
ERICSSON NIKOLA TESLA D.D.

The Management Report on the Group and the Company Ericsson Nikola Tesla business performance and comments on 2015 financial results

Highlights:

- Sales revenue: MHRK **1,364.3**
- Gross margin: **13.0%**
- Operating profit: MHRK **91.4**
- Net profit: MHRK **91.3**
- Cash flow from operating activities: MHRK **243.1**
- Information on dividend proposal amount will be subsequently published

Gordana Kovačević, the President of Ericsson Nikola Tesla comments:

„Business results in 2015 show a stable business performance. Sales revenue increased by 3.8% year-over-year. A significant increase in revenue was recorded in Ericsson market, thus neutralizing the revenue decrease in other markets. If we analyze the relation between internal and external customers from 2010, until 2015, share of internal Ericsson market in the Group revenue increased from 36% to 60%. During 2015, internal Ericsson market share significantly grew due to increased volume in managed services, but also due to new responsibilities within global organization (research and development center, global and regional services centers, as well as customer solutions centers). We have maintained the position as the Croatia's leading ICT exporter and the leading exporter of knowledge. In 2015 we continued hiring and employed 435 experts. The number of employees working in research and development surpassed 1,000 and at the end of 2015 Ericsson Nikola Tesla Group had a total of 2,789 employees.

In other markets, sales revenue decreased as some projects and contracts have been postponed. The factors that slowed down certain processes are slow economic development and, in some markets, political uncertainty. An additional challenge for our business performance is strong competition and global customers/operators centralized procurement & consolidation.

On the other hand, new business opportunities are created through the convergence of operators and industry, and their transformation through mobility, broadband and cloud. Our markets recognize an increasing importance and role ICT has on transformation processes in business and society. To our customers we want to be the leading ICT

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transformation partner. Our significant advantage is a strong position and customers' trust we enjoy in local and regional markets, thus empowering us to be the leading ICT transformation partner to our customers.

Almost every key financial performance indicator shows positive trend. Operating profit increased by 12.2% year-over-year to MHRK 91.4, while net profit increased by 4.6% to MHRK 91.3. Gross margin is slightly lower year-over-year, as a result of change in business mix (increase in services to Ericsson) and a continuous price pressure. This change in business mix results in lower margin, however, at the same time it reduces substantially business and operating risks and allow lower levels of working capital to be employed. Our continuous focus on cost efficiency has brought solid cost savings. Sales and administrative costs decreased by 9.1% year-over-year, thus ensuring a solid operating income. A strong cash flow from operating activities of MHRK 243.1, allowed build-up of the total cash balances, including short term financial assets to MHRK 287.1. Continuous focus on working capital efficiency has led to a decrease in the account receivables by 9% year-over-year and inventory levels by 31.5% year-over-year. The working capital efficiency, measured by the performance indicator Working Capital Days (WCD) is 32 days. The cash conversion rate is at high 153%. In 2015, the annual Employee Engagement Survey (Dialog) confirmed the Company's motivating culture and strong employee engagement. Furthermore, the annual Customer Satisfaction Survey confirmed a high level of satisfaction among our key customers/partners.

We continued partnership with universities and research institutions by implementing joint projects, some of which are funded by the European Union. In 2015 we marked 15 years of Ericsson Nikola Tesla Summer Camp. During this period, more than 600 students from universities in the country and abroad participated in the Summer Camp and realized more than 400 innovative high-tech projects.

In line with our strategy, during 2015 we worked on various projects and initiatives focused on business development in all markets, and profitability improvement through cost efficiency and business excellence.

Through the strategic initiative that focuses on business growth in the domestic and export markets (without the internal Ericsson market), we focused on key deals in 2015, as well as defining strategic areas and competence development.

During the year, we realized several key deals. Business deals/contracts with Vipnet and Kosovo operator IPKO in mobile network segment, thus keeping the solo vendor position for these operators. In ICT solutions for Industry and Society segment, I would like to highlight contracts regarding the upgrade and expansion of Joint Information System of Land Registry and Cadaster, and maintenance and upgrade of the Republic of Croatia Central Healthcare Information System (CEZIH). For the Ministry of the Interior of the Republic of Croatia for Operational and Communication Center we implemented the solution for assistance in emergency situations. In CIS market, new business opportunities emerged in operators' segment and in eHealth segment, with two new customers in Armenia and Kazakhstan.

We continued to invest in targeted areas (IP networks, Cloud, TV & Media, Industry & Society, OSS and BSS). Sales grew by 12% year-over-year, reaching MHRK 194.2, corresponding to 14% of Group sales.

An initiative focused on business growth in internal Ericsson market resulted in increase in business volume and new responsibilities. We took over the responsibility and also became the largest development center for the CUDB (Centralized User Data Base) node design. Our experts had an important role in developing one of the most

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significant Ericsson projects in 2015, HDS 8000 (Hyperscale Datacenter System) and become the Ericsson competence hub for this solution. Development Unit Radio Access gained responsibility for LTE development. In Services organizations, new global responsibilities were obtained for RAN, OSS and Cloud as well as global responsibilities for GRAN (GSM radio access network) network design & optimization and BSP (Blade Server Platform) customer support.

Our Networked Society strategy remains unchanged. Our aim is to strengthen the position / sales in core business, in targeted growth areas and to increase profitability and market competitiveness by cost optimization. Considering the business results, in combination with our ongoing strategic initiatives, we are well positioned to create future value for our customers, shareholders, employees and society“.

Ericsson Nikola Tesla Group financial highlights:

- Sales revenue amount to MHRK 1,364.3 (2014: MHRK 1,314.9), 3.8% increase year-over-year. Of the total sales revenue, the domestic market accounts for 21.5%, services to Ericsson account for 60.2%, while other export markets participate with 18.3%.
- Sales in the network segment amount to MHRK 613.4 (45% of the total sales), services segment amounts to MHRK 705.1 (51.7% of the total sales), and support solution segment accounts for MHRK 45.7 (3.3% of the total sales).
- Gross profit amounts to MHRK 177.2 (2014: MHRK 179.6), a 1.3% decrease year-over-year. Gross margin slightly decreased to 13.0% (2014: 13.7%) due to an increase in services to Ericsson in total business mix.
- Selling and administrative expenses were decreased by 9.1% to MHRK 82.2 (2014: MHRK 90.5).
- Operating profit increased by 12.2% and amounts to MHRK 91.4 (2014: MHRK 81.4).
- Net finance income is MHRK 1.6 (2014: MHRK 6.9) due to low interest rate environment and net foreign exchange losses on cash and short-term financial assets.
- Net profit increased by 4.6% year-over-year and amounts to MHRK 91.3 (2014: MHRK 87.4). Return on sales (ROS) is 6.7% (2014: 6.6%).
- Cash flow from operating activities is MHRK 243.1 (2014: MHRK 176.4). The cash conversion rate is 153%. WCD is 32 days.
- Total cash and cash equivalents, including short term financial assets, as at 31 December 2015 amount to MHRK 287.1 (39.7% of the total assets), while at the end of 2014 amounted to MHRK 231.0 (33.0% of the total assets).
- The Group has a solid balance sheet with total assets of MHRK 723.9, a 3.5% increase year-over-year. The equity ratio is at 42.5%.

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- With related parties, the transactions were as follows: sales of products and services amounted to MHRK 868.5 (2014: MHRK 634.5), while the purchase of products and services amounted to MHRK 253.3 (2014: MHRK 367.9).
- As at 31 December 2015, balances outstanding with related parties were as follows: receivables amounted to MHRK 117.0 (end 2014: MHRK 86.6), and payables MHRK 52.7 (end 2014: MHRK 46.5).

Business situation in major markets

In the domestic market sales revenue amounted to MHRK 293.5, 12% decrease year-over-year.

With strategic partner Vipnet, the collaboration continued on radio access network and transport telecom network modernization, as well as on increasing the capacity of 3G and 4G technology. Further testing of new functionalities in various core and access network that contribute to increased quality and new services for end users, is ongoing.

Business collaboration with Hrvatski Telekom (HT) was marked by implementation of MPLS (Multi-Protocol Label Switching) architecture in core and access IP network. This project was further strengthened and expanded by the delivery of data security solution in IP networks. Business collaboration on IP core telecommunication network modernization started with Iskon. Activities regarding IP core infrastructure maintenance are ongoing with Optima Telekom. The year was also marked by a successful delivery of HT telecommunication infrastructure build and maintenance services.

The collaboration with mobile operator Tele 2 continued on core and transport network modernization, with the aim of expanding the existing capacities and introducing new functionalities. Furthermore, we continue to provide support services as well as telecom network maintenance. During the year, the project regarding the enhancement of core network infrastructure functional reliability was finished, thus enabling the operator to efficiently introduce new Networked Society services.

In Q4, in the segment of ICT solutions for Industry & Society, eHealth informatization continues. The implementation of the first national platform for mHealth was completed as well as informatization of processes regarding eMedial Assistive Devices and eHome Care/ePhysical Home Therapy. Within the project eHospitals, mutual information networking was agreed with several medical institutions. Informatization of Land Registry and Cadaster successfully continues, by signing a new contract on delivery of software with the aim of expanding the Joint Information System platform. Furthermore, contracts regarding implementation of telecommunication exchange equipment in Zagreb Airport as well as maintaining the 112 Systems of the National Protection and Rescue Directorate have been signed.

In export markets (without the Ericsson market) sales revenue amount to MHRK 249.4, 29% lower year-over-year. The slow economic development and political uncertainty affect the level and the dynamics of operators' investment.

In the markets of Southeast Europe (Bosnia and Herzegovina, Montenegro and Kosovo) sales revenue decreased by 15% year-over-year and amounted MHRK 176.7.

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In Bosnia and Herzegovina, the collaboration with BH Telecom and HT Mostar continues in the segment of modernizing fixed and mobile networks with an emphasis on mobile broadband.

In Q4, a contract was signed with BH Telecom regarding upgrade of the radio access network and upgrade and expansion of the BH Telecom packet core network capacity.

In Kosovo market, the collaboration on expansion of IPKO mobile network continues, as well as with Crnogorski Telekom in Montenegro.

In CIS market, sales revenues amount to MHRK 72.7, a decrease by 50% year-over-year. The activities of modernizing fixed and mobile networks with several key customers are ongoing. New business opportunities have emerged in the operator segment and e-Health segment.

[In Ericsson market](#) sales revenue amounted to MHRK 821.4, an increase by 31% year-over-year. Ericsson Nikola Tesla Servisi d.o.o., a daughter company of Ericsson Nikola Tesla d.d., contributed with MHRK 181.8.

Ericsson Nikola Tesla Research and Development Centre (R&D) continues its successful work. The application and platform software development for mobile systems within the development units (DU Radio, PDU Mobile Core, PDU User Data Management and PDU Infrastructure & Hardware) are going as planned, as well as the activities of development and services for so-called already implemented fixed network base. During the year, we have additionally strengthened our position which resulted in 10% increased volume, compared to the previous year. Our R&D center in 2015 was again estimated as one of the best and most reliable research and development centers in the Ericsson Group, which confirms the continuity of excellence and gives encouragement to future work and collaboration development. In line with the strategic plans, R&D begun with the competence development, required for new assignments.

Service Delivery Center experts have been engaged in numerous projects for the following customers: BASE Belgium, Deutsche Telekom Germany, Docomo Japan, TeliaSonera Sweden, Vodafone Ireland, Vodafone UK, O2 Great Britain, T-Mobile USA, Orange France, Polkomtel Poland and Telecom Slovenije. We can highlight the activities regarding IPTV project for Vodafone Ireland, LTE optimization for O2 Great Britain, VoLTE for Deutsche Telekom Germany, OBS transformation for T-Mobile USA, Cloud project for Orange France and Docomo Japan and MPS (Mobile Positioning System) for Polkomtel Poland.

The Centre's experts also provided e2e solutions and consulting services for Mobility Saudi Arabia, MTN South Africa, Orange Botswana, Vodafone Netherlands and T-mobile Czech Republic.

Intensive work is ongoing on the development and implementation of software tools for mobile network management and optimization, such as: Smart Laptop, E/// Design Optimization Service, Smart Rollout Support, Rehoming Automation Management Tool, Radio Network Proposal Tool and other.

The experts of Global Competence Domain for RAN & OSS are working on several Ericsson strategic projects. We would like to highlight partnership with OTT companies (Facebook in Thailand and TenCent in Hong Kong) in optimizing end user experience and creating global e2e optimization team.

The energy and the effort invested in creating innovation climate and innovations at Ericsson Nikola Tesla is reflected through the development of new products and solutions in line with the network society strategy and

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numerous awards to individuals and teams. Ericsson Global Network Design and Optimization forum awarded, as the best innovation, the idea SNACK (*Social Network Application Coverage Kit*), which addresses the problem of optimizing the telecom network settings, bearing in mind the end use experience. The solution for Automated Aerial Radio frequency measurement by using drone for radio access network measurement and optimization was also awarded.

Ericsson Nikola Tesla Servisi d.o.o., a services provider in telecommunication infrastructure build and maintenance, significantly contributes to business results. In 2015, the transformation process has begun, with the aim to align the Company with Ericsson's global models and standards for providing managed services. Furthermore, the state of the art Network Operations Centre in this part of Europe, was opened.

Other information

Ericsson Nikola Tesla's major shareholders (as at 31 December 2015)

	Number of shares	% of share capital
Telefonaktiebolaget LM Ericsson	653,473	49.07
Hypo Alpe-Adria-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	41,117	3.09
Hypo Alpe-Adria-Bank d.d. / PBZ Croatia osiguranje Mandatory Pension Fund, B category	27,521	2.07
PBZ d.d. / The Bank of New York as custodian	21,951	1.65
Zagrebačka banka d.d. / Custodian client account for Unicredit Bank Austria AG	14,770	1.11
Zagrebačka banka d.d. / State Street Bank and Trust Company, Boston	12,350	0.93
PBZ d.d. / Custodian Client Account	8,469	0.64
Hypo Alpe-Adria-Bank d.d. / Raiffeisen Voluntary Pension Fund	7,934	0.60
PBZ d.d. / State Street client account	7,436	0.56
Other shareholders	413,115	31.00

Information on share price in 2015:

Highest (HRK)	Lowest (HRK)	Closing (HRK)	Market cap. (in MHRK)
1,390	930	1,045	1,391.6

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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 2015 to 31 Dec 2015 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 performance, please visit:

<http://www.ericsson.hr>

Communication

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