Annual Report 2012

Hrvatski Telekom

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Financial Highlights

T-HT GROUP

in HRK million	Jan - Dec 2012	Jan - Dec 2011	% of change A12/A11
Revenue	7,456	8,067	-7,6%
EBITDA before exceptional items	3,520	3,832	-8.1%
Exceptional items	144	162	-11.1%
EBITDA after exceptional items	3,376	3,670	-8.0%
EBIT (Operating profit)	2,050	2,222	-7.7%
Net profit after minority interest	1,696	1,811	-6.4%
EBITDA margin before exceptional items	47.2%	47.5%	-0.3 p.p.
EBITDA margin after exceptional items	45.3%	45.5%	-0.2 p.p.
EBIT margin	27.5%	27.5%	0.0 p.p.
Net profit margin	22.7%	22.5%	0.3 p.p.
Balance Sheet	**At 31 Dec 2012**	**At 31 Dec 2011**	**% of change A12/A11**
Total non current assets	7,858	7,549	4. 1%
Total current assets	5,254	5,675	-7.4%
TOTAL ASSETS	**13,113**	**13,224**	**-0.8%**
Total issued capital and reserves	10,899	11,019	-1.1%
Total non current liabilities	279	322	-13.5%
Total current liabilities	1,935	1,883	2.8%
TOTAL EQUITY AND LIABILITIES	**13,113**	**13,224**	**-0.8%**
Cash flow	**Jan - Dec 2012**	**Jan - Dec 2011**	**% of change A12/A11**
Net cash flow from operating activities	2,982	3,050	-2.2%
Net cash flow from investing activities	-1,717	-758	-126.7%
Net cash flow from financing activities	-1,825	-1,874	2.6%
Cash and cash equivalents at the end of period	**3,146**	**3,704**	**-15.1%**
CAPEX	1,180	938	25.8%
CAPEX / Revenue ratio	15.8%	11.6%	4.2 p.p.
	At 31 Dec 2012	**At 31 Dec 2011**	**% of change A12/A11**
ROE	15.5%	16.4%	-0.9 p.p.
ROCE	18.3%	19.6%	-1.3 p.p.
Number of employees (FTEs)	5,780	6,032	-4.2%

Operational Highlights

Key operational data	Jan - Dec 2012	Jan - Dec 2011	% of change A12/A11
Mobile subscibers in 000			
Number of subscribers	**2,326**	2,418	**-3.8%**
- Residential - Business	1,859 467	1,964 454	-5.4% 2.9%
Number of postpaid subscribers	**1.011**	1,035	**-2.3%**
- Residential - Business	578 433	581 454	-0.6% -4.6%
Number of prepaid subscribers	**1,315**	1,383	**-4.9%**
Minutes of use (MOU) per average subscriber [1]	**146**	128	**13.7%**
- Residential - Business	121 244	97 271	25.5% -9.8%
Blended ARPU (monthly averaqe for the year in HRK)	**91**	94	**-3.0%**
- Residential - Business	74 160	74 184	0.0% -13.0%
Blended non-voice ARPU (monthly average for the year in HRK) [2]	**28**	26	**9.0%**
SAC per gross add in HRK	**80**	122	**-34.6%**
Churn rate (%)	**3.2**	2.7	**0.4 p.p.**
Penetration (%) [3]	**116.7**	119.9	**-3.2 p.p.**
Market share of subscribers (%) [3]	**46.5**	47.0	**-0.5 p.p.**
Data subscribers	**862**	661	**30.5%**
Smartphone subscribers (%) [4]	**22.6**	15.0	**7.7 p.p.**
Smartphones sold (%) [5]	**52.0**	-	**-**

1) 2011 restated due to change in „one company view" reporting (internal minutes between former segmentsT-Com and T-Mobile are excluded)

2) 2011 restated due to change in reporting of bundle tariffs

3) Source: published VIPnet's quarterly report for 4Q 2011 and Tele2's quarterly report for 4Q 2011. Number of subscribers for VIPnet and Tele2 for 4Q 2012 are internally estimated

4) Number of subscriber using a smartphone handsets in total number of mobile subscribers

5) Number of smartphones sold in total number of handsets sold (postpaid only)

Operational Highlights

Key operational data	Jan - Dec 2012	Jan - Dec 2011	% of change A12/A11
Fixed mainlines in 000			
Fixed mainlines- retail	**1,208**	**1,260**	**-4. 1%**
- Residential - Business	1,032 176	1,068 193	-3.3% -8.7%
Fixed mainlines - wholesale (WLR) [1]	**104**	**124**	**-16.1%**
- Residential - Business	85 19	109 15	-21.4% 23.0%
Total Traffic (mill, of minutes)	**2,405**	**2,790**	**-13.8%**
- Residential - Business	1,851 554	2,083 706	-11.2% -21.5%
ARPA voice per access (monthly average for the year in HRK) [2]	**115**	**121**	**-5.1%**
- Residential - Business	97 216	100 238	-3.2% -9.0%
IP mainlines/customers in 000			
Broadband access lines - retail [3]	**633**	**647**	**-2.1%**
- Residential - Business	526 107	539 107	-2.4% -0.4%
Broadband access lines - wholesale [4]	**25**	**4**	**485.2%**
- Business	25	4	485.2%
TV customers	**364**	**341**	**6.9%**
- Residential - Business	344 21	321 19	7.0% 6.1%
thereof IPTV	**332**	**323**	**2.8%**
- Residential - Business	312 20	304 19	2.8% 3.9%
thereof Cable TV	**6**	**6**	**0.1%**
- Residential - Business	6 0	6 0	0.1% -1.3%
thereof Satellite TV	**26**	**12**	**121.4%**
- Residential - Business	26 1	12 0	121.1% 131.0%

Key operational data	Jan - Dec 2012	Jan - Dec 2011	% of change A12/A11
Fixed-line customers	**1**	**1**	**3.2%**
VPN connection points	**4**	**4**	**1.4%**
Broadband retail ARPA (monthly averaae for the year in HRK) 5)	**126**	**123**	**2.4%**
- Residential	124	120	3.0%
- Business	134	134	0.0%
Data lines in 000			
Total data lines	**5**	**5**	**-3.0%**
Wholesale customers in 000	**0**	**0**	**0**
CPS (Carrier Pre-Selection)	32	96	-66.7%
NP (Number portability) users/number	646	514	25.7%
ULL (Unbundled Local Loop)	162	148	9.1%

1) Includef OTS, FGSM, ISDN ; 201 1 and Budget restated according new definition = pay from total number of mainlines

2) 2011 and Budget restated in line with 2012 reporting ; Payphones excluded

3) Includes ADSL, FTTH and Naked DSL

4) Includes Naked Bitstream + Bitstream

5) 2011 restated due to subsequent split of Iskon revenues from internet bundle package

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.

Presented financial figures may slightly differentiate from Consolidated Financial statements due to rounding principle (in Consolidated Financial statements all mathematic operations are performed with numbers without decimal places).

Introduction

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Letter To Shareholders

Dear Shareholders,

In 2012 Croatian Telecom's business operations were again conducted against a challenging economic backdrop. Unemployment continued to increase, whilst the decline in GDP and the increase in corporate sector insolvency continued. At the same time, the regulatory framework and intense competition put significant pressure on the telecommunications market.

As we indicated during the course of the year, these factors inevitably impacted T-HT's business and performance. Revenue dropped by 7.6% to HRK 7,456 million, primarily as a result of reduced revenue from voice services. Revenue from non-voice services rose, however, due to increased use of broadband services both in the mobile and fixed network. Other service revenue decreased largely due to lower ICT revenue as a consequence of the persistent recession in Croatia and a reduction in government contracts.

Despite successful cost-cutting, the fall in revenue resulted in an 8.0% drop in EBITDA, which totaled HRK 3,520 million.

In a highly competitive fixed-telephony market, bundled telecommunications offers brought additional competitive pressures. By maintaining a consistent focus on customer needs, we successfully offered attractive, quality services in this segment. Economic conditions and the consequent decline in personal consumption led to a fall in mobile telephony customers. At the same time, however, we increased our broadband customer base in the mobile segment. The number of IPTV customers continues to grow, while DSL services have recorded a decrease in retail customer numbers and an increase on the wholesale level due to the impact of regulatory changes.

In the face of this tough environment, the Group has maintained its market leadership position due to a range of activities aimed at providing advanced communications and ICT solutions and a high level of service quality.

In March, the Group launched a commercial LTE network. During the course of the year, we continuously expanded our 4G network coverage, particularly in large urban areas. At the end of 2012, we made this network available to customers in some rural and sparsely populated areas.

We also made significant progress in migrating our telecommunications networks to a fully IP-based infrastructure - by the end of 2012, almost 30% of customers had been redirected onto the new infrastructure.

In December, T-HT was the first in the DT Group to present the pilot network of the future - TeraStream. This concept provides all services, including the traditional telco services (voice, IPTV, Internet access), from the Cloud, at access speeds many multiples higher than they are today.

Capital expenditure increased by 25.8% to HRK 1,180 million, primarily due to the further development and transformation of the Group's infrastructure, as well as the cost of securing a 4G wireless frequency license in the 811-821/852-862 Mhz range.

For T-HT, 2012 will come to be seen as a key period - a year during which numerous transformation projects were launched that, in years to come, will be crucial for the Group's strategic positioning as a market leader in the evolution of the telecommunications industry and its convergence with the ICT and media sectors.

T-HT's shares were by far the most traded shares on the Zagreb Stock Exchange, where turnover almost halved due to the difficult economic conditions. At end of the year, the CROBEX index remained flat to the previous year, whilst the value of T-HT's shares was 18.5% lower.

In light of the Group's performance in 2012 and its cash position, the Management Board and the Supervisory Board proposed to the General Assembly of Croatian Telecom Inc. a dividend of HRK 20.51 per share.

Corporate social responsibility remains a key constituent of our business operations. Our business is characterized by a responsible approach to the society in which we operate. In 2012, we reported on our activities in this area by applying for the first time the Global Reporting Initiative (GRI) guidelines. This application of the highest standard of reporting supports the fact that we take our commitment to corporate responsibility very seriously.

This is additionally motivated by our awareness that we are part of a sector that is developing extremely fast. This offers opportunities to make a strong contribution to the welfare of our society.

A broad range of activities in the area of social responsibility are based around excellent communication and networking opportunities in private life and work, integration into the information and knowledge society and environmental protection, responsible use of resources and the reduction of greenhouse gas emissions.

In the years ahead, T-HT aims to continue to deliver top quality services and to retain its market-leading position. We will continue to provide reliable integrated communications and ICT services to our business customers and to provide integrated communication services focusing on cloud-based services, entertainment and content to improve the quality of our residential customers' lives. In this way, and by being a digital company, we will create, acquire and apply the latest technology and expertise, enabling us to supply top level services to all our customers.

I would like to thank all our shareholders for the trust they have placed in us; my thanks also go to the employees of the Group for their commitment and loyalty and to my colleagues from the Management Board and Supervisory Board for their cooperation in 2012.

Ivica Mudrinić
President of the
Management Board

Corporate Profile

At a Glance

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.

The core activities of Hrvatski Telekom d.d. and its subsidiary companies comprise the provision of electronic communications services and design and construction of electronic communications networks within the Republic of Croatia. In addition to the provision of fixed telephony services (fixed telephony line access and traffic, as well as fixed network supplementary services), the Group also provides Internet, IPTV and ICT services, data transmission services (lease of lines, Metro-Ethernet, IP/MPLS, ATM), operating with GSM, UMTS and LTE 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 operations on 1 January 1999.

Pursuant to the terms of the 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% stake 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% stake.

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 telecommunications services. HTmobile commenced commercial activities on 1 January 2003 and in October 2004, the company's name was officially changed to T-Mobile Croatia d.o.o. (T-Mobile).

On 1 October 2004, the Company was re-branded T-HT, thus becoming a part of the global „T“ family of Deutsche Telekom. This evolution of the corporate identity 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.

On 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 May 2006, the Company acquired 100% of shares of Iskon Internet d.d., one of the leading 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 total shares in the Offering, 25% were sold to Croatian retail investors, while 7.5% were acquired by Croatian and international institutional investors.

Following the sale of shares to current 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%, giving private and institutional investors 38.5% in total.

In October 2009, T-Mobile Croatia was merged into HT d.d. The merger came into effect on 1 January 2010, following which 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. completed the acquisition of IT services company Combis d.o.o., extending its reach into the provision of IT software and services for a client base that ranges from small businesses to government departments.

In December 2010, the 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 Pensioners' Fund. As a result of this transfer, the Republic of Croatia no longer holds shares of Hrvatski Telekom d.d.

Investor Information

Economic environment and share price performance

2012 brought another year of global uncertainty and turbulent capital markets. Nevertheless, positive developments in the second half of the year around the debt crises in Europe, along with the commitment by the European Central Bank to support the euro, in conjunction with other initiatives, helped most major indices globally to end the year in positive territory.

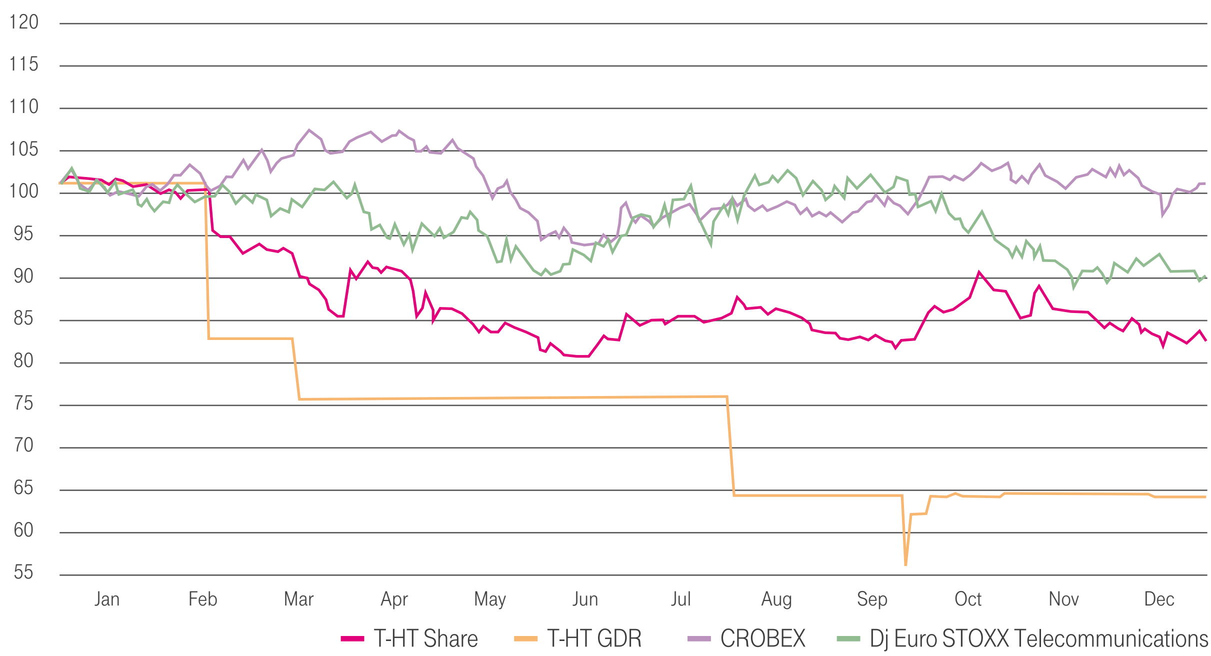
Croatia's benchmark CROBEX index, however, was flat (0.0%), on pressure from a lacklustre performance by the Croatian economy and low volumes traded on the stock market in 2012 (down 44.3% on the previous year). This followed a 17.6% fall in the CROBEX in 2011. In addition, the Croatian capital market was hit by the introduction of a 12% dividend tax, introduced in March 2012.

The Croatian economy is still characterised by declining industrial production, rising unemployment, high public spending, increasing indebtedness and a lack of meaningful structural reforms. As a consequence, Croatia saw downgrades in its credit rating at the end of 2012 by two leading ratings agencies. In December, for example, Standard & Poor's moved Croatia to a long-term BB+ rating, its highest non-investment grade, with a stable outlook. On average, Croatian GDP in 2012 is expected to show a fall of around 1.8%, but is expected to grow 0.5% in 2013. Croatia is also heading towards membership of the EU on 1 July 2013.

The European telecommunications sector came under pressure from outlook downgrades and dividend reductions by some operators and the overall sector performed poorly as a result, with the DJ Euro Stoxx Telecommunications Index (a leading indicator of the telecommunications industry that measures the performance of some of Europe's largest telecoms companies) down 10.7%, as the graph below illustrates.

T-HT Shares were not immune to broader trends in the European telecommunications sector and the impact

T-HT Share and GDR as compared to CROBEX and Dow Jones Europe Stoxx Telecommunications Index 1 January 2012 - 31 December 2012



of Croatia's economic woes, and the share price fell 18.5% to HRK 197.20. The high for the year was HRK 244.50, aga-inst a low of HRK 190.04 (Source: Zagreb Stock Exchange).

Whilst volumes traded were down 52.5% from the previous year, T-HT was once again the most traded share on the Zagreb Stock Exchange, with nearly HRK 600 million of turnover, accounting for 20.6% of the ZSE's total trade by value of shares in 2012 (2011: HRK 1.3 billion, 24.1%).

As at 31 December 2012, T-HT was the second largest company on ZSE, with a market capitalisation HRK 16.1 billion (EUR 2.1 billion), representing 12.6% 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 10% of the index.

As well as T-HT shares' listing on the Official Market of the Zagreb Stock Exchange, Global Depositary Receipts (GDRs), each representing one T-HT share, are traded on the London Stock Exchange.

In October, at a conference of the Zagreb Stock Exchange and Croatian investment fund industry, T-HT accepted the top award for Investor Relations in Croatia 2012 sponsored by the popular business newspaper Poslovni dnevnik (2011: second place award for best IR)

In December, at the presentation ceremony of the newly established Zagreb Stock Exchange Awards for 2012, T-HT received the award in the "Share with highest turnover" category.

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 2011 financial year

In April 2012, the General Assembly of the Company decided on a dividend payment to shareholders of HRK 1,813,012,164.90 (HRK 22.14 per share), representing a dividend payout ratio of 100%.

Pursuant to the above, following Supervisory Board consent to the Management Board, an advance dividend payment of HRK 11.07 per share was made in February 2012 with the residual amount of HRK 11.07 per share being paid to shareholders in May 2012.

At the end of 2012, this represented a dividend yield of 11.2% on T-HT's closing share price of HRK 197.20, on the final trading day of the year. Using the average closing share price over 2012, HRK 210.75, the dividend yield was 10.5%.

Dividend proposal for the 2012 financial year

The Management Board and Supervisory Board of Hrvatski Telekom d.d. propose to this year's General Assembly, the distribution of a dividend of HRK 20.51 per share which will be paid from Company's 2012 financial year net profit, resulting in total dividend payment of HRK 1,679,533,852.85, and allocation of the remainder of the net profit of HRK 510,635.17 to retained earnings.

The dividend will be paid to shareholders registered at the Central Depository and Clearing Company (SKDD) on the day of the General Assembly, planned for 17 June 2013. According to the proposal, the dividend will be paid on 8 July 2013.

As explained earlier, the taxation of dividends, at the rate of 12%, was introduced as of 1 March 2012.

Shareholder Structure as at 31 December 2012.

Deutsche Telekom	51.0%
Raiffeisen Mandatory Pension Fund	7.1%
War Veterans' Fund	7.0%
Pensioners' Fund	3.5%
Private and other institutional investors	31.4%

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 the Central Depositary & Clearing Company web site at the end of 2012, it held 7.1% of T-HT shares.

The remaining 31.4% is in private and other institutional hands, with more than 211,000 Croatian private investors holding T-HT shares representing 22.3% of the total share capital of the Company.

Financial Calendar

Release of full year 2012 results	**February 14, 2013**
Release of first quarter 2012 results	April 30, 2013
The General Assembly of the Company	June 17, 2013
Release of first half 2012 results	July 26, 2013
Release of first nine months 2012 results	October 30, 2013

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
Number of Shares:	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

IVICA MUDRINIĆ

President of the Management Board and
Chief Executive Officer

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 became adviser for communications to the President of the Republic. At the end of 1991, he became Assistant Minister for Maritime Affairs, Transportation and Communications, and in 1992 was appointed Minister. From 1994 Mr 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 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, Mr Mudrinić has served as President of the Management Board of Hrvatski Telekom.

NORBERT HENTGES

Member of the Management Board and
Chief Operating Officer

Norbert Hentges was born in 1961. After graduating in Communications Engineering, he began his career in the Optical Networks Product Marketing Department of Richard Hirschmann GmbH, followed by a period in the Sales and Consulting Department of data transmission company Telemation Gesellschaft für Datenübertragung.

Mr Hentges joined the Deutsche Telekom Group in 1994 and has held a number of senior roles within the Group including Head of the Technology and Platforms Central Unit of Deutsche Telekom AG; Head of the Wholesale business unit of Deutsche Telekom / T-Com; and Chairman of the Managing Board of the Business Unit for German Business Customers in Deutsche Telekom.

From 2010 to August 2012, Mr Hentges was Head of Save-for-Service in the Business Segment Europe. As member of the Europe Leadership Team he oversaw efficiency and cost programs across the national companies.

In September 2012, Mr Hentges joined the Management Board of Hrvatski Telekom, and took the newly created role of Chief Operating Officer.

DINO IVAN DOGAN

Member of the Management Board and
Chief Financial Officer

Dino Dogan was born in 1963, and graduated in Technical Business Administration from the University of Stuttgart in 1988.

Dr Dogan brings considerable experience of the telecommunications industry. He served as Chief Financial Officer and Member of the Board at Mobilkom Austria AG from August 2009 and was appointed Chief Integration Officer for Mobilkom Austria AG's merger with Telekom Austria AG in 2010.

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, Dr Dogan became a Member of the Management Board and Chief Financial Officer of Hrvatski Telekom.

IRENA JOLIĆ ŠIMOVIĆ

Member of the Management Board and
Chief Human Resources Officer

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 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 a Member of T-HT's Management Board and Chief Human Resources Officer. Ms Šimović was Chief Operating Officer of 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 September 2012 she was again appointed Chief Human Resources Officer.

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 at 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 1 January 2003, when the subsidiary company T-Mobile Croatia was launched.

In March 2007, Mr Poldrugač was appointed Member of the Management Board and Chief Technical and Chief Information Officer for the T-HT Group.

NATAŠA RAPAIĆ

Member of the Management Board and Chief Operating Officer Residential

Born in 1969 in Zagreb. Graduated from the Faculty of Economics in Zagreb in 1993 and completed MBA studies at IE in Madrid in 2000. Ms Rapaić has gained professional experience working in various positions of responsibility. She was a co-founder and director of export/import operations in the company Milna Parket, economic analyst in the Economic Office at the Embassy of Spain, where she worked on research into the Croatian market and boosting economic cooperation between the two countries, and worked as a financial analyst in the investment department of the bank Grupo Caixa Galicia.

Ms Rapaić acquired marketing experience in the telecom industry working as a consultant at Madrid-based Europraxis Consulting and on various projects for the marketing sector of Telefónica Móviles.

She joined Hrvatski Telekom in 2003 as the Executive Director of the Sub-Unit Responsible for Communications. On 1 September 2005 she was appointed Member of T-Com Executive Board and Chief Marketing Officer.

In 2010 she took over the position of the Operating Director of the Residential Marketing Sector and on 1 February 2013 was appointed to the position of Member of the Management Board of HT d.d. and Chief Operating Officer Residential.

BRANKA SKARAMUČA

Member of the Management Board and Chief Human Resources Officer until 17 September 2012

JOHAN BUSÉ

Member of the Management Board and Chief Operating Officer Residental until 1 August 2012

Compensation to the Management Board members in 2012

In 2012, Ivica Mudrinić, President of the Management Board, was paid the fixed salary in annual gross amount of HRK 2,221,829 in an average net monthly installments of HRK 96,944. Variable part, in accordance with 2011 goals achievement, amounted to HRK 516,106 net. Payment according to HT MTIP 2009 amounted to HRK 232,271 net. Income in kind amounted to HRK 82,727 gross, for company car usage.

Irena Jolić Šimović, member of the Management Board, was in 2012 paid a fixed salary in annual gross amount of HRK 1,536,605 in average net monthly installments of HRK 66,919. The variable part, in accordance with 2011 goals achievement, amounted to HRK 213,486 net. Payment according to HT MTIP 2009 amounted to HRK 130,072 net. The income in kind amounted to HRK 138,828 gross, for company car usage.

Johan Hendrik Martinus Busé, member of the Management Board until July 31st 2012, was in this period 2012 paid a fixed and variable salary in gross amount of HRK 2,188,360. The amount of income in kind was HRK 196,705 gross for insurance, rental of an apartment and company car usage.

Norbert Hentges, member of the Management Board from September 1st 2012, was in this period 2012 paid a fixed salary in gross amount of HRK 980,307. The amount of income in kind was HRK 143,214 gross for insurance, rental of the apartment and company car usage.

Božidar Poldrugač, member of the Management Board, was in 2012 paid the fixed salary in annual gross amount of HRK 1,446,779 in an average net monthly installments of HRK 66,190. Variable part, in accordance with 2011 goals achievement, amounted to HRK 263,829 net. Payment according to HT MTIP 2009 amounted to HRK 121,414 net. The income in kind amounted to HRK 157,378 for company car usage.

Dino Ivan Dogan, member of the Management Board, was in 2012 paid the fixed salary in annual gross amount of HRK 1,684,237, in an average net monthly installments of HRK 73,882. Variable part, in accordance with 2011 goals achievement, amounted to HRK 232,744 net. The income in kind amounted to HRK 54,616 gross, for company car usage.

Branka Skaramuča, member of the Management Board until September 16th 2012, was in this period 2012 paid a fixed salary in gross amount of HRK 1,173,171, in average net monthly installments of HRK 61,195. The variable part, in accordance with 2011 goals achievement, amounted to HRK 243,434 net. Payment according to HT MTIP 2009 amounted to HRK 123,103 net. The benefit in kind amounted to HRK 97,509 gross for company car usage.

Share-based and non Share-based payment transactions

Various mid-term (HT MTIP 2010, Transitional HT MTIP 2011) and long-term incentive plans (LTIP: HT Variable II 2011 and HT Variable II 2012) currently exist at the Company level. Their purpose is to ensure competitive total compensation for members of the Management Board, senior executives and other participants. The plans promote the medium and long-term value enhancement of the Company, thus aligning the interests of management and shareholders. The first HT's MTIP was introduced in 2008.

MTIP is set up as a cash-based plan linked to two equally weighted, HT share-based performance parameters - one absolute and one relative. If both performance targets are achieved, then the total amount earmarked as an award to participants is paid out, if one performance target is achieved, 50% of the amount is paid out, and if neither performance target is achieved, there is no payment.

MTIP's targets cannot be changed during the MTIP duration. The first target is based on the increase of the HT share price by a certain percentage; the second target is related to the share price movement compared to the composite return index.

MTIPs cover a period of three years (i.e. MTIP 2010 covers the period from 1 January 2010 to 31 December 2012). Upon expiry of the term of the plan, the HT Supervisory Board determines 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.

The incentives themselves are based on 20% or 30% of the participant's 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. Participant's individual annual salary is defined as the annual amount of total fixed salary and the amount of variable salary in case of a 100% target achievement.

In February 2012 the rewards for participants of HT MTIP 2009 were paid out. By decision of the Supervisory Board it was determined that at the end of HT MTIP 2009 (on December 31, 2011), one target out of two has been achieved. In accordance with targets achievement, the participants were paid 50% of the total amount awarded at the beginning of HT MTIP 2009.

LTIP - HT Variable II 2011 is a four years cash-based plan, introduced for the first time in 2011, based on four equally weighted performance parameters which cannot be changed during the 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 satisfaction and employee satisfaction.

Unlike the MTIP structure, Variable II offers the opportunity of exceeding the amount 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 on a graded basis per target parameter (departure from the principle of "all or nothing").

The amount of Variable II awarded to participants is based, same as in MTIPs, on 30% or 20% of the participant's individual annual salary as contracted on the beginning of the plan, depending on the management level and according to the Supervisory Board decision.

At the beginning of 2012 HT Variable II 2012 was launched.

Parallel with the introduction of LTIP - Variable II in 2011, the new Compensation model consisting of Variable I (Share Matching Plan) and Variable II, for International Business Leaders (BLTs) was implemented and precisely defined in their individual employment contract. 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 in each year, starting from 2011 onwards.

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.

Supervisory Board

Andreas Moelich
President of the Supervisory Board
until 31 August 2012

Mark Klein
President of the Supervisory Board
from 10 September 2012
Member from 25 April 2012

dr.sc. Ivica Mišetić
Deputy President

Oliver Morbach
Member

Kathryn Walt Hall
Member

dr. Ralph Rentschler
Member

dr. Lutz Schade
Member until 25 April 2012

Andreas Hesse
Member until 25 April 2012

Slavko Leban
Member until 21 April 2012

dr. Oliver Knipping
Member from 25 April 2012

Damir Grbavac
Member from 25 April 2012

Juko Cikojević
Member

As specified by the Company, a chairman of the Supervisory Board receives remuneration in the amount of 1.5 of the average net salary of employees of the Company, paid in the preceding month. To a deputy chairman, the amount of 1.25 of the average net salary of employees of the Company paid in the preceding month, is paid, while any other member receives the amount of one average net salary of employees of the Company paid in the preceding month. To a member of the Supervisory Board who is at the same time a Chairman of the Audit Committee of the Supervisory Board, the amount of 1.5 of the average monthly net salary of employees of the Company paid in the preceding month, is paid. To a member of the Supervisory Board who is at the same time a Member of the Audit Committee of the Supervisory Board, the amount of 1.25 of the average monthly net salary of employees of the Company paid in the preceding month, is paid. To a member of the Supervisory Board who is at the same time a Member of the Compensation and Nomination Committee of the Supervisory Board, the amount of 1.25 of the average monthly net salary of employees of the Company paid in the preceding month, is paid. 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 members of the Supervisory Board.

Compensation to the Supervisory Board members in 2012 is as follows:

	Period in which compensation is paid		
	From	To	Gross HRK
Juko Cikojević	January 1st 2012	December 31st 2012	160,507.12
Kathryn Hall	January 1st 2012	December 31st 2012	187,040.48
Slavko Leban	January 1st 2012	May 31st 2012	51,791.16
Ivica Mišetić	January 1st 2012	December 31st 2012	198,979.23
Damir Grbavac	May 1st 2012	December 31st 2012	90,744.03

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. Mark Klein, Chairman of the Supervisory Board, Mr. Ivica Mišetić, Ph.D., Deputy Chairman of the Supervisory Board, Mr. Oliver Morbach, Dr. Oliver Knipping, Dr. Ralph Rentschler, Ms. Kathryn Walt Hall, Mr. Damir Grbavac 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 2012 and on the results of the examination of the business and financial reports for the business year 2012

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 2012,
- the results of the examination of the annual financial statements as of 31 December 2012 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 2012,
- the results of the examination of the report on relations with the governing company and affiliated companies thereof.

Corporate Profile

On 31 December 2012, 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 per cent of shares, and the Pensioner's Fund 3.5 per cent of shares. Other private and institutional investors hold the remaining 38.5 per cent of shares. Raiffeisen obvezni mirovinski fond (Raiffeisen Mandatory Pension Fund) is the investor with the largest shareholding among the private and institutional investors. As at 31 December 2012 Raiffeisen obvezni mirovinski fond had 7.1 per cent shares of the Company. An up to date list of the top ten shareholders of the Company may be found on the Central Depository & Clearing Company web site (start your search by entering HT-R-A in the browser in the browser).

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 (whereby one position in the SB is vacant), one member nominated by the Raiffeisen Mandatory Pension Fund, two independent members and one member appointed by the Workers' Council of HT d.d.

Supervisory Board

During 2012, the composition of the Supervisory Board of the Company changed as follows:

The term of office of the Member of the Supervisory Board, Mr. Slavko Leban, M.D., expired on 21 April 2012.

Members of the Supervisory Board, Mr. Andreas Hesse and Dr. Lutz Schade, have resigned from their positions in the Supervisory Board with effect as of 25 April 2012.

Mr. Damir Grbavac, Dr. Oliver Knipping and Mr. Mark Klein were elected as new Members of the Supervisory Board as of 25 April 2012.

Member of the Supervisory Board and its Chairman, Mr. Andreas Moelich, has resigned from his membership of the Supervisory Board with effect as of 31 August 2012.

Mr. Mark Klein, Supervisory Board Member, was elected as the Chairman of the Supervisory Board as of 10 September 2012.

On 7 February 2013, the Supervisory Board has received the resignation of the member of the Supervisory Board, Mr. Oliver Morbach, with effect as of the closing of the first regular General Assembly in the year 2013.

Therefore, regarding this second vacancy in the Supervisory Board membership, the Supervisory Board, at its session held on 13 February 2013, made the proposal to the General Assembly for election of Mr. Mark Nierwetberg and Mr. Elias Drakopoulos, Ph.D., as Members of the Supervisory Board.

Audit Committee

During 2012, Mr. Kay Nolden, Chairman, Mr. Ivica Mišetić, Ph.D., Member, and Mr. Franco Musone Crispino, Member, were the members of this Committee.

On the day of issuance of this report, Mr. Kay Nolden resigned from his position of Chairman of the Audit Committee, and the Supervisory Board appointed Mr. Axel Brandes as the new Chairman of the Audit Committee.

Compensation and Nomination Committee

On the day of issuance of this report: Mr. Mark Klein, 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, whereby the position of COO Business is vacant, and activities falling within these Officers' responsibilities are temporarily assigned to the function of COO.

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

The Supervisory Board has adopted the new division of competences among Management Board Members. In line therewith function of Chief Operating Officer (COO) was introduced, applicable as of 20 July 2012.

Mr. Norbert Hentges was appointed as the Member of the Management Board and Chief Operating Officer (COO), with commencement of his term of office as of 1 September 2012. Until that date activities falling within these Officer's responsibilities were temporarily added to the function of the President of the Management Board and CEO, Mr. Ivica Mudrinić.

Mr. Johan Busé resigned from his position as a Member of the Management Board and Chief Operating Officer Residential (COO Residential), effective as of 31 July 2012. Activities falling within these Officer's responsibilities are temporarily added to the function of the President of the Management Board and CEO, Mr. Ivica Mudrinić, until the appointment of new COO Residential.

Ms. Branka Skaramuča resigned from her position as a Member of the Management Board and Chief Human Resources Officer (CHRO), effective as of 17 September 2012. Activities falling within these Officer's responsibilities were added to the function of the Member of the Management Board and Chief Operating Officer Business (COO Business), Ms. Irena Jolić Šimović.

Ms. Irena Jolić Šimović was appointed as the Member of the Management Board and Chief Human Resources Officer (CHRO), with commencement of her term of office as of 1 October 2012, following the expiry of her term of office as the Member of the Management Board and COO Business.

Activities falling within the Officer's responsibilities of the Member of the Management Board and COO Business were temporarily added to the function of the Member of the Management Board and Chief Operating Officer (COO), Mr. Norbert Hentges, in the period from 1 October 2012 until the appointment of new COO Business.

On 30 January 2013, the Supervisory Board has appointed Ms. Nataša Rapaić as the new Member of the Management Board and Chief Operating Officer Residential (COO Residential), with commencement of her term of office as of 1 February 2013.

Performed supervision during the business year 2012

In 2012, there were six (6) sessions of the Supervisory Board and two (2) decision makings out-of-session. One proposed decision making out-of-session in January 2012 was closed, since one Supervisory Board Member opposed to such decision making, and shortly thereafter a session was convoked.

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 and protection of core business, focus on broadband and IPTV, growth opportunities outside core, service orientation and focus on customer, IP based services and quality of service, integrated and cloud based service platforms, IT main projects, network transformation and customer migration, fiber optical infrastructure, extension of ICT products and services, cost efficiency and optimization of key processes, T-HT Transformation Program 2013 - 2015,
- Regulatory framework - regulations and requirements with regard to the distributive fiber optics network, significant market power, cost accounting, network access and regulated products, unbundled local loop pricing, provisioning universal services, prepaid registration, Wholesale line rental, retail broadband and IPTV, alignment with EU regulatory framework, etc.,
- New trends - commercial launch of 4G Long Terms Evolution (LTE) network and new MuptiPlus mobile brand with partners, new MAX bundle packages, enabeling of use of mobile television on smartphones - MAXtv To Go, introduction of mobile payment based on NFC technology, new tariffs for residential customers, further development of cloud services portfolio for business customers, application for acquisition of the "digital dividend" band, strategic agreement with Google, etc.,
- HR accomplishments and challenges, strategy, plans and activities, headcount development, performance management system, management development framework and sucession planning, employee career management,
- Corporate Governance, division of competences among Management Board Members and membership of the Management Board as described above,
- Decision proposals for the General Assembly,
- International activities of the Company,
- Annual Business Plan for 2013 and Strategic Plan for 2014 - 2016,
- Cash management and savings initiatives of the Company,
- Reports and 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,
- 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 2012, the Audit Committee of the Supervisory Board held five (5) regular sessions and discussed various issues, especially:

- 2011 year-end closing of T-HT Group,

- Implementation and effectiveness of internal control over financial reporting according to Internal Control System,
- Update of status of penetration testing procedures in T-HT,
- Changes in Internal Control System in 2012,
- Status of procurement function improvement,
- T-HT transformation program 2012,
- External Auditor's Report (quarterly reports, Auditor's Independence, Report on auditor engagement, accounting policies and disclosure requirements in 2012, Management recommendation letter 2011, 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", increase of VAT rate, tax on mobile services, ADSL and MAXtv regulation 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 2012,
- Audit program 2012 execution,
- Supervision over the realization of audit measures and audit reports,
- Internal auditing program for 2013,
- Trainings for AC members (e.g. changes of IFRS, IT landscape deep dive).

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 2012, the Compensation and Nomination Committee began the target-setting procedure for 2013 and also began preparing the target evaluation procedure for 2012. Changes in the Membership of the Management Board as outlined above were also covered by their Agenda as well as running the Mid Term and Long 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 2012 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 examination of the above report in accordance with the International Standard on Assurance Engagements 3000 "Assurance Engagements other than Audits or Reviews of Historical Information". Based on the results of their work as described in their audit report, the auditor concluded that nothing has come to their attention that causes them to believe that the above report is not presented, in all material respects, in accordance with the criteria as set out in Article 497 of the Croatian Company Law.

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 2012 and draft decision on utilization of profit

The Supervisory Board issued an order to Pricewater-houseCoopers, the Company's auditor, for the examination of the annual financial statements for the year 2012.

The Supervisory Board, after considering the audited financial statements for the business year 2012, established that the Company acted in 2012 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 Compa-ny'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 2012.

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 2012 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 accorda-nce 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 1,679,533,852.85 will be distributed to shareholders as dividend payment, in the amount of HRK 20.51 per share, and the remainder of net profit in the amount of HRK 510.635,17 is to be allocated to retained earnings. The joint proposal by the Management Board and the Supervisory Board on the utilization of profit for 2012 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 2012.

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 across all areas of operation and achieved solid financial results in 2012, in the face of a number of challenges including intensified competition, falling consumption and further economic slowdown.

Aside from the financial results for the year 2012, the Supervisory Board considered and approved the Company's business plan for the year 2013 and the Strategic Plan for 2014-2016.

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 2012.

Mark Klein
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, 137/09 and 111/12), 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 2012 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 website 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 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 (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:

- Request 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 was 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 the day of issuance of this Statement, 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 and the Pensioner's Fund 3.5 per cent of shares. The remaining 38.5 per cent of shares are owned by Croatian citizens and by other domestic and foreign institutional investors. Raiffeisen obvezni mirovinski fond (Raiffeisen Mandatory Pension Fund) is the investor with the largest shareholding among the private and institutional investors. As at 31 December 2012 Raiffeisen obvezni mirovinski fond had 7.1 per cent shares of the Company. An up to date list of the top ten shareholders of the Company may be found on the Central Depository & Clearing Company web site (start your search by entering HT-R-A in the browser).

The President of the Management Board of Hrvatski Telekom d.d., Mr. Ivica Mudrinić, owns 6,500 shares in total; Mrs. Branka Skaramuča, MB Member until 17 September 2012, 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 (On 28 January 2013, Mr. Ivica Mišetić, Ph.D., disposed of 63 shares and after this disposition does not hold any shares in the Company) and Mr. Juko Cikojević, Supervisory Board Member (workers' representative), 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. Current composition of the Management Board includes seven members: the President of the Management Board (CEO); MB Member and Chief Operating Officer (COO); 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 Information Officer (CTIO) and MB Member and Chief Human Resources Officer (CHRO), whereby the position of Chief Operating Officer Business (COO Business) is vacant on the day of issuance of this Statement.

The Company is offering fixed and mobile telephony services as well as wholesale, Internet and data 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. In line therewith, the Management Board adopted in 2012 the Treasury share buyback program for the purpose of realization of the long-term incentive plans for senior management. In accordance with the said Program, in May 2012 the Company acquired at the Zagreb Stock Exchange 1,931 Company shares.

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.

Business review 2012

Croatian Telecommunications Market Overview
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Croatian Telecommunication Market Overview

Strong performance in face of negative economic trends

T-HT Group successfully maintained its leading position in the Croatian telecommunications market across all areas of operation in 2012, in the face of a number of challenges including intensified competition, falling consumption and further economic slowdown.

Notable events in 2012 include the following:

- LTE network commercial launch in March 2012; continued promotions of 4G mobile internet tariffs in Q3
- July 2012, MAXtv To Go - an innovative mobile TV service on smartphones
- In ICT segment, continued to develop a portfolio of cloud services following the launch of IaaS and SaaS services
- September 2012, concluded strategic agreement with Google to be major partner for Google AdWords in Croatia
- December 2012, presented for the first time in the world the network of the future - TeraStream, which enables speeds 50 times higher than currently available

Market trends

Negative economic trends, regulatory measures and increased competition had a significant negative impact on the development of the Croatian telecommunications market.

Intense competition in the mobile market from flat rate tariffs and an increasing number of bundled voice, data and TV offers have been key drivers of competition in 2012. In Q4 2012 a new pay TV market player launched, intensifying competition on the Croatian pay TV market.

At the same time, a new concept of co-operation was launched in 2012 for the first time in the market: prepaid mobile brand by a leading retail chain in co-operation with T-HT.

Voice revenue continued to decline due to lower usage, a fall in mobile termination rates and pricing competition. However, major growth areas include broadband, data traffic, TV, ICT solutions and integrated offers of telecommunication services.

T-HT launched its LTE network in March 2012, enhancing its mobile broadband offer with two new T-Mobile Extreme tariffs based on LTE technology. The commercial launch of LTE by the two dominant mobile operators in the Croatian market, along with an increase in smartphone and tablet penetration, boosted growth in mobile broadband.

The 6% fee imposed by the Croatian Government on revenues from mobile services was re-introduced at the end of January 2012 and abolished again at the beginning of July 2012.

On 14 September 2012, the Agency announced a public submission process for a 12-year wireless frequency license on the 790MHz-862MHz band. The Agency approved two licenses at the end of October 2012, granting one to T-HT Group.

Macroeconomic trends

Improved investment climate and structural economic reforms are vital for growth

Having experienced a significant decline at the end of 2011 and the beginning of 2012, economic activity in Croatia stagnated in the second half of 2012. Real GDP is expected at -2.0% for the whole 2012 due in large part to falling personal consumption and the absence of investment.

Employment in Croatia also continued to fall in 2012 for the fourth consecutive year. As in previous years, a fall in the employment rate was experienced in the private sector, while public sector employment showed an increase. As a result, the average annual registered unemployment rate in 2012 is expected to reach 18.5%, an increase on the 18.0% in 2011. The unemployment rate had a negative impact on personal consumption in 2012[1] and an upturn in the labour market is not expected in 2013.

[1] Source: Croatian Central Bureau of Statistics, December 2012

Higher unemployment, a fall in real income (down 1.2% in real terms for the first nine months of 2012 against the same period in 2011), the associated fall in consumer confidence and Q4 2012 trends in retail sales figures indicate that personal consumption in Q4 2012 was also lower. Consequently, a significant decline in personal consumption is expected again for the whole of 2012 (-2.4% on an annual level), after stagnation in 2011 (0.2%). The decline in industrial output, unpaid bills at a record high of HRK 44.5bn and a total of 72,654 insolvent businesses in October 2012 put downward pressure on all sectors and on exports in 2012.

Inflation was significantly higher in 2012 as a result of an increase in VAT, droughtand energy price increase. The average annual inflation rate for 2012 is expected to reach 3.5%.

Fixed-line market

Dominant market position maintained in face of tough competitive environment

Fixed telephony remains highly competitive in Croatia, with nine operators active in the market. In addition, market consolidation in 2012 further increased competitive pressure from bundled telecommunications offers.

Competitive pressure notwithstanding, T-HT successfully maintained its leading position in the fixed line market, reflecting the Group's continuing dedication to high-quality services and improved offers.

Fixed voice usage showed a further decline whilst fixed broadband and mobile usage increased. The number of fixed-line minutes of use (MOU) decreased by 16% in the first nine months of 2012 compared with the same period in 2011.

Estimated fixed-line penetration rate for 2012 is 37% of the Croatian population.

Mobile telecommunications

Market leadership continues despite intense competitive pressure

Through a range of brands, the Group maintained a leading market position in a saturated mobile market, served by three operators since 2005. Mobile penetration is estimated to reach116.7% and the Company's share of total mobile customers is estimated at 46.5% at the end of 2012. Mobile competition increased in Q4 2012 with a new MVNO partnership between T-HT's fixed and mobile competitors.

Despite increased mobile usage, mobile revenue continued on a declining trend due to lower mobile termination rates and intense pricing pressure. Total Croatian mobile market minutes of use (MOU) increased by 11% and the number of SMSs sent increased by 10.8% in first nine months of 2012 compared with the same period in 2011. The demand for mobile Internet continued to grow in 2012, with all three mobile operators promoting mobile broadband offers alongside increasing smartphone and tablet offers. At the same time, an increasing range of mobile applications and mobile services are now available, including e-books and mobile TV.

Internet

Stable growth continues in fixed broadband, pay TV markets

The Croatian fixed broadband market continued to grow in 2012, with 879,597 fixed broadband connections reported at the end of September 2012.[2] The market grew 4% compared with the end of September 2011. DSL is still the dominant broadband technology.

At the end of 2012, T-HT Group had 632,994 broadband access lines.

[2] Source: Croatian Post and Electronic Communications Agency, December 2012

The Croatian broadband market still represents a growth opportunity for T-HT with an estimated 48.8% of Croatian households connected to fixed broadband network compared to an average of 66% in Western Europe.[3]

The Croatian pay TV market grew by 1% in first nine months of 2012, against the same period in 2011, reaching 603,240 customers4. During that period, competition intensified with the launch of a new pay TV service in Q4 2012.

The Group reported 364,324 TV customers at the end of 2012, representing 57.6 % of T-HT's total fixed broadband customer base. During the period, T-HT enhanced its TV services with the introduction of MAXtv To Go - an innovative mobile television service for smartphones.

In March 2012, regulation was extended within the IPTV segment, making Croatia the only country in Europe with a regulated IPTV market.

Data

Continued migration to IP-based services

T-HT maintained its leading position in a data market that is migrating from traditional data services to more cost-effective, IP-based services. Although the data market is relatively small it represents an important service for business customers.

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

Wholesale

High demand for new services resulting from regulatory initiatives

Following liberalization of the fixed line market, demand for infrastructure services requested by alternative operators remained high in 2012 as a result of the introduction of Wholesale Line Rental (WLR) and naked bitstream services in 2011.

The number of broadband wholesale customers (BSA and Naked BSA) reached 24,578 at the end of 2012. In addition, significant demand for Unbundled Local Loop (ULL) continued, and the number of customers increased to 161,768 at the end of 2012.

As of 1 January 2012, wholesale prices were amended for the following regulated services: call origination, fixed and mobile call termination.

IT market impacted by economic crisis

The Croatian IT market demonstrated a negative trend in 2012 owing to economic pressures. Significant IT budgets cuts amid the current economic recession and a generally downbeat business outlook resulted in cautious spending plans by Croatian businesses, whilst a high level of unpaid bills put further downward pressure on IT consumption. The Croatian IT market is estimated to decline by 4.8% in 2012[4]. Combis, which is part of the T-HT Group, has maintained its leading position in the Croatian ICT services market[5].

[3] Source: Analysys Mason

[4] Source: Updated forecast of Croatian IT market for 2012 (in USD), IDC Adriatics, December 2012

[5] Source: „Croatia IT Services Market 2012-2016 Forecast and 2011 Vendor Shares“, IDC Adriatics, September 2012

Regulatory Environment

The Croatian Law on Electronic Communications, which replaced the previous Law on Telecommunications, has been in force since 1 July 2008. The law transposed the 2002 EU New Regulatory Framework onto Croatia's electronic communications market and has since undergone two sets of amendments. The first amendments to the Law on Electronic Communications were adopted by Croatian Parliament in July 2011 and came into force in August 2011. The purpose of these amendments was to align Croatia's electronic communications market with the EU Regulatory Framework of 2009. Croatian telecoms operators were provided a 90 day-period to consolidate their business operations within the new provisions of the Law. The second amendments to the Law on Electronic Communications were adopted by the Croatian Parliament in November 2012 and came into force in December 2012. These were designed to reduce the members of the Council of Croatian Post and Electronic Communications Agency (hereinafter: the Agency) from seven to five. To date, the Agency has adopted several by-laws prescribing the terms and conditions for the provision of electronic communications services in Croatia. In line with Croatian regulatory framework, and in line with the latest EU recommendations, the Agency can impose regulatory remedies only after proper market analysis and determination of the existence of significant market power (SMP). According to the market analysis conducted by the Agency in July 2009, in 2011 and in 2012, the Company holds SMP in the following markets:

1. Call origination in the fixed network
2. Call termination in the fixed network
3. Wholesale (physical) network infrastructure access (including shared or fully unbundled access)
4. Wholesale broadband access
5. Call termination in the mobile network
6. Wholesale terminating segments of leased lines
7. Wholesale trunk segments of leased lines (non-competitive lines)
8. Retail access to the public communications network at a fixed location
9. Publicly available local and/or national telephone service provided at a fixed location for residential customers
10. Publicly available local and/or national telephone service provided at a fixed location for non-residential customers
11. Retail broadband Internet access (regulated as of 23 March 2012)
12. Retail market for transmission of TV programs with remuneration - IPTV market (regulated as of 23 March 2012).

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

- In markets 1 - 7: network access and use of special network facilities (this obligation is extended to the Company's optical fibre access network), non-discrimination, transparency, price control and cost accounting, accounting separation (applies only to the Company's fixed business)
- In market 8: 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, the Company published wholesale reference offers for naked bitstream and WLR in June /July 2011
- In markets 9 - 12: price controls and regulation of promotional offers were imposed upon the Company and Iskon.

Moreover, the Company retains SMP status defined under the old legal framework (i.e. under the Law on Telecommunications that was replaced by the Law on Electronic Communications in 2008) on the following market:

- Retail leased lines market - market analysis started in 2010 and is expected to conclude in 2013 according to an announcement by the Agency

In March 2011, the Agency reduced the Company's prices (monthly fees) charged for the wholesale unbundled local loop service (ULL) from HRK 52.14 to HRK 43.61. The Company's monthly fee for Shared ULL was reduced in October 2012 from HRK 16.92 to HRK 16.68.

Under a decision adopted in November 2011, the Agency increased the "x" percentage used to calculate the Company's prices for wholesale bitstream access on copper - IP level (retail minus methodology) from 40% to 60%. In December 2011, the Agency adopted a decision on amendments of the Company's reference offer for wholesale bitstream access on copper and FttH (fibre to the home). This decision imposed more than 60 amendments and defined final concepts for the provision of wholesale bitstream access on copper and FttH. In March 2012, the Agency adopted a decision on regulation of the retail broadband Internet access market and retail market for the transmission of TV programs with remuneration (IPTV market), thus imposing strict regulatory obligations upon the Company's retail broadband/IPTV business (cost orientation, notification of pricing 45 days in advance, regulation of promotional offers, regulation of bundled offers). In July, 2012, the Agency initiated a second round of wholesale market analysis (unbundled local loop access, bitstream access, origination and termination in fixed network, termination in mobile network). Publication of the draft market analysis is expected in the first quarter of 2013. Final decisions are expected in 2013. In September 2012 the Agency deregulated wholesale markets for network access for value-added service providers and network access for narrowband Internet access. Consequently, the Company does not hold SMP status in that market any longer. As of October 2010, the Company was (re)designated as the universal service provider for the next five years for all 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."

In July 2012, the Croatian Parliament adopted the Government's proposal to abolish the 6% fee on revenues generated by mobile services, including SMS, MMS and voice, that had been payable by all mobile operators. Accounting separation (this applies only to the Company's fixed business): the cost accounting project, initiated at the end of 2008, is ongoing. In the third quarter of 2011 the Agency started developing its own cost modeling for all regulated services.

On 29 October 2012 in the public assignment process for 12-year wireless frequency licenses on the 790MHz-862MHz band (the "digital dividend") the Company was granted with the frequency block of 811-821/852-862 MHz for the period from 29 October 2012 to 18 October 2024 for a fixed one-off fee for the spectrum license of HRK 150 million, plus additional annual fees for the use of the frequencies.

Group's Strategy

T-HT Group Mission

Communication, Information & Entertainment - Always & Everywhere

Increasing number 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 - to be the online company and to power the online society and digital economy in Croatia and the Region

T-HT is the leading digital solution provider that powers the online society and digital economy in Croatia and the Region.

T-HT Group Strategy

Our strategy centres around three key pillars:

GROW - COMPETE - TRANSFORM

GROW focuses on developing business opportunities around mobile and fixed Internet, online consumer services, ICT, media, advertising and innovative services arising from advances in technology and business.

COMPETE ensures the Group's continued focus on its existing fixed and mobile telecommunications business by enhancing our core offers and leveraging our high quality networks.

TRANSFORM refers to a radical process of e-transformation involving the shift to online of both internal and external business processes; the next phase of customer care, targeting customer satisfaction and organizational efficiency; network transformation through the migration to all-IP technology; and an improved cost structure across all core operations.

To further strengthen these transformational activities across the organisation, the position of Chief Operating Officer was introduced as of July 20 2012 to coordinate, manage and integrate these activities alongside key operational activities.

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 the best people to help us build our business.

Regional expansion

The Group continues to monitor and evaluate expansion opportunities.

Organization of the Group

New Group organization focused on strengthening e-business

The Group comprises the customer facing Business and Residential units and centralized technical functions (CTIO), support and steering functions (CEO, CFO and CHRO), and subsidiaries including Combis d.o.o., Iskon d.o.o. and KDS d.o.o.

Since 20 July 2012 the Group's organization has been strengthened with the introduction of a Chief Operating Officer (COO).

Residential unit

The Residential unit is headed by the Chief Operating Officer Residential (COO Residential) and incorporates Residential Marketing and Sales .

Business unit

The Business unit is headed by the Chief Operating Officer Business (COO Business) and incorporates Business Marketing, Corporate and SME Sales and ICT Business Solutions.

Chief Operating Officer

The main responsibilities of the new Group Chief Operating Officer (COO) position include coordinating, managing and integrating operational and transformational activities across the Residential and Business Customer Facing Units, Wholesale, Customer Services and Technical Functions.

The organizational structure of the Group is as follows:

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

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

Overview

- T-HT maintained its leading position in all three markets (mobile, fixed line and IP)
- Postpaid EXTRA tariffs were enhanced with the introduction of EXTRA total+ tariffs
- Continuous MNP and retention efforts both in postpaid and prepaid segment
- Extra Obitelj+ tariff introduced Parental Control feature
- New communication platform for Simpa and launch of attractive offers
- Innovations in sales channels in prepaid segment
- Launch of new MVNO brand in Croatia in March, in partnership with Multiplus Card - Multiplus mobile
- First to launch 4G mobile Internet and first to expand 4G mobile network beyond urban areas
- 526,000 ADSL mainlines and 344,000 TV customers at end-2012
- MAX 2/3 bundle packages promotions
- Satellite TV, an extension of classic IPTV service, and MAXtv To Go continue to grow successfully

Major achievements in 2012

In the mobile segment, 2012 was characterised by marketing activities that emphasized the potential of the Group's customer community. EXTRA total+ tariffs were introduced at the beginning of June enabling free, unlimited talk with all users using T-HT's mobile and fixed network without a call set up fee. The promotion of EXTRA total+ tariffs was accompanied by attractive handset offers with the latest smartphones, such as the iPhone and Samsung Galaxy S3.

Alongside the new EXTRA total+ tariffs, a campaign promoting EXTRA Obitelj+ tariff was also launched. The EXTRA Obitelj+ tariff offers unlimited data usage, unlimited calls within T-HT mobile and fixed networks without call set up fees and various additional benefits including Parental Control (a unique new feature that enables parents to monitor their children's mobile phone activities).

In addition, in 2012 a SIM-only offer in the postpaid segment was introduced. Under the offer, customers are able to sign a contract for a postpaid tariffs without buying a handset. The postpaid segment also ran promotional offers for younger people (18 to 28 year old), mobile number portability offers with a range of benefits and other options designed to provide value for money.

In December 2012, T-HT also offered for the first time on the market in Croatia a handset insurance scheme that enables customers to insure any cell phone or tablet purchased as part of a T-HT offer. This service is offered in partnership with Allianz.

Within the prepaid segment, the focus on the T-HT customer community was furthermore emphasized by the "Pričaj" tariff, which offers unlimited calls to all T-HT fixed and mobile users regardless of the top up amount and various options such as the recently launched "Sve u mreži".

At the start of June 2012, Simpa launched a new promotional campaign including a compelling offer - "Prejaka opcija" - of unlimited text messages, with 1GB mobile internet included and thousand minutes for cross net calls for a very affordable price. After the promotional campaign period, the offer remained permanent.

Innovations in sales channels have been another feature of the prepaid segment in 2012 - with Simpa and T-prepaid customers now able to top up their accounts through a web shop (via credit card), SMS (via a postpaid account) and in fixed line with new service called Halo bon - and receive additional 10% credit.

Bonbon maintained its successful trajectory in 2012 with various acquisition campaigns and promotional offers for new and existing bonbon users. The unique bonbon tariff offer was also enhanced - voice, text and data packages, which are free for bonbon users to combine according to their particular needs, now include twice as many minutes, SMS and data traffic at the same price.

Bonbon also launched a new website with enhanced functionalities.

The tourist season in Croatia saw the success of T-HT's "All inclusive packages" offering visitors a range of benefits including flat internet access via T-HT Hot Spots on locations throughout the whole country.

In March 2012, a new MVNO brand in Croatia, Multiplus mobile, was launched with partners from the Multiplus Card program. During 2012, Multiplus mobile continued to make progress through the introduction of mobile internet option, attractive handset offers and special promotions.

HT was the first in the Croatian telecoms market to complete the commercial launch a new 4G network based on LTE technology in March 2012. The 4G network offers users data transmission up to 10 times faster than the current 3G network. The launch was accompanied by promotions of mobile internet tariffs based on 4G through creation of the first-ever live commercial in Croatia and continued through the "Move on" campaign, where movie fans were able to participate in the creative process of making a movie using various functionalities of superfast 4G mobile internet. In December 2012, HT was also first on market to start expanding the 4G network beyond major cities.

In the fixed segment, alongside promotions for new and existing T-HT customers, in 2012 T-HT launched its MAX 2/3 and MAX Total bundled packages offering customers savings without having to compromise on the quality of service.

2012 also saw a number of promotional offers for MAXtv satellite TV and the successful roll out of MAXtv To GO services. In October 2012, a new service - live betting on MAXtv - was launched in partnership with SuperSport and is expected to expand further in 2013.

At the beginning of 2012, T-HT launched the MyT web portal with functionalities for both fixed and mobile services. In July 2012, a fully functional web shop was launched on T-HT commercial web page.

The mobile subscriber base decreased by 5.4%, to 1,859,000 subscribers at the end of 2012 from 1,964,000 subscribers at the end of 2011, largely owing to a fall in customers with double SIM cards due to favorable cross net offers. The decrease was driven primarily by a 7.4% decrease in prepaid subscribers, partly a result of migration to postpaid contracts.

Minutes of usage per average subscriber at the end of 2012 increased by 25.5% compared to 2011 due to the introduction of flat offers and offers of bundles including a large amount of minutes in postpaid and prepaid tariffs.

Blended ARPU remained at the same level in 2012 compared to 2011, as a result of attractive offers and increased minutes of usage.

By the end of year 2012, total fixed access mainlines of 1,032,000 were 3.3% lower than in 2011, with the extent of the decline curtailed by successful winback activities. The decline was due to the regulatory introduction of new wholesale products and is in line with the telecommunication market trend of fixed to mobile and IP substitution. The Group also maintained its competitiveness with offers that emphasize the benefits of the T-HT fixed and mobile community as well as service excellence.

Fixed telephony users generated 1,851 million minutes in 2012, down 11.2% than the previous year. This market trend demonstrates the substitution of fixed traffic with mobile and IP traffic.

Fixed voice ARPA decreased 3.2% from 2012 year as a result of the prevailing market trends mentioned above.

By the end of 2012, number of broadband retail accesses totalled 526,000, down 2.4% on the previous year. At the same time broadband retail ARPA increased by 3.0% due to an increased share of customers with higher traffic packages.

The TV customer base is growing steadily and at the end of 2012, there were 344,000 customers, up 7.0% over 2011.

Satellite TV, an extension of classic IPTV services, continues to grow (in 2012 increased 121.1% over 2011), with continuously improved offers driving uptake of these services.

Business Segment

Overview

- T-HT maintained its leading position in all three markets (mobile, fixed line and IP)
- Retail revenue declined year-on-year due to lower mobile prices per minute and fixed voice usage, in line with market trends
- ICT saw further development of Cloud services portfolio and launch of market place
- New mobile tariffs (Extra Biz) launched
- Integrated fixed voice / internet offering for Small & Medium Enterprises segment (Max 2 Biz packages)
- Net phone package Duo Flat packages introduced

Major achievements in 2012

The Group's mobile customer base rose 2.9% over the previous year. In 2012 business prepaid customers were separately reported out of the whole prepaid base. Due to challenging economic factors, both minutes of use and ARPU demonstrated a negative trend. Minutes of use per average subscriber fell 9.8% from the previous year and blended ARPU was down 13%.

The Priča, Mix and Total new Extra Biz tariffs were launched for existing and new business users. Extra Biz Total tariffs with the Neograničena priča (unlimited talk) option offer unlimited calls to the T-Com and T-Mobile community, flat-rate Internet access and attractive packages of messages and minutes to other networks. As of 1 June, the Total tariff group was enhanced by the removal of a call setup fee.

From October, new and existing business customers signing up for the Extra Biz Total+ L, XL and XXL tariffs received 50% discount on the monthly fee (three months for a 12-month contract or 12 months for a 24-month contract). Customers transferring mobile number to T-HT from another network received 50% off the monthly fee (six months for a 12-month contract and 12 months for a 24-month contract).

At the end of October, the Option Flat was offered to business customers on Extra Biz Total+ tariffs for an HRK 50 monthly fee, enabling unlimited communication to all networks and unlimited SMS.

In mobile Internet, in July and August new and existing business customers signing up for the Mobile Internet L or Mobile Internet XL tariffs received 50% on the monthly fee for six months on a 12-month contract or 12 months on a 24-month contract.

From September until the end of year, all new and existing business customers willing to sign up for Mobile net L or Mobile net XL tariff received a 50% discount on the monthly fee during for six months on a 12-month contract or 12 months on a 24-month contract.

All new and existing business customers from September to the end of year were offered the new Podijeli net service, which allows additional data subscribers to use data traffic as part of their existing monthly tariff for voice services.

Under the VPN Exclusive tariff, unlimited calls towards T-mobile HR network and all HR fixed networks were introduced in March.

In Q4, the Group launched retail professional SMS and USSD (Unstructured Supplementary Service Data) in the form of the Service Odlazni SMS Pro and package USSD Pro products.

T-HT's fixed retail customer base performed in line with overall trends seen in the global telecommunications market, due to increasing fixed to mobile substitution, IP migration. At the same time, this part of the business has been hard hit by the challenging economy and rising unemployment and the number of line fell 8.7% to 176,000.

As a consequence, total fixed traffic was 21.5% down on the previous year and fixed voice ARPA decreased 9.0% to HRK 216.

In May, the Group introduced convergent offers - packages including fixed, mobile and ICT services. In Q3, the Net Phone Office, Data Office services were introduced in fixed telephony.

The broadband retail subscriber base was 0.4% lower than the previous year reaching to 107,000 due to market regulation, whilst ARPA remained flat to 2011.

At the beginning of March, Max2 Biz S, M and Flat packages were introduced on a permanent basis. The Group also launched special offers on flat packages with 4Mbps speeds and to the customers signing 12/24 month contracts were offered gadgets with attractive prices.

In August, the Group introduced its NPP2 Flat packages (Mini2, Start2 and Plus2), comprising 2-8 phone lines, flat calls to T-Com and flat Internet. Special offers on MAX2 Biz packages were offered, with attractive gadget prices for customers signing 12/24 month contracts.

The TV subscriber base grew 6.1% to 21,000 subscribers compared with the previous year, as a result of continuous improvements in customer service and programming.

Until end of year, the Group ran promotional offers to new DTH (Direct-to-home satellite dish) users. Customers signing 24-month contracts during the promotion received 50% off the monthly fee for first 12 months and one month access to one of the following: Sports plus package and HBO & Cinemax.

For existing IPTV customers, the Group ran an offer where customers signing a 24-month contract for IPTV received the Sports plus package for free for six months.

New and existing customers on the Snimalica 10 or Snimalica 30 products were provided free services for one month.

The IP Fixed line customer base increased by 3.2%.

The VPN customer base increased by 1.4% compared to 2011. T-HT continues to promote the migration of existing traditional data customers to IP based products.

The number of data lines fell 3% on the previous year. Traditional data lines fell, but the Metro Ethernet service showed growth.

ICT

The ICT business launched a number of products in in 2012: Cloud Fleet Management, Hybrid Cloud, Fiscal Registers and VPS redesign and the Group continues to develop its ICT portfolio. In addition, the Group launched its ICT Marketplace - a new ICT distribution channel for all SaaS applications. The Group also delivered a range of customized ICT solutions targeting the enterprise segment with Combis.

tportal

tportal ranks among top five Croatian web portals, with more than 800,000 unique visitors per month, according to Gemius, an independent Internet traffic research agency. tportal's penetration stands at around 40% of Croatian internet users.

In Q4 2012 tportal completed preparations for the launch of a redesigned product optimized for desktop computers. The new layout offers more content on a single page, and should further improve click-through rates.

Leveraging the Group's UEFA Champions League and Europe League broadcasting rights, a new fantasy football community microsite was launched at fantasy.tportal.hr, allowing users to create their own teams and play the role of manager in a virtual soccer league. The champions won a trip to London to see the final of the actual Champions League soccer tournament.

Other new projects have included a popular Food subsection, providing recipes and healthy eating information.

The number of tportal's Facebook page followers showed continuous growth to more than 275,000, consolidating the portal's positioning in social networks and further improving its statistical metrics.

This content is available through PDAs, mobile devices, SMS information alerts and T-Mobile WAP portal, and on social networks like Facebook and Twitter. In addition, T-Mobile iPhone users can customize the tportal interface.

Wholesale

Domestic wholesale market

The ULL (Unbundled local loop) market in 2012 reported growth in active ULL lines to 162,000 from 148,000 in 2011. The number of ULL lines is expected to show further growth but at a slower rate, as operators start to maximize the utilization of existing collocation rooms.

Wholesale bitstream access on copper also demonstrated growth in 2012. The number of Naked BSA lines is still not significant (below 2,000) but in the months ahead, the Group expects increased interest in Naked BSA and more churn from BSA to Naked BSA resulting in the growth of the total wholesale bitstream access customer base.

With the launch of Wholesale Line Rental (WLR), the number of "pure" Carrier Pre-Selection (CPS) customers fell to 32,000 at the end of 2012 from 96,000 in 2011. New CPS activations were primarily connected with WLR activations and contribute to WLR gross additions (rather than to CPS gross additions). The number of WLR lines shrank to 104,000 at the end of 2012, owing to the migration of these customers to other services.

In light of the decreased number of WLR and CPS customers and the lower ARPU value of new CPS customers, originated minutes declined by 27% compared to the same period last year. On the other hand, the number of terminated minutes into the T-HT network remained flat to the previous year.

In 2012, the volume of Bulk SMS messages increased by 33% over the previous year, mainly due to the consolidation of the Bulk SMS market with integrators generating more than half of the Bulk SMS traffic.

In 2012, National Roaming voice traffic increased by 17%, data traffic was 5.5 times higher than previous year, while SMS stayed on the 2011 level.

International wholesale market

Sales to international operators remained a significant part of total fixed wholesale revenue in 2012. The majority of international business is related to termination of international voice traffic into the Republic of Croatia and neighbouring countries. Although incoming traffic to Croatia remained at the same level as in 2011, traffic to the fixed network increased by 5% and traffic to Croatian mobile networks decreased by 6%. At the same time transit traffic to neighbouring countries declined by 17%.

Despite increased competition and price erosion in the international data and capacity market, due to the number of new contracts, new interconnections and upgrades of existing capacities, the international data and capacity business scored notable success with 162% growth of capacities sold to international operators, delivering stable revenue. Despite Telekom Slovenia starting operations of its physical PoP (point of presence) in Bosnia and Herzegovina (causing a fall in IP wholesale services prices of more than 70%), T-HT achieved 18% growth in sold IP capacities in neighbouring countries, which partly offset the revenue decrease in this segment.

On the cost side, the biggest success resulted from a strategic policy to force non-commercial international

IP peering wherever possible and to reduce commercial IP upstream to appropriate levels. At the end of 2012, T-HT's share of free of charge IP peering in total IP upstream rose to 62% from 52% in the previous year. Reduced costs further enhanced the competitiveness of the T-HT offer in the IP market.

Intensive activities related to the international network were the key reason for an overall strong performance in the international business. Continuous upgrades of capacity and technologies at international points of presence and border crossings were carried out in 2012. A large number of border crossings (33) with international operators in neighbouring countries as well as a flexible low-cost interconnection at international points of presence (Frankfurt, Vienna and Sarajevo), resulted in 92 direct voice and data interconnections with global and regional operators in 2012. During 2012, 19 new international roaming partners were interconnected resulting in a total of 410 roaming partners worldwide. Overall, 81 new international roaming services (voice, GPRS, UMTS, Camel) were launched in 2012 with those partners.

International roaming traffic from visitors in Croatia grew in the SMS segment by 5%, in data by 101% and decreased in voice by 4%. At the same time, traffic generated by T-HT customers while roaming in foreign countries decreased in all traffic categories (data by 15%, voice by 22% and SMS by 24%). Improved steering capabilities, as well as the renegotiation of a number of international agreements, led to a significant decrease in total international roaming cost of 38% compared to 2011.

Network and Information Technologies

Network and service platforms

In 2012, T-HT has focused on further developing the network infrastructure, increasing broadband access capacity, and modernizing transport/core network and service platforms, along with the migration of PSTN (public switched telephone network) services and customers.

In the fixed network, T-HT has adopted a strategy of providing all services via one common broadband port. The Group's access network has been transformed by the construction of a new optical access network that includes an optical access platform (GPON) alongside selective modernization of copper access network. Furthermore, the Group has continued to upgrade the existing service platform to enable VoIP telephony provision on the broadband port.

In the mobile network, the Group launched the Mobile BroadBand (MBB) project. This targets radio access and core network transformation, to enable the development and rapid implementation of innovative and cost effective technologies (e.g. HSPA, LTE), whilst ensuring maximum utilization of existing infrastructure and frequency resources. The project aims at improving data services coverage through both existing and newly deployed technologies such as UMTS900. The Group continued expansion of the network infrastructure and network capacity expansion to support a strong increase in data traffic.

A number of projects have also been initiated to reduce the complexity of service development and maintenance and improve cost management.

Network infrastructure

Fiber optical infrastructure

The Group is currently undertaking activities related to FTTC (fiber-to-the-curb) and FTTN (fiber-to-the-node) options that will result in a shorter local loop due to the installation of new nodes.

Energy and cooling infrastructure

In 2012, the Group completed its project to extend the electricity and cooling infrastructure of the Utrina data center facility, thus increasing the availability of power to the building. Reconstruction of the Zagreb-Selska facility started.

Energy efficiency

In the 2012, the Group is achieved a 2% decrease in electricity consumption compared to the 2011. Energy efficiency measures implemented during the year include the following: switching off and dismantling equipment in the fixed network, platform consolidation, new 3G equipment in mobile network, an increased working temperature on mobile network locations, efficient cooling devices and power supply, data center consolidation, a shift to more favorable tariff models and greater scrutiny of billing.

Fixed access

DSL (Digital Subscriber Line)

The Group continues to roll out DSLAMs (DSL Access Multiplexers) to expand its customer base for broadband services. Following a public tender by the Agency, in mid-September T-HT was chosen for subsidized development of broadband access in the rural areas of three counties. The Group plans to leverage the synergies of T-HT's fixed and mobile networks as part of this project.

Mobile access

Evolution and modernization of 2G radio access network

The SingleRAN project is aimed at modernizing the 2G network. The process of exchanging the former base transceiver stations with new technology started in mid-May.

3G radio access network enhancement

The Group has continued to optimize the parameters of the radio access network and expand capacity, to support the increasing number of smartphones and tablets on the 3G network and the rapidly increasing volumes of data traffic, which doubled over the previous year.

In November 2012, dual cell functionality with 42 Mb/s downlink speeds was activated on the numerous 3G locations (Zagreb, Split, Osijek, Rijeka, Zadar, Pula, Slavonski Brod and Varaždin). HSPA+ functionality covering 49% of population with access to 21 Mb/s downlink speeds and uplink speeds of 5.8 Mb/s. HSDPA functionality with downlink speeds of up to 7.2 Mb/s is now available to 63% of the population. In September, the intensive rollout of UMTS900 locations in Slavonia began, making 3G technology available in smaller towns and rural areas where, until now, mobile broadband services had not been available (Istočna and Zapadna Slavonija, Lika, Gorski Kotar, Banija, Kordun and Dalmatinska Zagora).

LTE radio access network

In 2012 the Group developed the first commercial LTE (Long Term Evolution, or 4G) network in Croatia on the 1800 MHz frequency band, with coverage in the four main cities of Zagreb, Split, Rijeka and Osijek. T-HT was also in November granted use of the digital dividend (800 MHz frequency band) by the Agency which will enable national coverage of the LTE network. By the end of 2012, an LTE signal with download data speeds of up to 75 Mb/s was available to 13% of the Croatian population.

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.

Advanced radio network OSS tools

During the year, the Group implemented advanced software tools for the optimization of 3G mobile networks as well as mobility between 3G and 2G networks, to achieve higher levels of operability, robustness and overall network performance.

Transport layer

Migration to IP

In line with the Group's "all-IP" strategy, the transmission migration for 3G base stations from ATM to IP technology continued, bringing lower costs and higher access throughputs for mobile Internet.

DWDM network reconstruction

The national DWDM (dense wavelength division multiplex) network reconstruction was completed in 2012 with the modernization of six P2P links that connect up regional centers. Network capacity was and network quality and performance monitoring were upgraded, whilst advanced broadband and wholesale service development was enabled.

The implementation of an international DWDM system between Croatia and Italy on the existing SDH system route Umag - Mestre was finalised.

TeraStream

In December, T-HT launched TeraStream pilot, an innovative concept that simplifies IP networks through Cloud-enabled IPv6 architecture. It combines network technology, data center technology, and fiber infrastructure and enables simple implementation and integration of advanced next-generation services.

TeraStream raises access network speeds by around 50 times the current rate, providing users with speed of 1 Gbit/s. The new technology significantly reduces the unit cost of data transmission and allows the proliferation of optical accesses. HT is the first Company in the DT Group to put into pilot use this innovative technology in order to test the concept and improve its functionalities.

Core layer

IP core network

The Group replaced two Provider routers at the Varaždin site and two Provider Edge routers in the Zagreb site to improve capacity.

Fixed core modernization

The project to migrate access nodes from AXE based technology towards IP based technology was finished. The first phase of optimization of the PSTN transit layer was completed. The IMS upgrade project, designed to increase platform capacity and service availability, was also completed.

PSTN migration

In total, over 300,000 customers have been migrated to the VoIP - HALO service over broadband access ports and MSAN ports. The installation of access equipment for PSTN migration is underway on 18 chosen all-IP local exchange areas.

Mobile core modernization

The Group completed the integration of new packet-switched core elements in 2012. These core elements include MME (Mobility Management Entity), S-GW (Serving GateWay) and P-GW or PDN-GW (Packet Data Network Gateway). Integration of listed network elements was a prerequisite for launching the first Croatian LTE connection. Also, installation and integration of packet-switched core elements was the first step of complete packed core migration towards the new ePC (evolved Packet Core) network. Also to support the launch of the LTE service, integration of HSS-FE (Home Subscriber Server - Front End) was undertaken alongside the central customer data-base CNTdB (Common Network Technology Data Base).

To improve voice quality on the mobile network, the Group implemented a TFO (Tandem Free Operation) and TrFO (Transcoding Free Operation). These enable transmission of voice services with a minimum of speech transcoding. This resulted in the Group's voice quality MOS (Mean Opinion Score). TFO functionality enabled the continuation of the HD Voice project, which targets HD voice quality within the 2G mobile network. The Group also completed the installation of 2G HD voice, making T-HT one of the first mobile operators in Europe that enables HD voice in both the 2G and 3G mobile networks.

Service layer

Intelligent network for mobile services

In 2012, the Group implemented a new prepaid platform and all prepaid and Favourite-postpaid customers were successfully migrated on to it.

IPTV

T-HT successfully upgraded the IPTV platform and to provide a new user interface. The project also included shifting VoD (Video On Demand) on to a new platform, enabling new capacities for NPVR (network personal video recorder) services and the launch of the TVoY (TV of Yesterday) service. The Group also introduced other interactive services including MAXtv Betting and the MAXtv Recommendation Engine.

ISP platform

The Group launched a Google AdWords portal, and HT became a Google Premier Partner. The DLSi platform (part of the Group's Connected Life stream) was upgraded to version R2. Other initiatives included the launch of a hosted solution for Crnogorski Telekom; the upgrade of the DNS platform for IPv6 rollout; the introduction of the first web portal available over IPv6 - www.tportal.hr; an upgrade of the e-commerce backend platform; the e-commerce platform aligned with the highest security standards and PCI-DSS certification was completed; and a new DHCP platform was installed for the FEMTO Cell, LTE project and other initiatives.

Portal services

In this area of business, the Group launched a new residential self-assistance and web shop 2.0 portal (moj.hrvatskitelekom.hr). This allows customers to manage all services with a more transparent and faster user interface and represents the first phase of the new portal platform implementation project. In addition, a new MyT Business portal with bill-check functionality and a new Bonbon portal were introduced.

Fleet management

The fleet management product, one of the Group's Cloud services, is designed for medium-sized and large businesses, providing fleet control systems that increase fleet efficiency.

SMSC/OMG

The Group upgraded the SMSC (Short Message Service Centre) and OMG (Open Messaging Gateway) Disaster Recovery to increase platform stability.

Traffic steering platform

The Group successfully integrated its traffic steering platform, providing better control of outbound roaming traffic. The integration has boosted control of outbound traffic to 95% from 80%, bringing significant inter-operator tariff savings.

Media Box service for Montenegro Telecom

The Group developed Media Box, a fully hosted and managed service for storing, browsing and sharing personal multimedia files, for Montenegro Telecom.

Service and Network Operations

Technicians as a salesman

The sale of ICT services by technicians started in the second quarter of 2012 and throughout the year the Group continued a program of staff education, including workshops, e-learning and 1-to-1 sales tuition. It also continued incentive schemes for technicians and managers, such as awards for top salespeople and the inclusion of technicians in the European Winners Circle Program (EWC). As a result, process and systems support improved. In addition, sales by technicians doubled over 2011.

Quality and efficiency

In 2012, the Group introduced a number of projects aimed at the further reducing indirect costs and increasing efficiency. An IMS quality tuning workshop was held to define areas for improvement. As a result, the Group has seen improvements in cost management and communication with other business areas regarding user requirements and fault repairs. The Group has also implemented monitoring of CPE (Customer-premises equipment) by serial number, recognized as best practice within the DT Europe & Technology division.

Information Technology

Information Technology is a key business enabler in the telecommunications industry and a powerful tool to improve customer service. The Information and Business Systems Sector is responsible for information technology initiatives that support the Group's goals to increase revenue and improve internal efficiency, whilst enhancing product development and accelerating time to market. The Sector's activities are aimed at supporting the implementation of the 'digital company' and 'on-line' business model and represent one of the key pillars of the Group's strategy.

The Sector is particularly focused on convergence in CRM & billing, fixed/mobile systems consolidation, marketing, the fulfilment of regulatory requirements and the implementation of innovative ICT services. The Sector also focuses significant effort on improving service delivery processes and developing advanced customer, market and business intelligence capabilities.

The Sector's notable achievements in 2012 include:

- Initiation of a bill formatter project to standardize invoicing processes for both mobile and fixed services and support future business needs (e.g. convergent invoices, bundled packages); Phase 2 (invoicing for fixed services) delivered

- New Rating Engine: a new mobile rating system was released to enable traffic data processing within one hour; near real-time rating based products create parameters for marketing and support for regulatory requirements, whilst enabling new functionalities
- An upgrade of mobile services mediation systems was undertaken to enable new functionalities, support for LTE services, performance and systems monitoring enhancements
- Standardization of Revenue Assurance solutions to support revenue control; following the development of a roadmap, the project is now underway
- Implementation of the MPC (multi-project control) system for monitoring, ordering and controlling services from suppliers and sub-contractors and optimization and automation of internal processes
- Completion of pilot of customers' data consolidation project (MDM - Master Data Management) for three T-Centers and roll-out to other T-Centers is on-going in line with the initial project plan
- The introduction of My T portal has brought significantly improved communications with customers; automation of Call Center operations through the implementation of advanced IVRs (intelligence voice routing) has boosted CS (Customer Support); proactive online sales chat has improved customers' experience whilst utilizing on-line communications channels in line with the Group's objective to be an online e-business
- The Paperclip project to digitalize customer documentation, processing and archiving and improve sales processes was successfully implemented and rolled-out to T-Centers
- Consolidation of back-up systems to unify all systems, increase control and quality of process, reduce maintenance costs and fulfill expanding business needs; to achieve maximum cost and process optimization, ICT and CTO systems were included in the scope of the project
- eTransformation - alongside organizational changes, the e-Transformation project has been initiated to develop a comprehensive IT landscape that will facilitate new and converged services and implement appropriate CRM, billing and OSS systems that emphasize e-business and process automation

Data and IT security

The protection of customers', sales partners', employees', shareholders' and telecoms traffic data is a crucial concern throughout T-HT. Mediation systems for fixed voice and mobile services are certified according to the international standard ISO/IEC 27001:2005. Regular audits concluded the Group's systems conform to the standard.

Improvements were undertaken in systems security improvements, resulting from Customer Data Security Assessments in concert with DT Group. A PSA (Privacy & Security Assessment). Procedures for IT/NT incident response and a HT CERT (Computer Emergency Response Team) were established.

Regular checking of security measures and the usage of customer data in T-shops and partner shops was undertaken to protect customer data. A process of regular annual penetration testing was initiated to improve IT/NT system security.

Following global trends in online payment and in accordance with T-HT and DT Group's strategy for 2013, Croatian Telecom achieved compliance with Level 2 of PCI DSS Standard for Payway system (credit card payment processing system). New security requirements, aligned with changes at DT Group level, were approved.

Corporate responsibility

Key CR strategy areas
Responsibility to society
Responsibility to employees
Responsibility to customers
Responsibility to suppliers
Responsibility to evironment
Corporate responsibility in subsidiaries

Corporate Responsibility

T-HT, Croatia's largest telecommunications operator strives at all times to facilitate and improve communication, making it easier and more effective. At the heart of the success of T-HT lies innovation, and its introduction to the market through new technologies and services. Equally, however, T-HT's success depends upon a profound appreciation of the role the Group plays within the community in which it operates. This results from a deep rooted understanding that a responsible approach in business can provide a significant strategic advantage over the long-term.

Sustainable business operations, therefore, through a responsible approach to the society in which it operates, is an integral part of T-HT's business culture. The Group endeavours to contribute to the daily activities and knowledge base of the wider community and, in doing so, articulates its corporate values to a broad range of stakeholders on a daily basis.

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.

In this comprehensive Corporate Social Responsibility report, T-HT Group aims to outline and articulate its strong sense of responsibility towards its stakeholders.

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 and thereby nurture 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

The system of values that the Group promotes is defined by the Guiding Principles of the Company. The Principles provide guidelines that we need to follow in our daily work, that promote ethical behaviour, mutual respect, team work, accomplishment of the best results possible as efficiently as possible, open expression of opinions, assumption of responsibility and the creation of an environment that encourages, recognizes and appreciates exceptional results.

By promoting common standards of behaviour towards our customers and our co-workers, we create an atmosphere in which it is a pleasure to work and contribute to the overall business success of the Company.

Dialog with stakeholders

T-HT Group believes strongly in the importance of open and transparent communication with all its stakeholders. The Group has continued to engage with key audiences in 2012 through the medium of social networks.

T-HT utilizes a range of networks to enable customer communications including Facebook, Twitter, YouTube and Flickr and does so on a daily basis, to provide problem solving support and compile feedback on products and services.

In 2012 T-HT also joined LinkedIn, the specialized social network primarily used for personal networking amongst business associates.

In 2012, the Group introduced T-Blog, a new external communication channel, in beta version. T-Blog will serve as a platform for discussing telecommunications and technological issues related to the services the Company is offering, alongside explorations of broader telecom and ICT industry themes.

In 2012, the Group launched its redesigned web portal, pulling together all information on all services on to a single site to improve the user experience.

Transparent communication with investors is of particular importance in order to articulate the Group's current status and potential in ways that will enable them to come to a fair valuation. In 2012, T-HT was given an award for the best investor relations national company by Poslovni dnevnik magazine.

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

Compliance with local laws and regulations along with internal rules and the Code of Conduct form the basis of responsible corporate management. As such, these principles are a necessary prerequisite for the success of the business and should inform every aspect of business processes.

T-HT actively promotes the principles of ethical business through a robust compliance framework to ensure adherence to all relevant codes and regulations.

The Business Compliance Department was formed in 2008 to promote ethical business dealings across the Group and implement the Group's Anti-Corruption Policy.

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 is based on the company's Guiding Principles, encapsulated in the statement "Respect and integrity guide our behaviour."

A significant section of the Code focuses on relationships with customers, partners and suppliers, with special attention paid to the management of information and conflicts of interest. The Code provides clear instructions on the appropriate course of action in the case of doubt or perceived breaches of principles and values.

Certificates

T-HT reported on CSR, applying the guidelines of the international organization Global Reporting Initiative (GRI), for the first time in 2012 with reference to 2011. The Report was audited by PricewaterhouseCoopers and the Group's self-assessed reporting level B was then confirmed by the global issuer of the guidelines. As a result, the Group produced the first sustainability report in Croatia to achieve a GRI level that has been confirmed by the GRI.

PricewaterhouseCoopers d.o.o. provided independent assurance on the 2011 Sustainability Report of T-HT

In 2012, T-HT was included, for the fourth consecutive year, in the Vienna Stock Exchange's CEERIUS Sustainability Index for 2013. This rates shares in leading CEE region companies with respect to social, environmental and economic performance.

T-HT, its brands T-Com and T-Mobile, once more received the Trusted Brand award by Reader's Digest. This is the sixth consecutive honouring the T-Com brand with the same award.

Oekom Research added T-HT to its Prime category, with respect to its standards of corporate responsibility and sustainable development policies, in 2008. T-HT was proud to again receive this recognition again for 2012.

T-HT was also recognized by being granted a CSR Index (Indeks DOP-a) listing for 2011 in the large companies category. The original national CSR measurement tool, the so-called CSR Index, outlines the level of a company's social responsibility and the application of sustainable business principles.

In 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.

In 2007, T-HT joined the UN Global Compact initiative, which supports fundamental social values within the 10 principles of responsible business. Starting in 2009, the Group regularly reports on its progress in the implementation of these principles.

Donations and sponsorships

A common characteristic of T-HT's charitable activities is its focus on projects of lasting value that pull together the various strands of modern technology, education, charity and ecology. Most projects are ongoing and this increases their efficacy and leads to better and stronger relationships between the company and beneficiaries.

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 psycho-social support for parents of young children with disabilities as well as children with developmental issues. Alongside corporate donations, T-HT has provided a system whereby customers can also contribute to this valuable UNICEF project.

Another initiative again supported by the Group in 2012 is the Childrens' Rights Festival, providing access to sight and hearing impaired children to enjoy a rich program of Croatian and international films.

In May 2012, UNICEF launched "Telefončić" (Little Phone), a phone and Internet help line for the parents and guardians of children aged 0-7.

"Zajedno smo jači" (Together we are stronger)

"Zajedno smo jači" is an initiative in which T-HT employees play a key role. It is the employees who propose and ultimately select the projects to which the Company donates funds.

In 2012, the seventh year of the initiative, 20 projects were chosen from 125 applications received from all over Croatia and T-HT donated a total of HRK 572,000. The funds were awarded to medical institutions, institutions working with the disabled, the elderly and with children, educational institutions, and environmental organizations.

060 numbers - charity action support

In 2012, T-HT continued to support other charity campaigns by providing telephone lines to allow the public to make contributions, an activity in which it has engaged since 2001. Campaigns and organizations assisted in this way in 2012 included the Ana Rukavina Foundation, Rotary club Zagreb Kaptol, SOS Children's Village Hrvatska and RTL Helps Children. T-HT donated all proceeds from these initiatives to the causes concerned, raising a total of HRK 1,5 million for charity.

Knowledge society

"Znanjem rastemo" (Growing through Knowledge) Conference

In October 2012, T-HT held its fifth "Znanjem rastemo" (Growing through Knowledge) conference in Zagreb. The Group invites speakers from academia, the business community and the media to initiate debate on key topics. In 2012, the guest speakers were Dr Michio Kaku, a prominent physicist and futurologist, professor of theoretical physics and advocate of scientific ethics and social responsibility and Sarah Lacy, an award-winning journalist and author on innovation and entrepreneurship.

Support to expert conferences

T-HT plays a key role in the development of the knowledge society through its support for gatherings of technology experts including as WinDays 2012, the MIPRO Conference, the Combis Conference, the Cisco Conference, IDC Conference, the Imagine Cup 2012 project, Hospi-Taly Days related to m-health and other events related to the telecommunications sector and its communities.

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

Cooperation with the academic community

T-HT has a long-standing 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, aimed at promoting the transfer of knowledge and ideas between science and the economy.

T-HT also works closely with the Faculty of Law in Zagreb and plans similar agreements with other faculties and universities, which in turn offer a rich pool of potential future recruits that can help the business to grow and innovate.

Scholarships

The Group also continues its T-HT Scholarship project. In 2012, for the second year six undergraduates received monthly scholarships. The candidates were selected from the top students at the Faculty of Electrical Engineering and Computing in Zagreb who have achieved excellent results at university and demonstrated participation in a broad range of extracurricular activities.

Also in 2012 and again for the second year, T-HT awarded scholarships to five students who lack adequate parental support to fund further educational opportunities under the "Korak u život" (Step into Life) scheme, organized by the Rotary Club Zagreb Kaptol.

Culture

T-HTnagrada@msu.hr

T-HT has been the main partner of the Museum of Contemporary Art (MSU) since 2007. This partnership continued throughout 2012 with the annual award for the best Croatian contemporary work of art. The fifth T-HTnagrada@msu.hr , one the most prestigious annual awards in the field of contemporary art in Croatia, was held in 2012. From a total of 249 works of art submitted the international jury selected 40 for an exhibition in the MSU. Submissions for selection came from artists across all generations, and the only criterion for selection was excellence. As well as financial support, T-HT also provides telecommunications services to the museum.

Theatres

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

Film festivals

In 2012, 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

For the fifth consecutive year tportal.hr ran its competition for the roman@tportal.hr literary prize worth HRK 100,000. The journalist and author Ivica Đikić won the prize for his novel „Sanjao sam slonove" ("I dreamed of elephants").

Electronic Beats Festival

T-HT supported the Electronic Beats Zagreb Festival 2012, which attracted more than 2,000 visitors for performances by some of the hottest performers on the current electronic music scene, such as Hot Chip, Modeselektor, Woodkid, Dillon, Kimiko, and Itch/Pytzek.

Sports

The Croatian Olympic Committee

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

At Summer Olympics, which were held in London from 27 July to 12 August, Croatia was represented by 110 male and female athletes competing in 15 sports.

Paralympic Foundation

T-HT is one of the first supporting members of the Paralympic Foundation. The Croatian Paralympic Committee launched the Foundation to help top athletes with disabilities improve their skills and to provide the same access to top facilities for training and competing.

MAXtv Premier League

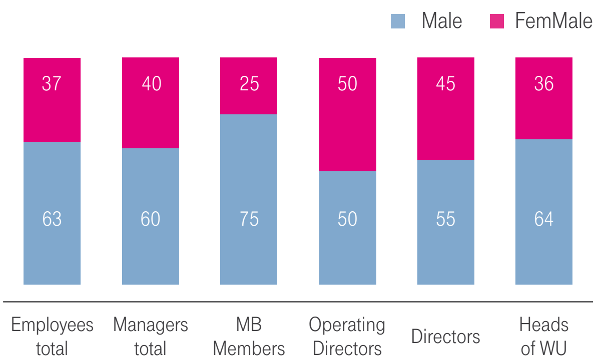
The cooperation between MAXtv and the Croatian Premiere Football League (prva hrvatska nogometna liga), the MAXtv Prva liga, continued in 2012 bringing premium production quality and delivering Croatian football matches on new interactive platforms. T-HT also sponsors the Croatian Premier Football League.

Sportske igre mladih (Youth Sports Games)

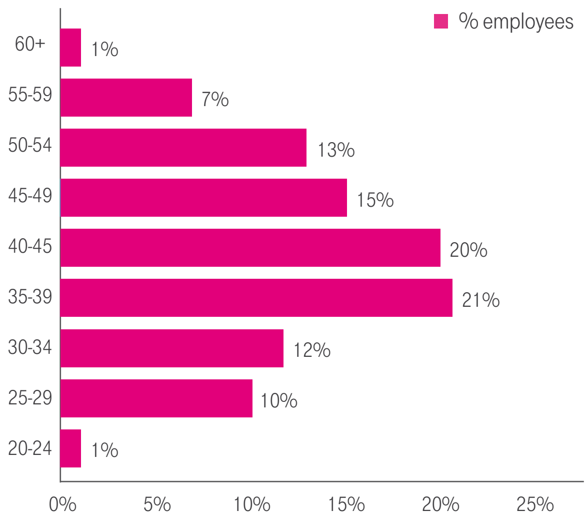
T-HT is a long-standing sponsor of the Youth Sports Games, the largest amateur sports event in Croatia. In 2012, around 80,000 young competitors from 7 to 18 years old came together to compete in 10 sports and 16 cities. The event is underpinned by a strong anti-drugs, anti-alcohol and anti-violence message.

Responsibility towards employees

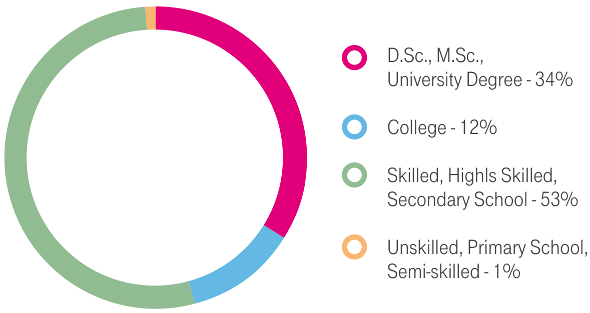
Gender structure in HT 2012



Age structure



Education structure



Management career development remains a key focus

The Group has continued its management development initiatives throughout the year, promoting the sharing of knowledge and experience. The practice of learning from colleagues across the organisation to increase management competencies has proved to be a highly valued exercise amongst all management personnel. These initiatives have provided the opportunity to enhance leadership skills, exchanging experiences in small groups facilitated by professional coach. Our aim was to increase cross-functional cooperation through a deeper understanding of different business areas and their objectives, so the management teams were seconded to other business unit to shadow colleagues for period of several days. We have also continued our “Closer to the customer“ program to foster excellence in customer service. Under the scheme, the participants studied both the theoretical and practical aspects of good service, spending time at sales outlets, call centers and in the field with technicians.

Further development of employees remains fundamental to our culture

In 2012 the Group continued initiatives aimed at developing staff capabilities and encouraging excellence, following the “Go Ahead “ program introduced for all employees in 2011. Internal channels for knowledge transfer were extended and successful programs such as „Knowledge on Thursday“ (employee lectures delivered by experts in particular areas) and „Closer to the Customer“ (referred to above) have continued. We have focused our activities on enhancing performance and internal cooperation, and supporting innovation and the development of project management capabilities.

Additional opportunities for star employees

In 2012, we put a particular emphasis on nurturing our most talented employees - those that have delivered a strong performance and displayed potential for further development. These employees were given opportunities to take on increasingly complex tasks, acquire new experiences, participate in discussions with top management and share knowledge and experience on an international level.

In total, 25 the Group's top performing employees were also offered the chance to continue further professional education on the T-HT scholarship scheme and undertake post graduate study or a professional or MBA program.

Performance management

To promote high achievement across all areas of the business, in 2012 we developed a rewards system for sales staff, technicians and call center personnel, alongside a new performance management system for the entire Group.

We also introduced the „To je To!" (This is It!) program that recognizes and rewards additional effort, employee excellence, and service that goes way beyond customer expectations. By providing our employees with opportunities for relaxation, entertainment and cultural pursuits, we show our appreciation for the dedication and commitment they have demonstrated in the course of their work.

Human Resources strategic planning

In 2012 we started implementing a new Human Resources strategic planning methodology which will enable us to define and develop the competencies, skills and knowledge the Group will required for the future.

Cooperation with the academic community

As the leading telecom provider, T-HT has close links with the academic community, particularly the Faculty of Law in Zagreb and Faculty of Electrical Engineering and Computing (FER). This long-standing cooperation focuses on scientific research and development activities with the objective of promoting the transfer of knowledge and ideas between science and the broader economy.

The Group's recognition of the value of up-and-coming experts was demonstrated when FER granted the prestigious „Josip Lončar" award to a young T-HT employee whose professional and academic achievements were already monitored and supported by T-HT throughout his studies.

T-HT also participated in a Summer Practice Program for promising first-year graduate students of the Faculty of Electrical Engineering and Computing. The Group readily accepts invitations to cooperate from various student organizations with the aim of tapping into their new ideas and dynamism.

Additional employee benefits

The Group provides numerous benefits to its employees - both financial and non- financial. Financial benefits include the annual vacation bonus, Christmas bonus, gift for children, vouchers for Easter and jubilee rewards as part of a range of financial assistance as set out in the Collective Agreement.

The health of our staff is of course a key priority and the Group provides regular annual medical check ups for all employees along with vaccinations against a number of potential health problems such as seasonal influenza.

Staff also have access to a range of recreational and sports activities funded by the Group. In 2012 T-HT reaffirmed its dedication to promoting a healthy lifestyle with the continuation of its long-standing tradition of employees' sports days.

Guiding Principles - Open hearts

Every year the Group dedicates one day specifically to the Guiding Principles that form the basis of our corporate culture. These principles call for the highest standards throughout all activities and conduct within the company and a commitment to protecting the environment.

As part of this, we organized an competition for staff to write song lyrics celebrating the Guiding Principles, as a way of underscoring the Group's objectives of ethical business conduct, respect for colleagues and customers, with customer satisfaction at the heart of all we do. Lyrics for the song "Open hearts" were produced entirely by T-HT employees.

Employee Satisfaction Survey

The group conducts an Employee Satisfaction Survey every two years to gauge levels of satisfaction regarding management, the working environment, and staff recognition and acknowledgement. This year 65% of T-HT employees responded to the survey.

One section of the survey was dedicated to work life balance, stress in the working environment, and wellbeing of employees in general. Survey results will be communicated to all employees and measures to address issues indicated by the employees' responses will be determined.

Responsible restructuring

As a result of global trends in the telecoms market as well as factors specific to the Group, in 2012 the number of employees was reduced by 369. The Group carried out this headcount reduction in full accordance with its responsibilities its staff. All employees affected received severance payments that exceeded the amount prescribed by law several times over, and all were given access to content and services from the Support Plus Program both during the notice period and for at least six months afterwards. Within the scope of this program, which the Group has undertaken since 2006, a range of useful tools is offered, along with the assistance of qualified experts who offer counselling and advice to those going back into the labour market.

Statistical data

The Group's respect for diversity and the promotion of equal opportunities is reflected in the proportion of female employees in management, which by far exceeds the Croatian average, and which has increased further from 2011.

Responsibility towards customers

Customer care

Customer care and satisfaction are the key focus of T-HT's Call Center activities. Its operatives are equipped to answer all queries and provide support on a 24/7 basis, by phone, e-mail, postal mail, fax and social networks. The Call Centre plays a key role in the maintenance of good relationships with customers. Staff also makes customers aware of products and services that are tailored to their particular and 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 improvements may be required.

Responsible approach to customers

T-HT tailors its services to take into account the varying needs of its customers, as evidenced by special discounts, stores accessible to disabled people, special packages for customers on low incomes, services for young people, discounts granted to Croatian Homeland War disabled veterans, parental protection on MAXtv, 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

■ 4G technology

In 2012, T-HT launched the first commercial 4G network in Croatia. This network provides customers with up to 10 times faster data transfer speeds and is available in the cities of Zagreb, Rijeka, Osijek, and Split.

■ ICT Marketplace

The ICT Marketplace, an innovative cloud service, was also launched in 2012. This is a business application and ICT services store that provides business customers with a one stop shop for renting a range of advanced cloud services and computer applications for business use.

■ NFC mobile payments

T-HT was the first in Croatia initiate mobile payments based on NFC (Near Field Communication) technology, enabling fast and secure payments of small amounts via mobile phones and completely replacing the use of cash.

■ MAXtv To Go

MAXtv To Go, a TV-on-the-move product, was also introduced in 2012. This is available on smart phones, tablets and laptops anytime and anywhere.

■ TeraStream

At the end of 2012, T-HT presented the TeraStream network - a simplified IP network concept that combines network technology, data center technology, and fiber infrastructure. TeraStream raises access network speeds by around 50 times the current rate, providing users with speed of 1 Gbit/s. The new technology significantly reduces the unit cost of data transmission and allows the proliferation of optical accesses.

The TeraStream network concept enables simpler implementation and integration of advanced next-generation services. It provides all services (including voice, IPTV, Internet access) from the Cloud, where currently these services are provided through a network.

T-Hrvatski Telekom is the first Company in the Deutsche Telekom Group to put into pilot use this innovative technology in order to test the concept and improve its functionalities, confirming the position of the Group as a technology leader.

Responsibility towards suppliers

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

The Sustainable Procurement Program includes supply chain management that weighs social and ecological risks against the long-term benefit for the Group, supplier selection under clearly defined minimum standards (including Social Charter or International Labour Organization conventions), and regular checks to ensure compliance.

Responsibility towards the environment

Promoting ecological awareness in T-HT

T-HT encourages a strong understanding of environmental issues amongst its staff. To this end, more than 2,000 employees undertook an online course about environmental protection and more than 220 employees, whose daily work activities can significantly impact the environment, attended lectures on environmental protection in 2012. Additionally, 27 new employees were provided with environmental education as part of the induction process.

T-HT's vehicle fleet totals around 220 LPG operated vehicles. LPG is considered the most environmentally friendly motor fuel available and T-HT actively encourages its employees to use LPG in their vehicles. Through a range of internal initiatives and measures, the cumulative usage of LPG for the fleet in first 9 months of 2012 increased by 30% compared to usage in 2011.

Ecological disposal of 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, T-HT also organized a handset recycling campaign for business customers in 2012.

Implementation of green technologies

As the only telecommunications company in Croatia certified under the ISO 14001 Environmental Management Standards, T-HT focused on the implementation of green technologies in telecommunications. The Group is witnessing major technological changes, and the Group aims to align these changes with high ecological standards.

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's project to promote energy efficiency at corporate level was launched in 2011 and is showing very positive results.

The absolute amount of electricity consumption by the Group reduced in 2012 in comparison with 2011. This was as a result of more efficient air conditioning and power supply systems, the 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 and a range of other activities.

In addition, two new wind-solar systems for electricity production were installed for base stations of T-HT mobile networks in 2012.

In 2012, T-HT commenced energy audits and energy certifications of its buildings with the aim of improving energy efficiency. Independent energy assessments provide recommendations on improving energy efficiency that can lead to better workplace conditions and significant energy savings.

The assessment of the authorized body that performs energy audits for the Group has stated that the condition of buildings owned by the Group are significantly better than the average in buildings throughout the Republic of Croatia. The general condition of buildings inspected so far has been found to be satisfactory with respect to the year and type of construction, primarily due to regular maintenance and the quality of materials and equipment installed.

In 2012, T-HT also participated in the “Earth Hour” -the largest global initiative against climate change, with more than 7,000 cities and towns in 152 countries and territories switched off their lights for an hour, sending a powerful message for action to save the planet.

Certification and membership

T-HT has held the ISO 14001 Environmental Management System certificate since 2010. In June 2012, an audit of the ISO 14001 EMS was successfully completed and this confirmed the integration of environmental protection in all processes and the activities of all employees, whilst highlighting the importance of environmental protection amongst the Group's staff.

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

Corporate responsibility within affiliated companies

Combis

At Combis, the key focus is on the promotion of health, education, social development and overall excellence. In 2012, Combis supported, through donations and sponsorships, a range of projects in the areas of humanitarian work, sports and culture:

Combis provided financial support to the “Oaza” humanitarian association in its efforts to provide better conditions for abandoned children. In 2012 Combis also donated technological equipment to the “KBC Sestre milosrdnice” Clinical Hospital Center.

In the sphere of education, Combis donated funds to the “OŠ Pavleka Miškine Zagreb” elementary school and also provided assistance to the “Srednja škola - Centar za odgoj i obrazovanje Zagreb“ high school for children with disabilities by donating ICT equipment and services in order to help them create a Computer Lab.

Combis considers education to be key to development and to social prosperity. In 2012 Combis also provided financial support to enable a student to participate in the Erasmus exchange program and study for a year in Sweden.

Combis is also a strong advocate of sports. In the professional sports arena, Combis sponsored the Croatian wrestling federation's Junior European Wrestling Championship in Zagreb.

Combis also supports the top event of the Croatian athletics season - the IAAF World Challenge Zagreb, which is also known as the Boris Hanžeković Athletics Meeting.

Culture is another area where Combis is active. In 2012, Combis supported Culture Center Omiš and the "Omiš Guitar Fest." Combis also supported "Crtani Romani Šou" (the Comics Show) association and assisted in the organization of the 15th International Comics Festival in Zagreb.

Combis traditionally sponsors and supports IT conferences. In 2012 these included the Cisco Expo partner conferences in Croatia and Bosnia and Herzegovina, Microsoft WinDays Conference, the IBM Forum, Oracle Days in Zagreb and the Serbia Oracle User Group Conference (SrOUG).

In addition, in 2012 Combis organized its sixth annual Combis Conference, which took place in Opatija and brought together more than 300 participants from Croatia and the surrounding region, from the financial and telecommunications sectors, public administration and industry. Under the main topic: "Vision Technology ICT", leading technology experts gave keynote speeches, presentations, and case studies, and shared their knowledge and expertise.

Iskon

Throughout 2012, 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 fourth 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 the official internet provider of the Croatian National Football Team for eleven years. Is also provides 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 2012, Iskon continued to support the table tennis club HASTK Mladost Iskon. It also renovated the table tennis facilities at Jarun lake and donated table tennis equipment to homes for orphans in Zagreb, Split, Osijek Rijeka, Ladimirevci and Lekenik.

In 2012, Iskon was the official sponsor of telecommunications services at the ATP Zagreb Indoors and Zagreb Open tennis tournaments, for the fourth consecutive year.

In 2012, Iskon supported the CARNet annual conference CUC (CARNet Users Conference), TEDx Maksimir conference - a global program to bring together people with ideas worth spreading - and the Gradec Summer Open Air Cinema.

Financial Review 2012

T-HT Group Financial Results
Analysis of Segments Results

Financial Review 2012

Group Financial Performance

Disclosure

As of 2012, disclosure of key operational data for the fixed segment has been amended from the methodology employed the previous year. This amendment impacts the way the total number of fixed mainlines and broadband access lines (previously reported as ADSL mainlines) have been divided between retail and wholesale. As a consequence, the number of Wholesale Line Rentals is now reported under fixed mainlines - wholesale.

The definition for fixed mainlines retail has been amended to exclude public telephones from the total number of retail mainlines. As a consequence, the number of fixed lines retail and ARPA voice per access has been restated for all respective periods, in line with the new definition.

The Group has changed the recognition of the content provider cost to align the treatment of it with best industry practice. As a consequence, the Group has changed the accounting policy of content provider costs making reconciliation of the following positions in the financial statement for the year ended 31 December 2011: Material expenses (HRK -50 million), Depreciation and amortization (HRK +33 million), Financial expenses (HRK +17 million), Capital expenditure (HRK +61 million), Intangible assets (HRK +88 million), Non-current liabilities (HRK +17 million) and Current liabilities (HRK +71 million).

In order to reconcile the presentation of comparable period data with data presented in 2012, the following positions in the financial statements for the year ended 31 December 2011 were also reclassified as follows: Other operating income (HRK -97 million), Merchandise material and Energy expenses (HRK -21 million), Employee benefits expenses (HRK -13 million), Other expenses (HRK -63 million), Non-current liabilities (HRK +2 million) and Accrued expenses and deferred income (HRK -2 million).

Revenue

Throughout 2012, Group revenue was again impacted by negative economic trends, regulatory measures and increased competition. Despite growth in non voice revenues driven by Wholesale and Mobile data revenues, total revenue fell 7.6% to HRK 7,456 million (2011: HRK 8,067 million).

This revenue decline was primarily driven by lower voice revenue due to a highly competitive market, downward pressure on pricing and the harsh economic environment. The fall was accompanied by a decline in other service revenues and terminal equipment revenues, which slightly offset by an increase in non voice and miscellaneous revenues. Other service revenues declined, due to a fall in ICT segment revenues and due to lower revenue from basic subscriptions as a result of higher number of subscribers in bundle tariffs and the consequent revenue recognition in voice and non voice services.

The impact of the 6% mobile fee on net revenue from telecoms services until its abolition on 9 July 2012 totalled HRK 56 million (2011: HRK 145 million).

Operating expenses

Overall operating expenses fell 5.7%, or HRK 263 million, to HRK 4,339 million (2011: HRK 4,602 million), as a result of tight cost controls and lower costs related to telecommunication services.

Material expenses decreased by 9.0% to HRK 1,914 million, on a strong decline in Merchandise costs, down 13.9% to HRK 872 million, and a reduction in Services costs by 4.5% to HRK 1,042 million, mostly as a result of lower telecommunication services.

Total employee benefits decreased by 5.9% to HRK 1,208 million including lower redundancy provisions booked in 2012 (HRK 144 million vs HRK 162 million in 2011). Excluding redundancy costs, total employee costs fell by 5.2%, mainly due to a reduced number of employees resulting from the Group's ongoing program to rationalize business processes and drive efficiency improvements (FTE in 2012: 5,780 vs. 6,032 in 2011) alongside the introduction of cost savings initiatives.

Other costs fell by 1.4% to HRK 1,213 million, primarily due to lower advertising expenses, postal charges and maintenance costs.

The write-down of assets increased by 33.4% to HRK 89 million, mainly driven by an increase in the write-down of inventories and write-down of receivables in the business segment. Depreciation and amortization decreased by 8.4% to HRK 1,326 million mainly due to a change in the useful life period for terminal equipment.

T-HT Group profitability

EBITDA before exceptional items decreased by 8.1% to HRK 3,520 million in 2012 from HRK 3,832 million in 2011, primarily as a result of revenue trends, partially offset by an increase in other operating income by 26.7%, and lower operating expenses, excluding exceptional items, by 5.5%.

Operating profit (EBIT) fell 7.7% to HRK 2,050 million (2011: HRK 2,222 million), as a result of lower EBITDA before exceptional items, partially offset by decreased depreciation and amortization and lower redundancy costs (HRK 144 million vs. HRK 162 million in 2011). Net profit for 2012 was HRK 1,696 million, down 6.4% (2011: HRK 1,811 million), due largely to EBIT being boosted by a 25.9% rise in net financial income and a 10.7% fall in taxation.

Balance sheet

T-HT's balance sheet remains strong with total assets of HRK 13,113 million, down 0.8% (2011: HRK 13,224 million).

Total non-current assets increased by 4.1% to HRK 7,858 million at 31 December 2012 from HRK 7,549 million at 31 December 2011, mainly due to increased noncurrent financial assets due to investments into foreign bonds.

Total current assets decreased by 7.4% to HRK 5,254 million at 31 December 2012 from HRK 5,675 million at 31 December 2011, mainly due to higher cash and cash equivalents invested into non-current foreign bonds.

At 31 December 2012, cash and cash equivalents stood at HRK 3,146 million, compared with HRK 3,704 million at 31 December 2011.

Total issued capital and reserves decreased by 1.1% to HRK 10,899 million (2011: HRK 11,019 million), due to lower net profit in 2012.

Total liabilities remains stable at HRK 2,214 million, compared with HRK 2,205 million at 31 December 2011.

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 operating activities decreased by 2.2% to HRK 2,982 million (2011: HRK 3,050 million), mostly as a result of Group performance influenced by improved working capital management.

Cash flow from investing activities decreased by 126.7%, mainly as a result of higher investment into securities and capital expenditures.

Cash flow from financing activities improved by 2.6% mostly due to lower dividend payments (2012: HRK 1,813 million vs. 2011: HRK 1,863 million).

Capital expenditure

Capital expenditure increased by 25.8% in 2012 to HRK 1,180 million from HRK 938 million in 2011 (including capitalization of rights to broadcast content in 2012: HRK 32 million and in 2011: HRK 61 million), largely due to investment in the digital dividend - spectrum licenses, investment in building and investment required for the TeraStream project.

The Residential segment reported 1.2% higher capital expenditure when compared to the same period in 2011, mostly due to higher capitalization in residential Mobile broadband.

Business segment capital expenditure at the end 2012 rose from 2011 by 55.7%, mainly due to increased investment in network platforms.

Capital expenditure in the Network and Support Functions segment at the end of 2012, which represents the cross-segment management and support functions, was 40.6% higher than the previous year, mainly due to the digital dividend - spectrum license - recognized in October, the acquisition of a building from Croatian Post in Split and the investment required for the TeraStream project.

Analysis of segment results

Residential Segment Financial review

Revenue

Total residential revenue in 2012 fell 7.5 % to HRK 4,099 million, mostly as a result of lower voice revenue both in mobile and fixed and partially as a result of lower terminal equipment revenue.

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 e.g. the redesign of mobile loyalty programs.

Voice revenue

Voice revenue at the end of 2012 was down by 11.5% to HRK 2,353 million. Retail mobile voice revenue fell as a result of a highly competitive market, downward pressure on pricing and harsh economic environment. In addition, voice mobile termination revenue was higher by 14.9% due to attractive cross net/off net tariffs offered by all three mobile service providers in Croatia.

Mobile minutes of use (MOU) per average subscriber rose 25.5% mainly due to flat tariffs, with the revenue decline resulting from of lower price per minute of use amid a tough economic environment and competitive pressure.

Fixed telephony revenue fell 17.2% due to the continuation of fixed to mobile substitution, fixed to internet substitution and stronger competition, leading to a 5.0% fall in the total number of mainlines (retail and wholesale) and a 11.2% decline in minutes of use. As a result of lower minutes spent and downward pricing pressure, voice average revenue per access (ARPA) declined by 3.2%.

Non voice revenue

Non voice revenue rose 2.7% to HRK 1,597 million as a result of higher revenue from fixed and mobile postpaid services. Mobile services rose 4.7% to HRK 540 million, mainly boosted by the postpaid segment with prepaid revenue down 1.5%.

Mobile business is seeing a shift from non voice revenue to data revenue. The share of data revenue in total non voice revenue has increased to 35.9% in 2012 from 32.4% in 2011. This is in line with global trends (increasing numbers of tariffs including data traffic in the basic package), with the average mobile user is using increasingly advanced services such as data transmission and fewer traditional non voice services such as SMS.

Fixed non voice (IP) revenue increased 1.7% mostly due to higher broadband retail ARPA (3.0%) and 7.0% rise in TV subscribers to 344,000.

Other service revenue

As a result of higher share of subscribers on bundle tariffs and revenue reposting from basic subscription to voice and non voice services based on usage, other revenue is lower by HRK 53 million compared to same period last year.

Terminal equipment

A decline of 12.3% to HRK 134 million in terminal equipment revenue was caused primarily by a HRK 20 million fall in mobile as a result of a lower number of acquired and retained mobile postpaid customers, and the absence this year of any campaigns to promote mobile acquisition and retention.

Contribution to EBITDA

In 2012, the Residential segment contribution to EBITDA amounted to HRK 2,838 million, down 8.9% on 2011. Lower EBITDA was driven by a 7.5% decrease in revenue (HRK 334 million lower revenue in 2012) offset by a 4.4% decrease in operating expenses (down HRK 57 million in 2012).

Lower operating expenses were largely the outcome of lower non usage related direct costs as a result of a 14.5% fall in merchandise costs and a 4.8% decline in cost of sales commissions (deriving from lower commission cost in the mobile segment as a result of lower sales transactions through indirect sales channels). Copyright costs were 14.6% higher than last year. In addition, losses on accounts receivable were significantly reduced, as a direct benefit of better collection of unpaid bills facilitated by changes in legislation, especially in the mobile segment.

Usage related direct cost is slightly lower than last year by 2.0%. Slightly lower usage related cost is a result of lower international telecommunication services cost by HRK 15 million due to lower unitary cost of roaming services. This impact was mitigated with higher domestic telecommunication services cost as a result of higher off net usage due to higher number of cross net and off net tariffs.

Indirect costs were broadly flat to the previous year, falling 1.6%. With lower revenue offset by cost savings, the EBITDA contribution margin decreased by 1.0 percentage points to 69.2% from 70.3%.

Business Segment financial review

Revenue

In 2012, total business revenue fell 7.6 % to HRK 3,358 million. This fall was largely the result of lower voice revenue in mobile and in the fixed network. Revenue in 2012 was supported by one-off benefits including the termination of points related to a mobile loyalty program.

Voice revenue

Voice revenue fell 13.0%, to HRK 1,561 million. The fall was largely driven by a 25.1% decline in fixed retail voice revenue (HRK 155 million), on a 21.5% fall in total minutes in traditional voice. This resulted in part from an 8.7% decrease in total traditional voice mainlines and from migration to mobile voice.

In wholesale voice revenues, fixed revenues fell 4.4%, or HRK 13 million, mainly due to lower national voice revenue, which was HRK 10 million lower coming from price reductions following an NRA decision and a decline in usage, and lower international hubbing revenue, which fell by HRK 5 million due to traffic decrease. National hubbing services revenues were up HRK 2 million.

Mobile voice revenues were 8.8%, or HRK 72 million, lower at HRK 744 million, with retail accounting for a HRK 41 million fall and wholesale for a HRK 30 million decline. The HRK 72 million mobile voice revenue fall was mainly driven by lower voice ARPU (-13.0%) and lower average minutes per subscriber (-9.8%). A 2.9% increase in subscribers partially offset the revenue decline. Voice mobile termination revenue grew by 1.5%, or HRK 1 million, to HRK 88 million due to usage increase, which compensated for the lower mobile termination rate introduced by the NRA. A reduction in visitor voice revenue by 18.7%, or HRK 32 million, to HRK 138 million was driven by a 30% fall in prices.

Non voice revenue

Non voice revenue grew 4.0% to HRK 1,164 million. Fixed non voice revenue was 5.2% higher at HRK 828 million, as a result of a 22.3% increase in wholesale revenue, which was partially reduced by a decrease in retail of 4.8%. Fixed retail revenue decreased, on lower revenue from traditional data, which declined 8.8% owing to the migration to IP data, while the IP revenues fell 3.5%.

Within the non-voice fixed wholesale revenue segment, an increase of 22.3%, or HRK 65 million, was due largely to higher revenue from infrastructure resulting from WLR, ULL and BSA, with an increase in access lines. Non voice mobile revenue rose 1.4%, or HRK 5 million, to HRK 336 million. Retail accounted for HRK 242 million of the total, driven by mobile data, while visitor revenue declined by 19.1%, or HRK 18 million, to HRK 77 million as a result of lower prices - a 30% fall in SMS prices and a 55% fall in data, which was partially offset by higher data usage.

Other service revenue

Other services revenues were down 17.6% to 455 million in 2012.

As a result of a higher number of subscribers in bundle tariffs and revenue rebooking from basic subscription to voice and non voice services based on usage (not as subscription fees), postpaid basic subscription revenues dropped 47.3%, or HRK 46 million, compared to the previous year.

ICT revenue fell 11.3%, or HRK 51 million, to HRK 396 million. This was largely due to the persistent recession in Croatia and to a reduction in government contracts.

Terminal equipment

Revenue from terminal equipment was down 18.7% to HRK 49 million, with fixed falling 43.6%, or HRK 1 million, to HRK 2 million, and mobile down 17.4%, or HRK 10 million, to HRK 47 million.

Miscellaneous revenue

Miscellaneous revenue increased by 18.1% or HRK 20 million, in 2012. The increase was primarily driven by a 17.6% (HRK 19 million) increase in business wholesale mobile miscellaneous revenue, resulting from higher national roaming (usage impact) and SMS bulk revenue (usage growth).

Contribution to EBITDA

The Business Segment contribution to EBITDA fell 9.7%, to HRK 2,068 million, driven largely by a HRK 277 million revenue decline. Operating expenses fell HRK 56 million. Merchandise costs were down 17.7% to total HRK 402 million, mainly due to merchandise costs from the Combis ICT business and non having strong push mobile campaign in 2012. Indirect costs were up 21.1%, or HRK 61 million, at HRK 349 million, due largely to the contribution of HT. Usage related direct costs in 2012 were down 8.9%, or HRK 45 million, at HRK 458 million. Losses on account receivables grew 41.1%, or HRK 17 million, at HRK 59 million, due to the deep recession, illiquidity and a large number of insolvencies amongst business customers.

Network and Support Functions Financial review

Contribution to EBITDA

The contribution to EBITDA rose 11.8% to HRK -1,386 million. This resulted from an increase in other operating income of HRK 55 million and a fall in operating expenses of HRK 132 million.

Other operating income rose by 26.7% to HRK 259 million primarily driven by higher revenues from the sale of real estate (HRK 50 million), higher revenues from land registration (HRK 13 million) and higher revenues from charging of dunning letters (HRK 16 million) which were offset by lower revenues from penalties (HRK -9 million), lower revenues from commitment write offs (HRK -7 million) and lower other revenues (HRK -8 million).

Operating expenses fell by 7.4% to HRK 1,645 million from HRK 1,777 million mainly as a result of lower postal charges, maintenance costs and services costs. This cost decrease is a result of cost saving measures, as well as e-bill introduction and renegotiation of contracts. Decrease in operating expenses is additionally contributed by decrease in personnel cost.

Consolidated financial statements 31 December 2012

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Notes to the consolidated financial statements

Responsibility for the consolidated financial statements

Pursuant to the Croatian Accounting Act in force, the Management 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 (Hrvatski Telekom d.d. and its subsidiaries) for that period.

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

In preparing those consolidated financial statements, the responsibilities of the Management 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 Management 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 Management 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 5 February 2013.

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

5 February 2013

On behalf of the Group,

Mr. Ivica Mudrinić
President of the Management Board (CEO)

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 2012 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 2012, 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 28 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 2012 is HRK 855 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., Zagreb, 5. February 2013.

John Mathias Gašparac
Procurator

Tamara Maćašović
Certified Author

Consolidated statement of comprehensive income

For the year ended 31 December 2012

	Notes	2012 HRK millions	2011 HRK millions Restated
Rendering of services		7,152	7,765
Sale of goods		304	302
Revenue	3	7,456	8,067
Other operating income		259	204
Merchandise, material and energy expenses		(872)	(1,013)
Service expenses	4	(1,042)	(1,091)
Employee benefits expenses	6	(1,208)	(1,283)
Work performed by the Group and capitalised		85	81
Depreciation, amortization and impairment of non-current assets	5	(1,326)	(1,447)
Other expenses	7	(1,302)	(1,296)
Total operating costs		(5,665)	(6,049)
Operating profit	3	2,050	2,222
Finance income		78	83
Finance costs		(63)	(65)
Net finance income		15	18
Net share in investments in associate and joint venture	12,13	27	15
Profit before income tax		2,092	2,255
Income tax expense	8	(396)	(444)
Profit for the year		1,696	1,811
Other comprehensive income for the year			
Change in value of available for sale financial assets		2	(2)
Actuarial (losses)/gains and other (expense)/income		(5)	19
Other comprehensive (loss)/income for the year, net of tax		(3)	17
Total comprehensive income for the year, net of tax		1,693	1,828
Earnings per share - basic and diluted, for profit for the year attributable to ordinary equity holders of the Company	9	HRK 20.71	HRK 22.12

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

Consolidated statement of financial position

As at 31 December 2012

	Notes	31 December 2012 HRK millions	31 December 2011 HRK millions Restated	1 January 2011 HRK millions Restated
ASSETS				
Non-current assets				
Intangible assets	10	1,142	1,087	1,222
Property, plant and equipment	11	5,733	5,953	6,336
Investments in associate and joint venture	12,13	398	395	380
Available-for-sale financial assets	14	499	39	42
Other non-current receivables		21	23	24
Deferred income tax assets	8	65	52	64
Total non-current assets		7,858	7,549	8,068
Current assets				
Inventories	16	155	175	216
Trade and other receivables	17	1,215	1,307	1,423
Prepayments and accrued income		149	126	110
Income tax prepayments		4	-	25
Available-for-sale financial assets	14	86	323	463
Loans to banks	15	239	-	-
Time deposits	18 b)	261	40	2
Cash and cash equivalents	18 a)	3,146	3,704	3,282
Total current assets		5,255	5,675	5,521
TOTAL ASSETS		13,113	13,224	13,589

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

Consolidated statement of financial position (continued)

As at 31 December 2012

	Notes	31 December 2012 HRK millions	31 December 2011 HRK millions Restated	1 January 2011 HRK millions Restated
EQUITY AND LIABILITIES				
Issued capital and reserves				
Issued share capital	23	8,189	8,189	8,189
Legal reserves	24	409	409	409
Fair value reserves		(1)	(3)	(1)
Retained earnings	25	2,302	2,424	2,457
Total issued capital and reserves		10,899	11,019	11,054
Non-current liabilities				
Provisions for legal claims and other provisions	22	87	113	101
Employee benefit obligations	20	140	158	192
Deferred income	21	2	2	74
Other non-current liabilities		50	49	44
Total non-current liabilities		279	322	411
Current liabilities				
Trade and other payables	19	1,577	1,418	1,532
Provisions for redundancy	6	146	169	133
Other accruals	26	84	116	196
Income tax payable		-	20	-
Deferred income	21	122	151	250
Short-term borrowings		6	9	13
Total current liabilities		1,935	1,883	2,124
Total liabilities		2,214	2,205	2,535
TOTAL EQUITY AND LIABILITIES		13,113	13,224	13,589

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

Signed on behalf of the Group on 5 February 2013:

Mr. Ivica Mudrinić
President of the Management Board (CEO)

Mr. Dino Ivan Dogan, Ph. D.
Member of the Management Board and
Chief Financial Officer (CFO)

Consolidated statement of cash flows

For the period ended 31 December 2012

	Notes	2012 HRK millions	2011 HRK millions Restated
Operating activities			
Profit before income tax		2,092	2,255
Depreciation, amortization and impairment of non-current assets	5	1,326	1,447
Interest income		(54)	(34)
(Gain)/Loss on disposal of assets		(58)	6
Share of profit in joint venture	13	(27)	(15)
Decrease in inventories		20	41
Decrease in receivables and prepayments		89	65
Increase/(Decrease) in payables and accruals		104	(347)
Decrease in employee benefit obligations	20	(18)	(34)
(Decrease)/Increase in provisions		(50)	48
Other non-cash items		(9)	7
Cash generated from operations		3,415	3,439
Interest paid		(0)	(2)
Income tax paid		(433)	(388)
Net cash flows from operating activities		2,982	3,049
Investing activities			
Purchase of non-current assets	10,11	(1,180)	(938)
Proceeds from sale of non-current assets		64	3
Purchase of available-for-sale financial assets		(1,481)	(944)
Proceeds from sale of available-for-sale financial assets		1,045	1,065
Purchase of reverse REPO arrangements	15	(634)	-
Proceeds from reverse REPO arrangements	15	395	-
Interest received		48	57
Dividend received	13	25	-
Net cash flows used in investing activities		(1,718)	(757)
Financing activities			
Repayment of lease liability and borrowings		(12)	(11)
Dividends paid	25	(1,813)	(1,863)
Net cash flows used in financing activities		(1,825)	(1,874)
Net (decrease)/increase in cash and cash equivalents		(561)	418
Exchange gains on cash and cash equivalents		3	4
Cash and cash equivalents at 1 January		3,704	3,282
Cash and cash equivalents at 31 December	18 a)	3,146	3,704

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 2012

	Issued share capital HRK millions (Note 23)	Legal reserves HRK millions (Note 24)	Fair value reserves HRK millions	Retained earnings HRK millions (Note 25)	Total HRK millions
Balance as at 1 January 2011	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
Profit for the year	-	-	-	1,696	1,696
Other comprehensive income for the year	-	-	2	(5)	(3)
Total comprehensive income for the year	-	-	2	1,691	1,693
Dividends paid to equity holders of the Company	-	-	-	(1,813)	(1,813)
Balance as at 31 December 2012	8,189	409	(1)	2,302	10,899

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 2012

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 2012 was 5,999 (31 December 2011: 6,239).

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 2012 were authorized for issue in accordance with a resolution of the Management Board on 5 February 2013. 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:

Entity	Country of Business	Ownership Interest 31 December 2012	Ownership Interest 31 December 2011
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 except as is disclosed at the end of this Note.

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.

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 Group adopted this amendment that affects disclosure only and did not impact on the Group's financial position or performance.

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 do 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. Amended IAS 12 does not 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.

Standards and interpretations issued but not yet effective:

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 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 IFRS 12 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 IFRS 13 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.

Standards and interpretations issued but not yet effective (continued):

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 recognise 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.

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. The Group is considering the implications of the amendment and the impact on the Group.

Amendment to IFRS 1 First time adoption on government loans (effective for annual periods beginning on or after 1 January 2013).

This amendment addresses how a first-time adopter would account for a government loan with a below-market rate of interest when transitioning to IFRS. It also adds an exception to the retrospective application of IFRS, which provides the same relief to first-time adopters granted to existing preparers of IFRS financial statements when the requirement was incorporated into IAS 20 in 2008. This amendment is not relevant to the Group's operations.

Amendment to IFRSs 10, 11 and 12 on transition guidance (effective for annual periods beginning on or after 1 January 2013).

These amendments provide additional transition relief to IFRSs 10, 11 and 12, limiting the requirement to provide adjusted comparative information to only the preceding comparative period. For disclosures related to unconsolidated structured entities, the amendments will remove the requirement to present comparative information for periods before IFRS 12 is first applied. The Group is considering the implications of the amendments and the impact on the Group.

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.

IFRS 9 Financial Instruments (effective for annual periods beginning on or after 1 January 2015)

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.

Amendments to IFRS 10, IFRS 12 and IAS 27 - Investment entities (issued on 31 October 2012 and effective for annual periods beginning 1 January 2014)

The amendment introduced a definition of an investment entity as an entity that (i) obtains funds from investors for the purpose of providing them with investment management services, (ii) commits to its investors that its business purpose is to invest funds solely for capital appreciation or investment income and (iii) measures and evaluates its investments on a fair value basis. An investment entity will be required to account for its subsidiaries at fair value through profit or loss, and to consolidate only those subsidiaries that provide services that are related to the entity's investment activities. IFRS 12 was amended to introduce new disclosures, including any significant judgements made in determining whether an entity is an investment entity and information about financial or other support to an unconsolidated subsidiary, whether intended or already provided to the subsidiary. The Group is currently assessing the impact of the amendments on its financial statements.

Annual improvements 2011 (effective for annual periods beginning on or after 1 January 2013)

These annual improvements, address six issues in the 2009-2011 reporting cycle. It includes changes to:
IFRS 1, 'First time adoption'
IAS 1, 'Financial statement presentation'
IAS 16, 'Property plant and equipment'
IAS 32, 'Financial instruments; Presentation'
IAS 34, 'Interim financial reporting'

The Group is considering the implications of the improvements and the impact on the Group.

Voluntary accounting policy change

In 2012, the Group voluntary changed its accounting policy for the treatment of content provider cost. Previously, the Group expensed content provider costs in the period in which they occurred. The Group now recognizes these costs as an intangible asset at the inception of related contract. The Group determined that the following conditions have to be met for capitalization of content provider contracts: contract duration must be longer than one year, cost must be determined or determinable, contracted rights must be continuous and costs under the contract are unavoidable. Assets recognized under these contracts will be amortized over the contract period. The Group believes that recognizing the content provider costs as intangible assets results in better presentation of the financial position and provides more relevant information. The accounting treatment of content provider costs varies within the media and telecommunication industry, but the Group believes the current accounting policy is more appropriate as it is aligned better with industry best practices and the policies followed by Deutsche Telekom AG.

The change in accounting policy has been accounted for retrospectively, and the Group restated the comparative amounts for each prior period presented as if the new accounting policy had always been applied. The effects of the accounting policy change on financial information for 2011 and 2010 are as follows:

Statement of comprehensive income

Position	2011 As reported HRK millions	Impact on change HRK millions	2011 Restated HRK millions
Service expenses	(1,141)	50	(1,091)
Depreciation, amortization and impairment of non-current assets	(1,414)	(33)	(1,447)
Financial costs	(48)	(17)	(65)

Voluntary accounting policy change (continued)

Statement of financial position

Position	1 January 2011 As reported HRK millions	Impact on change HRK millions	1 January 2011 Restated HRK millions
Intangible assets	1,162	60	1,222
Other non-current liabilities	43	1	44
Trade and other payables	1,473	59	1,532

Position	31 December 2011 As reported HRK millions	Impact on change HRK millions	31 December 2011 Restated HRK millions
Intangible assets	999	88	1,087
Other non-current liabilities	32	17	49
Trade and other payables	1,347	71	1,418

Statement of cash flows

Position	2011 As reported HRK millions	Impact on change HRK millions	2011 Restated HRK millions
Depreciation, amortization and impairment of non-current assets	1,414	33	1,447
Decrease in payables and accruals	(375)	28	(347)
Purchase of non-current assets	877	61	938

There was no any effect on earnings per share related to the restatement in 2011.

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 the 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 22 and 28. Changes in these judgments could have a significant impact on the segments of the Group.

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 a 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.

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. The value in use calculation is based on a discounted cash flow model. The cash flows are derived from the financial plan covering a mid-term period. The cash flows beyond the planning period are extrapolated using appropriate growth rates given in Note 10. 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. Further details including carrying values and effects on the result of the period are given in Notes 10 and 11.

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 is 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.

In 2012, the Group reassessed useful life of customer premises equipment (CPE) which was increased from 3 and 5 to 7 years. The effect is reduced annual depreciation cost by HRK 59 million. The change was made based on lower replaced malfunctioned devices during the time that passed since the initial useful life was estimated and due to new purchases of higher quality equipment.

The following table demonstrates the sensitivity to a reasonably possible change in useful life on amortization and depreciation, with all other variables held constant, on the Group's profit post tax:

	Increase / decrease in %	Effect on profit post tax HRK millions
Year ended 31 December 2012	+10	(34)
	-10	148

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.

b) 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 intercompany 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 rights	
UMTS licence	20 years
LTE licence (digital dividend)	12 years
GSM licence	15 years
Right of servitude for Distributive Telecommunication Infrastructure DTI)	30 years
Software, content 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
Customer premises equipment (CPE)	7 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

Assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

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 inventory 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, the receivables 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 20). 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 is 3 years in 2012.

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, domestic interconnection revenues related to mobile network, revenues for short and multimedia messages and data traffic revenues.

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.

Revenue from ICT includes revenue from restructuring business processes services, application management services, technology infrastructure and system maintenance and the design and development of complex IT systems to a client's specifications (design and build).

Revenues from application management services, technology infrastructure and system maintenance are recognised on a straight line basis over the term of the contract. Revenues from time and material contracts are recognised based on contracted prices and direct cost incurred. Revenue from product maintenance contracts are recognized on a straight-line basis over the delivery period.

Revenues and expenses from fixed-price design and build contracts where the outcome can be estimated reliably are recognised under percentage-of completion (POC) method. Estimates are revised and can result in decrease or an increase of estimated revenues and expenses and are included in statement of comprehensive income in the year in which circumstances that give rise to the revision become known to management.

Revenues from one-time-charge licensed software are recognized at the inception of licence term all revenue recognition criteria have been met. Revenues from monthly licence charges are recognised on a subscription basis over the period that the client is entitled to use the licence. Revenues for maintenance, unspecified upgrades and technical support are recognised over the period such items are delivered.

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.

Securities purchased under agreements to resell ('reverse REPOs') are recorded as loans to banks and cash equivalents, as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method.

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 and equity-settled transactions is measured initially at fair value at the grant date using a binomial model, further details of which are given in Note 33. 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 2012, following positions in the financial statements for the year ended 31 December 2011 were reclassified:

Statement of comprehensive income

Position	2011 HRK millions
Other expenses	(63)
Employee benefits expenses	(13)
Merchandise, material and energy expenses	(21)
Other operating income	(97)

3 Segment information

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.

The Management Board, as the 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 or segment results (as calculated in the table below).

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

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

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

Residential and Business segments

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

Year ended 31 December 2011	Residential HRK millions	Business HRK millions	Network & Support functions HRK millions	Total HRK millions
Segment revenue	4,432	3,635	-	8,067
Service revenues	4,263	3,466	-	7,729
Terminal equipment	153	60	-	213
Other	16	109	-	125
Usage related direct costs	(324)	(502)	-	(826)
Income and losses on accounts receivable	(17)	(41)	-	(58)
Contribution margin I	4,091	3,092	-	7,183
Non-usage related direct costs, restated	(569)	(513)	-	(1,082)
Segment result, restated	3,522	2,579	-	6,101
Other income	-	-	204	204
Other operating expenses	(409)	(288)	(1,939)	(2,636)
Depreciation, amortization and impairment of non-current assets, restated	-	-	(1,447)	(1,447)
Operating profit, restated	3,113	2,291	(3,182)	2,222
Capital expenditures	386	91	461	938
Year ended 31 December 2012				
Segment revenue	4,099	3,357	-	7,456
Service revenues	3,947	3,180	-	7,127
Terminal equipment	134	49	-	183
Other	18	128	-	146
Usage related direct costs	(318)	(458)	-	(776)
Income and losses on accounts receivable	(8)	(59)	-	(67)
Contribution margin I	3,773	2,840	-	6,613
Non-usage related direct costs	(533)	(424)	-	(957)
Segment result	3,240	2,416	-	5,656
Other income	-	-	259	259
Other operating expenses	(401)	(349)	(1,789)	(2,539)
Depreciation, amortization and impairment of non-current assets	-	-	(1,326)	(1,326)
Operating profit	2,839	2,067	(2,856)	2,050
Capital expenditures	391	141	648	1,180

3 Segment information (continued)

Revenue - by geographical area

	2012 HRK millions	2011 HRK millions
Republic of Croatia	6,829	7,411
Rest of the World	627	656
	7,456	8,067

The majority of Group's assets are located in Croatia (2012: 99.99%; 2011: 99.99%).

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

4 Service expenses

	2012 HRK millions	2011 HRK millions
Domestic interconnection	442	445
International interconnection	334	382
Other services	266	264
	1,042	1,091

5 Depreciation, amortization and impairment of non-current assets

	2012 HRK millions	2011 HRK millions
Depreciation	912	1,029
Amortization	356	369
	1,268	1,398
Impairment loss	58	49
	1,326	1,447

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

6 Employee benefits expenses

	2012 HRK millions	2011 HRK millions
Gross salaries	849	881
Taxes, contribution and other payroll expenses	231	252
Redundancy expenses	144	162
Long-term employee benefits (Note 20)	(16)	(12)
	1,208	1,283

The movements of redundancy provision are as follows:	2012 HRK millions	2011 HRK millions
Provision at 1 January - current	169	133
Additions charged to the statement of comprehensive income	144	162
Utilisation	(167)	(126)
Total provision for redundancy 31 December	146	169
Of that - current	146	169

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 2012 due to business reasons.

7 Other expenses

	2012 HRK millions	2011 HRK millions
Maintenance services	265	271
Rent (Note 27)	185	178
Licence cost	165	163
Advertising	121	163
Selling commission	120	128
Postal expenses	69	95
Provision of trade receivables	68	59
Call centre and customer care support	50	56
Non-income taxes and contribution	45	51
Contract workers	35	23
Daily allowances and other costs of business trips	21	22
Write down of inventories	21	8
Education and consulting	18	18
Insurance	14	13
Loss on disposal of fixed assets	1	2
Other operating charges	104	46
	1,302	1,296

8 Income tax expense

a) Tax on profit	2012 HRK millions	2011 HRK millions
Current tax expense	409	435
Deferred tax (income)/expense	(13)	9
Taxation	396	444

b) Reconciliation of the taxation charge to the income tax rate	2012 HRK millions	2011 HRK millions
Profit before taxes	2,092	2,255
Income tax at 20% (domestic rate)	418	451
Dividends received and incentives	(16)	(1)
Tax for previous years	(11)	(14)
Entertainment expenses and car usage	2	2
Tax effects of tax loss carry forward	(1)	-
Other	4	6
Taxation	396	444
Effective tax rate	18.93%	19.69%

8 Income tax expense (continued)

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

	31 December 2012 HRK millions	Charged / (credited) in 2012 HRK millions	31 December 2011 HRK millions	Charged / (credited) in 2011 HRK millions	31 December 2010 HRK millions
Deferred tax asset recognized in statement of comprehensive income					
Non-tax deductible value adjustments	23	1	22	3	19
Property, plant and equipment write down	16	7	9	(3)	12
Accrued interest on legal cases	7	1	6	0	6
Deferred revenue from connection fees	-	-	-	(11)	11
Other	15	4	11	2	9
Deferred tax asset recognized in statement of other comprehensive income					
Actuarial gains and losses	4	0	4	(3)	7
Total deferred tax assets	65	13	52	(12)	64

A deferred tax asset has been recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised. Deferred tax assets have not been discounted.

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 359 million became tax deductible in the period from 2002 to 2012, and the remaining HRK 36 million will be tax deductible in future periods.

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. 2014 for the 2012 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.

Deferred income tax assets are recognised for tax loss carry-forwards to the extent that the realisation of the related tax benefit through future taxable profits is probable in the amount of HRK 1 million. The Group did not recognise deferred income tax assets of HRK 28 million in respect of losses amounting to HRK 141 million that can be carried forward against future taxable income.

Losses expires in:	HRK million
2013	38
2014	45
2015	38
2016	27
	148

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:

	2012	2011 Restated
Profit for the year attributable to ordinary equity holders of the Company in HRK millions	1,696	1,811
Weighted average number of ordinary shares for basic earnings per share	81,887,256	81,888,535

10 Intangible assets

	Licences HRK millions	Software HRK millions	Goodwill HRK millions	Assets under construction and other assets HRK millions	Total HRK millions
At 1 January 2011					
Cost	281	2,509	162	340	3,292
Accumulated amortization	(143)	(1,830)	-	(97)	(2,070)
Net book value	138	679	162	243	1,222
Year ended 31 December 2011					
Opening net book value	138	679	162	243	1,222
Additions	-	154	-	88	242
Transfers	2	55	-	(57)	-
Transfers from PPE	-	2	-	-	2
Amortization charge	(10)	(295)	-	(64)	(369)
Impairment loss	-	(2)	-	(8)	(10)
Net book value	130	593	162	202	1,087
At 31 December 2011					
Cost	281	2,660	162	367	3,470
Accumulated amortization	(151)	(2,067)	-	(165)	(2,383)
Net book value	130	593	162	202	1,087
Year ended 31 December 2012					
Opening net book value	130	593	162	202	1,087
Additions	150	186	-	81	417
Transfers	-	39	-	(39)	-
Amortization charge	(12)	(264)	-	(80)	(356)
Impairment loss	-	(6)	-	-	(6)
Net book value	268	548	162	164	1,142
At 31 December 2012					
Cost	432	2,767	162	366	3,727
Accumulated amortization	(164)	(2,219)	-	(202)	(2,585)
Net book value	268	548	162	164	1,142

The intangible assets of the Group as of 31 December 2012 include the UMTS licence with the carrying value of HRK 81 million (31 December 2011: HRK 88 million). The UMTS licence is amortised over a period of 20 years (starting from June 2005) according to Concession contract.

Assets under construction primarily relate 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 179 million and licence for use of the radio frequency spectrum in 800 MHz band (digital dividend) in the amount of HRK 150 million. The LTE licence is amortized over a period of 12 years (starting from November 2012) according to licence granted.

Impairment loss

During 2012, the Group recognized impairment loss of intangible assets of HRK 6 million (2011: HRK 10 million).

Impairment testing of goodwill

Goodwill is allocated to the Group's cash-generating units (CGUs) identified according to operating segment. An operating segment-level summary of the goodwill allocation is presented below:

	31 December 2012 HRK millions	31 December 2011 HRK millions
Residential	55	55
Business	107	107
	162	162

The key assumptions used for value-in-use calculations are as follows:

	Residential		Business	
	31 December 2012	31 December 2011	31 December 2012	31 December 2011
Growth rate	2.0%	2.0%	2.0%	2.0%
Discount rate	9.6%	9.6%	9.6%	9.6%

The recoverable amount of a CGU is determined based on value in use calculations. The key assumptions on which the determination of CGUs value in use is based reflect past experience and expectations of market development, in particular: development of revenue, market share, customer acquisition and retention cost, capital expenditures, growth rate. The growth rate does not exceed the long-term average growth rate for the industry in which the CGU operates. The weighted average growth rate is used to extrapolate cash flows beyond the budgeted period and post-tax discount rate is applied to the cash flow projections.

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 2011					
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
Year ended 31 December 2012					
Opening net book value	1,122	4,320	286	225	5,953
Additions	29	291	39	404	763
Transfers	7	98	14	(119)	-
Disposals	(16)	-	(2)	(1)	(19)
Amortization charge	(104)	(709)	(99)	-	(912)
Impairment loss	-	(49)	-	(3)	(52)
Net book value	1,038	3,951	238	506	5,733
At 31 December 2012					
Cost	2,160	11,420	1,139	509	15,228
Accumulated amortization	(1,122)	(7,469)	(901)	(3)	(9,495)
Net book value	1,038	3,951	238	506	5,733

Included within assets under construction of the Group are major spare parts of HRK 19 million (31 December 2011: HRK 27 million), net of a provision of HRK 1 million (31 December 2011: HRK 1 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 2012, the Group recognized an impairment loss of property, plant and equipment of HRK 52 million (2011: HRK 39 million) due to transfer to the newer technology. The recoverable amount of that equipment is its estimated 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 in the gross amount of HRK 420 million.

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 the Company'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 portion of these assets are 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 Group 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 Group 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 28 b).

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 2012 is HRK 855 million (31 December 2011: HRK 885 million).

12 Investment in associate

The net book value of investments in associate comprises:

	31 December 2012 HRK millions	31 December 2011 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 2012 and during the year ended 31 December 2011 was as follows:

Net book value	2012 HRK millions	2011 HRK millions
At 1 January	2	2
Share of profits	0	0
Impairment of investments	(0)	(0)
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 2012 Unaudited HRK millions	31 December 2011 Audited HRK millions
Current assets	14	15
Non-current assets	17	17
Current liabilities	(3)	(3)
Non-current liabilities	0	0
Net assets	28	29

Share of the associate revenue and loss	2012 Unaudited	2011 Audited
Revenue	28	29
Loss	(2)	0

13 Investment in joint venture

The net book value of investments in joint venture comprises:

	31 December 2012 HRK millions	31 December 2011 HRK millions
HT d.d. Mostar	396	393
	396	393

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, the 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 2012, is recognized in the statement of comprehensive income in the amount of HRK 27 million (2011: HRK 15 million of profit was recognized based on unaudited results of profit for the year ended 31 December 2011 which was later confirmed by the audit report).

In 2012, HT received a dividend of HRK 25 millions from HT d.d. Mostar (2011: nil).

Share of the jointly controlled entity assets and liabilities:	31 December 2012 Unaudited HRK millions	31 December 2011 Audited HRK millions
Current assets	124	135
Non-current assets	563	554
Current liabilities	(129)	(139)
Non-current liabilities	(42)	(60)
Net assets	516	490

Share of the jointly controlled entity revenue and profit:	2012 Unaudited	2011 Audited
Revenue	393	370
Profit	27	15

14 Available-for-sale financial assets

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

Issuer	Currency	Maturity	31 December 2012 HRK millions	31 December 2011 HRK millions
Domestic bond:				
Government of Croatia	HRK	8 February 2017	35	31
Foreign bonds:				
Government of France	EUR	25 September 2014	153	-
Government of Germany	EUR	12 September 2014	151	-
Government of Germany	EUR	13 July 2014	75	-
Government of Netherland	EUR	15 April 2015	77	-
Other equity securities	HRK		8	8
			499	39

Interest rate on domestic bond is 4.75%. Interest rates on foreign bonds are up to 0.75%.

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

			31 December 2012 HRK millions	31 December 2011 HRK millions
Unit holdings in money market funds:			11	22
Foreign bond:				
Government of France	EUR	12 January 2013	75	-
Foreign treasury bills:				
Government of France	EUR	9 February 2012	-	75
Government of Germany	EUR	15 February 2012	-	76
Government of France	EUR	22 March 2012	-	75
Government of France	EUR	23 August 2012	-	75
			86	323

Interest rate on foreign bond is 3.75%. Interest rates on foreign treasury bills were up to 1.00%.

The estimated fair value of investments in treasury bills and bonds at 31 December 2012 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 2012.

15 Loans to banks

Issuer	Currency	Maturity	31 December 2012 HRK millions	31 December 2011 HRK millions
Reverse REPO agreements (Note 30 g):				
Erste Steiermärkische Bank d.d.	HRK	23 January 2013	86	-
Erste Steiermärkische Bank d.d.	HRK	27 February 2013	79	-
Privredna banka Zagreb d.d.	HRK	29 March 2013	74	-
			239	-

Interest rates on reverse REPO agreements are up to 1.00%.

16 Inventories

	31 December 2012 HRK millions	31 December 2011 HRK millions
Inventories and spare parts	78	84
Merchandise	77	91
	155	175

17 Trade and other receivables

	31 December 2012 HRK millions	31 December 2011 HRK millions
Trade receivables	1,146	1,233
Other receivables	69	74
	1,215	1,307

The aging analysis of trade receivables is as follows:

			Past due but not impaired				
	Total HRK millions	Neither past due nor impaired HRK millions	< 30 days HRK millions	31-60 days HRK millions	61-90 days HRK millions	91-120 days HRK millions	> 120 days HRK millions
31 December 2012	1,146	823	176	73	30	29	15
31 December 2011	1,233	896	192	71	48	19	7

Value adjustment is done for outstanding domestic receivables older than 120 days, and for outstanding foreign receivables that are due more than 150 days. Value adjustment for receivables from subsidiaries, domestic telecommunication operators, receivables for the international settlement and key customers under extraordinary collection method value adjustment is done according to the collection estimate.

Short-term receivables are written-off in the case when the debtor is liquidated or ceased its business activities; when the legal case is lost by the final court decision or in the case of lapse of receivables.

As at 31 December 2012, trade receivables with a nominal value of HRK 1,085 million (31 December 2011: HRK 1,047 million) were deemed impaired and fully provided for.

Movements in the provision for impairment of receivables were as follows:

	2012 HRK millions	2011 HRK millions
At 1 January	1,047	1,028
Charge for the year	151	143
Unused amounts reversed	(83)	(91)
Receivables written-off	(30)	(33)
At 31 December	1,085	1,047

18 Cash and cash equivalents and time deposits

a) Cash and cash equivalents

Cash and cash equivalents comprise the following amounts:

	31 December 2012 HRK millions	31 December 2011 HRK millions
Cash on hand and balances with banks	741	1,937
Time deposits with maturity less than 3 months	1,857	1,767
Reverse REPO agreements affairs with maturity less than 3 months	548	-
	3,146	3,704

b) Time deposits with maturities more than 3 months

	31 December 2012 HRK millions	31 December 2011 HRK millions
Foreign bank	259	-
Domestic banks	2	40
	261	40

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

	31 December 2012 HRK millions	31 December 2011 HRK millions
HRK	2,659	2,828
EUR	723	874
USD	25	42
	3,407	3,744

19 Trade and other payables

	31 December 2012 HRK millions	31 December 2011 HRK millions Restated	1 January 2011 HRK millions Restated
Trade payables	1,428	1,244	1,373
Payroll and payroll taxes	81	82	75
VAT and other taxes payable	38	62	40
Other creditors	30	30	44
	1,577	1,418	1,532

20 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:

	2012 HRK millions	2011 HRK millions
At 1 January	158	192
LTIP - Variable II (Notes 6 and 33)	1	1
Service costs (Note 6)	11	13
Interest costs	8	10
Amortization losses/(gains) (Note 6)	(1)	(23)
Benefit paid	(13)	(12)
Curtailments (Note 6)	(27)	(3)
Actuarial losses/(gains)	3	(20)
At 31 December	140	158

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

	2012 %	2011 %
Discount rate (annually)	6.5	6.5
Wage and sallary increases (annually)	2.0	2.0

21 Deferred income

	31 December 2012 HRK millions	31 December 2011 HRK millions
Connection fee	2	2
Deferred income - non current	2	2
Prepaid vouchers	66	72
Customer loyalty programme	34	49
Connection fee	2	4
Other	20	26
Deferred income - current	122	151
	124	153

22 Provisions for legal claims and other provisions

	2012 HRK millions	2011 HRK millions
At 1 January	113	101
Additions	25	10
Reversals	(24)	-
Interest cost	2	5
Utilisation	(29)	(3)
At 31 December	87	113

As at 31 December 2012, 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.

23 Issued share capital

Authorised, issued, fully paid and registered share capital	31 December 2012 HRK millions	31 December 2011 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 2012.

In 2012, the Group acquired 1,931 of its own shares and are held as 'treasury shares' (2011: nil).

24 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.

25 Retained earnings

In 2012, the Group paid a dividend of HRK 1,813 million (2011: HRK 1,863 million), respectively HRK 22.14 per share (2011: HRK 22.75).

26 Other accruals

	31 December 2012 HRK millions	31 December 2011 HRK millions
Variable salary to employees	69	86
Unused vacation	15	30
	84	116

27 Commitments

a) Operating lease commitments

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

Operating lease charges:

	2012 HRK millions	2011 HRK millions
Current year expense (Note 7)	185	178

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

	31 December 2012 HRK millions	31 December 2011 HRK millions
Within one year	174	227
Between 1 and 5 years	573	524
Greater than 5 years	428	466
	1,175	1,217

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 2012 HRK millions	31 December 2011 HRK millions
Intangible assets	63	60
Property, plant and equipment	869	864
	932	924

28 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 22).

a) Competition / Regulatory matters

The Group 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

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.

In January 2012 Misdemeanour Court rendered a decision in which it has suspended the proceedings against HT. Against this decision in HT's favour, the Competition Agency filed appeal in March 2012. 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.

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 55 million.

In addition, on 24 October 2012 HT received an additional Misdemeanour Indictment Proposal as a result of the expert supervisions that HAKOM had undertaken in October 2009 and January 2010, HAKOM submitted to the Misdemeanour Court the Indictment Proposal against HT and a responsible person, claiming that HT proceeded in its Bitstream Standard Offer contrary to the regulatory obligations regarding the price calculation and publication of the offer VoIP and IPTV special virtual channels, as defined in the wholesale bitstream access market analysis conducted by HAKOM within its decision dated of 17 July 2009.

Thereby proposing the 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 28.6 million.

Access to 064/069 numbers case

Pursuant to Metronet notification from 2010, HAKOM initiated supervision and in April 2010 issued a decision that HT shouldn't have conditioned network access with the changed numbering of VAS services with the contract annex, but should have provided the service directly instead. Pursuant to this decision, HT in June 2012, received a Misdemeanour Indictment based on HAKOM's decision from 2010 proposing 1% fine on the T-Com business annual gross revenue from the year 2008. On the basis of the results for 2008, 1% of the gross revenue would amount to HRK 48 million. HT submitted written defence and proposed suspension of the procedure until the Constitutional Court of RoC decides on HT's Request on conformity assessment of the Law on electronic communications.

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 up 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.

On 10 December 2012, the Company received the partial interlocutory judgement and partial judgement by which it is determined that HT is obliged to pay to ZHZDG the fee for usage of the DTI system, and that until the legal validity of this partial interlocutory judgment, litigation will be stopped regarding the amount of the claim. Furthermore, the claim in the part concerning the establishment of the ownership of the City of Zagreb over DTI and other communal infrastructure for laying telecommunication installations on the area of the City of Zagreb for the purpose of communication-information systems and services is rejected. Decision on the litigation costs is left for the later judgment. On 21 December 2012, the Company submitted the appeal against this judgment.

Since the plaintiff was rejected with the main part of his claim, and since the interlocutory partial judgement defines that the amount of the claim shall be discussed only after legal validity of the judgement, management concluded that no provision is required to be recognised in the financial statements for this case.

29 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 2012 and 2011. Further, DTAG provided technical assistance to the Group of HRK 13 million (2011: HRK 10 million).

The main transactions with related parties during 2012 and 2011 were as follows:

	Sales		Purchases	
Related party:	2012 HRK millions	2011 HRK millions	2012 HRK millions	2011 HRK millions
Immediate parent				
Deutsche Telekom AG, Germany	30	21	59	48
Joint venture				
HT Mostar, Bosnia and Herzegovina	32	34	53	53
Subsidiaries of immediate parent				
Telekom Deutschland, Germany	19	27	8	7
T-Mobile Austria, Austria	5	10	3	5
T-Systems International, Germany	3	-	6	6
Others	22	49	8	17
Total	111	141	137	136

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

	Receivables		Payables	
Related party:	31 December 2012 HRK millions	31 December 2011 HRK millions	31 December 2012 HRK millions	31 December 2011 HRK millions
Immediate parent				
Deutsche Telekom AG, Germany	4	3	48	26
Joint venture				
HT Mostar, Bosnia and Herzegovina	-	-	3	6
Subsidiaries of immediate parent				
Telekom Deutschland, Germany	-	-	80	44
T-Mobile Austria, Austria	-	-	18	16
T-Mobile Czech, Czech Republic	-	-	16	13
T-Systems International, Germany	-	-	2	-
Others	3	2	68	60
Total	7	5	235	165

29 Balances and transactions with related parties (continued)

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 2012, the Group paid a total amount of HRK 0.7 million (2011: HRK 0.7 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 2012 the total compensation paid to key management personnel of the Group amounted to HRK 45 million (2011: HRK 46 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 2012 HRK millions	31 December 2011 HRK millions
Short-term benefits	42	44
Share-based payments	3	2
	45	46

30 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 17) 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 2012, the Group had business transactions with fourteen banks (2011: thirteen banks). The Group held cash and deposits in six banks almost exclusively. For those six domestic banks with foreign ownership, the Group received guarantees for deposits given from parent banks which have a minimum rating of BBB+ or guarantees in form of low-risk government securities. 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 2012 HRK millions	31 December 2011 HRK millions
Trade receivables for rendered telecom services to domestic customers	726	775
Trade receivables for rendered telecom services to foreign customers	34	30
Other trade receivables	63	91
	823	896

30 Financial risk management objectives and policies (continued)

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			Other non-current liabilities			
all amounts in HRK millions	Less than 3 months	3 to 12 months	Total	1 to 3 years	3 to 5 years	> 5 years	Total
Year ended 31 December 2012	1,526	51	1,577	32	6	12	50
Year ended 31 December 2011	1,331	87	1,418	25	5	19	49
Year ended 31 December 2010	1,457	75	1,532	19	6	19	44

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 HRK millions
Year ended 31 December 2012	post tax	
Croatian Kuna	+100	13
	-100	(13)
Euro	+100	9
	-100	(9)
Year ended 31 December 2011		
Croatian Kuna	+100	6
	-100	(6)
Euro	+100	10
	-100	(10)

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 2012	+3%	27
	-3%	(27)
Year ended 31 December 2011	+3%	29
	-3%	(29)

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, non-current 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 10,899 million as at 31 December 2012 (31 December 2011: HRK 11,019 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 2012 and 31 December 2011 (see Notes 23 and 25).

30 Financial risk management objectives and policies (continued)

g) Accepted collaterals

Accepted collaterals for reverse REPO affairs include:

	31 December 2012 HRK millions	31 December 2011 HRK millions
Foreign bonds:		
Government of Austria	581	-
Government of France	75	-
Foreign treasury bills:		
Government of Germany	150	-
	806	-

All above stated values are fair market values. Neither of accepted collaterals is currently sold nor repledged. There are no specific terms and conditions related to the use of collaterals.

31 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 2012 HRK millions	31 December 2011 HRK millions	31 December 2012 HRK millions	31 December 2011 HRK millions
Financial assets				
Cash and cash equivalents	3,146	3,704	3,146	3,704
Time deposits	261	40	261	40
Available-for-sale assets, non-current	499	39	499	39
Available-for-sale assets, current	86	323	86	323
Loans to banks	239	-	239	-
Financial liabilities				
Interest-bearing loans	17	22	17	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 rates.

32 Authorization for Services and Applicable Fees

The Group 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. In the meantime, two Amendments to the Law on Electronic Communications entered into force on 10 August 2011 and on 3 December 2012. 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 was last 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.

32 Authorization for Services and Applicable Fees (continued)

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

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) Authorization for usage of radio frequency spectrum

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, the Company 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, HAKOM issued 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, HAKOM issued 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.

After the conducted public call procedure for granting licences for use of the radio frequency spectrum for public mobile electronic communications networks in the territory of Republic of Croatia, a licence for use of the radio frequency spectrum in 800 MHz band (digital dividend) was issued to the Company in November 2012.

c) 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 maritime affairs, 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 2012, 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 maritime affairs, transport and infrastructure (in favour of State budget, Official Gazette 154/08, 28/09, 97/10, 92/12) 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, 133/11).

d) Audiovisual and electronic media services

Pursuant amendment of the Law on audiovisual activities, which entered into the force in July 2011, the Company is obliged to pay the fee in the amount of 2% of the total annual gross income generated from the performing of audiovisual activities on demand for the purpose of the implementation of the National Programme.

Also, the Company (as the operator of public communication network) is obliged to pay a fee in the amount of 0,8% of the total annual gross income generated in previous calendar year by performing transmission and/or retransmission of audiovisual programmes and their parts through public communication network, including internet and cable distribution for the purpose of the implementation of the National Programme.

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.

e) 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 was replaced by the new Ordinance on Certificate and Fees for the Right of Way (Official Gazette 152/11) 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.

33 Share-based and non-share based payment transactions

Various mid-term (MTIP 2010 and Transition MTIP 2011) and long-term incentive plans (LTIP - HT Variable II 2011 and HT Variable II 2012) 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.

MTIP is set up as a cash-based plan linked to achievement of two equally weighted, share-based performance parameters, related to the value of HT share - 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% of the amount is paid out, and if neither performance target is achieved, no payment is made.

MTIP targets 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.

All MTIPs cover period of three years (i.e. MTIP 2010 covers the period from 1 January 2010 to 31 December 2012). Upon expiry of the term of the plan, the Supervisory Board 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.

The incentives themselves consist of 20% or 30% 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% target achievement.

The rewards for participants of MTIP 2009 were paid out in February 2012. Based on decision of the Supervisory Board it was established that one MTIP 2009 target out of two has been achieved. 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% 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").

Along with introduction of LTIP - Variable II 2011, a new compensation model for International Business Leaders (BLT's) was introduced. It consists of Variable I (Share Matching Plan - SMP) and Variable II. The SMP is program under which the participant can receive HT shares on expiry of a four-year period. The participant is obliged to invest an amount from 10% to a maximum 33.33% of the paid out gross annual variable salary - to HT shares. The participant is granted one additional HT share for each share, under condition that he/she held them continuously for a period of at least four years from the date of purchase (vesting period). Employee services are recognized as expenses on a pro rata basis over the vesting period. The Group is measuring value of employee services, indirectly, by reference to the fair value of the equity instruments granted. The fair value of the equity instruments granted is measured at grant date by using observable market price.

HT Variable II was introduced in beginning of 2012.

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

	2012 HRK millions	2011 HRK millions
Expenses for providing for cash-settled share-based and non share-based payment transactions	1	3
Gains arising from cancellation of provision for cash-settled share-based and non-share based payment transactions	3	-

34 Auditor's fees

The auditors of the Group's financial statements have rendered services of HRK 5 million in 2012 (2011: HRK 6 million). Services rendered in 2012 mainly relate to audits and reviews of the financial statements, audit of financial statements prepared for regulatory purposes, audit of sustainability report and upgrade of Cost and Profitability Calculation tool. Services rendered in 2011 relate to the audits and reviews of the financial statements, audit of financial statements prepared for regulatory purposes and audit of SAP transformation project.

35 Events after reporting period

No other events or transactions have occurred since 31 December 2012 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.

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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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