ANNUAL REPORT
2016

LIFE IS FOR SHARING.

LIFE IS FOR SHARING.

CONTENT

FINANCIAL HIGHLIGHTS

Income statement in HRK million	2015	2016	% of change A16/A15
Revenue	6,919	6,970	0.7%
Mobile	2,731	2,821	3.3%
Fixed voice	1,092	953	-12.7%
Broadband & TV	1,328	1,315	-1.0%
Fixed wholesale	339	365	7.5%
Other fixed	714	727	1.9%
System solutions	659	677	2.7%
Miscellaneous	56	112	101.1%
EBITDA before exceptional items	2,783	2,821	1.4%
Exceptional items	91	85	-7.1%
EBITDA after exceptional items	2,691	2,736	1.7%
EBIT (Operating profit)	1,199	1,239	3.4%
Net profit after non controlling interests	925	934	1.0%
EBITDA margin before exceptional items	40.2%	40.5%	0.3 p.p.
EBITDA margin after exceptional items	38.9%	39.3%	0.4 p.p.
EBIT margin	17.3%	17.8%	0.5 p.p.
Net profit margin	13.4%	13.4%	0.0 p.p.
Balance Sheet	**At 31 Dec 2015**	**At 31 Dec 2016**	**% of change A16/A15**
Total non current assets	8,444	8,889	5.3%
Total current assets	5,636	5,566	-1.2%
TOTAL ASSETS	**14,079**	**14,455**	**2.7%**
Total issued capital and reserves	11,641	12,046	3.5%
Total non current liabilities	548	561	2.4%
Total current liabilities	1,890	1,847	-2.3%
TOTAL EQUITY AND LIABILITIES	**14,079**	**14,455**	**2.7%**
Cash flow	**2015**	**2016**	**% of change A16/A15**
Net cash flow from operating activities	2,367	2,075	-12.3%
Net cash flow from investing activities	-557	-1,742	
Net cash flow from financing activities	-832	-833	-0.1%
Cash and cash equivalents at the end of period	**3,175**	**2,676**	**-15.7%**
CAPEX	1,474	1,608	9.1%
CAPEX / Revenue ratio	21.3%	23.1%	1.8 p.p.
	At 31 Dec 2015	**At 31 Dec 2016**	**% of change A16/A15**
Number of employees (FTEs)	4,742	4,427	-6.6%
RESIDENTIAL SEGMENT in HRK million	**2015**	**2016**	**% of change A16/A15**
Revenue	3,776	3,749	-0.7%
Contribution to EBITDA before exceptional items	2,611	2,563	-1.8%
BUSINESS SEGMENT in HRK million	**2015**	**2016**	**% of change A16/A15**
Revenue	2,718	2,780	2.3%
Contribution to EBITDA before exceptional items	1,353	1,360	0.5%
NETWORKS & SUPPORT FUNCTIONS in HRK million	**2015**	**2016**	**% of change A16/A15**
Contribution to EBITDA before exceptional items	-1,406	-1,341	4.6%
SEGMENT OPTIMA CONSOLIDATED in HRK million	**2015**	**2016**	**% of change A16/A15**
Revenue	425	441	3.8%
Contribution to EBITDA before exceptional items	224	239	6.4%

OPERATIONAL STATISTICS

Key operational data	2015	2016	% of change A16/A15
Mobile customers in 000			
Number of customers	**2,233**	**2,234**	**0.1%**
- Prepaid	1,114	1,075	-3.4%
- Postpaid	1,119	1,159	3.6%
Minutes of use (MOU) per average customer	**195**	**206**	**5.7%**
Blended ARPU (monthly average for the period in HRK)	**75**	**76**	**1.1%**
- Prepaid	43	42	-1.6%
- Postpaid	109	110	0.9%
SAC per gross add in HRK	**96**	**105**	**9.3%**
Churn rate (%)	**2.6**	**2.8**	**0.1 p.p.**
Penetration (%) 1)	**113**	**114**	**0.8 p.p.**
Market share of customers (%) 1)	**47**	**47**	**0.0 p.p.**
Smartphone customers (%) 2)	**51**	**57**	**5.3 p.p.**
Smartphones sold (%) 3)	**79**	**79**	**0.0 p.p.**

1) Source: internal estimation of competitors' customers for EOY 2016
2) Number of customers using smartphone handsets in the total number of mobile customers
3) Number of smartphones sold in the total number of handsets sold (postpaid customers only)

Key operational data	2015	2016	% of change A16/A15
Fixed mainlines in 000			
Fixed mainlines - retail 1)	**968**	**924**	**-4.6%**
Fixed mainlines - wholesale (WLR - wholesale line rental)	**104**	**83**	**-20.8%**
ARPA voice per access (monthly average for the period in HRK) 2), 5)	**90**	**84**	**-6.8%**
IP mainlines/customers in 000			
Broadband access lines - retail 3)	**603**	**618**	**2.4%**
Broadband access lines - wholesale 4)	**105**	**134**	**28.0%**
TV customers	**388**	**401**	**3.4%**
Broadband retail ARPU (monthly average for the period in HRK) 5)	**124**	**122**	**-2.3%**
TV ARPU (monthly average for the period in HRK)	**81**	**82**	**1.4%**
Wholesale customers in 000			
ULL (Unbundled Local Loop)	**159**	**148**	**-6.6%**

1) Includes PSTN, FGSM and old PSTN Voice customers migrated to IP platform; payphones excluded
2) Payphones excluded
3) Includes ADSL, VDSL, FTTH and Naked DSL
4) Includes Naked Bitstream + Bitstream
5) ARPU Voice and BB retail restated for 2015

Note: Optima Telekom's non financial KPIs not integrated into Group results due to limited access to Optima Telekom's information as a result of "Chinese wall" introduced by regulator

Presentation of information in the Annual Report

Unless the context otherwise requires, references in this publication to "HT Group" or "the Group" or are to the Company - Hrvatski Telekom d.d., together with its subsidiaries.
References to "HT" or "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

LETTER TO SHAREHOLDERS

Dear shareholders,

Behind us is a very successful year in which we recorded growth of all financial indicators along with a significant investment in infrastructure and the transformation of the company. We reversed a downward trend and created conditions for growth in the highly competitive environment while making first steps in the regional market.

These are the results of our joint work and efforts invested in the company in the past three years, and I am very grateful for your trust and patience in awaiting these results.

At the beginning of 2014, we were a company that for five years had not delivered its business objectives, facing decreasing trends in all key performance indicators. Therefore we have set ourselves clear and very ambitious goals and strategic priorities until 2016. During 2014, we focused on delivering results and projects as well as the reorganization of the company, those being important preconditions for a more agile and efficient business. In 2015, we focused on customers and took a number of measures in the organizational field to improve the user experience, and we invested in our network, giving momentum to the market. In 2016 we continued to take measures to improve the user experience, to adapt the business model to market requirements and expectations of users and to focus on ensuring stable growth, at the same time following the situation in the region and opportunities for expansion.

Therefore, I am proud to present to you the results of Hrvatski Telekom for 2016: we generated revenue amounting to HRK 6.97 billion, which is 0.7% more than in 2015, when we stopped our multi-year decline in revenues. We kept our leading position in all segments of the telecommunications market.

The positive turnaround is based on investment, therefore in the past year we increased the value of investments to HRK 1,608 billion, which is 9.1% more than in 2015. Investments were aimed at increasing the capacity for broadband Internet access, improving user experience and increasing competitiveness.

Strong investment momentum has enabled us to expand the access to optical network to 295,000 households, which is 68% more than in 2015. For more than 50% of users we enabled, at no additional charge, broadband speeds that are two to five times higher than previously. Internet access speeds greater than 30 Mbit/s have been offered in total to 800 thousand Croatian households, thus bringing Croatia closer to achieving the goals of the European Digital Agenda.

In the mobile segment, we increased the 4G network coverage with download speeds of up to 225 Mbit/s to 51% of the population, while at the end of 2015 it stood at 31%. We have also increased the 4G outdoor network coverage of the population from 93.1 to 96.9%, compared with 2015.

In the first half of 2016, we presented a new and unique concept of services in the telecommunications market, Magenta 1, and in the first half-year it has already attracted more than 53,000 households. We have significantly improved customer satisfaction in all areas, from the first lines of communication through the network quality to the final product.

Even with such a strong investment momentum we have generated growth in EBITDA before exceptional items by 1.4% compared to the year 2015. EBITDA in 2016 amounted to HRK 2.82 billion, with a strong EBITDA margin of 40.5%, which is 0.3 percentage points more than in 2015. In 2016, we generated a net profit of HRK 934 million, an increase by HRK 9 million or 1% from the year before.

The Management Board and the Supervisory Board have made a proposal to the General Assembly to pay out the dividend of HRK 6 per share from the net profit generated in 2016. The total dividend amount is HRK 491.3 million, while HRK 417.5 million would be allocated to retained earnings.

We also announce the intention to launch a Treasury Share Buyback Program on the Zagreb Stock Exchange in accordance with the decision of the General Assembly from April 21, 2016. After all internal procedures are implemented and subject to satisfactory market conditions, we will make public the scope, size and duration of the Treasury Share Buyback Program under the applicable legal framework.

In early January 2017, we acquired a 76.53% stake in Crnogorski Telekom for the purchase price of EUR 123.5 million. The transaction is a part of HT's strategy of growth through expansion into regional markets. We expect to it to generate significant synergy effects and added value to the shareholders and customers. For financial year 2017 the Management Board currently expects the dividend payment in the amount of at least HRK 6 per share.

In 2017, we shall continue to invest in infrastructure development and our technological know-how will be focused on innovation and further enhancement of the user experience. We remain focused on the growth strategy of Hrvatski Telekom as a leader in the domestic and regional market of telecommunications and digital services. We shall remain watchful of opportunities for potential business expansion in Croatia and the region, of which you as shareholders will be informed in time.

I would like to thank all our employees, my colleagues in the Management Board and the Supervisory Board for their dedicated work. We have entered another challenging business year, but I am certain that we will successfully meet your expectations.

Davor Tomašković
President of the Management Board of Hrvatski Telekom d.d.

CORPORATE PROFILE

Overview

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. (HT d.d. or the Company) 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, retail electricity 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. is a joint stock company, majority owned by Deutsche Telekom Europe B.V. It was incorporated on December 28, 1998 in the Republic of Croatia, pursuant to the provisions of the Act on 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 January 1, 1999.

Pursuant to the terms of the Act on Privatization of Hrvatske telekomunikacije d.d. (hereinafter referred to as "AOP") (Official Gazette Nos. 65/99 and 68/01), on October 5, 1999, the Republic of Croatia sold 35% of shares in HT d.d. to Deutsche Telekom AG (DTAG), and on October 25, 2001, DTAG purchased further 16% of shares in HT d.d. and thus became the majority shareholder with a 51% stake. Pursuant to the Share Transfer Agreement, in December 2013, DTAG transferred 51% of its shares in the Company to T-Mobile Global Holding Nr. 2 GmbH. Pursuant to the Deed of issuance of a share against non-cash contribution, in February 2014, T-Mobile Global Holding Nr. 2 GmbH transferred 51% of shares in the Company to CMobil B.V. In April 2015, CMobil B.V. changed its registered name into Deutsche Telekom Europe B.V. The above mentioned transfers of shares were executed as a part of the internal restructuring performed within DTAG and as a result thereof, DTAG's influence in HT d.d. remains unchanged.

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 January 1, 2003, and in October 2004, the company's name officially changed to T-Mobile Hrvatska d.o.o. (T-Mobile).

On 1 October 2004, the Company was rebranded as T-HT, thus becoming a part of the global "T" family of Deutsche Telekom. This evolution of corporate identity was followed by the creation of trademarks for the two separate business units of the Group: the fixed network operations business unit, T-Com – which provides wholesale, Internet and data services; and the mobile operations business unit, T-Mobile.

On February 17, 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 Members of Their Families, pursuant to the AOP.

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

As part of the continued privatization of HT d.d., on 5 October 2007, the Republic of Croatia sold 32.5% of HT ordinary shares through an initial public offering (IPO). Of the total shares, 25% were sold to

Croatian citizens, 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%, while private and institutional investors are holding a share of 38.5% in total.

In October 2009, T-Mobile Croatia was merged with HT d.d., effective as of January 1, 2010. HT Group consists of the Residential and Business unit. On 21 May 2010, The Company's registered name was changed from HT – Hrvatske telekomunikacije d.d. to Hrvatski Telekom d.d..

On May 17, 2010, HT d.d. completed the acquisition of IT services company Combis d.o.o., extending its reach into the provision of IT software support and services for a client base that ranges from small businesses users to government institutions.

In December 2010, according to the records stored in the Central Depository & Clearing Company Inc., the Republic of Croatia transferred 3.5% of its shares in the Company, to the Pensioners' Fund. On December 12, 2013, the Pensioners' Fund transferred 3.5% of shares in the Company to the account of the Restructuring and Sale Center – RSC. The Republic of Croatia founded RSC in July 2013 as a legal successor to the Government Asset Management Agency. As a result, the Republic of Croatia again holds a stake in Hrvatski Telekom d.d. In December 2015, following a public auction, RSC sold 500,000 of its shares in the Company (0.6% of HT d.d. share capital) via the Zagreb Stock Exchange trading system. Following this sale of shares, RSC reduced its holding from 3.5% to 2.9%.

In June 2014, HT took over the management of OT-Optima Telekom ("OT"), following the completion of a pre-bankruptcy settlement procedure. By the conversion of claims into share capital, and following the realization of a Mandatory Convertible Loan instrument in July 2014, HT acquired a total of 19.1% of Optima's share capital.

Zagrebačka banka, as the largest creditor of Optima Telekom, transferred controlling rights acquired in the pre-bankruptcy settlement procedure to HT. The Croatian Competition Agency ("CCA") has determined a set of measures defining the rules of conduct for HT with regard to management of Optima Telekom. The duration of the concentration between HT and Optima Telekom is limited to a period of four years, starting from HT's acquisition of control over Optima Telekom.

In July 2016, Optima's Management Board adopted a strategic decision on the merger of H1 Telekom d.d. with Optima, in order to achieve positive synergies among the companies and to increase Optima's value for its existing and new shareholders (previous H1 shareholders). Accordingly, Optima submitted to CCA a Notification of a Proposed Concentration. Following the aforementioned change in circumstances, HT submitted a request to prolong the temporary management of Optima until 2021. On November 3, 2014, an extraordinary General Assembly of Optima Telekom approved the conversion of Tax Administration receivables into company capital, increasing share capital by a total of HRK 2,910,110.00. After the registration of this change in the Court Registry, the ownership interest of HT decreased to 19.02%.

At the beginning of January 2017, Hrvatski Telekom signed a Share Purchase Agreement with Magyar Telekom, Nyrt, based in Budapest, Hungary. Under the agreement, Hrvatski Telekom acquired a 76.53% stake in Crnogorski Telekom A.D., based in Podgorica, Montenegro, at a purchase price of EUR 123.5 million (approximately HRK 933 million). Crnogorski Telekom is the largest telecommunications company in Montenegro and provides a full range of fixed and mobile telecommunications services. This transaction is part of HT's strategy of growth through expansion into regional markets. By creating considerable synergic effects, this acquisition will enable HT to provide added value for its shareholders and customers.

INVESTOR INFORMATION

Economic environment and share price performance

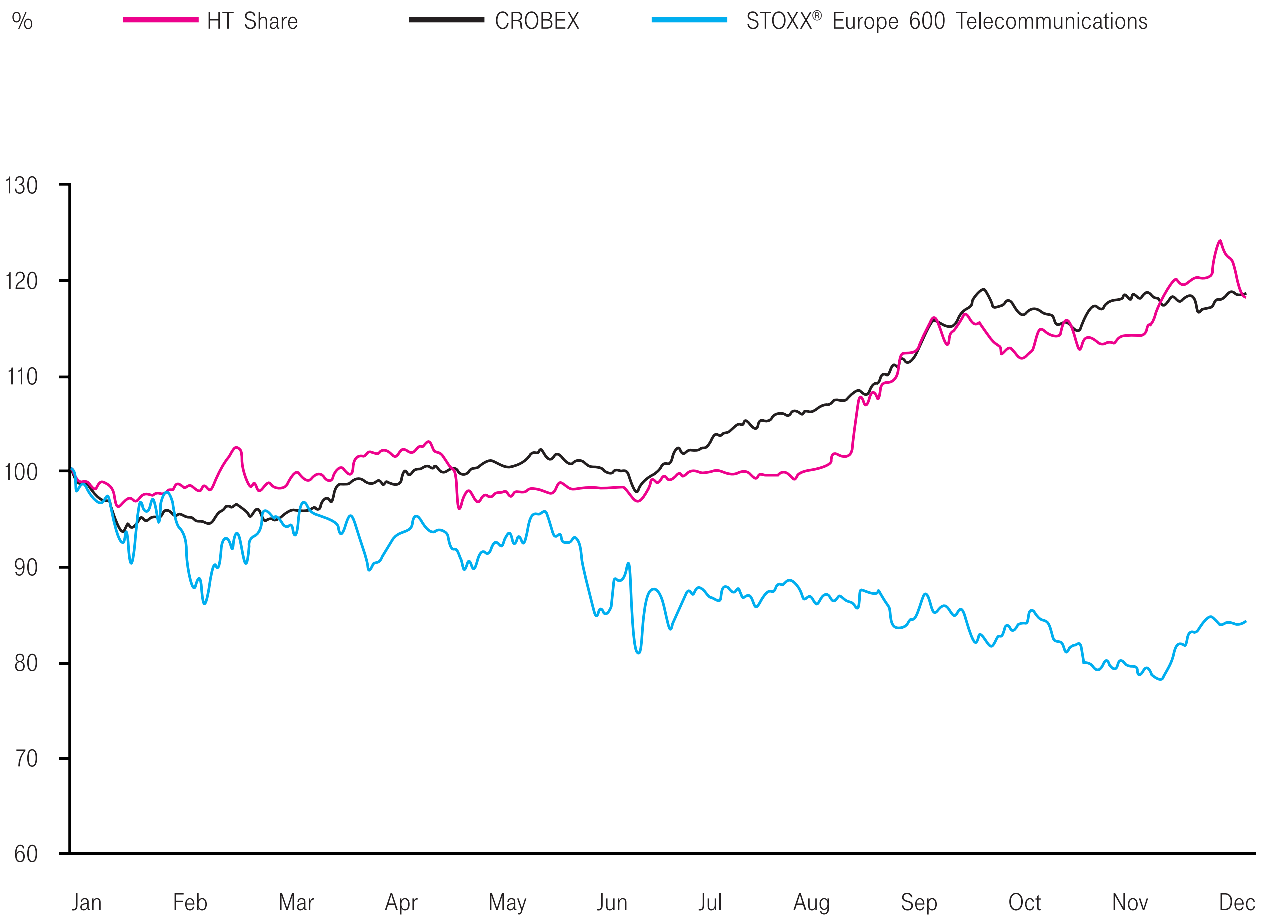
In 2016, global public limited-liability companies achieved mixed results, especially in Europe. Main indices in the US and the UK hit record highs, despite some uncertainties surrounding the US presidential elections and Brexit, while the Chinese market suffered a significant correction.

After a long period of severe recession in Croatia, domestic GDP grew further throughout 2016. Coupled with a strong tourist season and increased expectations following the October election of a new Government, seen as more economy-oriented than the previous ones, this had a positive impact on the situation on the Croatian stock market. CROBEX, the main stock exchange index, increased by 18.1% over the year.

The HT share followed the positive momentum of the CROBEX index and ended the year at HRK 169.00, up by 17.0% from the closing price of HRK 144.40 at the end of 2015. The year's highest share price was HRK 179.50, with the lowest being HRK 136.05 (Source: Zagreb Stock Exchange).

The underperformance of the Dow Jones Euro Stoxx Telecommunications Index (a leading indicator of the telecommunications industry that measures the performance of some of Europe's largest telecommunications companies) resulted from the overall underperformance of European stock exchanges and expectations of a worsening telecom regulatory environment, which pushed the Index down more than 15%.

HT Share as compared to CROBEX and STOXX® Europe 600 Telecommunications Index, 1 January 2016 – 31 December 2016



With 1.4% higher volumes traded in comparison with the previous year, the HT share was once again the most traded share on the Zagreb Stock Exchange (ZSE), with a turnover of HRK 357 million, accounting for 18.7% of ZSE's total value of shares traded in 2016 (2015: HRK 352 million, 14.7%).

In terms of free float market capitalization, as at December 31, 2016, HT was the largest company on the Zagreb Stock Exchange with HRK 5.8 billion (EUR 775.3 million), representing 16.7% of the total free float market capitalization by value (Source: Zagreb Stock Exchange).

At the last revision of the CROBEX index in September 2016, HT's weighting was again set at 10% of the index.

HT shares have been traded on the Zagreb Stock Exchange since the initial public offering in October 2007, and global depositary receipts were traded on the London Stock Exchange until the delisting and termination of the GDR facility on 6 October 2014. The shares will continue to be listed and tradable on the Zagreb Stock Exchange.

In December, at the presentation ceremony of the Zagreb Stock Exchange Awards for 2016, HT received the award for the "Share with highest turnover" for the fifth consecutive year.

Dividend policy

The dividend policy of the Company was set out in the prospectus for the 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 the initial public offering (IPO) 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 in the relevant period (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 2015 financial year

On April 21, 2016, the General Assembly of the Company approved a dividend payment to shareholders of HRK 491,307,624.00 (HRK 6.00 per share), representing a dividend payout ratio of 55.0% in relation to the Company's net profit. The dividend was paid in May 2016.

At the end of 2016, this represented a dividend yield of 3.5% on HT's closing share price of HRK 169.00.t

Dividend proposal for financial year 2016

As communicated at the Capital Markets Day in November 2015, HT has committed to announcing a minimum target dividend for each year at the start of that particular year, within the range as set out in our dividend policy e.g. from 50% to 100% of the Company's distributable net profit depending on its overall financial position and working capital needs.

In accordance with this commitment, in February 2016, HT announced that it expected to pay out a minimum dividend of HRK 6 per share out of 2016 net profit.

In accordance with the above, the Management Board and the Supervisory Board of Hrvatski Telekom d.d. propose to this year's General Assembly the distribution of a dividend of HRK 6 per share, which will be paid from the Company's 2016 net profit, resulting in a total dividend payment of HRK 491,313,414.00 and allocation of the remainder of the net profit of HRK 417,483,477.52 to retained earnings.

The General Assembly has been convened for April 25, 2017. According to the proposal, the above-mentioned dividend will be paid on May 22, 2017 to all shareholders registered at the Central Depository and Clearing Company (CDCC) on May 10, 2017.

Furthermore, Hrvatski Telekom also announces its intention to launch the Company's Share Buyback Program at the Zagreb Stock Exchange, in line with the decision of the General Assembly of April 21, 2016 granting the Management Board authority to acquire the Company's shares. Upon completion of all internal procedures and provided that market circumstances are satisfactory, the Company will announce the scope, volume, and duration of the Company's Share Buyback Programme in accordance with the applicable legislative framework.

Dividend proposal for financial year 2017

The Management Board currently expects to pay out a minimum dividend of HRK 6 from the profit for the whole year 2017.

Taxation of dividends at the rate of 12% was introduced as of 1 March 2012, while capital gains tax at the same rate was introduced as of 1 January 2016 (capital gains tax will not be levied on shares acquired after 1 January 2016 and held for more than three years).

Shareholder Structure as at 31 December 2016.

Deutsche Telekom Europe B.V.	51.0%
Raiffeisen Mandatory Pension Funds	8.9%
War Veterans' Fund	6.7%
Restructuring and Sale Center (RSC)/ Republic of Croatia	2.9%
Private and other institutional investors	30.5%

Total number of shares issued: 81,888,535

Deutsche Telekom Europe B.V. is the majority shareholder in HT with a 51% holding. (Deutsche Telekom Europe B.V. is a company wholly owned by Deutsche Telekom Europe Holding B.V., whose sole owner is Deutsche Telekom Europe Holding GmbH (formerly T-Mobile Global Holding Nr. 2 GmbH). Deutsche Telekom Europe Holding GmbH is 100% owned by Deutsche Telekom AG.)

The Croatian War Veterans' Fund owns 6.7%, with the Restructuring and Sale Center (RSC)/Republic of Croatia holding 2.9%.

Croatian citizens and other domestic and foreign institutional investors own the remaining 39.4% of shares. Raiffeisen Mandatory Pension Funds (Raiffeisen obvezni mirovinski fondovi) is the investor with the largest shareholding among private and institutional investors. As at December 31, 2016, Raiffeisen Mandatory Pension Funds had 8.9% of shares of the Company.

Financial Calendar

	Date
Release of results for the whole year 2016	February 23, 2017
The General Assembly of the Company	April 25, 2017
Release of results for the first quarter of 2017	April 27, 2017
Release of results for the first half of 2017	July 25, 2017
Release of results for the first nine months of 2017	October 26, 2017

The above-mentioned dates are subject to change.

General information on shares

Share ISIN:	HRHT00RA0005
ZSE share trading symbol:	HT-R-A
Reuters:	HT.ZA
Bloomberg:	HTRA CZ
Number of shares:	81.888.535
Type:	Ordinary share
Nominal value:	No nominal value

Investor Relations

Investor Relations
Hrvatski Telekom d.d.

Roberta Frangeša Mihanovića 9
10000 Zagreb

Tel.: +385 1 49 12000, +385 1 49 11114
Faks: +385 1 49 12012
E-mail: ir@t.ht.hr

MANAGEMENT BOARD

DAVOR TOMAŠKOVIĆ
President of the Management Board and CEO

Davor Tomašković was born in Vinkovci, Croatia, in 1969. He graduated in electrical engineering from the University of Zagreb in 1994. He subsequently completed an MBA program at Bocconi University in Milan, Italy, graduating summa cum laude in 1997. For over a decade, Mr. Tomašković has occupied top positions at some of the most prominent Croatian companies.

Following his graduation as an engineer, he started working at the Croatian Ministry of Science and Technology, implementing the first Internet network for academia. After his graduation from Milan, he worked at the consultancy firm McKinsey & Company in Austria.

In 2002, Mr. Tomašković returned to Croatia, assuming the position of Director of Corporate Strategy and Business Development at Hrvatski Telekom.

In 2004, he was appointed President of the Management Board of Tisak, the leading Croatian distribution company. After the successful implementation of an extensive restructuring process at Tisak, he assumed the position of President of the Management Board of TDR, the regional tobacco industry leader. He has occupied this position for the past seven years.

On January 1, 2014, Mr. Tomašković was appointed President of the Management Board of HT d.d.

JOSEF THÜRRIEGL
Member of the Management Board and Chief Financial Officer

Josef Thürriegl was born in Germany in 1968. He earned his degree in business administration, with a focus on accounting and finance, at the University of Passau in 1995. He also graduated from the London Business School and the T-Success Management Programme at the Telekom Business Academy.

From 2000 to 2009, he held various managerial positions in the area of finance at Hrvatski Telekom, from Advisor to the Chief Financial Officer and Executive Director of Controlling to Member of the Executive Board responsible for the finances of T-Com, HT's former organizational unit for fixed line business. He was also Member of the Management Board and COO Fixed Line Business at HT's affiliate HT Mostar.

From 2009 until his return to HT, he held the position of Vice President of Functional Controlling for Europe at Deutsche Telekom Headquarters.

HT's Supervisory Board appointed Mr. Josef Thürriegl Member of the Management Board and Chief Financial Officer (CFO) for a period of three years; he took up this position on 1 June 2016.

MANAGEMENT BOARD

MARIJA FELKEL
Member of the Management Board and Chief Human Resources Officer

Marija Felkel was born in Zagreb in 1973. She graduated from the University of Zagreb, Faculty of Law, in 1998. Having graduated in law, she began her professional life in public administration and very soon became a specialist in labor law. In 2004, she joined Siemens Croatia.

In this international corporation, over a period of more than ten years of work, she was responsible for all HR processes, leading a broad range of projects in the area of human resources. Particularly outstanding are the results in drawing HR functions nearer to business functions; under her leadership, the HR function truly developed into a recognized partner of the company's business management.

This way, she gained rich experience, having held all managerial positions – from Personnel Administration Manager to Head of Human Resources. Moreover, Ms. Felkel achieved remarkable results in leading international projects, and she has been at the helm of the entire Adriatic Region Group at Siemens. She is particularly active in work with young people, in cooperation with faculties, secondary and elementary schools, pointing out the importance of education and constant development.

Ms. Felkel is an active member of the HR Manager Association; she is promoting the HR function in the organization as a recognized business partner that contributes to the organization's success, advancing decisions that have an impact on employees as the company's most valuable resource. The Supervisory Board of Hrvatski Telekom has appointed Marija Felkel Member of the Management Board and Chief Human Resources Officer, for a period of three years. She has been holding this position as of 18 January 2016.

BORIS BATELIĆ
Member of the Management Board and Chief Customer Experience Officer

Boris Batelić was born in Pula in 1973. He graduated from the Faculty of Electrical Engineering and Computing in Zagreb in 1998, and in 2010, he earned his EMBA degree at the Cotrugli Business School in Zagreb.

He started his professional career in the technical services area at Hrvatske telekomunikacije d.d. in 1999, and in 2001, he advanced to the position of Key Account Manager. In 2007, he was appointed Executive Director of Region West. From 2010 to 2014, he held the position of Operating Director for Service Development and Network Systems. In March 2014, he took on responsibilities for implementation of the PSTN project, and in April of the same year, he was appointed Director of the Customer Technical Services Sector.

In May 2014, he was temporarily entrusted with activities falling within the scope of competence of the Member of the Management Board and Chief Customer Experience Officer, and was appointed to this function as of 1 May 2015.

MANAGEMENT BOARD

BORIS DRILO
Member of the Management Board and Chief Technical and Information Officer

Boris Drilo was born in Zagreb in 1976. He graduated from the Faculty of Electrical Engineering and Computing at the University of Zagreb, where he spent one year as Research Assistant in the area of wireless data communications. He is a Master of Science in the field of Electrical Engineering, and he completed the Executive Leadership Programme at the Boston University, as well as the Executive MBA degree course at Cotrugli Business School in Zagreb.

He joined Hrvatski Telekom in the year 2012, coming from Ericsson Group, where he had spent 12 years at project and managerial functions related to the development and application of telecommunications networks and new technologies.

He was appointed Member of the HT Management Board after the position of Sector Director in the CTIO area. Prior to this, he was a Member of the Management Board in charge of technology and IT of Iskon Internet d.d., a company fully owned by HT.

On his career path, starting from the University and continuing through Ericsson Group and HT Group, he has been focused on business development in new telecommunications and technology areas, which is extremely important for development of the digital society and for the reinforcement of the position of HT Group as a technology leader on the Croatian market.

The Supervisory Board of Hrvatski Telekom has appointed Boris Drilo Member of the Management Board and Chief Technical and Information Officer for a three-year period commencing as of January 1, 2017.

NATAŠA RAPAIĆ
Member of the Management Board and Chief Operating Officer Residential

Ms. Rapaić was born in Zagreb in 1969. She 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 September 1, 2005, she was appointed Member of T-Com Executive Board and Chief Marketing Officer.

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

MANAGEMENT BOARD

SAŠA KRAMAR
Member of the Management Board and Chief Operating Officer Business

Saša Kramar was born in 1968 in Čakovec. He has many years of experience in the ICT industry, as well as in sales, marketing, and management.

He started building his professional career at Novel Apple Centre, where he worked for ten years, including seven years as General Manager. He joined Iskon in 2000, starting at the position of Sales Manager, and in 2002, he assumed the position of Member of the Management Board in charge of sales, marketing, customer relations, and public relations. At the General Assembly in 2005, he was appointed Member of the Management Board with a five-year term of office. At the Iskon Internet d.d. Supervisory Board session held in June 2007, he was appointed CEO of the company wholly owned by Hrvatski Telekom.

His mandate as President of the Management Board of Iskon was prolonged in 2011 and 2014.

During his long-standing work within the HT Group, he gained experience through key projects and managerial positions related to sales management, strategic management, and customer relations management.

By decision of the Supervisory Board of HT, as of 1 June 2016, Saša Kramar took on responsibilities as HT's Member of the Management Board and Chief Operating Officer Business, for a term of three years.

Compensation to the Management Board members in 2016

Davor Tomašković, President of the Management Board and CEO, was paid a fixed and variable salary in the gross amount of HRK 3,515,208 in 2016. The gross amount of other benefits amounted to HRK 83,518 (company car usage). Christmas gift for the employee's children was paid in the net amount of HRK 1,200.

Nataša Rapaić, Member of the Management Board and COOR, was paid a fixed and variable salary and received a long term incentive plan (LTIP 2012) in the gross amount of HRK 2,178,983 in 2016. The gross amount of other benefits amounted to HRK 170,277 (company car usage and other compensation). Christmas gift for the employee's children was paid in the net amount of HRK 600.

Boris Batelić, Member of the Management Board and CCO was paid a fixed and variable salary and received long term incentive Plan (LTIP 2012) in the gross amount of HRK 1,644,955 in 2016. The gross amount of other benefits amounted to HRK 235,782 (company car usage, apartment rental). Christmas gift for the employee's children was paid in the net amount of HRK 1,200.

Marija Felkel, Member of the Management Board and CHRO from 18th January 2016, was paid a fixed salary in the gross amount of HRK 772,778 in 2016. The gross amount of other benefits amounted to HRK 53,529 (company car usage). Christmas gift for the employee's children was paid in the net amount of HRK 1,200.

Saša Kramar, Member of the Management Board and COOB from 1st June 2016, was paid a fixed salary in the gross amount of HRK 551,497 in 2016. The gross amount of other benefits amounted to HRK 25,715 (company car usage). Christmas gift for the employee's children was paid in the net amount of HRK 600.

Thorsten Albers, Member of the Management Board and CTIO until 14th May 2016, was paid a fixed and variable salary in the gross amount of HRK 2,008,872 in 2016. The gross amount of other benefits amounted to HRK 373,636 (insurance, apartment rental, children's school expenses, company car usage and other compensation).

Dr. Kai-Ulrich Deissner, Member of the Management Board and CFO until 31st March 2016, was paid a fixed and variable salary in the gross amount of HRK 1,927,701 in 2016. The gross amount of other benefits amounted to HRK 74,460 (insurance, apartment rental, company car usage and other compensation).

Josef Jakob Matthias Thuerriegl, Member of the Management Board and CFO from 1st June 2016, was paid a fixed salary in the gross amount of HRK 1,194,365 in 2016. The gross amount of other benefits amounted to HRK 310,810 (insurance, apartment rental, children's school expenses, company car usage and other compensation).

Long Term Incentive Plans for management

The following long-term incentive plans exist at the level of HT Group: HT Variable II 2013, HT Variable 2014, Lead to Win 2015 and Lead to Win 2016. Their goal is to ensure competitive compensation for members of the Management Board and senior executives. The plans promote medium and long-term value enhancement of HT Group, aligning the interests of management and shareholders.

HT Variable II 2012 ended on 31 December 2015, and the Supervisory Board has determined final target achievement of 11.5%. In June 2016, participants in the plan received awards in the total gross amount of HRK 257,929.

HT Variable II 2013 and HT Variable II 2014 are cash-based plans with four equally weighted performance parameters that cannot change during plan duration. Two targets are financial KPIs, adjusted earnings per share (EPS) and adjusted operating return on capital employed (ROCE), while third and fourth targets are customer and employee satisfaction. Duration of the plan is four years, effective 1 January every year. Upon the expiry of the term of the plan, the Supervisory Board shall determine whether each of the targets has been achieved and adopt an appropriate decision.

The Variable II amount awarded to International Business Leaders (BLTs) is a fixed sum specified in the individual employment contract. For other participants, the rewarded amount is 30% or 20% of the participants' individual annual salary as contracted at 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 annual amount of variable salary in case of a 100% target achievement.

In 2016, HT continued participation in the performance management corporate plan "Lead to win", model for HT senior management as one of the companies within the DT Group. Rewarding of top management is directly linked to individual performance and the achievement of collective KPI performance on the level of the DT Group.

The LTI (Long term incentive) plan, as part of the Lead to Win Program 2016, is a cash based plan and the awarded amount depends on the Management Group (MG 1 – MG 3) to which the participant's position belongs and on individual performance. Only those who achieve a minimum performance rating of 3 (score range is from 1 to 5) can participate in the plan. The participation amount can be from 10% to 30% of the contracted annual salary depending on MG and on individual performance rating. The plan currency shall be euro, and four defined success parameters are the parameters of the DT Group. They are: ROCE (Return on Capital Employed), Adjusted EPS (Earnings per Share), Customer satisfaction and Employee satisfaction. The success parameters have an achievement corridor between 0% and 150%. The term of the LTI plan shall cover the period from January 1, 2016 to December 31, 2019. HT Supervisory Board shall declare the target achievement after the end of each year.

Lead to Win Program 2016 also includes Share Matching Plan (SMP) for the award of bonus shares to managers in Managements Groups MG1 – MG3. The criteria for participation in the SMP and the amount of additional shares depend on the executive's overall performance. Participants in the plan purchase shares in DT before the start of the plan ("voluntary personal investment"). The amount of the voluntary personal investment is between 10% ("minimum amount") and one third ("maximum amount") of the gross amount of the 2015 Short Term Incentive (STI) (Variable I), paid in 2016, and is determined by the plan participant upon acceptance of the offer. The term of the 2016 SMP shall cover the period from July 1, 2016 to June 30, 2020. Participants in the plan shall hold the shares purchased as part of the voluntary personal investment uninterruptedly from the purchase date to the end of the plan ("lock-up period"). At the end of the plan term, the plan participant shall receive DT shares free of charge based on the personal performance of the plan participant. Share Matching Plan is obligatory for the President of the Management Board and voluntary for Management Board members.

SUPERVISORY BOARD

Mark Klein	Chairman	Until April 25, 2016
Dr. sc. Ilias Drakopoulos	Chairman	Member from June 17, 2013 Chairman from May 11, 2016
Dr. sc. Ivica Mišetić	Deputy chairman	Member from April 21, 2008 Deputy chairman from May 8, 2008
Dr. Oliver Knipping	Member	From April 25, 2012
Mr. Mark Nierwetberg	Member	Until April 21, 2016
Vesna Mamić	Member, workers' representative	From January 1, 2016
Damir Grbavac	Member	From April 25, 2012
Dolly Predovic	Member	From April 29, 2014
Marc Stehle	Member	From December 16, 2015
Eirini Nikolaidi	Member	From April 25, 2016
Evelyn Jakobs	Member	From April 21, 2016

Compensation to members of the Supervisory Board

The Chairman of the Supervisory Board receives remuneration of 1.5 of the average net salary of the employees of the Company paid in the preceding month. The Deputy Chairman's remuneration equals 1.25 of the average net salary of Company employees paid in the preceding month, while other members of the Board shall receive remuneration of one average net salary of Company employees paid in the preceding month. The member of the Supervisory Board who is also the Chairman of the Audit Committee of the Supervisory Board shall receive remuneration of 1.5 of the average monthly net salary of Company employees paid in the preceding month. The member of the Supervisory Board who is also a Member of the Audit Committee of the Supervisory Board shall receive remuneration of 1.25 of the average monthly net salary of Company employees in the preceding month. The member of the Supervisory Board who also a Member of the Compensation and Nomination Committee of the Supervisory Board shall receive remuneration in the amount of 1.25 of the average monthly net salary of Company employees paid in the preceding month. In accordance with DTAG's policy, DTAG representatives shall not receive any remuneration for their membership in the Supervisory.

Compensation to members of the Supervisory Board

		The period of 2016 in which the allowance was paid		
		From	**Until**	**Gross I (HRK)**
Juko Cikojević	SB member	1st January	31st January	14.475
Vesna Mamić	SB member	1st February	31st December	156.817
Dolly Predovic	SB member	1st January	31st December	204.535
Ivica Mišetić	SB member	1st January	31st December	217.591
Total				**593.419**

SUPERVISORY 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 Croatian Telekom Inc., the Supervisory Board of Croatian Telekom Inc., Zagreb, Roberta Frangeša Mihanovića 9, (hereinafter referred to as "HT d.d." or "the Company"), consisting, on the day of issuance of this report, of Mr. Ilias Drakopoulos, Ph.D., Chairman of the Supervisory Board, Mr. Ivica Mišetić, Ph.D., Deputy Chairman of the Supervisory Board, Dr. Oliver Knipping, Mr. Marc Stehle, Ms. Eirini Nikolaidi, Ms. Evelyn Jakobs, Ms. Dolly Predovic, Mr. Damir Grbavac and Ms. Vesna Mamić, submits to the General Assembly this

REPORT

on performed supervision during the business year 2016 and the results of the examination of the business and financial reports for the business year 2016

The content of this report includes:

- the manner and extent to which the management of the Company has been monitored by the Supervisory Board during the business year 2016,
- the results of the examination of the annual financial statements as of December 31, 2016 together with auditor's report and 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 2016,
- the results of the examination of the report on relations with the governing company and affiliated companies thereof.

Corporate Profile

On December 31, 2016, significant Company shareholders are as follows.

Deutsche Telekom Europe B.V. is the majority shareholder with a 51 per cent holding. (Deutsche Telekom Europe B.V. is a company wholly owned by Deutsche Telekom Europe Holding B.V. whose sole owner is Deutsche Telekom Europe Holding GmbH (formerly T-Mobile Global Holding Nr.2 GmbH). Deutsche Telekom Europe Holding GmbH is wholly owned by Deutsche Telekom AG).

The Croatian War Veterans' Fund owns 6.7 per cent of shares and the Restructuring and Sale Center (RSC), the legal successor to the Government Asset Management Agency, owns 2.9 per cent of shares of the Company. Croatian citizens and by other domestic and foreign institutional investors own the remaining 39.4 per cent of shares.

With an 8.9 per cent holding in the Company, Raiffeisen Mandatory Pension Funds (category A and category B) are investors with the largest shareholding among private and institutional investors.

An up to date list of the top ten shareholders of the Company may be found on the website of the Central Depository & Clearing Company.

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

The Company's shares have been listed on the Zagreb Stock Exchange since October 5, 2007.

Supervisory Board

The Supervisory Board consists of nine members, five members representing Deutsche Telekom AG, one member nominated by the Raiffeisen Mandatory Pension Funds, two independent members, and one member appointed by the Workers' Council of HT d.d.

During 2016, the composition of the Supervisory Board of the Company changed as follows:

Member of the Supervisory Board, Mr. Mark Nierwetberg, has resigned with effect as of April 21, 2016.

The term of office of Supervisory Board Member and its Chairman, Mr. Mark Klein, also the Chairman of the Compensation and Nomination Committee of the Supervisory Board, expired on April 25, 2016.

Ms. Evelyn Jakobs and Ms. Eirini Nikolaidi were elected as new Members of the Supervisory Board by the General Assembly held on April 21, 2016.

Mr. Ilias Drakopoulos, Ph.D., Supervisory Board Member, was elected as the Chairman of the Supervisory Board as of May 11, 2016.

Audit Committee

On the day of issuance of this report, Mr. Klaus-Peter Kneilmann, Chairman, Mr. Ivica Mišetić, Ph.D., Member, and Mr. Marc Stehle, Member, are members of this Committee.

Mr. Franco Musone Crispino has resigned from his position of Member of the Audit Committee, effective as of March 1, 2016, and the Supervisory Board appointed Mr. Marc Stehle as the new Member of the Audit Committee as of March 1, 2016.

Compensation and Nomination Committee

On the day of issuance of this report, Mr. Ilias Drakopoulos, Ph.D., Chairman, Dr. Oliver Knipping, Member, and Ms. Dolly Predovic, Member, are members of this Committee.

Mr. Mark Nierwetberg also resigned from his position of Member of the Compensation and Nomination Committee, and the Supervisory Board appointed Dr. Oliver Knipping, Supervisory Board

Member, as the new Member of this Committee as of May 11, 2016.

Pursuant to the By-Laws on the Work of the Compensation and Nomination Committee, the newly elected Chairman of the Supervisory Board, Mr. Ilias Drakopoulos, Ph.D., became Member and the Chairman of the Compensation and Nomination Committee of the Supervisory Board, by default, as of May 11, 2016.

Management Board

On the day of issuance of this report the Management Board of the Company has seven members.

The following section lists the changes in the Management Board membership:
Dr. Kai-Ulrich Deissner resigned from his position of Chief Financial Officer (CFO), effective as of April 1, 2016. The Supervisory Board temporarily assigned these Officers' responsibilities to the CEO, Mr. Davor Tomašković

Mr. Thorsten Albers resigned from his position of Chief Technical and Information Officer (CTIO), effective as of May 15, 2016. The Supervisory Board temporarily assigned these Officers' responsibilities to the CEO, Mr. Davor Tomašković.

In addition to the above stated, activities falling within the Officers' responsibilities of Chief Operating Officer Business (COO Business) were performed by the CEO, Mr. Davor Tomašković, in line with the Supervisory Board decision from July 2015.

Mr. Josef Thürriegl was appointed as Chief Financial Officer (CFO), as of June 1, 2016.

Mr. Saša Kramar was appointed as Chief Operating Officer Business (COO Business) as of June 1, 2016.

Mr. Boris Drilo was appointed as Chief Technical and Information Officer (CTIO), as of January 1, 2017.

Performed supervision during the business year 2016

In 2016, there were five sessions of the Supervisory Board and six decision makings out-of-session.

The Supervisory Board supervised the managing of the Company's business operations and performed other tasks in accordance with the Companies Act, the Articles of Association of the Company, and the By-Laws on the Work of the Supervisory Board of the Company.

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

- Transformation activities and Horizon 2016 strategic program, delivering results in the areas of customer experience, business improvement, and financial performance,
- Redesigned portfolio of services and new innovative convergent offer, Magenta 1, offering fixed and mobile services for residential customers, and fixed, mobile and cloud services for business customers that drive market recovery,
- Utilization of optical network FTTH access technology and enabling high-speed VDSL internet access,
- HT's engagement in the PAN IP program directed at creating a Pan-European integrated service production platform and production environment, including the Agreement with Deutsche Telekom Europe Holding GmbH, providing the contractual framework for this program,
- Continued increased investment activities of the Company focused on the modernisation and development of high-speed Internet access infrastructure,
- Customer satisfaction and Employee satisfaction initiatives,
- HR accomplishments and challenges, plans and activities, performance management system, etc.,
- Corporate Governance topics and membership of the Management Board as described above,
- Proposals for the General Assembly,
- International activities of the Company, i.e. B&H activities and performances of HT Mostar,
- Business Plans for 2017 and onwards,
- Composition of the Compensation and Nomination Committee and their reports and proposals on target-setting and target-achievement of the Company, its management, and remuneration proposals for MB Members,
- Composition of the Audit Committee and their reports,
- Capital Market trends and Continuing obligations of the Company following the listing of its shares on the Zagreb Stock Exchange,
- Approval for prolongation of management control of HT d.d. over Optima Telekom d.d., subject to the Croatian Competition Agency approval, and for the merger of H1 Telekom d.d. to Optima Telekom d.d.,
- Approval for investment in securities issued by Deutsche Telekom AG, with the goal of more efficient cash management,
- Approval for Acquisition of 76.53% stake in Crnogorski Telekom A.D., granted at the beginning of January 2017,
- Financial performance of the Company in 2016.

In 2016, the Audit Committee of the Supervisory Board held four regular sessions and one decision making out-of-session and discussed various topics, in particular:

- 2015 year-end closing of HT d.d. and HT Group,
- Quarterly financial results of HT d.d. and HT Group,
- External Auditor's Report,
- Risk Reporting for HT d.d. and HT Group,
- Reports of the Compliance officer,
- Implementation and effectiveness of internal control over financial reporting,
- Internal Control System optimization,
- Annual audit program 2016 execution,
- Supervision over the realization of audit measures,
- Set up of Annual audit program 2017.

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

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 2016 in total, realized by contractual affiliating and other undertaken legal actions, were within the scope of ordinary business and entrepreneurial relationships, according to standard conditions and by applying regular prices.

The Company's auditor, PricewaterhouseCoopers d.o.o. Zagreb, reported on the results of its audit and issued the clean confirmation on the audit of the above report, as described in continuation.

Report of Independent Accountants

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 Companies Act.

The Supervisory Board has no objections to the results of the auditor's examination and statement of the Management Board as listed above.

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 2016 and the proposal on utilization of profit

The Supervisory Board issued an order to PricewaterhouseCoopers, the Company's auditor, for the examination of annual financial statements for the year 2016.

After considering the audited financial statements for the business year 2016, the Supervisory Board established that, in 2016, the Company acted in accordance with the law, the acts of the Company and the decisions of the General Assembly, that the annual financial statements were made in line with the situation in the Company's ledgers and that they indicate the correct property and business status of the Company. The Supervisory Board has no objections to the auditor's report on the examination of the annual financial statements for the business year 2016.

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 2016 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 and 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 proposal of the Management Board on the distribution of the net profit from 2016, which is that a part of net profit in the amount of HRK 491,313,414.00 be paid out as dividend to shareholders, in the amount of HRK 6.00 per share, and the remainder of net profit in the amount of HRK 417,483,477.52 be allocated to retained earnings.

Furthermore, the Supervisory Board supports the announced intention of the Company to launch a Company's Share Buyback Program at the Zagreb Stock Exchange, in line with the decision of the General Assembly of April 21, 2016 granting the Management Board authority to acquire Company's shares. Upon completion of all internal procedures and provided that market circumstances are satisfactory, the Company will announce the scope, volume, and duration of the Company's Share Buyback Program in accordance with the applicable legislative framework.

The joint proposal by the Management Board and the Supervisory Board on the utilization of profit for 2016 is to be referred to the General Assembly of the Company for decision making.

Summary

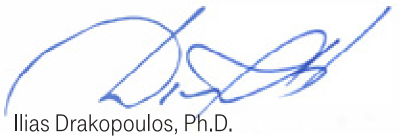
The Management Board of the Company regularly informed the Supervisory Board of the Company's business, status of assets and liabilities, revenues, and organizational and other changes related to the management of the Company's business operations.

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 2016.

After analyzing the reports of the Management Board of the Company and monitoring the changes in the financial indicators, it was assessed that targets set for 2016 were reached. Financial outlook was achieved, and the Company is reporting year-on-year revenue and EBITDA growth, accompanied by significant investments in the network, marked by higher CAPEX compared to previous year, with the focus on increasing broadband access availability, improving customer experience and boosting competitiveness.

The results of the HORIZON 2016 program are visible in terms of costs savings, improved customer experience, positive mobile and fixed net adds trends, better utilization of technology, and in the continuation of marketing innovation by Magenta 1 and FMC offers that drive market recovery. HT Group maintains the leading position in the Croatian telecommunications market across all business segments in 2016 in spite of a strong regulatory environment and increasing competitive pressure.

This report shall be delivered to the General Assembly of the Company.



Ilias Drakopoulos, Ph.D.
Chairman of the Supervisory Board

CORPORATE GOVERNANCE CODE COMPLIANCE STATEMENT

In accordance with Article 250b, paragraphs 4 and 5, and Article 272p of the Companies Act ("Official Gazette" Nos. 111/93, 34/99, 121/99, 52/00 – Decision of the Constitutional Court of RoC, 118/03, 107/07, 146/08, 137/09, 152/11 – clean text, 111/12, 68/13 and 110/15), Hrvatski Telekom d.d. (hereinafter referred to as "HT d.d." or "the Company") hereby issues the Corporate Governance Code Compliance Statement.

The Company applies the Zagreb Stock Exchange Corporate Governance Code, in effect as of January 1, 2011 and available on the website of the ZSE (www.zse.hr) and on the website of the Croatian Financial Services Supervisory Agency, HANFA (www.hanfa.hr).

The Company complies with the recommendations of the Code, with the exception of those provisions whose implementation is not practical at a given moment. These exceptions are as follows:

- The Company does not provide, without additional expense, proxies for shareholders who are not able to vote at the Assembly for whatever reason, so that those proxies vote at the Assembly in compliance with the shareholders' instructions. Shareholders who are not in a position to vote in person at the Assembly should determine, at their own discretion, suitable proxies who are obliged to vote in compliance with the shareholders' instructions (Part 2.5.).
- At previous General Assembly meetings, shareholders have not received 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 Supervisory Board is not composed mostly of independent members; however, two out of nine Supervisory Board members are independent members (Part 4.2.).
- The remuneration received by members of the Supervisory Board is determined according 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. Out of three Committee members one is an independent member of the Supervisory Board, one is a member of the Supervisory Board representing Deutsche Telekom AG, and also a financial expert. The remaining Committee member is an internal audit expert independent from the Supervisory Board, employee of Deutsche Telekom AG (Part 4.12.3.).
- The Supervisory Board did not prepare an evaluation of its performance in the preceding period (Part 4.16.).
- Members of the Management Board are entitled to remuneration determined according to the Global Compensation Guidelines and Performance Dialogue Policy for MB Members, adopted by the Supervisory Board. Remuneration to members of the Supervisory Board is determined by the decision of the General Assembly according to the average net salary of Company employees. Statement on the Remuneration Policy for the Management Board and the Supervisory Board was not composed separately; however, the information on the remuneration of the Management Board and the Supervisory Board is disclosed within the Annual Report (Part 6.3.).

Internal control and risk management

The principal responsibilities of the Audit Committee of the Supervisory Board are the preparation and supervision of the implementation of Supervisory Board decisions in relation to controlling, reporting and audit activities within HT d.d. and the HT Group. The Audit Committee oversees audit activities of the Company (both internal and external), discusses specific issues brought to its attention 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.

The Audit Committee is authorized to:

- request the necessary information and supporting documentation from the management and senior executives of the Company and from external associates;
- participate at meetings held within the Company, regarding issues that fall under the scope of activities and responsibilities of the Audit Committee;
- appoint advisors to the Audit Committee on a permanent or case-by-case basis, if needed;
- at the Company's expense, obtain external legal or other independent professional advice on any matter within their scope of work, 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 through comprehensive audit reports (findings and proposed improvements). The Internal Audit Charter is a strategic document for internal audit performance, which defines the framework and main principles in the work of the internal audit function within HT d.d. and the HT Group.

As part of its main tasks, Corporate Internal Audit :

- tests, analyses, evaluates, and communicates data in an independent and objective manner in order to add value and

improve the Company's operations;
- provides advice and instructions for Company's operations related to accomplishing its objectives, in order to evaluate and improve the efficiency of risk, control and process management;
- supervises the organization, management and functioning of a unique internal control system within the Company;
- reviews the implementation of laws, by-laws and general acts of the Company during audits;
- recommends preventive measures in the area of financial reporting, compliance, business and control, in order to eliminate risks and eventual deficiencies that could lead to process ineffectiveness, inefficiency or fraud.

Significant company shareholders

As at 31 December 2016, significant Company shareholders are as follows:

- Deutsche Telekom Europe B.V. is the majority shareholder with a 51% holding (Deutsche Telekom Europe B.V. is wholly owned by Deutsche Telekom Europe Holding B.V., whose sole owner is Deutsche Telekom Europe Holding GmbH (formerly T-Mobile Global Holding Nr. 2 GmbH). Deutsche Telekom Europe Holding GmbH is wholly owned by Deutsche Telekom AG).
- The Croatian War Veterans' Fund owns 6.7% of shares in the Company.
- Restructuring and Sale Center (RSC) of the Republic of Croatia (a legal successor to the Government Asset Management Agency) owns 2.9% of shares in the Company.
- Croatian citizens, domestic and foreign institutional investors own the remaining 39.4% of shares.

Raiffeisen Mandatory Pension Funds are investors with the largest shareholding among the private and institutional investors. As at 31 December 2016, Raiffeisen Mandatory Pension Funds (category A and category B) owned 8.9% shares of the Company.

An up to date list of the top ten shareholders of the Company can be found on the website of the Central Depository & Clearing Company (start your search by entering HT-R-A in the browser).

Mr. Davor Tomašković, President of the Management Board of Hrvatski Telekom d.d., owns 1,069 shares in total; Mr. Boris Batelić, Management Board Member of Hrvatski Telekom d.d., owns 1 share in total; Mr. Saša Kramar, Management Board Member of Hrvatski Telekom d.d., owns 219 shares in total; Mr. Boris Drilo, Management Board Member of Hrvatski Telekom d.d., owns 205 shares in total; and Mr. Damir Grbavac, Supervisory Board Member of Hrvatski Telekom d.d., owns 69 shares in total.

Appointment and activities of the management board and amendments to the articles of association

Members and the 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. The Management Board has between five and seven members. In its current composition, the Management Board includes seven positions. They are the President of the Management Board and CEO; MB Member and Chief Financial Officer (CFO); MB Member and Chief Operating Officer Residential (COO Residential); MB Member and Chief Operating Officer Business (COO Business); MB Member and Chief Technical and Information Officer (CTIO), MB Member and Chief Human Resources Officer (CHRO); and Member of the Management Board and Chief Customer Experience Officer (CCO).

The Company provides fixed and mobile telephony services, as well as wholesale, Internet and data services. It is composed of 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 is responsible for managing the business affairs of the Company. It is obligated and authorized to perform all activities and make decisions that it considers necessary for successful management of the Company's business affairs, subject to approvals as may be required from the Supervisory Board for certain matters and decisions.

Any two members of the Management Board may represent the Company jointly.

The Management Board was authorized by respective General Assembly decisions from 2009, 2010, 2011 and 2016 (authorization is valid until April 21, 2021) to acquire Company shares. The Supervisory Board granted its prior approval to start the process of acquiring and managing of Company shares in accordance with the authority given by the above-mentioned General Assembly decisions.

In 2012, the Management Board adopted the Treasury Share Buyback Program for the purpose of realization of the long-term incentive plans for senior management (Matching Share Plan), applicable at that time only to the President of the Management Board, as member of the business leaders group (BLT) within the DT Group.

For the purpose of implementation of the above-described Matching Share Plan, the Company acquired at the Zagreb Stock Exchange 1,931 Company shares in May 2012 and another 2,000 Company shares in May 2013. There were no acquisitions of Company shares in the years to follow.

Matching Share Plan, initiated in 2012, ended in 2016. Pursuant to the conditions for participation in the plan, and given the fact that his employment at HT ended on 31 December 2013 and he continued working for the DT Group until December 31, 2015, Mr. Mudrinić became entitled to one half of the total number of Company shares purchased in the year 2012. In line therewith, in December 2016, 965 Company shares were transferred to the custodian account of Mr. Ivica Mudrinić. Following this transfer, HT holds in total 2,966 Company shares on the day of issuance of this Statement.

The Company still has an obligation towards Mr. Mudrinić pursuant to the Matching Share Plan initiated in 2013, which will end in the year 2017.

The composition and functions of the supervisory board

The Supervisory Board consists of nine members. The General Assembly elects eight members, and the Workers' Council appoints one as a representative of the Company's employees. The Supervisory Board is responsible for the appointment and removal of Management Board members, and for supervising the management of the Company's business affairs. Certain major transactions, 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.

ECONOMIC ENVIRONMENT

MACROECONOMIC DEVELOPMENT
MARKET OVERVIEW
REGULATORY OVERVIEW

MACROECONOMIC DEVELOPMENT

HT Group's good performance in 2016

HT Group successfully responded to market challenges and kept the leading position on the Croatian telecommunications market across all business segments in 2016. A combination of different HT Group offers and brand positioning strengthened the Company's market position.

Estimated real GDP growth rate in 2016 higher than expected

In the first half of 2016, growth strengthened for the seventh consecutive quarter to 2.8%, after six years of recession. This was the result of the growth in exports, increased private consumption, and a rebound of investment. Croatian GDP growth speeded up in Q3 2016 (+2.9% on yearly level). Growth was broad-based, with an encouraging performance from industrial production and retail trade, and robust tourist and construction activity. Positive economic activities continued in the last quarter of 2016 (growth of industrial production and personal consumption), which may affect the estimated GDP's yearly growth by 2.6% in Q4 2016. Therefore, it is expected that GDP growth for the whole 2016 will reach 2.8%.[1]

The registered unemployment rate kept a decreasing trend in 2016 compared to the 2015 level. In November 2016, the registered unemployment rate was 14.4% (down by 3.3pp in annual terms).[2] Besides new employment, the unemployment rate additionally deceased due to the growing emigration of active population to the EU countries.

The registered average net income for October 2016 amounted to HRK 5,642 (up by 0.1pp in annual terms).2 The average annual inflation rate in 2016, calculated by the Consumer Prices Index (CPI), was -1.1%.[2]

Source: [1] Source: „Macroeconomic Trends and Forecast", Croatian National Bank, December 2016; The World Bank
[2] Source: Croatian Bureau of Statistics

CROATIAN MARKET OVERVIEW

Key market trends: investments in networks, consolidation of the fixed market and convergent offers

The consolidation activities in the telecommunications market continued in 2016. Optima Telekom submitted an official request for the acquisition of H1 Telekom on July 29, while Vipnet took over the controlling share in Metronet in December 2016. Besides official M&A activities, there was a Christmas promotional offer as a co-operation between a mobile network operator and a content provider.

Croatian mobile market has been marked by strong market competition and regulatory measures that influence mobile revenue. Estimated mobile SIM penetration rate was 113.9% at the end of December 2016. The Company's estimated share of total mobile telecommunications customers remains stable at 47.0% at the end of December 2016.

All three mobile operators offer 4G services with favorable data packages and attractive smartphones/tablets that additionally encourage the usage of OTT services. As a result, the total number of sent SMS messages continued to decrease on the annual basis by 9.8% in the first nine months of 2016, and total mobile market minutes of use (MOU) grew by only 1.3% in the same period.3 On the other hand, total broadband traffic grew by 37.0% in the first nine months of 2016 compared to total traffic in 3Q 2015.[3]

Total fixed originating voice minutes continued to decline by 8.4% on the yearly level in the first nine months of 2016.[3]

According to the report by the Croatian Post and Electronic Communications Agency, Croatian fixed broadband market continued to grow yearly by 5.1% in September 2016, reaching more than 1,025 thousand fixed broadband connections.4 The share of fixed high-speed broadband (>30Mbps) connections grew from 3% in Q3 2015 to 11% in Q3 2016. This is a result of fixed operators' higher investments in network and increased user demand for high-speed Internet access service.[4]

HT Group has set a strong focus on further development of the network infrastructure, increasing broadband access capacity and availability in order to maintain the leading position as the largest fixed broadband operator in Croatia. HT Group had 618 thousand broadband access lines at the end of December 2016.

The Croatian Pay TV market continued to grow in 2016, reaching 785 thousand customers in September 2016 (+ 4.6% on the yearly level).[4]

Besides classic telecommunication services offers, in March 2016, HT Group introduced Magenta1, a unique concept of integrated/convergent services offering. For residential customers, enjoying in fixed and mobile services, HT provides the fastest Internet access and the widest choice of TV content as part of MAXtv. For business customers, the Magenta1 Business package provides the best from the fixed, mobile and cloud world in one place.

Wholesale

Following the liberalization of the fixed line market, the demand for infrastructure services requested by alternative operators remains high in 2016, with a major focus on broadband services. The number of broadband wholesale customers (BSA and Naked BSA) increased to 134 thousand at the end of December 2016, which is an increase of 28.0% compared to the end of 2015. Due to high churn and migration to broadband services (NBSA), the number of Unbundled Local Loops (ULL) and Wholesale Rental Lines (WLR) decreased, amounting to 148 thousand ULL accesses and 83 thousand WLRs at the end of 2016.

IT market

According to IDC Adriatics , Croatian IT market is expected to grow by 4.8% yearly in 2016. The strongest growth is projected in the area of IT services (5.7%), followed by packaged software (5.4%) and hardware (4.0%). HT Group is positioned in all three segments by providing standard and customized services with a strategic focus on cloud and managed services.

Energy market

The retail energy market for business customers has entered a consolidation phase after three years of intense price war. The existing dominant operator has tried to win back his lost market share, but alternative suppliers still hold approximately 40% of business customers. Profit margins in the area of energy supply for business customers are limited due to market competition. Recovery is expected soon in order to achieve sustainability. In residential segment, certain improvements in the regulatory environment are ahead, after which significant penetration will be possible (expected in year 2017). Unlike all other energy suppliers, who are performing this business as their primary activity, HT is seeking to exploit the synergistic effect from telco-energy convergent proposition, which was first launched as a highly innovative offer in June 2016.

Source: [3] Source: Croatian Post and Electronic Communications Agency's quarterly report for Q3 2016
[4] Source: Croatian Post and Electronic Communications Agency's quarterly report for Q3 2016
[5] Source: IDC Adriatics, May 2016

REGULATORY OVERVIEW

Determining the reasonable return on investment rate (WACC)

On May 31, 2016, the Croatian Regulatory Authority for Network Industries (HAKOM) adopted a decision related to a decrease in the weighted average cost of capital (WACC) rate in order to implement the regulatory obligation of price control and cost accounting in the mobile and fixed network. New WACC rates are:

1. 8.73% for services in the fixed public communications network
2. 9.13% for services in the mobile public communications network

WACC rate for services in the fixed public communications network will be increased by an additional risk premium of 3.33% for services based on the FTTH/FTTB concept.

New WACC rates will be applicable in the period from January 1, 2017 until January 1, 2020. In its regulatory financial statements for the years 2016, 2017 and 2018, HT is obliged to use the above-mentioned WACC rate under point 1, with the possibility of an increase for an additional risk premium for services based on the FTTH/FTTB concept.

Determining the monthly fee for the fully unbundled local loop (ULL) service on the basis of a copper pair

On May 31, 2016, HAKOM adopted a decision on the change of the monthly fee (price) for ULL based on the BU-LRAIC+ cost model. The new ULL price is set at the level of HRK 49.53, which represents an increase in comparison to the existing price (HRK 43.61). The new ULL price will start to apply from January 1, 2017.

Determining new fees for the wholesale broadband access service (BSA)

On September 14, 2016, HAKOM adopted a decision on the reduction of fees for the BSA and NBSA access on copper (access where the network access is realized via services provided by the alternative operator) and BSA service on FTTH, on the increase of fees for private virtual channels for voice, IPTV and data transmission, and on the introduction of a new price category for the NBSA service on ADSL/VDSL technology for speeds of 30 Mbps and above. This differentiation of NBSA prices on ADSL/VDSL technology for speeds of 30 Mbit/s and above reflects the value of HT's investments with the aim of building an NGA infrastructure and realizing the goals of the EU Digital Agenda 2020. The amended HT's Reference offer for the wholesale BSA service containing new BSA/NBSA fees was published on the official HT's web pages on September 22, 2016. New fees will be applicable as of January 1, 2017. The impacts of these changes in BSA prices on the company's operations are positive in general.

Determining new fees for the wholesale line rental service (WLR)

On September 14, 2016 HAKOM adopted a decision on the increase of HT's WLR fees, including the obligation for HT to publish new fees within the amended WLR Reference offer, within 15 days from the receipt of the decision at the latest, if HT intends to begin with the application of new WLR fees as of January 1 2017. On September 29, 2016, HT published an amended WLR Reference offer, announcing the entry of the new WLR fees into force as from July 1, 2017.

Determining new interconnection fees

As of July 1, 2017, based on a decision of HAKOM, interconnection fees for the wholesale fixed origination (FOR) and wholesale fixed termination (FTR) will increase, while the interconnection fees for the wholesale mobile termination rate (MTR) will decrease. New FOR equals 1.01/0.50 lipa/min (peak/off-peak; 0.135/0.067 €c/min), new FTR equals 0.88/0.44 lipa/min (peak/off-peak; 0.117/0.059 €c/min) while new MTR amounts to 4.70 lipa/min (0.628 €c/min). Overall, these changes are not expected to have a significant impact on the company's operations.

Determining new wholesale leased lines fees

On September 14, 2016, HAKOM adopted a decision on setting new wholesale leased lines fees. New fees are based on HAKOM's updated LRAIC+ bottom up cost model and will be applicable as of January 1, 2017.

Amendments to the Reference Offer for Wholesale Broadband Access (BSA) and the Reference Offer for the unbundled local loop service (ULL)

On September 14, 2016, HAKOM adopted a decision on the amendments to Reference offers for BSA and ULL services, doubling penalty fees for the delay in service provision and fault repair for BSA and ULL. This signifies an increase from HRK 50 to HRK 100 (for the delay in service provision during the first 10 days/for delay in fault repair during the first 48 hours), and from HRK 75 to HRK 150 (for delay exceeding the initial 10 days/48 hours). New penalty fees will enter into force on January 1, 2017.

On April 26, 2016, HAKOM adopted a decision on the amendments to HT's Reference offer for ULL, reducing the minimum distance from the central office locations and FTTC (fibre-to-the-cabinet) locations in HT's network. This change enables the realization of more than 200 announced FTTC locations (loop shortenings) and the provision of Internet access speeds of 30 Mbps and above.

Amendments to the Margin Squeeze Methodology

On November 30, 2016, HAKOM adopted amendments to the Margin Squeeze Methodology (MSQ) that applies to HT's retail prices for fixed network access, fixed broadband access, and the IPTV service. As a follow up to the amended MSQ methodology, as per HAKOM's request, HT delivered the requested data for updating the MSQ model in December 2016. HAKOM's decision on this matter is expected in the course of first quarter of 2017.

Introduction of new packages for fixed line customers

As of January 1, 2017, HT introduced new packages for fixed line customers with the aim to continue the broadbandization of Croatia.

Abolition of the annual fee of HRK 60 for mobile radio frequency

On August 16, 2016, the Ministry for maritime affairs, transport and infrastructure adopted amendments to the Ordinance on payment of fees for the right to use of addresses, numbers and radio frequency spectrum, abolishing the annual fee of HRK 60 for mobile radio frequency, which represented an additional financial burden on mobile subscribers. Abolition entered into force on September 1, 2016. This change has a neutral effect on the company's operations, but a positive impact on end customers.

Shared use of electronic communications infrastructure (ECI) and other associated facilities

On April 13, 2016, HAKOM adopted amendments to the Ordinance on manner and conditions of access and shared use of electronic communications infrastructure and other associated facilities. These amendments introduce an exemption from the obligation to fully fill ducts in the case of excessive, economically ineffective construction.

These amendments are in force since April 28, 2016.

Universal services

On April 26, 2016, HAKOM adopted amendments to the Ordinance on universal services in electronic communications. These amendments introduce a decrease in the number of installed public payphones.

Amendments to the Ordinance on the manner and conditions for provision of electronic communications networks and services (OPECNS)

On April 26, 2016, HAKOM adopted amendments to OPECNS. These amendments of OPECNS provide for a greater protection of customers' rights, particularly with regard to remote contract conclusion and the use of Internet access services. Amendments related to user rights enter into force on July 4, 2016, and amendments related to the minimum Internet access speed enter into force on January 1, 2017.

Starting from January 1, 2017, HT adjusted minimum Internet access speeds with OPECNS amendments, do that they amount to 70% for speeds up to 10 Mbps. For HT's retail customers this change applies to both download and upload speeds, while for HT's wholesale customers it currently applies only to download speeds.

Roaming regulation

HT's roaming offer is aligned with the EU roaming regulation amendments and HAKOM requirements as of April 30, 2016. Following the above-mentioned change, a transitional period ensued in which retail prices of regulated roaming services in the EEA are defined as a sum of national retail off net price in RoC and roaming surcharge. The amounts of roaming surcharges and maximum prices of regulated roaming services in the EEA are limited in accordance with the EU roaming regulation.

In December 2016, the European Commission adopted an implementing regulation laying down a fair use policy for the consumption of regulated retail roaming services in the EEA and methodology for assessing the sustainability of the abolition of roaming surcharges. The adoption of this regulation and the completion of the procedure of setting new wholesale roaming charges before June 15, 2017 are prerequisites for the end of the transitional period and abolition of retail roaming surcharges in the EEA as of June 15, 2017.

BUSINESS REVIEW

OPERATIONAL HIGHLIGHTS

MAJOR ACHIEVEMENTS

OPERATIONAL HIGHLIGHTS

Disclosure

In 2014, the Croatian Competition Agency has conditionally allowed the concentration of HT with Optima Telekom based on the proposal of financial and operational restructuring of Optima Telekom within the pre-bankruptcy settlement procedure. The Croatian Competition Agency determined a set of measures defining the rules of conduct for HT with regard to the management and control over Optima Telekom. One of them is the implementation of the so-called “Chinese wall” between Optima Telekom’s and HT employees involved in Optima Telekom’s business, in relation to all sensitive business information, with the exception of reporting on the financial data necessary for consolidation. In accordance with this, only financial statements are subject to consolidation, while non-financial KPIs are not consolidated in the Group’s results due to limited access to Optima Telekom’s information.

HT Group Mobile KPI’s

Key operational data	2015	2016	% of change A16/A15
Mobile customers in 000			
Number of customers	**2,233**	**2,234**	**0.1%**
- Prepaid	1,114	1,075	-3.4%
- Postpaid	1,119	1,159	3.6%
Minutes of use (MOU) per average customer	**195**	**206**	**5.7%**
Blended ARPU (monthly average for the period in HRK)	**75**	**76**	**1.1%**
- Prepaid	43	42	-1.6%
- Postpaid	109	110	0.9%
SAC per gross add in HRK	**96**	**105**	**9.3%**
Churn rate (%)	**2.6**	**2.8**	**0.1 p.p.**
Penetration (%) 1)	**113**	**114**	**0.8 p.p.**
Market share of customers (%) 1)	**47**	**47**	**0.0 p.p.**
Smartphone customers (%) 2)	**51**	**57**	**5.3 p.p.**
Smartphones sold (%) 3)	**79**	**79**	**0.0 p.p.**

1) Source: internal estimation of competitors’ customers for EOY 2016
2) Number of customers using smartphone handsets in the total number of mobile customers
3) Number of smartphones sold in the total number of handsets sold (postpaid customers only)

HT Group Fixed KPI's – EOY

Key operational data	2015	2016	% of change A16/A15
Fixed mainlines in 000			
Fixed mainlines - retail [1]	968	924	-4.6%
Fixed mainlines - wholesale (WLR - wholesale line rental)	104	83	-20.8%
ARPA voice per access (monthly average for the period in HRK) [2), 5)]	90	84	-6.8%
IP mainlines/customers in 000			
Broadband access lines - retail [3]	603	618	2.4%
Broadband access lines - wholesale [4]	105	134	28.0%
TV customers	388	401	3.4%
Broadband retail ARPU (monthly average for the period in HRK) [5]	124	122	-2.3%
TV ARPU (monthly average for the period in HRK)	81	82	1.4%
Wholesale customers in 000			
ULL (Unbundled Local Loop)	159	148	-6.6%

1) Includes PSTN, FGSM and old PSTN Voice customers migrated to IP platform; payphones excluded
2) Payphones excluded
3) Includes ADSL, VDSL, FTTH and Naked DSL
4) Includes Naked Bitstream + Bitstream
5) ARPU Voice and BB retail restated for 2015

Note: Optima Telekom's non financial KPIs not integrated into Group results due to limited access to Optima Telekom's information as a result of "Chinese wall" introduced by regulator

MAJOR ACHIEVEMENTS

Significant efforts taken to maintain the market position

- HT managed to keep the leading mobile market share with a stable estimated portion of 47.0%
- HT has launched Magenta1as a fixed and mobile convergent offer that defines this unique concept of integrated services as a new market driver

According to the Economic Atlas issued by the Institute of Economics, Zagreb, HT is the leading company in Croatia with regard to its positive impact on Croatian economy

- HT is the largest private investor in Croatia, having made investments in the amount of HRK 5.7 billion in last five years, and a company whose operations brought the largest value added for the Croatian economy
- HT Group achieves more than 3% of the Croatian GDP and generates more than 27 thousand jobs in Croatia

Main financial KPIs have started growing

- Revenues exceed the last year's realization by HRK 51 million or 0.7%. The main source of revenue growth are mobile communications, energy business and system solutions.
- EBITDA exceed last year realization by HRK 39 million or 1.4%
- Capex is higher by HRK 135 million or 9.1% comparing to 2015

Strategic achievements

- The transformation program Horizon 2016 successfully delivered results visible in cost savings, positive mobile and fixed net adds trends
- Magenta1 results confirm FMC as the main market driver in the residential segment, at the end of December, 53 thousand households were achieved
- Deutsche Telekom Group is determined to play an active role in technological changes and become the first operator to work in the Pan-European all-IP integrated production model through transformation into a centralized production based on modularity. For this purpose, a subsidiary Pan-Net has been established, building production platforms on centralized virtual architecture with the aim of increasing the quality of user experience and long-term sustainable business. In 2016, HT signed an umbrella cooperation agreement with DT for the provision of Pan-Net services to HT.
- At the beginning of January 2017, a share purchase agreement was signed for acquiring majority shareholding in Crnogorski Telekom AD Podgorica from Magyar Telekom, Nyrt

Significant investment in network driven by integrated network strategy and regulatory demands

- Indoor population 4g network coverage increased from 65.0% at the beginning of 2016 to 68.2% at the end of 2016, while outdoor coverage increased up to 96.9%
- Maximum LTE throughput increased from 225 Mbps to 262.5 Mbps
- Optical access network FTTx access was enabled for 295 thousand households at the end of 2016
- HT enabled NGA speeds for a total of 54% of Croatian households, bringing Croatia closer to Digital Agenda targets

New sources of revenue growth potential

- System solution is the strongest in the area of customized ICT solutions and IP communication, recording an annual revenue of HRK 677 million

- Energy services are becoming established as a sustainable business, recording an annual revenue over HRK 100 million

Strong marketing activities continued with a special focus on segmented approach and fixed and mobile convergent offers

- Launch of Magenta 1 as a unique concept of premium customer experience and benefits
- Introduction of new offers for elders as a respond to their needs for telco services
- Joint image campaign within the DT Group –titled "Feel connected all over Europe. With the best network"

Mobile telecommunications

Mobile customer base increased by 0.1%, to 2,234 thousand customers at the end of 2016 in comparison to 2015. This was mainly because of a good response to attractive tariffs "Najbolja" launched in the second half of 2015 and the launch of Magenta1 convergent offers in March 2016. The increase was partially offset by generally aggressive competitors' offers on the market and a decrease in customers with double SIM cards due to the continuing trend of favorable flat and cross net offers.

The number of postpaid customers increased by 3.6% to 1,159 thousand at the end of 2016 in comparison to 2015 as a result of the general encouragement of successful and attractive tariffs and handsets, mobile net offers, and successful "Bonbon" campaigns, resulting in great overall performance.

In March, HT launched the sales of Samsung Galaxy S7 and Samsung Galaxy S7 Edge, the new generation of Samsung's most popular smartphone. The phones are available as part of the "Najbolja" tariff plans, which include the highest 4G speed with the highest 4G coverage in Croatia. Furthermore, new, most powerful iPhone 7 started selling in HT at the end of September.

At the end of March, HT presented its new unique concept of premium customer experience and benefits under the name Magenta1, which offers HT's private and business customers numerous free benefits such as TV packages, the fastest Internet speed, additional international and national minutes, discounts on mobile tariffs for the entire household, and attractive smartphones, including Samsung J3.

The goal of Magenta1 is to ensure a complete service for households and the best mobile and fixed services to all customers. All private customers immediately enter the Magenta1 world if they use HT's Internet line in their household and if they have at least one mobile HT line, thus becoming a part of a whole new world of special, custom-made offers and benefits. The second wave Magenta1 campaign was launched in the second quarter prior to the European Football championship together with giveaways on social networks that invited everyone to support the Croatian national football team. At the end of September, a new campaign was introduced communicating all the benefits and attractiveness of the Magenta1 offer that was further enriched with Playstation 4. During the Christmas and New Year period, the Magenta1 offer was further improved with Playstation 4 PRO, currently the most powerful game console in the world, for HRK 0 and a game for HRK 1.

After the launch of Magenta1 for business customers and the offer for very small enterprises in March 2016, at the end of November, HT launched Magenta1 for small and medium enterprises and corporate business customers and become the first on the local market with a convergent seat based offer.

In August, HT launched a new image campaign "Feel connected all over Europe. With the best network." featuring Andrea Bocelli in Croatia and other Deutsche Telekom countries. Campaign highlights the overarching idea of a connected Europe and borderless communication.

In September, the first multimedia T-center opened on Vukovarska Street in Zagreb, offering an improved customer experience, innovative and new services, and high-tech products like smart watches, virtual reality headsets, drones and high quality HD TVs.

In November, HT launched a new attractive mobile offer for the elderly. The offer included easy-to-use simplified handsets and a digital pressure gauge.

The number of prepaid customers decreased by 3.4% to 1,075 thousand at the end of 2016 in comparison to 2015 due to an overall decline of the prepaid market and strong market competition. The ongoing decline is countered by continuous mobile number portability (MNP) and retention efforts in the prepaid segment, with a focus on additional value for HT's prepaid customers. During the summer, HT prepared a special offer for tourists that included 7 days of flat mobile Internet at 4G speed.

In addition to the existing weekly and monthly "Zmajska" option, Simpa offers its customers two new monthly offers "Zmajčić" and "Zmajić" which provide even greater flexibility. The summer promo offer was further enriched with 4G Huawei Y5 II smartphone for HRK 66 per month over a period of 12 months and "Zmajska" keyboard free of charge.

Bonbon continued with bringing its customers additional value, this time through a new media campaign "Rollover" which enables its customers to transfer unused units (MB/min/SMS) into the next month upon automatic reactivation of the package. Bonbon customers are able to set their own combination of smartphones/gadgets with additional discounts available.

At the beginning of October, HT introduced a new service called "Stream On", unique in the Croatian and European market. It allows users to watch entertainment content on mobile phones without spending data from their tariff plan. It is available as a part of "Najbolja" tariffs and Magenta1 and includes 10 hours of streaming of HBO GO and Pickbox programs.

HT customers who have activated the option "Road assistance" for Croatia or Europe can use the DriverAngel application free of charge. This application processes and analyses the customer's driving data and, in case of an accident, automatically calls the Oryx Group's call center whose agents then contact the customer or call emergency services.

In 2016, minutes of usage per average customer increased by 5.7% to 206 compared to the 2015 in line with the overall market trends of fixed-to-mobile substitution and free minutes included in tariffs.

Blended ARPU increased by 1.1% to HRK 76 in 2016 compared to 2015 due to a better tariff combination and good results of "Najbolja" tariffs.

Fixed lines

By the end of 2016, total fixed access mainlines of 924 thousand were lower by 4.6% than at the end of 2015, but this decrease is slowing down (7.8% in 2015 in comparison to 2014). The decline is driven by the market trend of fixed-to-mobile and IP substitution, regulation and strong market competition, but HT continues with proactive and reactive churn prevention offers and activities.

To mitigate the ongoing decline, HT introduced a promo offer for fixed lines, offering a phone connection for HRK 1 with 24-month contract duration and accompanied by new and attractive fixed line tariffs.

Furthermore, HT launched a new attractive offer for the elderly, including flat Internet and fixed voice minutes towards all fixed and mobile networks. The offer also included the tablet Lenovo Tab 3-850F WIFI with special simplified applications and easy-to-use screen. HT later introduced another offer for the elderly, which included MAXtv with additional packages and flat fixed voice minutes towards all fixed and mobile networks.

Fixed voice ARPU decreased by 6.8% to HRK 84 in 2016 when compared to 2015 due to the mentioned general market trends.

Broadband services

At the end of 2016, the broadband customer base turned to growing and was higher by 2.4% in comparison to 2015, reaching 618 thousand, due to the results of Magenta1 and offers for the elderly.

At the same time, broadband retail ARPU, at the level of HRK 122, was 2.3% lower than in 2015 due to stronger market competition and aggressive market offers. To mitigate the decrease, HT continues with the push of MAX2/MAX3 packages and Ultra MAX packages on FTTH. The offer included attractive promo options as part of the price and MAXtv for all new Ultra MAX customers for HRK 1 during the first 9 months of usage. These packages are based on the FTTH technology which enables ten times higher speeds than the standard ADSL. In addition, at the end of March 2016, HT launched new convergent Magenta1 Business packages, consisting of flat fixed and mobile services at the highest available speeds, 4G backup, network security and cloud storage with a capacity of one terabyte. HT will continue to invest in the development of fiber network and plans to expand fiber-optic Internet zones.

2016 result was influenced by the contribution of Smart Office packages, launched in the fourth quarter of 2015 for small and medium business customers, with high speed flat Internet and fixed line, including antivirus protection, Business Connect application, and the possibility of 4G backup, making them a unique and most reliable connection for business customers on Croatian market.

TV services

TV customer base increased by 3.4% to 401 thousand at the end of 2016 in comparison to 2015 as a result of continuous service and program offer improvements, which resulted in increased TV ARPU by 1.4% to HRK 82 in comparison to 2015, driven by premium content and enriched exclusive TV content. Moreover, HT continued with the promotion of MAXtv package “Pickbox” including more than 70 hit series and 300 movies.

Satellite TV, an extension of classical IPTV service, continues to grow thanks to further improvements of the offer providing more value for the customers, and it is expected to contribute significantly to the overall TV success. It continued with an attractive promo offering a 50% discount on the monthly fee for Basic or Basic Extra package during the first nine months for activations during the promo period.

Wholesale services

At the end of 2016, there were 148 thousand of active ULL lines, which was lower by 6.6% in comparison to the same period last year. The number of ULL lines decreased due to a stronger focus of alternative operators on broadband services.

Broadband wholesale access lines (BSA and naked BSA lines) reached 134 thousands at the end of 2016, which was 28.0% above the number of last year realization, primarily thanks to an increase in the number of naked BSA lines.

The number of WLR lines at the end of 2016 decreased by 20.8% compared to the previous year and reached 83 thousands due to the declining voice market and migration to broadband services. Because of the WLR offer, the number of "pure" CPS customers decreased compared to the same period last year.

The growth in the number of ported numbers compared to last year is mainly connected with the growth of broadband wholesale access lines.

In 2016, successful sales continued in spite of a competitive domestic wholesale market of data and IP services. Especially successful was the sale of IP upstream services with a growth of 34.7% in volume compared to the same period last year.

The total capacity of sold IP on the international wholesale market increased by 38.6%, contributing to the stability of international wholesale revenue.

Visitor roaming services are a significant source of international wholesale revenue. Roaming traffic shows further growth in 2016, both from foreign visitors in the HT mobile network and HT retail users abroad. Visitors generated 25.0% more voice originating minutes and 159.8% more data traffic than last year. At the same time, on the wholesale cost side, HT's mobile customers generated 46.2% more roaming voice traffic in foreign countries and 413.8% more data traffic. During 2016, additional 4G (LTE) international roaming services with foreign partners were set up, reaching 102 4G worldwide roaming interconnections in total.

Another significant contributor to wholesale international revenue is the termination and transit of international voice traffic. The total international voice traffic volume terminating in the HT mobile network increased by 28.0% in 2016 compared to 2015. On the wholesale cost side, international outgoing traffic from HT fixed network users decreased by 15.0%, and from HT mobile network users it increased by 24.0%.

System solutions

Continuous growth in all portfolio segments resulted from HT Group's strategic focus in the area of cloud and managed solutions. The strongest growth was recorded in the area of customized ICT solutions.

The focus stays on market education and customer experience with the aim of further strengthening HT Group's leading position on the market. Additionally, high focus is on the development of telco and ICT converged offers. The biggest projects were recorded in the banking, real and telecommunications sector in all production/service segments, but primarily in the IP communication, IT infrastructure and professional solutions segment.

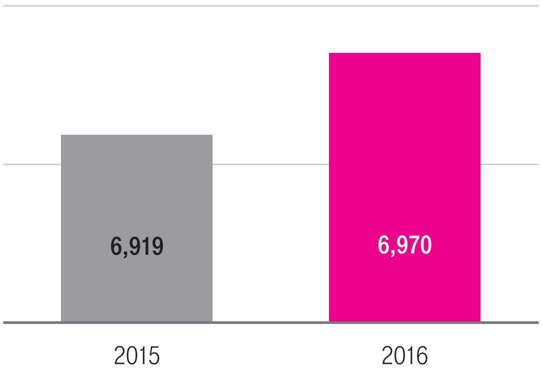
Energy services

Revenue from energy services was higher by HRK 55 million or 116.0% compared to 2015 due to an increase in the number of customers by 11.8%. Growth is present in both residential and business segments with an even more positive outlook for the future. Telco-energy convergent offer is in focus with the intention to increase customer loyalty.

FINANCIAL HIGHLIGHTS

FINANCIAL HIGHLIGHTS - EOY

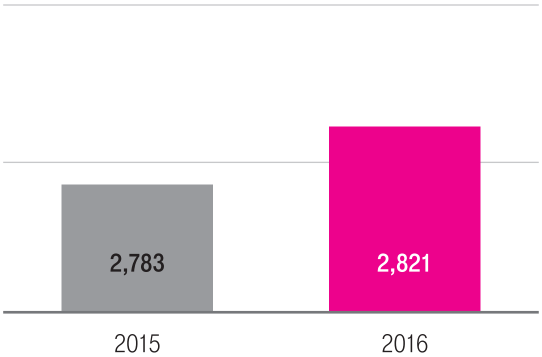
Revenue
in HRK million



REVENUE

- Revenue is increased by HRK 51 million or 0.7% compared to 2015, driven by revenue growth in mobile, energy, fixed wholesale and system solutions
- Revenue from fixed voice services continued to decline in line with market trends
- Mobile revenue increased by HRK 89 million or 3.3% compared to 2015, driven by a higher realization of handsets, higher postpaid customer base and ARPU due to "Najbolja" and Bonbon tariffs
- Miscellaneous revenue increased by HRK 56 million or 101.1% compared to 2015 due to the energy business

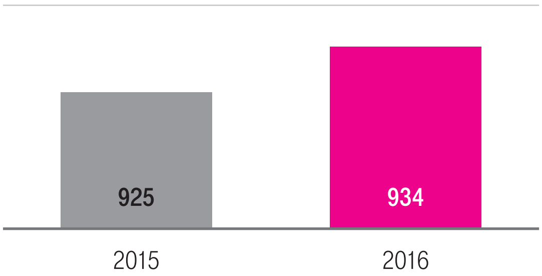
EBITDA before EI
in HRK million



EBITDA before exceptional items

- EBITDA increased by HRK 39 million or 1.4% compared to 2015. Revenue increase was followed by direct cost increase, while EBITDA achievement mainly came from a reduction in indirect costs due to implemented saving measures and the sale of fixed assets.
- EBITDA margin is slightly higher at the level of 40.5% (2015: 40.2%)

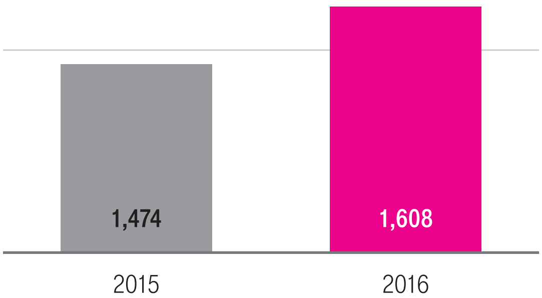
NET PROFIT after NCI
in HRK million



NET PROFIT after non-controlling interests

- Net profit after NCI increased by HRK 9 million or 1.0% compared to 2015, driven by higher EBITDA contribution, which was partially offset by EUR exchange rate losses (2016: 7.56 in comparison to 2015: 7.64)

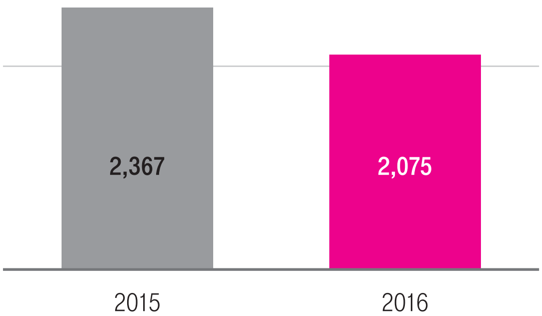
CAPEX
in HRK million



CAPEX

- Capex realization increased by HRK 135 million or 9.1% compared to 2015, with a focus on fixed and mobile access network development, especially NGA data throughput and LTE coverage extension with the aim of boosting competitiveness and customer experience
- Capex sales ratio increased to 23.1% from 21.3% in 2015

Cash flow from operating activities
in HRK million



Cash flow from operating activities

- Net cash flow from operating activities decreased by HRK 292 million or 12.3% due to contribution of working capital mainly due to higher payments for value added tax in comparison with 2015 when corporate income tax paid in advance was used for settlement of value added tax liabilities

HT Group

Income statement in HRK million	2015	2016	% of change A16/A15
Revenue	6,919	6,970	0.7%
Mobile	2,731	2,821	3.3%
Fixed voice	1,092	953	-12.7%
Broadband & TV	1,328	1,315	-1.0%
Fixed wholesale	339	365	7.5%
Other fixed	714	727	1.9%
System solutions	659	677	2.7%
Miscellaneous	56	112	101.1%
EBITDA before exceptional items	2,783	2,821	1.4%
Exceptional items	91	85	-7.1%
EBITDA after exceptional items	2,691	2,736	1.7%
EBIT (Operating profit)	1,199	1,239	3.4%
Net profit after non controlling interests	925	934	1.0%
EBITDA margin before exceptional items	40.2%	40.5%	0.3 p.p.
EBITDA margin after exceptional items	38.9%	39.3%	0.4 p.p.
EBIT margin	17.3%	17.8%	0.5 p.p.
Net profit margin	13.4%	13.4%	0.0 p.p.
Balance Sheet	**At 31 Dec 2015**	**At 31 Dec 2016**	**% of change A16/A15**
Total non current assets	8,444	8,889	5.3%
Total current assets	5,636	5,566	-1.2%
TOTAL ASSETS	**14,079**	**14,455**	**2.7%**
Total issued capital and reserves	11,641	12,046	3.5%
Total non current liabilities	548	561	2.4%
Total current liabilities	1,890	1,847	-2.3%
TOTAL EQUITY AND LIABILITIES	**14,079**	**14,455**	**2.7%**
Cash flow	**2015**	**2016**	**% of change A16/A15**
Net cash flow from operating activities	2,367	2,075	-12.3%
Net cash flow from investing activities	-557	-1,742	
Net cash flow from financing activities	-832	-833	-0.1%
Cash and cash equivalents at the end of period	**3,175**	**2,676**	**-15.7%**
CAPEX	1,474	1,608	9.1%
CAPEX / Revenue ratio	21.3%	23.1%	1.8 p.p.
	At 31 Dec 2015	**At 31 Dec 2016**	**% of change A16/A15**
Number of employees (FTEs)	4,742	4,427	-6.6%
RESIDENTIAL SEGMENT in HRK million	**2015**	**2016**	**% of change A16/A15**
Revenue	3,776	3,749	-0.7%
Contribution to EBITDA before exceptional items	2,611	2,563	-1.8%
BUSINESS SEGMENT in HRK million	**2015**	**2016**	**% of change A16/A15**
Revenue	2,718	2,780	2.3%
Contribution to EBITDA before exceptional items	1,353	1,360	0.5%
NETWORKS & SUPPORT FUNCTIONS in HRK million	**2015**	**2016**	**% of change A16/A15**
Contribution to EBITDA before exceptional items	-1,406	-1,341	4.6%
SEGMENT OPTIMA CONSOLIDATED in HRK million	**2015**	**2016**	**% of change A16/A15**
Revenue	425	441	3.8%
Contribution to EBITDA before exceptional items	224	239	6.4%

REVENUE

In order to maintain consistency with the presentation of revenues for 2016 in a new structure, last year's items were reclassified for comparative purposes. The main revenue items used in the past for revenue presentation – voice revenue, non-voice revenue, other service revenue, terminal equipment revenue and miscellaneous revenue – were replaced by new categories: mobile revenue, fixed revenue, system solution revenue and miscellaneous. This change enables an easier comparison of the financial data of HT Group with those of other market participants.

Total consolidated revenue increased by HRK 51 million or 0.7% to HRK 6,970 million in 2016 in comparison to 2015. The increase was driven by higher mobile revenue (HRK 89 million or 3.3%), miscellaneous revenue (HRK 56 million or 101.1%) and system solution revenue (HRK 18 million or 2.7%), but it was partially offset by lower fixed revenue (113 million or 3.3%).

The contribution of subsidiaries to the Group's revenue in 2016 amounted to HRK 386 million for Iskon (2015: HRK 381 million) and HRK 468 million for Combis (2015: HRK 471 million).

Optima Telekom's contribution to HT Group amounted to HRK 294 million in 2016 (2015: HRK 296 million). It consisted of HRK 441 million of Optima Telekom third party contributions (2015: HRK 425 million), which was shown under fixed revenue in the whole amount , and of HRK 147 million of inter-company relations, that mainly decreased fixed wholesale revenue (2015: HRK 129 million).

Mobile revenue

Mobile revenue increased by HRK 89 million or 3.3% to HRK 2,821 million in 2016 in comparison to 2015. The growth resulted mainly from higher handset revenue (HRK 55 million or 17.4%), postpaid revenue (HRK 44 million or 3.1%) and other mobile revenue (HRK 11 million or 2.9%), while prepaid revenue decreased (HRK 21 million or 3.6%).

From the total deviation, HRK 88 million or 4.9% came from the residential segment, and the rest came from the business segment (HRK 2 million or 0.2%).

Handset revenue growth came from an increased sales volume of smartphones, higher number of contract prolongations with handset purchases, and a higher share of higher-price handsets, mainly in the residential segment, which was additionally supported by growing convergent offers.

Postpaid revenue increased primarily due to higher mobile data revenue (HRK 43 million or 7.7%) as both the number of subscribers (3.6%) and usage increased as a result of the trend of continuous substitution of traditional voice and SMS services with data services, higher data traffic included in tariff bundles, and an increasing share of customers with smartphones. Tariffs "Najbolja" introduced in 2015 contributed to a higher data revenue thanks to the focus on 4G network services included in tariffs.

Postpaid SMS revenue increased by HRK 17 million or 14.8% due to a 0.6% increase in the number of sent messages.

MTC revenue increased by HRK 8 million or 7.2% mainly due to of the deregulation of non-EU international termination rate from April 2015. The rate increased from 0.063 HRK/min to 1.73 HRK/min from April 2015 and additionally to 2.00 HRK/min in July 2016.

This revenue increase was offset by a decline in voice revenue (HRK 24 million or 3.7%) due to strong price competition on the market.

Other mobile revenue increase (HRK 11 million or 2.9%) was driven by several factors. They include higher visitor revenue (HRK 24 million) due to a higher usage thanks to an excellent touristic season in Croatia, higher revenue from new services offered to customers within packages (e.g. road assistance) (HRK 6 million), and a larger effect of regulatory fee (HRK 5 million) introduced on July 1st 2014, due to a higher number of customers. This was partially offset by lower national roaming revenue (HRK 24 million) from the entry into force of new contract conditions in June 2015.

Prepaid revenue decrease was a result of lower retail and MTC revenue. The retail prepaid was lower (HRK 14 million or 2.9%) due to a 3.4% reduction in the customer base, which resulted in lower voice (HRK 29 million or 9.6%) and SMS revenue (HRK 11 million or 17.6%). Revenue decline was partially offset by an increase in mobile data revenue (HRK 26 million or 21.5%) resulting from continuous promotional offers with a focus on data traffic at 4G speed (Bonbon's "Moćni noćni" package and Simpa's "Zmajska" option). The decrease in MTC revenue (HRK 7 million or 7.0%) came from lower usage.

Fixed revenue

Fixed revenue dropped by HRK 113 million or 3.3% to HRK 3,360 million in 2016 in comparison to 2015. This was caused mainly by lower voice revenue (HRK 139 million or 12.7%) and broadband revenue (HRK 22 million or 2.3%), but it was partially offset by higher wholesale revenue (HRK 26 million or 7.5%), other fixed telecommunications (HRK 13 million or 1.9%) and TV revenue (HRK 9 million or 2.4%).

From total deviation, HRK 118 million or 6.0% came from the residential segment, and HRK 11 million or 1.0% came from the business segment, while Optima consolidated segment realized a higher contribution (HRK 16 million or 3.8%).

In 2016, fixed line voice retail revenue decreased in comparison to 2015 mainly as a result of continuous decline in the number of fixed mainlines by 4.6% due to the ongoing fixed-to-mobile substitution trend caused by strong mobile offers, which are much more attractive than fixed voice offers, and a strong regulatory environment. Consequently, the number of usage minutes decreased and voice ARPU declined by 6.8%. ARPU decline is under the influence of more low value residential customers using fixed voice services (mostly the elderly population).

Proactive and reactive churn prevention actions are taken to slow down the erosion of the customer base. In the residential segment, new attractive fixed line tariffs were introduced, accompanied with a phone connection for HRK 1 with a 24-month contractual obligation. In the business segment, new "Smart Office" packages were introduced in order to ensure stabile customer base development.

A decrease in broadband revenue was a result of lower broadband retail ARPU by 2.3% despite a slight increase of the broadband customer base by 2.4%. ARPU decline is a result of stronger market competition and aggressive offers on the market. To mitigate this decrease, HT continues to push MAX2/MAX3 packages and Ultra MAX packages on FTTH, and it has introduced the Magenta1 offer.

Fixed wholesale revenue increased mainly due to higher infrastructure wholesale revenue driven by NBSA growth. A positive contribution from the deregulation of international prices as of April 1, 2015, additionally increased in March 2016, was partially offset by lower non-EU termination traffic in 2016.

Other fixed revenue increase was driven by a higher contribution of Optima consolidated segment (HRK 16 million) and retail data revenue (HRK 3 million), which was partially offset by lower revenue from dunning and interest revenue (HRK 6 million) due to an earlier collection of receivables.

TV revenue increased in comparison to the same period last year due to an increase in the TV customer base by 3.4% and in ARPU by 1.4% as a result of continuous improvements of the service and program offer driven by premium content and enriched exclusive TV content. Moreover, HT continued with the promotion of MAXtv package "Pickbox" which contains more than 70 hit series and 300 movies and covers the majority of Hollywood productions.

System Solutions

System solution revenue increased by HRK 18 million or 2.7% to HRK 677 million in 2016 compared to 2015. This represents a continued annual growth trend. The growth was achieved mostly in the area of sales of ICT equipment, licenses, specific IP communication and safety equipment, enterprise software/professional solutions, but also in the area of providing consulting services.

Miscellaneous revenue

Miscellaneous revenue increased by HRK 56 million or 101.1% to HRK 112 million in 2016 in comparison to 2015.

The increase in miscellaneous revenue comes mainly from energy business due to a larger customer base (11.8%) and constant efforts aimed at increasing customer loyalty.

OPERATING EXPENSES

Total consolidated operating expenses increased by HRK 67 million or 1.5% to HRK 4,392 million in 2016 mainly due to revenue growth. In 2016, HT Group ran OPEX savings project that delivered disciplined cost management and measures with a positive impact on indirect expenses in 2016.

Operating expenses increase was a result of higher material expenses (HRK 114 million or 5.8%) and other expenses (HRK 31 million or 2.3%), and it was partially offset by lower employee benefits expenses (HRK 37 million or 3.6%), write down of assets (HRK 29 million or 43.7%) and higher work performed by the Group and capitalized (HRK 12 million or 13.9%).

Excluding exceptional items relating to headcount reduction program of HRK 85 million (2015: HRK 91 million), operating expenses increased by HRK 73 million or 1.7% to HRK 4,307 million in 2016. Exceptional items are recognized under employee benefits expenses in amount of HRK 80 million (2015: HRK 91 million) and under other expenses in the amount of HRK 5 million (2015: HRK 0 million)

Material expenses

Material expenses increased by HRK 114 million or 5.8% to HRK 2,096 million in 2016 as a result of higher merchandise, material and energy expenses (HRK 82 million or 6.5%) and services expenses (HRK 32 million or 4.5%).

Merchandise, material and energy expenses increased mainly due to higher energy sales costs (HRK 44 million or 90.2%), which is in line with energy revenue growth. In addition, merchandise costs increase (HRK 38 million or 3.6%) was mainly driven by a higher mobile merchandise realization in the residential segment as a result of an increased sales volume of smartphones, a higher number of contract prolongations with handsets, and a higher share of higher-price handsets, which was additionally supported by growing convergent offers.

Services expenses increase was driven by higher telecommunication costs (HRK 25 million or 5.1%), mainly due to higher mobile–to-mobile usage, hubbing traffic and roaming usage. Copyright fees increase (HRK 7 million or 11.2%) was mainly the result of an increase in TV customers by 3.4% and enriched content included in TV packages.

Employee benefits expenses

Total employee benefits expenses decreased by HRK 37 million or 3.6% to HRK 986 million in 2016 in comparison to the same period last year. This was a result of lower redundancy costs (HRK 11 million or 12.4%) treated as exceptional items, and lower personnel costs (HRK 26 million or 2.7%) due to a lower number of employees and new conditions of a collective agreement per employee.

The number of FTE employees decreased by 315 from 4,742 in 2015 to 4,427 in 2016, mainly due to the Headcount Optimization program, which was partially offset by new employments.

Other expenses

Other expenses increased by HRK 31 million or 2.3% to HRK 1,373 million in 2016. Excluding costs related to exceptional items in the amount of HRK 5 million (2015: HRK 0 million), other expenses increased by HRK 26 million comparing to the same period last year. This was mainly due to higher external employment costs (HRK 37 million or 32.4%), sales commissions (HRK 7 million or 7.0%) and advertising (HRK 6 million or 5.1%), which was partially offset by lower maintenance costs (HRK 24 million or 7.6%).

The increase in external employment costs mainly came from the additional employment of agency technicians and agents in the call center, and from additional sales activities in the residential segment.

The increase in sales commissions came from the introduction of strong sales initiatives which resulted in more transactions realized in indirect sales channels compared to door2door and telesales activities.

Advertising costs increased as a result of a marketing campaign in support of the launch of Magenta1.

The decrease in maintenance costs was a result of lower network costs due to better conditions negotiated with vendors related to SLA contracts and vouchers.

Assets write-down

The assets write-down decreased by HRK 29 million or 43.7% to HRK 38 million in 2016 mainly due to a lower value adjustment of receivables as a result of earlier collection of receivables. A better collection of receivables is the result of new activities implemented in the collection process that include the sale of account receivables.

Depreciation and amortization

Depreciation and amortization increased by HRK 5 million or 0.3% to HRK 1,497 million in 2016 mainly due to a higher amortization of terminal equipment for broadband services, which was partially offset by a lower amortization of software licenses.

PROFITABILITY

EBITDA before exceptional items

EBITDA before exceptional items increased by HRK 39 million or 1.4% to HRK 2,821 million in 2016. This increase was a result of higher other operating income (HRK 61 million or 62.8%) and higher revenue (HRK 51 million or 0.7%), and it was partially offset by higher operating expenses (HRK 73 million or 1.7%).

Other operating income increased by HRK 61 million or 62.8% to HRK 159 million in 2016 mainly as a result of higher sale of fixed assets, mostly from the sale of land in Rijeka and Požega, sale of vehicles, commitment write-off related to the obligation for antenna poles retirement, and rental of real estates and telco infrastructure.

Optima Telekom's contribution to HT Group's EBITDA for 2016 amounted to HRK 106 million (2015: HRK 106 million) and consisted of HRK 239 million of Optima Telekom third party contributions (2015: HRK 224 million) and HRK 132 million of inter-company relations (2015: HRK 118 million).

Net profit after non-controlling interests

In comparison to 2015, consolidated net profit after non-controlling interests increased by HRK 9 million or 1.0% to HRK 934 million in 2016. Net profit after non-controlling interests increased due to a higher EBITDA before exceptional items (HRK 39 million), higher contribution from non-controlling interests (HRK 22 million), higher financial income (HRK 10 million) and lower exceptional items (HRK 6 million), which was partially offset by higher financial expenses (HRK 56 million), higher taxation (HRK 7 million), and higher depreciation and amortization (HRK 5 million).

The negative contribution of financial expenses by HRK 56 million mainly came from exchange rate loss resulting from the EUR exchange rate decline (2016: 7.56 vs 2015: 7.64) and interests coming from Optima Telekom. Financial income growth of HRK 10 million was mainly driven by the sales of non-current financial assets.

Optima Telekom contributed to the net profit of HT Group with the loss of HRK 1 million (2015: net profit of HRK 4 million).

FINANCIAL POSITION

Balance sheet

Total value of assets increased by HRK 375 million or 2.7% to HRK 14,455 million in comparison to the end of 2015, followed by significant investments in non-current financial assets.

Total issued capital and reserves increased from HRK 11,641 million at 31 December 2015 to HRK 12,046 million at 31 December 2016. This is mainly due to net profit for 2016 of HRK 934 million, which was offset with dividend payment of HRK 491 million.

Total current liabilities decreased by HRK 43 million or 2.3% to HRK 1,847 million at 31 December 2016 mainly due to a decrease in current portion of financial liabilities for capitalised content transmission contracts.

Cash flow

Cash flow from operating activities is HT Group's principal source of funds enabling the Company to finance capital investments and dividend distributions.

Net cash flow from operating activities decreased by HRK 292 million or 12.3% due to contribution of working capital, which is mainly due to higher payments for value added tax in comparison with 2015 when corporate income tax paid in advance was used for the settlement of value added-tax liabilities.

Net cash flow from investment activities decreased by HRK 1,185 million or 212.7%, mainly due to significant investments in financial assets, mostly bonds, commercial bills and REPO arrangements, and higher CAPEX paid in 2016 compared to 2015.

Net cash flow from financial activities slightly decreased by HRK 1 million or 0.1%, mainly due to higher repayments for Electronic Communication Infrastructure contract, which was partially offset by a lower dividend paid.

CAPITAL EXPENDITURE

Capital expenditure realization increased by HRK 135 million or 9.1% to HRK 1,608 million in comparison to 2015 mostly due to investments in realization of integrated network strategy (INS) and MPLS aggregation network, as well as fulfilling regulatory requirements related to the Electronic Communications Infrastructure.

During 2016, Integrated Network Strategy brought households up to NGA speeds (30Mbps plus) and ultra-fast NGA speeds (100Mbps plus), along with providing an extensive LTE (4G) coverage in the mobile segment boosting competitiveness and customer experience. One of the main contributions in the fixed network was enabled in the FTTx access for 295 thousand households, which represents an increase of 68% compared to the end of year 2015. HT enabled and offered broadband speeds 2 to 5 times faster than previously for 180 thousand customers, with at no additional charge. From households with enabled NGA, over 200 thousand have access to the fiber optic network and ultra-fast speeds over 100 Mbps. In total, NGA speeds are enabled for 54% Croatian households solely thanks to HT's efforts, bringing Croatia closer to the targets of the European Digital Agenda.

In the mobile network, "indoor" 4G population coverage has increased from 65.0% to 68.2%, and "outdoor" coverage increased from 93.1% up to 96.9% since the beginning of 2016. Regarding throughput distribution, 4G population coverage of download up to 225 Mbps has increased from 31% at the end of 2015 to 51% at the end of 2016. The rollout of 4G layer with ultra-high download speeds of up to 262.5 Mbps has started.

Strong investments in the access network within the Integrated Network Strategy and speed increase are followed by investments in the core network and service platforms. To follow up enabled NGA speeds, focus is on modernization and network upgrades to meet increased capacity and traffic demands, ensure network stability, achieve better performance and provide new functionalities.

A part of the PAN IP Program is the VoXX project (VoLTE / VoWiFi), which will serve for providing voice services based on VoLTE and VoWiFi technologies. Basic integration scope has been implemented and tested in laboratories, and integration and testing of full service in laboratories is in progress. The mobile core network was upgraded to the latest version to ensure business continuity and support for VoLTE. The migration of prepaid and postpaid mobile subscribers to the new IN platform was successfully performed without any impact on customer experience. The planned modernization of the aggregation network (MPLS) in 2016 is in its final phase and will result with an extended capacity for traffic growth. Trouble ticketing tools have been consolidated, enabling better performance.

IT continued with transformation to a digital society, which includes the automation of work with HT partners for construction and maintenance works on access networks, upgrade of T-spot solutions, upgrade of "Moj Hrvatski Telekom" portal that enabled customers to pay HT bills via the portal and mobile application. The first phase of "Virtual Basket" has been implemented as a step forward towards a strategy for all channels.

The first phase of Magenta1 program was implemented, with the main goal to retain fixed and mobile services customers. The concept of households was implemented to enable an easier and more focused sale approach by using tools for tariff recommendation. Integration with the system of customer relations management has been ensured and intensive work on Business IT Transformation has been continued.

HT INC. FINANCIAL HIGHLIGHTS

Revenue

Revenue increased by HRK 43 million or 0.7% to HRK 5,919 million in 2016 compared to 2015. The increase was driven by higher mobile revenue (HRK 93 million or 3.4%) coming from higher realization of mobile data and handset revenues, miscellaneous revenue (HRK 55 million or 115.1%) coming from energy business, and system solution revenue (HRK 20 million or 10.5%). This increase was partially offset by a decrease in fixed revenue (HRK 125 million or 4.3%) mostly resulting from lower voice revenue driven by the general market trend of fixed-to-mobile substitution and broadband revenues, mostly due to lower ARPU driven by a highly competitive market.

EBITDA before exceptional items

EBITDA before exceptional items increased by HRK 26 million or 1.0% to HRK 2,596 million in 2016, mainly as a result of higher other operating income (HRK 60 million or 66.1%), mostly driven by sales of fixed assets and higher revenue (HRK 43 million or 0.7%). This increase was partially offset by higher operating expenses (HRK 77 million or 2.3%) driven mainly by higher energy sales costs and merchandise costs related to higher energy and handsets revenues.

Net profit

Net profit increased by HRK 15 million or 1.7% to HRK 909 million in 2016. This increase was primarily a result of higher EBITDA before exceptional items (HRK 26 million or 1.0%), higher financial income (HRK 21 million or 43.5%), lower depreciation and amortization (HRK 4 million or 0.3%), and lower exceptional items related to the headcount restructuring program (HRK 4 million or 4.8%). It was partially offset by higher financial expenses (HRK 30 million or 40.5%) mainly related to negative exchange rate differences and higher taxation (HRK 9 million or 4.0%).

OVERVIEW OF SEGMENT PROFITABILITY

Disclosure

After financial consolidation of Optima Telekom into Group's results for Q3 2014, the Group's operating segments are the Residential Business Unit, the Business Unit, Network and Support Functions, and Optima consolidated unit.

The Residential Business Unit (RBU) includes marketing, sales and customer care activities, focused on providing mobile, fixed line telecommunications and TV distribution services to residential customers.

The Business Unit (BBU) includes marketing, sales and customer care activities, focused on providing mobile and fixed line telecommunications, system integration services to corporate customers, small and medium business and the public sector. In addition, BBU is responsible for wholesale business for both fixed and mobile services.

The Network and Support Function (NSF) performs cross-segment management and support functions, including the Technology Department, Procurement, Accounting, Treasury, Legal and other central functions.

Iskon, Combis, KDS and E-tours, companies in HT's full ownership, are part of the abovementioned segments and have the same structure as the parent company.

Optima consolidated unit includes the contribution of all Optima Telekom's functions to HT Group's financial results following the same reporting structure as used for other operating segments, except revenue details that are only reported in the total amount under the item "Fixed revenue line". According to the "Chinese wall" principle introduced by the regulator, access to Optima Telekom figures is limited. This is why only financial consolidation is performed, while Optima Telekom non-financial KPIs are not included into HT Group achievements.

In its financial reports, HT Group reports on segments based on contributions to EBITDA before exceptional items. The revenue and expenses of segments include primary results.

Depreciation is not allocated to segments, except for the part related to Optima Telekom, as the majority is related to the fixed and mobile network, which is part of NSF.

Residential segment – EOY

in HRK million	2015	2016	% of change A16/A15
Mobile revenue	1,782	1,870	4.9%
Fixed revenue	1,958	1,840	-6.0%
System solutions	0	0	-
Miscellaneous	36	39	7.3%
Revenue	**3,776**	**3,749**	**-0.7%**
Operating expenses	**1,166**	**1,185**	**1.7%**
Contribution to EBITDA before exceptional items	**2,611**	**2,563**	**-1.8%**

Business segment – EOY

in HRK million	2015	2016	% of change A16/A15
Mobile revenue	949	951	0.2%
Fixed revenue	1,090	1,079	-1.0%
System solutions	659	677	2.7%
Miscellaneous	20	73	
Revenue	**2,718**	**2,780**	**2.3%**
Operating expenses	**1,364**	**1,420**	**4.1%**
Contribution to EBITDA before exceptional items	**1,353**	**1,360**	**0.5%**

Network and support functions – EOY

in HRK million	2015	2016	% of change A16/A15
Other operating income	96	157	64.2%
Operating expenses	1,501	1,498	-0.2%
Contribution to EBITDA before exceptional items	**-1,406**	**-1,341**	**4.6%**

Segment Optima consolidated – EOY

in HRK million	2015	2016	% of change A16/A15
Fixed revenue	425	441	3.8%
Revenue	**425**	**441**	**3.8%**
Other operating income	**2**	**2**	**2.5%**
Operating expenses	**203**	**204**	**0.8%**
Contribution to EBITDA before exceptional items	**224**	**239**	**6.4%**

PL bridge to HT Group EBITDA by segments – EOY

in HRK million	2015	2016	% of change A16/A15
Segment Result (Contribution to EBITDA)			
Residential Segment	2,611	2,563	-1.8%
Business Segment	1,353	1,360	0.5%
Network and Support Functions	-1,406	-1,341	4.6%
Segment Optima consolidated	224	239	6.4%
Total Contribution to EBITDA before exceptional items of the Segments	**2,783**	**2,821**	**1.4%**
Exceptional items	91	85	-7.1%
Total EBITDA	**2,691**	**2,736**	**1.7%**

CORPORATE RESPONSIBILITY

CORPORATE RESPONSIBILITY

The extent of HT Group's impact on the wider community is addressed in the Economic Atlas, a socioeconomic contribution study conducted by the Institute of Economics. Based on its results, HT is the leading company in Croatia in terms of its positive impact on the wider social environment, and the largest private investor contributing HRK 5.7 billion over the last five years. HT Group generates more than 3% of GDP and supports, through its business operations, 27,000 jobs.

For its socially responsible relations with the community, HT won the Corporate Social Responsibility Index awarded by the Croatian Business Council for Sustainable Development and the Croatian Chamber of Economy as part of the 8th Corporate Social Responsibility Conference.

The aforementioned supports the fact that corporate social responsibility is an integral part of HT. Namely, a company's reputation does not depend only on the quality, price, or particular features of its products and services. Of equal importance are the company's attitudes towards all stakeholders – employees, customers, suppliers, and investors, as well as towards the environment and the community in which it operates.

Compliance with laws and other regulations, observance of internal rules and the Code of Conduct are the basis of responsible corporate governance.

Since 2015, HT Group and all its members have been applying the Social Responsibility Policy, which is the basis on which the Group has been continuously establishing, maintaining, monitoring, and developing its responsibilities pertaining to corporate responsibility and related duties.

In December, a central internal audit of HT's Integrated Environment, Health, and Security Management System, as part of the DTAG's Integrated Management System, was successfully conducted by DTs auditors, in line with the requirements of the ISO 14001 and OHSAS 18001 standards. The audit confirmed the integration of environmental care into all relevant work processes and a high level of environmental awareness of employees. The certification company DEKRA has issued new ISO 14001 and OHSAS 18001 certificates for the following three years.

Responsibility towards the Community

Knowledge Society

HT has close links with the academic community, particularly with the Faculty of Electrical Engineering and Computing (FER). The Company promotes the transfer of knowledge and focuses this long-standing cooperation on joint project work, scientific research, and development activities. In 2016, HT and FER signed a five-year collaboration contract, providing for the best exchange of knowledge and practices among students and employees in the STEM area. In addition to regular professional training of HTs employees and the scholarship and mentoring scheme for the best final year students, the contract provides students with a better opportunity to participate in international projects.

HT STEM HUB program– an incubator for fostering the development of skills in science, technology, engineering, and mathematics – has been established. The first project partner is FER. Through HT STEM HUB, students can acquire new knowledge in the STEM area, and develop and apply it in practice by participating in domestic and international projects. They also receive an opportunity to win a scholarship or even a job. Last year, HT awarded scholarships of HRK 3,000 to the highest achieving FER students.

Donations and Sponsorships

A common feature of HT's socially responsible activities is the focus on projects of lasting value in the area of technology and education. Among the most prominent projects is the annual competition "Together We Are Stronger" for granting donations to projects of special significance for the community. In 2016, the competition invited applications for projects promoting STEM education in primary schools and enabling the acquisition of knowledge in the area of science, technology, engineering, and mathematics through practical work and games. The first category was intended for projects using robotic or sensor systems, programming, or innovative communications, while the second was intended for projects educating through scientific experiments or encouraging students' interest in science.

The partnership with the Museum of Contemporary Art (MSU) continued in 2016, with the ninth consecutive annual T-HTnagrada@msu.hr award for the best Croatian contemporary work of art.

In 2016, the Company provided sponsorship support to five film festivals: ZagrebDox, Pula Film Festival, Motovun Film Festival, Vukovar Film Festival, and Zagreb Film Festival.

For the ninth year in a row, news site "tportal" ran a competition for the roman@tportal.hr literary prize worth HRK 50,000. The winner was Slobodan Šnajder with his novel "The Brass Times" ("Doba mjedi").

With the project of a virtual tour through the Vukovar-based Homeland War Memorial Centre, HT made it possible for everyone around the globe to become acquainted with the recent history of Vukovar via the website of the Memorial Centre. The virtual tour provides 360° panoramic images of five venues within the Memorial Centre. The technique has been achieved by taking photographs of the localities aiming to present the details as faithfully as possible.

HT was the general sponsor of the tech show "Bug Future Show 2016" and supported "Idea Knockout", the largest regional start-up competition, which enabled the winning team to visit and have an exhibition stand at CES 2017, the largest consumer electronics show in the world.

In collaboration with the start-up incubator "hub:raum", Hrvatski Telekom organized the hackathon "Hack It!" open to all innovators. Teams consisting of proactive and innovative developers had an opportunity to design how communications will be carried out in a future, digital world. The main criteria for selecting the winner were innovation and development of the idea and its market potential. The winning solution, Maggie project, which shared a vision of a personal digital assistant, won the main award worth HRK 20,000.

HT celebrates 25 years of mobile telephony in Croatia with the "1991-2016 Mobile Revolution" exhibition in the HT Museum. By presenting the most important moments, the exhibition shows the development of mobile telephony in Croatia over the last 25 years, in which HT has played a key role.

Responsibility towards Employees

Development programs for employees, realized through the HT Academy, offer employees insights into the latest trends and achievements. We continue with our program "Education of Your Choice", providing employees with an opportunity to opt for courses they wish to attend. We are one of the few companies that have identified key talents in all areas of the Company. We encourage an individual approach to career development and support and monitor employees with a view to increasing their competences, engagement, and motivation in a targeted way. Last year, 26% of talented employees were promoted to a higher position.

The program "Thank You!" recognizes and awards employees who put their heart into work since in doing so, we work better, learn more, and provide a top service with a smile.

Aware of the fact that, as a technology leader, we set high operational standards, we also take care of the work and life balance of our employees. This includes, among many things, flexible working hours, a day off for the parents of first-grade pupils on their first day at school, and "Friday in Slippers".

We find the health of our employees very important. Some of the activities used to promote a healthy lifestyle include free-of-charge full medical check-ups, fit corner, exercising, anti-stress workshops, and nutritional advice. "HT Olympics", a sports meeting of our employees, is an opportunity for employees to show their sports skills in a competitive spirit during a three-day event. A large turnout of employees in the B2B Run is an additional promotion of life on the move. This year, B2B Run motivated almost five hundred employees to take part in sports activities. In 2016, HT once again won the title of the B2B fittest company.

We have also confirmed our Employer Partner status with a high rating owing to our excellence in human resources management, continuous improvement of work processes, and following global trends.

Responsibility towards Customers

We strive to provide our customers with the best services based on innovations and state-of-the-art technologies at any time they need them and to keep customer experience in focus.

For us, customer care is more than raising the quality of services at points of sale or removing faults in a faster and high-quality way. Instead, we pay special attention to proactive consideration of how our customers' experience with any part of our Company and our services can be transformed into an excellent one and how to put the customer at the center of our activities.

With that aim in mind, this year, we designed a special program called "100 Days" for our Magenta 1 customers. We monitored our customers in the critical phases from the beginning of service provision through a welcome call and the receipt of the first invoice with the explanation of each single item. The success of the program was confirmed by the convincingly improved satisfaction of Magenta 1 customers as expressed in surveys using the TRI*M methodology. We have proactively informed customers of the status of their requests for fixed-line services, influencing their satisfaction in that segment as well. We continued working on internal processes related to customer support, thus increasing the number of resolved first-level queries and difficulties and reducing the number of repeated contacts. We have worked on performance increase in remote fault removal, which has become more efficient and faster this year.

HT is the first company in Croatia to present the latest LTE-A Pro (4,5G Pro) and G.fast technologies, developed together with the Faculty of Electrical Engineering and Computing and the company Nokia Solutions and Networks. In doing so, HT continues to pave the way towards the digital future by building a technology infrastructure that is a prerequisite for the state-of-the-art ICT services in all economic segments. These technologies enable data transmission at rates exceeding one gigabit per second, creating space for the development of a range of new services, such as augmented reality, and remote vehicle and home appliances management.

State-of-the-Art Technologies for a Better Quality of Life

As a project within the so-called Internet of Things (IoT), Smart City refers to the benefits of using ICT solutions and digitized processes focused on improvement of management efficiency in the city, increasing the quality of life for citizens, and achieving savings. The project has already provided proof that cities and counties are ready for technology, through modernized records of waste disposal, analytical review of traffic and tourist trends (Heat Maps service), IT-supported network of e-charging stations (e-mobility), digitized operation of city authorities and offices (e-bill, efficient document management in the cloud, kindergarten entrance and exit monitoring system, etc.), and leading solutions in public lighting, parking, traffic, air quality supervision, and the increase of energy efficiency in cities. All of the aforementioned is designed to be monitored, analyzed, and controlled through a common smart city platform (IoT platform).

Digital economy and ICT solutions in the IoT area represent the fastest growing segment of the economy. Together with its strategic and local partners, HT is currently the only company in Croatia offering comprehensive solutions for smart cities. At the Smart City Expo in Barcelona, the most prestigious world congress on ICT solutions for the future of cities, HT and its partners presented three solutions for smart cities. With the Sea Hero Quest mobile game, promoted by Hrvatski Telekom in the Croatian market, members of the Deutsche Telekom Group jointly set a new standard for researching dementia, currently affecting 47 million people worldwide. Since its launch in May, around 2.5 million people worldwide have played Sea Hero Quest, thus creating the first global benchmark for human spatial navigation, which is considered a key step in the development of new, early diagnostic tools for dementia. This has created the largest dementia study in the world. The data collected in the first 6 months have provided scientists with valuable information on the early stage of the disease. The first processed results indicate that spatial navigation abilities begin to decline from early adulthood and that they continue on this trajectory across the lifespan.

Responsibility towards Suppliers

HT implements a Sustainable Procurement Program for the purchase of products and services at the Group level. The Group tries to use the best value for the money invested, taking into account parameters such as price, quality, availability and functionality, impact of products and/or services on the environment, social aspects, working conditions, and human rights. The Program includes supply chain management with regard to social and environmental risks and the possibility for a long-term benefit for the Company, selection of suppliers according to clearly defined minimum standards (including the Social Charter or Conventions of the International Labor Organization), and regular overviews that ensure compliance.

Responsibility towards the Environment

HT strives to strengthen the environmental awareness of its employees. The majority of employees attended a course on environmental protection, while new employees take an initial course on environmental protection as a part of introduction to their jobs.

As the only telecommunications company in Croatia certified under the ISO 14001 Environmental Management Standard, HT is focused on the implementation of green technologies.

The year 2016 saw the continuation of the Energy Efficiency Project at the corporate level, resulting in a 2% decrease in electricity consumption compared to 2015. The key saving initiatives include efficient air conditioning and power supply systems, modernization of telecommunications equipment, optimization of the real estate portfolio, refurbishment of property owned by HT in line with energy efficiency principles, procurement of new vehicles meeting the highest environmental criteria, a more extensive use of IT resources, wind and solar power supply systems for HT's base mobile stations, along with a range of other activities that contribute to more efficient energy consumption. In addition, as a step further in its continuous efforts to protect the climate and reduce greenhouse gas emissions, since 2016, HT has been procuring green electricity generated solely from renewable sources.

In 2016, energy audits and certifications of buildings continued with a view to improving the energy efficiency of the real estate portfolio. In total, 50 technology and office premises and buildings were certified, with an average energy class D, which is satisfactory with regard to the year and type of construction, primarily due to the quality of regular maintenance and the materials and equipment installed.

The car fleet, the average age of a car being below 3.5 years, is subject to constant renewal and modernization in line with the highest environmental criteria. It also includes approximately 40 vehicles that can run on LPG fuel considered the most environmentally friendly motor fuel.

Within the objective to transform the business operations through automation, digitalization, and simplification of business processes, the quantity of disposed and recycled paper waste decreased by approximately 10% compared to 2015.

Alongside the regular collection of used devices in T-Centers, we continued the buy-back program for old mobile devices, under which customers can receive discounts when buying a new device. So far, HT has collected and disposed of more than 137 thousand old mobile devices, batteries, and related equipment in an environmentally friendly manner.

Corporate Responsibility in Companies owned by HT

Combis

In 2016, COMBIS organized its first try{code}catch hackathon, a 24-hour programming competition, where students were provided with an opportunity to demonstrate their knowledge and imagination by creating applications based on the given subject. The winners received the opportunity to continue developing their applications as part of an internal start-up – Neostartup. With the help of experienced engineers, the best students of the COMBIS hackathon developed two business applications, which COMBIS decided to donate to non-profit organizations.

COMBIS sponsored the organization of "App Start Contest" and "Mobile Challenge Cup", competitions for students in the area of mobile applications development, and as a traditional sponsor of urban culture, COMBIS supported "Comic Book Show", the 19th International Comic Book Festival.

As a company that cares about the improvement and development of society and the environment in which it operates, HT supported the Medvednica Nature Park by organizing a landscaping action at several locations in the Medvednica Nature Park, in which 200 employees participated as volunteers.

Traditionally, COMBIS encourages the exchange of knowledge at various ICT conferences. In 2016, it sponsored IDC Predictions 2016, Cisco Connect, Microsoft Windays, Oracle Day, Technobank Conference in Serbia, IATA Ops Conference in Denmark, and Cartes in France.

The jubilee 10th Combis Conference under the umbrella theme "10ading Evolution. 10ading Change. Future 10aded." also justified high expectations. More than 400 participants from Croatia and the region gathered at this conference that took place in Umag.

COMBIS granted financial donations to support the XV Grammar School in the organization of its students' trip to CERN, Kristina Leko's exhibition "How People Live – A Report on Passivity", and the "Neighbor Helping Neighbor" Association. It also supported the Croatian Guide Dog and Mobility Association through equipment donation.

Iskon

In 2016, Iskon Internet continued supporting cultural events as a general sponsor of the Thirsty Ear ("Žedno uho") music brand, which has been presenting international musicians to the local audience for 20 years. The main event SuperEar ("SuperUho") Festival took place in Primošten and attracted 6,000 guests.

Iskon was also the sponsor of the first Croatian music hackathon organized by the Muzika.hr portal. Competing with Deezer and ZAMP, the winner was a team of developers and designers who developed the prototype of the "Iskon Scene" application for Iskon. Iskon became the sponsor of the big Music Outlet, which attracted 20,000 visitors to the Culture Factory, with additional 200,000 people following the live streaming of Yammatovo's concert on the Dnevnik.hr portal and on Iskon.TV.

Iskon provided financial support to the most important events for the actors in creative industries in Croatia. In addition to sponsoring the D-Day event, representing authors below 30 years of age for the third year in a row, Iskon became one of the main sponsors of the first Design District in 2016. The project transformed the entire zone surrounding Martićeva Street in Zagreb into a design center. As part of the District project, applications were invited for the design of Iskon's points of sale. The winning solution received a financial award and was put into production.

In September, Iskon, as a technical partner, attended the biannual 15/16 Exhibition organized by the Croatian Designers Association and offering an overview of the best domestic design. The Exhibition presented Iskon.Smarthome, a smart home solution developed exclusively in collaboration with Croatian companies, craft businesses, and designers.

Iskonstrukcije, Iskon's web platform, organized free–of-charge workshops in Zagreb and Opatija during the whole year, while in Samobor the youngest ones were provided with an opportunity to spend time with Mark Kofs, the most influential YouTube blogger in the region. The first four online programming lectures for children between 7 and 12 years of age were created as well.

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 endorsed by the European Union ("EU") give a true and fair view of the financial position and results of Croatian Telecom Inc. and its subsidiaries (the "Group") 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 8 February 2017.

Croatian Telecom Inc.
Roberta Frangeša Mihanovića 9
10000 Zagreb
Republic of Croatia

8 February 2017

On behalf of the Group,

Davor Tomašković
President of the Management Board (CEO)

Ms. Marija Felkel
Member of the Management Board and CHRO

Mr. Josef Thürriegl
Member of the Management Board and CFO

Mr. Boris Batelić
Member of the Management Board and CCO

Mr. Boris Drilo
Member of the Management Board and CTIO

Ms. Nataša Rapaić
Member of the Management Board and COO Residential

Mr. Saša Kramar
Member of the Management Board and COO Business

INDEPENDENT AUDITOR'S REPORT

To the Shareholders and Management Board of Hrvatski Telekom d.d.:

Our opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Hrvatski Telekom d.d. (the "Company") and its subsidiaries (together – the "Group") as at 31 December 2016, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted in European Union ("IFRS"). .

What we have audited

The Group's consolidated financial statements comprise:

- the consolidated statement of financial position as at 31 December 2016;
- the consolidated statement of comprehensive income for the year then ended;
- the consolidated statement of changes in equity for the year then ended;
- the consolidated statement of cash flows for the year then ended; and
- the notes to the consolidated financial statements, which include a summary of significant accounting policies.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Consolidated Financial Statements section of our report.

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

Independence

We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code). We have fulfilled our other ethical responsibilities in accordance with the IESBA Code.

Our audit approach

Overview

- Overall materiality for consolidated financial statements: HRK 68 million, which represents 2.5% of Earnings Before Interest, Taxes, Depreciation and Amortisation (EBITDA).
- We conducted audit work at four legal entities in Croatia (Hrvatski Telekom, Combis, Iskon and Optima).
- Our audit scope addressed 99% of the Group's revenues and 99% of the Group's absolute value of underlying profit.
- Capitalisation of content rights
- Contingent liabilities and regulatory claims
- Impairment testing of goodwill

How we tailored our Group audit scope

We designed our audit by determining materiality and assessing the risks of material misstatement in the consolidated financial statements. In particular, we considered where management made subjective judgements; for example, in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. We also addressed the risk of management override of internal controls, including among other matters consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.
We tailored the scope of our audit in order to perform sufficient work to enable us to provide an opinion on the consolidated financial statements as a whole, taking into account the structure of the Group, the accounting processes and controls, and the industry in which the Group operates.

Materiality

The scope of our audit was influenced by our application of materiality. An audit is designed to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement. Misstatements may arise due to fraud or error. They are considered material if individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the consolidated financial statements.
Based on our professional judgement, we determined certain quantitative thresholds for materiality, including the overall Group materiality for the consolidated financial statements as a whole as set out in the table below. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and in aggregate on the consolidated financial statements as a whole.

Overall materiality for consolidated financial statements

HRK 68 million (2015: HRK 67 million)

How we determined it

2.5% EBITDA. EBITDA is operating profit adjusted for depreciation, amortisation, impairment of property, plant and equipment and intangible assets.

Rationale for the materiality benchmark applied

We consider EBITDA to be the key metric in the industry of the Group, and it is the benchmark against which the performance of the Group is most commonly measured by shareholders.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key audit matter	How our audit addressed the Key audit matter
Capitalisation of content rights	
Refer to note 2.4.e (Summary of accounting policies) and note 15 (Intangible assets). The Group consolidated statement of financial position includes capitalised intangible assets of HRK 1,738 million, which includes capitalised content rights of HRK 192 million. We focused on this area because of the significance of the costs capitalised and the fact that there is judgement involved. There are two main risks that we addressed in our audit: (1) the risk of whether the criteria required for capitalisation of such costs have been met, and (2) the risk that management's estimate of future consideration from content contracts is not reasonable.	We obtained a detailed analysis of capitalised content contracts in current and prior periods, and reconciled these amounts to prior year information and current year general ledger. No significant reconciling differences were identified. We have tested a sample of costs capitalised in the period by review of related contracts and invoices to assess whether they have been appropriately capitalised in line with the Group's accounting policy. In addition, we assessed the reasonableness of assumptions (estimated number of future customers and discount rate) used for measurement of future consideration. We compared the future customers estimate to historical data, and considered the consistency of the future growth rate assumptions with management's business plans. We also compared the discount rate used to market information. We identified no significant variances. Overall, we found that the costs were capitalised in line with the Group's accounting policy, and management's assumptions were reasonable.
Contingent liabilities and regulatory claims	
Refer to note 2.3 (Significant accounting judgements, estimates and assumptions), note 27 (Provisions for other liabilities and charges) and note 32 (Contingencies). We focused on this area because the Group is exposed to a significant number of legal, regulatory and competition claims. Consequently, management makes judgements about the future outcomes and amounts of contingent liabilities which may arise from such matters.	The Group has developed an internal methodology to ensure appropriate identification, reporting, assessment and quantification of legal, regulatory, and competition matters. We assessed the design and consistency of application of such methodology by performing the following procedures: ■ we gained an understanding of the status of each significant claim and historical outcomes of previous similar cases, ■ we evaluated the Group's assessment of the nature of litigation and claims by discussing the most significant cases with the Group's management and in-house legal counsel, and ■ we read related correspondence and obtained external confirmations from relevant third party legal representatives regarding certain material cases. Based on the evidence obtained, while noting the inherent uncertainty with such legal and regulatory matters, we agree with management's assessment of the likelihood of future material cash outflows arising from these matters. We determined that the matters assessed as probable to result in future cash outflows have been recorded as provisions, while the matter assessed as possible to result in future cash outflows has been appropriately disclosed.

Impairment testing of goodwill

Refer to note 2.3 (Significant accounting judgements, estimates and assumptions) and note 15 (Intangible assets). The Group statement of financial position includes goodwill of HRK 252 million.

The Group is required to, at least annually, test goodwill for impairment. We focused on this area because management's assessment of the 'fair value less costs of disposal' of the related cash-generating units involves significant judgement about future results of the business, particularly those relating to the cash flow forecast (revenue projections and growth rates) and the applied discount rate.

We specifically focused on the goodwill related to the Optima cash-generating unit (carrying value at balance sheet date is HRK 90 million) due to the historically small difference between the carrying amount and fair value less costs of disposal.

The remaining goodwill balance at the balance sheet date related to cash-generating units for which the Group assessed there is substantial headroom.

In the evaluation of the assumptions as disclosed in note 2.3 as well as methodologies used (discounted cash flow model) by management, we used internal valuation experts to assist us in evaluating the methodology used and underlying assumptions.

We discussed with management their estimate of future cash flow forecasts, and the process by which they were drawn up. We tested the mathematical accuracy of underlying calculations, and we compared the cash-flow forecasts to approved budgets. We noted no significant exceptions.

We compared current year actual results with prior year forecasts as an indication of the quality of the forecasting process. We found no significant differences, but noted that management did adjust future forecasts for changes in market trends.

We evaluated and challenged the discount rate used by comparing the rates used to comparable organisations and market information. We also reviewed management's sensitivity analysis on the key assumptions to ascertain the extent of change in those assumptions that either individually or collectively would cause the goodwill to be impaired. We found that the post-tax discount rate used by management was consistent with market data, and the growth rate assumption was consistent with historical results and did not exceed the industry forecasts.

We agree with management's assessment that no significant impairment to the carrying amount of goodwill was identified, based on available evidence.

Other information

Management is responsible for the other information. The other information comprises the Consolidated Annual Report of the Group, which includes the Management Report and Corporate Governance Statement (but does not include the consolidated financial statements and our auditor's report thereon).

Our opinion on the consolidated financial statements does not cover the other information, including the Management Report and Corporate Governance Statement.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

With respect to the Management Report and Corporate Governance Statement, we also performed procedures required by the Accounting Act in Croatia. Those procedures include considering whether the Management Report includes the disclosures required by Article 21 and 24 of the Accounting Act, and whether the Corporate Governance Statement includes the information specified in Article 22 of the Accounting Act.

Based on the work undertaken in the course of our audit, in our opinion:

- the information given in the Management Report and the Corporate Governance Statement for the financial year for which the consolidated financial statements are prepared is consistent, in all material respects, with the consolidated financial statements;
- the Management Report has been prepared in accordance with the requirements of Article 21 and 24 of the Accounting Act; and
- the Corporate Governance Statement includes the information specified in Article 22 of the Accounting Act.

In addition, in light of the knowledge and understanding of the Group and its environment obtained in the course of the audit, we are also required to report if we have identified material misstatements in the Management Report and Corporate Governance Statement. We have nothing to report in this respect.

Responsibilities of management and those charged with governance for the consolidated financial statements

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

In preparing the consolidated financial statements, management is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's financial reporting process.

Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 Group's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this independent auditor's report is Tamara Maćašović.

PricewaterhouseCoopers d.o.o.
Zagreb, 8 February 2017

Tamara Maćašović
Member of the Management Board and Certified Auditor

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2016

	Notes	2016 HRK million	2015 HRK million
Revenue	4	6,970	6,919
Other operating income	5	159	98
Merchandise, material and energy expenses	6	(1,354)	(1,272)
Service expenses	7	(743)	(710)
Employee benefits expenses	9	(987)	(1,023)
Work performed by the Group and capitalised		101	88
Depreciation, amortization and impairment of non-current assets	8	(1,497)	(1,492)
Other expenses	10	(1,410)	(1,409)
Operating profit	4	**1,239**	**1,199**
Finance income	11	64	53
Finance costs	12	(144)	(88)
Finance costs – net		(80)	(35)
Share of profit of investments accounted for using the equity method	18	3	4
Profit before income tax		**1,162**	**1,168**
Income tax expense	13	(234)	(227)
Profit for the year		**928**	**941**
Items that may be subsequently reclassified to comprehensive income			
Change in value of available for sale financial assets		(1)	2
Other comprehensive income for the year, net of tax		**(1)**	**2**
Total comprehensive income for the year, net of tax		**927**	**943**
Profit attributable to:			
Equity holders of the Company		934	925
Non-controlling interest		(6)	16
		928	941
Total comprehensive income arisen from continuing operations attributable to:			
Equity holders of the Company		933	927
Non-controlling interest		(6)	16
		927	943
Earnings per share			
Basic and diluted, from continuing operations attributable to equity holders of the Company during the year	14	HRK 11.40	HRK 11.30

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

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 31 December 2016

	Notes	31 December 2016 HRK million	31 December 2015 HRK million
Assets			
Non-current assets			
Intangible assets	15	1,738	1,651
Property, plant and equipment	16	5,576	5,558
Investment property	17	44	57
Investments accounted for using the equity method	18	377	399
Available-for-sale financial assets	19	949	591
Trade and other receivables	21	121	98
Bank deposits	23	26	43
Deferred income tax asset	13	59	46
Total non-current assets		**8,890**	**8,443**
Current assets			
Inventories	20	111	110
Trade and other receivables	21	1,328	1,214
Prepayments	22	261	272
Income tax prepayments		-	7
Available-for-sale financial assets	19	46	78
Bank deposits	23	1,143	780
Cash and cash equivalents	23	2,676	3,175
Total current assets		**5,565**	**5,636**
TOTAL ASSETS		**14,455**	**14,079**

CONSOLIDATED STATEMENT OF FINANCIAL POSITION (CONTINUED)

As at 31 December 2016

	Notes	31 December 2016 HRK million	31 December 2015 HRK million
EQUITY AND LIABILITIES			
Issued capital and reserves			
Issued share capital	28	9,823	9,823
Legal reserves	29	491	444
Fair value reserves		3	4
Retained earnings	30	1,567	1,193
Total		**11,884**	**11,464**
Non-controlling interest		163	177
Total issued capital and reserves		**12,047**	**11,641**
Non-current liabilities			
Provisions for other liabilities and charges	27	42	56
Borrowings	36	262	279
Employee benefit obligations	26	12	12
Deferred income	25	19	2
Other liabilities	24	148	143
Finance lease	36	42	11
Deferred income tax liability	13	36	45
Total non-current liabilities		**561**	**548**
Current liabilities			
Trade payables and other liabilities	24	1,615	1,701
Income tax payable		23	-
Provisions for other liabilities and charges	27	91	82
Finance lease	36	13	4
Deferred income	25	89	103
Borrowings	36	16	-
Total current liabilities		**1,847**	**1,890**
Total liabilities		**2,408**	**2,438**
TOTAL EQUITY AND LIABILITIES		**14,455**	**14,079**

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

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 31 December 2016

	Notes	2016 HRK million	2015 HRK million
Operating activities			
Profit before income tax		1,162	1,168
Depreciation, amortization and impairment of non-current assets	8	1,497	1,492
Interest income	11	(19)	(19)
Interest expense	12	93	59
Gain on disposal of assets	5, 10	(35)	(11)
Other net financial loss (gain)	11, 12	6	(6)
Share of profit of joint venture	18	(3)	(4)
(Increase) / decrease in inventories	20	(1)	9
(Increase) / decrease in receivables and prepayments		(142)	20
(Decrease) / increase in payables and accruals		(149)	13
Increasein employee benefit obligations	26	-	1
Decrease in provisions		(12)	(44)
Other non-cash items		(19)	12
Cash generated from operations		2,378	2,690
Interest paid		(78)	(64)
Income tax paid		(225)	(260)
Net cash flows from operating activities		**2,075**	**2,366**
Investing activities			
Payments for non-current assets		(1,173)	(990)
Proceeds from sale of non-current assets		55	25
Purchase of available-for-sale financial assets and deposits		(1,018)	(616)
Proceeds from sale of available-for-sale financial assets and deposits		972	974
Purchase of secured deposits (reverse REPO arrangements)	23	(2,207)	(1,407)
Proceeds from secured deposits (reverse REPO arrangements)	23	1,608	1,438
Interest received		18	18
Dividend received	18	3	-
Net cash flows used in investing activities		**(1,742)**	**(558)**
Financing activities			
Dividends paid	30	(491)	(573)
Repayment of radio frequency spectrum, content and ECI contracts		(294)	(212)
Other financial repayments		(30)	(34)
Repayment MCL		(8)	(8)
Repayment of lease liability and borrowings	28	(10)	(4)
Net cash flows used in financing activities		**(833)**	**(831)**
Net increase in cash and cash equivalents		(500)	977
Cash and cash equivalents as at 1 January		3,174	2,192
Exchange gains on cash and cash equivalents		2	6
Cash and cash equivalents as at 31 December	23	**2,676**	**3,175**

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

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2016

	Issued share capital HRK millions (Note 28)	Legal reserves HRK millions (Note 29)	Fair value reserves HRK millions	Retained earnings HRK millions (Note 30)	Total HRK millions	Non-Controlling interest HRK millions	Total equity HRK millions
Balance as at 1 January 2015	**8,883**	**409**	**2**	**1,816**	**11,110**	**166**	**11,276**
Profit for the year	-	-	-	925	925	16	941
Other comprehensive income for the year	-	-	2	-	2	-	2
Total comprehensive income for the year	-	-	2	925	927	16	943
Dividends paid to equity holders of the Company (Note 30)	-	-	-	(573)	(573)	-	(573)
Capital increase	940	35	-	(975)	-	-	-
Value of conversion rights of MCL						(8)	(8)
Increase of share capital based on pre-bankruptcy settlement agreement	-	-	-	-	-	3	3
Balance as at 31 December 2015	**9,823**	**444**	**4**	**1,193**	**11,464**	**177**	**11,641**
Profit for the year				934	934	(6)	928
Other comprehensive income for the year	-	-	(1)	-	(1)	-	(1)
Total comprehensive income for the year	-	-	(1)	934	933	(6)	927
Dividends paid to equity holders of the Company (Note 30)	-	-	-	(491)	(491)	-	(491)
Increase in legal reserves based on transfer from retained earnings	-	47	-	(47)	-	-	-
Value of conversion rights of MCL	-	-	-	-	-	(8)	(8)
Prior period correction of error from HT d.d. Mostar (Note 18)	-	-	-	(22)	(22)	-	(22)
Balance as at 31 December 2016	**9,823**	**491**	**3**	**1,567**	**11,884**	**163**	**12,047**

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

1. Corporate information

Croatian Telecom Inc. ("HT" or the "Company") is a joint stock company whose majority shareholder is Deutsche Telekom Europe B.V. with a 51% holding. Deutsche Telekom Europe B.V. is 100% owned by Deutsche Telekom Europe Holding B.V. Deutsche Telekom Europe Holding B.V is 100% owned by Deutsche Telekom Europe Holding GmbH which is 100% owned by Deutsche Telekom AG. Thus, Deutsche Telekom AG is the ultimate controlling parent.

The registered office address of the Company is Roberta Frangeša Mihanovića 9, Zagreb, Croatia.

The total number of employees of the Group as at 31 December 2016 was 4,656 (31 December 2015: 4,951).

The principal activities of the Group are described in Note 4.

The consolidated financial statements for the financial year ended 31 December 2016 were authorized for issue in accordance with a resolution of the Management Board on 8 February 2017. 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) as endorsed by the EU. The consolidated financial statements also comply with the Croatian Accounting Act on consolidated financial statements, which refers to IFRS as endorsed by the EU.

The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial assets (Note 19), as disclosed in the accounting policies hereafter.

The Group's consolidated financial statements are presented in Croatian Kuna ("HRK") which is the Group's presentation currency. 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 Croatian Telecom Inc. and the following subsidiaries comprise together HT Group ("Group"):

		Ownership interest	
Entity	Country of Business	31 December 2016	31 December 2015
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%
E-tours d.o.o.	Republic of Croatia	100%	100%
Optima Telekom d.d. /i/	Republic of Croatia	19.02%	19.02%

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

For the year ended 31 December 2016

2.1. Basis of preparation (continued)

/i/ Control over Optima was obtained through transfer of managerial rights in accordance with the agreement with Zagrebačka banka d.d., the single largest shareholder of Optima.

The Croatian Competition Agency has conditionally allowed the concentration of HT and determined a set of measures with regard to management and control over Optima, among which is the implementation of a so called "Chinese wall" between Optima's and HT employees, in relation to all sensitive business information with the exception of reporting of financial data necessary for consolidation.

The control of HT over Optima is limited to a period of four years, up to 18 June 2018. Upon the expiration of the four-year period it is automatically terminated, without the possibility of extension. On the expiry of the three years, HT is required to commence the process of selling all of its Optima shares, during which HT will have the right to sell Optima shares held by Zagrebačka banka as well.

Set out below is summarised financial information for Optima Telekom d.d. The amounts disclosed are before intercompany eliminations including purchase price fair value allocation on consolidation level.

Summarised statement of financial position	31 December 2016 HRK million	31 December 2015 HRK million
Current assets	103	105
Current liabilities	115	114
Current net assets	**(12)**	**(9)**
Non-current assets	528	576
Non-current liabilities	320	356
Non-current net assets	**208**	**220**
Net assets	**196**	**211**
Accumulated non-controlling interest	163	177

Summarised statement of comprehensive income	31 December 2016 HRK million	31 December 2015 HRK million
Revenue	454	438
Profit for the period	(7)	20
Other comprehensive income	-	-
Total comprehensive income	**(7)**	**20**
Profit allocated to non-controlling interest	(6)	16
Dividends paid to non-controlling interest	-	-

Summarised statement of cash flows	31 December 2016 HRK million	31 December 2015 HRK million
Cash flow from operating activities	60	62
Cash flow from investing activities	(36)	(36)
Cash flow from financing activities	(35)	(32)
Net decrease in cash and cash equivalents	**(11)**	**(6)**

2.2. Changes in accounting policies and disclosures

The accounting policies adopted are consistent with those of the previous financial year unless otherwise stated and disclosed.

(a) New and amended standards adopted by the Group

The Group has adopted the following new and amended standards for their annual reporting period commencing 1 January 2016 which were endorsed by the European Union and which are relevant for the Group's financial statements:

- Accounting for Acquisitions of Interests in Joint Operations – Amendments to IFRS 11.
- Disclosure Initiative - Amendments to IAS 1.
- Annual Improvements to IFRSs 2012-2014 Cycle comprising changes to four standards (IFRS 5, IFRS 7, IAS 19, IAS 34).

The adoption of the improvements did not have any impact on the current period or any prior period and is not likely to affect future periods.

(b) New standards and interpretations not yet adopted

Certain new standards and interpretations have been published that are not mandatory for 31 December 2016 reporting periods and have not been early adopted by the Group. None of these standards and interpretations are expected to have significant effect on the Group's financial statements, except for the following standards:

- IFRS 9 Financial instruments and associated amendments to various other standards (effective for annual periods beginning on or after 1 January 2018)

IFRS 9 addresses the classification, measurement and derecognition of financial assets and financial liabilities and introduces new rules for hedge accounting.

The Group assessed the impact of the new standard IFRS 9 on its financial statements as follows:

- The Group does not expect any impact from the new classification, measurement and derecognition rules on the Group's financial assets and financial liabilities.
- There will also be no impact on the Group's accounting for financial liabilities, as the new requirements only affect the accounting for financial liabilities that are designated at fair value through profit or loss and the Group does not have any such liabilities.
- The new hedging rules will not impact the Group since it does not have any hedging arrangements.
- The new impairment model is an expected credit loss (ECL) model which may result in the earlier recognition of credit losses. The Group has not yet assessed how its impairment provisions would be affected by the new rules.

The Group plans to adopt the standard on its effective date.

- IFRS 15 Revenue from contracts with customer and associated amendments to various other standards (effective for annual periods beginning on or after 1 January 2018)

The IASB has issued a new standard for the recognition of revenue. This will replace international accounting standard (IAS) 18 which covers contracts for goods and services, and IAS 11 which covers construction contracts. The new standard is based on the principle that revenue is recognised when control of a good or service transfers to a customer – so the notion of control replaces the existing notion of risks and rewards.

The Group plans to adopt the standard on its effective date with prospective application. Like many other telecommunications companies, the Group currently expects this standard to have a significant impact on the Group's financial statements, primarily in respect of the following changes (depending on the business model):

- In the case of multiple-element arrangements (such as mobile contract plus handset) with subsidized products delivered in advance, a larger portion of the total remuneration is attributable to the component delivered in advance (mobile handset), requiring earlier recognition of revenue. This will lead to the recognition of what is known as a contract asset – a receivable arising from the customer contract that has not yet legally come into existence – in the statement of financial position. As a result, the Group expects higher revenue from the sale of goods and merchandise, and lower revenue from the provision of services.
- Future capitalization and allocation of the expenses for sales commissions (customer acquisition costs) over the estimated customer retention period.
- Increase in total assets on first-time adoption due to the capitalization of contract assets and customer acquisition costs.

The Group's operations and information systems are complex, and the Group is currently implementing new accounting policies, developing estimates and adjusting processes to comply with this new standard. Such effort is expected to be finalised mid-2017. As a result, at this time, it is not possible to make a reasonable quantitative estimate of the effects of this new standard on the Group's current revenue recognition policies.

- IFRS 16 Leases (effective for annual periods beginning on or after 1 January 2019)

The new standard sets out the principles for the recognition, measurement, presentation and disclosure of leases. IFRS 16 eliminates the classification of leases as either operating leases of finance leases as is required by IAS 17 and, instead, introduces a single lessee accounting model

- IFRS 16 will result in the recognition of almost all leases on the balance sheet. The standard removes the current distinction between operating and financing leases and requires recognition of an asset (the right to use the leased item) and a financial liability to pay rentals for virtually all lease contracts. An optional exemption exists for short-term and low-value leases.
- The income statement will also be affected because the total expense is typically higher in the earlier years of a lease and lower in later years. Additionally, operating expense will be replaced with interest and depreciation, so key metrics like EBITDA will change.
- Operating cash flows will be higher as cash payments for the principal portion of the lease liability are classified within financing activities. Only the part of the payments that reflects interest can continue to be presented as operating cash flows.

The Group is currently assessing the impact of this new standard on its financial statements. The Group plans to adopt the standard on its effective date and when endorsed by the European Union. Please refer to note 31 a) for operating lease commitments.

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 as to if and in what amount provisions need to be recorded in the financial statements as explained further in Notes 27 and 32. Changes in these judgments could have a significant impact on the financial statements 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 of disposal 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. 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 15 and 16.

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 the Group's total assets, the impact of significant changes in these assumptions could be material to the financial position and results of operations of the Group.

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 million
Year ended 31 December 2016	+10	108
	-10	(103)
Year ended 31 December 2015	+10	107
	-10	(103)

Impairment of goodwill

The Group tests annually whether goodwill has suffered any impairment. The recoverable amounts of cash-generating units have been determined based on fair value less cost of disposal calculations. These calculations require the use of estimates (Note 15). Management believes that no reasonably possible change in any of the key assumptions would cause the carrying value of the business and residential cash-generating units to materially exceed their recoverable amount. In case of cash-generating unit Optima Telekom, a reasonably possible change in certain key assumptions when viewed separately (such as decrease of revenue growth by 10%, increase of costs by 10% or change in capex and revenue ratio) with all other variables held constant, could result in an impairment charge of up to HRK 89 million.

Intangible assets with an indefinite life

In arriving at the conclusion that the acquired brand has an indefinite life, the Group considered the fact that the brand represents a whole business segment and relates to an operator with proven and sustained demand for its products and services in a well-established market. The brand has historically been supported through spending on consumer marketing and promotion. The Group considered other factors such as the ability to continue to protect the legal rights that arise from the brand name indefinitely and the absence of any competitive factors that could limit the life of the brand name. The Group expects continued economic benefits from the acquired brand in the future. However, a strategic decision to withdraw marketing support from the brand or the weakening in the brand's appeal through changes in customer preferences might result in an impairment charge in the future. Also, reasonable change in certain key assumptions (such as change of revenues by 10% and change in royalty relief rate by 0.1%) could result in an impairment charge of up to HRK 10 million.

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, share of profit and loss 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 control. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group, and are deconsolidated from the date that control ceases.

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 acquire 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 acquire on an acquisition-by-acquisition basis, either at fair value or at the non-controlling interest's proportionate share of the recognized amounts of acquire'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 acquire 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 amount of non-controlling interest in the acquire over the fair value of identifiable net assets acquired. If this consideration is lower than the fair value of the net assets acquired, the difference is recognized in the statement of comprehensive income. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses.

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

Purchases of subsidiaries from parties under common control

Purchases of subsidiaries from parties under common control are accounted for using the predecessor values method. Under this method the consolidated financial statements of the combined entity are presented as if the businesses had been combined from the beginning of the earliest period presented or, if later, the date when the combining entities were first brought under common control. The assets and liabilities of the subsidiary transferred under common control are at the predecessor entity's carrying amounts.

The predecessor entity is considered to be the highest reporting entity in which the subsidiary's IFRS financial information was consolidated. Related goodwill inherent in the predecessor entity's original acquisitions is also recorded in these consolidated financial statements. Any difference between the carrying amount of net assets, including the predecessor entity's goodwill, and the consideration for the acquisition is accounted for in these consolidated financial statements as an adjustment to reserves within equity.

c) Investment in associate

In the Group's financial statements, investment in an associated company (generally a shareholding of between 20% and 50% of voting rights) where significant influence is exercised by the Group is 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 associate, 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 associate. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

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 joint venture, 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 on transactions between the Group and its joint venture are eliminated to the extent of the Group's interest in the joint venture. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

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. The amortization method is reviewed annually at each financial year-end. Amortization of the telecommunication licence commences when the licence is acquired and ready for use, with the amortization period being the term of the licence.

The Group recognizes costs of content as an intangible asset at the inception of the 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. Content contracts which do not meet the criteria for capitalization are expensed and presented in 'other expenses' in the statement of comprehensive income.

The Group capitalizes rights of servitude and rights of way related to the Electronic Communication Infrastructure (ECI) as intangible assets according to criteria for acquired rights at the moment of signing the contract for rights of servitude or receiving certificate for right of way. The Group presents the acquired rights as intangible assets and financial liability as the acquired rights, and related cost is capitalized for the period of 3 years. The cost is the amount of one-off fee paid at entering into the arrangement and any other fees which are considered to be unavoidable. The non-cancellable term of the contract is three years, as it is assumed that this payment is unavoidable due to the fact that there will be no significant changes in technology and topology in that time period, and the Group cannot change its routes or find other locations for ECI in a shorter time period. In 2016, the Group changed its estimate used in this accounting policy by revising the estimated liability and useful life of ECI assets to a consistent period of three years from each balance sheet date (rather than from the moment of signing the contract for rights of servitude or receiving certificate for right of way). As a result, this change in estimate had the following impact on the balance sheet of the Group: intangible assets increased by HRK 39 million and liability increased by HRK 39 million as of 31 December 2016. Unwinding of accrued interest is recognized as an interest expense and is presented within other financial income/expense.

Useful lives of intangible assets are as follows:

Licences and rights	
Radio frequency spectrum in 2100 MHz frequency band	15 years
Radio frequency spectrum in 900/1800 MHz frequency bands	13 years
Radio frequency spectrum in 800 MHz frequency band	11-12 years
Right of servitude for Distributive Telecommunication Infrastructure (DTI)	3 years
Software, content and other assets	2-5 years
Customer base	7 years
Brand	Indefinite
Long-term customer contracts	1.5-7 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 and intangible assets with indefinite useful lives are reviewed for impairment, annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

Impairment for goodwill is determined by assessing the recoverable amount, based on fair value less cost of disposal, 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 15 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.

Subsequent expenditure on an asset that meets the recognition criteria to be recognized as an asset or an addition to an asset is capitalized, while maintenance and repairs are charged to expense when incurred.

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
Customer premises equipment (CPE)	7 years
Tools, vehicles, IT, office and other equipment	4-15 years

Land and assets under construction are not depreciated.

Useful lives, 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.

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount and are recognised within 'Other expenses' in the statement of comprehensive income.

g) Investment property

Investment property, principally comprising business premises and land, is held for long-term rental yields or appreciation and is not occupied by the Group. Investment property is treated as a long-term investment unless it is intended to be sold in the next year and a buyer has been identified in which case it is classified within current assets.

Investment property is carried at historical cost less accumulated depreciation and provision for impairment. Depreciation of buildings is calculated using the straight-line method to allocate their cost over their estimated useful lives of 10 to 50 years (2015: 10 to 50 years).

Subsequent expenditure is capitalised only when it is probable that future economic benefits associated with it will flow to the Company and the cost can be measured reliably. All other repairs and maintenance costs are charged to the statement of comprehensive income when incurred. If an investment property becomes owner-occupied, it is reclassified to property, plant and equipment, and its carrying amount at the date of reclassification becomes its deemed cost to be subsequently depreciated.

h) 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 of disposal and value in use amount. 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 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.

Provisions for impairment are measured according to the collection best estimate. 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.

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.

i) 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 inventory impairment immediately.

j) 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 collection is expected after one year 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.

k) 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.

l) 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.

Finance leases are capitalised at the lease's inception at the fair value of the leased property or, if lower, the present value of the minimum lease payments. The corresponding rental obligations, net of finance charges, are included in other short-term and long-term payables. Each lease payment is allocated between the liability and finance cost. The property, plant and equipment acquired under finance leases is depreciated over the asset's useful life or over the shorter of the asset's useful life and the lease term if there is no reasonable certainty that the Group will obtain ownership at the end of the lease term.

m) Taxation

The income tax charge is based on profit for the year and includes deferred taxes. Deferred taxes are calculated using the balance sheet 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 Group expects, at the reporting date, to recover or settle the carrying amount of its assets and liabilities.

Deferred income tax liabilities are provided on taxable temporary differences arising from investments in subsidiaries, associates and joint arrangements, except for deferred income tax liability where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future. Generally the Group is unable to control the reversal of the temporary difference for associates. Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes assets and liabilities relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

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 and deferred taxes 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.

n) Employee benefit obligations

The Group provides other long-term employee benefits (Note 26). These benefits include retirement payments. The defined benefit obligation is calculated annually by independent actuary 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 the statement of 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 net interest cost is calculated by applying the discount rate to the net balance of the defined benefit obligation and the fair value of plan assets. This cost is included in employee benefit expense in the statement of comprehensive income.

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

o) 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 and sales of electricity. In these cases, the Group is acting as an agent.

Revenue from fixed telephony includes revenue from activation fees, monthly fees, calls placed by fixed line subscribers and revenue from additional services in fixed telephony.

Revenue from wholesale services includes interconnection services for domestic and international carriers, and revenue from usage of network by other operators.

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 are recognized in the period of related usage.

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.

Revenue from the sales of electricity is recognized at fair value in the period when service is provided to customers.

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, Ethernet services, ADSL subscription and traffic, fixed line access, 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, 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) and WEB hosting. For bundled offer arrangements, revenue recognition for each of the elements 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 deliverable).

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 when 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 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 which is the rate that discounts receipts through the expected life of the financial instrument to the net carrying amount of the financial asset).

p) Cash and cash equivalents

Cash and cash equivalents comprise cash on hand, demand deposits, corporate commercial papers 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. Investments that are classified as cash and cash equivalents are held only as means of settling liabilities and not as an investment.

q) 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.

Mandatory convertible loan (MCL) is classified as equity and it is recognized at its nominal value which approximates its fair value.

r) 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 obtained under agreements to resell ("reverse REPO agreements") are essentially guarantees or collateral for money held with banks and are not recorded in the balance sheet. The related amounts held by banks are recorded as secured deposits for maturities over three months or as cash equivalents for maturities under three months.

s) 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 financial 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.

Levies and charges, such as taxes other than income tax or regulatory fees based on information related to a period before the obligation to pay arises, are recognised as liabilities when the obligating event that gives rise to pay a levy occurs, as identified by the legislation that triggers the obligation to pay the levy. If a levy is paid before the obligating event, it is recognised as prepayment.

t) Contingencies

Contingent assets are not recognized in the financial statements. They are disclosed when an inflow of economic benefits is probable.

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.

u) 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 38. This fair value is expensed over the period until the vesting date with recognition of a corresponding liability for cash-settled and equity-settled transactions are recognised in equity. 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.

v) 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 to the consolidated financial statements when material.

w) 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.

x) Dividend distribution

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

y) 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.

z) Contributed equity

Ordinary shares are classified as equity. Shares held by the Company are disclosed as treasury shares and deducted from contributed equity.

3. Business combinations

In 2014, the Group acquired voting shares in Optima Telekom d.d. (Optima) through pre-bankruptcy settlement. Shares with a value of HRK 52 million were acquired directly through court decision by converting receivables into equity share as of 18 June 2014. An additional interest was acquired through the Mandatory Convertible Loan (MCL) instrument in the amount of HRK 69 million, as of 9 July 2014, hereby was converted into Optima equity pursuant to Management Board decision as of 23 July 2014 and approval of the Supervisory Board. These two transactions are treated as a single transaction in these consolidated financial statements.

The Group's total share in Optima amounts to 19.02% as of 31 December 2016 (31 December 2015: 19.02%). Control over Optima was obtained through transfer of managerial rights in accordance with the agreement with Zagrebačka banka d.d., the single largest shareholder of Optima.

The Croatian Competition Agency has conditionally allowed the concentration of HT with Optima based on the proposed financial and operational restructuring plan of Optima within the pre-bankruptcy settlement procedure. The Croatian Competition Agency has determined a set of measures defining the rules of conduct for a participant in concentration with regard to management and control over Optima, among which is the implementation of a so called ''Chinese wall'' between Optima's and HT employees, in relation to all sensitive business information with the exception of reporting of financial data necessary for consolidation.

The control of HT over Optima is limited to a period of four years starting 18 June 2014. Upon the expiration of the four-year period it is automatically terminated, without the possibility of extension. On the date of expiry of the third year, HT is required to commence the process of selling all of its Optima shares, during which HT will have the right to sell Optima shares held by Zagrebačka banka as well.

4. Segment information

The business reporting format of the Group for purpose of segment reporting is determined to be Residential, Business, Network and Support Function and Optima Telekom 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, electricity and TV distribution and services to residential customers.

The Business Segment includes marketing, sales and customer services, focused on providing mobile and fixed line telecommunications, electricity 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 segment 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 Optima Telekom segment includes the contribution of all Optima Telekom's functions to Group financial results following the same reporting structure as used for other operating segments, except revenue details that are only reported in the whole amount on the Miscellaneous revenue line. According to the restrictions introduced by the regulator, access to Optima Telekom revenue information is limited.

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 or segment result (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, KDS and E-tours are consolidated within the respective operating segments to which they relate.

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

Year ended 31 December 2015	Residential HRK million	Business HRK million	Network and Support functions HRK million	Optima Telekom consolidated HRK million	Total HRK million
Net revenue	3,776	2,718	-	425	6,919
Mobile revenue	**1,782**	**949**	**-**	**-**	**2,731**
Fixed revenue	**1,958**	**1,090**	**-**	**425**	**3,473**
System solutions revenue	**-**	**659**	**-**	**-**	**659**
Miscellaneous revenue	**36**	**20**	**-**	**-**	**56**
Usage related direct costs	(212)	(197)	-	(92)	(501)
Income and losses on accounts receivable	(35)	(23)	-	(3)	(61)
Contribution margin I	3,529	2,498	-	330	6,357
Non-usage related direct costs	(529)	(778)	-	(4)	(1,311)
Segment result (contribution margin II)	3,000	1,720	-	326	5,046
Other income	-	-	96	2	98
Other operating expenses	(411)	(377)	(1,557)	(108)	(2,453)
Depreciation, amortization and impairment of non-current assets	-	-	(1,401)	(91)	(1,492)
Operating profit	**2,589**	**1,343**	**(2,862)**	**129**	**1,199**

Year ended 31 December 2016	Residential HRK million	Business HRK million	Network and Support functions HRK million	Optima Telekom consolidated HRK million	Total HRK million
Net revenue	3,749	2,780	-	441	6,970
Mobile revenue	**1,870**	**951**	**-**	**-**	**2,821**
Fixed revenue	**1,840**	**1,079**	**-**	**441**	**3,360**
System solutions revenue	**-**	**677**	**-**	**-**	**677**
Miscellaneous revenue	**39**	**73**	**-**	**-**	**112**
Usage related direct costs	(211)	(221)	-	(95)	(527)
Income and losses on accounts receivable	(8)	(21)	-	(3)	(32)
Contribution margin I	3,530	2,538	-	343	6,411
Non-usage related direct costs	(594)	(822)		(8)	(1,424)
Segment result (contribution margin II)	2,936	1,716	-	335	4,987
Other income	-	-	157	2	159
Other operating expenses	(389)	(371)	(1,550)	(100)	(2,410)
Depreciation, amortization and impairment of non-current assets	-	-	(1,401)	(96)	(1,497)
Operating profit	**2,547**	**1,345**	**(2,794)**	**141**	**1,239**

Revenue by geographical area	2016 HRK million	2015 HRK million
Republic of Croatia	6,526	6,554
Rest of the world	444	365
	6,970	**6,919**

The majority of the Group's assets are located in Croatia. None of the Group's external customers represent a significant source of revenue.

5. Other operating income

	2016 HRK million	2015 HRK million
Gain from sale of non-current assets	36	13
Rental income	31	27
Income from penalties and damage compensations	16	12
Other income	76	46
	159	**98**

6. Merchandise, material and energy expenses

	2016 HRK million	2015 HRK million
Cost of goods sold	1,116	1,078
Energy costs	102	104
Energy sales costs	92	48
Cost of raw material and supplies	29	31
Arrangement sales cost	15	11
	1,354	**1,272**

7. Service expenses

	2016 HRK million	2015 HRK million
Domestic interconnection	242	298
International interconnection	284	202
Other services	217	210
	743	**710**

8. Depreciation, amortization and impairment of non-current assets

	2016 HRK million	2015 HRK million
Depreciation	884	903
Amortization	533	566
	1,417	1,469
Impairment loss	80	23
	1,497	**1,492**

Notes 15, 16 and 17 disclose further details on amortization and depreciation expense and impairment loss.

9. Employee benefits expenses

	2016 HRK million	2015 HRK million
Gross salaries without contribution	593	604
Taxes, contribution and other payroll costs	168	177
Contribution from gross salaries	145	148
Redundancy expenses (Note 27)	80	91
Long-term employee benefits	1	3
	987	**1,023**

10. Other expenses

	2016 HRK million	2015 HRK million
Licence cost	315	324
Maintenance services	287	311
Rent (Note 31)	151	134
Advertising	120	114
Selling commission	106	99
Contract workers	114	79
Provision of trade receivables – net (Note 21)	32	61
Call centre and customer care support	45	49
Postal expenses	37	40
Non-income taxes and contribution	37	39
Education and consulting	31	33
Discounts granted to customers	14	14
Daily allowances and other costs of business trips	13	13
Insurance	12	11
Expenses related to customers acquisition	10	4
Provisions for charges and risks	9	(1)
Expenses from penalties and damage compensations	7	8
Write down of inventories	5	6
Loss on disposal of fixed assets	1	1
Other operating charges	64	70
	1,410	**1,409**

11. Finance income

	2016 HRK million	2015 HRK million
Interest income	19	19
Foreign exchange gains	33	34
Income from sale of bonds	12	-
	64	**53**

12. Finance cost

	2016 HRK million	2015 HRK million
Interest expense	93	59
Foreign exchange loss	44	17
Other	7	12
	144	**88**

13. Income tax expense

a) Tax on profit	2016 HRK million	2015 HRK million
Current tax expense	256	227
Deferred tax expense	(22)	-
	234	**227**

b) Reconciliation of the taxation charge to the income tax rate	2016 HRK million	2015 HRK million
Profit before tax	1,162	1,168
Income tax at 20% (domestic rate)	232	234
Tax effect of:		
Income not subject to tax	(3)	(1)
Expenses not deductible for tax purposes	6	4
Tax effects of tax loss carry forward for which no deferred income tax asset was recognised	(7)	(11)
Other	3	1
Impact of the tax rate reduction /i/	3	-
	234	**227**
Effective tax rate	20.14%	19.43%

/i/The reduction of Croatia's income tax rate from 20% to 18% will be effective from 1 January 2017. As a result, the relevant deferred tax balances have been remeasured.

The Group utilized a tax incentive in previous periods in respect of reinvesting profit and increasing the share capital in the same amount. If subsequently the capital that was increased by reinvested profit is decreased, this may result in a future tax liability for the Group. The Group believes a future tax liability will not arise in this regard. Issued share capital was increased in 2015 in the amount of HRK 940 million (Note 28).

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

Deferred tax assets and liabilities recognized in:	31 December 2016 HRK million	(charged) / credited in 2016 HRK million	31 December 2015 HRK million	(charged) / credited in 2015 HRK million	31 December 2014 HRK million
Statement of comprehensive income					
Non-tax deductible provisions	11	(4)	15	(6)	21
Property, plant and equipment write down	32	20	12	1	11
Accrued interest on legal cases	1	(1)	2	(1)	3
Other	15	(2)	17	1	16
	59	13	46	(5)	51
Other comprehensive income					
Actuarial gains and losses	-	-	-	-	
Deferred income tax asset	**59**	**13**	**46**	**(5)**	**51**
Statement of comprehensive income					-
Past service costs			-	-	-
Purchase price a llocation	33	(9)	42	(5)	47
	33	(9)	42	(5)	47
Other comprehensive income					
Actuarial gains and losses	3	-	3	-	3
Deferred income tax liability	**36**	**(9)**	**45**	**(5)**	**50**

Deferred tax assets have 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. Out of total deferred tax assets, current portion amounts to HRK 23 million.

Deferred tax asset arises on the property, plant and equipment impairment, on provision of impairment of receivables and inventories (materials, merchandise), and related to accruals and provisions and other temporary differences.

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 six years. The limitation period of six years starts with the year that follows the year of submission of tax declarations, i.e. 2018 for the 2016 tax liability.

The Group has not recognised deferred income tax assets of HRK 14 million in respect of losses amounting to HRK 80 million that can be carried forward against future taxable income. These losses relate to subsidiaries of the Group for which it is uncertain whether there will be sufficient future taxable profits to realise these deferred income tax assets.

In 2015, the tax authorities started conducting a supervision review of HT's corporate tax and VAT returns for the year ended 2014. This review by the tax authorities is still on-going.

Losses expires in:	HRK million
2017	48
2018	32
	80

14. 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:

	2016	2015
Profit for the year attributable to ordinary equity holders of the Company in HRK million	934	925
Weighted average number of ordinary shares for basic earnings per share	81.884.604	81.884.604
	11.40 kuna	**11.30 kuna**

15. Intangible assets

	Licences HRK million	Software HRK million	Goodwill HRK million	Other assets HRK million	Assets under construction HRK million	Total HRK million
As at 1 January 2015						
Cost	593	3,090	252	1,022	44	5,001
Accumulated amortization and impairment losses	(231)	(2,533)	-	(515)	-	(3,279)
Net book value	**362**	**557**	**252**	**507**	**44**	**1,722**
Year ended 31 December 2015						
Opening net book value	362	557	252	507	44	1,722
Additions	-	182	-	218	97	497
Transfers	-	56	-	1	(57)	-
Amortization charge	(35)	(294)	-	(237)	-	(566)
Impairment loss	-	(2)	-	-	-	(2)
Net book value	**327**	**499**	**252**	**489**	**84**	**1,651**
As at 31 December 2015						
Cost	494	3,297	252	1,241	84	5,368
Accumulated amortization and impairment losses	(167)	(2,798)	-	(752)	-	(3,717)
Net book value	**327**	**499**	**252**	**489**	**84**	**1,651**
Year ended 31 December 2016						
Opening net book value	327	499	252	489	84	1,651
Additions	2	169	-	330	110	611
Transfers	-	60	-	24	(65)	19
Amortization charge	(36)	(236)	-	(261)	-	(533)
Impairment loss	-	(10)	-	-	-	(10)
Net book value	**293**	**482**	**252**	**582**	**129**	**1,738**
As at 31 December 2016						
Cost	497	3,361	252	1,300	129	5,539
Accumulated amortization and impairment losses	(204)	(2,879)	-	(718)	-	(3,801)
Net book value	**293**	**482**	**252**	**582**	**129**	**1,738**

The intangible assets of the Group as at 31 December 2016 include five licences for use of the radio frequency spectrum (Notes 2.4. e) and 37 b)).

Assets under construction primarily relate to software and the various licences for the use of software.

Intangible assets with indefinite useful life consist of brand name related to Optima Telekom d.d. Carrying value as at 31 December 2016 is HRK 61 million (31 December 2015 HRK 61 million).

Additions of intangible assets

Major additions in 2016 relate to capitalised content costs in the amount of HRK 195 million, application, system and network technology software and user licences in the amount of HRK 169 million and capitalised cost of electronic communication infrastructure in amount of HRK 125 million.

Impairment loss

During 2016, the Group recognized an impairment loss for intangible assets of HRK 10 million (2015: HRK 2 million).

Disposal of intangible assets

The disposal of intangible assets primarily relates to the disposal of capitalized content costs in gross amount of HRK 288 million and software HRK 170 million (2015: HRK 100 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 2016 HRK million	31 December 2015 HRK million
Residential	55	55
Business	107	107
Optima Telekom consolidated	90	90
	252	**252**

The key assumptions used for fair value less cost of disposal calculations are as follows:

	Optima Telekom consolidated		Residential		Business	
	31 December 2016	31 December 2015	31 December 2016	31 December 2015	31 December 2016	31 December 2015
Growth rate	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%
Discount rate	9.79%	10.06%	8.93%	10.03%	8.93%	10.03%

The recoverable amount of a CGU is determined based on fair value less cost of disposal calculations. The key assumptions reflect past experience and expectations of market development, particularly the development of revenue, market share, customer acquisition and retention cost, capital expenditures and 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. The costs of central functions (Management and Administration) have been allocated between the segments for the purpose of impairment testing based on internal secondary cost allocation, using defined planed internal products. Forecast period is 10 years.

Impairment testing of brand

Optima has registered the name and trade mark “Optima” as intellectual property rights. Brand is an indefinitive – lived asset, and it is tested for impairment annually using the Relief from Royalty method. The brand value represents the net present value of the projected brand earnings, discounted using the after-tax discount rate on projected cash flows. The net present value calculation comprises both the explicit five and a half year projections and the terminal period, as this reflects the brands ability to create revenues in perpetuity. The growth rate of projected cash flows and the discount rate used is the same as the key assumptions utilised in the impairment testing of goodwill (reflected above).

16. Property, plant and equipment

	Land and buildings HRK million	Telecom plant and machinery HRK million	Tools, vehicles, IT and office equipment HRK million	Assets under construction HRK million	Total HRK million
As at 1 January 2015					
Cost	2,239	12,482	1,009	318	16,048
Accumulated depreciation and impairment l osses	(1,229)	(8,476)	(814)	(8)	(10,527)
Net book value	**1,010**	**4,006**	**195**	**310**	**5,521**
Year ended 31 December 2015					
Opening net book value	1,010	4,006	195	310	5,521
Additions	14	520	38	401	973
Transfers	6	214	12	(232)	-
Disposals	(10)	-	(2)	(2)	(14)
Depreciation charge	(86)	(746)	(69)	-	(901)
Impairment loss	-	(20)	-	(1)	(21)
Net book value	**934**	**3,974**	**174**	**476**	**5,558**
As at 31 December 2015					
Cost	2,242	12,626	1,036	485	16,389
Accumulated depreciation and impairment l osses	(1,308)	(8,652)	(862)	(9)	(10,831)
Net book value	**934**	**3,974**	**174**	**476**	**5,558**
Year ended 31 December 2016					
Opening net book value	934	3,974	174	476	5,558
Additions	24	606	28	339	997
Transfers	27	334	21	(390)	(8)
Disposals	(18)	(1)	-	-	(19)
Depreciation charge	(80)	(734)	(68)	-	(882)
Impairment loss	-	(70)	-	-	(70)
Net book value	**887**	**4,109**	**155**	**425**	**5,576**
As at 31 December 2016					
Cost	2,274	12,967	978	426	16,645
Accumulated depreciation and impairment l osses	(1,387)	(8,858)	(823)	(1)	(11,069)
Net book value	**887**	**4,109**	**155**	**425**	**5,576**

Included within assets under construction of the Group are major spare parts of HRK 60 million (31 December 2015: HRK 16 million), net of an impairment provision of HRK 0 million (31 December 2015: 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.

Additions of property, plant and equipment

Major additions in 2016 relate to infrastructure and network equipment.

Impairment loss

In 2016, the Group recognized an impairment loss on property, plant and equipment of HRK 70 million (2015: HRK 21 million) mostly relating to change of customer premises equipment due to transfer to newer technology. The recoverable amount of that equipment is its estimated fair value less costs of disposal, 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. The fair value measurement is categorised within level 3 under IFRS13 categorisation. The impaired asset is used jointly by residential and business segments.

Disposal of property, plant and equipment

The disposal of the property, plant and equipment primarily relates to the disposal of telecom switches and devices, old tools, IT, office equipment and vehicles in the gross amount of HRK 731 million (2015: HRK 650 million).

Ownership over ducts

Although 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 to the share capital at the foundation of the Company on 1 January 1999, according to other Croatian legislation, part of the Group's infrastructure that is 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 a major portion of these assets is not registered in the land registry, which may be relevant to the issue of proving the ownership towards third parties. Intrusions in HT's ducts by other competitors and some claims of ownership over these assets by the local authorities (the City of Zagreb), may have a material effect on the financial statements in the case that HT will not be able to prove its ownership rights for such ducts. However, HT management believes the likelihood of occurrence of such circumstances is remote. 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 2016 is HRK 857 million (31 December 2015: HRK 812 million).

Leased assets

Equipment includes the following amounts where the Group is a lessee under a finance lease:

	31 December 2016 HRK million	31 December 2015 HRK million
Cost	84	48
Accumulated depreciation	(19)	(13)
Net book value	**65**	**35**

17. Investment property

	HRK million
As at 1 January 2015	
Cost	101
Accumulated depreciation	(45)
Net book value	**56**
Year ended 31 December 2015	
Opening net book value	56
Additions	3
Depreciation charge	(2)
Net book value	**57**
As at 31 December 2015	
Cost	104
Accumulated depreciation	(47)
Net book value	**57**
Year ended 31 December 2016	
Opening net book value	57
Additions	-
Transfers to property, plant and equipment	(11)
Depreciation charge	(2)
Net book value	**44**
As at 31 December 2016	
Cost	83
Accumulated depreciation	(39)
Net book value	**44**

The Group has classified unoccupied buildings and undeveloped land as investment property.

18. Investments accounted for using the equity method

The net book value of investments accounted for using the equity method comprises (financial information for 2016 represents estimations as HT d.d Mostar and HP d.o.o. Mostar did not issue their financial statements up to the date of issuing consolidated financial statements of HT Group):

	31 December 2016 HRK million	31 December 2015 HRK million
Joint venture HT d.d. Mostar:		
As at 1 January	397	393
Prior period correction of error	(22)	-
Share of profit	3	4
Dividends paid	(3)	-
As at 31 December	375	397
Associate HP d.o.o. Mostar:		
As at 1 January	2	2
Share of (loss) / profit	1	(1)
(Impairment loss) / reversal of impairment loss	(1)	1
As at 31 December	2	2
	377	**399**

a) Investment in joint venture:

The Group has an ownership interest of 39.1% in its joint venture HT d.d. Mostar which is incorporated in the Federation 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 the Federation of Bosnia and Herzegovina (50.10%).

The Group's share in HT d.d. Mostar profit for the year ended 31 December 2016 is recognized in the statement of comprehensive income in the amount of HRK 3 million (2015: HRK 4 million). In 2016, HT adjusted net book value of investment in HT d.d. Mostar for HRK 22 million related to correction of the Group's share in HT d.d. Mostar profits in prior periods as a result of misstatement of deferred subsidised customer costs in HT d.d, Mostar financial statements.

In 2016, HT received dividend from HT d.d. Mostar in the amount of HRK 3 million (2015: nil).

b) Investment in associate:

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

Summarised financial information for investments accounted for using the equity method is as follows:

Summarised statement of financial position:	31 December 2016 HRK million	31 December 2015 HRK million
Joint venture HT d.d. Mostar:	Estimated	Actual
Current		
Cash and cash equivalents	100	41
Other current assets	231	231
Total current assets	**331**	**272**
Financial liabilities	1	1
Other current liabilities	294	252
Total current liabilities	**295**	**253**
Non-current		
Non-current assets	**1,234**	**1,343**
Financial liabilities	10	11
Other liabilities	16	28
Total non-current liabilities	**26**	**39**
Net assets	**1,244**	**1,323**
Associate HP d.o.o. Mostar:		
Current		
Cash and cash equivalents	12	11
Other current assets	16	31
Total current assets	**28**	**42**
Financial liabilities	-	-
Other current liabilities	16	15
Total current liabilities	**16**	**15**
Non-current		
Non-current assets	**73**	**58**
Financial liabilities	-	-
Other liabilities	1	2
Total non-current liabilities	**1**	**2**
Net assets	**84**	**83**

Summarised statement of comprehensive income:	31 December 2016 HRK million	31 December 2015 HRK million
Joint venture HT d.d. Mostar:		
Revenue	809	807
Depreciation and amortisation	(223)	(240)
Interest income	5	8
Interest expense	-	(1)
Pre-tax profit	**(48)**	**9**
Income tax expense	-	(3)
Net income	(48)	6
Dividends received	**3**	**-**
Associate HP d.o.o. Mostar:		
Revenue	95	95
Depreciation and amortisation	(3)	(3)
Interest income	1	1
Interest expense	-	-
Pre-tax gain / (loss)	**2**	**(4)**
Income tax expense	**-**	**-**
Net income	**2**	**(4)**
Dividends received	**-**	**-**

Reconciliation of summarised financial information	31 December 2016 HRK million	31 December 2015 HRK million
Joint venture HT d.d. Mostar		
Opening net assets 1 January	1,323	1,313
Profit for the period	9	6
Prior period correction of error	(57)	
Dividends paid	(8)	-
Foreign currency translation	(23)	4
Closing net assets	1,244	1,323
Interest in joint venture 39.10%	487	517
Foreign currency translation	8	-
Impairment	(120)	(120)
Carrying value	375	397
Associate HP d.o.o. Mostar		
Opening net assets 1 January	83	86
Profit / (loss) for the period	2	(4)
Foreign currency translation	-	1
Closing net assets	85	83
Interest in associates 30.29%	26	25
Foreign currency translation	1	1
Impairment	(25)	(24)
Carrying value	2	2

19. Available-for-sale financial assets

Available-for-sale financial assets, at fair value, include the following:

Issuer	Credit rating	Currency	Maturity	31 December 2016 HRK million	31 December 2015 HRK million
Domestic bond:					
Government Republic of Croatia	BB+	HRK	8 February 2017	35	36
Foreign bonds:					
Government of Netherland	AAA	EUR	15 July 2025	-	145
Government of France	AA	EUR	25 May 2024	-	86
Government of Germany	AAA	EUR	15 May 2023	-	83
Government of Germany	AAA	EUR	4 September 2022	-	83
Government of Austria	AA+	EUR	20 October 2025	-	79
Government of Germany	AAA	EUR	15 February 2025	-	76
Government of Netherland	AAA	EUR	15 April 2016		76
Deutsche Telekom	BBB+	EUR	3 April 2020	946	-
Other				14	5
				995	**669**
Non-current				949	591
Current				46	78
				995	**669**

Interest rate on domestic bond is 4.75%. Interest rate on foreign bond is 0.049%.

The estimated fair value of investments in bonds at 31 December 2016 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 belongs to level 1 under the financial instruments fair value hierarchy category. There were no classification changes among financial instruments fair value hierarchy categories in 2016.

20. Inventories

	31 December 2016 HRK million	31 December 2015 HRK million
Merchandise	86	82
Inventories and spare parts	25	28
	111	**110**

21. Trade and other receivables

	31 December 2016 HRK million	31 December 2015 HRK million
Trade receivables	95	70
Other receivables	26	28
Non-current	121	98
Trade receivables	1,276	1,162
Other receivables	52	52
Current	1,328	1,214
	1,449	**1,312**

During 2013, the Group entered into several prebankruptcy settlements with its debtors which stipulate that part of reported current trade receivables is converted to non-current receivables (HRK 32 million) with maturities up to 5 years.

The aging analysis of trade receivables is as follows:

	Total	Neither past due nor	Past due but not impaired				
			< 30 days	31-60 days	61-90 days	91-180 days	>180 days
	HRK million	HRK million	HRK million	HRK million	HRK million	HRK million	HRK million
31 December 2016	1,276	894	278	40	17	36	11
31 December 2015	1,162	914	136	42	19	43	8

As at 31 December 2016, trade receivables with a nominal value of HRK 1,068 million (31 December 2015: HRK 1,117 million) were deemed impaired and fully provided for, and refer to mainly receivable past-due over 180 days.

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

	31 December 2016 HRK million	31 December 2015 HRK million
As at 1 January	1,117	1,150
Charge for the year (Note 10)	90	120
Unused amounts reversed (Note 10)	(58)	(59)
Receivables written-off	(81)	(94)
As at 31 December	**1,068**	**1,117**

22. Prepayments

Prepayments mainly consist of prepaid liabilities for concession fees towards regulator in amount of HRK 177 million (2015: HRK 177 million).

23. Cash and cash equivalents and bank deposits

a) Cash and cash equivalents

Cash and cash equivalents comprise the following amounts:	31 December 2016 HRK million	31 December 2015 HRK million
Cash on hand and balances with banks	1,261	2,057
Commercial papers	982	-
Time deposits with maturity less than 3 months	433	754
Secured deposits (reverse REPO agreements)	-	364
	2,676	**3,175**

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

	31 December 2016 HRK million	31 December 2015 HRK million
HRK	1,175	1,693
EUR	1,406	1,613
USD	76	79
BAM	19	18
GBP	-	2
	2,676	**3,405**

c) Time deposits with maturities more than 3 months

	31 December 2016 HRK million	31 December 2015 HRK million
Foreign bank	-	230
Domestic banks	-	1
	-	**231**

d) Guarantee deposits

	Current		Non-current	
	31 December 2016 HRK million	31 December 2015 HRK million	31 December 2016 HRK million	31 December 2015 HRK million
Foreign bank	11	17	26	43
Domestic banks	1	-	-	-
	12	**17**	**26**	**43**

e) Secured deposits (reverse REPO agreements)

Issuer	Currency	Maturity	31 December 2016 HRK million	31 December 2015 HRK million
Reverse REPO agreements (Note 34 g)):				
Erste Steiermärkische Bank d.d.	HRK	27 January 2016	-	177
Raiffeisen Bank Austria d.d.	HRK	18 April 2016	-	117
Erste Steiermärkische Bank d.d.	HRK	22 February 2016	-	90
Raiffeisen Bank Austria d.d.	HRK	14 January 2016	-	74
Raiffeisen Bank Austria d.d.	HRK	1 February 2016	-	74
Erste Steiermärkische Bank d.d.	HRK	16 January 2017	160	-
Raiffeisen Bank Austria d.d.	HRK	14 February 2017	118	-
Erste Steiermärkische Bank d.d.	HRK	23 January 2017	157	-
Erste Steiermärkische Bank d.d.	HRK	24 January 2017	172	-
Raiffeisen Bank Austria d.d.	HRK	24 March 2017	79	-
Raiffeisen Bank Austria d.d.	HRK	9 May 2017	76	-
Raiffeisen Bank Austria d.d.	HRK	18 May 2017	75	-
Erste Steiermärkische Bank d.d.	HRK	28 April 2017	82	-
Erste Steiermärkische Bank d.d.	HRK	5 May 2017	127	-
Erste Steiermärkische Bank d.d.	HRK	21 April 2017	85	-
			1,131	**532**

Interest rates at 31 December 2016 on reverse REPO agreements range up to 0.35%.

24. Trade payables and other liabilities

	31 December 2016 HRK million	31 December 2015 HRK million
Content contracts	52	60
ECI contracts	79	36
Licence for radio frequency spectrum	9	15
Other	8	32
Non-current	148	143
Trade payables	1,278	1,279
Content contracts	164	175
VAT and other taxes payable	29	69
Payroll and payroll taxes	64	65
Liabilities related to pre-bankruptcy settlements	-	29
ECI contracts	45	34
Licence for radio frequency spectrum	9	8
Other	26	42
Current	1,615	1,701
	1,763	**1,844**

25. Deferred income

	31 December 2016 HRK million	31 December 2015 HRK million
Connection fee	-	2
Deferred equipment rental income	19	-
Non-current	19	2
Prepaid vouchers	45	61
Connection fee	-	1
Other	44	41
Current	89	103
	108	**105**

26. Employee benefit obligations

Long-term employee benefits include retirement payments in accordance with the collective agreement. Jubilee awards were discontinued during 2014. 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 in the period in which they occur.

Long-term employee benefits include a compensation for the employees described in Note 38.

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

	2016 HRK million	2015 HRK million
As at 1 January	**12**	**8**
LTIP – Variable II (Note 38)	3	3
Current portion of employee benefits obligations (Note 27)	(3)	-
Service costs	1	3
Benefit paid	(1)	(1)
Actuarial gains	-	(1)
As at 31 December	**12**	**12**

Retirement	2	2
LTIP – Variable II	10	10
	12	**12**

As at 31 December 2016, the current portion of the provision for LTIP programme amounts to HRK 3 million.

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

	2016 in %	2015 in %
Discount rate (annually)	3.00	4.15

27. Provisions for other liabilities and charges

	Legal claims HRK million	Asset retirement obligation HRK million	Redundancy HRK million	Variable salary HRK million	Unused vacation HRK million	Total HRK million
As at 1 January 2016	**28**	**28**	**4**	**70**	**8**	**138**
Additions	15	-	80	94	4	193
Utilisation	(17)	-	(67)	(96)	(7)	(187)
Reversals	(6)	(13)	-	(2)	-	(21)
Current portion of employee benefits obligations (Note 26)	-	-	-	3	-	3
Interest costs	-	7	-	-	-	7
As at 31 December 2016	**20**	**22**	**17**	**69**	**5**	**133**
Non-current	20	22	-	-	-	42
Current	-	-	17	69	5	91
	20	**22**	**17**	**69**	**5**	**133**

a) Legal claims

As at 31 December 2016, the Group has provided estimated amounts for several legal actions and claims that management has assessed as probable to result in outflow of resources of the Group.

b) Asset retirement obligation

Asset retirement obligation primarily exists in the case of telecommunications structures constructed on third parties' properties. The Group carries out a revision of the necessary provisions every year.

c) Redundancy

Redundancy expenses and provisions include the amount of gross severance payments and other related costs for employees whose employment contracts are terminated during 2016.

28. Issued share capital

Authorised, issued, fully paid and registered share capital:

	31 December 2016 HRK million	31 December 2015 HRK million
81,888,535 ordinary shares without par value	9,823	9,823

The number of shares in issue remained unchanged between 1 January 1999 and 31 December 2016.

In 2016 the Group did not acquire any of its own shares (2015: nil). The Group holds 2,966 of its own treasury shares as at 31 December 2016.

Issued share capital increased in 2015 by amount of HRK 940 million due to partial reinvestment of profit for the year 2014 in accordance with provisions of the related tax regulations (Note 13).

29. 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 share 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 share capital of the Group. These reserves are not distributable.

30. Retained earnings

In 2016, the Group paid a dividend of HRK 6.00 per share (2015: HRK 7.00) for a total of HRK 491 million (2015: HRK 573 million).

31. Commitments

a) Operating lease commitments

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

Operating lease charges:

	2016 HRK million	2015 HRK million
Current year expense (Note 10)	151	134

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

	31 December 2016 HRK million	31 December 2015 HRK million
Within one year	149	137
Between 1 and 5 years	341	381
Greater than 5 years	133	148
	623	**666**

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 2016 HRK million	31 December 2015 HRK million
Intangible assets	108	100
Property, plant and equipment	554	964
	662	**1,064**

32. Contingencies

At the time of preparation of these consolidated financial statements, there are outstanding claims 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 (Note 27).

The Group vigorously defends all of its legal claims and potential claims, including regulatory matters, third party claims and employee lawsuits. 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.

Competition Agency proceedings regarding retransmission

Competition Authority initiated, ex officio, by its decision dated 3 January 2013, formal proceedings against HT relating to potential abuse of dominant position in the market of distribution of premium sport content due to the fact that ArenaSport channels and premium sport content (such as Croatian national league – MAXtv Prva liga, UEFA Champions League and UEFA Europe League) are available only through MAXtv service.

The proceeding is pending.

The pecuniary fine pursuant to the Competition Act is limited to up to 10% of yearly turnover of the Company in the last year for which financial reports have been concluded. Also, according to the Agency´s practice, the fine is usually connected with up to 30% of the turnover acquired from the services provided on the relevant market. On the basis of the results for 2016, 30% of the revenue of MAXtv services would amount to HRK 105 million.

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 16), on 16 September 2008, the Company received a lawsuit filed by the Zagreb Holding Ltd. branch Zagreb Digital City ("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 of up to HRK 390 million plus interest.

This law suit is based on a claim that HT is using DTI owned by the City of Zagreb without any remuneration.

On 10 December 2012, the Company received the partial interlocutory judgement and partial judgement by which it was 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 was rejected. Decision on the litigation costs was left for later judgment. On 21 December 2012, the Company submitted the appeal against this judgment.

On 4 August 2015 the second instance County Court of Varaždin accepted HT's remedy and returned the case back to the first instance court proceeding within which the plaintiff will need to justify its right to file a claim before the court (i.e. to raise an action/ locus standi) as well as to justify and substantially evidence his claim against HT – what kind of DTI, where/ on which location, how and during what period was used by HT.

In June 2016, the plaintiff raised its claim for the additional amount of HRK 90 million; that is fee for usage of the DTI system in the area of Zagreb for period as of June 20, 2011 until June 20, 2012, as to avoid statute of limitation for this period. Therefore, the claim amounts now altogether to HRK 480 million, plus interest.

Based on the merit and development of the above legal proceedings, the Company concluded that the likelihood of an obligation arising from these legal cases is remote and that there was no need to present a provision related to these cases in these financial statements.

33. Balances and transactions with related parties

The transactions disclosed below primarily relate to transactions with the companies owned by 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 2016 and 2015. Further, DTAG provided technical assistance services to the Group of HRK 7 million (2015: HRK 13 million).

The main transactions with related parties during 2016 and 2015 were as follows:

	Revenue		Expenses	
Related party:	2016 HRK million	2015 HRK million	2016 HRK million	2015 HRK million
Ultimate parent				
Deutsche Telekom AG, Njemačka	82	49	127	126
Joint venture				
HT d.d. Mostar, Bosna i Hercegovina	7	6	6	4
Subsidiaries of ultimate parent				
Telekom Deutschland GmbH, Germany	16	10	12	11
T-Mobile Austria GmbH, Austria	3	2	3	1
T-Systems International GmbH, Germany	4	3	14	6
Magyar Telekom Nyrt., Hungary	6	6	5	3
Slovak Telecom a.s., Slovakia	13	4	-	-
Others	14	12	10	8
	145	**92**	**177**	**159**

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

	Receivables		Payables	
Related party:	31 December 2016 HRK million	31 December 2015 HRK million	31 December 2016 HRK million	31 December 2015 HRK million
Ultimate parent				
Deutsche Telekom AG, Germany	21	3	159	117
Subsidiaries of ultimate parent				
Telekom Deutschland GmbH, Germany	-	-	3	2
Magyar Telekom, Hungary	1	2	1	-
Slovak Telecom a.s., Slovakia	10	-	-	-
T-Systems International GmbH, Germany	-	-	6	2
Other	4	4	2	1
	36	**9**	**171**	**122**

At the year end the Group purchased commercial paper of ultimate parent in the amount of HRK 982 millions (Note 23).

The Federal Republic of Germany is both a direct and an indirect shareholder and holds approximately 32 percent of the share capital of DTAG. Due to the average attendance at the shareholders' meetings, the Federal Republic of Germany represents a solid majority at the shareholders' meetings of DTAG, although it only has a minority shareholding, making DTAG a dependant company of the Federal Republic of Germany. Therefore, the Federal Republic of Germany and the companies controlled by the Federal Republic of Germany or companies over which the Federal Republic of Germany can exercise a significant influence are classified as related parties of DTAG, and consequently of the Group as well.

The Group did not execute as part of its normal business activities any transactions that were individually material in the 2016 or 2015 financial year with companies controlled by the Federal Republic of Germany or companies over which the Federal Republic of Germany can exercise a significant influence.

Compensation of the members Supervisory Board

The chairman of the Supervisory Board receives remuneration in the amount of 1.5 times of the average net salary of the employees of the Company paid in the preceding month. To the deputy chairman, remuneration is the amount of 1.25 times 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, remuneration is the amount of 1.5 times 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, remuneration is the amount of 1.25 times 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, remuneration is the amount of 1.25 times 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 2016, the Group paid a total amount of HRK 0.8 million (2015: HRK 0.8 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 2016, the total compensation paid to key management personnel of the Group amounted to HRK 38 million (2015: HRK 38 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:	2016 HRK million	2015 HRK million
Short-term benefits	38	38
	38	**38**

34. 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 (Note 21) 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 2016, the Group had business transactions with seventeen banks (2015: twenty one banks). The Group held cash and deposits in nine banks almost exclusively. For five domestic banks with foreign ownership, the Group received guarantees for deposits placed 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 in 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 2016 HRK million	31 December 2015 HRK million
Trade receivables for rendered telecom services to domestic customers	768	824
Trade receivables for rendered telecom services to foreign customers	45	19
Other trade receivables	81	71
Current	**894**	**914**
Trade receivables from prebankruptcy settlements	32	36
Trade receivables for merchandise sold	63	32
Other receivables	26	30
Non-current	**121**	**98**

Other current receivables are neither past due nor impaired.

The credit quality of all other financial assets (see Note 35): the total carrying amount as at the balance sheet date is considered neither past due nor impaired.

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.

The amounts disclosed in the table are the contractual undiscounted cash flows:

	Less than 3 months	3-12 months	1-5 years	>5 years
31 December 2016	HRK million	HRK million	HRK million	HRK million
Trade and other payables	1,430	13	-	-
Capitalized content rights	58	169	69	-
Finance lease	-	13	44	1
Bank borrowings	3	21	120	151
Capitalized ECI rights	15	46	87	53
Liabilities from pre-bankruptcy settlement	-	-	-	-
Issued bond	2	10	69	8
Other liabilities	20	10	58	24

	Less than 3 months	3-12 months	1-5 years	>5 years
31 December 2015	HRK million	HRK million	HRK million	HRK million
Trade and other payables	1,488	5	10	12
Capitalized rights	55	160	79	-
Finance lease	-	5	10	1
Bank borrowings	3	9	113	180
Capitalized ECI rights	10	29	43	34
Liabilities from pre-bankruptcy settlement	-	31	-	-
Issued bond	1	3	64	24
Other liabilities	-	8	49	22

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, time deposits and bank borrowings

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

	Increase/ decrease in basis points	Effect on profit post tax HRK million
Year ended 31 December 2016		
HRK	+100	16
	-100	(16)
EUR	+100	19
	-100	(19)
Year ended 31 December 2015		
HRK	+100	9
	-100	(9)
EUR	+100	10
	-100	(10)

d) Foreign currency risk

The Group's functional currency is the Croatian Kuna. 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 and equivalents, receivables and payables 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 EUR rate	Effect on profit post tax HRK million
Year ended 31 December 2016	+3%	62
	-3%	(62)
Year ended 31 December 2015	+3%	36
	-3%	(36)

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 business support and maximise shareholder value. The capital structure of the Group comprises of issued share capital, reserves and retained earnings and totals HRK 12,047 million as at 31 December 2016 (31 December 2015: HRK 11,641 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 2016 and 31 December 2015 (Notes 28 and 30).

g) Accepted collaterals

Accepted collaterals for reverse REPO affairs include:

	Credit rating	31 December 2016 HRK million	31 December 2015 HRK million
Foreign bonds:			
Government of Germany	AAA	156	-
Government of Austria	AA+	797	764
Government of France	AA	200	154
		1,153	**918**

All above stated values are fair market values. The accepted collateral is level 1 under IFRS13 categorisation.

h) Offsetting

The following financial assets and financial liabilities are subject to offsetting:

	Trade receivables		Trade payables	
	31 December 2016 HRK million	31 December 2015 HRK million	31 December 2016 HRK million	31 December 2015 HRK million
Gross recognised amounts	106	66	240	185
Offsetting amount	(60)	(54)	(60)	(54)
	46	**12**	**180**	**131**

35. 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 2016 HRK million	31 December 2015 HRK million	31 December 2016 HRK million	31 December 2015 HRK million
Financial assets:				
Cash and cash equivalents	2,676	3,175	2,676	3,175
Guarantee deposits, current	12	17	12	17
Time deposits	-	231	-	231
Available-for-sale assets, non-current	949	591	949	591
Available-for-sale assets, current	46	78	46	78
Secured deposits	1,131	532	1,131	532
Guarantee deposits, non-current	26	43	26	43
Trade receivables – current and non-current	1,371	1,232	1,371	1,232

Fair value of financial assets other than available-for-sale assets are classified as level 3 fair value in the fair value hierarchy due to inclusion of an unobservable inputs such as counterparty credit risk. Available-for sale assets belong to level 1 (Note 19). The fair values in level 3 of the fair value hierarchy were estimated to be equal to their carrying amount.

36. Borrowings

	Carrying amount		Fair value	
	31 December 2016 HRK million	31 December 2015 HRK million	31 December 2016 HRK million	31 December 2015 HRK million
Bank borrowings	198	208	198	208
Issued bond	64	71	64	71
Finance lease	42	11	42	11
Non-current	**304**	**290**	**304**	**290**
Bank borrowings	9	-	9	-
Issued bond	7	-	7	-
Finance lease	13	4	13	4
Non-current	**29**	**4**	**29**	**4**
Total	**333**	**294**	**333**	**294**

The fair value of borrowings has been calculated by discounting the expected future cash flows at prevailing interest rates, and they belong to level 2 under financial instruments fair value hierarchy category, except for the bond which is level 1. The weighted average interest rate for borrowings amounts to 4.53% at 31 December 2016 (31 December 2015: 4.54%).

Currency breakdown of financial liabilities

	31 December 2016 HRK million	31 December 2015 HRK million
HRK	64	72
EUR	198	207
	262	**279**

Issued bond

Pursuant to the prebankruptcy settlement, the issued bonds are debt securities with multiple maturities. In the period from 30 May 2014 to 30 May 2017 the Group will pay semi-annual interest at interest rate of 5.25% per year, and principal will be repaid from 30 May 2017 to 30 May 2022.

Finance lease liability breakdown

Commitments in relation to finance lease are payable as follows:	31 December 2016 HRK million	31 December 2015 HRK million
Within one year	13	5
Later than one year but not later than five years	44	10
Later than five years	1	1
Minimum lease payments	**58**	**16**
Future finance changes	(2)	(1)
Recognised as a liability	**56**	**15**
The present value of finance lease liabilities is as follows:		
Within one year	13	4
Later than one year but not later than five years	42	10
Later than five years	1	1
Minimum lease payments	**56**	**15**

37. Authorization for Services and Applicable Fees

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

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

On 1 July 2008, a new Law on Electronic Communications entered into force and introduced general authorization for all electronic communications services and networks. In the meantime, four Amendments to the Law on Electronic Communications entered into force and were published in the Official Gazette No. 90/11, 133/12, 80/13 and 71/14. 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 3 November 2015:

- 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),
- premium rate and freephone 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 in the Republic of Croatia, and
- other services.

On 26 February 2013 the Croatian Regulatory Authority for Network Industries (HAKOM) issued to the Company special authorization to perform account reconciliation of accounts for the provision of electronic communications services in maritime for a period of 10 years i.e. till 26 February 2023.

In accordance with HAKOM's decision of 23 September 2015, the Company was designated as the Universal services provider in the Republic of Croatia for a period of four years with the obligation to provide following universal services during the mentioned period:

- access to the public communications network and publicly available telephone services at a fixed location, allowing for the voice communications, 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 as well as the technological feasibility,
- setting up of public pay telephones or other publicly available access points for the public voice service 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 or other

publicly available access points for the public voice service and their accessibility for disabled persons,
- special measures for disabled persons, including access to services under 1 and 2 above, including the access to emergency services, equivalent to that enjoyed by other end-users, and
- special pricing systems adjusted to the needs of the socially disadvantaged groups of end-users, that comprise the service under item 1 above.

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, the Company shall continue to provide the service on commercial basis.

b) Authorization for usage of radio frequency spectrum

HAKOM issued to the Company the following licenses for use of the radio frequency spectrum for public mobile electronic communications networks:

- licence for the use of radio frequency spectrum in 900 MHz and 1800 MHz frequency bands with the validity from 1 December 2011 until 18 October 2024,
- licence for the use of radio frequency spectrum in 2100 MHz frequency band with the validity from 1 January 2010 until 18 October 2024,
- licence for the use of radio frequency spectrum in 800 MHz frequency band with the validity from 29 October 2012 until 18 October 2024,
- licence for the use of radio frequency spectrum in 800 MHz frequency band with the validity from 6 November 2013 until 18 October 2024, and
- licence for the use of radio frequency spectrum in 1800 MHz frequency band with the validity from 22 December 2013 until 18 October 2024.

HAKOM also issued to the Company licences for the use of radio frequency spectrum for satellite services (DTH services) with the validity from 12 August 2015 until 11 August 2020.

c) Fees for providing electronic communications services

Pursuant to the Law on Electronic Communications, the Group is obliged to pay the fees for the use of addresses and numbers, radio frequency 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 radio frequency spectrum).

In 2016, the Group paid the following fees:

- the fees for the use of addresses, numbers and radio frequency spectrum pursuant to the ordinance passed by the Ministry of the maritime affairs, transport and infrastructure (in favour of State budget, Official Gazette No. 154/08, 28/09, 97/10, 92/12, 62/14, 147/14, 138/15 and 77/16)
- fees for the use of assigned radiofrequency spectrum pursuant to the Decision on the selection of the preferred bidder of November 6, 2013 and
- the fees for use of addresses, numbers, radio frequency 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 No. 122/15)

d) Audiovisual and electronic media services

Pursuant amendment of the Law on audiovisual activities, which entered into the force in July 2011, the Group 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 Group (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 Group 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.

Licences are not issued to all members of the Group.

e) Electronic communications infrastructure and associated facilities

The Company, as the infrastructure operator, is obligated to pay fees for the right of way in amount that the Company contracted with land owners or accordance with the Law on Electronic Communications. The fees for the right of way are defined by the Ordinance on Certificate and Fees for the Right of Way (Official Gazette No. 152/11 and 151/14) that was adopted by HAKOM in December 2011 and became 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.

f) Supply of electricity

Croatian Energy Regulatory Agency (HERA) has reissued a licence for energy activities relating to supply of electricity to the Company on 16 October 2016 for a period of five years.

38. Share-based and non share-based payment transactions

Long-term incentive plans, HT Variable II 2013, HT Variable II 2014 and Lead to Win 2015 and Lead to Win 2016 currently exist at Group level.

Lead to Win is a new DT model of performance management for Executives adapted for the local needs and it integrates target management, performance and potential review (PPR) and succession management. This model is based on clear and transparent link between performance rating and rewards for short term incentive STI, LTI (Long term incentive) and SMP (Share matching Plan), based on DT share. Eligibility and grant-value depend on individual performance and MG (Management Group) level (MG1 – MG3), and MG1 represents the highest level managerial positions.

LTI plan, as a part of Lead to Win model is a global Deutsche Telekom Group's (DT Group) 2016, Group-wide compensation instrument. The aim of the 2016 LTI is to enhance willingness to take on entrepreneurial responsibility and identification with DT Group and thus boost the Group's value in the medium to long-term. This leads to a greater balance of management and shareholder interests. The term of the 2016 LTI shall cover the period from 1 January 2016 to 31 December 2019.

HT Variable II 2012 ended on 31 December 2015, and the Supervisory Board has determined final target achievement of 11,5%. In accordance to this achievement, in June 2016 the awarded amount was paid to participants.

HT Variable II 2013 and HT Variable II 2014 are cash-based plans with four equally weighted performance parameters that cannot be changed during plan duration. Two targets are financial KPIs, adjusted Earnings Per Share (EPS) and adjusted operating Return On Capital Employed (ROCE), third and fourth targets are customer and employee satisfaction. Duration of the plan is four years effective from 1 January every year.

Upon expiry of the term of the plan, the HT Supervisory Board shall determine whether each of the targets has been achieved. Based on the findings of the HT Supervisory Board, the HT Management Board determines and announces the level of target achievement.

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

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.

LTI as part of Lead to Win Program 2015 and 2016 are also cash based plan, and awarded amount depends on MG (Management Group) to which positions of participant belongs and on individual performance. Participants can be only those who meet at least performance rating 3 (score range is from 1 to 5). Based on this the amount shall be from 10% to 30% of the annual target salary depending on MG and on individual performance rating. The relevant amount will be converted into a number of phantom shares in DTAG divisible by four and awarded to the future plan participant in the form of shares The number of phantom shares is linked to four equally weighted success parameters. The target values of the success parameters are set at the beginning of the four-year plan term, and at the end, the total number of received phantom shares, that is dependent on the achievement of defined targets, will be converted into a cash amount to be paid to participants of the plan. An interim value shall be determined for each annual tranche. The plan currency is euros, and four defined success parameters are DT parameters.

Success parameters are: ROCE (Return on Capital Employed), Adjusted EPS (Earnings per Share), Customer satisfaction and Employee satisfaction. The success parameters have a target achievement corridor of between 0% and 150% and the shares awarded (basic number) correspond to target achievement of 100%.

The DTAG Supervisory Board determines the target achievement after the end of each year of the plan period. Based on the levels determined, the DTAG Board of Management determines the target achievement for the plan participants On this basis, the responsible bodies or committees of the participating companies shall take the necessary measures for these companies.

The (Matching Share Plan) MSP 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).

As a part of Lead to Win Program 2015 and 2016, Share Matching Plan was introduced for managers in Managements Groups MG1, MG2 and MG3. The share matching plan is a long-term voluntary compensation instrument, which makes the executives co-owners of the DT and enables them to benefit from the success of the DT share. The amount of the voluntary personal investment is between 10% and a third of the gross payment amount of the Short Term Incentive payment for previous year. The term of the 2016 SMP shall cover the period from July 1, 2016 to June 30, 2020. The shares in DTAG purchased as part of the voluntary personal investment are locked for the entire period and labelled with a corresponding lock indicator. At the end of the plan term the plan participant will be granted DTAG shares free of charge. The ratio between the number of shares purchased as part of the voluntary personal investment and the number of matching shares will depend on the personal performance of the plan participant.

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.

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

	2016 HRK million	2015 HRK million
Expenses	(1)	(2)
	(1)	**(2)**

39. Auditor’s fees

The auditors of the Group’s financial statements have rendered services of HRK 5 million in 2016 (2015: HRK 4.8 million). Services rendered in 2016 and 2015 mainly relate to audits and reviews of the financial statements and audit of financial statements prepared for regulatory purposes.

40. Events after reporting period

In January 2017, the Group signed a Sale and Purchase agreement to acquire majority shareholding in Crnogorski Telekom AD Podgorica from Magyar Telekom NYRT Hungary. The transaction will be executed through purchase of a SPV entity which holds 76.5283% shares of Crnogorski Telekom AD. Since the entities involved in this transaction are all part of the DT Group, the Group intends to record all assets acquired, liabilities assumed and any non-controlling interest in the acquire using the predecessor accounting method. The fair value of consideration transferred in this transaction was HRK 933 million. Preliminary estimate of net assets of Crnogorski Telekom AD at acquisition date amounts to HRK 1,143 million.

CONTACTS

Hrvatski Telekom d.d.
Corporate Communications
Roberta Frangeša Mihanovića 9
10000 Zagreb, Croatia
Phone: +385 1 49 12100
Fax: +385 1 49 12133
E-mail: pr@t.ht.hr
www.t.ht.hr

Please refer all questions relating
to HT Shares to:

Hrvatski Telekom d.d.
Investor Relations
Roberta Frangeša Mihanovića 9
10000 Zagreb, Croatia
Phone: +385 1 49 11114
Fax: +385 1 49 12012
E-mail: ir@t.ht.hr