - excellent communication and networking opportunities in the private life and work, integration into the society of information and knowledge, and environmental protection and responsible use of resources and reduce greenhouse gas emissions.

The year ahead will be yet another tough and challenging year for the Croatian economy, including the telecommunications sector. In the coming period, Hrvatski Telekom will retain its focus on developing new services tailored to customers' needs as well as on developing and improving the network infrastructure. The enhanced operating efficiency will remain central to our efforts to maintain our leading market position with top quality services and high levels of customer satisfaction.

Finally, I would like to thank all our shareholders for the trust they place in us. I also extend my gratitude for their dedicated work and support to all employees of the Group and to my colleagues on the Management Board.

Ivica Mudrinić
President of the
Management Board

Corporate Profile

At a Glance

The T-HT Group is the leading provider of telecommunications services in Croatia, offering fixed and mobile telephony services as well as wholesale, Internet and data services. As of 1 January 2010, the Group conducts its business through its Residential and Business units.

The basic activities of Hrvatski Telekom d.d. and subsidiary companies comprise the provision of electronic communications services and the design and construction of electronic communications networks within the Republic of Croatia. In addition to the provision of fixed telephony lines services (fixed telephony line access and traffic, as well as fixed network supplementary services), the Group also provides Internet and ICT services, data transmission services (lease of lines, Metro-Ethernet, IP/MPLS, ATM), operating with GSM and UMTS mobile telephone networks.

History and Incorporation

Hrvatski Telekom d.d. (HT d.d. or the Company) is a joint stock company majority owned by Deutsche Telekom AG (DTAG). It was incorporated on 28 December 1998 in the Republic of Croatia, pursuant to the provisions of the Act on the Separation of Croatian Post and Telecommunications into Croatian Post and Croatian Telecommunications, by which the business operation of the former HPT - Hrvatska pošta i telekomunikacije (HPT s p.o.) was separated and transferred into two new joint stock companies, HT - Hrvatske telekomunikacije d.d. (HT d.d.) and HP — Hrvatska pošta d.d. (HP d.d.). The Company commenced its operations on 1 January 1999.

Pursuant to the terms of the of Law on Privatization of Hrvatske telekomunikacije d.d. (Official Gazette No. 65/99 and No. 68/01), on 5 October 1999, the Republic of Croatia sold a 35% share in HT d.d. to DTAG, and on 25 October 2001 DTAG purchased a further 16% share in HT d.d. and thus became the majority shareholder with a 51% share in ownership. As of 17 February 2005, the Government of the Republic of Croatia transferred 7% of its shares in HT d.d. to the Fund for Croatian Homeland War Veterans and Their Families, pursuant to the Law on Privatization of HT d.d. (Official Gazette No. 65/99 and 8/2001).

In 2002, HT mobilne komunikacije d.o.o. (HTmobile) was established as a separate legal entity and subsidiary wholly owned by HT d.d. for the provision of mobile telecommunication services. HTmobile commenced its commercial activities on 1 January 2003 and in October 2004, the company name was officially changed to T-Mobile Croatia d.o.o. (T-Mobile).

On 1 October 2004, the Company was re-branded as T-HT, thus becoming a part of the global „T“ family of Deutsche Telekom. The change of identity at corporate level was followed by the creation of trade marks for the two separate business units of the Group: the fixed network operations business unit, T-Com, which also provided wholesale, Internet and data services, and the mobile operations business unit, T-Mobile.

In May 2006, the Group acquired 100% of shares of Iskon Internet d.d., one of the leading telecom alternative providers in Croatia.

Pursuant to the provisions of the Law on Privatization of HT d.d. (Official Gazette No. 65/99 and No. 68/01), on 5 October 2007, the Republic of Croatia sold 32.5% of T-HT ordinary shares by Initial Public Offering (IPO). Of the 32.5% of shares, 25% were sold to Croatian retail investors, while 7.5% were distributed among Croatian and international institutional investors.

Following the sale of shares to present and former employees of Hrvatski Telekom and Croatian Post in June 2008, the Government of the Republic of Croatia reduced its holding from 9.5% to 3.5%, while private and institutional investors held 38.5%.
In October 2009, an agreement was signed by which T-Mobile Croatia was merged into HT d.d. The merger came into effect on 1 January 2010, after which time the Group was organised into Residential and

Business units. In addition the Company's registered name was officially changed from HT — Hrvatske telekomunikacije d.d. to Hrvatski Telekom d.d. on 21 May 2010.

On 17 May 2010 HT d.d. has completed the aquisition of the IT services company Combis d.o.o., extending its reach into the provision of IT software and services for a client base that ranges form small businesses to government departments.

In December 2010 Republic of Croatia transferred 2,859,148 shares of Hrvatski Telekom d.d., equal to 3.5% of the entire share capital of the Company, to the owner account of the Pensioners' Fund. Following this transfer, the Republic of Croatia no longer holds shares of Hrvatski Telekom d.d.

Investor Information

Economic environment and share price performance

Global uncertainties and market volatility prevailed in 2011, with growing budget deficits, the Eurozone debt crisis, an overall fall in consumer confidence, social unrest and a slowdown in the economies of Asia and South America, among others. These factors reignited concerns about a prolonged global recession. Uncertainty was further exacerbated by the Japanese tsunami, the Arab Spring and other tensions in the Middle East, with the latter triggering concerns about global oil supplies and inflation.

Global markets were highly volatile and largely subdued. In August, Standard & Poor's removed for the first time the AAA credit rating of US, and this prompted further downward pressure on stock markets worldwide.

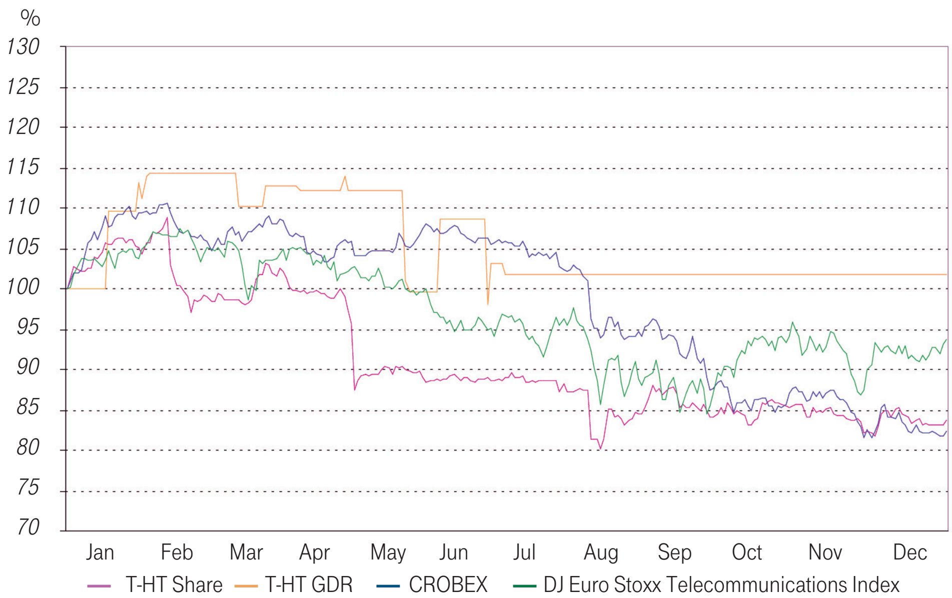
With Croatia's parliamentary election in December 2011, the long overdue fiscal consolidation and structural reforms of Croatia's economy were postponed. Domestic consumption hit a new low, unemployment remained high and problems with overdue payments persisted. These factors caused analysts to downgrade Croatia's 2011 GDP growth forecast throughout the year to settle at around zero.

Big policy initiatives from the newly elected left-of-centre coalition Government are yet to emerge. The major credit agencies are expected to visit Croatia in first half of 2012 to discuss the sovereign credit rating. Meanwhile, in January 2011 a referendum on EU membership showed majority support and the accession target date is 1 July 2013.

Against the economic backdrop outlined above and poor liquidity, the Zagreb Stock Exchange experienced strong downward pressure, especially in the second half of the year, amid speculation that a dividend tax would be introduced. Consequently, the benchmark CROBEX index fell 17.6% in 2011, after two years of growth. Annual trading volumes showed another year of decline, falling 9.4%.

T-HT shares ended the year at HRK 242.00, down 16.2% on the HRK 288.71 closing price at the end of 2010 and marginally outperforming the CROBEX. The price decline was primarily seen in the first half of the year following the Company's dividend announcement in mid February and ex-dividend

T-HT Share and GDR as compared to CROBEX and Dow Jones Europe Stoxx Telecommunications Index 1 January 2011 - 30 December 2011



date in early May. The year's highest price was HRK 315.99, the lowest being HRK 224.05 (Source: Zagreb Stock Exchange).

In 2011, T-HT shares underperformed the Dow Jones Euro Stoxx Telecommunications Index (a leading indicator of the telecommunications industry that measures the performance of some Europe's largest telecom companies) by 10 percentage points, having outperformed it for the previous two years.

Although its turnover was around 15% lower than in 2010, T-HT was once again the most traded share on the Zagreb Stock Exchange, with HRK 1.3 billion of turnover, accounting for 24.1% of the ZSE's total trade by value of shares in 2011 (2010: HRK 1.5 billion, 25.8%).

As at 31 December 2011, T-HT was the second largest company on ZSE, with a market capitalisation HRK 19.8 billion (EUR 2.63 billion) representing 15.2% of the total market capitalization by value (Source: Zagreb Stock Exchange).

At the last revision of the CROBEX index, T-HT's weighting was set at 15% of the index.

Besides T-HT shares being listed on the Official Market of the Zagreb Stock Exchange, Global Depositary Receipts (GDRs), each representing one T-HT Share, are traded on London Stock Exchange.

In October, at the 21st annual conference of the Zagreb Stock Exchange, T-HT accepted the second place award for Investor Relations in Croatia 2011 sponsored by popular business newspaper Poslovni dnevnik (2010: first place award for best IR.)

Dividend policy

The Dividend policy of the Company was set out in the prospectus that accompanied its Initial Public Offering in October 2007:

The future dividend policy should be that any dividends declared and paid in respect of any year following the year in which Offering takes place, shall range from 50% to 100% of the Company's distributable profits earned in the immediately preceding year. Any annual dividend shall depend on the overall financial position of the Company and its working capital needs at the relevant time (including but not limited to the Company's business prospects, cash requirements, financial performance, and other factors including tax and regulatory considerations, payment practices of other European telecommunications operators and general economic climate).

Dividend for the 2010 financial year

On 4 May 2011, the General Assembly of the Company approved a dividend payment to shareholders of HRK 1,863,783,056.60 (HRK 22.76 per share), representing a dividend payout ratio of 100%. The dividend was paid in second half of May 2011.

At the end of 2011, this represented a dividend yield of 9.4% on T-HT's closing price of HRK 242.00. Using the average closing share price over 2011, HRK 265.56, the dividend yield was 8.6%.

Dividend proposal for the 2011 financial year

The Management Board and Supervisory Board of Hrvatski Telekom d.d. propose to this year's General Assembly, to be held on April 25, the distribution of a dividend of HRK 22.14 per share which will be paid from 2011 financial year profit, resulting in total dividend payment of HRK 1,813,012,164.90.

The Supervisory Board gave its consent to the Management Board to pay to the shareholders an advance dividend of HRK 11.07 per share or HRK 906,506,082.45 in total. The date on which shareholder acquires the right to advance dividend payment amount, is established as 20 February 2012 and the due date for advance dividend payment is 27 February 2012.

According to the proposal, the date on which shareholder acquires the right to residual dividend amount of HRK 11.07 per share is 25 April 2012, the day of the General Assembly session. The residual amount will be paid to shareholders on 21 May 2012.

Shareholder Structure as at 31 December 2011.

Deutsche Telekom	51.0%
War Veterans' Fund	7.0%
Raiffeisen Mandatory Pension Fund*	5.3%
Pensioners' Fund	3.5%
Private and other institutional investors	33.2%

* Excludes possible GDR holdings
Total number of shares issued: 81,888,535

Deutsche Telekom remains the majority shareholder with a 51% holding, while the Croatian War Veterans' Fund continues to own 7%. In November 2010 the Republic of Croatia transferred its 3.5% holding to the Pensioners' Fund.

In April 2011 the Company received notification from Raiffeisen Mandatory Pension Fund Management Company Plc that Raiffeisen Mandatory Pension Fund has exceeded the 5% threshold in HT d.d. According to Central Depositary & Clearing Company web site at the end of 2011, it held 5.3% of T-HT shares.

The remaining 33.2% is in private and other institutional hands, with more than 220,000 Croatian private investors holding T-HT shares representing 23.3% of the total share capital of the Company.

Financial Calendar

Release of full year 2011 results	February 14, 2012
The General Assembly of the Company	April 25, 2012
Release of first quarter 2012 results	April 27, 2012
Release of the first half 2012 results	July 30, 2012
Release of the first nine months 2012 results	October 30, 2012

The above-mentioned dates are subject to change

General information on Shares and GDRs

Shares:	ISIN: HRHT00RA0005
Regulation S GDRs:	ISIN: US44330H2004
Rule 144A GDRs:	ISIN: US44330H1014
ZSE Share trading symbol:	HT-R-A
LSE GDR trading symbol:	THTC
Portal Rule 144A GDR listing symbol:	P443296108
Reuters:	THTC.L, HT.ZA
Bloomberg:	THTC LI, HTRA CZ
Numbers of share:	81,888,535
Type:	Ordinary share
Nominal value:	HRK 100

Each GDR represents one Share on deposit with the Custodian.

The depository for the GDR is:
JPMorgan Chase Bank, N.A.,
1 Chase Manhattan Plaza, Floor 21
New York
New York, 10005-1401
United States of America

The Custodian is:
Privredna Banka Zagreb
Račkoga 6
10000 Zagreb
Croatia

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Management Board

Branka Skaramuča, Dino Ivan Dogan, Božidar Poldrugač, Ivica Mudrinić, Irena Jolić Šimović, Johan H.M. Busé

Ivica Mudrinić
President of the Management Board and CEO

Ivica Mudrinić was born in 1955. He graduated in electrical engineering from the University of Toronto in 1978. His first job was in the Product Development Department of Motorola Communications, and in 1985 he founded his own company, MX Engineering Inc. In 1990, he returned to Croatia and soon became adviser for communications to the President of the Republic. At the end of the following year, he became Assistant Minister for Maritime Affairs, Transportation and Communications, and in 1992 was appointed Minister. From 1994 Ivica Mudrinić also served as President of the Telecommunications Council. He held the post of President of the Management Board of Hrvatska radiotelevizija (Croatian Radio and Television) from 1996 until 15 October 1998, when he was appointed General Manager of Hrvatska pošta i telekomunikacije (Croatian Post and Telecommunications). Since the separation of Croatian Post and Telecommunications on 1 January 1999, he has served as President of the Management Board of Hrvatski Telekom.

Dino Ivan Dogan
Member of the Management Board and Chief Financial Officer

Born in 1963, completed the Study 'Business Administration (technical oriented)', University of Stuttgart, in 1988. Dr. Dino Dogan brings considerable experience of the telecommunications industry, having served as Chief Financial Officer and Member of the Board at Mobilkom Austria AG since August 2009. In 2010, he also assumed the role of Chief Integration Officer for Mobilkom Austria AG's merger with Telekom Austria AG.
Prior to joining Mobilkom Austria AG, Dr. Dogan was Chief Financial Officer and Member of the Board of its subsidiary, the Croatian mobile operator VIPnet, a post he held from July 2003 to July 2009, after spending 10 years in managerial positions at Alcatel.
From 1 April 2011 on, he will hold the position of Member of the Management Board and Chief Financial Officer of Hrvatski Telekom.

Irena Jolić Šimović
Member of the Management Board
Chief Operating Officer Business

Irena Jolić Šimović was born in 1969. She graduated from the Faculty of Economics in Zagreb and received an MBA from IEDC, Bled, Slovenia. Prior to joining Hrvatski Telekom in 1998, she worked at Croatian Radio and Television (HRT), the Ministry of the Sea, Transport and Communications and the Ministry of Immigration. She was Executive Director for Corporate Strategy and Business Development until August 2006, when she was appointed Member of T-HT's Management Board and Chief Human Resources Officer. Irena Jolić Šimović was Chief Operating Officer T-Com from October 2008 until December 2009. Following the Group's restructuring in January 2010, she became Chief Operating Officer Business with responsibility for Sales, Marketing, Customer Service, Wholesale and ICT Business Solutions. In March 2010, Irena Jolić Šimović was honoured as one of the World Economic Forum's Young Global Leaders 2010, a unique community of exceptional young leaders who share a commitment to shaping the global future.

Johan H.M. Busé
Member of the Management Board
Chief Operating Officer Residential

Johan Busé was born in 1969. After completing the study of economics, he started his career in retail marketing at British Petroleum in Belgium and the Netherlands, joining T-Mobile in 2000, where he took the position of the Head of Business Development. After that he led several marketing departments of T-Mobile in the Netherlands, Germany, and Croatia. From 2006 to 2008 he held the position of the Member of the Management Board and Chief Marketing Officer of T-Mobile Croatia. He then joined the Indonesian mobile operator AXIS as Chief Marketing Officer, helping it to become the fastest growing 3G operator in Indonesia. On 1 April 2010 Mr. Busé returned to HT when he was appointed Member of the Management Board and Chief Operating Officer Residential, responsible for Sales, Marketing, and Customer Services.

Branka Skaramuča
Member of the Management Board
Chief Human Resources Officer

Branka Skaramuča was born in 1958 and in 1982 obtained a master's degree in Psychology at the Faculty of Philosophy, University of Zagreb.
She began her career with the pharmaceutical company PLIVA in 1985, where she worked in Human Resources.
In 1989 she was appointed Head of Marketing Communications in part of its FMCG portfolio, being promoted to the position of HR Director for Croatia in 1993 and then becoming Global HR Director until February 2002.
She joined Hrvatski Telekom in 2002 as a Member of the Management Board and Chief Human Resources Officer, becoming a Management Board member and Chief Human Resources Officer of T-Mobile Hrvatska in March 2004.
In September 2008 the Supervisory Board of Hrvatski Telekom appointed Branka Skaramuča a Member of the Management Board and Chief Human Resources Officer of the T-HT Group.

Božidar Poldrugač
Member of the Management Board
Chief Technical and Chief Information Officer

Božidar Poldrugač was born in 1967. He graduated from the Faculty of Electrical Engineering and Computing, Zagreb University in 1992 and earned a master's degree from the same faculty in 2000. He began his career at Croatian Post & Telecommunications in 1993 and participated in all the development activities related to implementation of the first GSM network in Croatia. After the separation of Croatian Post & Telecommunications, he continued his career in Hrvatski Telekom, where he served as a Member of the Management Board and Director of Mobile Communications from October 1999 to October 2001. He was Chief Technical Officer for Mobile Communications at Hrvatski Telekom from October 2001 to January 2003, when the subsidiary company T-Mobile Croatia was launched. In March 2007, he was appointed Member of the Management Board and Chief Technical and Chief Information Officer for the T-HT Group.

Jürgen P. Czapran
Member of the Management Board and Chief Financial Officier until 31 March 2011

Compensation to the Management Board members in 2011

In 2011, Ivica Mudrinić, President of the Management Board, was paid a fixed salary contracted in annual gross amount of HRK 2,120,500 in average net monthly installments of HRK 93,085. Variable part, in accordance with 2010 goals achievement, amounted to HRK 616,899 net. Payment according to MTIP 2008 amounted to HRK 222,909 net. Income in kind amounted to HRK 154,565 gross for company car usage.

Irena Jolić Šimović, member of the Management Board, was in 2011 paid a fixed salary contracted in gross amount of HRK 1,561,171 in average net monthly installments of HRK 68,379. Variable part, in accordance with 2010 goals achievement, amounted to HRK 243,956 net. Payment according to MTIP 2008 amounted to HRK 101,180 net. The income in kind amounted to HRK 139,679 gross for company car usage.

Johan Busé, member of the Management Board, was in 2011 paid a fixed and variable salary contracted in annual gross amount of HRK 2,578,961. The amount of income in kind was HRK 380,073 gross for rental, insurance and company car usage.

Božidar Poldrugač, member of the Management Board, was in 2011 paid a fixed salary contracted in annual gross amount of HRK 1,430,865 in average net monthly installments of HRK 65,741. Variable part, in accordance with 2010 goals achievement, amounted to HRK 290,223 net. Payment according to MTIP 2008 amounted to HRK 121,376 net. The income in kind amounted to HRK 157,378 for company car usage.

Jürgen P. Czapran, member of the Management Board until March 31st 2011, was in this period 2011 paid a fixed and variable salary contracted in annual gross amount of HRK 1,288,058. The amount of income in kind was HRK 172,184 gross for rental, insurance and company car usage.

Dino Dogan, member of the Management Board from April 1st 2011, was in 2011 paid a contracted fixed salary in gross amount of HRK 1,113,421, in average net monthly installments of HRK 73,806. Contracted sign-in bonus amounted to HRK 523,107 net. The income in kind amounted to HRK 87,693 gross for company car usage.

Branka Skaramuča, member of the Management Board, was in 2011 paid a fixed salary contracted in annual gross amount of HRK 1,379,016, in average net monthly installments of HRK 60,338. Variable part, in accordance with 2010 goals achievement, amounted to HRK 260,079 net. Payment according to MTIP 2008 amounted to HRK 113,126 net. The benefit in kind amounted to HRK 136,589 gross for company car usage.

Share-based payment transactions

Mid-term incentive plans (MTIPs) and long-term incentive plan (LTIP - Variable II) exist at HT level to ensure competitive total compensation for members of the Management Board, senior executives and other beneficiaries. The plans promote the medium and long-term value enhancement of the Company, thus aligning the interests of management and shareholders. First HT’s MTIP is introduced in 2008.

MTIP is generally set up as a cash-based plan linked to two equally weighted, share-based performance parameters – one absolute and one relative. If both performance targets are achieved, then the total amount earmarked as an award to the beneficiaries by the respective employers is paid out; if one performance target is achieved, 50 percent of the amount is paid out, and if neither performance target is achieved, no payment is made.

In 2011 new cash-based long-term incentive plan LTIP - Variable II was established. Variable II includes four equally weighted performance parameters. In contrast to the former MTIP structure, Variable II offers the option of exceeding the amounts earmarked for award, limited to 150% of the award volume per parameter. The parameters are independent from each other, hence each parameter is assessed separately. Both potential excesses and shortfalls in relation to targets are accounted for on a graded basis per target parameter (departure from the principle of “all or nothing”).

As a result of the extension of the new LTIP – Variable II 2011 duration from three to four years, there appears a lack of payment after three years. In order to close the lack of a payout option, the Transitional HT MTIP 2011 is established. Transitional HT MTIP 2011 was set up as a “bridging instrument” before introducing newly designed four-year-term LTIP 2011 (Variable II).

All MTIPs cover period of three years and LTIP-Variable II covers period of four years. Upon expiry of the term of the plan (after three years for MTIP and after four years for LTIP- Variable II), the Supervisory Board of the Company shall determine for MTIP whether each of the targets has been achieved or for Variable II target achievement for each of four parameters. Based on the findings of the Supervisory Board, the Management Board shall determine and announce the level of target achievement.

Based on decision of the Supervisory Board who has established that one target (of two) MTIP 2008 have been achieved, in March 2011 was the payment for participants HT MTIP 2008. In accordance with targets achievements, payment of 50% of the total amount was made.

Currently are in progress HT MTIP 2009, HT MTIP 2010, Transitional HT MTIP 2011 and LTIP - Variable II 2011. All MTIPs have two targets which are equally weighted and cannot be changed during the MTIP duration. One target is based on the increase of the share price by a certain percentage; the second target is related to the share price movement compared to the complex return index.

The incentives themselves consist of 20 or 30% of the participants’ individual annual salary as contracted on the beginning of the each MTIP, depending on the management level of the participant and according to the Supervisory Board decision. Participants’ individual annual salary is defined as the annual amount of total fixed salary and the amount of variable salary in case of a 100 percent target achievement.

LTIP – Variable II has four equally weighted performance parameters and also cannot be changed during the LTIP durations. Two targets are financial KPIs, Earnings Per Share - EPS and adjusted operating Return On Capital Employed - ROCE, third target is customer satisfaction and fourth target is employee satisfaction.

The amounts awarded for LTIP – Variable II 2011 are for International Business Leaders (BLT’s) – HT CEO is fixed sum specified in the individual employment contract,and for other participant is 30% or 20% of the participants’ individual annual salary as contracted on the beginning of the LTIP- Varaible II 2011. depending on the management level of the participant and according to the Supervisory Board decision. Participants’ individual annual salary is defined as the annual amount of total fixed salary and the amount of variable salary in case of a 100 percent target achievement.

In 2011 HT Matching Share Plan is introduced, following its implementation for DT Group International Business Leaders (BLTs). For the time being it is applicable only for the President of the Management Board (CEO), as a member of DT Group BLTs.

HT Matching Share Plan is established to ensure the long-term incentive effect and orientation towards the sustained development of the Company.

According to the provisions of the Plan, the participant is obliged to invest in HT shares, through a personal investment, minimum 10% and maximum 33.33% of his annual gross variable salary (Bonus/Variable I) paid for 2011.

These shares are to be held for a period of at least 4 years (lock-up period). After the lock-up period expires, one additional share (matching share) Company will grant for each share acquired as a part of the aforementioned personal investment.

Consequently, the new compensation model for the President of the Management Board (CEO) was introduced based on the above described Matching Share Plan.

Supervisory Board

Guido Kerkhoff
president of the Supervisory Board until 31 March 2011

Andreas Moelich
member and president of the Supervisory Board from 4 May 2011

dr.sc. Ivica Mišetić
Deputy president

dr. Steffen Roehn
member until 4 May 2011

Oliver Morbach
member from 4 May 2011

Kathryn Walt Hall
member

dr. Lutz Schade
member

dr. Ralph Rentschler
member

Andreas Hesse
member

dr. Slavko Leban
member

Juko Cikojević
member

As specified by the Company, the chairman of the Supervisory Board receives remuneration in the amount of 1.5 of the average net salary of the employees of the Company paid in the preceding month. To the deputy chairman, the amount of 1.25 of the average net salary of the employees of the Company paid in the preceding month is paid while any other member receives the amount of one average net salary of the employees of the Company paid in the preceding month. To a member of the Supervisory Board who is in the same time the Chairman of the Audit Committee of the Supervisory Board in the amount of 1.5 of the average monthly net salary of the employees of the Company paid in the preceding month. To a member of the Supervisory Board who is in the same time a Member of the Audit Committee of the Supervisory Board in the amount of 1.25 of the average monthly net salary of the employees of the Company paid in the preceding month. To a member of the Supervisory Board who is in the same time a Member of the Compensation and Nomination Committee of the Supervisory Board in the amount of 1.25 of the average monthly net salary of the employees of the Company paid in the preceding month. DTAG representatives do not receive any remuneration for the membership in the Supervision due to a respective policy of DTAG. No loans were granted to the members of the Supervisory Board.

Compensation to the Supervisory Board members in 2011 is as follows:

	Period in which compensation From	To	Gross HRK
Juko Cikojević	1 February 2011	31 December 2011	144,044.38
Kathryn Walt Hall	1 January 2011	31 December 2011	184,437.54
Slavko Leban	1 January 2011	31 December 2011	126,368.82
Ivica Mišetić	1 January 2011	31 December 2011	196,210.12
Josip Pupić	1 January 2011	31 January 2011	12,923.76

Since the remuneration of the Supervisory Board members is based on net average salary paid to the employees of the Company in previous month, only gross amounts are shown therein.

Supervisory's Board Report

Pursuant to Article 263, paragraph 3, and Article 300.c of the Companies Act and Article 31 of the Articles of Association of Hrvatski Telekom d.d., the Supervisory Board of Hrvatski Telekom d.d. Zagreb, Savska cesta 32 (hereinafter referred to as "the Company"), consisting, on the day of issuance of this report, of Mr. Andreas Moelich, Chairman of the Supervisory Board, Mr. Ivica Mišetić, Ph.D., Deputy Chairman of the Supervisory Board, Mr. Oliver Morbach, Dr. Lutz Schade, Dr. Ralph Rentschler, Mr. Andreas Hesse, Ms. Kathryn Walt Hall, Mr. Slavko Leban, M.D and Mr. Juko Cikojević, representative of the workers of HT d.d., Members of the Supervisory Board, submits to the General Assembly this

REPORT
on performed supervision during the business year 2011 and on the results of the examination of the business and financial reports for the business year 2011

The content of this report includes:

- in which manner and to which extent the managing of the Company has been monitored by the Supervisory Board during the business year 2011,
- the results of the examination of the annual financial statements as of 31 December 2011 together with auditor's report as well as of the proposal for the utilization of the profit,
- the results of the examination of the Management Board's report on the status of business operations for the business year 2011,
- the results of the examination of the report on relations with the governing company and affiliated companies thereof.

Corporate Profile

On 31 December 2011, according to the list of the top ten shareholders of the Company published by the Central Depository & Clearing Company, significant Company shareholders are as follows. Deutsche Telekom AG (hereinafter referred to as "DTAG") is the majority owner of the Company with 51 per cent of total outstanding shares. The Croatian War Veteran's Fund owns 7% of shares, the Raiffeisen Mandatory Pension Fund holds 5.3 percent of shares[1] and the Pensioner's Fund 3.5% of shares. Other private and institutional investors hold the remaining 33.2 % of shares. An up to date list of the top ten shareholders of the Company may be found on the Central Depository & Clearing Company web site.

The shares of the Company are included in depository services of the Central Depository & Clearing Company as of 12 July 2002.

The Company's shares have been listed on the Zagreb Stock Exchange since 5 October 2007. Global Depository Receipts (GDR), each representing one (1) HT d.d. share, have been listed on the London Stock exchange since 5 October 2007.

On the day of issuance of this Report, the Supervisory Board has five members representing Deutsche Telekom AG, one member nominated by the Republic of Croatia, two independent members and one member appointed by the Workers' Council of HT d.d.

Supervisory Board

During 2011, the composition of the Supervisory Board of the Company changed as follows:

Member of the Supervisory Board and its Chairman, Mr. Guido Kerkhoff, has resigned from his membership of the Supervisory Board with effect as of 31 March 2011.

Member of the Supervisory Board, Mr. Steffen Roehn, has resigned from his membership of the Supervisory Board with effect as of 4 May 2011.

Mr. Andreas Moelich and Mr. Oliver Morbach were elected as Members of the Supervisory Board as of 4 May 2011. In addition, Mr. Andreas Moelich was elected as Chairman of the Supervisory Board as of 4 May 2011.

The Workers' Council appointed Mr. Juko Cikojević as Workers' Representative on the Supervisory Board, with effect from 1 January 2011.

[1] Excludes possible GDR holdings

Audit Committee

On the day of issuance of this report: Mr. Kay Nolden, Chairman, Mr. Ivica Mišetić, Ph.D., Member, and Mr. Franco Musone Crispino, Member, are the members of this Committee.

Compensation and Nomination Committee

On the day of issuance of this report: Mr. Andreas Moelich, Chairman, Dr. Ralph Rentschler, Member, and Ms. Kathryn Walt Hall, Member, are the members of this Committee.

Management Board

On the day of issuance of this report, the Management Board of the Company has six (6) members.

The following section lists the changes in the Management Board membership:

Mr. Ivica Mudrinić was reappointed as President of the Management Board (CEO) for another term of office in the duration of three years, with commencement as of 1 January 2011.

Mr. Božidar Poldrugač was reappointed as Member of the Management Board and Chief Technical and Chief Information officer (CTO/CIO) for another term of office in the duration of three years, with commencement as of 15 March 2011.

Mr. Jürgen P. Czapran resigned from his position as Member of the Management Board and Chief Financial Officer (CFO) effective as of 31 March 2011.

Mr. Dino Ivan Dogan, Ph.D., was appointed as Member of the Management Board and Chief Financial Officer (CFO) for a period of three years, with commencement of his term of office as of 1 April 2011.

Performed supervision during the business year 2011

In 2011, there were five (5) sessions of the Supervisory Board and three (3) decision makings out-of-session. The Supervisory Board supervised the managing of the Company's business operations and performed other tasks in accordance with the Companies Act, the Articles of Association of the Company, and the By-Laws on the Work of the Supervisory Board of the Company.

Aside from the regular reports of the Management Board of the Company on the results and status of business operations of the Company and joint consultations on business development, the issues below were discussed in detail, and the Supervisory Board provided respective prior approvals and recommendations:

- Strategic program – re-invention of core services – tariffs, broadband, service orientation and focus on customer, IP based services and quality of service, integrated and cloud based service platforms, IT main projects, network transformation, fiber optical infrastructure, extension of ICT products and services, cost efficiency, T-HT Transformation Program 2012 - 2014
- Regulatory framework – regulations and requirements with regard to the distributive fiber optics network, significant market power, network access and regulated products, unbundled local loop pricing, provisioning universal services, prepaid registration, Wholesale line rental, etc.
- New trends – re-launch of prepaid brand Simpa; new tariffs for residential customers; exclusive offering the new Apple iPhone 4S; launch of new services for business customers (My T-Business portal, HotHot application, ICT services), etc.
- HR accomplishments and challenges, strategy, plans and activities, headcount development, performance management system, management development framework,
- Corporate Governance and membership of the Management Board as described above,
- Decision proposals for the General Assembly
- International activities of the Company,
- Annual Business Plan for 2012 and Strategic Plan for 2013 – 2015,

- Cash management and savings initiatives of the Company,
- Reports and the proposals of the Compensation and Nomination Committee of the Supervisory Board with regard to the target-setting and target-achievement of the Company and Management Board and remuneration proposals for MB Members; establishment of the new cash-based long-term incentive plan LTIP - Variable II; introduction of the Matching Share Plan following its implementation for DT Group International Business Leaders (BLT's). Matching Share Plan is for the time being applicable only for the President of the Management Board as a member of DT Group BLT's. In order to ensure the long-term incentive effect and orientation toward the sustained development of the company, an amount of min. 10% of the gross annual variable bonus (Variable I / Bonus) is to be invested in shares of HT (personal investment). Business Leaders have the option of voluntary increase to a maximum of 33.3% of the Variable I / Bonus. These shares are to be held for a period of at least 4 years (lock-up period). After the lock-up period of 4 years has passed, the Company will grant one additional share („matching share") for every share acquired as part of the aforementioned personal investment. Consequently, new compensation model for the President of the Management Board (CEO) was introduced based on the above described Matching Share Plan.
- Reports of the Audit Committee of the Supervisory Board
- Capital Market trends and Continuing obligations of the Company following the listing of its shares on the Zagreb Stock Exchange and the listing of GDR's representing the Company's shares on the London Stock Exchange,
- Impacts of the strong competition and a serious and prolonged downturn in the Croatian economy, the mobile tax impacts, etc to the results of the Company.

In 2011, the Audit Committee of the Supervisory Board held five (5) regular sessions and discussed various issues, especially:

- 2010 year-end closing of T-HT Group,
- Recommendation for appointment of external auditor,
- Implementation and effectiveness of internal control over financial reporting according to S-OX; S-OX 404 project in T-HT & Testing results,
- Effectiveness of Corporate monitoring functions (Audit of financial statements, Internal auditing system, Risk management, Compliance system, External auditing system and Internal control system)
- Implementation status of "Code of conduct"
- Status of penetration testing procedures in T-HT
- Implementation of new Internal Control System,
- Implementation of new international audit guideline, "Specific Area policy – International cooperation on internal auditing",
- External Auditor's Report (quarterly reports, Auditor's Independence, Report on auditor engagement, new accounting and disclosure requirements in 2011, Management recommendation letter 2010, etc.),
- Significant risks and exposures (legal framework related to DTK/ducts, consumer protection litigation status, Wholesale Line rental and Reference Interconnection Offer (RIO), New by-law on "right of way", etc.),
- Quarterly Fraud Reports and Risk Reports for T-HT Group,
- Quarterly financial results of T-HT
- Reports of the compliance officer and compliance risk assessment results 2011,
- Audit program 2011 execution,
- Supervision over the realization of audit measures and audit reports (e.g. IT security and data protection activities, procurement processes audits, assessment of inventory count shortages, etc.),
- Internal auditing program for 2012.

According to the available information, Audit Committee finds that in relation to financial reporting, risk management, compliance management system, internal and external audit engagement there is no indication that internal control system does not work effectively.

In 2011, the Compensation and Nomination Committee began the target-setting procedure for 2012 and also began preparing the target evaluation procedure for 2011. Changes in the Membership of the Management Board as outlined above were also covered by their Agenda as well as running the Mid Term Incentives Plans.

The Supervisory Board supported the Management Board in their efforts to protect the interests of HT d.d. in Bosnia and Herzegovina.

Results of the examination of the Management Board report on relations with the governing company and affiliated companies thereof

The Management Board submitted to the Supervisory Board the Report of the Management Board on relations with the governing company and affiliated companies thereof (Report of the Dependent Company), compiled in accordance with Articles 474 and 497 of the Companies Act and in accordance with the principles of conscientious and truthful reporting.

In the opinion of the Management Board, the relationships of affiliated companies in the business (calendar) year 2011 in total, realized by contractual affiliating and other undertaken legal actions, were within the scope of ordinary business and entrepreneurial relationships, standard conditions and the application of regular prices.

The Company's auditor, PricewaterhouseCoopers d.o.o. Zagreb, reported on the results of its audit and issued the following confirmation on the audit of the above report:

Report of Independent Accountants

Quote:

> This report is produced in accordance with the terms of our Contract dated 11 July 2011 for the purpose of reporting to the Supervisory Board and shareholders of Hrvatski Telekom d.d. ('HT') in connection with the relationships with the governing entity (Deutsche Telekom AG) and its affiliated entities (herein the 'Related party report') for the year ended 31 December 2011.
>
> *Management's responsibility*
>
> Management of Hrvatski Telekom d.d. is responsible for the preparation of the Related party report in accordance with the criteria as set out in Article 497 of the Croatian Company Law. Management's responsibility includes presenting in a complete and accurate manner the following information in the Related party report: all legal transactions that the Company undertook during 2011 with Deutsche Telekom AG and its affiliated entities (including description of underlying contract terms, related invoices and postings in accounting records), determining whether such transactions were carried out within the ordinary scope of business and whether HT has received a respective counteraction (ie. receipt of payment or goods/ services) for such transactions and actions without incurring any damage.
>
> *Description of the subject matter and identification of the criteria*
>
> The subject matter upon which we performed assurance procedures was limited to the contracts and related transactions concluded between HT and Deutsche Telekom AG and its affiliated entities for the year ended 31 December 2011 as presented in sections E and F of the Related party report.
>
> We assessed whether the information presented in the Related party report is consistent with the books and records of HT as required by Article 497 of the Croatian Company Law.
>
> *Our responsibility*
>
> Our responsibility is to report on the Related party report based on our work performed.
>
> We conducted our engagement in accordance with the International Standard on Assurance Engagements 3000 "Assurance Engagements other than Audits or Reviews of Historical Information" ("ISAE 3000"). This Standard requires that we comply with ethical requirements and plan and perform the assurance engagement to obtain limited assurance whether the Related party report complies, in all material aspects, with the requirements of Article 497 of the Croatian Company Law.

Summary of the work performed

Within the scope of our work we performed, among others, the following procedures:

- Acquiring an understanding of the process used by HT for identifying contracts and transactions to be included in the Related party report.
- Discussions with the staff entrusted with compiling and preparing the Related party report.
- Comparing information presented in the Related party report to HT's accounting records (general ledger and supporting ledgers) as at and for the year ended 31 December 2011.
- Inspection of the relevant HT documentation (contracts and invoices) supporting the transactions recorded in the Related party report.
- Reviewing the appropriateness of the presentation of information in the Related party report
- Obtaining written representation from HT's management relevant to the Related party report.

The nature and extent of our procedures were determined based on our risk assessment and our professional judgment in order to obtain limited assurance.

The scope of work did not include matters related to legal interpretation of HT's compliance with requirements of Article 497 of the Croatian Company Law.

In a limited assurance engagement the evidence-gathering procedures are more limited than for a reasonable assurance engagement, and therefore, less assurance is obtained than in a reasonable assurance engagement.

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

Conclusion

Based on our work described in this report, nothing has come to our attention that causes us to believe that the Related party report is not presented, in all material respects, in accordance with the criteria as set out in Article 497 of the Croatian Company Law.

Restriction of use and distribution

This independent assurance report is provided solely for the use of the Management Board, Supervisory Board and shareholders of Hrvatski Telekom d.d. and only for the purpose of HT's compliance with the requirements of Article 497 of the Croatian Company Law and should not be used for any other purpose or distributed to any other parties.

PricewaterhouseCoopers d.o.o.
Zagreb, 6 February 2012

John Mathias Gašparac Procurator	Tamara Mačašović Croatian Certified Auditor

End of quote.

The Supervisory Board has no objections to the results of the auditor's examination of the Management Board Report on relations with the governing company and the affiliated companies thereof.

After considering the Management Board Report, the statement of the Management Board and the results of the auditor's examination, the Supervisory Board states that the Company, according to the circumstances that were known at the time of undertaking the legal affairs and actions stated in the said Management Board Report, received a respective counter-action for each legal affair, without any damage to the Company.

Results of the examination of the annual financial statements and auditor's report, Management Board Report on the status of business operations for the business year 2011 and draft decision on utilization of profit

The Supervisory Board issued an order to PricewaterhouseCoopers, the Company's auditor, for the examination of the annual financial statements for the year 2011.

The Supervisory Board, after considering the audited financial statements for the business year 2011, established that the Company acted in 2011 in accordance with the law, the acts of the Company and the decisions of the General Assembly, that the annual financial statements were made in line with the situation in the Company's ledgers and that they indicate the correct property and business status of the Company. The Supervisory Board has no objections to the auditor's report on the examination of the annual financial statements for the business year 2011.

The Supervisory Board has no objections to the audited financial statements delivered by the Management Board and gives its approval of the delivered audited financial statements. The said financial statements are considered adopted by both the Management Board and the Supervisory Board and are to be presented to the General Assembly.

The Supervisory Board has considered the Annual Report on the status of business operations for the business year 2011 and has no objections to the delivered report. Furthermore, the Supervisory Board has no objections to the statement on the Code of Corporate Governance applied, given within the above Report. The Supervisory Board has no objections to the statements made in the answers within the attached questionnaire requested to be completed by the Zagreb Stock Exchange and states that the answers given to this questionnaire are to their best knowledge truthful in their entirety.

The Supervisory Board holds the opinion that the proposal of the Management Board on utilization of the profit is in accordance with the business results, is in accordance with the business plan for the current year, protects the Company's and shareholders' interests and is in accordance with the positive regulations of the Republic of Croatia.

Therefore, the Supervisory Board gave its consent to the net profit utilization proposal of the Management Board and that is, that the amount of HRK 1,813,012,164.90 will be distributed to shareholders as dividend payment, in the amount of HRK 22.14 per share, whereby an advance dividend of HRK 906,506,082.45 or HRK 11.07 per share is to be paid to the Shareholders in February 2012. The remainder of net profit in the amount of HRK 283,022.36 is to be allocated to retained earnings. The joint proposal by the Management Board and the Supervisory Board on the utilization of profit for 2011 is to be referred to the General Assembly of the Company for decision making.

Summary

The Management Board of the Company regularly informed the Supervisory Board of the Company's business, status of assets and liabilities, revenues, and organizational and other changes related to the management of the Company's business operations.

The Supervisory Board analyzed the realization of the planned results and the implementation of the basic goals of the Company's business policy for the year 2011.

After analyzing the reports of the Management Board of the Company and monitoring the changes in the financial indicators, it was assessed that certain planned parameters were not realized to the full extent due to different impacts (majority of which were unexpected in such extent), as follows: regulatory impacts (mobile termination prices, ULL, DTK, WLR opt out, etc.), mobile tax effects, GDP drop, falling disposable income, high unemployment and overall market decline. However the Company and whole T-HT Group successfully maintained its leading position in the Croatian telecommunications market and achieved solid financial results in 2011 despite strong competition and a serious and prolonged downturn in the Croatian economy.

Aside from the financial results for the year 2011, the Supervisory Board considered and approved the Company's business plan for the year 2012 and the Strategic Plan for 2013-2015 .

Pursuant to all of the above, the Supervisory Board will deliver to the General Assembly of the Company this Report on the performed supervision of the managing of the Company's business operations in 2011.

Andreas Moelich
Chairman of the Supervisory Board

Corporate Governance Code Compliance Statement

Hrvatski Telekom d.d. (hereinafter referred to as “the Company”) has, in accordance with Article 250b, paragraphs 4 and 5 of the Companies Act (“Official Gazette” Nos. 111/93, 34/99, 121/99, 52/00, 118/03, 107/07, 146/08 and 137/09), prepared the Annual Report of the Management Board on the Status and Business Operations of the Company and the T-HT Group for the Business Year 2011 consisting of the Annual Report on the Status and Business Operations of the Company and the Consolidated Annual Report on the Status and Business Operations of the Company (hereinafter referred to as “Annual Report”), as well as the Corporate Governance Code Compliance Statement.

Given the fact that the Company’s shares are admitted to trading on a regulated market, the Company applies the Corporate Governance Code published on the web-site of the Zagreb Stock Exchange Inc. (www.zse.hr) and on the web-site of the Croatian Financial Services Supervisory Agency (www.hanfa.hr), and in effect as of 1 January 2011.

The Company complies with the recommendations of the Code, with the exception of those that were not, or are not practical for the Company to implement at the relevant time. These exceptions are as follows:

- The Company does not provide, without additional expense, proxies for shareholders who for whatever reason are not able to vote at the Assembly, such that those proxies will vote at the Assembly in compliance with the shareholders’ instructions. Shareholders who are not in a position to vote in person at the Assembly by themselves should at their own discretion determine suitable proxies who are obliged to vote in compliance with the shareholders’ instructions (Part 2.5.).
- At previous General Assembly meetings shareholders have not been given the opportunity to participate by means of modern communication technologies. Such participation will be implemented in the future to the extent that it is practical (Part 2.6.).
- The date on which the shareholder becomes entitled to payment of dividend was not set as recommended by the Code. The dividend date was set as the date of the holding of the General Assembly at which the decision on dividend payment was passed as in accordance with the Companies Act (Part 2.8.).
- The Supervisory Board is not composed mostly of independent members. Only two out of nine Supervisory Board members are independent members (Part 4.2.).
- Remuneration received by the members of the Supervisory Board is determined in relation to the average net salary of Company employees and not according to Supervisory Board members’ contribution to the Company’s business performance (Part 4.7.).
- The Compensation and Nomination Committee is not composed mostly of independent members of the Supervisory Board. One out of three Committee members is an independent member of the Supervisory Board (Part 4.12.1. and 4.12.2.).
- The Audit Committee is not composed mostly of independent members of the Supervisory Board. One out of three Committee members is an independent member of the Supervisory Board. Two remaining Committee members are external experts independent from the Supervisory Board (one of which is a financial expert, the other is an internal audit expert), both are employees of Deutsche Telekom (Part 4.12.3.).
- The Supervisory Board did not prepare an evaluation of its performance in the preceding period (Part 4.16.).
- The remuneration strategy adopted for Management Board and Supervisory Board members is based on Deutsche Telekom’s Guidelines, adapted for local needs. The Statement on the policy of remuneration of the Management Board and the Supervisory Board was not composed separately. The remuneration of the Management Board and the Supervisory Board are disclosed within the Annual Report (Part 6.3.).

Internal Control and Risk Management

The Audit Committee of the Supervisory Board of the Company was established in April 2002. The Audit Committee’s principal responsibilities are the preparation of the decisions of the Supervisory Board of the Company and the supervision of the implementation of such decisions in relation to the controlling, reporting and audit activities within the Company. Revisions to the Audit Committee's term of reference were adopted in November 2006, amended in 2008 and adjusted in accordance with the Sarbanes Oxley Act and the Croatian Audit Act. The Audit Committee oversees the audit activities of the Company (internal and external), discusses specific issues brought to the attention of the Audit Committee by the auditors or the management team and makes recommendations to the Supervisory Board. The Audit Committee is responsible for ensuring the objectivity and credibility of the information and reports submitted to the Supervisory Board.

In executing its activities, the Audit Committee is authorized to:

- equest the necessary information and supporting documentation from the management and senior employees of the Company and from external workers,
- participate at meetings held within the Company on issues that fall under the scope of activities and responsibilities of the Audit Committee,
- appoint advisors to the Audit Committee on a permanent basis or case by case if needed,
- obtain, at the Company's expense, external legal or other independent professional advice on any matter within its terms of reference provided that such advice is needed for the fulfillment of the Committee's scope of activities and responsibilities.

The Corporate Internal Audit of the Company performs an independent audit and control function on behalf of the Management Board and informs managers with comprehensive audit reports (findings and proposed improvements). Implementation of the annual Audit Program contributes to the minimization of risks and the improvement of operational efficiency. Audit Manual of the Corporate Internal Audit of the Company latest updated in December 2009.

The Financial Reporting Audit ensures the reliability of the Company's financial reporting by:

- Identifying risks and fields of improvement,
- Performing audits of areas of risk,
- Monitoring implementation of the audit measures and, if necessary, escalation of problems,
- Providing support in TOP projects in a way that would not conflict with the principles of objectivity and independence,
- Conducting ad hoc audits upon management request.

Significant Company Shareholders

On 31 December 2011, according to the list of the top ten shareholders of the Company published by the Central Depository & Clearing Company, significant Company shareholders are as follows. The majority owner of the Company is Deutsche Telekom AG, with 51 per cent of total outstanding shares. The Croatian War Veterans' Fund owns 7.0 per cent of shares, the Raiffeisen Mandatory Pension Fund holds 5.3 percent of shares and the Pensioner's Fund 3.5 per cent of shares. Remaining 33.2 per cent of shares are owned by Croatian citizens and by other domestic and foreign institutional investors. An up to date list of the top ten shareholders of the Company may be found on the Central Depository & Clearing Company web site.

The President of the Management Board of Hrvatski Telekom d.d., Mr. Ivica Mudrinić, owns 4,569 shares in total; Mr. Jürgen P. Czapran, MB Member until 31 March 2011, owns 185 shares in total; Mrs. Branka Skaramuča, MB Member, owns 200 shares in total; Mrs. Irena Jolić Šimović, MB Member, owns 45 shares in total; Mr. Ivica Mišetić, Ph.D., deputy Chairman of the Supervisory Board, owns 63 shares in total and Mr. Juko Cikojević, Supervisory Board Member (workers' representative, as of 1 January 2011), owns 263 shares in total.

Appointment of the Management Board, its Functions and the Amendments to the Articles of Association

The Members and President of the Management Board are appointed and removed by the Supervisory Board. Their term of office is up to five years, with the possibility of re-appointment. Pursuant to the Company's Articles of Association, the Management Board consists of between five and seven members.

Currently the Management Board has six members: the President of the Management Board (CEO); MB Member and Chief Financial Officer (CFO); MB Member and Chief Operating Officer Residential (COO Residential); MB Member and Chief Operating Officer Business (COO Business); MB Member and Chief Technical and Chief Information Officer (CTO/CIO) and MB Member and Chief Human Resources Officer (CHRO).

The Company is offering fixed and mobile telephony services as well as wholesale, Internet, data and ICT services, organized into two business units, Business and Residential.

The Management Board needs prior approval from the Supervisory Board for the proposal of any amendments to the Articles of Association at the General Assembly.

Authorities of the Management Board Members

Pursuant to the Companies Act and the Company's Articles of Association, the Management Board has responsibility for managing the business affairs of the Company. It is obligated and authorized to perform all the activities and to pass all the resolutions that it considers necessary to successfully manage the business affairs of the Company, subject to such approvals as may be required from the Supervisory Board for certain matters and decisions.

Under the Articles of Association, the Company may be represented by any two members of the Management Board.

The Management Board was authorized by respective General Assembly decisions from 2009, 2010 and 2011 to acquire Company shares, with associated prior approval of the Supervisory Board to start the process of acquiring and managing of Company shares as in accordance with the authority given by the above mentioned General Assembly decisions. No Company shares were acquired during 2009, 2010 and 2011.

The Composition and Functions of the Supervisory Board

Pursuant to the Company's Articles of Association, the Supervisory Board consists of nine members. Eight members are elected by the General Assembly and one is appointed by the Company's employees. The Supervisory Board is responsible for the appointment and removal of Management Board members as well as for supervising the management of the Company's business affairs. Certain major or uncommon transactions such as large capital expenditure items, the assumption of long-term indebtedness or significant appointments require the approval of the Supervisory Board. The Supervisory Board established the Compensation and Nomination Committee and the Audit Committee.

II. Business review 2011

Croatian Telecommunications Market Overview

Strong performance in the face of negative economic trends

In 2011, T-HT Group successfully maintained its leading position in the Croatian telecommunications market across all services, despite further competitive pressure and falling consumption amid economic stagnation in Croatia.

Notable events in 2011 include the following:

- In February 2011, T-HT launched eBooking, a service that enables online booking of private accommodation.
- T-HT launched new mobile postpaid tariffs for consumers that include unlimited data usage.
- T-HT launched FlexBiz - new, simplified tariffs for SMEs and the "Internet for the team" data-bundling tariff for business customers.
- In May, T-HT launched five mobile Internet tariffs for consumer and business customers. Also in May, T-HT launched four new mobile postpaid group tariffs for consumers/families.
- T-HT launched new ICT services - tCloud and ICT LAN - for business customers.
- T-HT launched the Planet9 eBook store and "Spremalica", a multimedia content storage service for TV, mobile and PC/laptop .
- T-HT offered exclusive broadcasts of Croatia's Premier Football League to MAXtv IPTV users.
- In October 2011, T-HT launched MAX3 packages with a range of triple-play offers for consumers.
- In October 2011, T-HT launched a new Simpa offer for mobile prepaid users.
- T-HT's launched "MAXtv To Go" – making its IPTV services available anytime anywhere.

Market trends

Negative economic trends, new regulatory measures and growing competition significantly impacted the Croatian telecommunications market in 2011. In June, the Croatian telecommunications market saw further consolidation with the merger of VIPnet and B.net, which resulted in increasing competition in bundled telecommunications offers. In addition, regulation affecting Wholesale Line Rental (WLR) and naked bit-stream, which came into force in July 2011, means all operators are gaining full country-wide reach. Revenues from voice services declined, on the back of decreased usage, reductions in the mobile termination rate and competitively priced offers from rival operators.

The key growth areas are broadband, data traffic and TV. During 2011, all major Croatian operators launched pay-TV and broadband offers, both mobile and fixed, in order to increase market share.
Mobile broadband is also experiencing significant growth, driven by continuously rising penetration of smartphones and other mobile broadband devices such as tablet computers. According to estimates by Nokia Siemens Networks, more than half a million smartphones and several hundred mobile applications for business, entertainment and information purposes were used in Croatia by the end of 2011. In the past year, the number of tablet computers increased from around 5,000 to almost 30,000. All three mobile operators in Croatia offer mobile TV services and around 1.4m Croatian citizens use social networks for communication, networking and sharing information/content.
The special 6% fee related to mobile services, introduced as an antirecession measure, remained in place throughout 2011.

Macroeconomic environment

No sign yet of economic recovery

Amid a lack of public sector reforms and investment to stimulate growth, the Croatian economy stagnated in 2011. According to the Croatian Central Bureau of Statistics, Croatian GDP showed modest growth of 0.2% in 2011.

At the same time, further negative factors are emerging from the Eurozone: increasing cost of capital; declining demand for Croatian exports; and continued lack of investment.

In 2011, unemployment in Croatia remains high: 18.7% in December 2011 (compared with 18.8% in December 2010). Given the high levels of household debt (above the regional average) and stagnation of real income (0.3% lower in real terms for the first 10 months of 2011 against the same period of 2010), personal consumption growth has been minimal. Illiquidity rose again to HRK 40bn in October 2011. More than 76% of businesses have had their accounts blocked for longer than a year, and account for 83% of the total amount of overdue payments (or HRK 33.5bn).

Fixed-line market

T-HT maintained leadership in face of market decline

Fixed telephony remained highly competitive in Croatia with 10 active operators, including T-HT Group. VIPnet's acquisition of B.net is likely to increase the competition in bundled telecommunication offers.
T-HT successfully maintained its market leading position, however, with an estimated share of around 77%. This success reflects the Group's continuing dedication to high-quality services and improved marketing with offers tailored to suit the needs of specific customer segments.
According to the Croatian Central Bureau of Statistics, the number of fixed-line minutes of use (MOU) decreased by 9% during the first nine months of 2011, following similar global trends. According to the Cullen International report for 2011, fixed-line penetration is estimated at 39% of the Croatian population at the end of 2011.

Mobile telecommunications

T-HT maintained dominant market position in shrinking market

T-HT, through its T-Mobile brand, remained the leader in a saturated mobile market, served by three operators since 2005. Mobile penetration rate was estimated to reach 120%[1] and the Company's share of total mobile customers was estimated at 47% at the end of 2011.
Mobile voice revenue declined in 2011 due to lower mobile termination rates and intense pricing competition. According to the Croatian Central Bureau of Statistics, total Croatian mobile market minutes of use (MOU) increased by 4.8%, but SMS traffic declined by 4.5% during the first nine months of 2011 compared with the same period of 2010 as users switched to social networks as a channel of communication. Demand for mobile Internet continued to grow in 2011, with all three mobile operators promoting their mobile broadband offers together with increasing smartphone and tablet computer offers. At the same time, hundreds of smartphone applications and new mobile services were introduced in 2011, such as e-books and mobile TV.

Internet

Fixed broadband and pay-TV market continued to grow

T-HT's IPTV and DTH satellite TV services were enriched by new and exclusive sports content, and pay per view and "try and buy" offers. Satellite TV became an increasingly important element of the Group's TV offer.
At the end of 2011, the Group had 650,713 ADSL subscribers, compared with 629,228 users by the end of 2010. The number of IPTV customers at the end of 2011 was 340,743, representing 52.4 % of T-HT's total ADSL customer base.
Despite the strong increase in broadband subscribers, the Croatian broadband market remains a significant growth opportunity for T-HT, with only 45% of Croatian households connected to fixed broadband compared to an average of more than 62% in Western Europe.

Data

Migration to IP-based services continued

T-HT maintained its leading position in a market that is migrating from traditional unmanaged data services to more cost-effective, IP-based services. Although the data market is relatively small, representing less than 1% of total telecommunication market revenues, it represents an important service for business customers.

[1] From Q1 2011, the regulator (HAKOM) amended the definition of the total prepaid subscriber base so that only SIMs showing traffic or voucher recharges in the previous 90 days should be considered as subscribers: thus number of total mobile customers decreased and penetration rate is lower than reported in 2010.-

The Group's main data service competitors continued to develop their own networks, targeting the corporate and government sectors.

Wholesale

New services introduced following new regulation

Liberalization of the fixed line market continued in 2011, with the introduction of Wholesale Line Rental (WLR) and naked bitstream services. WLR customers totalled 123,819 at the end of 2011.
As market liberalization continued in 2011, the number of Unbundled Local Loop (ULL) customers increased to 148,305, from 132,821 at the end of 2010.
In summary, during 2011, wholesale prices were amended for the following regulated services: bitstream access, call origination, call termination, cable ducts rental and unbundled local loop.

Regulatory Environment

Croatian Law on Electronic Communications, which replaced the previous Law on Telecommunications, has been in force since July 1st, 2008. This Law transposed the 2002 EU New Regulatory Framework onto Croatia's electronic communications market. Latest amendments to the Law on Electronic Communications were adopted by Croatian Parliament in July 2011 and entered into force in August 2011. Purpose of these amendments was to transpose the EU Regulatory Framework from 2009 onto Croatia's electronic communications market. Croatian operators were provided with a 90 days-period to consolidate their business operations with new provisions of the Law.

In line with Croatian regulatory framework, and taking into account the latest EU recommendations, the Agency can impose regulatory remedies only after analysing the market and determining the existence of significant market power (SMP). According to the market analysis conducted by the Agency in July 2009, and market analysis conducted in 2011, Company holds SMP position in the following markets:

1.call origination in fixed network
2.call termination in fixed network
3. wholesale (physical) network infrastructure access (including shared or fully unbundled access)
4. wholesale broadband access
5. call termination in mobile network
6. retail access to the public communications network at a fixed location
7. publicly available local and/or national telephone service provided at a fixed location for residential customers
8. publicly available local and/or national telephone service provided at a fixed location for non-residential customers

In these markets, remedies that were in place before the market analysis ceased to apply and the following remedies were imposed:

- in markets 1 - 5: network access and use of special network facilities (this obligation is extended to Company's optical fiber access network), non-discrimination, transparency, price control and cost accounting, accounting separation (applies only to Company's fixed business)
- in market 6: network access and use of special network facilities (obligation to offer wholesale line rental - WLR), non-discrimination, transparency, price control and cost accounting (notification of retail prices 30 days in advance; prohibition to unreasonably bundle services - introduction of naked DSL, provision of "pure" network access;) accounting separation; in line with these obligations, Company published wholesale reference offers for naked bitstream and WLR in June /July 2011
- in markets 7 and 8: Company and Iskon were imposed with price control obligations/promo-offers regulation.

In January 2011, the Agency imposed changes to Company's Reference Unbundling Offer (RUO) with almost 70 amendments, including the obligation to give access to the network even where there is no existing access line available, introduction of VDSL technology, reduction in installation fees, and reduction of monthly fees for second and third access lines to the same end-user.

In March 2011, the Agency reduced Company's prices (monthly fees) charged for the wholesale unbundled local loop service (ULL) from HRK 52.14 to HRK 43.61. Company's monthly fee for Shared ULL was reduced in October 2011 from HRK 18.17 to HRK 16.92

In May 2011, Agency issued a non binding interpretation of the decision dated 6 April, 2011 under which existing Carrier Pre-selection (CPS) customers shall be automatically migrated to WLR unless they make an objection within a reasonable period. In addition, on June 8th, 2011, Agency issued a decision imposing changes to Company's General Terms and Conditions for provision of services to its subscribers such that in the case of migration to WLR, a subscriber contract signed between the Company and its subscriber shall be automatically terminated (without the explicit request of the subscriber in question). Subsequently, on July 6th and 8th, 2011 Agency issued two decisions which amend Company's reference interconnection offer and reference offer for WLR in a way that existing CPS customers (customers who have contracted CPS before the reference offer for WLR came into force) may be automatically migrated to WLR without written request.

Decisions of this kind by Agency represent a significant intervention in the contractual relationship between the Company and its subscribers. As such, they are contrary to relevant regulations, including the general ordinance adopted by the Agency, and thereby discriminate against the Company in comparison to all other operators on which such obligations have not been imposed.
In addition, by these two decisions (dated July 6th and 8th) Agency has prohibited the Company to charge operators activation costs for wholesale services it provides them, thus forcing the Company to provide certain services to operators free of charge, i.e. at its own cost, as well as prohibiting Company from protecting its finances against debtors despite substantial undisputed debt on the part of the alternative operators to the Company. Such regulatory practice by Agency can be considered to have significant impact on Company's business and its related activities.

In October 2011, Agency determined that "three criteria test" for retail broadband Internet access was fulfilled, which qualified this market as susceptible to ex ante regulation. Finalization of market analysis and imposition of regulatory remedies is expected in Q1 2012. Proposed regulatory obligations relate to price control/promo offers regulation.
In addition, also in October 2011 Agency proposed to designate Company and Iskon as operators with SMP in the retail market for transmission of TV programs with remuneration, whereby rather strict regulatory remedies would apply both to Company's and Iskon's retail IPTV services. This procedure is pending, with expected finalization in Q1 of 2012.

Company is likely to be designated as SMP operator in remaining wholesale and retail (leased lines) markets, which are expected to be analyzed in 2012. By its decision adopted in November 2011, Agency increased the "x" percentage that is used for calculation of Company's prices for wholesale bitstream access on copper - IP level (retail minus methodology), from 40% to 60%.
In December 2011, Agency adopted decision on amendments of Company's Reference offer for wholesale bitstream access on copper and FTTH. This decision imposed more than 60 amendments and defined final concepts for the provision of wholesale bitstream access on copper and FTTH.
In October 2010, the Company was (re)designated as the universal service provider for the next five years for all universal services (except for the subscribers' directory, which the Company can continue to provide on a commercial basis). Tariffs for universal services must be set at an "affordable level." Other tariffs, besides those mentioned above, are subject to ex-post review and are essentially unregulated.
Accounting separation (applies only to the Company's fixed business); cost accounting project, initiated at the end of 2008, is ongoing. In Q3 2011 the Agency started developing its own cost modelling for all regulated services.
The registration of pre-paid customers in mobile networks is underway.

Group's Strategy

T-HT Group Mission:

Communication, Information & Entertainment, Always & Everywhere

Enormous volumes of photos and film clips are uploaded to the Internet and viewed every day, while virtual communities and social networks attract millions of new members every month. More and more, these applications are tailored to people's needs and can be used at any time through a wide variety of devices.

Checking e-mail and using the Internet are part of our everyday life. The Internet has revolutionized the way we spend our free time and the way we do business. We take for granted that we can access the Internet at home, in the office and on our mobile phones and we are constantly demanding faster access and better quality of service.

T-HT Group Vision:

T-HT — Leader in Connected Life & Work

The possibilities are endless. Technology works for us, making life easier, solving problems faster, leaving us with more spare time and making our lives a lot more fun. We can do business on our way to the airport, watch our favorite TV show on the screen of a mobile phone and stay in touch with our families, friends and colleagues, using mobile and Internet-based services to share our experience, ideas, information and thoughts.

T-HT Group Strategy

The telecommunications market is undergoing a fundamental transformation, characterized by a dramatic increase in data traffic. By 2015, the average mobile customer will consume around 14 gigabytes of data a month. In 2005, this figure was just a few megabytes. Consequently, our strategy remains focused on building a robust broadband network, developing new services and providing ICT products and services alongside our core telecommunications offerings. Our strategy is based on three main pillars:

FIX — TRANSFORM - INNOVATE

FIX: strive to protect the Company's traditional fixed and mobile business.

TRANSFORM: continue the rollout of fast speed broadband networks to support expected rapid data growth and facilitate new services. At the same time, we are significantly transforming our cost structures to protect our business.

INNOVATE: focus on developing and expanding new growth areas by exploiting consumer and technology trends built around Internet, media and ICT services

To achieve these targets, the Group has identified the following key strategic areas:

Connected Life and Work

Our strategic goal is the provision of innovative, converged services. The Group's strategic focus remains on broadband, both mobile and fixed, and broadband-related products such as IPTV, value-added services (VAS) and other content for growth, while exploring new growth segments.

Broadband and IPTV continue to offer the greatest opportunities for growth. Cloud computing and ICT also provide considerable growth potential. Furthermore, our networks, platforms and services enable us to support forthcoming changes in industries such as energy, healthcare and media.

Networks and Processes to facilitate the Gigabit Society

Our infrastructure is key to the services we provide and we forecast a rapid increase in data volumes in the coming years. Our goal is therefore to continue to transform operations by improving efficiency and by supplying the bandwidth capacity required. For this reason, we are focused on rolling out high speed fixed and mobile broadband networks and systematically implementing an all-IP proposition.

Cost Management and Efficiency Program

T-HT continuously maximizes the quality and efficiency of its operations by transforming and benchmarking its cost structure, while at the same time reviewing capital expenditure needs to support future growth opportunities. Together, these initiatives are intended to optimize Group operating costs and protect margins in an increasingly competitive environment.

Talent Management and Strategic Workforce Management

In a rapidly changing industry and with the strategic focus on new services and networks, T-HT continues to invest in new skills, talent management, education and training of staff. In this way, we are able to attract and retain first-rate people to help us build our business.

Regional Expansion

The Group continues to monitor and evaluate expansion opportunities.

Organization of the Group

T-HT Group's operations comprise the Business and Residential units and centralized technical functions (CTO/CIO), support and steering functions (CEO, CFO and CHRO), along with a number of subsidiaries including Combis d.o.o., Iskon d.o.o. and KDS d.o.o.

Residential unit

Residential unit is headed by the Chief Operating Officer Residential (COO Residential) and in particular includes Marketing, Sales and Customer Service for residential customers.

Business unit

Business unit is headed by the Chief Operating Officer Business (COO Business) and in particular includes Marketing, Sales and Customer Service for business customers, ICT Business Solutions and Wholesale.

Organizational structure of the Group comprises:

- Management Board
- Customer Facing Units /Support and Steering Functions/ Technical Functions
- Sectors
- Departments
- Work Units

Business units: Residental and Business

On 1 January 2010, the former divisions of T-Com and T-Mobile, serving the fixed and mobile markets respectively, were replaced by a new structure based on the Residential and Business segments. Starting from the first quarter of 2011, segmental reporting was introduced along these lines.

In its financial reports, the Group's segments are reported by contribution to EBITDA level.

Residential Segment

Overview

- T-HT maintained its leading position in the mobile, fixed and IP market
- From Q1 2011, the regulator (HAKOM) amended the definition of the total prepaid subscriber base so that only SIMs showing traffic or voucher recharges in the previous 90 days should be considered as subscribers. Actual data for 2010 was adjusted in accordance with this
- New postpaid EXTRA tariffs were introduced with a particular focus on data
- The Simpa prepaid tariff was reintroduced
- The Group conducted continuous retention initiatives in both postpaid and prepaid segments
- T-HT successfully defended its fixed voice customer base
- The Group has 539,000 ADSL mainlines and 321,000 TV customers
- The Group is increasing coverage with a Direct to Home satellite TV service. Also offered exlusive TV content on MAXtv – Croatia's Premier Football League, Formula 1 and launched MAXtv To Go – a TV service for smartphones, tablets, laptops and PCs.
- The Group launched MAX3 triple play offers

Major Achievements in 2011

HT a launched mobile acquisition and retention campaign for all new and existing customers signing 24-month contracts during first six weeks of the year. The strong focus on mobile broadband was further emphasized by the launch of new postpaid tariffs in March and new mobile Internet tariffs in May. Additionally, new Extra family tariffs were launched offering benefits for up to seven family members and including unlimited calls on the HT network. Extra tariffs also included a special offer targeting young people.

In October, the new rebranded Simpa tariff was re-launched, with attractive cross-network pricing, and a mobile number porting offer.

Bonbon, the prepaid brand aimed at young urban professionals, continued its growth with a successful marketing campaigns where customers allow to selecy select convenient price points and members also receive promotional offers.

The new fixed tariff option 'U mreži' was also launched offering more attractive rates for calls to the T-Mobile network.

Fixed and mobile products were bundled in ADSL customer acquisition campaigns promoting bundled packages.

In TV, customer acquisition campaigns were offered in both IPTV and DTH satellite TV service. IPTV offers were focused on expanding sports content and the introduction of new pay-per-view services. Market leadership was reinforced through exclusive content such as MAXtv, Croatian Premier League football and Formula 1.

The MAX3 triple play was launched with specially designed packages combining voice, ADSL and IPTV services with attractive pricing.

The launch of MAXtv To Go, a service for smartphones, tablets, laptops and PCs will make TV available everywhere and on all platforms.

The mobile subscriber base decreased by 1.9%, from 2,003,000 subscribers in 2010 to 1,964,000 subscribers in 2011, driven by a 3.6% decrease in prepaid subscribers, partly a result of migration to postpaid.

Minutes of usage per average subscriber in 2011 increased by 0.7% due to new, improved tariffs provided mainly in the prepaid segment.

Blended ARPU decreased by 11.0% in 2011, as a result of the economic situation and a highly competitive market.

By the end of 2011, total fixed access mainlines were 12.0% lower at 1,074,000. The decline was accelerated by the regulatory introduction of new wholesale products and was in line with the market trend of fixed to mobile and IP substitution. However, the Group maintained its competitiveness with attractive promotional offers and excellent service.

Fixed telephony users generated 2,083 million minutes in 2011. That was 10.2% lower than the previous year and reflects the impact of fixed substitution by mobile and IP traffic.

Fixed voice ARPA decreased by 5.7%, as a result of general market trends outlined above.

By the end of 2011, the number of ADSL mainlines increased to 539,000, up 2.9%. At the same time, ADSL mainline ARPU fell 3.1%.

The TV customer base showed strong growth. By the end of 2011, T-HT had 321,000 TV customers, an increase of 12.3%.

Satellite TV, an extension of the IPTV service, continues to grow after being repositioned and repriced in Q1 2011, offering more value for the customers.

Business Segment

Overview

- T-HT maintained leading position in the business segment in 2011
- Several ICT services were launched: tCloud Virtual Desktops, tCloud Human Resources, tCloud ERP, tCloud Virtual Private Servers and eBook store – Planet9
- Stable customer base across all segments
- New services Internet za tim and VPN private bill introduced to boost mobile customers
- Active customer retention efforts in both fixed and mobile
- My T-Business portal launched providing single location for managing all T-HT accounts
- HotHot – geo-marketing solution for business customers launched
- HT maintained leading position as major wholesale provider

Major achievements in 2011

HT had 454,000 postpaid business subscribers by the end of 2011, marking a 4.4% increase in the customer base. Minutes of use (MOU) per average subscriber were down 5.0%, as a result of the economic downturn. That pushed blended ARPU down 8.9% compared with 2010. Mobile data grew in line with general mobile market trends.

At the beginning of 2011, HT launched a mobile acquisition and retention campaign for all new and existing customers signing 24 months contracts.

New Flex Biz tariffs, Mobile START and Mobile PLUS tariffs for SMEs were launched allowing customers to choose tariff package with a HRK 200 or HRK 600 monthly fee, allowing unlimited calls between two to eight team members.

The mobile data usage FlexBIZ option “Internet za Tim” was launched, introducing one traffic bundle to be used by the whole team.

In September, the VPN Private bill service was launched.

Other services available to T-Mobile customers include the revamped Applicentar product, as well as FormIt and Momentem.

HT also launched online book store Planet 9, service Spremalica providing free 10 GB bandwidth, and the HotHot geo-marketing application.

T-HT’s business fixed line customers declined 11.4% due to fixed to mobile and IP substitution, regulatory decisions, increased competition and economic recession.

Fixed telephony business users consumed 706 million minutes, down 17.5% on the previous year.

As result of lower usage, ARPA decreased 10.0% to HRK 238.

The ADSL subscriber base is growing as a result of attractive and constant retention and acquisition campaigns, reaching 112,000 business users, an increase of 6.0%. ARPA decreased 2.5% to HRK 134.

The TV subscriber base has grown 12.4% to 19,000 customers as result of continuous improvements in services and programming. A range of promotional offers were available to both new and existing TV users.

The Hotel TV service was launched in March.

Offers around Christmas gave 50% off the monthly subscription fee for 12 months along with a free package of the subscriber's choice (Sportski paket plus, HBO or Snimalica 10) for six months when signing up for 24 months.

The IP fixed line customer base increased 5.1%.

The VPN customer base increased 10.0%. T-HT constantly promotes the migration of existing traditional data customers to IP-based products.

The number of data lines fell 6.7% with traditional data lines decreasing, whilst Metro Ethernet service is growing.

Beside regular telecommunications services, T-HT built an ICT portfolio in 2011. At the start of the year, a Virtual Private Server service was launched and the Desktop Management product followed shortly after.

In July, Virtual Desktops – tCloud were launched and at the end of September, the first two modules of Software as a Service products were introduced – tCloud Human Resources and tCloud ERP.

tportal.hr

In 2011, tportal.hr continuously ranked among the top three web portals in Croatia according to reach, with more than 800,000 unique visitors per month according to Gemius, an independent internet traffic research agency.

The most important projects developed by tportal's editorial, creative and web-design team in 2011 include the following:

- http://prvaliga.tportal.hr/, a central information point regarding the national football league sponsored by Hrvatski Telekom. The site carries exclusive footage of goals and match highlights. It has attracted more than 100,000 unique visitors since its launch;
- http://izbori2011.tportal.hr/, a specialized portal for parliamentary elections in Croatia, with analysis, comment, in-depth event coverage as well as photo and video content;
- live streaming of several important events such as the T-Mobile INmusic festival, Zagreb Pride, election night highlights and a number of debates.

By the end of the year, tportal's Facebook page had acquired over 150,000 fans, which provided additional credibility to the portal's positioning in social networks.

In addition, tportal traditionally organizes the roman@tportal.hr award, a competition for the best Croatian novel.

Tportal's editorial, design and development team continued to improve the presentation of its services across a range of platforms. Content is available through mobile devices, SMS alerts and the T-Mobile WAP portal, along with social networks like Facebook and Twitter. In addition, T-Mobile iPhone users get a customized interface when browsing tportal.

Wholesale

Domestic wholesale market

During 2011, ULL market continued to grow with the gross additions of 15,500 new ULL lines. Operators were still highly focused on a fully unbundled local loop which provides a more attractive broadband services option, while the number of shared accesses is declining and is expected to disappear.

Based on the Agency decision, T-HT has updated and published its wholesale bitstream offer providing two additional products: naked bitstream on copper and FTTH bitstream. Nine operators signed contracts in 2011 for the wholesale bitstream service and eight have had started commercial operations by early 2012 (in accordance with the standard wholesale bitstream offer).

T-HT also published a new WLR (Wholesale Line Rental) offer. The new WLR product created a large amount of interest from CPS operators, resulting in rapid migration of existing CPS customers to the WLR service.

In 2011, four operators signed WLR contracts and there were 124,000 active WLRs. Subsequently, the number of pure CPS customers was reduced to a large extent. At the end of the year, 96,000 pure CPS active customers were reported.

A decrease in the number of customers generating origination traffic and the lower ARPU generated by these customers, meant that originated minutes fell by 9% in 2011. On the other hand, the number of terminated minutes into T-HT network remained stable.

The public consultation regarding the Wholesale Leased Line offer was finalised at the end of 2011. The Agency published its decision and specified changes required. The most important change is a new distance oriented pricing structure applicable for all technologies.

International wholesale market

Sales to international operators remained a significant part of total fixed wholesale revenue in 2011. The majority of international business is related to termination of international voice traffic into the Republic of Croatia and neighboring countries. Incoming traffic to Croatia decreased by 14% and transit traffic to neighboring countries declined 30%.

Despite of massive competition and price erosion in the international data and capacity market, due to the number of new contracts and interconnections and the growth in capacity sold, total business remained flat to the previous year. The IP business scored notable success with 125% growth of capacity sold to neighboring countries, which boosted revenues. On the cost side, the biggest success resulted from a strategic policy to force non-commercial international IP peering wherever possible, and reduce commercial IP upstream to appropriate levels. In 2011, T-HT's share of free of charge IP peering in total IP upstream rose to 52% from 13%. Reduced costs further enhanced the competitiveness of the T-HT offer in the IP market and, alongside intensified sales activities, was the main driver of revenue growth.

Intensive activity on the international network were key to strong business results. Continuous upgrades of capacity and technologies at international points of presence (Frankfurt, Vienna) and existing border crossings were carried out in 2011, and three new border crossings toward neighboring countries were built, increasing the total number of border crossings to 32. A flexible and low-cost interconnection policy, enabled mostly through international points of presence, resulted in an increase in the number of international voice and data interconnections with global and regional operators: from 70 in 2010 to 92 in 2011.

During 2011, 31 new roaming partners were connected, increasing the total number to 391 roaming partners worldwide.

Network and Information Technologies

Network and Service Platforms

Network and Service Platforms are T-HT's core infrastructure, and are continuously upgraded and improved in line with the Group's strategy and marketing plans. Through the consolidation of its business operations, the Group started to converge the functionalities of its resources in both the fixed and mobile networks on joint service platforms, thus achieving improved availability of services and more cost efficient operations. In 2011, the Group further developed its network infrastructure, increasing broadband access capacity and establishing a common, fixed and mobile, transport and core network. In fixed networks, T-HT has adopted a strategy of providing all services via one common broadband port. This has brought a transformation of access network through the construction of a new optical access network, including an optical access platform (GPON) and selective modernization of the copper access network. Furthermore, the Group continued with functional upgrades of the existing PSTN network to enable VoIP telephony provision on broadband. In mobile networks, continuous radio access and core network transformation will support the development and rapid implementation of new, economically optimized technologies (e.g. HSPA, LTE), while facilitating maximum utilization of existing infrastructure and frequency resources. Mobile BroadBand (MBB) access was a key focus of development, through existing and newly deployed technologies such as UMTS900, in order to improve data services coverage. Expansion of the network by building new infrastructural points continued, along with capacity expansion to support a strong increase in data traffic.

Network infrastructure

Fiber optical infrastructure

The Group's activities were focused on deployment of FTTH (Fiber To The Home) on top of the existing FTTA (Fiber To The Area) infrastructure in order to increase RoI.

Electronic Communications Infrastructure (ECI) Registration and Documentation

In order to fulfill regulatory obligations, a "Network Inventory Gateway" solution was implemented, enabling Web display of T-HT's linear ECI to the regulator (HAKOM).

Fixed access

DSL (Digital Subscriber Line)

The roll-out of DSLAMs (DSL Access Multiplexers) continued to provide broadband services for new customers.

Mobile access

Evolution and modernization of 2G and 3G radio access network

The total aggregation layer of the radio access network was modernized, as part of the evolution of the 2G network. The evolution of the 2G network, replacing existing 2G HW with next generation of multiradio equipment, is prerequisite for mobile broadband in rural areas and for the introduction of more energy efficient hardware and a smooth transition to LTE technology. A new revision of 3G SW has been installed to enhance the radio network, providing improved signalization schemes for smartphones and tablets, higher data capacity and allowing a greater number of concurrent users. Total data volume over the radio network increased by 119.6% from 2010. In June 2011, HSPA+ functionality was enabled in the 3G network. In the Bjelovar and Kutina regions, four test sites were equipped with UMTS900 technology, enabling wider coverage of 3G than standard UMTS2100.

Rollout of radio network sites

The rollout of infrastructure is progressing in line with the revised implementation plan to enable the future development a proprietary network as well as renting out infrastructure to other operators.

Transport Layer

DWDM (Dense Wavelength Division Multiplex)

The division completed development of the DWDM-based transport network in the North-West area of Croatia as a technology that will further improve fast provisioning of wholesale services fulfilling broadband capacity demand and brings opex savings.

Modernization of IP/MPLS network

Replacement of older generation P routers with new terabit routers at the Osijek and Rijeka site was completed.

Migration to IP

The migration of 3G sites from ATM (Asynchronous Transfer Mode) to IP (Internet Protocol) is completed, aiming to increase mobile broadband data speeds and to lower cost. Migration of the T-Mobile IP network to the T-Com IP public networks completed.

Core Layer

Fixed core modernization

IMS core capacity was extended in accordance with PSTN migration plans. Migration from AXE based technology towards TSS/MGW (layered, IP based) technology continues.

Mobile core modernization

T-HT is the first operator within DT Group to embark on migration to R4 architecture (enabler for VoIP based services) and the migration of all traffic from R99 based network to the new R4 architecture was fully completed. The first phase of the project to introduce HD Voice on the 3G mobile network, based on WB-AMR codec, was successfully completed. To support marketing requirements related to Mobile Internet (MI), a PCRF platform was successfully installed and integrated. PCRF platform has a central role in the network when detecting and applying different QoS ("Quality of Service") profiles depending on the category of user ("Quality Differentiation") and / or category of services (Internet, voice, video, mobile TV). The first phase of PCRF integration has enabled SSD ("Speed Step Down") functionality in the Mobile Internet service.

PSTN Migration

67,300 customers were migrated to VoIP (HALO service over a broadband access port). Preparations and installations have started for all-IP on 13 local exchange areas.

Service Layer

Service platforms for value added services

The remote device management HW and SW modernization project was completed. The existing system was upgraded with a firewall to enable selective blocking of SMS messages received from SMS centers outside RH per sender.

IP TV

PPV (Pay-Per-View) functionality was launched for special events on dedicated channels on the MAXtv platform. A web/mobile TV platform was installed and the MAXtv-to-go service was launched. Facebook services were launched on the MAXtv platform.

DTH

The MAXtv SAT platform was upgraded and end user devices were paired with high security software. T-HT installed and launched its own satellite uplink in the Varaždin Data center.

Portal services

In 2011, the new MyT Business self care portal with bill checking functionality was launched. The MAXtv portal was launched on tportal. Other new services included DLSI (Digital Life Store International), My phonebook and a new portal for SLA services. This portal is a reporting tool for external and internal customers and a proactive fault repair tool for internal users.

Service and Network Operations

For its internal telecommunications needs, HT began using VoIP services from its own portfolio, which makes it the largest business customer for all-IP telecoms services. All data communication between T-HT locations is IP based, and voice communications on the largest locations is VoIP.
The automatic fault repair and quality of customer service tools were improved (automatic profile change) and a tool to monitor quality for IP-based voice services was developed and implemented.

Quality and Efficiency

The initial phase of a project to develop self-diagnosis and management of broadband services was completed. New tools for increasing efficiency were internally developed and implemented (including simpler CPE configuration, business services fault diagnostics, network migrations).

Proactive customer care

New tools for proactive customer support services were introduced and new channels of communication with the user were established. These enable the remote recognition of problems on customer sites so that customers can be contacted through a self-support portal.

Information Technology

Information Technology is one of the key business enablers in the telecommunications industry and a powerful tool for improving customer service.
The Information and Business Systems Sector is responsible for information technology initiatives that support the Group's drive to increase revenues and improve internal efficiency, while enhancing product development and reducing time to market for new products. Sector is actively participating in innovative IT based customer's service creating, design and implementation.

Significant effort is directed towards improving our service delivery processes, developing advanced customer, market and business intelligence capabilities.

Notable achievements in the 2011 include:

- Billing system upgrade successfully completed, new functionalities introduced;
- Bill Formatter project initiated to standardize Invoicing process for both mobile and fixed services and support future business needs (e.g. convergent invoice, bundled packages). Phase 1 (invoicing for mobile services) completed;
- Billing components (mobile services billing system) – completed database upgrade as prerequisite for the new functionalities and migration to a virtual infrastructure;
- MPC (Multi Project Control) system for monitoring, ordering and controlling services from suppliers / sub-contractors and optimization and automation of internal processes further implemented to meet new business requirements;
- DCC (Data Center Consolidation) – completed consolidation of infrastructure for T-HT's data centers, business applications were migrated to the new infrastructure;
- OSS systems further developed to improve and optimize related processes and enhance services and equipment quality control and monitoring;
- Significant focus on the implementation of regulatory requirements - depersonalization of traffic data implemented for Geneva system, RUO updated, naked ADSL naked MAXtv, ELR implemented. Wholesale Rental Line, standard broadband offer updated; shared services monthly fees amended;
- Support for innovative ICT services based on 'cloud computing' principles – Virtual Private Servers Hosting and Virtual Desktop (tCloud Računalo) services rolled out. New services designed and implemented: ICT for SME – LAN services, ICT for SME – desktop services. SaaS solutions offered to the customers: Cloud Fleet management, tCloud Human resources, tCloud ERP, tCloud CRM.

Data and IT Security

The protection of data relating to customers, sales partners, employees, shareholders and telecom traffic is a key priority for T-HT. Mediation systems for fixed voice services and mobile services are certified according to the international ISO/IEC 27001:2005 standard. Systems security improvements resulted from Customer Data Security Assessment in conjunction with DTAG. New IT/NT security policies were approved and 31 Security Requirement based on these policies were approved. Preparations for PCI DSS certification moved into the final phase.

III. Corporate Responsibility

Corporate Responsibility

The T-HT Group strives to attain high standards of corporate responsibility across all its business segments.

Our ambition is to promote sustainable development, define best practice for high quality communications, promote the growth of an information and knowledge-based society and take the lead in highlighting the importance of environmental protection.

The T-HT Group believes that a company's reputation is dependent on far more than simply the quality, price or particular features of its products and services. Of equal importance are attitudes towards employees, customers, suppliers and investors, towards the environment and the society in which it operates. T-HT frames its corporate responsibility policies around positive interaction with all its stakeholders across all sections of society.

In this comprehensive Corporate Social Responsibility report, T-HT Group aims to outline and articulate its strong sense of responsibility towards its stakeholders, who range from customers, employees and suppliers, along with the broader society within which the Group operates.

Key CR strategy areas

Work/life balance

Our business is predicated on enabling the optimal work/life balance. Our goal is to develop innovative telecommunications solutions and services that will improve everyday life through first-class communications and connectivity.

An information and knowledge-based society

We aim to provide widespread access to telecommunications services to foster the growth of the knowledge society. Our ambition is to ensure that advanced technologies are available on-demand to all.

Creating a low carbon society

Environmental protection is a key goal of our social responsibility initiatives, and specifically involves responsible use of resources and a lowering of greenhouse gas emissions.

Principles of socially responsible conduct

T-HT Group bases its everyday operations on the following corporate values: ethical conduct; customer focus; mutual respect; team work; delivery of best results in the most efficient way possible; open dialog and responsibility to all stakeholders; and creation of an environment where efforts are recognized and results are valued.

Dialog with stakeholders

The T-HT Group firmly believes in the importance of open and transparent communication with all its stakeholders. The Group continued to engage with key audiences using the medium of social networks in 2011. T-HT communicates now with customers on a range of networks including Facebook, Twitter, YouTube and Flickr on a daily basis, to provide support in addressing problems and receive feedback on our products and service.

Transparent communication with investors is of particular importance in order to articulate the Group's current status and potential, to enable them to reach a fair valuation.

T-HT does not provide financial support to political parties or campaigns. For several years, however, the Group has been supporting initiatives aimed at combating corruption and its consequences, e.g. Transparency International.

Business compliance

The operations of the Group are based on integrity and compliance. This involves adherence to the law, following best practice and observing internal and external regulations. The Business Compliance Department, which was formed in 2008, promotes ethical business dealing across the Group and implements an Anti-Corruption Policy. The policy is designed to deal with issues related to conflicts of interest and corruption that may arise during the course of business.

Code of Conduct

T-HT's Code of Conduct sets clear standards of business conduct and is based on the highest ethical principles. The Code includes policies governing such issues as the giving and receiving of gifts and the Group now undertakes an annual planning exercise. This is based on an assessment of the risk of (non) compliance, using a methodology that can assist in the early detection of inappropriate business conduct and allow an appropriate reaction.

Certificates

In 2007, T-HT joined the UN Global Compact initiative, which supports the fundamental social values within 10 principles of responsible business. In 2011, the T-HT Group reported, for the third time, on the implementation of these principles.

In February 2011, T-HT joined the Croatian Business Council for Sustainable Development (HR PSOR), an organization that brings together representatives of the Croatian economy who share knowledge and innovative ideas to promote a balance between commercial success, social welfare and environmental protection.

Oekom Research added T-HT to its Prime category, with respect to its standards of corporate responsibility and sustainable development policies, in 2008.

In 2011, T-HT was also included, for the third consecutive year, in the Vienna Stock Exchange's CEERIUS Sustainability Index for 2012. This rates shares in leading CEE region companies with respect to social and environmental, as well as economic, performance.

Also in 2011, T-HT's Telecom Infrastructure Services Sector was awarded the Charter for Promotion and Implementation of Quality in the Croatian Economy by the Croatian Society for Quality.

Corporate responsibility

Our goal is to lead the way in corporate responsibility, and we are committed to sustainable and responsible activities at every point along the entire value chain. Our business activities are guided at all times by responsibility towards society, the environment, our employees, our customers and our suppliers.

Responsibility towards society

The T-HT Group regularly cooperates with educational, cultural and scientific institutions, non-governmental organizations - especially those that focus on people with special needs and the disadvantaged, and organizations that promote the values of a civil society. Most projects are long-term initiatives, to ensure that they have a real impact. At the same time, employees of the Group also become personally involved in a number of projects. In this way, both the Group and its people participate directly in charitable works.

UNICEF

T-HT Group was UNICEF's first partner in Croatia, and we have built a strong relationship with the organization across the past seven years. In 2011, donations by T-HT supported the development of a new national model of early childhood intervention that, for the first time, puts the family at its centre. It also provides support to children with developmental issues. Alongside its corporate donation, T-HT has also provided a system whereby customers can also contribute to this valuable UNICEF project.

Another initiative the Group supported in 2011 was the Children's' Rights Festival, which provided access to both sight and hearing impaired to enjoy a rich festival program including Croatian and international films.

"Zajedno smo jači" (Together we are stronger)

"Zajedno smo jači" (Together we are stronger) is an initiative that gives a key role to T-HT's employees in suggesting and selecting the charity projects to which the Company awards funds. In 2011, the sixth year of the initiative, 24 projects were chosen from 294 applications received from all over Croatia. T-HT donated a total of HRK 775,000 to these projects. Recipients of these donations included medical institutions and institutions working with the disabled, the elderly and with children.

060 numbers - charity action support

In 2011, T-HT continued to support other charity campaigns by providing telephone lines to allow the public to make contributions, an activity it has engaged in since 2001. Campaigns and organizations assisted in this way in 2011 included the Ana Rukavina Foundation, “Društvo Naša djeca Vinkovci” (Our Children Association Vinkovci), Nada Vrbovec Association, the Autonomous Women’s House Zagreb and “Dva skalina” (Two Steps Association). T-HT donated all proceeds from these initiatives to the causes concerned, raising a total of HRK 3.6 million for charity.

e-Etiquette for social networks

T-HT compiled the first Croatian handbook for appropriate behavior on social networking sites, or e-Etiquette. The handbook defines formal and non-formal rules of conduct for Facebook, Twitter and other social networks. The Handbook has arisen from the rapid development of social networking in Croatia, which has outpaced the establishment of any framework for facilitating communication and understanding of the medium.

The handbook was compiled from submissions by everyday users of social networks and selected by an expert committee. The release of the e-Etiquette handbook coincided with three key anniversaries for T-HT in its communications history: 130 years of providing fixed telephony services; 20 years of mobile telephony; and five years of Internet TV.

Knowledge society

“Znanjem rastemo” (Growing through Knowledge) conference

In September 2011, T-HT held its fourth “Znanjem rastemo” (Growing through Knowledge) conference in Zagreb. The Group invites speakers to stimulate debate across society, academia and the business community and media, as well as its employees and customers. Guest speakers in 2011 were Nassim Nicholas Taleb, Ph.D., whose research focuses on issues such as happiness, risk, randomness, human error, probability and the philosophy of knowledge, and Amber Case — a cyber anthropologist who examines the way humans and technology interact and evolve together.

Support to expert conferences

T-HT also demonstrates its key role in developing the knowledge society through support it provides to gatherings of scientific experts such as WinDays 2011, the MIPRO Conference, the Combis Conference, the Cisco Conference, the Imagine Cup 2011 project, the Telecom Arena, the ICT Arena and other key thought leadership events related to the telecommunications sector and its communities.

In addition, T-HT provided financial support, for the sixth consecutive year, to the Mediterranean Institute for Life Sciences.

The Group has also provided infrastructure, technical support and equipment to a number of local and international forums and conferences.

Cooperation with the academic community

T-HT’s has a long-standing cooperation agreement with the Faculty of Electrical Engineering and Computing (FER), which originated in November 2006 with the Frame Contract on Cooperation in Scientific-Research and Development Activity, with a view to promoting transfer of knowledge and ideas between science and the economy.

T-HT also works closely with the Faculty of Law in Zagreb and it plans similar agreements with other faculties and universities, which in return offer a rich source of potential future recruits.

Scholarships

The Group announced the T-HT scholarship competition in 2011, an extension of a former T-Mobile project. Under the scheme, scholarships were awarded to six undergraduates, selected from the top candidates from the Faculty of Electrical Engineering and Computing in Zagreb, who have achieved excellent results at university, and also display a broad range of interests and participation in extracurricular activities.

Another scholarship is the “Korak u život” (Step into Life), organized by the Rotary Club Zagreb Kaptol, under which T-HT has awarded scholarships to five students who lack adequate parental support to fund further educational opportunities.

Culture

Museum of Contemporary Art
T-HT has been the primary partner of the Museum of Contemporary Art (MSU) since 2007. This partnership continued into 2011 with the annual award for the best Croatian contemporary work of art. T-HT provides telecommunications services to the museum alongside financial assistance.

T-HTnagrada@msu.hr
The fourth T-HTnagrada@msu.hr, one the most prestigious annual awards in the field of contemporary art in Croatia, was held in 2011, and a record number of art works were submitted. An international jury selected the winning submissions which, this year, were purchased and included in T-HT's collection, on show in the new building of the Museum of Contemporary Art.

Theatres
T-HT continued its tradition of sponsoring Croatian national theaters in Osijek, Split, Rijeka and Varaždin and the Gavella City Drama Theater in Zagreb. The "Špancirfest" street festival and Varaždin Baroque Evenings were supported through sponsorship of the City of Varaždin.

Film festivals
In 2011, T-HT supported a number of film festivals: the Pula Film Festival, the Vukovar Film Festival, Zagrebdox, the Zagreb Film Festival, Film Mania and the Forum Film Zadar.

The roman@tportal.hr prize
Tportal ran its fourth competition for the roman@tportal.hr literary prize worth HRK 100,000.

T-Mobile INmusic Festival
In 2011, T-Mobile supported the INmusic Festival for the third time. This is Croatia's largest open-air festival and it showcased more than 40 international and local performers on six stages. British daily newspaper The Times rated T-Mobile's INmusic Festival among the top 20 festivals in Europe.

Electronic Beats Festival
T-HT supported the first ever Electronic Beats Zagreb Festival, which attracted 1,500 visitors who enjoyed performances by some of the hottest performers on the current electronic music scene.

Sport

Croatian Olympic Committee
The T-HT Group continued its long-standing cooperation with the Croatian Olympic Committee, as its main sponsor, thus linking T-HT's values with the Olympic Games principles of fair competition, persistence and the pursuit of excellence.

MAXtv Premier League
In 2011, MAXtv launched exclusive broadcasts of Croatia's Premier Football League matches. The cooperation between MAXtv and the Croatian Premier Football League brings premium production quality and shows top-flight Croatian football matches on new interactive platforms. T-HT also sponsors the Croatian Premier Football League.

Sportske igre mladih (Youth Sports Games)
T-HT is a long-standing sponsor of the Youth Sports Games, the largest amateur sports event in Croatia. In 2011, more than 80,000 competitors from 7 to 18 years old came together to compete in 10 sports. The event is underpinned by a strong anti-drugs, anti-alcohol and anti-violence message.

Responsibility towards employees

Against a backdrop of economic crisis, the key challenge facing T-HT has been maintaining investment in employee development, to ensure a workforce that is motivated to provide quality customer service and maintain the competitiveness of Group. At the end of 2011, the Group had 6,032 employees (full-time equivalent).

Career development

The Group introduced a career development plan for managers (StepUP!) in 2006. This has now been reinforced by career development program for all employees (GoAhead), introduced in 2011. Under this plan, the most promising employees are offered additional opportunities for career development such as transfer to another business area, international experience, or other career development initiatives.

Management career development

In 2011, the management development initiative was based around mutual sharing of knowledge and experience. Programs were created with the aim of increasing manager competencies by learning from colleagues. Managers participated in the "Closer to the Customer" program, which included training at points of sale, call centers or field visits with technicians. They were also provided with opportunities to improve management skills through experience sharing sessions, facilitated by a professional coach.

Project management career development

With the need for high quality project management paramount, T-HT introduced a career structure for project managers, giving access to wider range of career development opportunities. Employees who opted for this career path have been given clearly defined progress and development criteria, as well as opportunities for acquiring highly regarded project management qualifications.

Knowledge on Thursdays

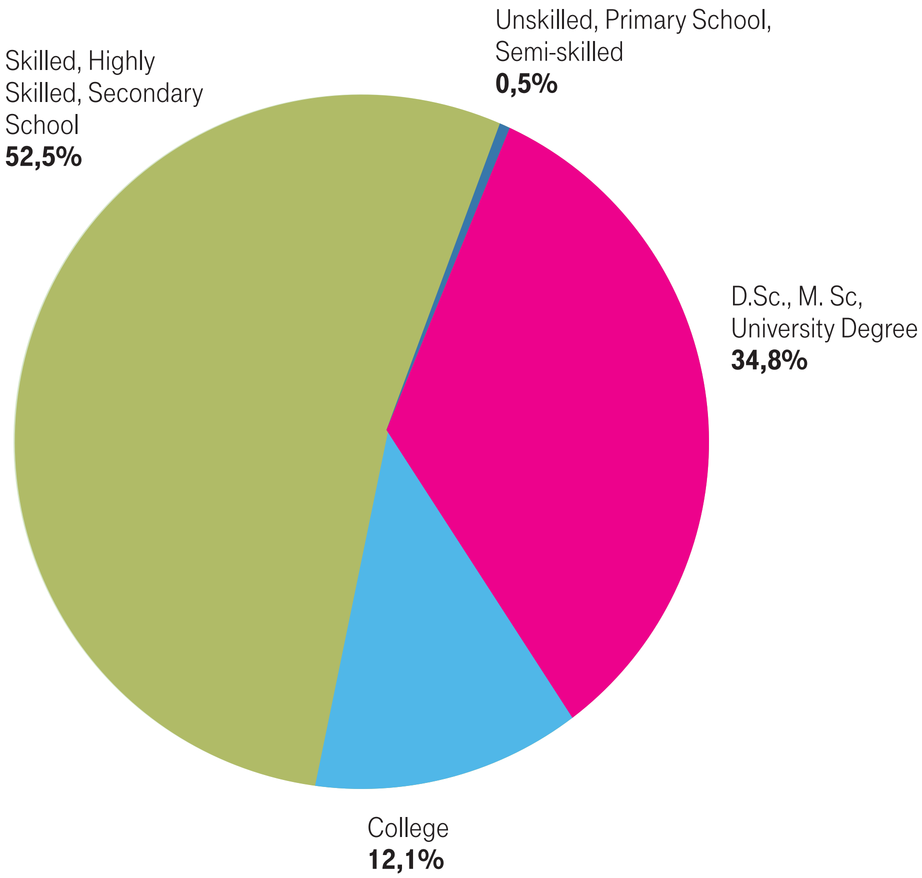
The Group continued its "Knowledge on Thursdays" lectures throughout 2011. Experts from varying parts of the business shared knowledge and experience with colleagues on topics including the network, new technologies, products and services, energy consumption, customer satisfaction, legal issues, data protection and security and business compliance.

Additional employee benefits

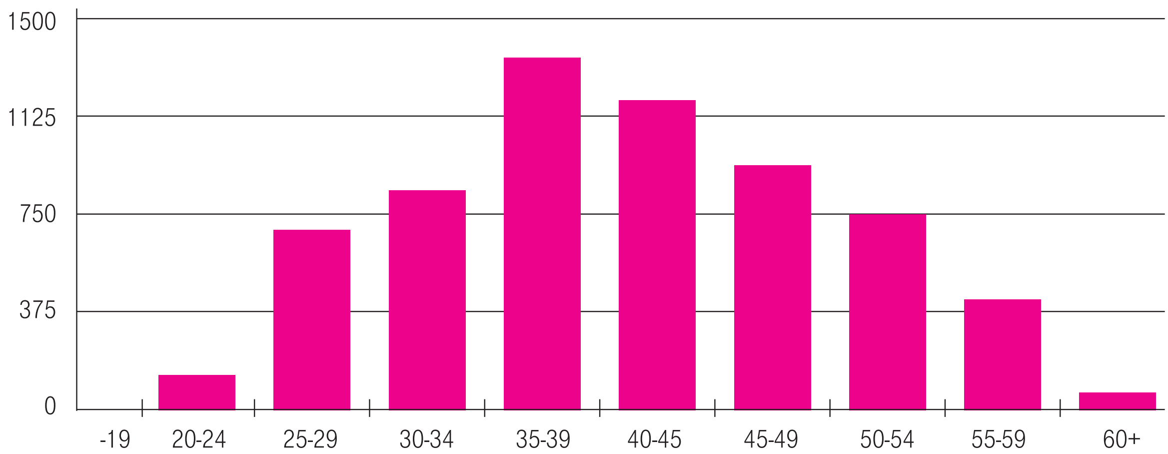
HT provides a range of benefits aimed at promoting health and wellbeing, including a free annual medical check-up and the opportunity to participate in a range of cultural and sports activities funded by the Company. The Company also offers incentives to join the HT pension scheme.

HT's respect for diversity and equal opportunities is clearly exemplified by the proportion of women holding senior management roles within the Company, which is above the national average.

Full time employees by education



Age structure in T-HT, end of 2011.



Responsibility towards the customers

Customer care

Customer care and satisfaction are the key focus of HT's Call Center activities. Its agents are ready to answer all questions or provide support on a 24/7 basis, by phone, e-mail, postal mail and fax. The Call Centre plays a key role in the maintenance of good relations with customers. Besides providing information, it also sells products and services tailored to customers' individual needs.

Monitoring customer satisfaction

T-HT continuously monitors customer satisfaction and loyalty, using the TRI*M methodology. This enables T-HT to evaluate the efficiency of business processes within the Group and identify where improvement is required.

Responsible approach to customers

T-HT tailors its services to take into account the varying needs of its customers' needs, as evidenced by special discounts, shops accessible to disabled people, special packages for customers on low incomes, services for young people, discounts granted to Croatian Homeland War disabled veterans, the MAXtv parental protection, protection for Internet users and various billing options such as web billing, voice billing and e-billing. In addition, T-HT complies with the Code of Advertising Standards, which prescribes advertising rules and principles.

Advanced technology available to all

As leader and innovator in the Croatian telecommunications market, T-HT continues to invest in the development of innovative technologies, broadband, IPTV and LTE technology. T-HT was the first operator in Croatia to offer the opportunity to test the most advanced LTE network, which provided up to 10 times higher data transmission rates.

tCloud
In 2011, the Group also started offering new and innovative services in the cloud. The tCloud Računalo (tCloud Computing) service enables business customers to use a virtual IT infrastructure without the cost of IT equipment – and it also saves energy. For residential customers, Spremalica (Data Storage) and Sinkronizacija podataka (Data Synchronization) services, provide easy and secure online storage and content sharing capabilities.

Planet9
T-HT's Planet9 online bookshop and Planet9 e-book reader enables access to a virtual library at any time and any place.

MAXtv To Go
T-HT's Internet TV offering has been expanded with a new service called MAXtv To Go. This enables viewers to watch MAXtv on the move, via mobile handsets and computers, and on additional screens at home.

HotHot
HotHot, the first local geo-location application in the Croatian language, gives smartphone owners an easy and practical overview of attractive consumer offers in the vicinity.

Responsibility towards the suppliers

T-HT implements a Sustainable Procurement Program for the purchase of products and services within the entire Group. The Group endeavors to obtain optimal value whilst considering factors such as price, quality, availability and functionality, the impact of product and/or service on the environment, social aspects, working conditions and human rights.

The Sustainable Procurement Program includes supply chain management with regard to social and ecological risks and the possibility of long-term benefit for the Company, supplier selection under clearly defined minimum standards (including Social Charter or International Labor Organization conventions), and regular checks to ensure compliance.

Responsibility towards the environment

Afforestation of fire affected areas

T-HT continued with its project of afforestation of areas affected by fire for the fourth consecutive year, with direct investments into extensive, ecologically important areas. In 2011, the project planted 27 hectares of burned forest area with seedlings of aleppo pine, cypress and pine trees. T-HT employees also joined the project as volunteers 2011.

Promoting ecological awareness in T-HT

T-HT has striven to encourage a strong understanding of environmental issues amongst its staff. To this end, 2,000 employees undertook an online course about environmental protection and more than 250 employees, whose daily work duties can significantly impact the environment, attended lectures about environmental protection.

T-HT's car fleet totals around 220 LPG operated vehicles. LPG is considered the most environmentally friendly motor fuel. To encourage employees to use LPG, T-HT has devised a system for awarding the most environmentally aware drivers.

Ecological disposal of used mobile devices

Since 2005, when organized collection and recycling of used mobile phones started, T-HT has assisted in the disposal of more than 111,000 mobile phones. Alongside the regular collection of used devices in T-Centers, the focus in 2011 was on raising public awareness about the importance of this activity. A successful ecological and education project aimed at collecting old mobile devices was completed in cooperation with the elementary school "Jure Kaštelan" in Zagreb.

T-HT also partnered a project for collecting used mobile devices called "S manje gnjavaže do reciklaže" (Hassle-Free Recycling), undertaken by students of the Faculty of Economics and Business.

Implementation of green technologies

As the only telecommunications company certified under the ISO 14001 Environmental Management Standards, T-HT focused on the implementation of green technologies in telecommunications.

Energy efficiency

The mobile, fixed and Internet networks present an immense challenge in terms of electric power consumption and energy efficiency. Every new service, subscriber increase and network development leads to greater energy requirements. T-HT launched a project to promote energy efficiency at corporate level. The main initiatives here include efficient air conditioning and power supply systems, modernization of telecommunications equipment, optimization of the real estate portfolio and renewal of property owned by T-HT according to energy efficiency principles, more extensive use of IT resources along with a range of other activities that can contribute to more economical consumption of energy.

Role of ICT in environmental protection

Given the increasingly important role that technology plays in environmental protection, in 2011 T-HT representatives participated in a workshop on sustainable development and green ICT within a MIPRO conference. T-HT also provided keynote speakers at the 68th International Session of the European Youth Parliament, addressing the topic of climate change before the Committee on Industry, Research and Energy. The Company also participated in the largest global initiative against climate change called – the "Earth Hour".

Certification and membership

T-HT has held the ISO 14001 certificate for environmental protection since 2010. In June 2011, the ISO 14001 audit was successfully completed, which confirmed the integration of environmental protection in all processes and the work of all employees according to the prescribed level, and that all employees are aware of the importance of environmental protection.

T-HT is also a member of the European Telecommunications Network Operators' Association (ETNO) and a signatory to the Environmental Protection Charter and Sustainable Development Charter.

Corporate responsibility within affiliated companies

Combis

At Combis, the key focus is on the promotion of excellence and social development. In 2011, Combis supported, through donations and sponsorships, a range of projects in the arenas of education, sport, health and culture.

In 2011, Combis financially supported young information scientists from V. High School in Zagreb and made it possible for them to participate in the final round of the International IT Competition in the USA.

Combis also recognized the work and innovation in sustainable development conducted at the Faculty of Engineering, University of Rijeka, by a team of young engineers who are working on the design and production of electric car and plug-in stations.

As part of its efforts to promote education Combis also supported the “Prijatelji talenata” (Talents’ Friends) fund which provides financial support to talented and needy students.

Combis also promotes sport and health. In 2011, it supported athletes both young and old. For the young sporting stars of the future, Combis assisted with the purchase of jerseys for participants in the Youth Academy of Trnje Football Club, which brings together more than 200 children. More established athletes benefited from Combis’ support for the top event of the athletic season in Croatia – the IAAF World Challenge Zagreb, also known as the Boris Hanžeković Athletic Meeting.

In the realm of urban culture, Combis supported “Crtani Romani Šou” (Comics Show) association and became the exclusive ICT partner of the 14th International Comics Festival, which took place in November in Zagreb.

Combis also supports those most in need, working alongside the Croatian Rotary Association and a project of providing assistance to mine victims to provide first aid and medical care, physical rehabilitation, psychological support and social reintegration, as well as professional and economic rehabilitation.

Combis traditionally supports industry events, and its sponsorship activities included Cisco Expo partner conferences, Microsoft WinDays conference, IBM Forum, Oracle - The Information Age in Zagreb, Sarajevo and Beograd, ICTI – International Conference of the Information and Communication Technology and Security and IDC Cloud Computing Roadshow conference in Budapest.

For the fifth time, in 2011 Combis organized the Combis conference in Opatija, which gathered more than 300 participants from Croatia and the region, from the area of finance and telecommunications, state administration, and industry. Under the umbrella topic ‘Competence. Excellence’, the top ICT experts gave lectures, presentations, and case studies, sharing knowledge and experience and thus contributing to the development of competence and business excellence.

Iskon

Throughout 2011, Iskon supported a number of social and cultural projects. Iskon was the sponsor of telecommunications services at the Motovun Film Festival and also sponsored the Best Short Film award - “Motovunski kratki” - for the third consecutive year. Iskon also made available to users of Iskon.TV all films that were shortlisted for the award on the eve of the Festival.

Iskon has been partner of the Croatian National Football Team and sponsor of the “Uvijek vjerni” (Always Faithful) fan club for ten years. With the signing of a new contract with the Croatian Football Federation in 2011, the cooperation was extended for another two years. In the upcoming period, Iskon will continue to be the official internet provider of the Croatian Football Federation and provide hosting and maintenance of the Croatian Football Federation web pages, as well as hosting of the web page of the “Uvijek vjerni” (Always Faithful) fan club.

In 2011, Iskon also extended its cooperation with the table tennis club HASTK Mladost Iskon.

In 2011, Iskon was the official sponsor of telecommunications services at the ATP Zagreb Indoors and Zagreb Open tennis tournaments, for the third consecutive year.

In 2011, the first augmented reality exhibition was held in Croatia, organized by Zagreb Art Kolektiv (ZARK), under the sponsorship of Iskon. In augmented reality certain models, photographs or video content are placed within the physical world using QR code, and then observed via mobile handset screens. The works of art were displayed on several locations in Zagreb.

In 2011, Iskon also supported the CARNet annual conference CUC (CARNet Users Conference), the international convention on information and communications technology, electronics and microelectronics MIPRO and KOM, a conference on electronic communications technologies and standards in IT.

Financial review 2011

T-HT Group Financial Results
Analysis of Segment Results

Group Financial Performance

Financial Result of the T-HT Group

Revenue

Throughout 2011, Group revenue was again impacted by the recession and special taxation measures that were adopted in response to it. Despite growth in the ICT business (classified as other service revenue), total revenue fell 3.6% to HRK 8,067 million (2010: HRK 8,372 million).
This revenue decline was primarily driven by lower voice revenue due to a highly competitive market, downward pricing pressure, a challenging economic environment and a tightening of the regulatory regime. The fall was offset to a degree by an increase in non-voice (data and broadband segment) and other service revenue (ICT segment).

Operating Expenses

Overall operating expenses fell 4.1%, or HRK 201 million, to HRK 4,749 million (2010: HRK 4,950 million), as a result of tight cost controls and lower costs related to lower usage and reduced interconnection fees.
Material expenses decreased by 6.4% to HRK 2,175 million, on a slight decline in Merchandise costs, down 0.9% to HRK 1,034 million, and a reduction in Services costs by 10.9% to HRK 1,141 million, mostly as a result of lower telecommunication services costs. At the same time, copyright fees rose as a result of growth in the Group's pay-TV subscriber base.
Total employee benefits increased by 8.2% to HRK 1,296 million as a result of higher redundancy provisions booked in 2011 (HRK 162 million vs HRK 31 million in 2010). Excluding redundancy costs, total employee costs fell by 2.9%, mainly due to a reduced number of employees resulting from the Group's ongoing program to rationalize business processes and drive efficiency improvements.
Other costs fell by 8.9% to HRK 1,292 million, primarily due to lower maintenance and advertising expenses.
The write-down of assets decreased significantly, by 41.4% to HRK 67 million, owing to better collection of unpaid bills supported by improved dunning procedures and legislation, while depreciation and amortization remained level with 2010 at HRK 1,414 million.

T-HT Group Profitability

While revenue fell 3.6%, EBITDA rose by 2.4% to HRK 3,782 million, before exceptional items of HRK 162 million, to give a 46.9% EBITDA margin (2010: HRK 3,694 million, 44.1%) on the back of a rise in other operating income and lower operating expenses. Operating profit (EBIT) fell 1.8% to HRK 2,205 million (2010: HRK 2,246 million), as a result of higher redundancy costs.
Net profit for 2011 was HRK 1,811 million, down 1.1% (2010: HRK 1,831 million), mainly as a result of higher redundancy expenses.

Balance Sheet

T-HT's balance sheet remains strong with total assets of HRK 13,136 million, down 2.9% (2010: HRK 13,529 million), mainly as a result of lower network investments.
Total non-current assets decreased to HRK 7,461 million at 31 December 2011 from HRK 8,008 million at 31 December 2010, due to lower investment in broadband access and core infrastructure.
An increase in total current assets to HRK 5,675 million at 31 December 2011from HRK 5,521 million at 31 December 2010 was due largely to a stronger cash position as a result of a lower dividend payment compared with 2010.
Total issued capital and reserves decreased to HRK 11,019 million (2010: HRK 11,054 million), due to lower net profit in 2011. At 31 December 2011, cash and cash equivalents stood at HRK 3,704 million, compared with HRK 3,282 million at 31 December 2010.

Cash Flow

Cash flow from operating activities is T-HT's principal source of funds, enabling the Group to finance capital investments and dividend distributions. Cash flow from operations decreased by 8.5% to HRK 2,988 million (2010: HRK 3,266 million), mostly as a result of lower current liabilities driven by a reduced volume of purchases and lower capex realization.

Capital expenditure

Capital expenditure in 2011 (HRK 877 million) was down on 2010 by 23.9%, largely due to the slower realization of backbone and backhaul projects and the reprioritization of real-estate related projects.

The Residential segment saw slightly higher capital expenditure in 2011, primarily as a result of the change in treatment of Consumer Premises Equipment (CPE) from OPEX to CAPEX in the second half of 2010, and as a result of increased capital expenditure related to IT.

Business segment capital expenditure rose in 2011, due in large part to increased investments in business-related IT solutions as well as a change in the treatment of CPE equipment and increased investment in Group subsidiaries.

Capital expenditure in the Network and Support Functions segment was lower in 2011, mostly due to the slower realization of backbone and backhaul projects.

Analysis of segment results

Business units: Residential and Business

On 1 January 2010, the former divisions of T-Com and T-Mobile, serving the fixed and mobile markets respectively, were replaced by a new structure based on the Residential and Business segments. Starting from the first quarter of 2011, segmental reporting was introduced along these lines. In its financial reports, the Group's segments are reported by contribution to EBITDA level.

Residential Segment Financial review

Revenue

Total residential revenue in 2011 fell 4.4 % to HRK 4,433 million, largely on lower voice revenue both in mobile and fixed.
This revenue trend has been driven by the slow economic recovery in Croatia, regulatory tightening and intensifying competition. Revenue was supported by one-off benefits, the revaluation of points related to a mobile loyalty program, the change of useful life of customer relationship and termination of a fixed loyalty program.

Voice revenue

Voice revenue at the end of 2011 was down 12.6% at HRK 2,582 million. Retail mobile voice revenue fell as a result of a highly competitive market, downward pressure on pricing and a harsh economic environment. In addition, voice mobile termination revenue was lower following reductions in termination rates. Mobile minutes of use (MOU) per average subscriber remained largely flat, so the revenue decline was the result of lower average revenue per usage (ARPU) arising from the tough economic environment. Fixed telephony revenue fell due to the continuation of fixed to mobile substitution, fixed to internet substitution, stronger competition and new regulation (such as WLR and naked ADSL regulation), leading to a 12.0% fall in the number of mainlines and a 10.2% decline in minutes of use. As a result of lower minutes spent and downward pricing pressure, voice average revenue per access (ARPA) declined by 5.7%.

Non voice revenue

Non voice revenue rose 6.1%, to HRK 1,500 million as a result of higher revenue from fixed services. Mobile services fell 7.2% to HRK 461 million mainly in prepaid segment, affected by economic crises and competitiveness that resulted with price decreasing. In comparison with last year there is visible lower revenue from messages services that could not be compensated with data revenue growth. Fixed non voice (IP) revenue was boosted by a 2.9% increase in ADSL mainlines and a 12.3% rise in TV subscribers. ADSL ARPA fell 3.1%, mostly due to stronger marketing and promotional offers for ADSL access and usage.

Other service revenue

Other service revenue rose 189.7% to HRK 182 million as a result of higher revenue from usage bundle tariffs.

Terminal equipment

A decline of 19.3% to HRK 153 million in terminal equipment revenue was caused primarily by the prepaid segment, as investments in prepaid customers were reduced in 2011 through offering a more affordable range of handsets.

Contribution to EBITDA

In 2011, the Residential segment contribution to EBITDA totaled HRK 3,025 million, up 1.0%, primarily driven by 14.3% decrease in operating expenses. Lower operating expenses were largely the outcome of lower usage and non usage related direct costs. Lower usage related direct costs were the consequence of lower termination and roaming prices.

On the other hand, lower non usage related direct costs were caused by lower merchandise costs, as a result of different treatment of CPE equipment in the fixed business and lower investments in prepaid customers in mobile. Sales commission costs were also lower as a result of lower acquired and retained customers in the mobile business. Additionally, losses on accounts receivable were significantly reduced, as a direct benefit of better collection of unpaid bills, especially in the mobile segment. Copyright fees increased on the previous year, as a result of a 12.3% increase in payTV subscribers and expanded content offers such as MAXtv Premier League football and Formula 1. Indirect costs were lower than in 2010 as a result of savings initiated throughout the year to optimize and improve efficiency.

Business Segment Financial review

Revenue

In 2011, total business revenue fell 2.7 % to HRK 3,635 million. This fall was largely the result of lower voice revenue in mobile and in the fixed network. Revenue in 2011 was supported by one-off benefits including the revaluation of points related to a mobile loyalty program, change of useful life of customer relationship and termination of a fixed loyalty program.

Voice revenue

Voice revenue fell 12.2%, to HRK 1,763 million. The fall was largely driven by a 10.0% decline in fixed retail voice revenue (HRK 75 million), largely driven by a fall in total minutes in traditional voice (-17.5%). This resulted in part from a decrease in total traditional voice mainlines (-11.4%) and from the migration to mobile voice. Fixed wholesale voice revenues fell 16.9% (HRK 61 million), due to NRA (Regulator) intervention in the form of lower interconnection prices from 1 January 2011. Voice services revenues from international operators fell by HRK 29 million, primarily as a result of lower traffic. Mobile voice revenues were 12.2%, or HRK 110 million, down at HRK 789 million, with retail accounting for a HRK 75 million fall and wholesale for a HRK 35 million decline. The HRK 48 million mobile voice revenue fall was mainly driven by lower voice ARPU (-8.9%) and lower average minutes per subscriber (-5.0%). A 4.4% increase in subscribers partially offset the revenue decline. Voice mobile termination revenue fell by 22.6%, or HRK 26 million, to HRK 90 million due to lower termination prices introduced by the NRA. A 17.2%, or HRK 35 million, fall in visitor voice revenue to HRK 170 million was driven by discounts as a result of new agreements with operators.

Non voice revenue

Non voice revenue fell 2.6%, to HRK 1,095. Fixed non voice revenue was 2.0% lower at HRK 787 million, as a result of a fall in retail revenue of 5.1%, which was partially offset by an increase in wholesale 3.8%. Fixed retail revenue decreased, on lower revenue from traditional data, which declined 17.8% owing to the migration to IP data, while the IP revenues remained flat. Non voice fixed wholesale revenue rose 3.8%, or HRK 11 million, to HRK 289 million. This was boosted by higher revenue from infrastructure, mostly because of WLR (Wholesale Line Rental) activations and international GIA (Global Internet Access). National leased lines revenue was lower, however, due to migration to new commercial models and cancelation of capacities. Non voice mobile revenue fell 4.1%, or HRK 13 million, to HRK 308 million. Retail accounted for HRK 213 million of the totals, driven by mobile data, while visitor revenue declined by HRK 20 million, or 17.3%, to HRK 95 million as a result of new agreements with operators.

Other service revenue

Other service revenue rose 61.6%, or HRK 230 million, to HRK 606 million. This was primarily due to growth in the ICT segment following the acquisition of Combis (consolidated as of May 2010), and more proactive efforts to win ICT business.

Terminal equipment

Revenue from terminal equipment was down 6.6% to HRK 60 million, with fixed falling 57.9%, or of HRK 4 million, to HRK 3 million, while mobile was flat to the previous year.

Miscellaneous revenue

Miscellaneous revenue decreased by 31.5% or HRK 51 million, to HRK 110 million. The decline was driven in large part by mobile. In retail, disconnection fee revenue was reclassified as service revenue from the start of 2011, decreasing revenue by HRK 15 million. Mobile wholesale miscellaneous revenue decreased by 25.6%, or HRK 37 million, to HRK 107 million, due to lower national roaming (NR) prices and lower usage.

Contribution to EBITDA

The Business Segment contribution to EBITDA fell 5.8%, to HRK 2,287 million, driven largely by a HRK 99 million revenue decline. Operating expenses rose on higher merchandise costs, which were up 26.9% to total HRK 492 million, mainly due to merchandise costs from the Combis ICT business. Indirect costs were up 12.0%, or HRK 35 million, at HRK 327 million, due largely to the contribution of Combis. Interconnection costs in 2011 were down 18.9%, or HRK 107 million, at HRK 459 million.

Network and Support Functions Financial review

Contribution to EBITDA

Contribution to EBITDA rose by 11.6% to HRK -1,530 million. This is a result of higher other operating income by HRK 61 million and lower operating expenses by HRK 139 million.
Other operating income rose by 25.3% to HRK 301 million primarily driven by increase in revenue from charging of dunning letters and increase in revenue from provisions release.
Operating expenses fell by 7.0% to HRK 1,831 million from HRK 1,970 million. This drop was result of lower maintenance and advertising expenses.

Consolidated financial statements 31 December 2011

Responsibility for the consolidated financial statements

Pursuant to the Croatian Accounting Act in force, the Board is responsible for ensuring that consolidated financial statements are prepared for each financial year in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) which give a true and fair view of the financial position and results of the Group for that period.

The Board has a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. For this reason, the Board continues to adopt the going concern basis in preparing the consolidated financial statements.

In preparing those consolidated financial statements, the responsibilities of the Board include ensuring that:

- suitable accounting policies are selected and then applied consistently;
- judgments and estimates are reasonable and prudent;
- applicable accounting standards are followed; and
- the consolidated financial statements are prepared on the going concern basis unless it is inappropriate to presume that the Group will continue in business.

The Board is responsible for keeping proper accounting records, which disclose with reasonable accuracy at any time the consolidated financial position of the Group and must also ensure that the consolidated financial statements comply with the Croatian Accounting Act in force. The Board is also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The accompanying consolidated financial statements were approved for issuance by the Management Board on 6 February 2012.

Hrvatski Telekom d.d.
Savska cesta 32
10000 Zagreb
Republic of Croatia

6 February 2012

On behalf of the Group,

Ivica Mudrinić
President of the Management Board

Independent auditor's report

To the shareholders and Board of directors of Hrvatski Telekom d.d.

We have audited the accompanying consolidated financial statements of Hrvatski Telekom d.d. and its subsidiaries (the 'Group') which comprise the consolidated statement of financial position as at 31 December 2011 and the consolidated statements of comprehensive income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2011, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Emphasis of matter

Without qualifying our opinion, we draw attention to Notes 11 and 27 b) to the consolidated financial statements, which describe the uncertainty related to the ownership of distributive telecommunications infrastructure (DTI) of which the net book value recognised as assets by the Group as at 31 December 2011 is HRK 885 million. Efforts are being undertaken by the Group to obtain certain legal documents and registrations necessary to fully evidence the Group's ownership of these assets. The Group is defending a lawsuit claiming ownership of DTI in the city of Zagreb together with a demand for payment of HRK 390 million plus interest in respect of the Group's use of these assets in prior years. The Group has not recognised any adjustments to its assets and liabilities in respect of these matters due to the uncertainty as to their outcome and their impact on the financial statements.

PricewaterhouseCoopers d.o.o., 6 February 2012

John M. Gašparac
Procurator

Tamara Mačašović
Statutory auditor

Consolidated statement of comprehensive income

For the year ended 31 December 2011

	Notes	2011 HRK millions	2010 HRK millions
Rendering of services		7,765	8,155
Sale of goods		302	217
Revenue	3	8,067	8,372
Other operating income		301	240
Merchandise, material and energy expenses		(1,034)	(1,044)
Service expenses	4	(1,141)	(1,281)
Employee benefits expenses	6	(1,296)	(1,198)
Work performed by the Group and capitalised		81	105
Depreciation, amortization and impairment of non-current assets	5	(1,414)	(1,415)
Other expenses	7	(1,359)	(1,533)
Total operating costs		(6,163)	(6,366)
Operating profit	3	2,205	2,246
Interest income		83	71
Financial costs		(48)	(55)
Net financial income		35	16
Net share in investments in associate and joint venture	12,13	15	13
Profit before income tax		2,255	2,275
Income tax expense	8	(444)	(444)
Profit for the year		1,811	1,831
Other comprehensive income for the year			
Change in value of available for sale financial assets		(2)	2
Actuarial gains and other income (expense)		19	(3)
Other comprehensive income for the year, net of tax		17	(1)
Total comprehensive income for the year, net of tax		1,828	1,830
Earnings per share - basic and diluted, for profit for the year attributable to ordinary equity holders of the Company	9	HRK 22.12	HRK 22.36

The accompanying accounting policies and notes are an integral part of these financial statements.

Consolidated statement of financial position

As at 31 December 2011

	Notes	31 December 2011 HRK millions	31 December 2010 HRK millions
ASSETS			
Non-current assets			
Intangible assets	10	999	1,162
Property, plant and equipment	11	5,953	6,336
Investments in associate and joint venture	12, 13	395	380
Available-for-sale financial assets	14	39	42
Other non-current receivables		23	24
Deferred income tax assets	8	52	64
Total non-current assets		7,461	8,008
Current assets			
Inventories	15	175	216
Trade and other receivables	16	1,307	1,423
Prepayments and accrued income		126	110
Income tax prepayments		-	25
Available-for-sale financial assets	14	323	463
Time deposits	17 b)	40	2
Cash and cash equivalents	17 a)	3,704	3,282
Total current assets		5,675	5,521
TOTAL ASSETS		13,136	13,529

The accompanying accounting policies and notes are an integral part of these financial statements.

	Notes	31 December 2011 HRK millions	31 December 2010 HRK millions
EQUITY AND LIABILITIES			
Issued capital and reserves			
Issued share capital	22	8,189	8,189
Legal reserves	23	409	409
Fair value reserves		(3)	(1)
Retained earnings	24	2,424	2,457
Total issued capital and reserves		11,019	11,054
Non-current liabilities			
Provisions for legal claims and other provisions	21	114	101
Employee benefit obligations	19	157	192
Deferred income	20	2	74
Other long-term liabilities		32	43
Total non-current liabilities		305	410
Current liabilities			
Trade and other payables	18	1,347	1,473
Provisions for redundancy	6	169	133
Other accruals	25	116	196
Income tax payable		20	-
Deferred income	20	151	250
Short term borrowings		9	13
Total current liabilities		1,812	2,065
Total liabilities		2,117	2,475
TOTAL EQUITY AND LIABILITIES		13,136	13,529

The accompanying accounting policies and notes are an integral part of these financial statements.

Signed on behalf of HT Group on 6 February 2012:

Ivica Mudrinić

Dr. Sc. Dino Ivan Dogan

Consolidated statement of cash flows

For the period ended 31 December 2011

	Notes	2011 HRK millions	2010 HRK millions
Operating activities			
Profit before income tax		2,255	2,275
Depreciation, amortization and impairment of non-current assets	5	1,414	1,415
Interest income		(34)	(8)
Loss on disposal of assets		6	2
Share of profit in joint venture	13	(15)	(11)
Decrease in inventories		41	39
Decrease/(Increase) in receivables and prepayments		65	(48)
(Decrease)/Increase in payables and accruals		(375)	73
(Decrease)/Increase in employee benefit obligations	19	(35)	-
Increase/(Decrease) in provisions		49	(2)
Other non-cash items		7	6
Cash generated from operations		3,378	3,741
Interest paid		(2)	(9)
Income tax paid		(388)	(466)
Net cash flows from operating activities		2,988	3,266
Investing activities			
Purchase of non-current assets	10, 11	(877)	(1,153)
Proceeds from sale of non-current assets		3	12
Purchase of available-for-sale financial assets		(944)	(807)
Proceeds from sale of available-for-sale financial assets		1,065	698
Interest received		57	31
Dividend received		-	6
Acquisition of subsidiary, net of cash acquired		-	(176)
Net cash flows used in investing activities		(696)	(1,389)
Financing activities			
Repayment of lease liability and borrowings		(11)	(4)
Dividends paid	24	(1,863)	(2,788)
Net cash flows used in financing activities		(1,874)	(2,792)
Net increase/(decrease) in cash and cash equivalents		418	(915)
Exchange gains on cash and cash equivalents		4	2
Cash and cash equivalents at 1 January		3,282	4,195
Cash and cash equivalents at 31 December	17 a)	3,704	3,282

The accompanying accounting policies and notes are an integral part of these financial statements.

Consolidated statement of changes in equity

For the year ended 31 December 2011

	Issued capital HRK millions (note 22)	Legal reserves HRK millions (note 23)	Fair value reserves HRK millions	Retained earnings HRK millions (note 24)	Total HRK millions
Balance as at 1 January 2010	8,189	409	(3)	3,417	12,012
Profit for the year	-	-	-	1,831	1,831
Other comprehensive income for the year	-	-	2	(3)	(1)
Total comprehensive income for the year	-	-	2	1,828	1,830
Dividends paid to equity holders of the Company	-	-	-	(2,788)	(2,788)
Balance as at 31 December 2010	8,189	409	(1)	2,457	11,054
Profit for the year	-	-	-	1,811	1,811
Other comprehensive income for the year	-	-	(2)	19	17
Total comprehensive income for the year	-	-	(2)	1,830	1,828
Dividends paid to equity holders of the Company	-	-	-	(1,863)	(1,863)
Balance as at 31 December 2011	8,189	409	(3)	2,424	11,019

The accompanying accounting policies and notes are an integral part of these financial statements.

Notes to the consolidated financial statements

For the year ended 31 December 2011

1 Corporate information

Hrvatski Telekom d.d. (“HT d.d.”, “HT” or the “Company”) is a joint stock company whose majority shareholder is Deutsche Telekom AG (“DTAG”) (51%). DTAG is also ultimate controlling parent.

The registered office address of the Company is Savska cesta 32, Zagreb, Croatia.

The total number of employees of the Group as at 31 December 2011 was 6,239 (31 December 2010: 6,519).

The principal activities of the Group are described in Note 3.

The consolidated financial statements of Hrvatski Telekom d.d. for the financial year ended 31 December 2011 were authorised for issue in accordance with a resolution of the Management Board on 6 February 2012. These consolidated financial statements are subject to approval of the Supervisory Board as required by the Croatian Company Act.

2.1 Basis of preparation

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

The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial assets (Note 14), as disclosed in the accounting policies hereafter.

The Group’s consolidated financial statements are presented in Croatian Kuna (HRK). All amounts disclosed in the consolidated financial statements are presented in millions of HRK if not otherwise stated.

The consolidated financial statements include the financial statements of Hrvatski Telekom d.d. and the following subsidiaries comprise together HT Group:

		Ownership Interest	
Entity	Country of Business	31 December 2011	31 December 2010
Combis d.o.o.	Republic of Croatia	100%	100%
Iskon Internet d.d.	Republic of Croatia	100%	100%
KDS d.o.o.	Republic of Croatia	100%	100%

2.2 Changes in accounting policies and disclosures

The accounting policies adopted are consistent with those of the previous financial year.

The Group has adopted the following new and amended IFRS and IFRIC interpretations during the year. When the adoption of the standard or interpretation is deemed to have an impact on the financial statements or performance of the Group, its impact is described below.

Amendment to IAS 32 Financial Instruments: Presentation – Classification of Rights Issues (effective for financial years beginning on or after 1 February 2010)

The amendment allows rights, options or warrants to acquire a fixed number of the entity’s own equity instruments for a fixed amount of any currency to be classified as equity instruments provided the entity offers the rights, options or warrants pro rata to all of its existing owners of the same class of its own non-derivative equity instruments. The adoption of the amendment did not have any impact on the financial position and performance of the Group, as the Group does not have such instruments.

IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments (effective for financial years beginning on or after 1 July 2010)

The interpretation clarifies the requirements of IFRSs when an entity renegotiates the terms of a financial liability with its creditor and the creditor agrees to accept the entity's shares or other equity instruments to settle the financial liability fully or partially. The adoption of the interpretation did not have any impact on the financial statements as the Group does not negotiate such terms with its creditors.

Amendment to IFRS 1 First time adoption — Limited Exemption from Comparative IFRS 7 Disclosures for First-time Adopters (effective for financial years beginning on or after 1 July 2010)

The amendment clarifies that first time adopters do not need to provide comparative disclosures as introduced by the IFRS 7 amendment issued in March 2009. The adoption of the amendment did not affect the financial statements of the Group.

Amendments to IAS 24 Related Party Disclosures (effective for financial years beginning on or after 1 January 2011)

The amendments simplify the definition of a related party and modify certain related-party disclosure requirements for government-related entities. The implementation of these amendments did not have any impact on the financial position and performance of the Group and the related parties' disclosures.

Amendment to IFRIC 14 The Limit On A Defined Benefit Assets, Minimum Funding Requirements And Their Interaction (effective for financial years beginning on or after 1 January 2011)

Removes unintended consequences arising from the treatment of pre-payments where there is a minimum funding requirement. Results in pre-payments of contributions in certain circumstances being recognized as an asset rather than an expense. The Group is not subject of minimum funding requirements; therefore the amendment of the interpretation did not have any effect on the financial position and performance of the Group.

Improvements to IFRSs (issued in May 2010)

The IASB issued improvements to IFRSs, an omnibus of amendments to its IFRS standards. The adopted amendments resulting from improvements to IFRSs to the following standards did not have any impact on the accounting policies, financial position or performance of the Group:

IFRS 1 First-Time Adoption of IFRS (effective for annual periods beginning after 1 January 2011)

(a) *Accounting policy changes in the year of adoption* - Clarifies that, if a first-time adopter changes its accounting policies or its use of the exemptions in IFRS 1 after it has published an interim financial report in accordance with IAS 34 Interim financial reporting it should explain those changes and update the reconciliations between previous GAAP and IFRS.

(b) *Revaluation basis as deemed cost* - Allows first-time adopters to use an event-driven fair value as deemed cost, even if the event occurs after the date of transition but before the first IFRS financial statements are issued. When such remeasurement occurs after the date of transition to IFRSs but during the period covered by its first IFRS financial statements, any subsequent adjustment to that event-driven fair value is recognized in equity.

(c) *Use of deemed cost for operations subject to rate regulation* - Entities subject to rate regulation are allowed to use previous GAAP carrying amounts of property, plant and equipment or intangible assets as deemed cost on an item-by-item basis. Entities that use this exemption are required to test each item for impairment under IAS 36 at the date of transition.

IFRS 3 Business Combinations (effective for annual periods beginning on or after 1 July 2010)

(a) *Transition requirements for contingent consideration from a business combination that occurred before the effective date of the revised IFRS* - Clarifies that the amendments to IFRS 7 Financial instruments: Disclosures, IAS 32 Financial instruments: Presentation, and

IAS 39 Financial instruments: Recognition and measurement, that eliminate the exemption for contingent consideration, do not apply to contingent consideration that arose from business combinations whose acquisition dates precede the application of IFRS 3 (as revised in 2008).

(b) *Measurement of non-controlling interests* - The choice of measuring non-controlling interests at fair value or at the proportionate share of the acquiree's net assets applies only to instruments that represent present ownership interests and entitle their holders to a proportionate share of the net assets in the event of liquidation. All other components of non-controlling interest are measured at fair value unless another measurement basis is required by IFRS.

(c) *Un-replaced and voluntarily replaced share-based payment awards* - The application guidance in IFRS 3 applies to all sharebased payment transactions that are part of a business combination, including un-replaced and voluntarily replaced share-based payment awards.

IFRS 7 Financial Instruments - Emphasises the interaction between quantitative and qualitative disclosures about the nature and extent of risks associated with financial instruments.

IAS 1 Presentation of Financial Statements - Clarifies that an entity will present an analysis of other comprehensive income for each component of equity, either in the statement of changes in equity or in the notes to the financial statements.

IAS 27 Consolidated and Separate Financial Statements - Clarifies that the consequential amendments from IAS 27 made to IAS 21 The effect of changes in foreign exchange rates, IAS 28 Investments in associates, and IAS 31 Interests in joint ventures, apply prospectively for annual periods beginning on or after 1 July 2009, or earlier when IAS 27 is applied earlier.

IAS 34 Interim Financial Reporting - Provide guidance to illustrate how to apply disclosure principles in IAS 34 and add disclosure requirements around: The circumstances likely to affect fair values of financial instruments and their classification; Transfers of financial instruments between different levels of the fair value hierarchy; Changes in classification of financial assets; and Changes in contingent liabilities and assets.

IFRIC 13 Customer Loyalty Programmes - The meaning of 'fair value' is clarified in the context of measuring award credits under customer loyalty programmes.

Standards and interpretations issued but not yet effective

Standards and interpretations that have been issued and are effective for period after 1 January 2011 are listed below:

Amendments to IFRS 7 Financial Instruments: Disclosures on Derecognition (effective for annual periods beginning on or after 1 July 2011)

This amendment will promote transparency in the reporting of transfer transactions and improve users' understanding of the risk exposures relating to transfers of financial assets and the effect of those risks on an entity's financial position, particularly those involving securitisation of financial assets. The amendment affects disclosure only and has no impact on the Group's financial position or performance. The Group plans to adopt this amendment on its effective date.

Amendments to IFRS 1 First Time Adoption: Fixed Dates and Hyperinflation (effective for annual periods beginning on or after 1 July 2011)

These amendments include two changes to IFRS 1 First-time adoption of IFRS. The first replaces references to a fixed date of 1 January 2004 with 'the date of transition to IFRSs', thus eliminating the need for entities adopting IFRSs for the first time to restate derecognition transactions that occurred before the date of transition to IFRSs. The second amendment provides guidance on how an entity should resume presenting financial statements in accordance with IFRSs after a period when the entity was unable to comply with IFRSs because its functional currency was subject to severe hyperinflation. The amendments will not have any impact on the Group's financial position or performance because the Group is not first time adopter.

IAS 12 Income Taxes – Deferred Taxes (effective for annual periods beginning on or after 1 January 2012)

IAS 12 Income taxes, currently requires an entity to measure the deferred tax relating to an asset depending on whether the entity expects to recover the carrying amount of the asset through use or sale. It can be difficult and subjective to assess whether recovery will be through use or through sale when the asset is measured using the fair value model in *IAS 40 Investment property*. This amendment therefore introduces an exception to the existing principle for the measurement of deferred tax assets or liabilities arising on investment property measured at fair value. As a result of the amendments, *SIC 21 Income taxes - recovery of revalued non-depreciable assets,* will no longer apply to investment properties carried at fair value. The amendments also incorporate into IAS 12 the remaining guidance previously contained in SIC 21, which is withdrawn. The Group does not expect that amended IAS 12 will have an impact on the financial statements of the Group as the Group currently does not have any investment property or non-depreciable asset which is measured using the revaluation model.

Amendment to IAS 1 Financial Statement Presentation Regarding Other Comprehensive Income (effective for annual periods beginning on or after 1 July 2012)

The main change resulting from these amendments is a requirement for entities to group items presented in 'other comprehensive income' (OCI) on the basis of whether they are potentially reclassifiable to profit or loss subsequently (reclassification adjustments). The amendments do not address which items are presented in OCI. The amendment affects presentation only and therefore is not expected to have an impact on the Group's financial position or performance.

Amendment to IAS 19 Employee Benefits (effective for annual periods beginning on or after 1 January 2013)

These amendments eliminate the corridor approach and calculate finance costs on a net funding basis. The amendment could have an impact on the Group's financial position or performance.

IFRS 9 Financial Instruments (effective for annual periods beginning on or after 1 January 2013)

IFRS 9 is the first standard issued as part of a wider project to replace IAS 39 *Financial Instruments: Recognition and Measurement*. IFRS 9 retains but simplifies the mixed measurement model and establishes two primary measurement categories for financial assets: amortised cost and fair value. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. The guidance in IAS 39 on impairment of financial assets and hedge accounting continues to apply. The Group does not expect IFRS 9 to have an impact on the financial statements. The Group plans to adopt this new standard on its effective date.

IFRS 10 Consolidated Financial Statements (effective for annual periods beginning on or after 1 January 2013)

The objective of IFRS 10 is to establish principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entity (an entity that controls one or more other entities) to present consolidated financial statements. Defines the principle of control, and establishes controls as the basis for consolidation. Set out how to apply the principle of control to identify whether an investor controls an investee and therefore must consolidate the investee. Sets out the accounting requirements for the preparation of consolidated financial statements. The Group is currently assessing the impact that IFRS10 will have on financial statements. The Group plans to adopt this new standard on its effective date.

IFRS 11 Joint Arrangements (effective for annual periods beginning on or after 1 January 2013)

IFRS 11 is a more realistic reflection of joint arrangements by focusing on the rights and obligations of the arrangement rather than its legal form. There are two types of joint arrangement: joint operations and joint ventures. Joint operations arise where a joint operator has rights to the assets and obligations relating to the arrangement and hence accounts for its interest in assets, liabilities, revenue and expenses. Joint ventures arise where the joint operator has rights to the net assets of the arrangement and hence equity accounts for its interest. Proportional consolidation of joint ventures is no longer allowed. The Group expects IFRS 11 could have an impact on the financial statements and is currently assessing the impact. The Group plans to adopt this new standard on its effective date.

IFRS 12 Disclosures of Interests in Other Entities (effective for annual periods beginning on or after 1 January 2013)

IFRS 12 includes the disclosure requirements for all forms of interests in other entities, including joint arrangements, associates, special purpose vehicles and other off balance sheet vehicles. The Group is currently assessing the impact of IFRS12 on financial statements. The Group plans to adopt this new standard on its effective date.

IFRS 13 Fair Value Measurement (effective for annual periods beginning on or after 1 January 2013)

IFRS 13 aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRSs. The requirements do not extend the use of fair value accounting but provide guidance on how it should be applied where its use is already required or permitted by other standards within IFRSs or US GAAP. The Group is currently assessing the impact of IFRS13 on financial statements. The Group plans to adopt this new standard on its effective date.

IAS 27 (revised 2011) Separate Financial Statements (effective for annual periods beginning on or after 1 January 2013)

IAS 27 (revised 2011) includes the provisions on separate financial statements that are left after the control provisions of IAS 27 have been included in the new IFRS 10. The Group is currently assessing the impact of IAS 27 on financial statements. The Group plans to adopt this new standard on its effective date.

IAS 28 (revised 2011) Associates and Joint Ventures (effective for annual periods beginning on or after 1 January 2013)

IAS 28 (revised 2011) includes the requirements for joint ventures, as well as associates, to be equity accounted following the issue of IFRS 11. The Group is currently assessing the impact of IAS 28 on financial statements. The Group plans to adopt this new standard on its effective date.

IFRIC 20 Stripping Costs in the Production Phase of a Surface Mine (issued in October 2011 and effective for annual periods beginning on or after 1 January 2013)

The interpretation clarifies that benefits from the stripping activity are accounted for in accordance with the principles of *IAS 2 Inventories* to the extent that they are realised in the form of inventory produced. To the extent the benefits represent improved access to ore, the entity should recognize these costs as a 'stripping activity asset' within non-current assets, subject to certain criteria being met. This amendment is not relevant to the Group's operations.

Offsetting Financial Assets and Financial Liabilities - Amendments to IAS 32 (issued in December 2011 and effective for annual periods beginning on or after 1 January 2014)

The amendment added application guidance to IAS 32 to address inconsistencies identified in applying some of the offsetting criteria. This includes clarifying the meaning of 'currently has a legally enforceable right of set-off' and that some gross settlement systems may be considered equivalent to net settlement. The Group is considering the implications of the amendment and the impact on the Group.

Disclosures— Offsetting Financial Assets and Financial Liabilities — Amendments to IFRS 7 (issued in December 2011 and effective for annual periods beginning on or after 1 January 2013)

The amendment requires disclosures that will enable users of an entity's financial statements to evaluate the effect or potential effect of netting arrangements, including rights of set-off. The amendment will have an impact on disclosures but will have no effect on measurement and recognition of financial instruments.

2.3 Significant accounting judgments, estimates and assumptions

The preparation of the Group's financial statements requires management to make judgments, estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the disclosure of contingent liabilities, during the reporting period or at the reporting date respectively. However, uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of the asset or liability affected in future periods. The key assumptions concerning the future and other key sources of estimation uncertainty at the statement of financial position date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

Provisions and contingencies

The Group is exposed to a number of legal cases and regulatory proceedings and ownership dispute over distributive telecommunication infrastructure that may result in significant outflow of economic resources or derecognition of related assets. The Group uses internal and external legal experts to assess outcome of each case and makes judgments if and what amount needs to be provided for in the financial statements as more explained in Notes 21 and 27. Changes in these judgments could have a significant impact on the segments of the Group.

Impairment of non-financial assets

Impairment exists when the carrying value of an asset or cash generating unit exceeds its recoverable amount, which is the higher of its fair value less costs to sell and its value in use. The fair value less costs to sell calculation is based on available data from binding sales transactions in an arm's length transaction of similar assets or observable market prices less incremental costs for disposing of the asset. Value in use calculation is based on a discounted cash flow model. The cash flows are derived from the budget for the next ten years and do not include restructuring activities that the Group is not yet committed to or significant future investments that will enhance the asset's performance of the cash generating unit being tested. The recoverable amount is most sensitive to the discount rate used for the discounted cash flow model as well as the expected future cash inflows and the growth rate used for extrapolation purposes. Non-financial assets are tested for impairment when there are indicators that the carrying amounts may not be recoverable. Further details including carrying values and effects on the result of the period are given in Notes 10 and 11.

Change in estimated life of customers relationship

The Group recognizes revenue from activation (connection fee) on a straight line basis through future periods depending on an average life of a single customer relationship. In 2011, based on the changes in market such as mergers between competitors and new regulations which demand introducing standalone broadband connection without fixed telephone line attached if a customer requests it, it was estimated that useful life has changed from 10 to 3 years, which resulted in increased revenue of HRK 73 million.

Useful lives of assets

The determination of the useful lives of assets is based on historical experience with similar assets as well as any anticipated technological development and changes in broad economic or industry factors. The appropriateness of the estimated useful lives is reviewed annually, or whenever there is an indication of significant changes in the underlying assumptions. We believe that this is a critical accounting estimate since it involves assumptions about technological development in an innovative industry and heavily dependent on the investment plans of the Group. Further, due to the significant weight of depreciable assets in our total assets, the impact of significant changes in these assumptions could be material to our financial position, and results of operations.

Tax payable on mobile revenues

In 2009, the Croatian Parliament introduced a 6% tax payable on SMS, MMS and voice revenues. Based on an analysis of the nature of this tax (including factors such as the calculation basis and economic substance of the tax), the Group presented the tax net of revenue (similar to a sales tax) rather than as an operating expense. Due to the significant magnitude of this tax, a change in the Group's assumptions could have a material impact on total revenues, but would not have an impact on results of operations.

2.4 Summary of accounting policies

a) Operating profit

Operating profit is defined as the result before income taxes and finance items. Finance items comprise interest revenue on cash balances in the bank, deposits, treasury bills, interest bearing available for sale financial assets, dividend income from associate and joint venture, interest expense on borrowings, gains and losses on the sale of available for sale financial assets and foreign exchange gains and losses on all monetary assets and liabilities denominated in foreign currency.

2) Business Combinations and Goodwill

Subsidiaries are all entities over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights are currently exercisable or convertible are considered when assessing whether the Group controls another entity.

The Group applies the acquisition method to account for business combinations. The consideration transferred for the acquisition of a subsidiary is the fair values of the assets transferred, the liabilities incurred to the former owners of the acquiree and the equity interests issued by the Group. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The Group recognizes any non-controlling interest in the acquiree on an acquisition-by-acquisition basis, either at fair value or at the non-controlling interest's proportionate share of the recognized amounts of acquiree's identifiable net assets. Acquisition-related costs are expensed as incurred.

If the business combination is achieved in stages, the acquisition date fair value of the acquirer's previously held equity interest in the acquiree is remeasured to fair value as at the acquisition date through the statement of comprehensive income.

Any contingent consideration to be transferred by the Group is recognized at fair value at the acquisition date. Subsequent changes to the fair value of the contingent consideration that is deemed to be an asset or liability is recognized in accordance with IAS 39 either in statement of comprehensive income or as a change to other comprehensive income. Contingent consideration that is classified as equity is not remeasured, and its subsequent settlement is accounted for within equity.

Goodwill is initially measured as the excess of the aggregate of the consideration transferred and the fair value of non-controlling interest over the net identifiable assets acquired and liabilities assumed. If this consideration is lower than the fair value of the net assets of the subsidiary acquired, the difference is recognized in the statement of comprehensive income. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses.

Inter-company transactions, balances, income and expenses on transactions between group companies are eliminated. Profits and losses resulting from inter-company transactions that are recognized in assets are also eliminated. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

c) Investment in associate

In the Group's financial statements, investment in associated company (generally a shareholding of between 20% and 50% of voting rights) where significant influence is exercised by the Group are accounted for using the equity method less any impairment in value. Under the equity method, the investment is initially recognized at cost, and the carrying amount is increased or decreased to recognize the investor's share of the profit or loss of the investee after the date of acquisition. An assessment of investment in associate is performed when there is an indication that the asset has been impaired or that the impairment losses recognized in previous years no longer exist.

When the Group's share of losses in an associate equals or exceeds its interest in the company, the Group does not recognize further losses, unless it has incurred legal or constructive obligations or made payments on behalf of the associate.

Unrealized gains on transactions between the Group and its associate are eliminated to the extent of the Group's interest in the company.

d) Investment in joint venture

The Group has an interest in a joint venture which is a jointly controlled entity, whereby the venturers have a contractual arrangement that establishes joint control over the economic activities of the entity. The Group recognizes its interest in the joint venture using equity method of accounting. The financial statements of the joint venture are prepared for the same reporting period as the parent company.

Adjustments are made where necessary to bring the accounting policies into line with those of the Group. Adjustments are made in the Group's financial statements to eliminate the Group's share of unrealised gains and losses on transactions between the Group and its jointly controlled entity. Losses on transactions are recognized immediately if the loss provides evidence of a reduction in the net realisable value of current assets or an impairment loss. Interest in the joint venture is derecognized at the date on which the Group ceases to have joint control over the joint venture.

When the Group's share of losses in a joint venture equals or exceeds its interest in the company, the Group does not recognize further losses, unless it has incurred legal or constructive obligations or made payments on behalf of the joint venture.

Unrealized gains/losses on transactions between the Group and its joint venture are eliminated to the extent of the Group's interest in the company.

e) Intangible assets

Intangible assets are measured initially at cost. Intangible assets are recognized in the event that the future economic benefits that are attributable to the assets will flow to the Group, and that the cost of the asset can be measured reliably. After initial recognition, intangible assets are measured at cost less accumulated amortization and any accumulated impairment losses. Intangible assets are amortised on a straight-line basis over the best estimate of their useful life. There are no intangible assets that are assessed to have an indefinite useful life. The amortization method is reviewed annually at each financial year-end.

Amortization of the UMTS licence has started when operations for the UMTS network started its commercial use, the amortization period is the term of the licence.

Useful lives of intangible assets are as follows:

Licences and concessions	
UMTS licences	20 years
Patents and concessions	5 – 10 years
Right of servitude for Distributive Telecommunication Infrastructure (DTI)	30 years
Software and other assets	2 – 5 years

Assets under construction are not amortised.

Goodwill arises on the acquisition of subsidiaries. For the purpose of impairment testing, goodwill acquired in a business combination is allocated to each of the Group's cash generating units, or groups of cash generating units, that are expected to benefit from the synergies of the combination. Each unit or group of units to which the goodwill is allocated represents the lowest level within the Group at which the goodwill is monitored for internal management purposes. Goodwill is reviewed for impairment, annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

Impairment is determined for goodwill by assessing the recoverable amount, based on value in use estimations, of the cash-generating unit (or group of cash-generating units), to which the goodwill relates. Where the recoverable amount of the cash-generating unit (or group of cash-generating units) is less than the carrying amount of the cash-generating unit (group of cash-generating units) to which goodwill has been allocated, an impairment loss is recognized.

Impairment losses relating to goodwill cannot be reversed in future periods. The Group performs its annual impairment test of goodwill as at 31 December. Please see Note 10 for more details.

f) Property, plant and equipment

An item of property, plant and equipment that qualifies for recognition as an asset is measured at its cost. The cost of an item of property, plant and equipment comprises its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates, and any directly attributable costs of bringing the asset to its working condition and location for its intended use.

In addition to directly attributable costs, the costs of internally constructed assets include proportionate indirect material and labour costs, as well as administrative expenses relating to production or the provision of services.

After recognition as an asset, an item of property, plant and equipment is measured at cost less accumulated depreciation and any accumulated impairment losses.

Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item is depreciated separately.

Depreciation is computed on a straight-line basis.

Useful lives of newly acquired assets are as follows:

Buildings	10 – 50 years
Telecom plant and machinery	
Cables	8 – 18 years
Cable ducts and tubes	30 years
Other	2 – 15 years
Tools, vehicles, IT, office and other equipment	4 – 15 years

Land and assets under construction are not depreciated.

The useful life, depreciation method and residual values are reviewed at each financial year-end, and if expectations differ from previous estimates, the change(s) are accounted for as a change in an accounting estimate.

Construction-in-progress represents plant and properties under construction and is stated at cost.

Depreciation of an asset begins when it is available for use.

g) Impairment of assets

Impairment of non-financial assets

The determination of impairment of assets involves the use of estimates that include, but are not limited to, the cause, timing and amount of the impairment. Impairment is based on the large number of factors, such as changes in current competitive conditions, expectations of growth in the industry, increased cost of capital, changes in the future availability of financing, technological obsolescence, discontinuance of services, current replacement costs, prices paid in comparable transactions and other changes in circumstances that indicate an impairment exists. The recoverable amount and the fair values are typically determined using the discounted cash flow method which incorporates reasonable market participant assumptions. The identification of impairment indicators, as well as the estimation of future cash flows and the determination of fair values for assets (or groups of assets) require management to make significant judgments concerning the identification and validation of impairment indicators, expected cash flows, applicable discount rates, useful lives and residual values. Specifically, the estimation of cash flows underlying the fair values of the business considers the continued investment in network infrastructure required to generate future revenue growth through the offering of new data products and services, for which only limited historical information on customer demand is available. If the demand for those products and services does not materialize as expected, this would result in less revenue, less cash flow and potential impairment to write down these investments to their fair values, which could adversely affect future operating results.

Impairment of trade receivables

A provision for impairment of trade and other receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the underlying arrangement. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganization, and default or delinquency in payments as well as historical collections are considered indicators that the trade receivable is impaired. Individual valuation is carried out for customers under litigation; bankruptcy proceedings and for the total receivables of customers with overdue receivables. When a trade or another receivable is established to be uncollectible, it is written off.

Impairment of available-for-sale financial assets

If an available-for-sale asset is impaired, an amount comprising the difference between its cost (net of any principal payment and amortization) and its current fair value, less any impairment loss previously recognized in the statement of comprehensive income, is transferred from equity to the statement of comprehensive income. Reversals in respect of equity instruments classified as available for sale are not recognized in the statement of comprehensive income. Reversals of impairment losses on debt instruments are reversed through the statement of comprehensive income if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss was recognized in the statement of comprehensive income.

h) Inventories

Inventories are valued at the lower of cost and net realisable value, after provision for obsolete items. Net realisable value is the selling price in the ordinary course of business, less the costs necessary to make the sale. Cost is determined on the basis of weighted average cost.

Phone sets are often sold for less than cost in connection with promotions to obtain new and/or retain existing subscribers with minimum commitment periods. Such loss on the sale of equipment is only recorded when the sale occurs if the normal resale value is higher than the cost of the phone set. If the normal resale value is lower than costs, the difference is recognized as an impairment immediately.

i) Receivables

Trade receivables are amounts due from customers for merchandise sold or services performed in the ordinary course of business. If collection is expected in one year or less, they are classified as current assets. If not, they are presented as non-current assets. Receivables are stated at the fair value of the consideration given and are carried at amortised cost, after provision for impairment.

j) Foreign currencies

Transactions denominated in foreign currencies are translated into local currency at the middle exchange rates of the Croatian National Bank prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into local currency at the middle exchange rates of the Croatian National Bank prevailing at the statement of financial position date. Any gain or loss arising from a change in exchange rates subsequent to the date of the transaction is included in the statement of comprehensive income within financial income or financial expense, respectively.

The results and financial position of all the Group entities (none of which has the currency of a hyper-inflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

(a) assets and liabilities for each statement of financial position presented are translated at the middle exchange rates of the Croatian National Bank prevailing at the statement of financial position date;
(b) income and expenses for each statement of comprehensive income are translated at average exchange rates of the Croatian National Bank; and
(c) all resulting exchange differences are recognized in statement of other comprehensive income.

k) Leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the statement of comprehensive income on a straight-line basis over the period of the lease.

Leases of property, plant and equipment where the Group has substantially all the risks and rewards of ownership are classified as finance lease. Finance leases are capitalised at the lease's commencement at the lower of the fair value of the leased property and the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charge. The corresponding rental obligations, net of finance charges, are included in borrowings. The interest element of the finance cost is charged to the statement of comprehensive income over the lease period so as to produce constant periodic rate of interest on the remaining balance of the liability for each period. The property, plant and equipment acquired under finance lease is depreciated over the shorter of the useful life of the assets and the lease term.

l) Taxation

The income tax charge is based on profit for the year and includes deferred taxes. Deferred taxes are calculated using the 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 at the reporting date.

Deferred tax is determined using income tax rates that have been enacted or substantially enacted by the financial statement date and are expected to apply when the related deferred tax asset is realized or the deferred tax liability is settled.

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

Deferred tax assets are recognized to the extent that it is probable that future taxable profit (or reversing deferred tax liabilities) will be available against which the temporary differences can be utilized.

Deferred tax assets and liabilities are not discounted and are classified as non-current assets and liabilities in the statement of financial position. Deferred tax assets are recognized when it is probable that sufficient taxable profits will be available against which the deferred tax assets can be utilised.

Current tax and deferred tax are charged or credited in other comprehensive income if the tax relates to items that are credited or charged, in the same or a different period in other comprehensive income.

m) Employee benefit obligations

The Group provides other long-term employee benefits (see Note 19). These benefits include retirement and jubilee (length of service) payments, and are determined 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.

Past service costs are recognized in other comprehensive income immediately in the period in which they occur. Gains or losses on the curtailment or settlement of benefit plans are recognized when the curtailment or settlement occurs. The benefit 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. Gains and losses resulting from changes in actuarial assumptions are recognized in other comprehensive income in the period in which they occur.

The Group provides death in service short term benefits which are recognized as an expense of the period in which it incurred.

n) Revenue recognition

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. Revenue is measured at the fair value of the consideration received, excluding discounts, rebates, and sales taxes or duty. The Group assesses its revenue arrangements against specific criteria in order to determine if it is acting as principal or agent. The Group has concluded that it is acting as a principal in all of its revenue arrangements with the exception of the provision of its telecommunications infrastructure to third parties that offer value added services to its customer. In these cases, the Group is acting as an agent.

Revenue from fixed telephony includes revenue from activation, monthly fees, calls placed by fixed line subscribers and revenue from additional services in fixed telephony. Revenue from activation (connection fees) is recognized on a straight-line basis throughout future periods depending on an average useful life of a single customer line. Estimated life changed from 10 years in 2010 to 3 years in 2011.

Revenue from wholesale services includes interconnection services for domestic and international carriers.

Revenue from mobile telephony includes revenue from monthly fee and call charges for “post-paid” mobile customers, call charges for “pre-paid” mobile customers, call charges for customers of international mobile operators when roaming on the Group’s mobile network, sale of mobile handsets and domestic interconnection revenues related to mobile network.

Revenue from unused tariff packages and prepaid vouchers is recognized when they are realised. Before their realisation, they are recorded as deferred revenues.

The Group offers certain multiple-element arrangements (bundled product offers) arrangements. For multiple-element arrangements, revenue recognition for each of the units of accounting (elements) identified must be determined separately. Total arrangement consideration relating to the bundled contract is allocated among the different elements based on their relative fair values (i.e., a ratio of the fair value of each element to the aggregated fair value of the bundled deliverables is generated). The relative fair value of an individual element is limited by the proportion of the total arrangement consideration to be provided by the customer, the payment of which does not depend on the delivery of additional elements. If the fair value of the delivered elements cannot be determined reliably but the fair value of the undelivered elements can be determined reliably, the total arrangement consideration provided by the customer is allocated by determining the fair value of the delivered elements as the difference between the total arrangement consideration and the fair value of the undelivered elements.

Revenue from Internet and data services includes revenue from leased lines, frame relay, ATM, Ethernet services, ADSL subscription and traffic, fixed line access, WEB hosting, VPN online, internet traffic to T-Com call number, Multimedia services, IP phone (access and traffic) and IPTV. Service revenues are recognized when the services are provided in accordance with contractual terms and conditions.

Revenues from the provision of its network to the provider of value added services are reported on a net basis. Revenues are exclusively the amount of the commission received.

Third parties using the Group’s telecommunications network include roaming customers of other service providers and other telecommunications providers which terminate or transit calls on the Group’s network. These wholesale (incoming) traffic revenues included in Voice and Non-voice (Data and Internet) revenues are recognized in the period of related usage. A proportion of the revenue received is often paid to other operators (interconnect) for the use of their networks, where applicable. The revenues and costs of these transit calls are stated gross in the financial statements as the Group is the principal supplier of these services using its own network freely defining the pricing of the services, and recognized in the period of related usage.

Revenues and expenses associated with the sale of telecommunications equipment and accessories are recognized when the products are delivered, provided that there are no unfulfilled obligations that affect the customer's final acceptance of the arrangement.

Revenue from dividends is recognized when the Group's right to receive the payment is established.

Interest revenue is recognized as interest accrues (using the effective interest rate that is the rate that exactly discounts receipts through the expected life of the financial instrument to the net carrying amount of the financial asset).

The Group maintains a loyalty point's programme, T-Club. In accordance with IFRIC 13, customer loyalty credits are accounted for as a separate component of the sales transaction in which they are granted. A portion of the fair value of the consideration received is allocated to the award credits and deferred. This is then recognized as revenue over the period that the award credits are redeemed.

o) Cash and cash equivalents

Cash and cash equivalents comprise cash on hand, demand deposits and short-term, highly liquid investments that are readily convertible to known amounts of cash with original maturities of three months or less and which are subject to an insignificant risk of change in value.

p) Borrowings

Borrowing costs, which include interest and other costs incurred in connection with the borrowing of funds, including exchange differences arising from foreign currency borrowings, are expensed in the period in which they are incurred, except those which directly attributable to the acquisition, construction or production of qualifying assets and are capitalised.

Borrowings are initially recognized in the amount of the proceeds received net of transaction costs.

q) Financial assets

All investments, other than loans and receivables originated by the Group, are classified as available-for-sale.

Available-for-sale financial assets are classified as current assets if management intends to realise them within 12 months after the statement of financial position date. All purchases and sales of investments are recognized on the settlement date.

Financial assets are initially measured at cost, which is the fair value of the consideration given for them, including transaction costs.

Available-for-sale financial assets and trading financial assets are subsequently carried at fair value without any deduction for transaction costs by reference to their quoted market price at the statement of financial position date. Gains or losses on measurement to the fair value of available-for-sale financial assets are recognized in other comprehensive income, until the investment is sold or otherwise disposed of, or until it is determined to be impaired, at which time the cumulative gain or loss previously recognized in other comprehensive income is included in the net profit or loss for the period.

Financial instruments are generally recognized as soon as the Group becomes a party to the contractual regulations of the financial instrument. However, in the case of regular way purchase or sale (purchase or sale of a financial asset under a contract whose terms require delivery of the asset within the timeframe established generally by regulation or convention in the marketplace concerned), the settlement date is relevant for the initial recognition and derecognition. A financial asset is derecognized when the cash is collected or the rights to receive cash from the assets have expired. A financial liability is derecognized when the obligation under the liability is discharged or cancelled or expires.

r) Provisions

A provision is recognized when, and only when, the Group has a present obligation (legal or constructive) as a result of a past event and it is probable 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 statement of financial position date and adjusted to reflect the current best estimate.

Where the effect of the time value of money is material, the amount of a provision is the present value of the expenditures expected to be required to settle the obligation. When discounting is used, the increase in provision reflecting the passage of time is recognized as interest expense.

Provisions for termination benefits are recognized when the Group is demonstrably committed to a termination of employment contracts, that is when the Group has a detailed formal plan for the termination which is without realistic possibility of withdrawal. Provisions for termination benefits are computed based on amounts paid or expected to be paid in redundancy programs.

s) Contingencies

Contingent liabilities are not recognized in the financial statements. They are disclosed unless the possibility of an outflow of resources embodying economic benefits is remote.

A contingent asset is not recognized in the financial statements but is disclosed when an inflow of economic benefits is probable.

t) Share-based payments

The cost of cash-settled transactions is measured initially at fair value at the grant date using a binomial model, further details of which are given in Note 32. This fair value is expensed over the period until the vesting date with recognition of a corresponding liability. The liability is remeasured to fair value at each statement of financial position date up to and including the settlement date with changes in fair value recognized in the statement of comprehensive income.

u) Events after reporting period

Post-year-end events that provide additional information about the Group's position at the statement of financial position date (adjusting events) are reflected in the financial statements. Post-year-end events that are not adjusting events are disclosed in the notes when material.

v) Trade payables

Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Accounts payable are classified as current liabilities if payment is due within one year or less. If not, they are presented as non-current liabilities.

w) Dividend distribution

Dividend distribution to the Group's shareholders is recognized as a liability in the Group's financial statements in the period in which the dividends are approved by the Group's shareholders.

x) Earnings per share

Earnings per share are calculated by dividing the profit attributable to equity holders of the Group by the weighted average number of ordinary shares in issue during the year excluding ordinary shares purchased by the Group and held as treasury shares.

y) Reclassifications

In order to reconcile the presentation of comparable period data with data presented in 2011, following positions in the financial statements for the year ended 31 December 2010 were reclassified:

- Statement of financial position:

Position	*HRK millions*
	(56)
Trade and other receivables	(56)
Trade and other payables	(7)
Other non-current receivables	7
deferred income tax assets	

- Statement of comprehensive income:

Position	*HRK millions*
Rendering of services	8
Sale of goods	(11)
Other operating income	3

The above reclassifications affecting the statement of financial position are not considered material, and therefore no opening statement of financial position is presented.

3 Segment Information

In contrast to previous reporting period, business reporting format is determined to be Residential, Business and Network and Support Function segments as the Group's risks and rates of return are affected predominantly by differences in the market and customers. The segments are organised and managed separately according to the nature of the customers and markets that the services rendered, with each segment representing a strategic business unit that offers different products and services.

The Residential Segment includes marketing, sales and customer services, focused on providing mobile, fixed line telecommunications and TV distribution services to residential customers.

The Business Segment includes marketing, sales and customer services, focused on providing mobile and fixed line telecommunications and systems integration services to corporate customers, small- and medium-sized businesses and the public sector. The Business Segment is also responsible for the wholesale business in both fixed and mobile services.

The Network and Support Functions performs cross-segment management and support functions, and includes the Technology, Procurement, Accounting, Treasury, Legal and other central functions. The Network and Support Functions is included in segment information as a voluntary disclosure since it does meet the criteria for an operating segment.

Management Board as chief operating decision maker monitors the operating results of business units separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance is evaluated based on contribution margin II (as calculated in the table below).

The Group's geographical disclosures are based on the geographical location of its customers.

Fully owned subsidiaries Iskon Internet, Combis and KDS are consolidated within the respective operating segments.

Management of the Group does not monitor assets and liabilities by segments and therefore this information has not been disclosed.

Residential and Business segments

The following tables present revenue and direct cost information regarding the Group's segments:

Year ended 31 December 2010	Residential HRK millions	Business HRK millions	Network & Support functions HRK millions	Total HRK millions
Segment revenue	4,638	3,734	-	8,372
Service revenues	4,432	3,509	-	7,941
Terminal equipment	189	64	-	253
Other	17	161	-	178
Usage related direct costs	(440)	(566)	-	(1,006)
Income and losses on accounts receivable	(75)	(38)	-	(113)
Contribution margin I	4,123	3,130	-	7,253
Non-usage related direct costs	(729)	(410)	-	(1,139)
Segment result	3,394	2,720	-	6,114
Other income	-	-	240	240
Other operating expenses	(399)	(292)	(2,002)	(2,693)
Depreciation, amortization and impairment of non-current assets	-	-	(1,415)	(1,415)
Operating profit	2,995	2,428	(3,177)	2,246
Capital expenditure	258	69	826	1,153

Year ended 31 December 2011				
Segment revenue	4,432	3,635	-	8,067
Service revenues	4,263	3,465	-	7,728
Terminal equipment	153	60	-	213
Other	16	110	-	126
Usage related direct costs	(367)	(459)	-	(826)
Income and losses on accounts receivable	(17)	(41)	-	(58)
Contribution margin I	4,048	3,135	-	7,183
Non-usage related direct costs	(632)	(521)	-	(1,153)
Segment result	3,416	2,614	-	6,030
Other income	-	-	301	301
Other operating expenses	(391)	(327)	(1,994)	(2,712)
Depreciation, amortization and impairment of non-current assets	-	-	(1,414)	(1,414)
Operating profit	3,025	2,287	(3,107)	2,205
Capital expenditure	330	86	461	877

Revenue — by geographical area	2011 HRK millions	2010 HRK millions
Republic of Croatia	7,411	7,661
Rest of the World	656	711
	8,067	8,372

The majority of Group's assets (2011: 94%; 2010: 93%) are located in Croatia.

None of the Group's external customers represent a significant source of revenue.

4 Service expenses

	2011 HRK millions	2010 HRK millions
Domestic interconnection	445	555
International interconnection	382	451
Other services	314	275
	1,141	1,281

5 Depreciation, amortization and impairment of non-current assets

	2011 HRK millions	2010 HRK millions
Depreciation	1,029	1,006
Amortization	336	344
	1,365	1,350
Impairment loss	49	65
	1,414	1,415

Notes 10 and 11 disclose further details on amortization and depreciation expense and impairment loss.

6 Employee benefits expenses

	2011 HRK millions	2010 HRK millions
Gross salaries	881	904
Taxes, contribution and other payroll expenses	253	258
Redundancy expenses	162	31
Long-term employee benefits (Note 19)	-	5
	1,296	1,198

The movements of redundancy provision are as follows:

	2011 HRK millions	2010 HRK millions
Provision at 1 January – current	133	7
Provision at 1 January - non current	-	113
Total provision for redundancy 1 January	133	120
Interest costs recognized in the statement of comprehensive income	-	20
Additions charged to the statement of comprehensive income	162	31
Utilisation	(126)	(38)
Total provision for redundancy 31 December	169	133
Of that – current	169	133

Redundancy expenses and provisions include the amount of gross severance payments and other related costs for employees whose employment contracts will be involuntary terminated after 31 December 2011 due to business reasons.

7 Other expenses

	2011 HRK millions	2010 HRK millions
Maintenance services	271	349
Rent (Note 26)	178	165
Advertising	163	192
Licence cost	163	155
Selling commission	128	139
Postal expenses	95	103
Provision of trade receivables	59	112
Call centre and customer care support	56	56
Non-income taxes and contribution	51	60
Contract workers	23	45
Daily allowances and other costs of business trips	22	23
Education and consulting	18	23
Insurance	13	14
Provision for charges and risks	10	16
Write down of inventories	8	2
Loss on disposal of fixed assets	2	4
Other operating charges	99	75
	1,359	1,533

8 Income tax expense

a) Tax on profit

	2011 HRK millions	2010 HRK millions
Current tax expense	435	455
Deferred tax expense/(income)	9	(11)
Taxation	444	444

b) Reconciliation of the taxation charge to the income tax rate

	2011 HRK millions	2010 HRK millions
Profit before taxes	2,255	2,275
Income tax at 20% (domestic rate)	451	455
Dividends received and incentives	(1)	(2)
Tax for previous years	(14)	(12)
Entertainment expenses and car usage	2	3
Other	6	0
Taxation	444	444
Effective tax rate	19.69%	19.52%

Components and movements of deferred tax assets and liabilities are as follows:

	31 December 2011 HRK millions	Charge to statement of comprehensive income HRK millions	31 December 2010 HRK millions	Charge to statement of comprehensive income HRK millions	31 December 2009 HRK millions
Deferred tax asset					
Non-tax deductible value adjustments	22	3	19	7	12
Property, plant and equipment write down	9	(3)	12	(4)	16
Accrued interest on legal cases	6	0	6	6	-
Deferred revenue from connection fees	-	(11)	11	(4)	15
Other	11	2	9	6	3
Deferred tax assets	48	(9)	57	11	46
		Charge to other comprehensive income HRK millions			
Actuarial gains and losses	4	(3)	7	1	6
Total deferred tax assets	52	(12)	64	12	52

The deferred tax asset of the Group arises on the property, plant and equipment impairment as a result of the fact that HRK 395 million of the impairment reported in 2001 was not tax deductible in that year. Of this amount, HRK 348 million became tax deductible in the period from 2002 to 2011, and the remaining HRK 47 million will be tax deductible in future periods.

The Group has recognized deferred tax assets based on temporary differences coming out of revenue recognition of connection fees in previous periods when the tax on those revenues was paid, and due to deferring these fees for the period of useful life of providing services to the customers for reporting purposes. Due to changes in estimate of customer relationship useful life, in 2011 the total amount of deferred revenue from this period is transferred to income. This resulted in the release of the total amount of deferred taxes, and tax expense on this basis amounts to HRK 11 million.

There are no formal procedures in the Republic of Croatia to agree the final level of tax charge upon submission of the declaration for corporate tax and VAT. However, such tax settlements may be subject to review by the relevant tax authorities during the limitation period of three years. The limitation period of three years starts with the year that follows the year of submission of tax declarations, i.e. 2013 for the 2011 tax liability. The counting of three years starts again with any action of tax authorities with the purpose to collect tax, interest or fines until the absolute statute of limitation of 6 years expires.

9 Earnings per share

Basic earnings per share amounts are calculated by dividing net profit for the year attributable to ordinary equity holders of the Group by the weighted average number of ordinary shares outstanding during the year.

Diluted earnings per share amounts are equal to basic earnings per share since there are no dilutive potential ordinary shares or share options.

The following reflects the income and share data used in the basic and diluted earnings per share computations:

	2011	2010
Profit for the year attributable to ordinary equity holders of the Company in HRK millions	1,811	1,831
Weighted average number of ordinary shares for basic earnings per share	81,888,535	81,888,535

10 Intangible assets

	Licences and concessions HRK millions	Software HRK millions	Goodwill HRK millions	Assets under construction and other assets HRK millions	Total HRK millions
At 1 January 2010					
Cost	677	1,811	77	200	2,765
Accumulated amortization	(419)	(1,204)	-	(44)	(1,667)
Net book value	258	607	77	156	1,098
Year ended 31 December 2010					
Opening net book value	258	607	77	156	1,098
Acquisition of a subsidiary	-	-	85	74	159
Additions	6	149	-	95	250
Transfers	(81)	191	-	(110)	-
Disposals	-	(1)	-	-	(1)
Amortization charge	(45)	(267)	-	(32)	(344)
Net book value	138	679	162	183	1,162
At 31 December 2010					
Cost	281	2,509	162	251	3,203
Accumulated amortization	(143)	(1,830)	-	(68)	(2,041)
Net book value	138	679	162	183	1,162
Year ended 31 December 2011					
Opening net book value					
Additions	138	679	162	183	1,162
Transfers	-	154	-	27	181
Transfers from PPE	2	55	-	(57)	-
Amortization charge	-	2	-	-	2
Impairment loss	(10)	(295)	-	(31)	(336)
	-	(2)	-	(8)	(10)
Net book value	130	593	162	114	999
At 31 December 2011					
Cost	281	2,660	162	217	3,320
Accumulated amortization	(151)	(2,067)	-	(103)	(2,321)
Net book value	130	593	162	114	999

The intangible assets of the Group as of 31 December 2011 include the UMTS licence with the carrying value of HRK 88 million (31 December 2010: HRK 94 million). The UMTS licence is amortised over a period of 20 years (starting from June 2005) according to Concession contract.

Net book value of total assets under construction amounts to HRK 27 million (2010: HRK 69 million) and primarily relates to software and the various licences for the use of software.

Additions of intangible assets

Major additions in the reporting period relate to applicative, system and network technology software and user licences in the amount of HRK 170 million.

Impairment loss

During 2011, the Group recognized impairment loss of intangible assets of HRK 10 million (2010: nil).

Impairment testing of goodwill

For impairment testing, goodwill acquired through business combinations has been allocated to cash-generating units. Goodwill arising from the Iskon acquisition has been allocated mainly to the Residential operating segment, while the goodwill arising from the Combis acquisition has been allocated to a separate cash-generating unit at a level lower than the operating segments.
The recoverable amount of the cash-generating units has been determined based on the value in use calculation using cash flow projections from financial budgets covering a ten-year period. The post-tax discount rate applied to all cash flow projections is 9.6% (2010: 11.0%) and cash flows beyond the ten-year period are extrapolated using a 2.0% growth rate (2010: 2.0%).

The calculation of value-in-use is most sensitive to the assumptions on market penetration, market share, regulation and discount rate.

With regard to the assessment of value-in-use, management believes that no reasonably possible change in any of the above key assumptions would cause the carrying value of the cash-generating units to materially exceed its recoverable amount.

11 Property, plant and equipment

	Land and buildings HRK millions	Telecom plant and machinery HRK millions	Tools, vehicles, IT and office equipment HRK millions	Assets under construction HRK millions	Total HRK millions
At 1 January 2010					
Cost	1,938	11,088	1,000	478	14,504
Accumulated amortization	(822)	(6,493)	(677)	(5)	(7,997)
Net book value	1,116	4,595	323	473	6,507
Year ended 31 December 2010					
Opening net book value	1,116	4,595	323	473	6,507
Acquisition of a subsidiary	-	-	7	1	8
Additions	62	515	50	276	903
Transfers	100	152	85	(337)	-
Disposals	(1)	(4)	(3)	(3)	(11)
Amortization charge	(103)	(774)	(129)	-	(1,006)
Impairment loss	-	(46)	(4)	(15)	(65)
Net book value	1,174	4,438	329	395	6,336
At 31 December 2010					
Cost	2,098	11,330	1,176	411	15,015
Accumulated amortization	(924)	(6,892)	(847)	(16)	(8,679)
Net book value	1,174	4,438	329	395	6,336
Year ended 31 December 2011					
Opening net book value	1,174	4,438	329	395	6,336
Additions	39	436	58	163	696
Transfers	25	257	28	(310)	-
Transfers to intangible assets	-	(2)	-	-	(2)
Disposals	(6)	(1)	(1)	(1)	(9)
Amortization charge	(105)	(796)	(128)	-	(1,029)
Impairment loss	(5)	(12)	-	(22)	(39)
Net book value	1,122	4,320	286	225	5,953
At 31 December 2011					
Cost	2,152	11,428	1,122	248	14,950
Accumulated amortization	(1,030)	(7,108)	(836)	(23)	(8,997)
Net book value	1,122	4,320	286	225	5,953

Included within assets under construction of the Group are major spare parts of HRK 27 million (31 December 2010: HRK 53 million), net of a provision of HRK 1 million (31 December 2010: HRK 10 million).

Beginning in 2001, the Group has performed additional procedures which have provided support for the existence of legal title to land and buildings transferred from HPT s.p.o. under the Separation Act of 10 July 1998. The Group is still in the process of formally registering this legal title.

The Group does not have any material property, plant and equipment held for disposal, nor does it have any material idle property, plant and equipment.

Impairment loss

In 2011, the Group recognized an impairment loss of property, plant and equipment of HRK 39 million (2010: HRK 65 million) due to transfer to the newer technology. The recoverable amount of that equipment is its fair value less costs to sell, which is based on the best information available to reflect the amount that the Group could obtain, at the statement of financial position date, from the disposal of the asset in an arm's length transaction between knowledgeable, willing parties, after deducting the costs of disposal.

Disposal of property, plant and equipment

The disposal of the property, plant and equipment primarily relates to the disposal of telecom machinery, old tools, IT, office equipment and vehicles of HRK 300 million and disposal of technical equipment for mobile voice services of HRK 380 million (all values stated as gross book values).

Ownership over ducts

Although the assets (including the ducts as a part of the infrastructure) were transferred from the legal predecessor of the Company, HPT Public Company by virtue of the "Law on Separation of Croatian Post and Telecommunication" and contributed by the Republic of Croatia ("RoC") to the share capital at the foundation of the Company on 1 January 1999, according to other Croatian legislation, part of HT's infrastructure that may be considered as a real estate which is also known as Distributive Telecommunication Infrastructure (DTI, TI or ducts) - does not have all the necessary documents (building, use permits etc.) and the major part is not registered in the land registry, which may be relevant to the issue of proving the ownership towards third parties. Intrusions in HT's ducts by other competitors and some requirements of ownership over these assets by the local authorities (the City of Zagreb and City of Split present the majority of problems), may have a material effect on the financial statements in the case that HT will not be able to prove its ownership rights for some ducts.

The Company formed the Technical Infrastructure Contractual Relation Management Work Unit that is responsible to assure that all network technology related assets are properly legalised, documented and that this documentation is available to all relevant departments and authorities. The overall process is slow and complex since the registration depends not only on HT but also on local and state authorities. Since the year 2006 the actions of HT have been concentrated on the conclusion of "right of servitude" contracts with local municipalities and "right of use" contracts with Croatian and County Roads.

In connection with the offer for sale of ordinary shares held by the Government of Republic of Croatia (RoC) in 2007, the Government of RoC, the Company and Deutsche Telekom AG have entered into a Memorandum of Understanding on how the various issues relating to the Initial Public Offering, including DTI infrastructure should be resolved. Inter alia this provides the underlying principles under which right of way charges and shared usage issues will be based.

The Government of the Republic of Croatia has committed, within the limits of its authority, to use its reasonable efforts to provide for the appropriate legislation and regulations under the Croatian legal system as soon as practicably possible.

In accordance with Ordinance on Manner and Conditions for Access and Joint Use of Electronic Communications Infrastructure and Related Equipment (Official Gazette No. 154/08 effective as at 6 January 2009) and Ordinance on Certificate and Fees for the Right of Way (Official Gazette No. 31/09 effective as of 19 March 2009) the Croatian Post and Electronic Communications Agency started issuing certificates for the rights of way for certain routes in the city of Zagreb to HT. The Company believes that the issued certificates for the rights of way might help HT in the lawsuit filed by Zagrebački Holding Zagrebački Digitalni Grad (ZHZDG) (Note 27).

The legalization process is to be speeded up due to Law on Electronic Communications which obliges local municipality and other owners of the land used for the construction of telecommunication infrastructure to give HT “right of way” if other solutions were not agreed.

The Group assessed and declared the existence of the risks thereon, including obtaining legal opinions with respect to certain of the issues involved; however, due to the fact that these issues are very complex so far the Group has not yet been able to determine the possible outcome and whether it will result in any impairment of the DTI assets concerned due to any inability to prove title or as a result of the additional right of way charges that may be imposed, which could have a retrospective effect. Therefore, no adjustments were made to these financial statements in respect of this matter.

The net book value of all the Group’s ducts as at 31 December 2011 is HRK 885 million (31 December 2010: HRK 889 million).

12 Investment in associate

The net book value of investments in associate comprises:

	31 December 2011 HRK millions	31 December 2010 HRK millions
HP d.o.o. Mostar	2	2
	2	2

HT d.d. has an ownership interest of 30.29% in its associate HP d.o.o. Mostar which is incorporated in the Republic of Bosnia and Herzegovina. The principal activity of the associate is provision of postal services.

The movement in investments in associates of the Group during the year ended 31 December 2011 and during the year ended 31 December 2010 was as follows:

Net book value	2011 HRK millions	2010 HRK millions
At 1 January	2	2
Share of profits	0	2
Impairment of investments	0	(2)
At 31 December	2	2

Summarisation of the Group's share in aggregated financial information of associate is as follows:

Share of the associates statements of financial position:	31 December 2011 Unaudited HRK millions	31 December 2010 Audited HRK millions
Current assets	15	17
Non-current assets	18	19
Current liabilities	(3)	(6)
Non-current liabilities	0	(1)
Net assets	30	29

	2011 Unaudited	2010 Audited
Share of the associate revenue and profit:		
Revenue	29	31
Profit	0	2

13 Investment in joint venture

The net book value of investments in joint venture comprises:

	31 December 2011 HRK millions	31 December 2010 HRK millions
HT d.d. Mostar	393	378
	393	378

HT d.d has an ownership interest of 39.1% in its joint venture HT d.d. Mostar which is incorporated in the Republic of Bosnia and Herzegovina. The principal activity of this company is provision of telecommunication services.

All decisions made by the Management Board and all decisions made by the Supervisory Board have to be approved by both of the majority shareholders. Therefore investment is classified as a jointly controlled entity. The rest of the company is mainly owned by Federation of Bosnia and Herzegovina (50.10%).

The Group's share in HT d.d. Mostar unaudited profit for the year ended 31 December 2011, is recognized in the statement of comprehensive income in the amount of HRK 15 million (2010: HRK 11 million of profit was recognized based on unaudited results of profit for the year ended 31 December 2010 which was later confirmed by the audit report).

During 2011, HT did not receive a dividend of from HT d.d. Mostar (2010: HRK 6 million).

Share of the jointly controlled entity assets and liabilities:	31 December 2011 Unaudited HRK millions	31 December 2010 Audited HRK millions
Current assets	124	102
Non-current assets	568	585
Current liabilities	(143)	(132)
Non-current liabilities	(59)	(83)
Net assets	490	472H

	2011 Unaudited	2010 Audited
Share of the jointly controlled entity revenue and profit:		
Revenue	370	346
Profit	15	11

14 Available-for-sale financial assets

Non-current available-for-sale financial assets include the following bonds:

Issuer	*Currency*	*Interest rate*	*Maturity*	31 December 2011 HRK millions	31 December 2010 HRK millions
Government of Croatia	HRK	4.75%	8 February 2017	31	32
Other equity securities	HRK			8	10
				39	42

Current available-for-sale financial assets include the following:

	Currency	*Interest rate*	*Maturity*	31 December 2011 HRK millions	31 December 2010 HRK millions
Unit holdings in money market funds:				22	20
Bonds:					
Government of Germany	EUR	1.25%	11 March 2011	-	74
Foreign treasury bills:					
Government of France	EUR	1.00%	9 February 2012	75	-
Government of Germany	EUR	1.00%	15 February 2012	76	-
Government of France	EUR	1.00%	22 March 2012	75	-
Government of France	EUR	1.00%	23 August 2012	75	-
Government of France	EUR	1.00%	21 April 2011	-	96
Government of France	EUR	1.00%	24 March 2011	-	74
Government of France	EUR	1.00%	19 May 2011	-	88
Government of France	EUR	1.00%	5 May 2011	-	37
Government of Germany	EUR	1.00%	23 February 2011	-	37
Government of Germany	EUR	1.00%	11 May 2011	-	37
				323	463

The estimated fair value of investments in treasury bills and bonds at 31 December 2011 is determined by reference to their market value offered on the secondary capital market which is an active market at the statement of financial position date and belong to the first financial instruments hierarchy category. There were no changes among financial instruments hierarchy categories in 2011.

15 Inventories

	31 December 2011 HRK millions	31 December 2010 HRK millions
Inventories and spare parts	84	103
Merchandise	91	113
	175	216

16 Trade and other receivables

	31 December 2011 HRK millions	31 December 2010 HRK millions
Trade receivables	1,233	1,328
Other receivables	74	95
	1,307	1,423

The aging analysis of trade receivables is as follows:

	Total	Neither past due nor impaired	Past due but not impaired				
			< 30 days	31-60 days	61-90 days	91-120 days	> 120 days
	HRK millions	HRK millions	HRK millions	HRK millions	HRK millions	HRK millions	HRK millions
31 December 2011	1,233	896	192	71	48	19	7
31 December 2010	1,328	883	242	97	38	22	46

Provisions are made for all outstanding receivables older than 120 days, except for receivables for international settlement for which provisions are made according to the collection estimate. International settlement account for the majority of past due but not impaired receivables older than 120 days.

As at 31 December 2011, trade receivables with a nominal value of HRK 1,047 million (31 December 2010: HRK 1,028 million) were impaired and fully provided for. Movements in the provision for impairment of receivables were as follows:

	2011 HRK millions	2010 HRK millions
At 1 January	1,028	946
Charge for the year	163	211
Unused amounts reversed	(144)	(129)
At 31 December	1,047	1,028

17 Cash and cash equivalents and time deposits

a) Cash and cash equivalents

Cash and cash equivalents comprise the following amounts:

	31 December 2011 HRK millions	31 December 2010 HRK millions
Cash on hand and balances with banks	1,937	494
Time deposits with maturity less than 3 months	1,767	2,788
Cash and cash equivalents	3,704	3,282

b) Time deposits with maturities more than 3 months

	31 December 2011 HRK millions	31 December 2010 HRK millions
Splitska banka d.d.	38	-
Zagrebačka banka d.d.	2	2
	40	2

c) Currency breakdown of cash and cash equivalents and time deposits:

	31 December 2011 HRK millions	31 December 2010 HRK millions
HRK	2,828	2,693
EUR	874	557
USD	42	34
	3,744	3,284

18 Trade and other payables

	31 December 2011 HRK millions	31 December 2010 HRK millions
Trade payables	1,173	1,314
Payroll and payroll taxes	82	75
VAT and other taxes payable	62	40
Other creditors	30	44
	1,347	1,473

19 Employee benefit obligations

Long-term employee benefits include retirement and jubilee (length of service) payments. One off retirement benefits are dependent on employees fulfilling the required conditions to enter retirement and are determined in the amount of six average monthly salaries paid to employees in the preceding month. Jubilee benefits are paid in the fixed amount depending on the number of years of service in the Group.

Long-term employee benefits are determined using the projected unit credit method. Gains and losses resulting from changes in actuarial assumptions are recognized as other comprehensive income/expense in the period in which they occur.

The movement in the liability recognized in the statement of financial position was as follows:

	2011 HRK millions	2010 HRK millions
At 1 January	192	192
Service costs recognized in the statement of comprehensive income	-	5
Interest costs recognized in the statement of comprehensive income	10	12
Payments made under scheme	(13)	(15)
Change in calculation parameters effect recognized in the statement of comprehensive income	(12)	-
Actuarial gains	(20)	(2)
At 31 December	157	192

The principal actuarial assumptions used to determine retirement benefit obligations as at 31 December were as follows:

	2011 %	2010 %
Discount rate (annually)	6.5	6.5
Wage and salary increases (annually)	2.0	4.5

20 Deferred income

	31 December 2011 HRK millions	31 December 2010 HRK millions
Connection fee	2	74
Deferred income — non current	2	74
Prepaid vouchers	72	97
Connection fee	4	32
Customer loyalty programme	49	95
Other	26	26
Deferred income — current	151	250
	153	324

The connection fee is recognized on a straight-line basis over future periods depending on the average useful life of a single customer line relationship. In 2011, average useful life in fixed telephony has been decreased from 10 to 3 years which resulted in of increased revenue in the amount of HRK 73 million.

21 Provisions for legal cases and other provisions

	2011 HRK millions	2010 HRK millions
At 1 January	101	116
Additions	11	3
Reversal	-	(3)
Interest cost	5	-
Utilisation	(3)	(15)
At 31 December	114	101

As at 31 December 2011 the Group has provided estimated amounts for several legal actions and claims that management has assessed as probable to be result in outflow of resources of the Group.

22 Issued capital

Authorised, issued, fully paid and registered share capital

	31 December 2011 HRK millions	31 December 2010 HRK millions
81,888,535 ordinary shares of HRK 100 each	8,189	8,189

The number of shares in issue remained unchanged between 1 January 1999 and 31 December 2011.

23 Legal reserves

Legal reserves represent reserves prescribed by the Company Act in the amount of 5% of the net profit for the year, until these reserves amount to 5% of the issued capital. Legal reserves that do not exceed the above amount can only be used to cover current year or prior year losses. If the legal reserves exceed 5% of the issued capital they can also be used to increase the issued capital of the Group.

24 Retained earnings

In 2011 the Group paid a dividend of HRK 1,863 million (2010: HRK 2,788 million), respectively HRK 22.75 per share (2010: HRK 34.05).

25 Ostale ukalkulirane obveze

	31 December 2011 HRK millions	31 December 2010 HRK millions
Variable salary to employees	86	94
Handset budget programme	-	63
Unused vacation	30	39
	116	196

26 Commitments

a) Operating lease commitments

The Group has operating lease commitments in respect of buildings, land, equipment and cars.

Operating lease charges:

	2011 HRK millions	2010 HRK millions
Current year expense (Note 7)	178	165

Future minimum lease payments under non-cancellable operating leases were as follows:

	31 December 2011 HRK millions	31 December 2010 HRK millions
Within one year	227	164
Between 1 and 5 years	524	558
Greater than 5 years	466	485
	1,217	1,207

The contracts relate primarily to property leases and car leases.

b) Capital commitments

The Group was committed under contractual agreements to capital expenditure as follows:

	31 December 2011 HRK millions	31 December 2010 HRK millions
Intangible assets	14	86
Property, plant and equipment	64	123
	78	209

27 Contingencies

At the time of preparation of these consolidated financial statements, there are a number of claims outstanding against the Group. In the opinion of the management, the settlement of these cases will not have a material adverse effect on the financial position of the Group, except for certain claims for which a provision was established (see Note 21).

a) Competition / Regulatory matters

HT vigorously defends all of the below competition / regulatory situations. There is no history of significant settlements in Croatia under either the Competition Law or imposed by misdemeanour courts. Due to the lack of relevant practice and due to the fact that the proceedings are still in progress, the Group is not able to determine the possible outcome of these cases, however management believes that any settlement will be significantly less than the maximum penalties outlined below.

Vipnet complaint in front of the Croatian Competition Agency and Optima claim in front of Croatian Post and Electronic Communications Agency (HAKOM)

VIPnet d.o.o. complained to the Competition Agency regarding Frame Agreements that HT and T-Mobile Croatia d.o.o. signed with our key and large business clients that allegedly contain anti competitive clauses. The Agency has initiated administrative proceedings for assessing whether the Company and T-Mobile Croatia d.o.o. have abused their dominant position by conclusion of the Frame Agreements.

The potential penalty for violations of the Law on Protection of Market Competition could amount up to 10% of the annual Company turnover of the financial year proceeding the year in which the infringement was committed. The first instance procedure of the misdemeanour proceedings against HT was finished in December 2011 and the verdict could be reached in 2012.

A similar complaint regarding Frame Agreements has been addressed by fixed competitor OT - Optima Telekom d.o.o. to HAKOM in June 2006. It should be pointed out that the penalty for violations of the Law on Telecommunications could amount to between 1% and 5% of the annual turnover of the fixed operations. A penalty based on 1% of the turnover for the relevant period would amount to HRK 50 million.

Croatian Post and Electronic Communications Agency's (HAKOM's) supervision on Bitstream Standard offer

On 17 July 2009, HAKOM passed decision regarding the analysis of the wholesale bitstream access service by which HT is designated as an operator having significant market power on the relevant market, through which certain regulatory obligations have been defined, including the obligation to publish a Bitstream Standard Offer within the transparency obligation.

HAKOM initiated a supervision relating to distinction between "existing" and "new" end-users in HT's Bitstream Standard Offer, claiming that such distinction is contrary to HAKOM's decisions, in which percentage of discount for all users has been determined in the amount of 40%.

HT received Misdemeanour Indictment in which HAKOM proposed that HT should be fined with penalty in the amount of 1% of yearly turnover gained by providing electronic communication networks and services in the year preceding the year in which the offence was committed. On the basis of the results for 2008, 1% of the turnover would amount to HRK 88 million.

Wholesale Line Rental case

According to HAKOM's Council decision from 6 April 2011 on the analysis of market on access to the public telephone network at a fixed location for residential and non-residential customers, on 1 July 2011 HT published Reference Offer for wholesale line rental (WLR) and accordingly changed the Reference Offer for Interconnection (RIO).

HAKOM's supervisor passed two decisions stating that by such publishing, HT breached its regulatory obligations and ordered HT several changes of Reference Offers that HT accordingly made. HT challenged these supervisor's decisions by submitting several lawsuits to the Administrative Court.

In October 2011, HT was informed that HAKOM has submitted two indictments to the Misdemeanour Court against HT because of HT's alleged breach of its regulatory obligations. HT has not yet officially received these indictments.

HAKOM has demanded from the Misdemeanour court to fine HT in the amount of 3% of HT's annual gross income in each of the two proceedings. On the basis of the results for 2010, 3% of the turnover would amount to HRK 250 million in each of the two proceedings. It can be expected that the Misdemeanour Court will soon deliver these indictments to HT for stating its objections.

Denial of ULL access to Amis and Metronet

In 2009 HT received two lawsuits filed by Metronet Telekomunikacije d.d. Zagreb (hereinafter: Metronet) and Amis Telekom d.o.o. Zagreb against HT. They claim that HT was late in setting up the collocation and providing an access to unbundled local loop and that access to unbundled local loop was conditioned with conclusion of the Contract on lease of DTI contrary to the Standard offer of HT for unbundled local loop. In addition, Metronet requests for the annulment of the Contract on lease of DTI from 22 July 2005. Total claim demanded in Metronet and Amis Telekom lawsuits amount to HRK 37 and 30 million HRK plus interest, retrospectively. Our attorneys in these cases are of a firm belief that they cannot succeed with their claim.

b) Ownership claim of Distributive Telecommunication Infrastructure (DTI) by the City of Zagreb

With respect to the ducts issue mentioned under Property, plant and equipment (Note 11), on 16 September 2008 the Company received a lawsuit filed by the Zagreb Digital City Ltd. branch of Zagreb Holding Ltd. (hereinafter: ZHZDG) against the Company. ZHZDG is claiming the ownership of the City of Zagreb over DTI on the area of the City of Zagreb and demanding a payment in the range from HRK 120 to 390 million plus interest.

The suit is based on the legal acts adopted by the Administration and Assembly of the City of Zagreb in the years 2006 and 2007 by which DTI has been declared a communal infrastructure owned by the City of Zagreb that are challenged by the Company and the suit was filled.

The Company's attorney is of the firm belief that ZHZDG cannot succeed with its claim if the court decision will be based on the positive legislation of the RoC.

As a result, management concluded that no provision is required to be recognized in the consolidated financial statements for this case.

28 Balances and transactions with related parties

The transactions disclosed below primarily relate to transactions with the companies owned by Deutsche Telekom AG (DTAG). The Group enters into transactions in the normal course of business on an arm's length basis. These transactions included the sending and receiving of international traffic to/from these companies during 2011 and 2010. Further, DTAG provided technical assistance to the Group of HRK 10 million (2010: HRK 13 million).

The main transactions with related parties during 2011 and 2010 were as follows:

	Sales		Purchases	
Related party:	2011 HRK millions	2010 HRK millions	2011 HRK millions	2010 HRK millions
Immediate parent				
Deutsche Telekom AG, Germany	21	26	48	58
Joint venture				
HT Mostar, Bosnia and Herzegovina	34	37	53	71
Subsidiaries of immediate parent				
Telekom Deutschland, Germany	27	27	7	12
T-Mobile Austria, Austria	10	13	5	9
T-Systems International, Germany	-	-	6	5
Others	49	48	17	24
Total	141	151	136	179

The statement of financial position includes the following balances resulting from transactions with related parties:

	Receivables		Payables	
Related party:	31 December 2011 HRK millions	31 December 2010 HRK millions	31 December 2011 HRK millions	31 December 2010 HRK millions
Immediate parent				
Deutsche Telekom AG, Germany	3	-	14	34
Joint venture				
HT Mostar, Bosnia and Herzegovina	-	-	6	20
Subsidiaries of immediate parent				
Telekom Deutschland, Germany	-	-	44	46
T-Mobile Austria, Austria	-	-	16	16
Everything Everywhere Ltd., UK	-	-	16	1
T-Systems International, Germany	-	-	-	1
Others	2	6	69	45
Total	5	6	165	163

Compensation of the Supervisory Board

The chairman of the Supervisory Board receives remuneration in the amount of 1.5 of the average net salary of the employees of the Company paid in the preceding month. To the deputy chairman, the amount of 1.25 of the average net salary of the employees of the Company paid in the preceding month is paid, while any other member receives the amount of one average net salary of the employees of the Company paid in the preceding month. To a member of the Supervisory Board who is in the same time the Chairman of the Audit Committee of the Supervisory Board in the amount of 1.5 of the average monthly net salary of the employees of the company paid in the preceding month. To a member of the Supervisory Board who is in the same time a Member of the Audit Committee of the Supervisory Board in the amount of 1.25 of the average monthly net salary of the employees of the company paid in the preceding month. To a member of the Supervisory Board who is in the same time a Member of the Compensation and Nomination Committee of the Supervisory Board in the amount of 1.25 of the average monthly net salary of the employees of the company paid in the preceding month. DTAG representatives do not receive any remuneration for the membership in the Supervisory Board due to a respective policy of DTAG.

In 2011, Group paid a total amount of HRK 0.7 million (2010: HRK 0.6 million) to the members of its Supervisory Board. No loans were granted to the members of the Supervisory Board.

Compensation to key management personnel

In 2011 the total compensation paid to key management personnel of the Group amounted to HRK 46 million (2010: HRK 40 million). Key management personnel include members of the Management Boards of the Company and its subsidiaries and the operating directors of the Company, who are employed by the Group. Compensation paid to key management personnel includes:

	31 December 2011 HRK millions	31 December 2010 HRK millions
Short term benefits	44	39
Share based payments	2	1
	46	40

29 Financial risk management objectives and policies

The Group is exposed to international service-based markets. As a result, the Group can be affected by changes in foreign exchange rates. The Group also extends credit terms to its customers and is exposed to a risk of default. The significant risks, together with the methods used to manage these risks, are described below. The Group does not use derivative instruments either to manage risk or for speculative purposes.

a) Credit risk

The Group has no significant concentration of credit risk with any single counter party or group of counterparties with similar characteristics. The Group procedures are in force to ensure on a permanent basis that sales are made to customers with an appropriate credit history and do not exceed an acceptable credit exposure limit.

The Group does not guarantee obligations of other parties.

The Group considers that its maximum exposure is reflected by the amount of debtors (see Note 16) net of provisions for impairment recognized at the statement of financial position date.

Additionally, the Group is exposed to risk through cash deposits in the banks. As at 31 December 2011 the Group had business transactions with thirteen banks (2010: eight banks). The Group held cash and deposits in five banks almost exclusively. For those five domestic banks with foreign ownership the Group received guarantees for deposits given from parent banks which have a minimum rating of BBB+. The management of this risk is focused on dealing with the most reputable banks in foreign and domestic ownership at the domestic and foreign markets and on contacts with the banks on a daily basis.

The credit quality of financial assets that are neither past due nor impaired can be assessed by historical information about counterparty default rates:

	31 December 2011 HRK millions	31 December 2010 HRK millions
Trade receivables for rendered telecom services to domestic customers	775	794
Trade receivables for rendered telecom services to foreign customers	30	20
Other trade receivables	91	69
	896	883

b) Liquidity risk

The Group policy is to maintain sufficient cash and cash equivalents or to have available funding through an adequate amount of committed credit facilities to meet its commitments for the foreseeable future.

Any excess cash is invested mostly in available-for-sale financial assets.

Trade and other payables	Due in	Due in	Due in	Due in	Due in	Total
all amounts in HRK millions	0-30 days	31-60 days	61-90 days	91-120 days	>120 days	
Year ended 31 December 2011	1,226	73	13	5	30	1,347
Year ended 31 December 2010	1,392	26	24	5	26	1,473
Other long-term liabilities all amounts in HRK millions			1 to 3 years	3 to 5 years	> 5 years	Total
Year ended 31 December 2011			5	7	20	32
Year ended 31 December 2010			18	6	19	43

c) Interest rate risk

The Group's exposure to the risk of changes in market interest rates relates primarily to the Group's available-for-sale financial assets, cash, cash equivalents and time deposits.

The following table demonstrates the sensitivity to a reasonably possible change in interest rates, with all other variables held constant, of the Group's profit post tax (through the impact on floating rate investments).

	Increase/decrease in basis points	Effect on profit post tax HRK millions
Year ended 31 December 2011	+100	6
Croatian Kuna	-100	(6)
	+100	10
Euro	-100	(10)
Year ended 31 December 2010	+100	6
Croatian Kuna	-100	(6)
	+100	6
Euro	-100	(6)

d) Foreign currency risk

The Group's functional currency is the Croatian Kuna (HRK). Certain assets and liabilities are denominated in foreign currencies which are translated at the valid middle exchange rate of the Croatian National Bank at each statement of financial position date. The resulting differences are charged or credited to the statement of comprehensive income but do not affect short-term cash flows.

A significant amount of deposits in the banks, available for sale financial assets and cash equivalents are made in foreign currency, primarily in Euro. The purpose of these deposits is to hedge foreign currency denominated liabilities and liabilities indexed to foreign currencies from changes in the exchange rate. The following table demonstrates the sensitivity to a reasonably possible change in the Euro exchange rate, with all other variables held constant, of the Group's profit post tax due to changes in the fair value of monetary assets and liabilities.

	Increase/decrease in Euro rate	Effect on profit post tax HRK millions
Year ended 31 December 2011	+3%	28
	-3%	(28)
Year ended 31 December 2010	+3%	19
	-3%	(19)

e) Fair value estimation

The fair value of securities included in available-for-sale financial assets is estimated by reference to their quoted market price at the statement of financial position date. The Group's principal financial instruments not carried at fair value are trade receivables, other receivables, long-term receivables, trade and other payables. The historical cost carrying amounts of receivables and payables, including provisions, which are all subject to normal trade credit terms, approximate their fair values.

f) Capital management

The primary objective of the Group's capital management is to ensure that it supports its business and maximise shareholder value. The capital structure of the Group consists of equity attributable to shareholders, comprising issued capital, reserves and retained earnings and totals HRK 11,019 million as at 31 December 2011 (2010: HRK 11,054 million).

The Group manages its capital structure and makes adjustments to it, in light of changes in economic conditions. To maintain or adjust the capital structure, the Group may adjust the dividend payment to shareholders, return capital to shareholders or issue new shares. No changes were made in the objectives, policies or processes during the years ended 31 December 2011 and 31 December 2010 (see Notes 22 and 24).

30 Financial instruments

Set out below is a comparison by category of carrying amounts and fair values of all of the Group's financial instruments:

	Carrying amount		Fair value	
	31 December 2011 HRK millions	31 December 2010 HRK millions	31 December 2011 HRK millions	31 December 2010 HRK millions
Financial assets				
Cash and cash equivalents	3,704	3,282	3,704	3,282
Time deposits	40	2	40	2
Available-for-sale assets, non-current	39	42	39	42
Available-for-sale assets, current	323	463	323	463
Financial liabilities				
Interest-bearing loans	32	22	32	22

Market values have been used to determine the fair value of listed available-for-sale financial assets. The fair value of loans has been calculated by discounting the expected future cash flows at prevailing interest

31 Authorization for Services and Applicable Fees

The Company is party to the following Authorization for Services, none of which are within the scope of IFRIC 12:

a) Service authorization for the performance of electronic communications services in a fixed and mobile network

On 1 July 2008 a new Law on Electronic Communications entered into force and introduced general authorization for all electronic communications services and networks. On 10 August 2011 Law on amendments to the Law on Electronic Communications, in compliance with EU framework, entered into force Pursuant to Article 32 of the Law on Electronic Communications the Company is entitled to provide the following electronic communication services based on the general authorisation which has been lastly updated on 15 November 2010:

- Publicly available telephone service in the fixed electronic communications network;
- Publicly available telephone service in the mobile

electronic communications network;
- Lease of electronic communication network and/or lines;
- Transmission of image, voice and sound through electronic communication networks (which excludes services of radio diffusion);
- Value added services;
- Internet access services;
- Voice over Internet protocol services;
- Granting access and shared use of electronic communications infrastructure and associated facilities;
- Satellite services;
- Providing of information about the numbers of all subscribers of publicly available telephony services in the Republic of Croatia;
- Issuing of comprehensive publicly available directory of all subscribers of publicly available telephone services in the Republic of Croatia;
- Other services.

Upon the merger of T-Mobile Croatia d.o.o. to the Company as of 1 January 2010, T-Mobile Croatia d.o.o. ceased to exist as a separate company and thus was erased from the list of the operators.

In accordance with HAKOM's decision of 28 November 2005 the Company was designated as the Universal services provider for a period of five years i.e. till 29 November 2010. Due to expiration of the 5-year period, on 27 October 2010 HAKOM adopted a new decision thereby designating the Company as the operator of the following universal services in the territory of the Republic of Croatia for the next 5-year period starting from 29 November 2010:

- access to the public telephone network and publicly available telephone services at a fixed location, allowing end-users to make and receive local, national and international telephone calls, facsimile communications and data communications, at data rates that are sufficient to permit functional Internet access, taking into account prevailing technologies used by the majority of subscribers and technological feasibility;
- access for end-users, including users of public pay telephones, to a telephone directory enquiry service;
- setting up of public pay telephones on public places accessible at any time, in accordance with the reasonable needs of end-users in terms of the geographical coverage, the quality of services, the number of public pay telephones and the accessibility of such telephones for disabled persons;
- special measures for disabled persons, including access to emergency services, telephone directory enquiry services and directories, equivalent to that enjoyed by other end-users;
- special pricing systems adjusted to the needs of the socially disadvantaged groups of end-users.

Following the later decision of HAKOM, the Company is no longer designated as universal service operator for service access for end-users to at least one comprehensive directory of all subscribers of publicly available telephone services, however, shall continue to provide the service on commercial basis.

b) Service authorization for provision of public telecommunications services with the usage of radio frequency spectrum in the global mobile network system – GSM and with the usage of radio frequency spectrum in third generation mobile network system UMTS

Upon the merger of T-Mobile Croatia d.o.o. to the Company as of 1 January 2010 all rights and licences for use of addresses and numbers and for the use of radiofrequency spectrum (GSM and UMTS and others) that were granted to T-Mobile Croatia d.o.o. until 31 December 2009 were transferred to the Company.

In 2010 upon the Company's request HAKOM issued following licenses to the Company:

- on 20 January 2010 received new technology neutral licences issued by HAKOM for use of radiofrequency spectrum in 900 MHz and 1800 MHz frequency bands (GSM licence) and for the use of radiofrequency spectrum in 2100 MHz frequency band (UMTS license); Both licences have been issued with the validity until 18 October 2024.
- on 13 September 2010 HAKOM issued licences for the use of radiofrequency spectrum for satellite services (DTH services);

In 2011 the Company submitted two requests to HAKOM for the assignment of additional radiofrequency spectrum in 1800 MHz frequency band.

Based on these requests, after conducted assignment procedure, HAKOM issued the following licences:

- on 20 April 2011 new technology neutral licences for use of radiofrequency spectrum in 900 MHz and 1800 MHz frequency bands, which replaced the licence received on 20 January 2010
- on 16 November 2011 new technology neutral licence for use of radiofrequency spectrum in 900 MHz and 1800 MHz frequency bands, which replaced the licence issued on 20 April 2011.

In addition during 2011 based on temporary licences HAKOM made possible the use of radiofrequency spectrum in 1800 MHz frequency band for the purpose of the Company's technical testing and exploration of LTE technology for non-commercial purposes.

b) Fees for providing electronic communications services

Pursuant to the Law on Electronic Communications, the Company is obliged to pay the fees for the use of addresses and numbers, radiofrequency spectrum and for the performance of other tasks of HAKOM pursuant to the ordinances of HAKOM and Ministry of the sea, transport and infrastructure The said regulations prescribe the calculation and the amount of fees. These fees are paid for the current year or one year in advance (in case of fees for usage of radiofrequency spectrum).

In 2011 the Company paid the following fees:

- the fees for the use of addresses, numbers and radiofrequency spectrum pursuant to the ordinance passed by the Ministry of the sea, transport and infrastructure (in favour of State budget, Official Gazette 154/08, 28/09, 97/10) and
- the fees for use of addresses, numbers and radiofrequency spectrum and for the performance of other tasks of HAKOM. Pursuant to the ordinance passed by HAKOM (in favour of HAKOM's budget, Official Gazette, 144/10).

c) Audiovisual and electronic media services

Pursuant to the Law on Audio-visual Services, which entered into force on 31 July 2007, the Company is obliged to pay the fee of 1% of the annual gross revenues realized from the provision of audio-visual services, to the state budget of the Republic of Croatia as a contribution to the funding of National Programme for Promotion of Audio-visual Works.

Pursuant to the Law on Electronic Media, which entered into force on 29 December 2009, the Company is obliged to pay upon the request the fee of 0.5% of the annual gross revenues realized from the provision of audiovisual media services and the electronic publication services.

d) Electronic communications infrastructure and associated facilities

The Company as the infrastructure operator is obligated to pay fees for the right of way in accordance with the Law on Electronic Communications. The fees for the right of way are defined by the Ordinance on right of way certificate and fee (Official Gazette, 31/09, 89/10) passed by HAKOM. This Ordinance is replaced by the new Ordinance on Certificate and Fees for the Right of Way (Official Gazette 152/2011) that was adopted by HAKOM in December 2011. The new Ordinance is effective as of 4 January, 2012. The fee is calculated according to the area of land used for the installation of electronic communications infrastructure and associated facilities.

32 Share-based and non share-based payment transactions

Various mid-term (MTIP 2009, MTIP 2010 and MTIP 2011) and long-term incentive plan (LTIP - Variable II 2011) exist at Group level to ensure competitive total compensation for members of the Management Board, senior executives and other beneficiaries. The plans promote the medium and long-term value enhancement of the Group, thus aligning the interests of management and shareholders. First HT's MTIP was introduced in 2008.

MTIP is generally set up as a cash-based plan linked to two equally weighted, share-based performance parameters – one absolute and one relative. If both performance targets are achieved, then the total amount earmarked as an award to the beneficiaries by the respective employers is paid out; if one performance target is achieved, 50 percent of the amount is paid out, and if neither performance target is achieved, no payment is made.

All MTIPs cover period of three years (i.e. MTIP 2008 covers the period from 1 January 2008 to 31 December 2010) and LTIP- Variable II 2011 covers period of four years. The payment of the awarded sum is subject to the achievement of two share value based performance targets. Upon expiry of the term of the plan, the Supervisory Board of the Company shall determine whether each of the targets has been achieved. Based on the findings of the Supervisory Board, the Management Board shall determine and announce the level of target achievement.

All MTIPs have two targets which are equally weighted and cannot be changed during the MTIP duration. The first target is based on the increase of the share price by a certain percentage; the second target is related to the share price movement compared to the complex return index.

The incentives themselves consist of 20 percent or 30 percent of the participants' individual annual salary as contracted on the beginning of each MTIP depending on the management level of the participant and according to the Supervisory Board decision. Participants' individual annual salary is defined as the annual amount of total fixed salary and the amount of variable salary in case of a 100 percent target achievement.

Based on decision of the Supervisory Board it was established that one MTIP 2008 target out of two has been achieved. The rewards for participants of MTIP 2008 were paid out in March 2011. In accordance with targets achievements, payment of 50% of the total amount was made.

LTIP – Variable II 2011 is new cash-based plan with four equally weighted performance parameters and cannot be changed during plan duration. Two targets are financial KPIs, Earnings Per Share (EPS) and adjusted operating Return On Capital Employed (ROCE), third and forth targets are customer and employee satisfaction.

According to LTIP – Variable II 2011, the amounts awarded for International Business Leaders (BLT's) is fixed sum specified in the individual employment contract and for other participant is 30% or 20% of the participants' individual annual salary as contracted on the beginning of the plan depending on the management level of the participant and according to the Supervisory Board decision. Participants' individual annual salary is defined as the annual amount of total fixed salary and the amount of variable salary in case of a 100 percent target achievement.

In contrast to the former MTIP structure, Variable II offers the option of exceeding the amounts earmarked for award, limited to 150% of the award volume per parameter. The parameters are independent of each other, hence each parameter is assessed separately. Both potential excesses and shortfalls in relation to targets are accounted for on a graded basis per target parameter (departure from the principle of "all or nothing").

All gains and expenses resulting from changes of the related provisions for all MTIP plans recognized for employee services received during the year are shown in the following table:

	2011 HRK millions	2010 HRK millions
Expenses for providing for cash-settled share-based and non share-based payment transactions	3	4
Gains arising from cancellation of provision for cash-settled share-based and non-share based payment transactions	-	1

33 Auditor's fees

The statutory auditors of the Group's financial statements have rendered services of HRK 6 million in 2011 (2010: HRK 7 million). Services rendered in 2011 and 2010 relate to the audits and reviews of the financial statements, audit of financial statements prepared for regulatory purposes and audit of SAP transformation project.

34 Events after reporting period

No other events or transactions have occurred since 31 December 2011 or are pending that would have a material effect on the financial statements at that date or for the period then ended, or that are of such significance in relation to the Group's affairs to require disclosure in the financial statements.

Disclaimer

This document does not constitute or form part of any offer or invitation to sell or issue, or any solicitation of any offer to purchase or subscribe for, any securities of the Company nor should they or any part of them or the fact of their distribution form the basis, or be relied on in connection with, any contract or investment decision in relation thereto.

The third party information contained herein has been obtained from sources believed by the Company to be reliable. Whilst all reasonable care has been taken to ensure that the facts stated herein are complete and accurate and that the opinions and expectations contained herein are fair and reasonable, no representation or warranty, expressed or implied, is made by the Company or its advisors, with respect to the completeness or accuracy of any information and opinions contained herein.

This document contains certain forward looking statements with respect to financial conditions, results of operations and business of the Group. These forward-looking statements represent the Company's current views, expectations or beliefs concerning future events. Such statements are subject to risk and uncertainties, most of which are difficult to predict and are generally beyond Company's control. If these or other risks and uncertainties materialize, or if the assumptions underlying any of these Statements prove incorrect, Company's /Group's actual results may be materially different from those expressed or implied by such statements. Company can offer no assurance that its expectations or targets will be achieved.

In addition, some key performance indicators utilized by the Company (non-IFRS measures, such as EBITDA) serve as additional indicators of the Group's operating performance and may be calculated differently by other companies operating in the sector. However such measures are not replacement for measures defined and required under IFRS. Therefore the non-IFRS measures and key performance indicators used in this document may not be directly comparable to those of the Group's competitors.

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