

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 Q1 2019

Highlights:

- Sales revenue: MHRK **388.2**
- Gross margin: **15.2 %**
- Operating profit: MHRK **41.4**
- Profit before tax: MHRK **42.4**
- Net profit: MHRK **32.9**
- Cash flow from operating activities: MHRK **26.8**

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

“Ericsson Nikola Tesla Group’s business results in Q1 2019 show a continuation of stable business performance. Sales revenue amounted to MHRK 388.2, up by 13.8 % year-over-year. Services to Ericsson increased as a result of business expansion and gaining new responsibilities, primarily in 4G/5G. Our experts are engaged worldwide in numerous projects related to 5G, and in addition, part of 5G development takes place in the Company’s R&D Center. The domestic market also recorded a significant growth in sales revenue. Croatia’s leading operators remain focused on mobile networks modernization, the preparation for introduction of 5G, and digital transformation projects. The revenue growth on the domestic market was also significantly impacted by successful implementation of the State Border Control System of the Republic of Croatia. In the markets of the Commonwealth of Independent States (CIS) and Southeast Europe, sales revenue is slightly lower compared to Q1 2018. In these markets we remain focused on implementation of the contracted projects in the field of mobile networks modernization and healthcare informatization.

Compared to Q1 2018, gross profit decreased by 2.6%, due to investments in the development and growth of Research and Development Center, and a significant increase in engagement and working capital on projects with the Group’s key customers. Operating profit is 2.2% lower due to lower gross profit, while profit before tax increased by 3.4% as a result of positive foreign exchange differences. Net profit increased by 8.6% to MHRK 32.9. A positive cash flow from operating activities was realized, amounting to MHRK 26.8, primarily as a result of collection of customer receivables. At the end of Q1 2019, total cash and cash equivalents, including short-term financial assets, amounted to MHRK 242.5. Group’s Working Capital Efficiency, expressed in Working Capital Days (WCD), was 39 days, and if we exclude services to Ericsson, Working Capital Efficiency was 95 days. Cash conversion rate was 43%.

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At MWC in Barcelona, the leading global event in the world of mobile communications, Ericsson presented many projects primarily focused on 5G and Internet of Things, as well as new possibilities offered to industry and end users. The main characteristics of 5G technology include high bandwidth per user (over 1Gbps), extremely fast network response of several milliseconds, and big capacity of simultaneously connected users and devices. This is extremely important considering that 5G enables a faster digital transformation, economic growth and better business performance for companies in various sectors. Ericsson solutions enable an efficient evolution towards 5G with lower operations costs by supporting the work of 5G with LTE and Massive IoT technologies on the same equipment and same frequencies. Special attention was dedicated to the efficiency of networks operations, which is supported by automation, machine learning, and artificial intelligence.

A Swisscom network optimization project, in which our Company's experts played a key role, was also presented in Barcelona. According to P3 measurement this network is one of the best in the world. The Company's experts also participated in the presentation of key aspects of mobile networks evolution towards 5G and IoT on the Ericsson City Model.

In line with our strategy, we are focused on development of solutions and sales in the field of mobile broadband Internet access (4G/5G mobile solutions), Industry & Society segment (healthcare, public safety, e-Business, etc.), solutions for digital transformation and networks management. As we have previously communicated, we have been working on strategic contracts and have been investing in 5G, which will impact margins short term, but will strengthen our market position in the long term. Furthermore, we are focused on strengthening our position in Ericsson market by focusing on maintaining high performance, quality, and cost efficiency. In line with the above, we continue hiring and investing in equipment and development of strategic knowledge and skills.

We remain focused on cost and operating efficiency and strategic risk management.“

Financial Highlights for the Group:

- Sales revenue amounted to MHRK 388.2 (Q1 2018: MHRK 341.0), up by 13.8% year-over-year. Of the total sales revenue, domestic market accounted for 23.6%, services to Ericsson accounted for 65.1% (of which 10.1% is related to Managed Services in Croatia), while other export markets accounted for 11.3%.
- Sales in the Networks segment amounted to MHRK 208.7 (Q1 2018: MHRK 203.4), Digital Services amounted to MHRK 140 (Q1 2018: MHRK 95.4), Managed Services amounted to MHRK 39.2 (Q1 2018: MHRK 41.9), and the segment Emerging Business and Other amounted to MHRK 0.2 (Q1 2018: MHRK 0.3).
- Gross profit amounted to MHRK 58.8 (Q1 2018: MHRK 60.4), down by 2.6% year-over-year due to investment in the development and growth of R&D Center, and significant increase in engagement and working capital on projects with the Group's key customers. Gross margin decreased to 15.2% (Q1 2018: 17.7%).
- Sales and administrative costs were 1.2% lower year-over-year and amounted to MHRK 17.5 (Q1 2018: MHRK 17.8).
- Operating profit amounted to MHRK 41.4 (Q1 2018: MHRK 42.4), a decrease by 2.2% year-over-year, due to lower gross profit.
- Gain from financial activities was MHRK 1.0 (Q1 2018: loss from financial activities amounted to MHRK -1.4).

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- Profit before tax increased by 3.4% year-over-year to MHRK 42.4 (Q1 2018: MHRK 41), primarily as a result of positive foreign exchange differences.
- Net profit increased by 8.6% year-over-year and amounted to MHRK 32.9 (Q1 2018: MHRK 30.3). Return on Sales (ROS) was 8.5% (Q1 2018: 8.9%).
- Cash flow from operating activities amounted to MHRK 26.8 (Q1 2018: MHRK 9.4). Cash conversion rate was 43% (Q1 2018: 17%). Working Capital Efficiency, expressed in Working Capital Days (WCD), was 39 days (Q1 2018: 27 days), and excluding services to Ericsson, WCD was 95 days (Q1 2018: 77 days).
- Total cash and cash equivalents, including short term financial assets, as at March 31, 2019 amounted to MHRK 242.5 (24.7% of the total assets), while at the end of 2018, it amounted to MHRK 236.4 (28.1% of the total assets).
- The Company has a lean balance sheet with total assets of MHRK 980.6 as at March 31, 2019, up by 17% compared to end 2018, due to significant increase in inventory and right-of-use assets. The level of inventory increased due to increased engagement on network modernization projects. Due to the application of new International Financial Reporting Standards (IFRS 16 Leases), in force as of January 1, 2019, the Company acknowledged MHRK 65 of the right-of-use assets and acknowledged lease commitments in the same amount.
- Equity ratio amounted to 34.5% (end of 2018: 36.3%).
- With related parties, the transactions were as follows: sales of products and services amounted to MHRK 255.7 (Q1 2018: MHRK 203.8), while procurement of products and services amounted to MHRK 89.5 (Q1 2018: MHRK 77.1).
- As at March 31, 2019, balances outstanding with related parties were as follows: receivables amounted to MHRK 114.7 (end of 2018: MHRK 113.2), and payables amounted to MHRK 67.6 (end of 2018: MHRK 40.4).

Business situation in major markets

In the domestic market, sales revenue amounted to MHRK 91.5 (Q1 2018: MHRK 57.9), up by 58% year-over-year.

With strategic partner A1 Hrvatska, we continue the successful realization of a multi-year frame agreement which encompasses modernization and expansion of radio access network by using the latest products from Ericsson's portfolio. Furthermore, the collaboration in the field of core network and transport telecom network continues, which contributes to an increased quality and new services for end users.

It has been a year since we contracted mobile network modernization with Hrvatski Telekom (HT). This project encompasses the complete modernization of infrastructure, transport capacities and radio equipment according to SRAN concept – a technology which ensures coexistence of 2G, 3G, 4G and 5G network on the same equipment. During the last 12 months, more than 50% of radio equipment locations were fully modernized, and network capacities were increased multiple times.

Additionally, Ericsson Nikola Tesla and Hrvatski Telekom continue a successful cooperation in the fields of fixed telecommunication network and delivery of services of telecommunication infrastructure maintenance and rollout.

For the operator Tele2, we have delivered the equipment for microwave transport network expansion. We increased the capacity of database with 4G user information, and continued to provide support services for voice core network.

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In the field of ICT solutions for Industry & Society, activities continue on the implementation and upgrade of the Joint Information System for Land Registry and Cadaster. The project of upgrading the Central Healthcare Information System of the Republic of Croatia continues. In line with the Agreement on further implementation of the State Border Control System, signed with the Ministry of Interior of the Republic of Croatia, we have fully completed the agreed contractual obligations.

In export markets (excluding Ericsson market) sales revenue decreased by 3.6% year-over-year to MHRK 43.8 (Q1 2018: MHRK 45.4).

In the markets of Southeast Europe (Bosnia and Hercegovina, Montenegro and Kosovo) sales revenue amounted to MHRK 23.4 (Q1 2018: MHRK 24), down by 2.4% year-over-year. We expect business activities to intensify in Bosnia and Herzegovina, following granting of LTE licenses and approval for commercial launch of LTE services. We should highlight the continuation of good cooperation with the operators HT Mostar, Crnogorski Telekom and Ipko on modernization and maintenance of telecommunication networks.

In CIS market sales revenue amounted to MHRK 20.4 (Q1 2018: MHRK 21.5), down by 5.1% year-over-year. Main activities encompass LTE network expansion with the operator beCloud (Belarus). Furthermore, activities on the project of healthcare system informatization in Kazakhstan, in cooperation with the Ministry of Healthcare of the Republic of Kazakhstan, continue.

In Ericsson market, sales revenue amounted to MHRK 252.9 (Q1 2018: MHRK 237.6), up by 6.4% year-over-year. The contribution of Ericsson Nikola Tesla Servisi d.o.o., a daughter company of Ericsson Nikola Tesla d.d., to revenue in this market segment amounted to MHRK 39.3 (Q1 2018: MHRK 42).

R&D Center continuously expands the Center's responsibilities. In the Networks segment (radio systems) and Unified Data Management (UDM) segment, R&D Center has delivered a series of new functionalities for the state-of-the-art systems to the market. Among many other projects, our experts worked on virtualization of products for Mobile Switching Centre (MSC), Home Location Register (HLR), and Equipment Identification Register (EIR) for many customers. During a regular management meeting, the colleagues from Ericsson Corporation have once again highly rated the quality, efficiency, innovativeness and results of R&D Center. The latest evaluations give an additional encouragement for further development, as the results achieved are the best since we have been participating in this assessment.

Experts from Services and Solutions Center for Networks, along with contracts for Ericsson Nikola Tesla, worked on projects for customers in France, Germany, Switzerland, Egypt, Saudi Arabia, Oman, Mexico, Indonesia, Iraq, South African Republic, etc. These are complex activities in the field of expert analytics, creation of new innovative solutions, optimization and upgrading of the existing networks, and consultancy services. We continued to work on the development and implementation of software tools for mobile networks management and optimization.

Experts from Services and Solutions Center for Digital Services and Operations were engaged on projects for the Ericsson customers in Austria, United Kingdom, Germany, Denmark, France, the Netherlands, Ireland, Switzerland, Italy, Slovenia, Serbia, Moldova, etc. These activities include the most complex projects of introducing 5G technology, operational and business support systems, as well as numerous projects of introducing core solutions in cloud.

Our teams from IT& Engineering Services and Industry and Society segment, achieve quality results on projects of test environment management, IT operations management, IoT platform, and Connected Urban Traffic.

Ericsson Nikola Tesla Servisi successfully provided services of monitoring, maintenance and rollout of HT's telecommunication network. During Q1, preparations were made for rollout of fiber optic networks.

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Other information

Ericsson Nikola Tesla Annual General Meeting shall be held on June 13, 2019. The right to participate at the Annual General Meeting have shareholders, or their proxies, respectively, who register to participate until June 06, 2019, at the latest.

The shareholders who have the Company shares registered on their securities account in the Central Depository & Clearing Company on June 19, 2019 are entitled for dividend payment in total amount of HRK 70.6 per share. Ex-dividend date is June 18, 2019.

Ericsson Nikola Tesla major shareholders (as at March 31, 2019)

	Number of shares	% of share capital
Telefonaktiebolaget LM Ericsson	653,473	49.07
Addiko Bank d.d. / Raiffeisen mandatory pension fund, B category	123,514	9.28
OTP banka d.d. / Erste Plavi mandatory pension fund, B category	44,955	3.38
Addiko Bank d.d. / PBZ Croatia osiguranje mandatory pension fund, B category	16,810	1.26
PBZ d.d. / The Bank of New York as Custodian	14,171	1.06
Zagrebačka banka d.d. / Unicredit Bank Austria AG – clients account	12,981	0.97
Zagrebačka banka d.d. / State Street Bank and Trust Company, Boston	12,428	0.93
PBZ d.d. / custodian client account	9,734	0.73
OTP banka d.d. /OTP Index fund - open-end alternative investment fund with public offering	8,462	0.64
Addiko Bank d.d. / Raiffeisen voluntary pension fund	7,934	0.60
Other shareholders	427,188	32.08

Share price information in Q1 2019:

Highest (HRK)	Lowest (HRK)	Closing (HRK)	Market cap. (In MHRK)
1.145,0	972,0	1.110,0	1.478,1

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Pursuant to the Articles 462 to 468 of the Capital Market Law (Official Gazette 65/18) 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 non-consolidated 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 January 1, 2019 to March 31, 2019 present a true and fair view of the financial position of the Company and the Group and of the financial performance and cash flows in compliance with applicable accounting standards.

Managing Director:

Gordana Kovačević, MSc

A handwritten signature in black ink, appearing to read "Gordana Kovačević".

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