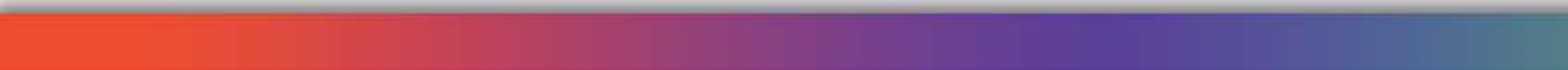
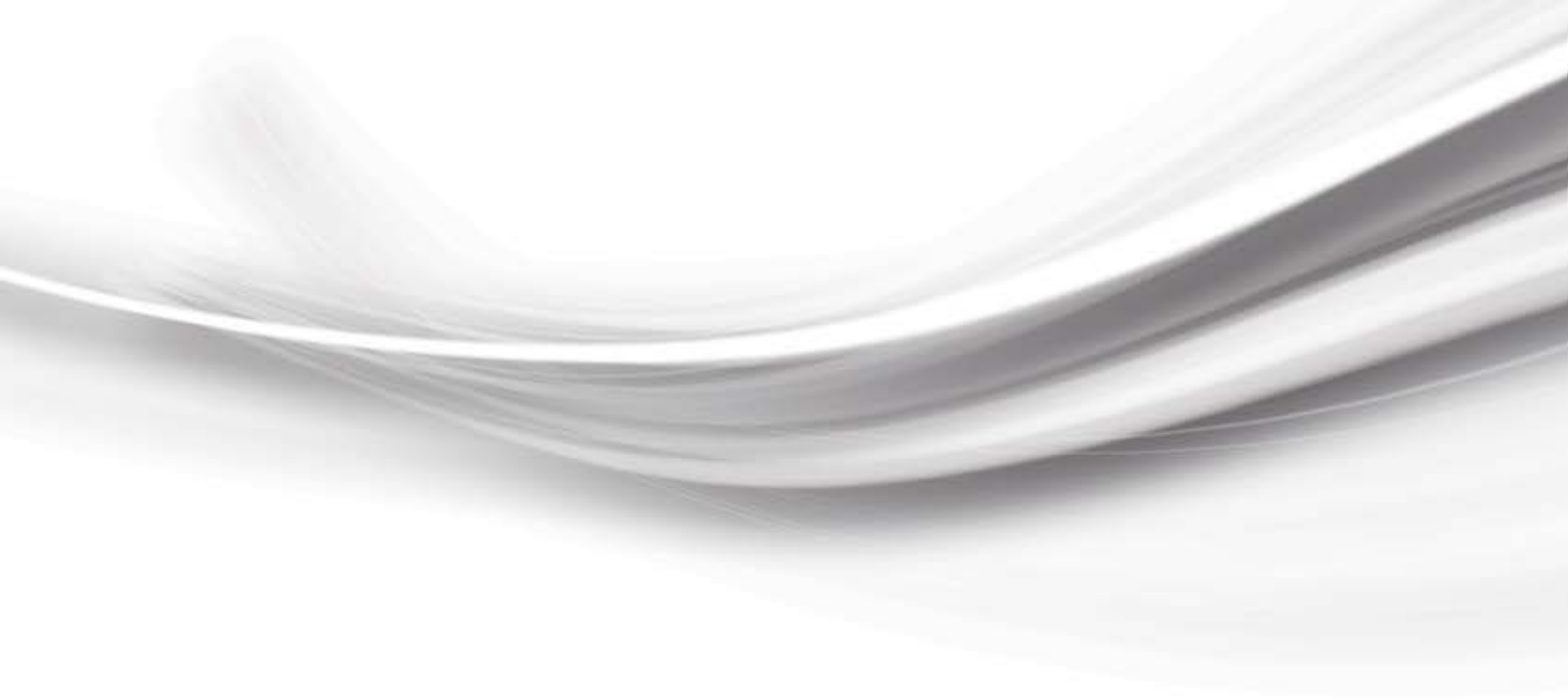


2012.



ANNUAL BUSINESS REPORT
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FOR 2012

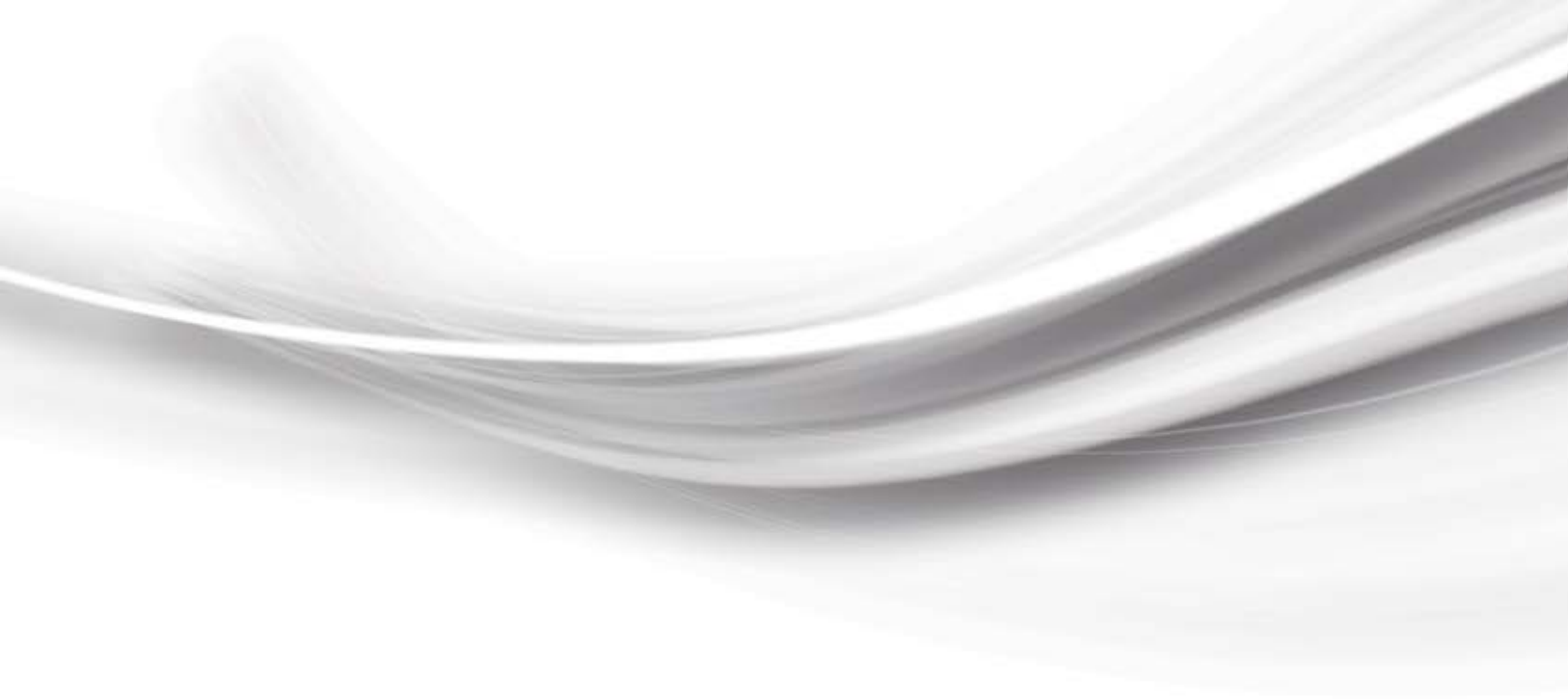






**ANNUAL BUSINESS REPORT
TELEKOM SRBIJA A.D.
FOR 2012**





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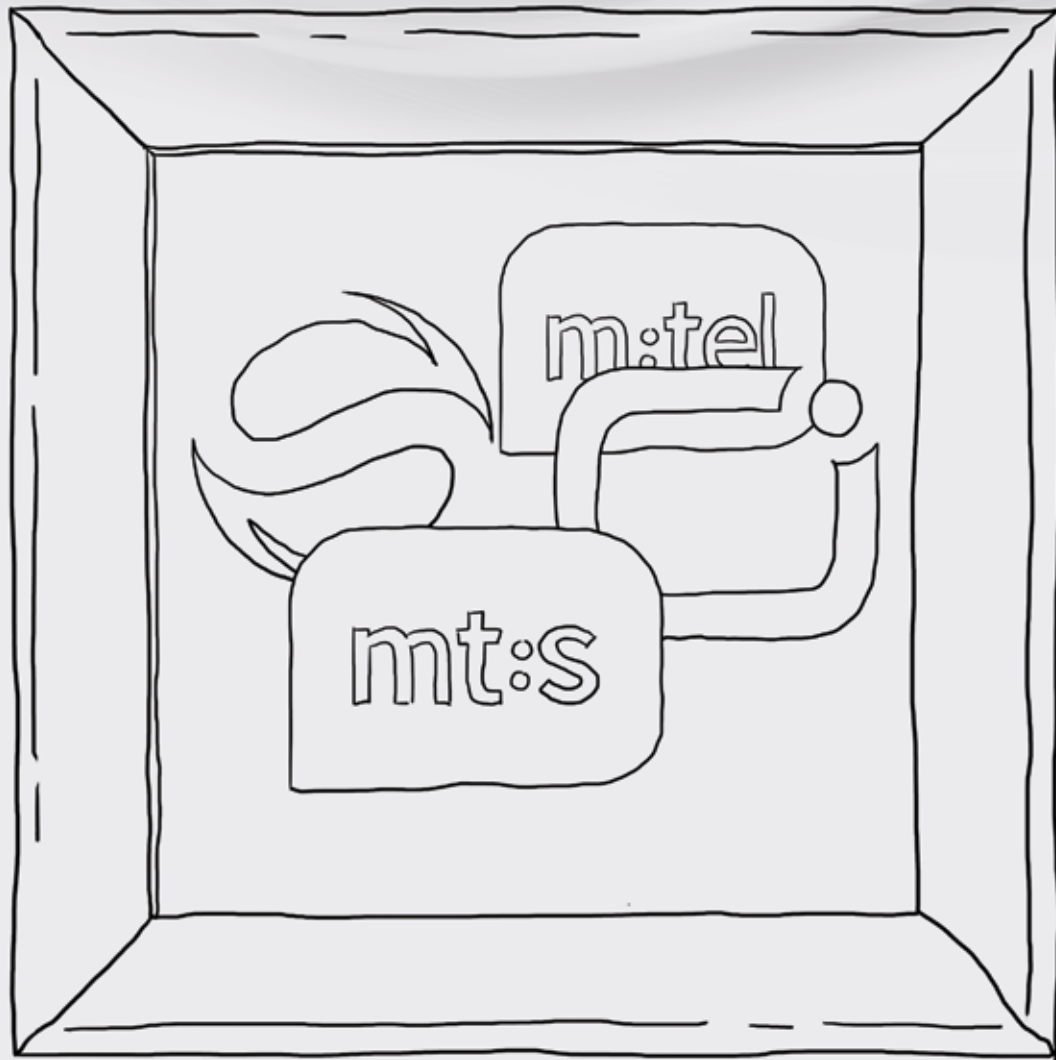
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SUMMARY REPORT

SUMMARY REPORT

TELECOMMUNICATIONS COMPANY TELEKOM SRBIJA A.D. AND SUBSIDIARIES

Telecommunications company Telekom Srbija a.d., Belgrade

Telecommunications Company Telekom Srbija a.d. (hereafter: Telekom Srbija or Company), in keeping with the Law on Electronic Communications (the Official Gazette of the Republic of Serbia No. 44 of 30 June 2010 – hereafter: Law on Electronic Communications) and the licences issued by the relevant regulatory body (hereafter: RATEL), performs the activity related to electronic communications, which comprises the construction or installation, maintenance, operation and lease of the public communications networks and the accompanying assets and provision of the publicly available electronic services.

Upon its incorporation in 1997, under the then applicable law, Telekom Srbija acquired the right to perform the telecommunications activity.

The Company held the position of as an exclusive fixed telephony operator until 9 June 2005, when, in compliance with the Telecommunications Law (the Official Gazette of the Republic of Serbia No. 44 of 24 April 2003 with Amendments No. 36 of 27 April 2006 (hereafter: Telecommunications Law), such position ceased to exist in legal terms. In accordance with the then applicable Law on Telecommunications, on 13 April 2007, the Company was granted the Licence by RATEL, by a substitution procedure, for construction, possession and operation of the public fixed telecommunications network and provision of services of the public fixed telecommunications network.

During 1998, the Company introduced the GSM mobile telephony network and commenced the provision of mobile telephony services. On 28 July 2006, pursuant to the Telecommunications Law and the Rules on the number of and the period for which the licence for the public mobile telecommunications networks and services is issued and the minimum requirements and lowest one-off licence fee

(the Official Gazette of the Republic of Serbia No. 29. of 7 April 2006), RATEL granted to the Company, by a procedure of substitution of the applicable GSM/GSM1800 licence, the Licence for the public mobile telecommunications network and services of the public mobile telecommunications network, in keeping with the GSM/GSM1800 and UMTS/IMT-2000 standard.

On 16 June 2009, the Parent Company obtained the Licence for the public fixed wireless telecommunications network (FWA) in the frequency band of 411.875-418.125/421.875-428.125 MHz and voice services, packet switched data and simultaneous voice and data transmission (CDMA Licence). The Licence was issued for the period of 10 years, and the commercial operation was to commence within six months from the Licence effective date.

Beside the above mentioned Licences, Telekom Srbija was registered in the registry of operators kept by RATEL for the service related to the broadband network access and distribution of the media content.

On 31 December 2012, Telekom Srbija's share in the capital of the subsidiaries is as follows:

	Share percentage
Telekom Srpske a.d., Banja Luka	65 %
mtel DOO, Podgorica	51 %
Telus a.d., Beograd	100 %
FiberNet DOO, Podgorica	100 %
TS:NET BV, Amsterdam	100 %
HD-WIN d.o.o., Beograd	51 %

Telekomunikacije Republike Srpske a.d. Banja Luka, (hereafter: Telekom Srpske) with the registered seat at Banja Luka is engaged in the provision of telecommunications services in the fields of the fixed and mobile telephony in the national and international traffic, Internet and multimedia services as its core activity.

Telecommunications Company "mtel" DOO, Podgorica (mtel) is engaged in the provision of telecommunications services in the field of mobile and fixed wireless telephony and Internet services, as its core activity.

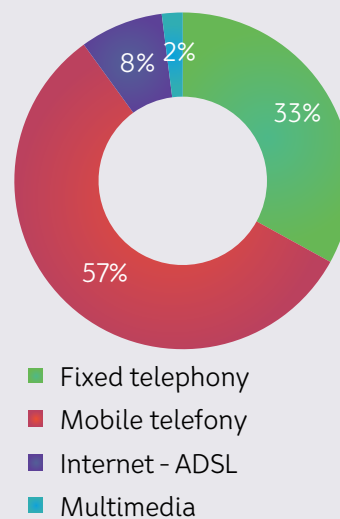
The Business Company for the Maintenance and Security of Facilities, Property and Other Services "TELUS" a.d, BEOGRAD (Telus) provides the following services, within its registered activity: security of facilities and property (FTO-physical and technical security, PPZ- fire protection and money escort services, maintenance of hygiene in business premises and buildings and services related to auxiliary jobs.

The core activity of Telecommunications Company "FiberNet" DOO (hereafter: FiberNet) is the construction, possession, operation and maintenance of the transport and telecommunications network and provision of telecommunications services.

The core activity of Business Company TS:NET, B.V., with the seat in Amsterdam, the Netherlands (hereafter: TS:NET, B.V.) is the lease of telecommunications equipment and performance of the related activities for the purpose of creating the conditions for the construction and operation of the international transport network of the Parent Company.

Telecommunications Company "HD-WIN" d.o.o. (hereafter: HD-WIN) deals with cable telecommunications via TV Channel Arena Sport and holds the right to broadcasting the sports channels in the territory of Serbia, Bosnia and Herzegovina, Montenegro and Croatia.

KEY BUSINESS INDICATORS



Users of the Company services per segment

The core activity of the Company is provision of services in the field of telecommunications so that the key segments of operation are fixed telephony, mobile telephony, Internet and multimedia.

The number of users of the fixed telephony in 2012 was 2,921,440, mobile telephony - 5,028,882, Internet - ADSL - 639,699 and multimedia - 191,621.

The traffic in the segment of fixed telephony in 2012 was 8,488 million minutes, while the traffic generated in mobile telephony y 2012 reached 5,152 million minutes.

The average monthly revenue per user (ATPU) in fixed telephony is 242 dinars and in mobile telephony 81 dinars.

In RSD	2012	2011
Fixed telephony	895	934
Mobile telephony	421	400

The average revenue per fixed and mobile customer (ARPU)

In RSD	2012	2011
Fixed telephony average	895	934
Residential customers	762	778
Business customers	2,052	2,292

The average monthly revenue (ARPU) in the segment of fixed telephony

In RSD	2012	2011
ADSL retail	1,300	1,204
Mobile internet	381	543
IPTV	699	670

The average monthly revenue (ARPU) in the segment of Internet and multimedia

In RSD	2012	2011
Mobile telephony average	421	400
Prepaid	257	273
Postpaid	937	853
Biznet	697	673
Blackberry	1,283	1,319

The average monthly revenue (ARPU) in the segment of mobile telephony

INTRODUCTORY NOTE BY THE DIRECTOR GENERAL

Dear Sirs,

The past year was one of many challenges which were primarily manifest in macro-economic instability and stronger competition in all business segments. Despite the unstable business environment, we managed to achieve satisfactory results.

On the market of the Republic of Serbia, we succeeded in maintaining business revenues on last year's level, whereas we saw growth on a consolidated level. In the course of 2012, operating expenses grew faster than operating revenues primarily because a substantial part of our costs is linked to a foreign currency (primarily EUR). This situation led to a decrease in operating results. Net profit significantly dropped as compared to the previous year, mostly as a result of foreign exchange losses and/or the aforementioned dinar depreciation.

During 2012, we purchased 20% of the shares from the minority shareholder and provided for an unhindered distribution of free shares to citizens and both current and former employees. This transaction was funded from external sources, which led to higher indebtedness.

A drop in the number of customers and the amount of traffic in fixed telephony is a global trend, which is also true of our operations. Due to a significant pressure from competitor companies, the number of mobile customers in the prepaid segment fell, whereas we managed to increase the number of customers in the post-paid segment with attractive packages. The number of our broadband customers is steadily on the increase, whereas the highest customer growth rate is seen in the sphere of multimedia.

Our integrated package of fixed, mobile, Internet and multimedia services, Box, has become a recognizable brand on the Serbian market, which distinguishes us from competitor companies.

We streamlined the mobile network and provided to our customers better quality services and faster data transmission rates.

The number of our Company's employees is stable and despite the inflation rate in 2012, we invested significant efforts in preventing more substantial cuts in salaries of our workers in real terms.

In the course of 2012, we paid some 11 billion dinars in dividends to our shareholders based on the results achieved in 2011.

The low purchasing power of the population, high unemployment rate and emergence of new and strengthening of current competitor companies in all operating spheres describe the business climate in 2013 as well, which adds pressure to the preservation of business results.

A drop in the revenues from traditional services is imminent and a more dynamic growth in the multimedia and broadband spheres is expected. The share of the two segments accounts for some 10% of the operating revenues on a consolidated level and significant efforts being invested are expected to increase the share of these segments in the operating results.

Given that a more significant increase in operating revenues can hardly be expected in the period to come, it is necessary to put additional pressure on operating expenses in order to maintain the Company's successful business operation in 2013.

The business year 2013 will also be marked by a substantial pressure on the Company's liquidity due to the servicing of current liabilities, primarily a syndicated loan which ensured funds for the purchase of 20% of the shares from the minority shareholder, OTE, on one hand, and extensive investments planned by the Company, on the other.

Extensive investments are planned in all business segments in order to provide higher quality services to our customers and maintain the current competitive advantage.

Despite all the challenges that we are confronted with, I believe we will continue successfully to operate on all markets in which we are present, that we will continue successfully to manage all available resources, both human and material, and that our good strategic decisions will help us to retain the regional leader position both in the sphere of business and corporate social responsibility, which is something we are recognized for in the Republic of Serbia and other markets on which we operate.

I am using this opportunity to thank our shareholders, all business partners and all employees, and particularly our customers who placed their confidence in us and who will continue to be in the focus of our activities and efforts in the future as well.

I invite you to maintain our business cooperation in which the success will be mutual.

Best regards,

Predrag Ćulibrk

Director General
of Telekom Srbija

2012.
We acquired the ownership of 20% of basic capital shares which were held by O.T.E.

2010.
Serbian government acquired the ownership of 80% of Telekom Srbija a.d. shares

2009.
We generated record profits from the launch of multimedia services (IPTV)

2008.
We conducted reorganization in accordance with the service convergence concept

2007.
We saw regional expansion towards B-H and Montenegro

2006.
We introduced 3G technology and the provision of ADSL Internet services

2003.
PTT became the owner of 80% of the stake after the purchase of shares from Telekom Italia

1998.
We commenced the provision of mobile telephony services.

1997.
Telekom Srbija a.d. was founded as a company and as of June that same year, it was owned by three shareholders: PE PTT Traffic Srbija, OTE Greece and Telecom Italia

DEVELOPMENT AND BUSINESS ENVIRONMENT

BACKGROUND

Telekom Srbija

May 1997

- The Public Enterprise of PTT Traffic "Srbija" (hereafter: PE PTT) founded Telekom Srbija as single-member joint-stock company.

June 1997

- Within the privatization of a part of the capital, 49% of shares were sold to STET INTERNATIONAL NETHERLANDS N.V., the affiliation of the Italian Telecommunications Company Telecom Italia in the Netherlands (29% of shares) and to Greek Telecommunications Company HELLENIC TELECOMMUNICATIONS ORGANIZATION S.A. (OTE) (20% of shares).

February 2003

- An agreement was concluded whereunder PE PTT bought back the entire package of shares of Telekom Srbija in the ownership of Telecom Italia and thus acquired a total of 80% shares in Telekom Srbija, while the outstanding 20% of shares remained in the ownership of OTE.

September 2010

- Based on the Conclusion of the Serbian Government 05 number 023-6816 of 21 September 2010 and Decision of the Managing Board of PE PTT of 20 September 2010 on the free transfer of shares in Telekom Srbija to the Republic of Serbia, the PE PTT and the Serbian Government concluded the Agreement on the Free Transfer of Telekom Srbija's Shares - Gift on 24 September 2010. By virtue of this agreement, the Republic of Serbia became the majority owner of Telekom Srbija and acquired the ownership right to 80% of the shares in Telekom Srbija, while 20% of the shares remained in the ownership of OTE.

December 2011

- On 16 December 2011, the General Meeting of Telekom Srbija passed the Decision on the Acquisition of Own Shares, No.399837/5. The conclusion of the Share Sale Agreement between Telekom Srbija and Hellenic Telecommunications Organization S.A. was approved by the

General Meeting in its decision No. 413850/3 of 29 December 2011. On 30 December 2011, the Agreement on the sale and purchase of all OTE's shares in the Company was signed.

January 2012

- On 25 January 2012, Telekom Srbija paid in full the funds for the stake of the minority shareholder OTE in the capital of Telekom Srbija. From that date on, Telekom Srbija has been the owner of 20% of the shares of Telekom Srbija and own shares.

May 2012

- Under the Decision of the Serbian Government on the free transfer of shares to the citizens - right holders and employees and former employees of Telecommunications Company Telekom Srbija a.d. of 27 April 2012, and in accordance with the Law on the right to free shares and a monetary compensation exercised by citizens in the privatization procedure (the Official Gazette of RS, No. 123/07 and 30/10), the procedure for and the manner of the transfer of free shares of Telekom Srbija to the citizens as the holders of such right and employees and former employees of Telekom Srbija, including the employees and former employees of PE PTT and their legal predecessors were defined, and based on such procedure the distribution of free shares was carried out. After the distribution of free shares, the structure of Telekom Srbija's equity changed so that the stake of the Republic of Serbia was 58.11%, the stake of Telekom Srbija was 20%, the Serbian citizens acquired 14.95% and the employees and former employees acquired 6.94% of shares in Telekom Srbija.

MARKET

Macroeconomic data

The effects of the world financial crisis that were first observed in the Republic of Serbia in the last quarter of 2008 caused the liquidity problems, currency fluctuation and further decrease in the value of dinar as compared to the foreign currencies and

decline in the economic activity in general and the spending capacity of the citizens and economy also during 2012.

The overall economic activity in 2012 measured by gross domestic product (GDP) in permanent prices resulted in a real decrease of 1.7%. The GDP, as expressed in an absolute amount, was EUR 28,692 million.

The industrial production in 2012 resulted in an inter-annual decrease by 2.9%. Viewed per sector, in December 2012, as compared to the same month in 2011, the following trends were observed: Processing Industry - a 1.8% growth, Supply of electric power, gas, steam and air conditioning - a 1.6% decrease, and Mining Industry- a 4.7 % decrease.

The export of goods, expressed in Euros, increased by 4.7% in 2012, while the import of goods increased by 3.7% relative to 2011. The deficit expressed in Euros amounts to 5,945.6 million, which accounts for a 2.4% increase as compared to the same period in the previous year. The export/import coverage index is 59.7%, which is higher than the percentage for the same period in the previous year (59.3%).

In the first two quarters of 2012, the inflation was within the targeted limits of inflation, but, in the third quarter the inflation significantly increased which, at the end of 2012, resulted in the inter-annual inflation growth of 12.2%.

The targeted inflation for the end of 2012 and 2013 was projected in the range from 2.5% to 5.5%. According to the notification by the National Bank of Serbia, the major deviation from the projected targeted inflation is the result of the growth in food prices, depreciation of the Dinar and increase in the VAT rate and excise taxes. The inter-annual inflation is expected to decline as of the second quarter of 2013 and go back to the targeted limits by the end of the year.

The total number of employees in Serbia in 2012 is 1.1% lower than in the previous year. In 2012, the unemployment rate reached 22.4%, while in 2011 it was 23.7%.

The average salary without taxes and contributions paid in 2012 in the Republic of Serbia, as compared to 2011 was higher by 9.0% in nominal terms, and 1.1% in real terms. The average gross salary in 2012 amounted to 57,430 dinars, while the average net salary of the employees in the Republic of Serbia in 2012 amounted to 41,377 dinars.

At the beginning of 2012, the reference interest rate was 9.75%. By the end of 2012, the reference interest rate was raised by 1.75%, and reached 11.25% at the end of the year. In early 2013, the reference interest rate increased and reached 11.75% in March 2013.

The fiscal deficit in 2012 was around 6.4% of the GDP.

In August 2012, Serbia's credit rating was downgraded to BB-.

Regulations

The Company performs the activity of electronic communications, in accordance with the Law on Electronic Communications and the relevant by-laws. The adoption of the Law on Electronic Communications is under way and shall be adjusted to the EU regulatory framework.

The following regulatory activities had the major implications on the Company's operation in 2012:

I. Based on the authorizations granted by the Law on Electronic Communications, RATEL rendered a decision at the end of 2011 (more precisely on 29 November 2011) declaring the Company as an operator with significant market power (SMP) on the following markets subject to ex-ante regulation :

- I - retail market for the access to the public telephone network on a fixed location,
- II - wholesale market for call origination in the public telephone network on a fixed location:
- III - wholesale market for call termination in the public telephone network:
- IV - wholesale market for (physical) access to the

network elements and the accompanying equipment (including shared and full unbundled local loop access):

- V - wholesale market for broadband access:
- VI - wholesale market for leased lines:
- VII - wholesale market for call termination in the mobile network:
- VIII - retail market for a publicly available telephone service on a fixed location,

In keeping with the above, the Company was declared as an SMP operator on 8 out of 9 markets subject to ex-ante regulation, i.e. on all such markets except for the retail market for the distribution of the media content and it thereby assumed at least 4 out of a maximum of 8 possible obligations on each of these markets.

One of the significant obligations assumed thereunder is an obligation of publishing the relevant data in the form of a standard offer within 60 days from the date of receipt of such request by RATEL.

According to RATEL's request, the Company has prepared the following standard offers:

- The standard offer for the services of interconnection with the public fixed communications network of Telekom Srbija a.d. - effective since 1 June 2012,
- The standard offer for the service of call termination in the mobile network of Telekom Srbija a.d. (interconnection) - published on 19 February 2012 and effective within 30 days from the date of publications on the web Internet page of Telekom Srbija,
- The standard offer for the service of unbundled local loop access in Telekom Srbija a.d. - effective since 1 June 2012,
- The standard offer for the services of access to the network elements and accompanying equipment of Telekom Srbija a.d. - effective since 1 June 2012,
- The standard offer for the lease of lines in wholesale of Telekom Srbija a.d. - published on 19 February 2012 and effective within 30 days from the date of publication on the internet web page of Telekom Srbija,
- The standard offer for the services of broadband

access in wholesale of Telekom Srbija a.d. - published on 19 February 2012 and effective within 30 days from the date of publication on the internet web page of Telekom Srbija,

Pursuant to the decisions passed by RATEL declaring Telekom Srbija as an SMP operator, the Company had to assume the obligation on all said markets to apply the cost-based accounting, in line with the Rules on the application of the cost-based principle, separate accounts and reporting by the SMP operators in the field of electronic communications (the Official Gazette of RS No. 52 of 15 July 2011).

2. In November 2012, RATEL postponed, until further notice, the commencement of application of the Rules on number portability in public telephone networks on a fixed location (the Official Gazette of RS No. 52/2011), which were to become effective on 1 December 2012.

On 4 June 2011, the Company Law came into force (the Official Gazette of RS No. 36 of 27 May 2011), and became effective as of 1 February 2012.

Under the Law on the amendments to the Company Law (the Official Gazette of RS No. 99 of 27 December 2011), the deadline was postponed from 1 February 2012 to 30 June 2012, when the existing joint stock companies are bound to harmonize their incorporation by-laws, articles of association and governance bodies with the provisions of the Company Law, which Telekom Srbija did.

In relation therewith, the General Meeting of Telekom Srbija, at its 43rd regular session held on 20 April 2012, rendered the Decision on the organization of Telecommunications Company Telekom Srbija a.d. for the purpose of harmonizing thereof with the Company Law (memorandum of Incorporation) and Articles of Association of Telekom Srbija a.d. In keeping with the Articles of Association, the structure of Telekom Srbija's governance bodies consists of: the General Meeting, the Supervisory Board and the Executive Board.

Telecommunications market

The telecommunications market in the Republic of Serbia has been structured and gradually deregulated per business segment since 2006.

Although the general slow-down of operating activities is notable in most industries, telecommunications are still yielding significant results and considerably contribute to social progress, which particularly refers to the information technologies industry. The total share of telecommunications in the GDP of the Republic of Serbia in 2012 was almost 6%.

The development of the IT industry is subject to the relevant legal and regulatory activities, including the adoption of the Strategy for the development of information society in Serbia, introduction of e-government in many state institutions and deregulation of the regulatory framework.

The fixed telephony market seems to have entered the phase of stagnation primarily due to the increasing share of mobile telephony. Yet, the importance of this market is still high which is evidenced by the fact that there are companies that are about to start operations in this segment.

Beside Telekom Srbija, the following telecommunications companies have been operating on the fixed telephony market since 2009: Orion Telekom d.o.o., formerly Media Works, Telenor d.o.o., which obtained the licence for the public fixed telecommunications network and services in 2010 and, since 2012, SBB and IKOM Telefon, the cable and internet operators that have been using the Internet as a voice transmission technology.

The operation of Telekom Srbija in the segment of fixed telephony remains dominant both in the financial and the technical sense.

As for the mobile telephony market, there are still three operators: Telekom Srbija, Telenor d.o.o. and Vip Mobile d.o.o. All the three operators possess the licence for the public mobile telecommunications network and services of the public mobile telecommunications network in compliance with the GSM/GSM1800 and UMTS/IMT-2000 Standard, issued

by Ratel. Such licences were issued for the territory of the Republic of Serbia for the period of 10 years, whereafter the licence validity is extended for the period of next 10 years without the request of the licence holder, provided all licence terms are fulfilled.

Several segments of mobile telephony are in a stable phase, recording a mild increase in the number of customers, primarily the users of postpaid services. The ADSL retail segment is expected to be a significant generator of growth in the forthcoming period. The projected number of customers is over 10 million, of which more than 5 million are the users of Telekom Srbija's services.

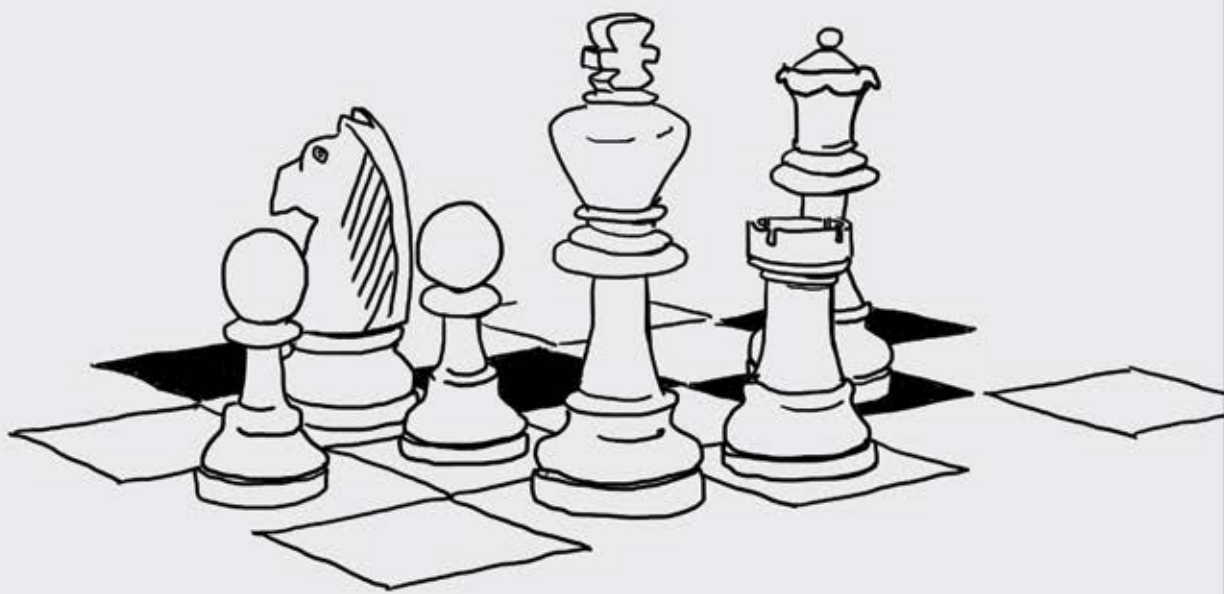
Nowadays, the use of Internet is an indispensable segment of the modern society and efficient support to the development of information society. Internet technologies are one of the extremely important drivers of economic growth and progress of each country because the increase in the number of lines for Broadband Internet Access has a direct impact on the increase in GDP.

The Internet market in the Republic of Serbia in 2012 continued the growing trend recorded in the previous years. The most represented method of Internet access is still the ADSL access. Internet access can also be made via a cable modem, directly, via the Ethernet, by means of an optical cable, by a wireless technology in the frequency ranges from 2.4 GHz to 5.8 GHz that are available for use, to a lower extent by using the ranges 3.4-3.6 GHz and via the UMTS (3G) network of the mobile operators.

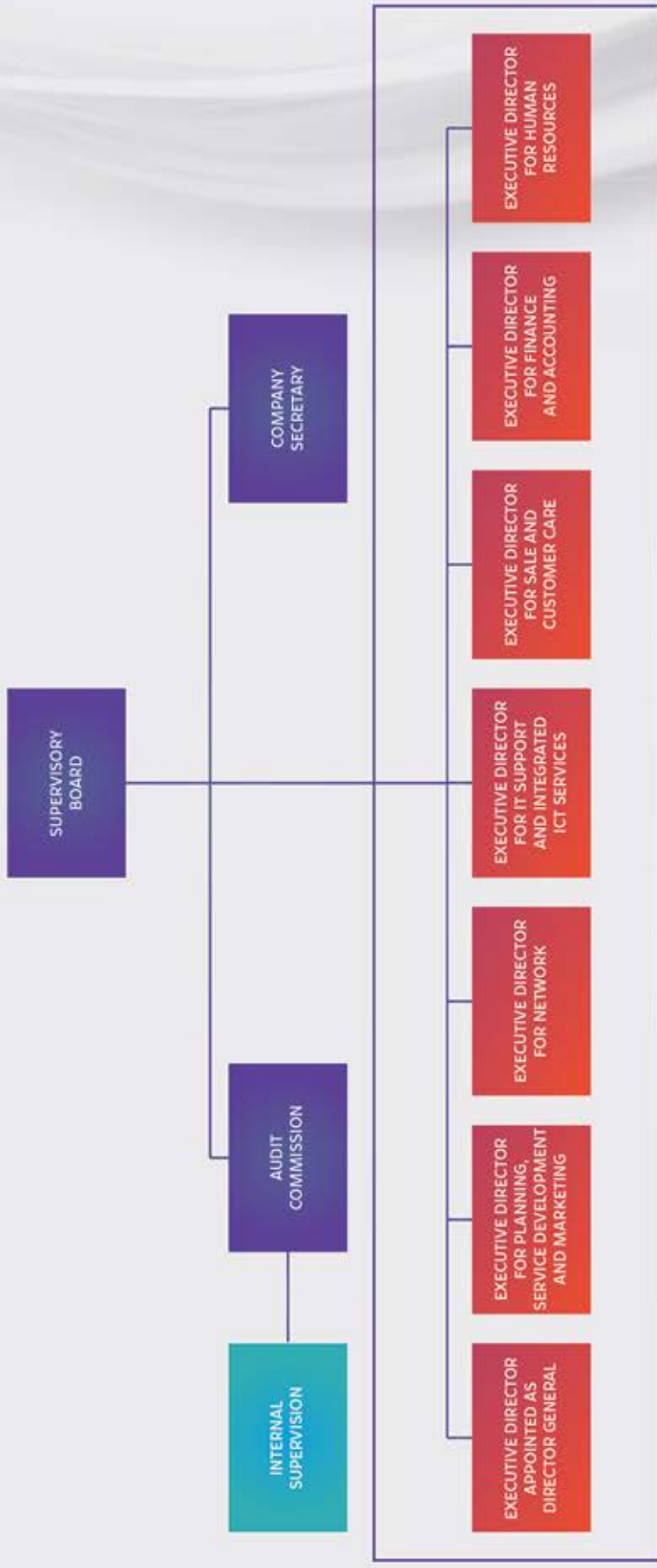
The market for the distribution of media content in the Republic of Serbia in 2012 did not change a lot by its structure and broadcasting technologies as compared to the previous year. The operators offered their services via the following public tele-communications networks:

- cable distributions networks (coaxial, hybrid and optical) - KDS, that include both the analogue and digital KDS;
- public fixed telephone networks- IPTV;
- satellite distribution networks (*Direct to Home*) - DTH.

The largest operator dealing with the distribution of media content in the Republic of Serbia in 2012 is still SBB, covering over 50% of the market.



CORPORATE MANAGEMENT



Organizational structure of Telekom Srbija

CORPORATE MANAGEMENT

Corporate management represents a system for the management and control of business companies. Owing to such management approach, Telekom Srbija can apply better mechanisms of organization and control and efficient distribution of competences. This approach also makes it possible for Telekom Srbija to gain the trust of investors. The separation of the ownership right and the management of Telekom Srbija, responsibility towards the shareholders, response to their interests, transparency and requirements of mandatory information are the current principles that bring better results.

The practice of good corporate management also contributes to a sustainable economic growth, because it increases the business result of the company, ensures the company's growth and boosts profitability. As a business company covering one of the main infrastructural functions of the company, Telekom Srbija hereby gives an incentive to numerous business partners and the society as a whole.

CORPORATE BODIES AND CORPORATE MANAGEMENT SYSTEM

In order to organize the management of the Company in the best possible way and respond to the business challenges, Telekom Srbija, as a responsible company, is organized as a two-tier system of management. The bodies of Telekom Srbija are:

- General Meeting
- Supervisory Board
- Executive Board.

The company represents a single business system structured by the functional, territorial and market-based principle, which attains its operating goals through the business units managed by executive directors.

General meeting

The General Meeting is a body where the shareholders exercise their ownership rights. The General Meeting is composed of all the shareholders of the Company. It has the broadest status - and ownership-related authorizations and is the highest body of the Company. In 2012, two sessions of the General Meeting were held: 43th regular General Meeting held on 20 April 2012 and 44th extraordinary General Meeting held on 13 December 2012.

Shareholders' rights

The Company guarantees the exercise of the ownership and non-ownership rights of the shareholders as stipulated by the Law, the Memorandum of Incorporation, the Articles of Association and other by-laws of the Company.

The Company is guided by the principle of equal and fair treatment of shareholders and takes the measures to that end, including in particular:

- Providing that the shares of the same class bear the same rights,
- Timely and regular provision of relevant information about the Company (including the information available on the website of the Company),
- Participation and voting at the General Meeting session,
- Provision of timely, true and full information about the issues of particular importance for the Company's operation, related to significant corporate changes, particularly the amendments to the Articles of Association, decrease or increase in capital, major changes in the ownership structure, status-related changes and changes in the legal form and disposition of high-value assets,
- Provision of equal treatment of all shareholders (including the minority and foreign shareholders), especially the efficient protection of the rights of minority shareholders against abuse by the majority shareholders.

The Company prohibits and shall continue to combat any unauthorized trade in shares based on confidential (insider) information and possible cases of abuse in mutual trade operations.

Supervisory board

The Supervisory Board is a corporate governance body. The number of Supervisory Board members is prescribed by the Company's Articles of Association, in accordance with the principle that the prescribed number should provide for continuous operation and a composition which ensures the skills and expertise required for the Supervisory Board's activities. The Supervisory Board includes 7 (seven) members, whereof at least one is an independent member in terms of the applicable Law on Business Companies.

The Supervisory Board and its members are under the obligation to act conscientiously and loyally towards the Company and its shareholders and to perform the tasks falling within the scope of their responsibly with due diligence and in the reasonable belief that their actions are in the Company's best interest.

Supervisory Board members:

- base their decision on impartial and competent judgement and all available information and opinions of experts in particular fields,
- comply with the rules related to the conclusion of transactions in which there is a personal interest and a competition ban in any legal transaction involving the Company or which is decided by the Bodies,
- during and after the expiry of their term of office, treat the data and material of the Company as confidential information no matter whether the information is confidential, in accordance with the Company's policy and by-laws governing confidential information.

Supervisory Board members are elected by the General Meeting by a simple majority of the attending or represented members with the voting right and

the shareholders that vote by circulation in accordance with the Law and the Articles of Association.

Supervisory Board member candidates are put up by the Supervisory Board, the Appointment Commission, if any, or the Company's shareholders with the right to propose an agenda for a General Meeting session.

Commission for the audit of the supervisory board

For the purpose of boosting business efficiency and in accordance with the Telekom Srbija Articles of Association, on 13 December 2012, the Supervisory Board passed a Decision on the set-up of a Commission for the Audit of the Telekom Srbija Supervisory Board. The Audit Commission is answerable to the Company's Supervisory Board and is under the obligation to submit reports on transactions and activities it takes in accordance with the competences laid down by the applicable regulations, at least twice a year and any time the Supervisory Board requests such reports to be submitted. The Audit Commission includes 3 (three) members, whereof one is the Commission chairman.

The Audit Commission oversees but does not manage the financial reporting process. Its supervisory role primarily implies making sure that the procedures and controls undertaken by the management and the external auditor are such to provide for identification and remedy of errors and irregularities and to make it possible for them to prepare and publish financial statements in a just and adequate manner. Likewise, the Audit Commission oversees the conduct of activities in the sphere of the internal supervision of the Company.

The Supervisory Board endeavoured to appoint to the Commission persons of adequate professional and personal characteristics and experts in relevant fields.

In order to ensure the quality and efficiency of operations and/or capacities of the Supervisory Board to perform its duties in a manner consistent with the shareholders' expectations, at least once a year, the Supervisory Board analyses its work and the

work of all commissions and reviews measures and activities to improve it.

The scope of evaluation is particularly the quality of the operative activities of the Supervisory Board, contribution and competence of its members, adequacy of the Supervisory Board's structure and quality of the Supervisory Board's engagement as regards all important issues falling within scope of its responsibility.

Executive board

Executive Board members, including the Director General, are elected by the Supervisory Board. The Telekom Srbija Executive Board includes 7 (seven) members. Executive Board members are executive directors.

Executive Board members of the Company (hereinafter: Executive Directors) may not be members of the Supervisory Board or the Company's procurists.

In conducting the operations of the Company, the Executive Board acts independently deciding and acting outside sessions. In case of no agreement between the Executive Directors on a particular issue and in other cases and activities laid down by the Rules of Procedure of the Executive Board, the Director General may call an Executive Board session in the manner set out by the Law, Articles of Association and Rules of Procedure of the Executive Board.

Company secretary

Telekom Srbija has a Company secretary who is appointed by the Supervisory Board. The competences of the Company secretary are stipulated by the Company's Articles of Association and relevant decisions of the Supervisory Board.

STATEMENT ON THE APPLICATION OF THE CODE OF CORPORATE MANAGEMENT

Telekom Srbija a.d (hereafter: Company) is applying the Corporate Management Code adopted at the 1st session of the Supervisory Board of the Company on 26 June 2012 and published on the Company's website www.telekom.rs.

The Company strives to develop a corporate management practice based on modern and generally accepted principles of corporate management, experiences and best practices in this sphere, honouring the requirements laid down by applicable regulations, with the respect for the global market conditions and trends on the domestic telecommunications market and defined developmental goals of the Company.

The Company Supervisory Board is competent for the application and interpretation of the Corporate Management Code (hereinafter: Code), regular monitoring of the implementation of the Code and compliance of the corporate organization and activities of the Company with the Code.

The application of the principle of adequately acknowledging the interests of all existing and potential shareholders, investors, creditors, service users, employees, and members of the Company's bodies, is ensured through the work and decision-making procedures of the corporate governance bodies as defined by the by-laws, through communication and the coordination of activities between all corporate bodies, managers at the business seat of the Company and units of its territorial organization, employees, shareholders and the public.

In implementing the corporate management system, there were no derogations from the rules envisaged by the Corporate Management Code.

Shareholders' rights

All shares of the Company are ordinary shares and each share grants a right to one vote in General Meeting sessions.

The right to personally participate in General Meeting sessions and debates on all issues on the agenda, including the right to forward motions, ask questions pertaining to the items of the Agenda of a General Meeting session and receive a response is exercised by the shareholders with at least 0.1% of the shares of the total number of shares of the Company and/or their proxies who represent at least 0.1% of the total number of the Company's shares.

The introduction of the aforesaid census for personal attendance of a General Meeting session resulted from the fact that there is a very strong corps of the shareholders of the Company (more than 4.8 million). In such conditions, statutory insistence on a census is imperative because its absence might affect efficiency and rationality in the process of organizing and holding a General Meeting session.

Naturally, the aforementioned census does not restrict the rights of the shareholders that individually hold less than 0.1% of the total number of shares of the Company to participate in the work of a General Meeting session through a joint proxy or to vote in absentia.

The Company is guided by the principle of an even-handed and equitable treatment of the shareholders and in that respect it takes measures which, inter alia, ensure:

- timely and regular receipt of all relevant updates about the Company in accordance with the obligations laid down by applicable regulations (including information available on the Company's website),
- participation and voting in General Meeting sessions,
- timely, accurate and full provision of information of special importance for the operation of the Company, pertaining to important corporate changes (particularly amendments to the Articles of Association, capital reductions or increases, significant changes in the ownership structure, status changes and changes in the legal form and disposal of high value assets),

- deciding on the election and dismissal of Supervisory Board members,
- determining remunerations for the persons elected to the Supervisory and Executive Boards of the Company,
- ensuring an even-handed treatment of all shareholders (including minority shareholders).

The Company endeavours to encourage the shareholders to participate in the work of the General Meeting and in that regard:

- it schedules General Meeting sessions in time to provide for the shareholders to familiarize themselves with the Agenda of the General Meeting and prepare for participation in a session,
- envisages a mechanism of the shareholders' in absentia vote so that personal vote and in absentia vote have an equal effect.

All relevant information and material for a General Meeting session, including power of attorney forms and in absentia vote forms are available on the Company's website www.telekom.rs, within the legally prescribed deadlines before the holding of the General Meeting session.

In view of the fact that there are a large number of shareholders, the Company frequently uses its website to communicate with the shareholders.

Supervisory Board

The Supervisory Board performs the tasks from its scope of responsibility in accordance with the applicable regulations, the Articles of Association of the Company and the Rules of Procedure of the Supervisory Board, in a bid to act in the Company's best interest.

The Rules of Procedure adopted by the Company Supervisory Board regulate as follows: organization, the method of work, including the deadlines and manner of submitting the material for a session to the Supervisory Board members, the method of drafting and content of the minutes, the voting pro-

cedure (quorums for the holding of sessions and decision-making) and other issues of importance for an efficient operation of the Supervisory Board.

The Supervisory Board includes 7 (seven) members elected by the Company General Meeting, whereof one is independent from the Company in terms of applicable regulations (an independent member of the Supervisory Board), and the chairman is elected by the Supervisory Board from among its members, by a majority vote of the total number of Supervisory Board members, at the proposal of the Supervisory Board members nominated by the controlling shareholder of the Company. When putting up candidates for the chairman of the Supervisory Board, the Supervisory Board members nominated by the controlling shareholder are guided by the principle of candidates' excellence on the professional and personal planes and in terms of the trust placed in them by the shareholders and other Supervisory Board members.

The Supervisory Board set up a Commission for the Audit of the Supervisory Board of the Company (Decision no. 380052/6 of 13 December 2012), which takes activities and actions in accordance with the competences laid down by legal regulations and the aforementioned decision on its set-up. The said decision, *inter alia*, specifies as follows: a quorum and the manner of holding a session of the Audit Commission, its composition and mandate and Commission members' right to remuneration. The Commission is answerable to the Supervisory Board and informs it about the tasks and activities it takes, at least twice a year, and any time the Supervisory Board requests that such reports be submitted.

Executive Board

The Executive Board includes 7 (seven) members – executive directors appointed by the Supervisory Board. One of the executive directors authorized to represent the Company is appointed as director general by the Supervisory Board. When electing executive directors, the Supervisory Board takes into consideration their professional, organizational and personal qualities and when electing a director general, it is guided by the candidate's organizational abilities which are particularly reflected in

an efficient organization of the Company's business operations and activities of the Executive Board and the coordination of the work of executive directors. The organization, method of operation and decision-making of the Executive Board are specified by the Rules of Procedure adopted by the Executive Board in line with its legal and statutory competences.

Remuneration and rewards for members of the corporate governance bodies

The General Meeting passed a Decision determining the rewards for the chairman and members of the Supervisory Board (no. 117294/12 of 20 April 2012) and a Decision on the rules (policy) of determining the remuneration for the executive directors (including the employment contracts of the director general and other executive directors) (no. 117294/13 of 20 April 2012). The Supervisory Board passed a Decision on the set-up of the Commission for the Audit of the Supervisory Board of Telekom Srbija a.d. whereby, among other things, it defined the remuneration for the chairman and members of the Commission (no. 380052/6 of 13 December 2012).

Internal supervision affairs

Set up within the Company is an organizational unit in charge of internal supervision affairs (under the name of: Internal Audit), which controls the compliance of the Company's operation with the law and other regulations and by-laws of the Company. Internal supervision pursues the activities in the domain of internal supervision which include: inspection of the compliance of the Company's business operations with the law, other regulations and by-laws of the Company; supervision over the implementation of accounting policies and financial reporting; control of the implementation of the risk management policies; monitoring of the compliance of the Company's organization and activities with the code of corporate management; evaluation of the policies and processes in the Company and forwarding proposals for their improvement. The manager of the Internal Division regularly informs the

Audit Commission of the audit of business operations. In its by-laws, the Supervisory Board regulated the method of conducting and organizing the activities of the internal audit of business operations, including the terms to be fulfilled by the persons performing the tasks of internal audit of business operations, as regards professional knowledge or expertise, experience and respect for ethical norms which make them suitable for the performance of said tasks in the Company.

In its decision (no. 246291/5 of 29 August 2013) the Supervisory Board adopted the Internal Audit Charter which is necessary for ensuring independent and objective functioning of the organizational unit in charge of internal audit affairs, which regulates the purpose, authorizations, duties and responsibilities of all participants in the performance of work, the method of performing work and other issues related to the Company's internal audit. Besides, the Supervisory Board also adopted the Code of Ethics which established the principles to be observed by the persons pursuing the audit activities.

Communication with the public, disclosure of information and transparency

The Company ensures the transparency of its operations with compliance of all envisaged obligations in terms of reporting and publication of accurate and complete information and the respect for the principle of providing regular and timely information on the Company's website. The shareholders and the public, primarily by way of the Company's website, report on the financial results of the Company and all important events regarding the Company for which the obligation of such reporting is laid down by the applicable regulations and by-laws of the Company.

Other activities in the application of the Code

The Company is investing maximum efforts in the permanent promotion of the corporate system which will guarantee the actions of all corporate

bodies, their members, employees and the Company as a whole, in accordance with the rules of the Code, particularly in the domains which regulate:

- personal interest and the obligation of avoiding the conflict of interest
- cooperation between the corporate governance bodies
- curbing and prevention of bribery and corruption
- engagement of external consultants
- business ethics

This statement represents an integral part of the Consolidated Annual Statements on the Company's operation for 2012.



BUSINESS OPERATIONS

BUSINESS OPERATIONS

STRATEGY

Business framework

Telekom Srbija enjoys a unique position as an integrated operator on the Serbian market of communications and multimedia. Telekom Srbija strives towards the preservation of the leading position on these markets through the innovative development of services, improvement of customer satisfaction and partner environment and increasing business revenues.

Strategic objectives

The strategic objectives of Telekom Srbija are clearly reflected in the statements of vision and mission of the Company, by emphasizing business ambitions, growth and development on the convergent market of electronic communications, media and ICT services of the new digital environment.

<p>Vision</p>	<p><i>We are striving towards enriching and making more beautiful people's lives providing for them global links and extraordinary communications as the regional leader in the information society of the future</i></p>
<p>Mission</p>	<p><i>New services we are introducing, technologies we are implementing, every change of ours and continual adjustments are intended for our customers, their needs for communication and entertainment, with our employees as the driving force, to the satisfaction of our shareholders.</i></p>

The accomplishment of business objectives in a strong competitor environment is supported by the continued engagement of the management and employees in the promotion and strengthening of organizational efficiency in accordance with changes in the environment.

Business strategy

Telekom Srbija aspires towards promoting the efficiency and effectiveness of its operations through an integrated and convergent model of organization and operation. A change in and the growth of customer needs are supported by the additional innovative development of networks and services.

Telekom Srbija is continuously strengthening its competitor capacity, analysing the trends and development of the technological base, economic environment and customer affinity. Further development of commercial service packages and the promotion of the service portfolio will pave the way for and secure the prospects of the market leaders. Telekom Srbija will lend support to overall economic recovery, backing other segments of the business environment, thus expanding its business activity and recognisability.

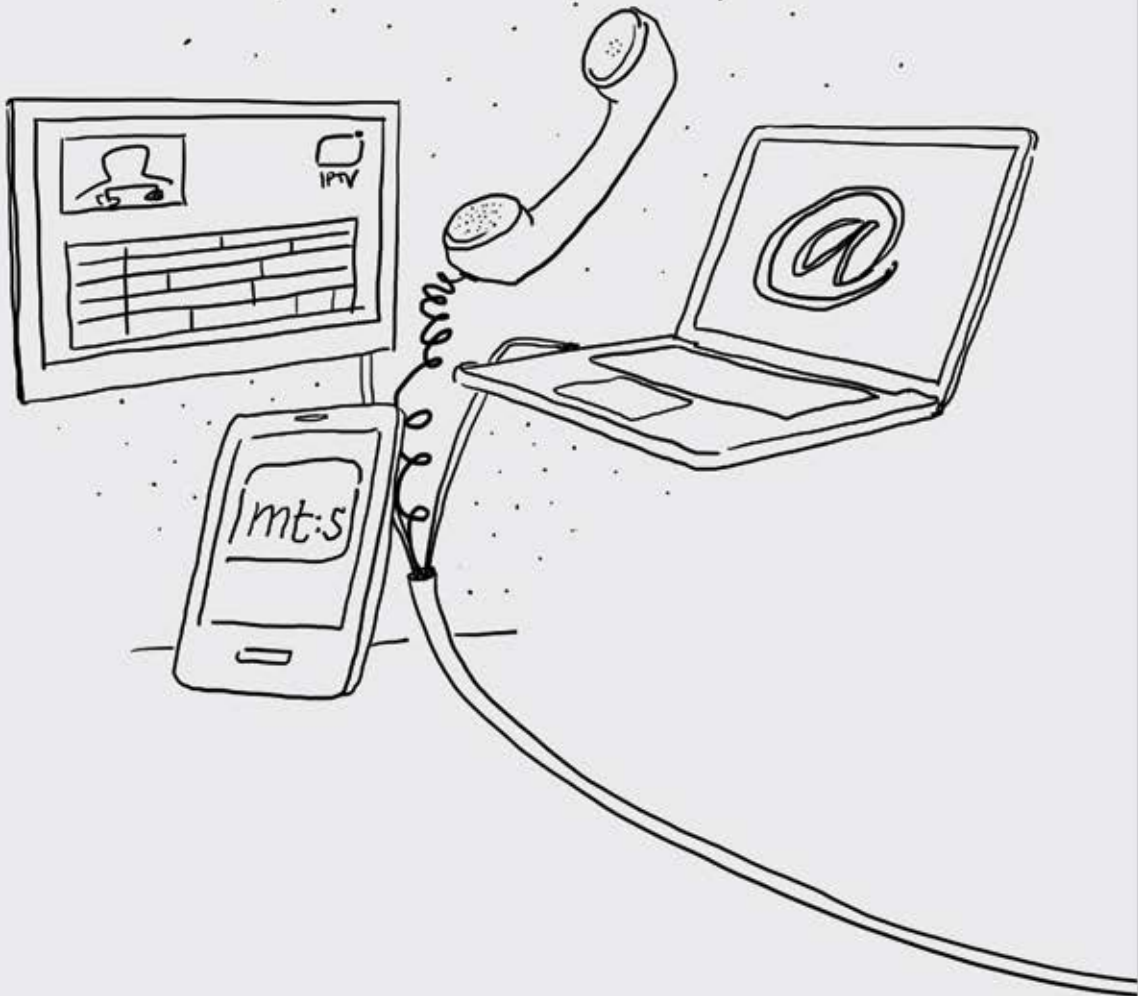
- On the fixed telephony and data market, Telekom Srbija will upgrade the quality of its services, offer services which meet customer needs and provide to its customers a respectable and recognizable ratio between the price and quality of its services.
- On the mobile telephony market, Telekom Srbija will, with its innovative offer and in the capacity of an integrated operator, provide to its customers a new customer experience, the quality of services and products and a recognizable ratio between the prices and quality of its services.
- On the market of broadband services of the fixed and mobile networks, Telekom Srbija will endeavour to maintain further growth of its customers and revenues, focusing on an increase in the quality of its services, coverage and availability through combined fixed and mobile offers.
- On the Pay TV market, Telekom Srbija will endeavour to increase its market share with an adequate offer of video content, with the highest level of service quality. The commercial aspect will stress the value of offered content as opposed to the offer of its competitors.

- On the on-line entertainment and advertising market, Telekom Srbija will maintain the concept of a unique portal for communication and entertainment in Serbia and the region at large in order to boost its use and revenues from advertising and electronic trade.
- On the ICT market, Telekom Srbija will invest maximum efforts with the aim of generating additional revenues from an expanded service portfolio.
- Telekom Srbija will continue to improve an integrated and customer-oriented organizational model of operation in order to meet customer needs to a greater extent and boost efficiency and efficacy.
- On the commercial level, Telekom Srbija will invest additional efforts and resources in ensuring that its customers more clearly recognize the value and functionalities of an integrated market and sales. Customer support will be more adequately adjusted to the needs in all market segments.
- Telekom Srbija aims to promote its market position through continued improvement of its network and services as an integrated operator, with special emphasis on service innovations in accordance with customer needs and at acceptable prices.
- Telekom Srbija will, in line with customer needs, improve its on-line sales channel, whereby the digital economy will be adequately and functionally supported.
- Telekom Srbija will continue to gradually integrate its operations, systems and the network towards full convergence in order to be able to offer a fully converged product portfolio.

For the purpose of achieving the necessary level of financial vitality, in accordance with the shareholders' expectations, Telekom Srbija will focus on the promotion of internal processes and metrics.

Implementation of the strategy

The accomplishment of strategic objectives and the implementation of the strategic business plan are supported by the introduction of organizational competences with the aim of improving decision-making, efficiency and metrics in the Company. Telekom Srbija bases the implementation of the strategy on the continuity of development and application of strategic initiatives, acknowledging the market momentum and the need for constant change from within, analysing changing customer needs, the activities of competitor companies and the expectations of the shareholders and a broader social community.



SERVICES

SERVICES

The core activity of the Company is the provision of services in the sphere of telecommunications. Ever since its incorporation, the Company has provided fixed and data services. As the Company strengthened and telecommunications services developed, the advancement of fixed telephony coincided with that of mobile, Internet and multimedia services and a broad range of add-on services.

In order to promote the sale of services to business customers in May 2012, the Company introduced the class of services – CoS SLA-managed L3VPN. With the introduction of services the customers are allowed, in line with their priorities, to group the applications which generate traffic into classes of traffic with pre-defined parameters. Telekom Srbija offers three classes for the service: Voice, Business and Best Effort.

The offer to the business segment of customers was expanded in August 2012 with the introduction of the level of service quality – SLA for the Leased Digital Line service in internal traffic. For the relevant service, defined are standard SLA parameters which Telekom Srbija guarantees, if there are technical conditions on the customer's site (Provisioning, Response Time, Restore Time and Availability).

VPN for video surveillance represents a service which has been provided to business customers since September 2012. The service is intended for the customers that are at the same time the customers of the Video Surveillance service. It provides for the connection of sites where cameras are located, to sites where storages are located, and the connection of sites and storage to a surveillance centre for the needs of transmission of video material recorded on storage servers, video streams transmitted in real time to the surveillance centre and traffic which serve for remote control and management of cameras.

At the end of 2012, the Nomadic Bizfon connection service was commercialized. It defines two types of Nomadic connection (start and plus) which represent members of Bizfon (IP Centrex group), and

which are realized independently from customer sites. A customer makes calls via the client software which he ensures and installs on a device with Internet access himself, under the terms defined in a decision.

The International freephone service, which was introduced at the end of 2012, allows that the business customers of Telekom Srbija's fixed telephony services are called by end users abroad who make such calls free of charge, where the costs of such international calls are covered by the called party in Serbia and/or subscriber to the International freephone service.

In order to accommodate the needs of mobile customers, with the aim of retaining the existing and winning new customers, in 2012 new services for all customer categories were introduced (prepaid, postpaid and biznet).


For residential customers the following new services were introduced: Bus Plus Info System, Mega Net Tariff, Mobile TV and Blackberry for Prepaid Customers.

The Bus Plus Info System service was launched in February 2012. A user receives information about the arrival of a bus to a bus station. The service is intended for commuters in Belgrade.

In June 2012, the Mega Net Tariff was introduced. The new tariff was specially created for the Samsung Galaxy S3 handset. The monthly subscription fee includes 4,000 min in national traffic, 40,000 min in the mt:s network after national minutes have been used up, 40,000 SMS and 40 Gb data. The accounting interval is 60s. The accounting unit for data transfer is 1kB.

The new service Mobile TV was also introduced in June and it provides for watching TV programmes via a mobile handset. This service is provided only to Mega Net Tariff users without extra charge. GPRS traffic generated using this service is not charged.

In December 2012, the Blackberry service was also provided to prepaid customers. A prepaid customer with a Blackberry device has an opportunity to

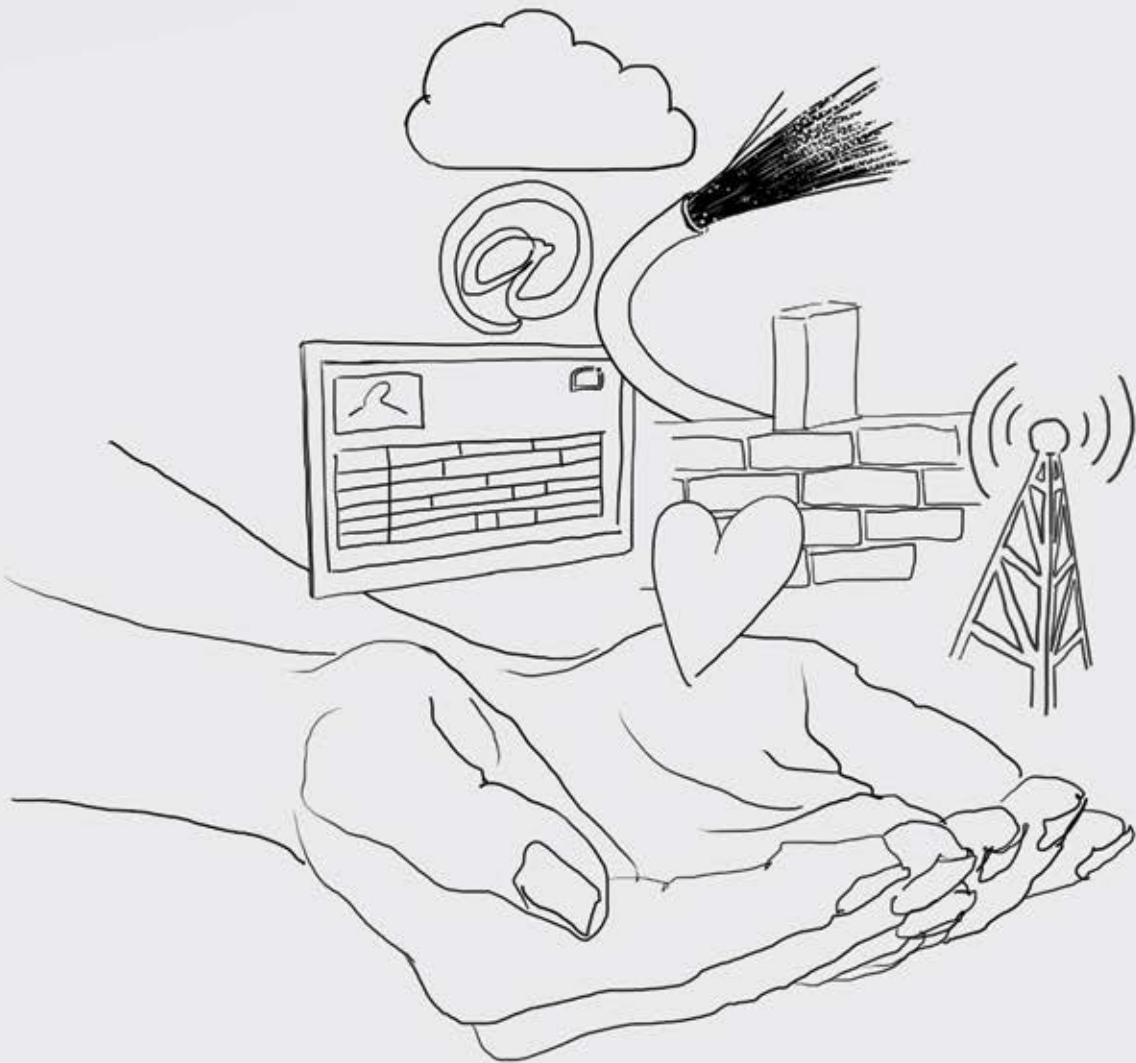


access the Internet unrestricted for a period of 30 days. The fee is charged after activation from a pre-paid account. If, after the expiry of the subscription fee, a user has enough credits on a prepaid account, the service will be automatically renewed for a period of 30 days.

In the sphere of multimedia services, in October 2012 commercialized was the KlikSport service (pay per view). The service is intended for residential customers of fixed and mobile Internet access who are allowed to view, via the relevant application or portal, matches of the UEFA Champions' League and the Europa League.

For business customers that deal with the transportation of passengers, in September 2012, a new service - WiFi Bus was introduced. The service makes it possible for passengers to use free of charge the wireless Internet on their laptops, tablet devices and smart phones via the mt:s network.

The new service in the sphere of electronic payment, which was introduced in January 2012 -SMS payment of electricity bills, implies the payment of electricity bills via the mobile payment system of Telekom Srbija. A request for payment is sent in an SMS and the electricity bill is charged from the DinaKard card, which is linked to the customer's mobile bank account. The service is intended for the customers who pay their electricity bills in territory of Belgrade.



Investments

INVESTMENTS

The telecommunications market in Serbia is free and open in which a large number of companies, both foreign and domestic, operate in an attempt, within RATEL's regulations, to improve their offer and service quality in order to strengthen their market position. The trend shows that it is only by way of adequate capital investments that it is possible to advance on such a market and to a certain extent, anticipate the trend of such a dynamic sector such as telecommunications industry.

Total capital investments in 2012 amount to 12.3 billion dinars. Investments were aimed at upgrading the technical capabilities of the network and introducing fresh capacities which provide for the provision of telecommunications services in geographical regions where it was impossible in the past.

The Company set aside 82% of the funds for the technical development of the network, whereas 18% of the total funds were invested in IT and logistics support. With intensive investments in technical development, the Company wishes to create a flexible and reliable network which will lay the groundwork for the regular operation of service platforms and to achieve a high level of customer satisfaction.

in million RSD	2012	Growth rate	2011
Technical investments	10,134	30.9 %	7,744
Infrastructural investments	2,204	-28.2 %	3,072
Total	12,339	14.1 %	10,816

Telekom Srbija's investments

In 2012, the development of technical investments was aimed at the following activities:

In fixed telephony, investments are primarily aimed at expanding and modernizing access network capacities as it will become the basis for the provision of new broadband services, and increasing the digitalization degree and separation of two-party line

separation in the access network. The digitalization degree of active subscriber capacities in 2012 is 99.1% (2011: 98.5%).

In mobile telephony, investments are directed towards the development of capacities and network quality in order to maintain the high level of services. In the relevant period, installed were 1,773 base stations, whereof 1,396 for modernization and 377 for expansion with the aim of modernizing and expanding the network. With the modernization of radio base stations into radio base stations *HSPA+*, which was made in 2012, all base stations now have the possibility of *IP/Ethernet* connections, and less delays in the system and on the user and signalling plane. Thus, the capacity of providing broadband services is increased, as is territorial and population coverage in Serbia. The current territorial coverage by the *GSM* signal is 81.5%, population coverage 87.5%, whereas *UMTS* signal territorial coverage is 66.4%, and population coverage 77.0%.

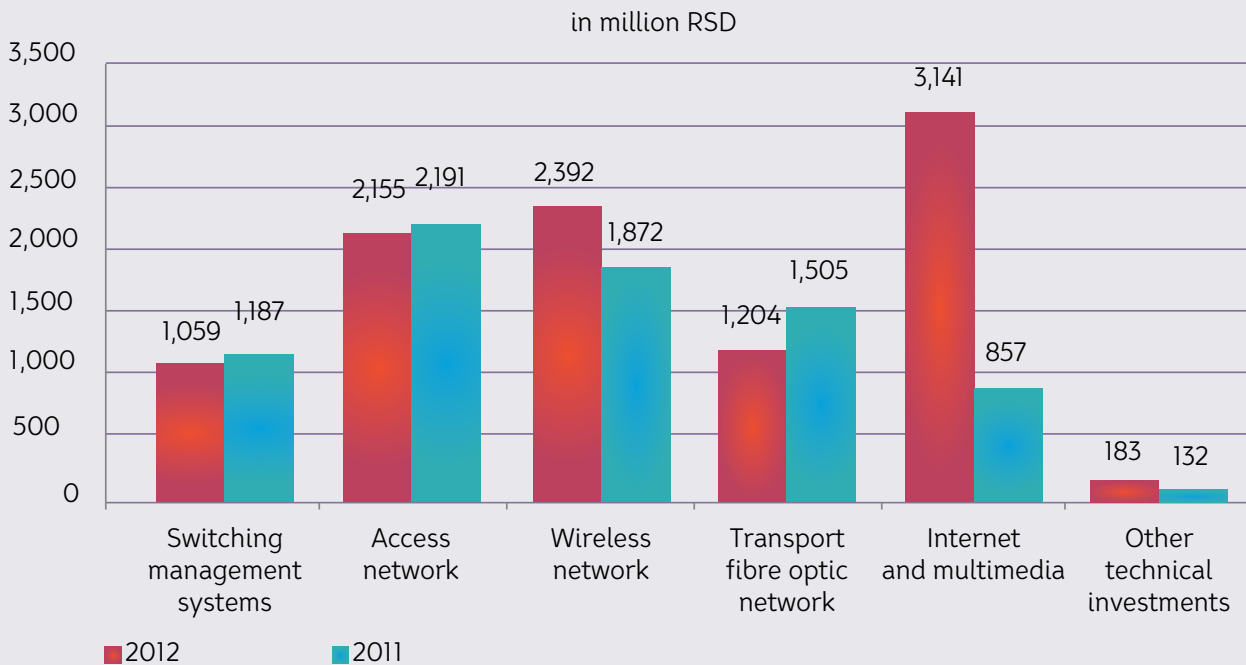
In the Internet sphere, investments are directed towards the development of the *IP/MPLS* network and increasing the capacities of the broadband Internet network. In 2012, the total number of ADSL ports increased by 14%, which led to an increase of free capacity by 32%.

In the sphere of multimedia services, invested are directed towards the expansion of the *Headend* and *Middleware* platforms and the promotion of the primary distribution services.

As for investments in the technical capacities of the telecommunications network, most of the investments in 2012 by the Company were made into the Internet and multimedia (31%), wireless network (24%), access network (21%), transport optical network (12%) and switching management systems (10%).

In 2012, infrastructural investments were realized in the amount of 2.2 billion dinars. Investments in the infrastructure mainly pertain to investments in logistics support (57%), and investments in IT (43%).

The most important projects in this period include: the expansion of the storage system, the delivery of equipment for the commercial email system, the delivery

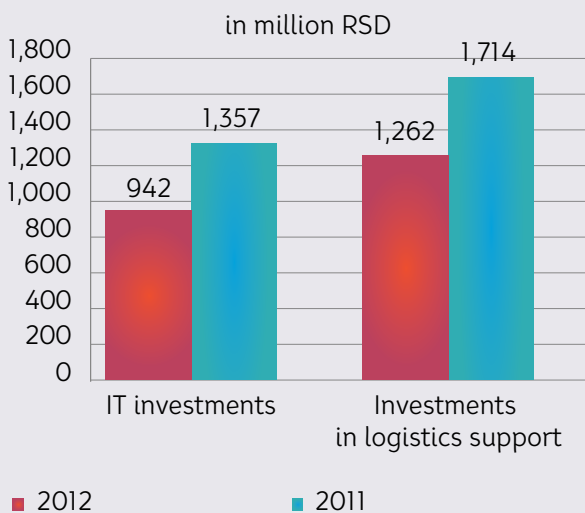


Technical investments

of equipment for the billing system, the delivery of equipment for the network inventory system and the provision of licences for the expansion of SLM.

As for investments in logistics support, conducted were the adjustments of the horizontal and vertical internal distribution of the ducts and reconstruction of part of the central heating installations at the TKC Belgrade, the refurbishment of the Data

Centre, the adjustment of the NN distribution at the TKC, adjustments and installations of radio base stations, the purchase of containers for MSAN, procurement of several mobile and stationary DEAs for multiple facilities. Likewise, in this period, a large number of facilities were refurbished and fitted out due to a change in the purpose and fresh needs arising from the Company's operations.



CUSTOMERS

Despite the challenges of economic environment and growing competition, Telekom Srbija has a considerable number of customers in fixed and mobile telephony and increasing number of Internet users. In addition to fierce competition in mobile telephony, multimedia and the Internet, competition is also present in the market of fixed telecommunications network.

Fixed telephony

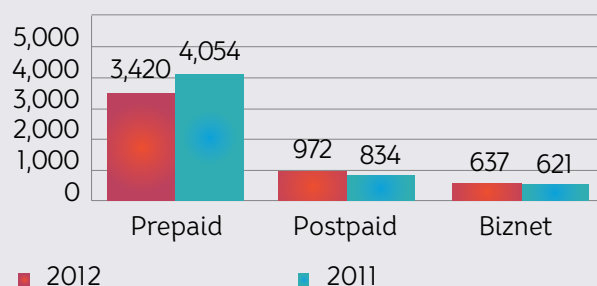
At the end of 2012, fixed telephony services of the Parent Company were used by almost 3 million customers. In 2012, the Company recorded 1.3% decline in the number of customers compared to 2011, among other things due to alternative types of communication such as mobile telephony and the Internet. The structure of fixed telephony comprises *POTS* connections with 97% share, while the rest consists of *ISDN* connections. In the structure of *POTS* customers, the largest increase in the number of new customers in 2012 was recorded in the *IP* phone segment.

In thousands	2012	Growth rate	2011
<i>POTS</i>	2,846	-1.1 %	2,878
<i>ISDN</i>	75	-8.5 %	82
Total	2,921	-1.3 %	2,960

The users of fixed telephony of Telekom Srbija

Fixed telephony development is conditioned by the implementation of state-of-the-art technologies enabling new types of services. By means of *CDMA* network, phone line is secured for the customers in remote and rural areas, where the telecommunications infrastructure is either undeveloped or underdeveloped. By the development of *IP* technology, customers are provided with services of making phone calls via *IP* network, such as *IP* phones and *IP Centrex*.

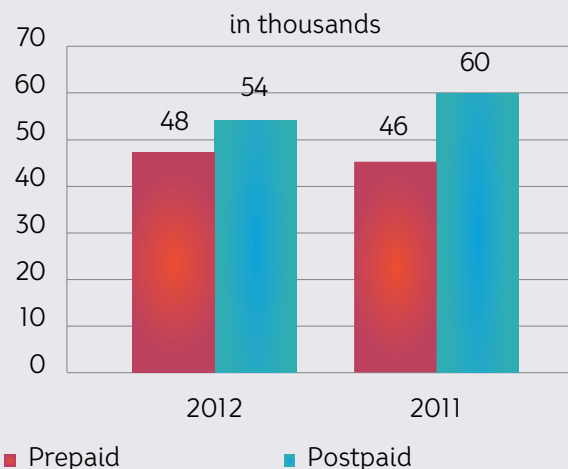
in thousands



*Mobile telephony customers**

**total number of customers with mobile Internet customers is shown*

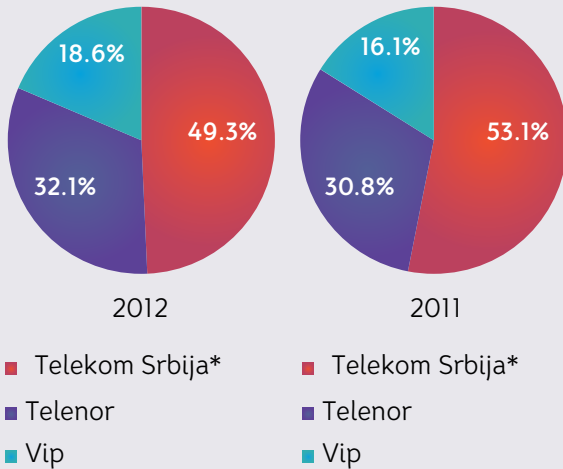
In 2012, a decrease in the total number of mobile telephony customers compared to 2011 was caused by reduced number of *prepaid* customers.



Mobile Internet customers

Mobile Internet customers that are shown within *prepaid* and *postpaid* customers of mobile telephony, recorded 3.8% decrease compared to 2011. At the end of 2012 the Company had 102 thousand mobile Internet customers.

Mobile telephony



The shares of mobile telephony operators
*total number of prepaid customers is shown

Market share	2012	2011
Telekom Srbija*	49.3%	53.1%
Telenor	32.1%	30.8%
Vip	18.6%	16.1%

The data are prepared on the basis of the Report of mobile operators

RATEL's data have been used

Despite a strong competition in the circumstances of a liberalized market, the Company is the leader on the market with some 49% market share.

Internet and multimedia

in thousands	2012	Growth rate	2011
ADSL retail	512	3.2 %	496
ADSL wholesale	128	0.0 %	128
IPTV	175	48.3 %	118
WEB TV	16	23.1 %	13
Total	831	10.1 %	755

Internet and multimedia customers

Significant changes can be observed in the Serbian Internet market, primarily those in the number of users, and then in the structure of Internet connections themselves. In the period 2007-2011 a growth of 2.5 million¹ Internet users was recorded (including 3G network users). Likewise, a decline in the number of dial-up customers is noticeable in the observed period, as well as a growing customers' need for broadband Internet, which reflects the customers' interest in the service enabling high-quality and easily accessible content.

At the end of 2012 the Company had 512 thousand ADSL customers in the retail segment, which accounts for 80% of the ADSL Internet market. Compared to the previous year, the Company recorded 3% growth of ADSL customer in retail.

As of October 2008, the Company offers the service of RTV program distribution via IP protocol (IPTV). The number of customers increased by 57,000 in 2012.

Web TV is a service providing customers with access to various online video contents (TV channels, Video clips, etc). Telekom Srbija has been providing this service since October 2011. At the end of 2012, the Company had total of 16,000 Web TV service customers.



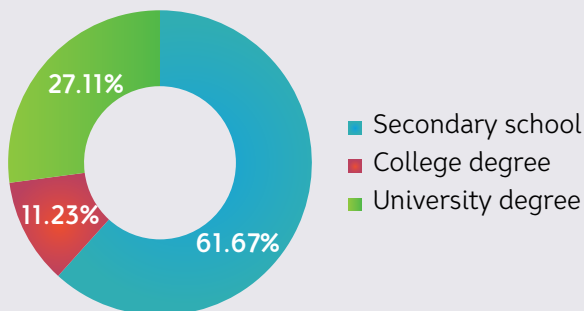
EMPLOYEES

EMPLOYEES

The management and development of human resources is one of the topmost goals and tasks of the Company. A care about employees involves care about overall satisfaction of employees, boosting their motivation and adherence to the Company. Telekom Srbija always strives to ensure for its employees a better future, adequate working conditions, equal treatment of employees, safety at work, health care and possibilities for further advancement and education.

The number of employees in the Company is 9,042. In addition, 830 persons without employment contracts were engaged on temporary and occasional tasks as at 31 December 2012.

Owing to the nature of jobs, certain number of employees, to be precise 17 employed with Telekom Srbija a.d., have a dormant employment status in their parent company as they are referred to work in another subsidiary.

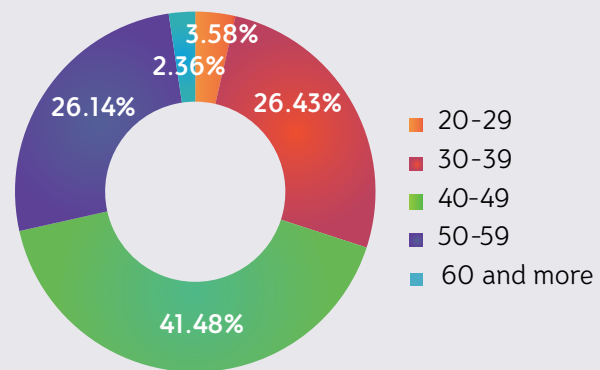


The educational structure of employees in Company

By analyzing the educational structure of employees on the Company level, it can be noticed that the largest share belongs to the employees with secondary school education (61.7%), followed by university education (27.1%) where the total number includes specialists, master and PhD degrees. The smallest share belongs to the employees with college education (11.2%).

As for the employees' age structure in the Parent Company, the largest share belongs to the employees aged between 40 and 49 (41.5%), followed by

30-39 age group (26.4%), 50 - 59 (26.1%), up to 29 years of age (3.6%), and the smallest share of employees over 60 (2.4%).



The age structure in the Company

Recruitment

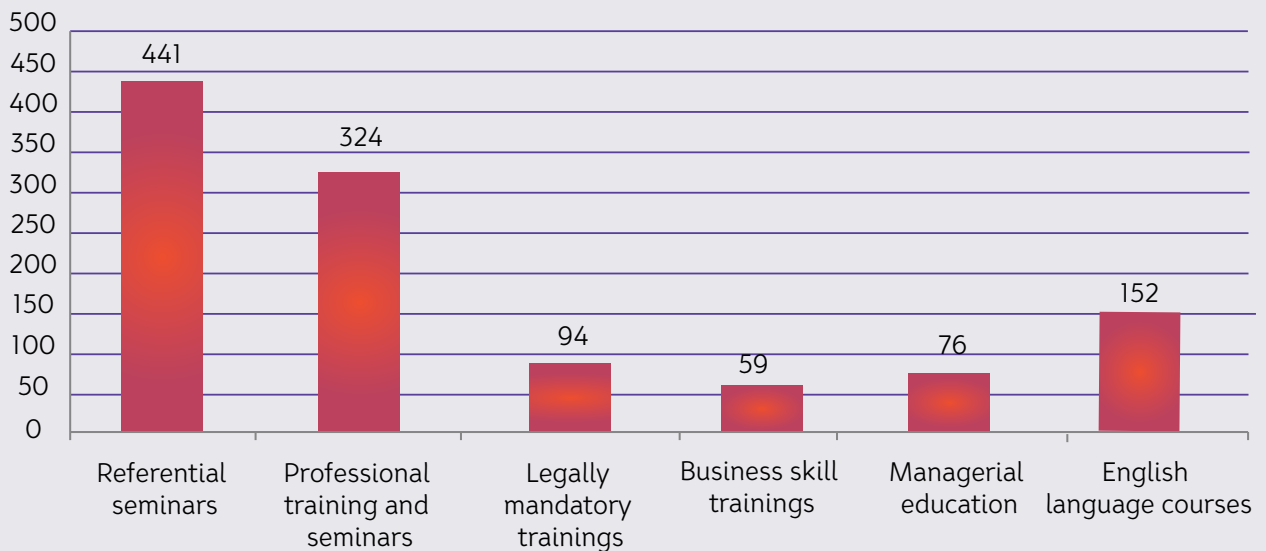
In order to secure the best possible human resources, trained and motivated to meet the business requirements in a competitive environment of telecommunications sector, 73 assistants with university degrees were admitted in 2012, based on a public announcement. On the other hand, the employment was terminated for total of 65 employees in 2012.

Education

In 2012, 1,703 employees were referred to external education in the country and abroad. Total of 1,146 beneficiaries were sent to various trainings in the country, according to the table below

The English language courses on different levels were realized in 2012 for 152 trainees. Likewise, the English language testing was conducted for 1,510 employees performing highly competent operations in the Company.

Educational events abroad were attended by total of 557 employees. 10 different internal trainings were conducted for 1,393 internal education trainees in the organization of the HR Training Centre.



Employees sent to various trainings in the country

Schooling

For the purpose of professional advancement and development of competences, the employees are continuously referred to various types of additional schooling. Mutual rights and obligations of the Company and employees, particularly with regard to manner of financing, the period of completion of schooling and the period of mandatory stay in the Company, are regulated by special contracts, the number of which equals 63 as at 31 December 2012. 27 new schoolings were approved in 2012, 19 for master studies, 6 for the 1st grade academic studies and 2 for the 1st degree vocational studies.

Licences, certificates, memberships

In 2012, the Company financed different types of licences, certificates, professional exams and enrolment fees for total of 686 employees.

PRACTICE

Professional practice has been organized in the Company for 333 trainees, 30 of whom were students and 303 pupils.

KNOWLEDGE BASE

Based on the assessment of appropriateness of the Expert Team, decisions were passed by the director general in 2012 regarding the renewal of the Company's membership in the knowledge bases of international organizations, such as:

1. Gartner Ireland Limited (modules: Gartner Executive Program EXP membership - CIO ESSENTIAL; Gartner for Business Leaders, Program Management&Marketing)
2. TeleManagement Forum - NGOSS program,
3. Information Security Forum



Different types of licences, certificates, professional exams and enrolment fees for total of 686 employees financed by the Company

4. Telegeography inc, Primetrica (modules: Global Internet Geography, Internet Transit Pricing Service, Wholesale Bandwidth Pricing Database)
5. Informa Telecoms & Media, report Global Mobile Forecasts to 2015,
6. Wireless Federation (modules: Telecom Loyalty and Churn management, Segmentation Strategies (Enhancing ARPU From Segmentation), Promotions (Recession Beating Operator Promotions), Reducing Churn Through Innovative Retention Programs: Best Mobile Operator Practices, MNO BRANDING: Most-successful Mobile Operator Branding Campaigns and Strategies, Global Mobile Innovative Pricing Tariffs and Strategies)

Assessment of Work Performance

According to the applicable annual model of evaluation of individual performances of all groups of employees, the procedure of Assessment of Work Performance (AWP) for 2011 was conducted in Q1 of 2012, on a sample of total 9,560 employees.

Employees' benefits

Payment of jubilee awards is made to employees and former employees who celebrate 10 years of continuous work in Telekom Srbija a.d. in the period from June 2th the previous year until June 1st of the current year, and 20, 30 or 35 years of continuous work in the PTT system of Serbia.

Implementing the policy of financial and social protection of employees

Collective Insurance Program

All employees in the Company are insured from the consequences of accidents, severe illness and surgeries, at work or outside the work (24x7), with additional insurance of employees who are assigned to the work posts entailing increased risk.

The program is implemented pursuant to the agreement/insurance policy, which the Company concluded with the insurance companies *DDOR Novi Sad a.d.o.* and *AMS Osiguranje a.d.o* in 2012, for the insurance of employees from the consequences of accidents and with *Delta Generali osiguranje a.d.o.* and *AMS Osiguranje a.d.o* for the case of severe illness and surgeries. Pursuant to the concluded insurance policies, the insurance companies reimbursed insured sums in 2012 for 262 employees and members of their close families.

Voluntary Retirement Insurance Program

All employees in the Company are provided with regular monthly payments against retirement contribution for voluntary pension insurance up to the amount of non-taxable amount in line with the Law. The program was implemented according to the agreement on retirement schemes which the Company has entered since 2007 with the joint stock companies for the management of voluntary pension funds *Delta Generali a.d.* and *Dunav a.d.*

Scholarship program for the children of deceased employees

In accordance with the Company's internal by-laws governing the field of monetary aid for the children of deceased employees during the regular secondary and university education (scholarships), the Company granted, based on the contracts concluded in 2012, regular monthly payment of scholarships for 114 children of deceased employees.

Solidarity Aid Program and other types of help

In accordance with the Company's internal by-laws governing the field of granting solidarity and other types of aid, the Company paid total of 391 solidarity aid on all grounds for granting such right, to the employees and members of their close families.

Implementation of the policy of harmonization of relations with employees

All employees in the Company have at their disposal expert teams of lawyers, psychologists and social workers in terms of labour, legal and psychological counselling. During 2012, 12 texts were published on the website – short professional topics and latest news in the domain of labour right, and 12 answers were published for the questions put by employees within the section Labour and Legal Counselling. Within the psychological counselling, 68 requests of employees were realized and 14 texts were published on the internal portal within the section Psychological Counselling.

IMPLEMENTATION OF POLICY OF INTERNAL INFORMING OF EMPLOYEES

It represents a program of continuous, accurate and timely informing of employees via the Internet and Company's *Newsletter*. The Intranet implies regular and continuous preparation, processing and publishing of information on the internal site *My Portal*. The posted information are classified in categories: *ad hoc* information related to important announcement in the field of human resources (the rights of employees), announcements of current events in the company which are posted on a daily basis and the information which are posted twice a month (current events in the sphere of culture and sports, telecommunications in the country and abroad, sections Visit Serbia, the Worlds, Famous Serbs, Great Thoughts by Great People, Proofreader's Perspective, Psychological Counselling, Labour and Legal Counselling, *Funny press clipping*, The German and English language tests, Survey and New Technologies). In 2012, 97,050 single user visits were recorded and 2,302,661 single hits, distribution of the corporate *Newsletter* was made (total of 16 issues), with the latest updates from subsidiaries,

presentation of new services and current events in the sphere of culture and telecommunications and 9 (nine) corporate bulletins were issued.

SOCIAL ACTIVITIES

The program of sport and in-house contests of employees - in line with the internal by-laws, in cooperation with the Association of Fitters, the Company implemented the Program of sport and in-house contests of employees where 2,500 employees took part.

The program of sport recreation of employees - in line with the internal by-laws, in 2012 the Program of sport recreation of employees was funded which was realized according to the contract on provision of sport recreation services which the representative trade unions concluded with service providers.

SOCIALLY RESPONSIBLE BEHAVIOUR

Humanitarian association of employees in Telekom Srbija "From the Heart" organized in Belgrade and all major towns in the territory of the Republic of Serbia in 2012, total of 37 blood donation campaigns where total of 1,230 employees took part and 5 campaigns of signing donor cards involving participation of 50 employees in the Company.

Within the promotion of socially responsible conduct of the Company, participation of a sport team of the Company employees was organized in September 2012, in a basketball fair play tournament organized by UNICEF.

RISK MANAGEMENT

Financial risk management

In its regular operations, Telekom Srbija is exposed, to different extent, to certain financial risks: market risk (including the risk of a change in the foreign exchange rates, the risk of a change in interest rates and the risk of a change in prices), liquidity risk and credit risk.

The risk management in the Company is directed to minimizing potential negative effects on financial position and Company's business operations in the circumstances of unpredictable nature of financial markets.

Risk management is defined by accounting and financial policies of the Parent Company, adopted by the competent corporate management body.

In 2012, there were no changes in the risk management policies.

MARKET RISK

The risk of a change in foreign currency exchange rates

The Company is exposed to the risk of a change in foreign currency exchange rates when performing business in the country and abroad, arising from the operations in different currencies, primarily EUR. The risk arises both from future business transactions and from recognized assets and liabilities in foreign currency.

The Company's management has established the risk management policy regarding the change in the foreign currency exchange rates versus its functional currency. The foreign exchange clause in contracts with local suppliers is possible only if contracts with credit lines are concerned, as well as lease contracts.

In case the local currency (RSD) recorded 10% growth/decline versus other currencies that are not the functional currency (i.e. if the RSD exchange rate vs. EUR amounted to RSD 102.3465/125.0901

for 1 EUR), as at 31 December 2012, and all other variables remained unaltered, the Company's profit for 2012, after taxation, would be higher/lower by RSD 6,798,869 thousand (2011: RSD 3,471,237 thousand), largely due to exchange rate gains/losses arising from credit liabilities, as well as from recalculation of claims/liabilities from international traffic.

The profit for 2012 was under stronger influence of changes in the foreign currency exchange rates than it was the case in 2011 as a result of considerable decrease in the value of dinar versus EUR, which was additionally influenced by increased liabilities in foreign currency, and the same directly influenced the amount of capital as at 31 December 2012.

Risk of a change in interest rates

Through the effects of changes in the amount of market interest rates, the Company is exposed to the risks that affect its financial position, operating results and cash flows. Given that the Company does not have significant interest-bearing assets, the revenues and cash flows are to a large extent independent of changes in the market interest rates.

The Company risk of changes in the fair value of interest rates primarily arises from the liabilities against long-term loans granted by banks and suppliers.

The loans granted at variable interest rates expose the Company to the interest-based risk of cash flows.

The loans granted at fixed interest rates expose the Company to the risk of a change in the fair value of interest rates.

In 2012 and 2011, the largest portion of liabilities against loans (99%) had a variable interest rate, which was linked to Euribor. The liabilities against loans with variable interest rates are expressed in foreign currency (EUR), i.e. they are linked to EUR by the foreign currency clause.

Gross interest rate on the loans granted by suppliers cannot exceed the level of Euribor plus a margin

of up to 2% p.a., while the price adjustment for local currency contracts is made on the basis of retail price growth above 5% only during the grace period.

The Company performs analyses of exposure to risk from the change in interest rates on a dynamical basis, taking into account alternative financing and refinancing sources, above all for long-term liabilities, given that they represent the most important interest-bearing position.

If the interest rate on loan-based liabilities in foreign currency (from banks and suppliers) was higher/lower by 0.1% annually, as at 31 December 2012, with other unalterable variables, the profit for 2012, after taxation, would be lower/higher by RSD 65,115 thousand (2011: RSD 35,417 thousand), as a result of higher/lower expenditures against interest.

If the interest on loans from suppliers and banks in the country was higher/lower by 0.1% annually, as at 31 December 2012, with other unalterable variables, the profit for 2012, after taxation, would be lower/higher by RSD 52,491 thousand (2011: RSD 6,700 thousand), as a result of higher/lower expenditure against interest.

Risk of a change in prices

The Company is not exposed to a change in the prices of proprietary securities given that the report on financial position does not include investments classified as being available for sale or as financial assets at fair value, for which the effects of changes in value would be expressed in the income statement. The Company's investments in the capital of subsidiaries are not subject to public trading in an active securities market.

On the other hand, the Company is exposed to risk of a change in the service prices, as it is faced with intensive competition in the sphere of mobile telephony, the Internet and multimedia, as well as the emergence of fixed telephony operators, which the Company tries to compensate for by introducing various services.

Besides, the Republic Agency for Electronic Communications (the Agency) has imposed, among oth-

er things, the obligation of price control for specific markets where the Company was pronounced an SMP operator.

Pursuant to the Decision of the Agency's Managing Board, dated 16 June 2011, the subscription for a direct telephone line was increased to RSD 430 (VAT exclusive) as of 1 August 2011, which includes 300 free-of-charge pulses (instead of 150 pulses thus far).

The prices of local calls were increased as well, and the prices of long-distance calls were reduced. By virtue of the Agency's Decision, the fees of termination in the fixed network for the traffic coming from mobile networks were reduced, while the fees for termination of traffic coming from other fixed networks were increased and brought to a cost-based level.

LIQUIDITY RISK


Liquidity management has been centralized on the Company level. The Company manages its assets and liabilities in a manner which ensures, at any time, fulfilment of its liabilities.

The Company has sufficient amount of highly-liquid funds (cash and cash equivalents), as well as continuous inflow of pecuniary funds from service implementation, which enable it to settle its liabilities within due dates. In general, the Company does not use financial derivatives.

In order to manage the liquidity risk, the Company has adopted financial policies, defining maximum amount of advance payments to suppliers of works and equipment, the grace period and repayment term, subject to the value and type of contracted procurement. Besides, the business policy has created dispersion in the decision-making levels when procuring goods/services.

CREDIT RISK

The credit risk emerges with cash and cash equivalents, deposits with banks and financial institutions, loans granted to employees, claims from buyers and assumed liabilities.

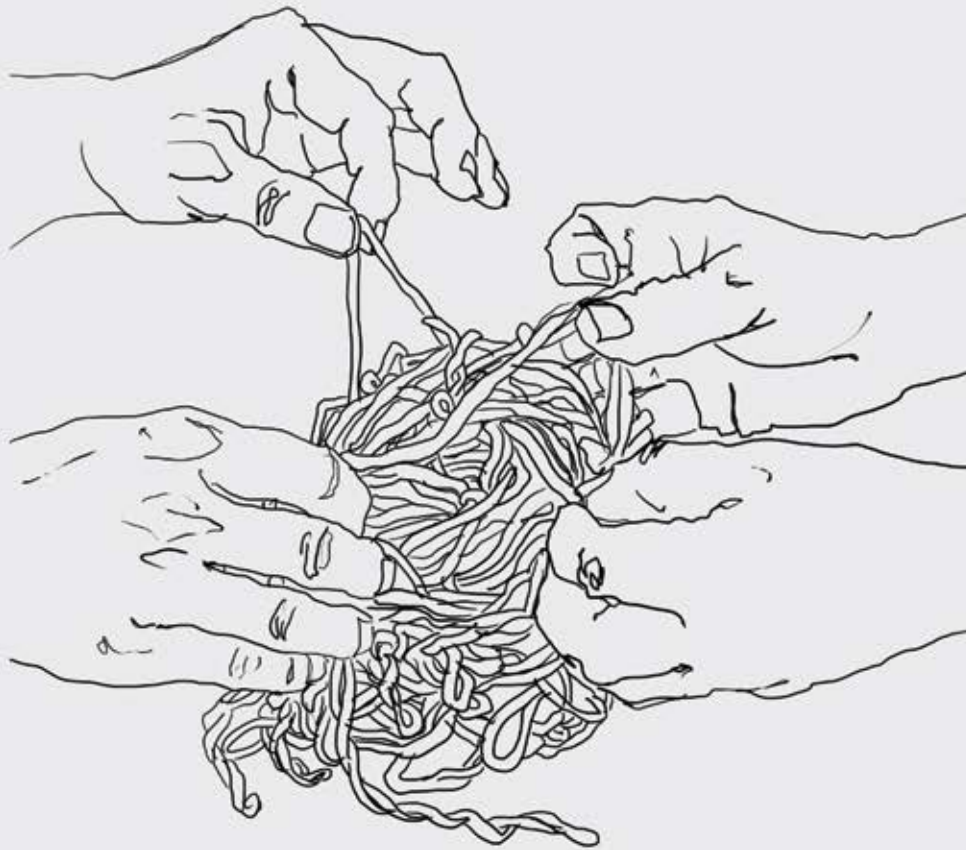


The Company is exposed to the credit risk to a limited extent. Security from credit risk has been constituted by taking specific measures and activities on the Company level.

In case of untimely settlement of customer's liabilities, the Company conducts defined measures for collecting receivables: notices, termination of service provision, suits, etc.

Receivables against roaming and international settlement are not under the direct influence of local market conditions. The said receivables are based on solid bilateral contracts, with concurrent and mutual service provision.

Collection of loans granted to employees in the Company is ensured through attachment of salary, i.e. through deducting the adequate instalment amount from salaries.



REPORT ON CORPORATE
AND SOCIAL RESPONSIBILITY

REPORT ON CORPORATE AND SOCIAL RESPONSIBILITY

Access to social responsibility

Telekom Srbija and its subsidiaries, as a group of successful telecommunications companies in the region, create by their activity a considerable impact on the social environment they operate in, and follow their strategic commitment to give back to the community a part of that business success through planned socially responsible activities.

The companies endeavour to integrate business responsibility into their day-to-day operations, guided by the principles of positive business practice towards the customers, as well as towards employees, business partners and community as a whole.

Besides conducting successful business activities in the region, the Company actively supported numerous socially responsible projects and initiatives in 2012. Stable presence in regional markets, in the field of telecommunications, facilitated the benefit from realized socially responsible activities to be felt in the wider community, which is an advantage that the success of the Company relies on.

Vision and values of Telekom Srbija

In accordance with the vision of the Company to contribute to sustainable development of the society by using communication tools and new technologies, through improving the quality of citizens' lives, the values are created for:

- Owners of the capital – by providing clear and available information, protection of interests and equitable treatment for all capital owners, with the goal to maximize the profits and value of the Company for its shareholders.
- Employees – safety and health at work, professional development, harmonization of internal relations, creation of motivation system, health and social protection, family care and timely and accurate informing.
- Customers – Telekom Srbija is a company focused on the needs and satisfaction of its customers, and regulation of customer relations

is the subject of the Company's Code of Ethics and it is implemented in accordance with the established principles, such as: providing relevant information, availability, choice of the type of service conformed to the specific needs, advisory and professional help, safety, protection and guaranteed quality.

- Community – for Telekom Srbija, investment in community represents an investment in the technologically advanced, knowledge-based inclusive society. The spheres supported by the Company are youth and education, vulnerable groups and areas, culture and art, health and environment. The Company has a strategic approach to the investments in community.

Corporate governance

For Telekom Srbija, good corporate governance does not only involve the work in the interest of shareholders, but it also means an adequate representation and protection of other interests of all interested parties: employees, partners, clients and society as a whole. This refers to equal treatment of all our stakeholders, clarity and availability of information provided to them and the general public, ethics and transparency in the efforts to achieve business objectives. The framework of corporate governance ensures that free market competition is observed and that illegal forms of conduct and unfair market practices are condemned. Books are kept in accordance with legal regulations. Financial statements are published annually, and the Company enables insight into other business-related data to its interested parties, on a voluntary basis. The Company adopted the Corporate Governance Code in 2012, which is available at the corporate website www.telekom.rs.

Transparency in operations

Telekom Srbija transparently and regularly publishes its financial results, within the annual financial statements, verified by an external auditor. In line with its statutory obligations, Telekom Srbija also publishes periodical reports, containing different types of data related to customers and services provided to customers, as well as other reports required by various state institutions, such

as the line ministry, the Serbian Government and RATEL. Internal websites are the means of informing the employees on the business principles, business processes and decisions, as well as on the ethical norms and standards cherished within the Company. Financial statements, as well as other relevant strategic documents, are available on the corporate website.

Code of Ethics

In order to achieve proper relations with and transparency to all interested parties in the conduct of all its business and other activities, Telekom Srbija relies on the established Code of Ethics, also published on the official Company website. This document is a starting point for the Company's social responsibility and it is an integral part of the corporate philosophy. It defines standards, ethical norms and conduct expected in relations with shareholders, employees, clients, community, etc. The Code of Ethics without exception refers to all employees within Telekom Srbija.

Approach to social responsibility

In 2012, the Company continued developing and enhancing its activities in the area of social responsibility, complying with the strategically established guidelines in the subject domain. The greatest efforts in that field were exerted by a task force in charge of implementation and enhancement of social responsibility in the Company. The support of management, CSR experts, and colleagues who contributed with their professional expertise and experience to finalization of the conceived projects, was of the vital importance in achieving success.

To adequately approach identifying and addressing complex social issues, Telekom Srbija points to the significance of setting strategic partnerships with other organisations from private, public and civil sectors, and tries to remain focused on the projects of wide social importance, which contribute to the welfare of a large number of people.

Strategy of socially responsible operations

In the field of social responsibility, the year 2012 was characterized by the activities that followed the key guidelines envisaged by the strategy of socially responsible conduct of the Company, while investments in youth and education, culture and art, development of employees and contribution to environmental protection, remained the topics that the Company was committed to in 2012 as well.

Strategy of investments in community

When selecting topics and content of projects, as well as when selecting partners, in 2012 Telekom Srbija likewise continued following the key strategic directions, focusing on the projects that include as many customers as possible and thus have stronger effect and response in the public. In that manner, a total number of 57 organisations and 48 projects were supported in 2012.

An important step ahead regarding the improvement of community relations is the launch of an *online* competition encouraging civic activism, *Uradi nešto* (Do Something). As a result of the idea itself and the medium through which it has been implemented, this competition represents a completely innovative approach to corporate philanthropy.

MEMBERSHIP IN ORGANISATIONS COMMITTED TO SOCIAL RESPONSIBILITY

Telekom Srbija is committed to constantly improving all its socially responsible activities, establishing partnerships of interest for the community and spreading a socially responsible concept among its employees, as well as among the companies it cooperates with.

Since August 2010, Telekom Srbija has been a member of the Global Compact, a network of socially responsible companies on the global level, operating in Serbia as of 2005. The local Serbian network comprises over 60 companies and associations operating in line with 10 principles based on the UN Millennium Goals, concerning human rights, work, environment and combat against corruption. In 2012, the Company took an active part in the Global

Compact work groups for social inclusion and support in emergencies.

Since 2011, Telekom Srbija has been a member of the Business Leaders Forum – the first network of socially responsible companies in Serbia, set up with a mission to encourage the development of socially responsible business activities and introduce permanent and stable social responsibility practices in domestic business sector. By right of its membership, Telekom Srbija took part in the Forum's regular annual activities.

Connected with employees

One of the basic characteristics of Telekom Srbija approach to social responsibility is protection offered to employees, care of their health and security, personal and professional development and generally of raising satisfaction in the work place to a higher level that guarantees higher motivation of employees and thus higher productivity and better operating results. Internal by-laws within the Company define the work standards and labour rights of our employees, and also the basic guidelines and values of socially responsible behaviour in our relationship with the employees.

According to the applicable Code of Ethics it is continuously invested in improvement of qualification structure of employees aimed at providing the same chances for education and advancement, monitoring and guiding each individual on their development path within the Company. This is also supported by the fact that in 2012 Telekom Srbija, in accordance with the Policy of professional development and continuous education of employees, invested rsd 94,769,000.00 in internal and external training and educational programs for employees aimed at encouraging their creativity and talent so to develop in the best possible way within the Company.

Implementation of the policy of professional development and continuous education of employees, implementation of the policy of social and material protection, implementation of the policy of harmonizing the relationships with employees are described in this Report, Part Employees.

Employee Volunteering

In 2012 Telekom Srbija tried to encourage both the employees and the business partners to take part in voluntary activities so contributing to arrangement of environment. In May 2012 cooperating with the Business Leaders Forum, the Company participated in the campaign entitled Our Belgrade dedicated to public space arrangement in the city. In November the employees in Niš had an opportunity to show their good will and team spirit participating in arrangement of Homeless Children Shelter in the town within the similar campaign, Our Niš.

We are also proud of the fact that ten employees were dedicated to preparing and participating in seminars of youth organizations, which the Parent company cooperates with, and to their tutorship so making considerable contribution to development of cooperation with young people in the field of education and transfer of knowledge and experience within the business field of the Company.

In September 2012, within promotion of socially responsible activities of the Company, the sports team of employees took part in the basketball fair play tournament organized by UNICEF.

The humanitarian association of employees, From the Heart organized 37 voluntary blood donation campaigns for employees in the Company. The total number of 1,230 responded to invitation contributing to this humanitarian campaign.

Also, there were organized 5 campaigns of organ donation cards responded by 50 employees in the Parent Company.

Connected with the business environment

The responsibility of the Parent Company relies on operations that are in accordance with the social moral and ethical standards as well as with generally accepted standards referring to respect of human rights, of both our clients and employees, our partners and suppliers and all those we come into contact with.

In the same way, and in accordance with the Public Procurement Law, Telekom Srbija conducts the process of public procurement. Special attention is paid to fostering partner realtions with product and service suppliers that reached the number of almost 3,000 in 2012 since it is the way of making an indirect contribution to development of the Company.

Telekom Srbija was conferred several awards. One of them was My Choice award, which was granted to mt:s brand in the category of services by Association of Citizens, My Serbia according to customer votes.

Also, as for mobile telephony services brand of the Parent Company, mt:s was granted two first awards by the Association of Serbian Economic Propagandists (UEPS) in the category of the corporate advertising the mobile network upgrade campaign, Upgraded Network and also in the category of Communication Products and Services for the spot entitled Novak and Friends.

Connected with the community

Telekom Srbija, the company that is running business throughout Serbia, employees a large number of people, provides services to a large number of customers, has a responsible approach to any operation conducted by the Company, which is its strategic orientation. Such approach contributes to overall development of the Company, and even better results are achieved if the business sector is working in synergy with the public and civil sectors.

The Company is making its best efforts in directing attention and support to those in need by careful estimation of the Company's needs and acting in accordance with well elaborated strategy.

Telekom Srbija is actively supporting a large number of education, culture and social programs and initiatives. Also, independently or cooperating with the partners, the Parent Company initiated several projects directed to development of the society.

Support to Citizen Activism - the competition Do Something!

Telekom Srbija announced on-line competition Do Something! for the citizens' initiative that contribute to improvement of living conditions in the local community. The Company decided to implement this project because its concept and goals fully correspond to the Company's vision of sustainable development of the Company and improvement of citizens' living conditions using communication tools and new technologies.

Do Something! is the web platform aimed at motivating the citizens to figure out, propose and perform the project that contribute to positive changes in their direct environment.

A total of 105 projects from 45 towns in Serbia entered into competition. More than 600,000 citizens' votes were collected supporting 9 projects in the total amount of RSD 4,320,000. The competition as an innovative solution in the field of corporate philanthropy became a permanent mechanism for supporting the projects from the local communities.

Youth and Education

For several years Telekom Srbija offers pupils and students the possibility of having in-company professional practice. Such practice is basically aimed at getting the youth familiar with the way of practical application of knowledge and skills acquainted at the university and at encouraging them to start thinking about their professional career even during education. Also, the professional practice provides the youth with better professional positioning on the labour market when they start their career.

The Company organized practice for 30 students and 303 pupils, in the first place of the technical profile in the field of telecommunications and information technologies, which is in accordance with the basic operations of the Company, but also for economists, psychologists and the organization science students.

An idea of practical application of knowledge characterizes both projects and activities in support-

ing young entrepreneurs, which the Company performed autonomously or in cooperation with the partners in this specific field.

Cooperation with High School of Mathematics

Within continuous cooperation with the eminent educational institution it was successfully completed the second mt:s Android competition for designing software in Android operating system, which is organized for the pupils attending this school by Telekom Srbija.

The competition was preceded by workshops for designing the Android software, which were held by our engineers as mentors, where the participants could additionally improve their knowledge in this field. The competition proved that mobile software make good platform for pupils to show their programming skills and creative potential that resulted in high level works.

In addition to the competition, the cooperation with the High School of Mathematics developed also through supporting the pupils to attend various competitions and organization of the Summer Math Camp, which was also attended by talented children of our employees.

Installation of solar mobile phone chargers

The successful cooperation with S Energy team initiated in the previous period was further developed by installation of solar mobile phone chargers in towns in Serbia.

This unique project, which is set up by the young entrepreneurs, the students of the Belgrade University, makes an excellent combination of an idea of using the renewable sources of energy and modern technologies and the Telekom Srbija's basic activities thus contributing to development mt:s brand and services.

Thanks to this project, the citizens of Kikinda, Vran-

je, Bor and Valjevo, the towns in the list of those that have the largest number of sunny days in a year, were offered the possibility to charge their mobile phones in the *Strawberry* tree using the solar energy in the public place. The Association of Young Entrepreneurs and Telekom Srbija also developed the portable model of solar charger, which will be installed in front of our retail store.

Pupils as Entrepreneurs

Telekom Srbija recognized an idea of supporting the young entrepreneurs as one of the additional ways of improving the education of young people. The Business Challenge competitions organized by the Serbia Junior Achievement organization were held in Belgrade, Niš, Novi Sad and Požega involving more than 300 secondary school pupils. Telekom Srbija tried to initiate creativity and inventiveness of pupils in resolving the business problems by making a list of actual topics.

Cooperation with students' organizations

Aware of the fact that educated young people are the holders of the development of society, the Company is consistent to its earlier orientation to transfer of recent experience from the world of business to students getting them familiar with contemporary trends in the sphere of telecommunications though expert lectures given by employees.

Supported by Telekom Srbija and cooperating with *ESTIEM (Organization for European Students of Industrial Engineering and Management)*, which has its seat at the Faculty of Organizational Sciences in Belgrade, there were organized two important events – *Case Study Show* and *Academy of Modern Management*. As for the case study, *ESTIEM* is a true partner due to its extensive experience. This year's task for the students was working out a comprehensive environmental protection project.

In this year's Open IT v.6. seminar on mobile phones application held by students organization AIESEC (Association Internationale des Etudiants en Sciences Economiques et Commerciales), the stu-

dents were offered the opportunity to improve their knowledge in this sphere and to get the first-hand information how the High School of Mathematics conceived and conducted the workshop on design of mobile phones application.

As regards the students of electrical engineering, the transfer of knowledge was a true challenge for our colleagues who attended the seminar, Brand New Engineers held by the students organization, EESTEC (Electrical Engineering Students' European Association) since those were the students whose future vocation is closely connected with the activities of the Company.

Cooperation with UNICEF in the School without Violence Programme

The successful multi-year cooperation with the UNICEF office in Belgrade continued through support to the School without Violence programme, according to which the schools in Prokuplje, Pirot and Bujanovac were given space on the future School without Violence website. This programme is aimed at creating safe and stimulating environment for learning, working and development of children in primary and secondary schools in Serbia.

Support to Health Care

Making its best efforts to grant aid and support on time and to the largest number of people, Telekom Srbija invested considerable funds in improvement of curing conditions and staying of patients in hospitals in Serbia. Thanks to such approach the Neurosurgical Department of the Serbia's Clinical Center was provided with the surgical microscope, the Abdominal Surgery Department of the Children Hospital in Belgrade was reconstructed, and also the incubators were procured supporting the Battle for the Babies campaign.

Support to Marginalized Social Groups

In addition to supporting many disabled persons associations, trying to make the status and inclusion of marginalized groups of children better, Telekom Srbija supported the issuance of magazine, Face of

the Street, which is sold by young people who come to Homeless Children Shelter in Belgrade.

Trying to unify all efforts in this sphere, the photo workshop project, EYE of the Street, was organized for the beneficiaries of the Shelter to instruct them how to take photos of city life, which were displayed at the exhibition in Belgrade Youth Center in May. Telekom Srbija contributed to addition education of the workshop attendees buying some photos displayed at the exhibition.

Thanks to Telekom Srbija's support, in May 2012, it was organized the second exhibition of the works by trainees in the art workshop, Tribute to the Hand, which involves persons with Down syndrome.

As the Company that shows special sensitivity to the youngest, by the end of 2012 Telekom Srbija donated Internet and IPTV services to children protection institutions in Serbia. Such donation involved 33 institutions for children and young people, children without parental care, the S.O.S. Children's Village Kraljevo, S.O.S. Children's Village Kamenica, the Foster Care Center in Miloševac, Institute for the Education of Children and Youth Center, Zvečanska.

Telekom Srbija donated the New Year's parcels to the Kolevka Residential Center in Subotica, the Homeless Children Shelter, and to children in Abdominal Surgery Department of the University Children's Hospital in Belgrade.

Culture and Art

In times when performance of many big events in the sphere of culture and art largely depends on support from the economy and successful companies, which is some way to pay back to the community, in 2012 Telekom Srbija identified several important projects in the sphere of culture.

The valuable donation supported renovation of the Bora Stanković Theatre in Vranje, which was almost completely destroyed in the fire. Telekom Srbija was among the first ones that were ready to restore splendour of this important cultural institution with the tradition longer than a century.

Making its contribution to affirmation of young and enterprising young artists in the sphere of design, architecture, interior decoration and visual communications, the Company recognized the potential of making the specially intended working space in Belgrade – Nova Iskra when such idea was in its very beginning. The Nova Iskra is the first design incubator in Serbia and in the region according to co-working concept intended for young professionals in design and architecture and for making connection between creative sector and production.

Opening of the street gallery Bezistan in Belgrade and the idea of converting the neglected passage in the city centre into space intended for exhibiting the works of young artists makes the completely new approach to gallery space and it is such first project in Serbia. The street gallery program is adjusted to exhibiting the works of unrecognized young artists, which illustrate important social themes.

Environmental Protection

By a series of actions of proper disposal of electronic waste and responsible relationship to nature, Telekom Srbija and related companies show their dedication to environmental protection and readiness to conduct ecologically appropriate activities.

In making its strategic decisions, Telekom Srbija takes into account the provisions of the applicable law regulating environmental protection, as well as any potential risks of its operations and impact that may reflect on the natural environment, particularly given the specific characteristics of the telecommunications sector operations. The programs in the field of energy efficiency, economic consumption of resources and e-waste management were continued, and the activities related to recycling and disposal of e-waste in Telekom Srbija produced positive results.

About 35,000 kg of paper was collected in the Printing Center and given free of charge to SWIFT Cooperative, which foundation was donated by the UN and the Republic of Norway Government. Also, in 2012 the Company gave free of charge or sold the following waste:

- In accordance with the obligations stipulated by the law the Company handed over free of charge the electronic waste in the amount of 8,200 kg;
- In accordance with the contract 4,200 toner cartridges were collected and given for recycling;
- It was sold 170 kg of used transformer batteries containing pyralene followed by liquidation and sale of written-off fixed assets consisting of various structure waste materials (about 30 types) in the amount of 747,500 kg, of which about 33,211 kg hazardous waste, or amounting to around RSD 35,300,000;
- In accordance with the obligations stipulated by the law the Company handed over free of charge about 15,000 l of hazardous waste – the unusable fuel collected when power supply units and boiler rooms were cleaned;
- In accordance with the obligations stipulated by the law the Company handed over about 2,000 l of hazardous waste – used antifreeze solution and 200 l of sulphuric acid collected during regular maintenance of power supply and air conditioning plants;
- In accordance with the obligations stipulated by the law the Company handed over about 2,000 l of hazardous waste – used engine oil collected during regular maintenance of spare power supply units.

Besides, Telekom Srbija is making effort to develop its employees and partners' awareness of this subject growing importance in the contemporary world in the field of services. Such efforts are much supported by partnership organizations.

Thus, it was started the cooperation with Green Initiative, the network of civic organizations which carry out activities aimed at development of functional mechanisms of waste primary selection on local and national level. Since the Company monitors standards and takes activities related to collecting and recycling the e-waste and paper the cooperation with Green Initiative will enable the vehicle for collecting the secondary raw materials in Požarevac is also used for transport of used paper from the Telekom Srbija's business premises and the retail store in the town.

%

Operating expenses

Net profit

1,573,000

Amortization

96%

Total liabilities

Consolidated Income Statements

Capital

Current assets

Free cash flow

FINANCIAL RESULTS

FINANCIAL RESULTS

Income Statement

In RSD million	2012	2011
Operating revenues	90,946	90,806
Operating expenses	(75,071)	(71,913)
EBIT	15,875	18,893
EBIT margin	17.5%	20.8%
EBITDA	32,677	36,277
EBITDA margin	35.9%	40.0%
Finance income/(expense) net	(5,465)	4,255
Profit tax	841	(874)
Net profit	11,251	22,274
Net profit margin	12.4%	24.5%
Earning per share	0,01	20,6

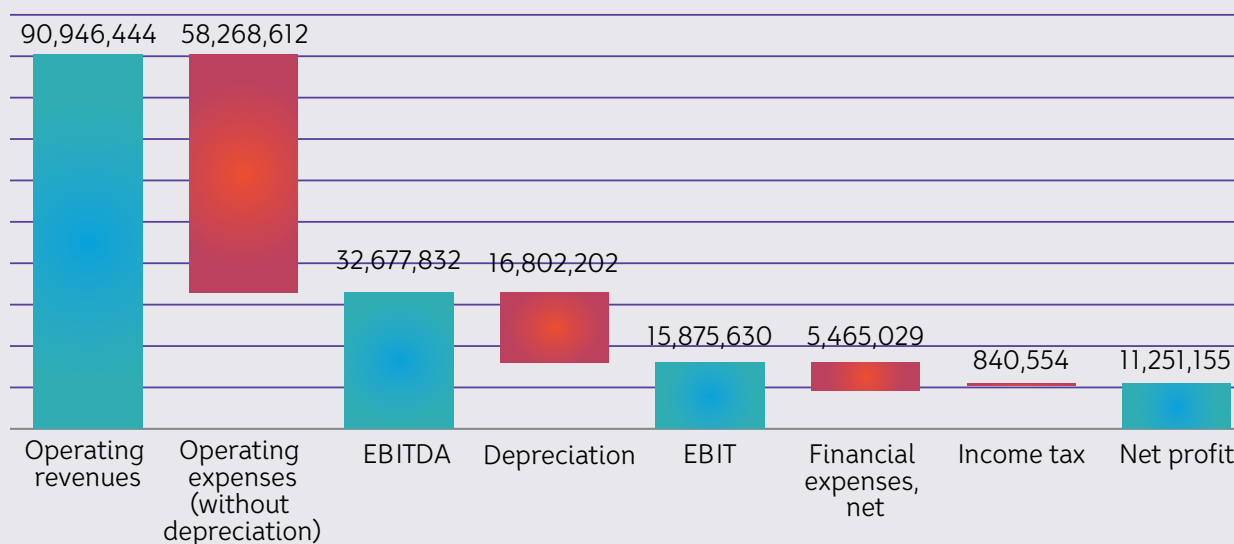
The Company profit after tax amounts to RSD 11.3 billion. Faster growth of operating expenses vs. operating revenues resulted in *EBIT* and *EBITDA* decline and their margins, too. In 2012, *EBIT* amounts to RSD 15.9 billion, whereas *EBITDA* amounts to RSD 32.7 billion.

In 2012 the net result was further considerably influenced by negative financial sub-balance resulting from forex losses and higher interest expenses for new borrowings aimed at financing payment of minor shareholder, OTE's share in the Company's equity and also for refinancing the liabilities under the *Term Facilities Agreement* concluded with financial institutions (the original lenders - 19 banks) of which Unicredit Bank A.G. London Branch Office is the facility agent, whereas Unicredit Bank Srbija a.d. is the payment agent. The total credit funds amount to EUR 470 million with 36 month repayment period for both facilities.

The positive effect on financial and net result was exerted by revenues from dividends paid by Telekom Srpske amounting to RSD 4.1 billion.

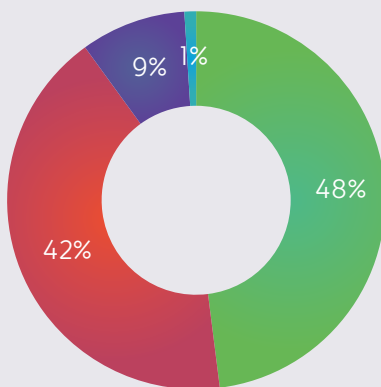
Income Statement

Net profit diagram
(in RSD thousand)



Net profit diagram

In the observed period the operating revenues increased by RSD 141 million amounting to RSD 90.9 billion. In the structure of the parent Company's business segments, fixed telephony recorded decline, whereas mobile telephony, Internet services and multimedia sale increased. An increase in revenues from *broadband* in 2012 covers decline of revenues from traditional services, but it is not sufficient for additional growth of operating revenues.

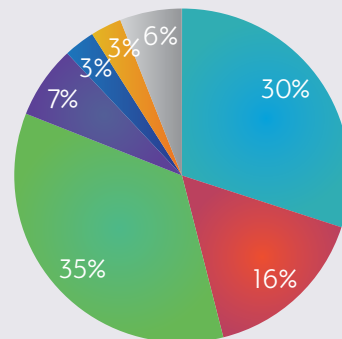


- Fixed telephony
- Mobile telephony
- Internet retail
- Multimedia

Operating revenues per business segments

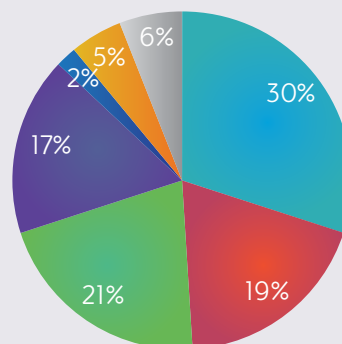
In 2012 the operating revenues from fixed telephony amount to RSD 43.2 billion recoding a decline by RSD 2.0 billion. The revenues from traffic continue to decline considerably amounting to RSD 2.2 billion due to smaller scope of minutes in generated traffic (13.8%) and also due to smaller number of customers (1.3%).

The revenues from mobile telephony increased by RSD 668 million and in the end of the observed period amount to RSD 38.2 billion. The revenues from *postpaid* increased (+15%) mostly resulting from higher revenues from monthly fees amounting to RSD 1.6 billion due to increased number of *postpaid* customers (16.5%), but also due to larger generated traffic. The revenues from interconnection increased by RSD 567 million. On the other hand, the revenues from *prepaid* services continue to



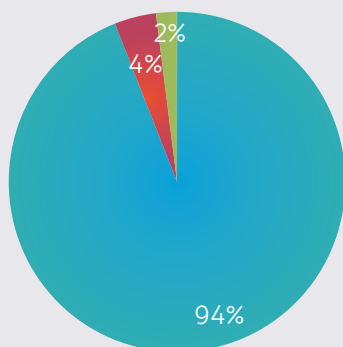
- Traffic in local market
- Foreign market
- Subscription fee
- Lease of lines and data transfer in the country
- Internet wholesale
- Interconnection
- Other

The structure of fixed telephony revenues



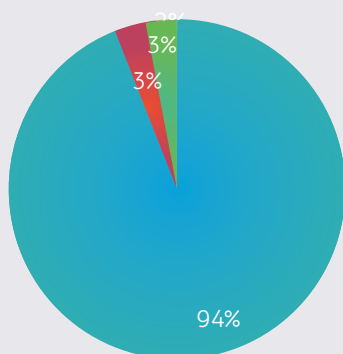
- Prepaid services
- Postpaid traffic
- Monthly fees
- Interconnection
- Roaming
- Incoming tel. traffic terminated in MTS network
- Other

The structure of the operating revenues from mobile telephony



- ADSL
- Direct Internet access
- Other

The structure of Internet retail revenues



- Monthly fees
- Installation services
- Other

The structure of multimedia revenues

decline by RSD 1.6 billion followed by decline in the number of customers (15.6%).

The operating revenues growth is considerably contributed also by *broadband* services, i.e. Internet and multimedia services, which share in the total operating revenues is becoming even more significant. The RSD 1.5 billion growth mostly resulted from increased number of customers.

The operating revenues from Internet retail increase at the rate of 14.7% reaching the amount of RSD 8.2 billion.

The multimedia operating revenues record growth at the rate of 49.4% reaching RSD 1.3 billion in the end of observed period.

In the observed period the operating expenses amount to RSD 75.1 billion and continue to increase at the rate of 4.4%. In the structure of operating expenses the major share is taken by amortization and depreciation, personnel costs and costs of operators

Costs of material and maintenance increased by RSD 738 million mostly due to increased sale of mobile phone packages amounting to RSD 757 million. Besides, the costs of fuel and electricity increased by RSD 171 million. On the other hand, the ADSL modem costs decline by RSD 145 million due to decline of the average purchase price of modems, whereas the costs of spare parts are lower by RSD 68 million.

An increase in the costs of operators by RSD 663 million is considerably influenced by larger costs of interconnection for termination of calls routed from MTS network on the networks of other national operators due to larger volume of traffic.

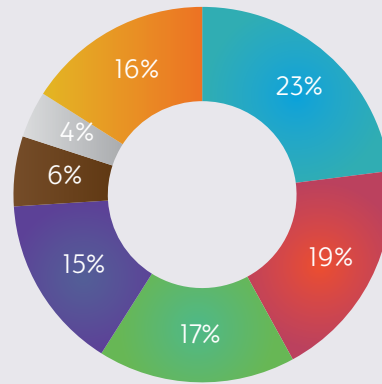
The rental costs increased by RSD 467 million mostly due to weakening of the rsd value vs. EUR (most rental contracts include the foreign currency clause).

The personnel costs declined by 2.0 billion at the rate of 12.5%. The costs related to Parent Company voluntary lay-off in 2011 amounted to RSD 1.6 billion when 597 employees left the Parent Company.

An increase in other costs is mostly influenced by growing costs of fees for public property usage and payment operations costs, which increased by RSD 545 million in total. Besides, in the current period there were recorded the costs of writing-off the replaced radio base stations during upgrade of mobile network in the estimated amount of RSD 2.5 billion.

The highest growth rate is recorded for the costs of IPTV licenses amounting RSD 1.6 billion.

As for personnel costs, which record 12.5% decline, the costs of employees' salaries were increased by 7.0% in January 2012, but the costs of the 13th salary and bonuses were reduced.



- Amortization and depreciation
- Personnel costs
- Operator costs
- Material and maintenance
- Rental costs
- Provision of receivables
- Other

The structure of operating expenses

Balance sheet

In RSD million	31.12.2012.	31.12.2011.
CURRENT ASSETS	34,565	35,924
Inventories	5,829	6,021
Receivables	12,670	12,427
Cash and cash equivalents	10,862	14,019
Other	5,204	3,457
NON-CURRENT ASSETS	167,845	174,308
Intangible assets	6,303	6,178
Property, equipment and advances	96,010	104,143
Share in capital of subsidiaries	60,909	60,894
Other	4,623	3,093
TOTAL ASSETS	202,410	210,232
CURRENT LIABILITIES	51,458	57,478
Current maturity of long-term loans	29,931	28,339
Accounts payable	6,908	6,634
Other short-term liabilities	14,619	22,505
LONG-TERM LIABILITIES	50,946	21,751
Long-term liabilities	46,658	17,317
Other long-term liabilities	4,288	4,434
EQUITY	100,006	131,003
TOTAL LIABILITIES	202,410	210,232

Despite considerable indebtedness level, the positive free cash flow was reached in the amount of RSD 12.7 million mostly due to operating activities cash inflow.

Cash Flows

In RSD million	2012	2011
Profit before tax	10,411	23,149
Depreciation and amortization	16,802	17,384
Adjustment in profit and change in working capital	(2,273)	(5,143)
Net cash flows from operating activities	24,940	35,390
Net capital expenditure	(12,202)	(10,773)
Free cash flow	12,738	24,617
Net cash flows from other investing activities	3,764	2,696
Net cash flows used in financing activities	(19,658)	(21,244)
Net cash (outflow) / inflow	(3,156)	6,069
Cash as of the end of year	10,862	14,019

In 2012 the dividends were paid to shareholders amounting to RSD 11.1 billion, which implies the amount of the preliminary dividends and a difference up to final amount of dividends in 2011.

Capital Structure

In RSD million	31.12.2012.	31.12.2011.
Share capital	100,000	82,513
Other capital	9	9
Reserves	590	590
Retained earnings	39,369	47,892
Negative issue premium	(23,459)	/
Repurchased own shares	(39,962)	/
Total	100,006	131,003

Profitability indicators	2012	2011
ROE (return on equity)	9.7%	17.6%
ROCE (return on capital employed)	10.5%	12.4%

Ratio Analysis

In RSD million	2012	2011
Total debt	76,589	45,656
Net debt	65,727	31,637
Debt coverage (Net debt/EBITDA)	2,01	0,87
Total liabilities/EBITDA	3,1	2,2
Interest expenditures / operating revenues	4.7%	1.8%
Acid test	0,7	0,6

In 2012 the indebtedness level increased mostly due to new borrowings of the Company and, on the other hand, due to repurchase of 20% of the own shares.

