
ERICSSON NIKOLA TESLA D.D.

The Management Report on the Company and Ericsson Nikola Tesla Group business performance with comments on the financial results for the nine months 2017

Highlights:

- Sales revenue: MHRK **1,069.4**
- Gross margin: **11.9%**
- Operating profit: MHRK **70.4**
- Profit before tax: MHRK **67.8**
- Net profit: MHRK **51.9**
- Cash flow from operating activities: MHRK **39.0**

Gordana Kovačević, the President of Ericsson Nikola Tesla, comments:

„In the first nine months, sales revenue of Ericsson Nikola Tesla Group decreased by 5.7% year-over-year. Despite continuous sales revenue growth from services in Ericsson market, we have still not been able to fully neutralize the decrease in sales in CIS markets. Sales revenue in the domestic market slightly decreased, while sales in the markets of Southeast Europe were on the same level as previous year. Ericsson market continues to record an increase in revenue due to expansion of responsibilities and new competencies of our experts in R&D and other expert centers. We have successfully entered into new technology areas, which resulted in high value added job openings. During the first nine months, we hired more than 200 new experts, primarily in R&D.

Almost all key performance indicators recorded a positive trend. Gross profit increased by 5.6%, while operating profit increased by 18.1% year-over-year. Profit before tax increased by 8.7% year-over-year to MHRK 67.8. Despite higher profit before tax, net profit decreased by 10.8% year-over-year due to absence of tax incentives for R&D activities. Gross margin increased year-over-year and amounts to 11.9%. We closed Q3 2017 with a healthy balance sheet and an equity ratio of 30.1%. A positive cash flow from operating activities was realized, amounting to MHRK 39. Dividend payment amounted to MHRK 119.9, so the total cash and cash equivalents, including short-term financial assets at the end of Q3 amounted to MHRK 178.4. Working capital efficiency remains strong, and expressed in Working Capital Days (WCD), is 33 days. Cash conversion is 31%.

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In the domestic market, we are positioned as a reliable partner to our customers in implementing technical solutions for the Networked Society. I would like to highlight a multi-year agreement signed with our long-term partner Vipnet, which encompasses the modernization and expansion of radio access network. This agreement confirms our solo vendor position in this segment. As far as export markets are concerned, we expect new business opportunities in the upcoming period, primarily in Bosnia & Herzegovina. In CIS markets, sales and marketing activities are ongoing on several projects in telecom segment and Industry & Society segment.

End of September, we marked the 17th Anniversary of Ericsson Nikola Tesla Summer Camp. Over the years, in cooperation with FER from Zagreb, FESB from Split, and many other scientific institutions from Croatia and abroad, nearly 800 top STEM students, as well as students from other areas, participated. This year, 70 students from various faculties from Croatia, Great Britain, and Bosnia & Herzegovina, teamed up with their mentors, and worked on projects in the IoT segment, analytics, safety and Cloud Computing.

We continuously adjust to the demands and needs of the market and our customers and make the necessary structural changes. Furthermore, we continue to employ and invest in knowledge and competences of our employees, in order to timely and with quality respond to global market demands and ensure technological leadership.

During Q3, we focused on strategic planning for the upcoming period, by analyzing the situation in all relevant markets, as well as ICT industry trends. We want to strengthen our position in strategic areas: 4G/5G, OSS and BSS, Managed Services and IoT, using the state-of-the-art technology and business models and concepts, such as Cloud solutions, X as a service model (XaaS), etc. In Ericsson internal market, our aim is to maintain the existing responsibilities, and to expand them, with a high quality of delivered services. Considering the current market environment, the company's position and business strategy, our focus remains on strengthening profitability, operational efficiency and responsible risk management, as well as investing in new strategic areas."

Financial highlights for the Group:

- Sales revenue amounts to MHRK 1,069.4 (first nine months 2016: MHRK 1,134.3), down 5.7% year-over-year. Of the total sales revenue, the domestic market accounts for 17%, services to Ericsson account for 62.9% (of which 12.0% relates to Managed Services in Croatia), while other export markets participate with 20.1%.
- Sales in the Network segment amounts to MHRK 651.5 (60.9% of the total sales revenue), IT and Cloud segment amounts to MHRK 416 (38.9% of the total sales revenue), and Media segment amounts to MHRK 1.9 (0.2% of the total sales revenue).
- Gross profit amounts to MHRK 127.6 (first nine months 2016: MHRK 120.8), up 5.6% year-over-year. Gross margin amounts to 11.9% (first nine months 2016: 10.7%).
- Sales and administrative expenses increased by 2.9% year-over-year to MHRK 60.9 (first nine months 2016: MHRK 59.2), primarily as a result of variable compensation to employees and intensified marketing and sales activities.
- Operating profit amounts to MHRK 70.4 (first nine months 2016: MHRK 59.7), up 18.1 year-over-year.

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- Loss from financial activities amounts to MHRK 2.6 primarily due to negative currency deviations (first nine months 2016: gain from financial activities was MHRK 2.8).
- Profit before tax increased by 8.7% year-over-year and amounts to MHRK 67.8 (first nine months 2016: MHRK 62.4).
- Tax losses carried forward on the basis of tax reliefs from R&D projects were used in 2016. Respectively, the estimated income tax liability was calculated, amounting to MHRK 15.9 (first nine months 2016: HRK 4.2).
- Net profit is MHRK 51.9 (first nine months 2016: MHRK 58.2), down 10.8% year-over-year. Return on Sales (ROS) is 4.9% (first nine months 2016: 5.1%).
- Cash flow from operating activities amounts to MHRK 39.0 (first nine months 2016: MHRK 75.1). The cash conversion rate is 31%.
- Total cash and cash equivalents, including short term financial assets, as at September 30, 2017 amount to MHRK 178.4 (24.5% of the total assets), while at the end of 2016, they amounted to MHRK 287.7 (35.6% of the total assets).
- The Company has a lean balance sheet with the total assets of MHRK 727.0. Equity ratio is 30.1%.
- With related parties, the transactions were as follows: sales of products and services amounted to MHRK 667.0 (first nine months 2016: MHRK 649.6), while procurement of products and services amounts to MHRK 184.8 (first nine months 2016: MHRK 299.4).
- As at September 30, 2017, balances outstanding with related parties were as follows: receivables amounted to MHRK 98.4 (end of 2016: MHRK 90.9), and payables to MHRK 71.0 (end of 2016: MHRK 89.3).

Business situation in major markets

In the domestic market, sales revenue amounted to MHRK 182.4, down 1.5% year-over-year.

With strategic partner Vipnet, a multi-year frame agreement was signed, encompassing modernization and expansion of radio access network by using the state-of-the-art technologies from Ericsson's extensive portfolio. The agreed activities will enable further increase in transfer speed and improve user experience for Vipnet users.

Business cooperation with Hrvatski Telekom was continued in the segment of fixed telecommunication network modernization by signing a contract on IMS core system upgrade to the latest technology. The solutions for the modernization of access, core, and transport IP network of HT Group were delivered. The implementation of access devices within TeraStream project was completed. The collaboration in the segment of telecom infrastructure build and maintenance services continues.

With the mobile operator Tele2, an upgrade of MGW nodes was realized within the core network upgrade project. Furthermore, during the third quarter we continued to provide support services for Tele2 entire telecom network.

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In the field of ICT solutions for Industry & Society, we have continued the activities in healthcare digitization, and digitization of the Joint Information System for Land Registry and Cadaster. Furthermore, with the Ministry of the Interior of the Republic of Croatia, the continuation of upgrade of the Border Control System was agreed. In addition to seven previously delivered locations, equipped for border control, the contracted project shall include additional six locations, which will further enhance border surveillance between the Republic of Croatia and the Republic of Serbia. Furthermore, we agreed the delivery of ICT solutions for smart parking for Split Parking utility company. This is the first overall solution for smart parking in Croatia, and represents one of the steps towards a smart city in the mobility segment.

In export markets (Ericsson market excluded) sales revenue amounted to MHRK 214.6, down 31.6% year-over-year.

In the markets of Southeast Europe (Bosnia and Herzegovina, Montenegro and Kosovo) sales revenue amounted to MHRK 97.1, up 0.8 % year-over-year. Long-term unfavorable economic and political situation in these markets has a negative impact on the level and dynamics of operators' investments. In Bosnia and Herzegovina, the operators' investments are expected after resolving regulatory prerequisites for introducing 4G networks. During Q3, we continued the cooperation with operators in fixed and mobile networks modernization and maintenance.

In CIS markets, sales revenue amounted to MHRK 117.5, down 46% year-over-year. We are currently engaged in implementation of projects agreed during 2016. Marketing and sales activities continue, with the aim of improving and developing business with the existing customers, as well as attracting new customers. In these markets, customer financing is key, therefore there is an increased need to cooperate with the Croatian Bank for Reconstruction and Development (HBOR) and commercial banks, in order to better take advantage of these business opportunities.

In Ericsson market, sales revenue amounted to MHRK 672.4, up 5.9% year-over-year. The contribution of the company Ericsson Nikola Tesla Servisi d.o.o., a daughter company of Ericsson Nikola Tesla d.d., to revenue in this market segment amounts to MHRK 128.7.

At the management meeting of Ericsson Nikola Tesla Research & Development Center (R&D), held in September, which gathered the representatives of all units with which we cooperate in Ericsson Corporation, our Center received recognition for its achievements and its ability to assume new responsibilities while retaining the quality level. The results confirm the continuity of excellence, and give impetus to future work and the development of cooperation. In Development Units (Radio, Mobile Core, User Data Management and Cloud) all activities are ongoing as planned. Within the technology innovation incubator *Ericsson Garage Croatia*, projects related to network safety, the application of machine learning algorithms, as well as the application of augmented reality technology for remote support, are ongoing.

The experts of Center for Services and Solutions for Networks & Media have been engaged in projects for numerous customers, such as: Swisscom (Switzerland), Deutsche Telekom (Germany), O2 (United Kingdom), A1 (Austria), Orange (France), Alfa (Lebanon) and Bouygues Telekom (France). These are complex activities of expert analysis, creation of new innovative solutions, optimization and upgrade of existing networks and consultancy services.

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Intense work is ongoing on the development and implementation of software tools for mobile networks management and optimization, such as: Smart Laptop, Smart Rollout Support, Rehomeing Automation Management Tool, and Ericsson Network Engineer.

Experts from Digital Services and Solutions Center were engaged in various demanding projects for customers, such as: Post (Luxembourg), Vodafone (Ireland), British Telecom (United Kingdom), Telekom Austria Group (TAG), Wind3 (Italy), Telekom Slovenije (Slovenia), T-Mobile and Vodafone (Czech Republic), DIGI (Hungary), Deutsche Telekom and Telefonica (Germany), Telefonica (Colombia), Telekom Egypt, Tele2 (Sweden), Veon (Russia), Orange (Belgium), and AsiaCell (Iraq). These activities include design, network applications, Cloud and digital business systems infrastructure.

In Q3, Ericsson Nikola Tesla Servisi d.o.o. was providing services of monitoring, maintenance, and build of telecommunication network to key customer. The growth trend in the segment of providing services towards other telecommunication companies in Europe continues. In the segment of telecommunication network monitoring, the range of application of Ericsson's tools for key customer's monitoring of business processes was expanded. Furthermore, the activities are ongoing regarding mobile broadband and optic network build, focusing on providing services to business users. Despite demanding weather conditions, especially in the southern part of Croatia, we continued to timely provide telecommunication network maintenance, which resulted in a high level of key customer's telecommunication network availability to end users.

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Other information

Ericsson Nikola Tesla major shareholders (as at September 30, 2017)

	Number of shares	% of share capital
Telefonaktiebolaget LM Ericsson	653.473	49,07
Addiko banka d.d. / Raiffeisen mandatory pension fund, B category	123.514	9.28
Splitska banka d.d. / Erste Plavi mandatory pension fund, B category	41.890	3.15
Addiko banka d.d. / PBZ Croatia Insurance mandatory pension fund, B category	21.614	1.62
PBZ d.d. / The Bank of New York as Custodian	17.141	1,29
Zagrebačka banka d.d. / Unicredit Bank Austria AG – clients account	16.700	1.25
Zagrebačka banka d.d. / State Street Bank and Trust Company, Boston	13.935	1.05
PBZ d.d. / custodian client account	9.069	0.68
Addiko banka d.d. / Raiffeisen voluntary pension fund	7.934	0.60
OTP BANKA d.d./INS683	6.944	0.52
Other shareholders	419.436	31.49

Share price information in Q3 2017:

Highest (HRK)	Lowest (HRK)	Closing (HRK)	Market cap. (in MHRK)
1,285.00	1,066.51	1,141.00	1,519.4

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Ericsson Nikola Tesla d.d.

Krapinska 45

Zagreb

OIB: 84214771175

Pursuant to the Articles 407 to 410 of the Capital Market Law (Official Gazette 88/08 and 146/08) the Managing Director of the joint stock company Ericsson Nikola Tesla d.d. Zagreb, Krapinska 45 gives the following:

Statement of the Management Board responsibility

The accompanying consolidated and nonconsolidated financial statements have been prepared in compliance with the International Financial Reporting Standards (IFRS). The financial statements also comply with the provisions of the Croatian Financial Accounting Law valid as of the date of these financial statements.

Unaudited financial statements for the period 1 January 2017 to 30 September 2017 present a true and fair view of the financial position of the Company and of its financial performance and its cash flows in compliance with applicable accounting standards.

Managing Director:

Gordana Kovačević, MSc

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For more information about Ericsson Nikola Tesla's business, please visit <http://www.ericsson.hr>