
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 of 2016

Highlights:

- Sales revenue: MHRK **1,134.3**
- Gross margin: **10.7%**
- Operating income: MHRK **59.7**
- Profit before tax: MHRK **62.4**
- Net profit: MHRK **58.2**
- Cash flow from operating activities: MHRK **75.1**

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

„During the first nine months, Ericsson Nikola Tesla continued its stable business performance. Sales revenue increased by 17% year-over-year, due to a significant increase in revenue in CIS and Ericsson market, thus neutralizing the decline in revenue in the domestic market, as well as the markets of Southeast Europe.

Despite the demanding market environment, our investments in new solutions development, as well as strong marketing and sales activities brought us success in CIS market. The main activities there concern the healthcare informatization in Kazakhstan, and the implementation of LTE networks in Belarus, Moldova and Armenia. During Q3, in collaboration with the Armenian operator Ucom, an advanced LTE network was rolled out in the capital city of Yerevan. Furthermore, the collaboration was agreed with the Belarusian company beCloud, regarding the delivery of LTE network and related services in three regions of the Republic of Belarus.

Export of services to Ericsson is growing, due to business expansion and new responsibilities in R&D center and Service Expertise Unit, which shows that the quality and added values that we deliver have been recognized by Corporation and the customers worldwide. Since the beginning of 2016, we hired 227 experts, most of whom work on research and development of new ICT products, solutions and services that address the Networked Society requirements.

In the markets of Southeast Europe, we record a decrease in sales revenue due to negative economic trends and complex political situation. In the domestic market, strong competition, as well as global customers/operators'

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consolidation and centralization of sourcing processes, pose additional challenges. In the eSystems segment, many projects have been postponed due to early parliamentary elections.

In the first nine months 2016, net profit amounted to MHRK 58.2, representing 5.1% ROS. Gross margin is lower year-over-year, due to changing business mix and continued price pressure. We continue to exercise firm cost control. Sales and administrative costs decreased by 1.5% year-over-year. The end of the quarter was concluded with a lean balance sheet and an equity ratio of 31.6%. A positive cash flow from operating activities was realized, amounting to MHRK 75.1. The total cash, including short-term financial assets, amounts to MHRK 193.8. Working capital efficiency remains strong, expressed in working capital days of 25. The cash conversion rate is 59%.

Estimated income tax expense disclosed for the period amounts to HRK 4.2 million. Income tax is calculated based on the tax laws, which includes the use of the Program relating to tax incentives for research and development projects and accompanying tax loss. Since the Program expired on 31 December 2014, the legal basis for applying for new research and development projects does not exist. Accordingly, income tax expense was recognized based on the estimate that the remaining tax reliefs and tax loss are not sufficient to offset the income tax base.

At the end of September, we marked the closing of 16th Ericsson Nikola Tesla Summer Camp. In this year's Summer Camp, a total of 62 students from 16 faculties from Croatia and neighboring countries participated. With the help of their mentors they worked on 26 projects in the following segments: IoT, Big Data, e/m Health and SW tools. Over time, Summer Camp became a recognizable and valued brand, representing an example of quality collaboration between business and the academic community. More than 700 students, who participated in the Summer Camp during the last 16 years, had the opportunity to work in real ICT industry environment, and to participate in the process of creating the latest technology products, solutions and services.

During the third quarter we launched a new cycle of strategic planning for the period up to 2019, by analyzing the current situation in all relevant business and technology segments and trends relating to the future developments in the ICT industry. Our goal is to strengthen business performance in strategic segments through transformation programs (4G/LTE, Managed Services, Operations and Business Support Systems, Cloud, Industry & Society), as well as Ericsson internal market. It is expected that economic uncertainty and unfavorable industry trends will continue in the future period. Therefore, a significant place in our strategy is dedicated to responsible risk management and cost and efficiency.

We continue to strengthen our technology leadership through innovation and invest in knowledge and competences of our employees, because that is precisely what makes us a strong business partner to existing and new customers. “

Financial highlights for the Group:

- Sales revenue amounts to MHRK 1,134.3 (first nine months 2015: MHRK 967.6), 17.2% increase year-over-year. Of the total sales revenue, the domestic market accounts for 16.3%, services to Ericsson account for 56% (of which 11.7% relates to Managed Services in Croatia), while other export markets participate with 27.7%.

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- Sales in the network segment amounts to MHRK 551.4 (48.6% of the total sales revenue), services segment amounts to MHRK 563.2 (49.7% of the total sales revenue), and support solutions segment accounts for MHRK 19.7 (1.7% of the total sales).
- Gross profit amounts to MHRK 120.8 (first nine months 2015: MHRK 124.6), down by 3% year-over-year. Due to changing business mix and continued price pressure, gross margin decreased to 10.7% (first nine months 2015: 12.9%).
- Selling and administrative expenses decreased by 1.5% year-over-year to MHRK 59.2 (first nine months 2015: MHRK 60.1).
- Operating income decreased by 2.5% year-over-year and amounts to MHRK 59.7 (first nine months 2015: MHRK 61.2).
- Net finance income is MHRK 2.8 (first nine months 2015: MHRK 0.1), primarily due to revaluation of financial assets.
- Profit before tax increased by 1.8% year-over-year and amounts to MHRK 62.4 (first nine months 2015: MHRK 61.3). The estimated income tax expense amounts to MHRK 4.2 (first nine months 2015: MHRK 0.4).
- Net profit is MHRK 58.2 (first nine months 2015: MHRK 60.9). ROS is 5.1% (first nine months 2015: 6.3%).
- Cash flow from operating activities is MHRK 75.1 (first nine months 2015: MHRK 138.1).
- Total cash and cash equivalents, including short term financial assets, as at September 30, 2016 amount to MHRK 193.8 (26.1% of the total assets), while at the end of 2015 they amounted to MHRK 287.1 (39.7% of the total assets).
- The Group has a lean balance sheet with total assets of MHRK 741.9 (end of 2015: MHRK 723.9). The equity ratio is at 31.6%.
- With related parties, the transactions were as follows: sales of products and services amounted to MHRK 649.6 (first nine months 2015: MHRK 610.8), while procurement of products and services amounted to MHRK 299.4 (first nine months 2015: MHRK 199.2).
- As at September 30, 2016 balances outstanding with related parties were as follows: receivables amounted to MHRK 100.6 (end of 2015: MHRK 117.0), and payables MHRK 92.5 (end of 2015: MHRK 52.7).

Business situation in main markets

In the domestic market, the total sales revenue amounted to MHRK 185.2, a decrease by 9.9 percent year-over-year.

The cooperation with the strategic partner Vipnet has continued on the modernization of radio access network and transport telecom network, as well as on 3G and 4G technology capacity increase. Further testing of new

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functionalities is ongoing in various areas of core and access network that contribute to the increased quality and new services for end users.

Business cooperation with Hrvatski Telekom has continued in the segment of modernization of the fixed telecom network, delivering solutions for Hrvatski Telekom's access IP network and transport network. Activities in the segment of telecom infrastructure build and maintenance services have intensified. Activities related to identification and realization of future projects are ongoing.

With the mobile operator Tele2, we engaged in the upgrade of software support for the network core nodes monitoring system. In order to insure sufficient network data transfer capacity, we worked on the transport network upgrade in microwave and fiber optic areas. Furthermore, we provide support and maintenance services for Tele2 entire telecom network.

In the field of ICT solutions for Industry & Society, we have continued the healthcare informatization (eHealth). In cooperation with the Croatian Health Insurance Fund (HZZO) we started the implementation of the eHealth Record, as well as the Portal for Patients available through eCitizens system.

Implementation of the Joint Information System of Land Registry and Cadaster continues with success and will be completed with the inclusion of the Zagreb Municipal Office for Cadaster.

[In export markets \(Ericsson market excluded\)](#) sales revenue amounted to MHRK 313.9, an increase by 76.8 percent year-over-year.

In Southeast Europe markets (Bosnia and Herzegovina, Montenegro and Kosovo) sales revenue decreased by 21.8 percent year-over-year and amounts to MHRK 96.3. The unfavorable economic and political situation continues to have a negative impact on operators' investment dynamics making them extremely slow. Cooperation with operators in fixed and mobile networks maintenance has continued.

In Q3, a contract related to fixed core network modernization, using the state-of-the-art Ericsson solutions, was signed with the Bosnia & Herzegovina operator HT Mostar. This modernization will enable quick development of fixed and mobile multimedia services in HT Mostar network.

In the Commonwealth of Independent States market, sales revenue amounted to MHRK 217.6, an increase by 300.1 percent year-over-year. The realization of projects in Kazakhstan, Belarus, Moldova and Armenia is ongoing.

During Q3, the collaboration on LTE network delivery, roll out and related services was agreed with the Belarusian company beCloud. This project that will be implemented by end 2017, belongs to the second phase of LTE technology introduction in three Belarusian regions.

In cooperation with the Armenian operator Ucom, an advanced LTE network, based on Ericsson multi-standard radio equipment and the best in class Antenna Integrated Radio (AIR) system, was rolled out in the area of the capital city of Yerevan. The roll out of this network supports the rapidly increasing data traffic in Armenia, and enables an increased quality, speed and more advanced applications.

[In the Ericsson market](#), sales revenue amounted to MHRK 635.2, an increase by 8.7 percent year-over-year.

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In the Research & Development, activities related to software application and platform development for radio systems within the Network Radio Development Unit significantly increased. Activities within the development units Mobile Core, User Data Management and Cloud are ongoing as planned.

Research projects are strongly focused on the segment of Big Data processing and analysis as well as on the virtualization and cloud solutions.

Ericsson Nikola Tesla Summer Camp that lasted five weeks gathered 62 students from Croatia and neighboring countries. Led by their mentors, they worked on 26 projects in the areas of Big Data processing and analysis; IoT, e/m-Health and Virtual and Augmented Reality.

Service and Solutions Delivery Center experts have been engaged in projects for customers worldwide: BASE (Belgium), DIGI (Hungary), POST (Luxembourg), Tango (Luxembourg), Telefonica (Germany), Deutsche Telekom Group, Telekom Austria Group, Vodafone (United Kingdom), Swisscom (Switzerland), Telekom Slovenije (Slovenia), Turk Telekom (Turkey), etc. We can highlight the activities related to Virtualization/Cloud for POST (Luxembourg) and Tango (Luxembourg), VSPP (Video Storage & Processing Platform) for Swisscom (Switzerland), ONE Core and BSS for Telekom Austria Group, and UDM (User Data Management) for BASE (Belgium), DIGI (Hungary) and Vodafone (United Kingdom). With our radio access network competence domain regional team transferring to Global Services Organization, Ericsson Nikola Tesla became an important site in the Global Expertise Unit, according to the number of experts. We would like to highlight that the experts of this unit developed the tool for supporting Key Events (Key Event Experience) that was used during the Olympic Games in Brazil. Furthermore, we provided e2e solutions design and consultancy services for KPN (Netherlands), MTN (Iran), Slovak Telekom (Slovakia), and Telefonica O2 (United Kingdom), as well as to Ericsson Teams in the Regions Western and Central Europe and Middle East.

There is a substantive engagement in the development and implementation of software tools for mobile networks management and optimization, such as: Smart Laptop, Smart Rollout Support, Rehoming Automation Management Tool, Radio Network Proposal Tool, Ericsson Network Engineer, Extended Support Request, etc.

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 133.3. From key activities towards Hrvatski Telekom in the past quarter, we would like to highlight a successful completion of the VDSL (Very high bit rate Digital Subscriber Line) user migration project, successful continuation of the project regarding capacity increase and mobile broadband coverage as well as additional engagement in the program of design and construction of fiber optic networks. Activities towards other customers in Europe in the area of radio access network modernization and fiber optic network design and build expanded. The transformation process aimed to adaptation to new business models and accompanying standards in the segment of telecom network build and maintenance services is ongoing.

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Other information

Overview of major shareholders of Ericsson Nikola Tesla (as at September 30, 2016)

| | Number of shares | % of share capital held |
|---|------------------|-------------------------|
| Telefonaktiebolaget LM Ericsson | 653,473 | 49.07 |
| Addiko bank d.d. / Raiffeisen Mandatory Pension Fund, B category | 123,514 | 9.28 |
| Societe Generale-Splitska banka d.d. / Erste Plavi Mandatory Pension Fund, B category | 41,890 | 3.15 |
| Addiko bank d.d. / PBZ Croatia osiguranje Mandatory Pension Fund, B category | 22,627 | 1.70 |
| PBZ d.d. / The Bank of New York as custodian | 21,298 | 1.60 |
| Zagrebačka banka d.d. / custodian account for Unicredit Bank Austria AG | 17,280 | 1.30 |
| Zagrebačka banka d.d. / State Street Bank and Trust Company, Boston | 13,705 | 1.03 |
| Addiko bank d.d. / Raiffeisen Voluntary Pension Fund | 7,934 | 0.60 |
| PBZ d.d. / custodian client account | 7,295 | 0.55 |
| OTP BANKA d.d./INS683 | 6,225 | 0.47 |
| Other shareholders | 416,409 | 31.25 |

Share prices in Q3 2016:

| Highest (HRK) | Lowest (HRK) | Closing (HRK) | Market cap. (MHRK) |
|---------------|--------------|---------------|--------------------|
| 1,165 | 1,000.03 | 1,142 | 1,520.7 |

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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 Jan 2016 to 30 Sep 2016 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

A handwritten signature in dark ink, appearing to read "Gordana Kovačević", written in a cursive style.

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