
ERICSSON NIKOLA TESLA D.D.

The Management Report on Ericsson Nikola Tesla and Ericsson Nikola Tesla Group business performance and comments on the financial results for H1 2015

Highlights:

- Sales revenues: MHRK **679.4**
- Gross margin: **13.8 %**
- Operating profit: **MHRK 52.3**
- Net profit: MHRK **51.0**
- Cash flow from operating activities: MHRK **42.2**

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

“In H1 2015 we achieved solid business results. Sales revenues increased by 3.5% year-over-year due to sales increase in Ericsson market and the markets of South East Europe. Sales in the domestic and CIS markets decreased year-over-year.

We have a strong focus on research and development activities and services sales in the Ericsson market. This market segment records a continuous growth, and accounts for 57% of sales revenues. We have succeeded to achieve this by investing in employees' competences, IT & test equipment and by high quality of delivered services. I would like to highlight that in 2015 we continued to employ new professionals, primarily in this segment.

Unfavourable political and economic trends continue to remain present in our major export markets. In the markets of South East Europe sales revenues record an increase, thanks to realization of the previously contracted projects. New business opportunities, primarily in Bosnia & Herzegovina, are expected in the next period. In Q2 2015, we signed a strategically important contract with the Kosovo mobile operator IPKO, regarding the expansion of IPKO's 3G network, as well as introducing 4G network, thus keeping our solo vendor position. In the CIS market many anticipated activities have been prolonged for the next period.

In the domestic market sales revenues decreased year-over-year due to the fact that our customers in radio access network and E-Systems segments have decreased investments or delayed contracts signing. We expect capital expenditures to increase in the network modernization and optimization as well as in OSS/BSS (Operations and Business Support Systems). We also witness an increased interest in telecommunication network build and maintenance services (managed services).

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Operating profit increased by 7% year-over-year and amounts to MHRK 52.3, while net profit increased 3% year-over-year to MHRK 51. The trend of declining gross margin is still present, as a result of change in the business mix (increase in services to Ericsson) and a continuous price pressure. This change in business mix put pressure on profitability but has simultaneously led to lower overall business and operational risks. Sales and administrative costs decreased by 21.6% year-over-year, as a result of our commitment to cost reduction program.

We are focused on working capital efficiency and cash conversion. We concluded end of H1 with a solid balance sheet and an equity ratio of 44%. Cash flow from operating activities was positive, amounting to MHRK 42.2. After the dividend payment of MHRK 119.7 in June this year, the total cash and cash equivalents, including short term financial assets end of H1 2015 amounted to MHRK 117.4. Our working capital efficiency is measured through KPI Working capital days (WCD). Showing a continuous improvement, it has been reduced to 34 days (among the best in Ericsson globally).

Ericsson Nikola Tesla collaborates for many years with numerous institutions of higher education in Croatia and abroad. This resulted in a series of innovative solutions and scientific and specialist papers. Recently, agreement was signed with the Faculty of Electrical Engineering and Computing regarding the work on research and development projects focused on the Networked Society challenges. One of the results of successful partnership is Summer Camp that will mark its successful 15th anniversary this year.

Our Networked Society strategy builds on a combination of growth in our core business and strengthening our position/ sales in targeted areas: IP Networks, Cloud, TV and Media, Industry and Society and OSS & BSS. Our strategic initiatives are related to the business development in all markets and profitability improvement. The cost efficiency programme is progressing ahead of plan, and already in H1 2015 shows excellent results.

The industry consolidation continues, both among vendors and customers, thus creating new opportunities as well as challenges. The results of our strategic initiatives show that we are well positioned to continue to create value for our customers in a transforming ICT market. “

Financial summary:

- Sales revenues amount to MHRK 679.4 (H1 2014: MHRK 656.2), an increase by 3.5% year-over-year. In total sales revenues, the domestic market accounts for 22.5%, services to Ericsson account for 57.1%, while other export markets participate with 20.4%.
- Sales in the network segment amounts to MHRK 312.4 (46% of the total sales revenue), services segment amounts to MHRK 340.9 (50.2% of the total sales revenue), and support solution segment accounts for MHRK 26.1 (3.8% of total sales revenues).
- Gross profit amounts to MHRK 93.6 (H1 2014: MHRK 98.1), a decrease by 4.6% year-over-year. Gross margin decreased to 13.8% (H1 2014: 15%), primarily due to change in the business mix.
- Sales and administrative expenses decreased by 21.6% to MHRK 40.1 (H1 2014: MHRK 51.1).
- Operating profit increased by 7% and amounts MHRK 52.3 (H1 2014: MHRK 48.8).

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- Net finance losses amount to MHRK 1.1 (Q1 2015 net finance profit: MHRK 0.5) mainly due to net foreign exchange losses as a result of HRK appreciation.
- Net profit increased by 3% year-over-year to MHRK 51.0 (H1 2014: MHRK 49.3). ROS of 7.5% is at the previous year's level.
- Cash flow from operating activities is MHRK 42.2 (H1 2014: MHRK 72.6). The conversion rate is at 55.3%. WCD is 34 days.
- Total cash and cash equivalents, including short term financial assets, as at 30 June 2015, amount to MHRK 117.4 (19.3% of the total assets), while at the end of 2014 amounted to MHRK 231.0 (33.0% of the total assets).
- The Company has a lean balance sheet with total assets of MHRK 606.8. The equity ratio is at a solid 44%.
- With related parties, the transactions were as follows: sales of products and services amount to MHRK 393.7 (H1 2014: MHRK 280.7), while the purchase of products and services amounts to MHRK 153.9 (H1 2014: MHRK 198.2).
- As at 30 June 2015, balances outstanding with related parties were as follows: receivables amounted to MHRK 87.6 (end of 2014: MHRK 86.6), and payables MHRK 46.3 (end of 2014: MHRK 46.5).

Business situation in major markets

In the domestic market, realized sales revenues amounted to MHRK 153, 22.5% decrease year-over-year.

During Q2, the collaboration with the strategic partner Vipnet continued on the modernization of radio access network (including LTE) and transport telecom network. Also, testing of new functionalities have been performed in various core and access network segments, contributing to an increase in quality and new services for end users.

With Hrvatski Telekom we work on strategic projects related to development and transformation of network and services. Also, a successful delivery of telecommunications infrastructure build and maintenance services continues.

With Tele 2, the work on increasing the functional reliability of the core network continues. Special attention was given to further expanding the existing capacities and introducing new functionalities in the core network.

During Q2, in ICT solutions for Industry & Society business segment, the upgrade of the business communication system of the Croatia Control was completed. The upgrade and expansion of Joint Information system of Land Registry and Cadaster (JIS) is ongoing. With our solution eHealth, we participate in the three year European project CareWell, financed by the EU Funds from the Competitiveness and Innovation Framework Programme.

In export markets, (except for Ericsson market) sales revenues are MHRK 138.4, 14.9% decrease year-over-year.

In Southeast Europe (Bosnia and Herzegovina, Montenegro and Kosovo) sales revenues increased by 9.4% year-over-year to MHRK 95.5.

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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 internet access.

In Montenegro, we successfully expanded and upgraded Crnogorski Telekom's radio access network (2G, 3G and LTE).

In Kosovo, with operator IPKO, good collaboration continues and a contract was signed regarding modernization of radio access and microwave network with an emphasis on expanding the mobile broadband Internet access based on 4G /LTE technology.

In CIS market, sales revenues amount to MHRK 42.9, representing a decrease by 43% year-over-year. Due to a challenging market environment many expected activities were prolonged for the next period. The Company has no financial exposure in Russia and Ukraine.

In Ericsson market, a total of MHRK 388 sales revenues was realized, an increase by 31% year-over-year. Managed Services to Hrvatski Telekom contributed with MHRK 77.1.

Ericsson Nikola Tesla Research and Development Center (R&D) continues activities on numerous development projects. The transfer of new responsibilities is ongoing regarding application development of radio software within Development Unit (DU) Radio. Furthermore, the transfer of development and maintenance of SW TIP (Telecom Internet Protocol) stacks and the release verification tasks within the Product Development Unit (PDU) mobile core networks is finished. A long-term and successful project of Telenor Sweden fixed network transformation was completed. The upgrade of the Irish operator Eircom and Andorra Telecom was also finalized.

Our global and regional centres continue with excellent performance. Service Delivery Center experts have been engaged in numerous projects on the markets worldwide for the following customers: A1 Austria, BMW Germany, Deutsche Telekom Germany, Orange Poland, PostLUX Luxembourg, Salt Switzerland, Translink Netherlands, Telekom Slovenia, Vodafone Ireland, Vodafone Netherlands, Swisscom Switzerland, Telcel Mexico, P4 Poland and Vodafone Great Britain. We can also highlight the activities related to IPTV project for Vodafone Ireland, Order care projects for BMW Germany and Translink Netherlands, VoLTE and WiFi Calling project for PostLUX Luxembourg, VoWiFi project for Salt Switzerland and P4 Poland, OSS project for Orange Poland, LTE optimization project for Telcel Mexico. The Centre's experts also provided consulting services and services of configuration and dimensioning for Deutsche Telekom Germany, DIGi Hungary, Mobili Saudi Arabia, Omantel Oman, Orange Egypt, Polkomtel Poland, Vodafone Netherlands and Turkcell Turkey.

There is intensive work ongoing on developing and implementing software tools for managing and optimizing mobile networks such as: Smart Laptop, E/// Design Optimization Service, Rehoming Automation Management Tool, Radio Network Proposal Tool, etc.

The experts of the Global Competence Domain for RAN & OSS, besides the activities in the existing projects, have begun working on new Facebook project to be delivered to DTAC, Thailand.

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Other information

At the Ericsson Nikola Tesla Annual General Meeting, held on June 2, 2015, a decision was passed on the payment of a regular dividend amounting to HRK 20 per share and an extraordinary dividend of HRK 70 per share, i.e. totaling HRK 90 per share. The dividend was paid on June 19, 2015 to all Ericsson Nikola Tesla shareholders who, on June 9, 2015 had the Company shares registered on their securities account in the Central Depository & Clearing Company.

The decision was adopted to allocate the Company's net income for the financial year 2014, amounting to HRK 82,749,937.54 for dividend payment in the amount lacking after the use of unallocated retained earnings and that the rest will go to retained earnings.

The shareholders adopted the decision to discharge from liability the Managing Director, Gordana Kovačević, and the Supervisory Board Chairman and members of the Supervisory Board for the management of the Company in 2014. The member of the Supervisory Board, Ignac Lovrek, was re-appointed for a 4 - year term. Vidar Mohammar, Vice President & Corporate Officer Finance, was elected as a new member of the Supervisory Board, succeeding Carita Annette Jönsson.

Furthermore, a decision was adopted to re-appoint PricewaterhouseCoopers as the Company auditors for 2015.

Ericsson Nikola Tesla's major shareholders (as at June 30, 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	32,961	2.48
Hypo Alpe-Adria-Bank d.d. / PBZ Croatia osiguranje Mandatory Pension Fund, B category	27,895	2.09
PBZ d.d. / State Street client account	24,867	1.87
PBZ d.d. / The Bank of New York as custodian	21,607	1.62
Zagrebačka banka d.d. / Custodian client account for Unicredit Bank Austria AG	17,320	1.30
Zagrebačka banka d.d. / State Street Bank and Trust Company, Boston	12,350	0.93
PBZ d.d. / Custodian Client Account	10,988	0.83
Hypo Alpe-Adria-Bank d.d. / Raiffeisen Voluntary Pension Fund	7,934	0.60
Other shareholders	398,741	29.93

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Information on share price in Q2 2015:

Highest (HRK)	Lowest (HRK)	Closing (HRK)	Market cap. (in MHRK)
1,370.00	1,122.00	1,155.00	1,538.1

Ericsson Nikola Tesla d.d.
Krapinska 45
Zagreb

OIB: 84214771175
Tax No.: 03272699

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 30 June 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

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

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For more information about Ericsson Nikola Tesla's business performance, please visit:

<http://www.ericsson.hr>

Communication

Ericsson Nikola Tesla

Ericsson Nikola Tesla d.d.
 Consolidated statement of comprehensive income
 for the period ended 30 June 2015

	2015	2014
	HRK '000	HRK '000
Sales revenue	679.436	656.159
Cost of sales	-585.802	-558.041
Gross profit	93.634	98.119
Selling expenses	-23.544	-33.425
Administrative expenses	-16.549	-17.693
Other operating income	2.187	2.290
Other operating expenses	-3.458	-506
Operating profit	52.270	48.784
Finance (expense)/income – net	-1.091	470
Profit before tax	51.179	49.254
Income tax	-228	-
Profit for the year	50.950	49.254
Other comprehensive income	6	25
Total comprehensive income for the year	50.956	49.279

Ericsson Nikola Tesla d.d.
Consolidated statement of financial position
as at 30 June 2015

	2015	2014
	HRK '000	HRK '000
ASSETS		
Non-current assets		
Property, plant and equipment	146.936	135.715
Intangible assets	7.001	5.481
Loans and receivables	20.116	19.153
Equity securities	40	40
Total non-current assets	<u>174.094</u>	<u>160.389</u>
Current assets		
Inventories	31.693	30.946
Trade receivables	189.448	190.572
Receivables from related parties	84.618	81.849
Other receivables	1.581	2.820
Income tax receivable	178	8
Financial assets at fair value through profit or loss	41.934	44.081
Prepayments and accrued income	7.797	1.956
Cash and cash equivalents	75.476	186.963
Total current assets	<u>432.724</u>	<u>539.195</u>
TOTAL ASSETS	<u>606.818</u>	<u>699.584</u>
EQUITY AND LIABILITIES		
Equity		
Share capital	133.165	133.165
Treasury shares	-8.462	-8.462
Legal reserves	6.658	6.658
Retained earnings	136.988	204.106
Total equity	<u>268.349</u>	<u>335.467</u>
Non-current liabilities		
Interest-bearing borrowings	-	32
Employee benefits	5.738	5.622
Other non-current liabilities	10.339	8.933
Total non-current liabilities	<u>16.076</u>	<u>14.587</u>
Current liabilities		
Payables to related parties	37.176	41.661
Interest-bearing borrowings	19	356
Trade and other payables	123.905	147.559
Provisions	7.162	11.073
Accrued charges and deferred revenue	154.131	148.881
Total current liabilities	<u>322.392</u>	<u>349.530</u>
Total liabilities	<u>338.469</u>	<u>364.117</u>
TOTAL EQUITY AND LIABILITIES	<u>606.818</u>	<u>699.584</u>

Ericsson Nikola Tesla d.d.
Consolidated statement of cash flows
for the period ended 30 June 2015

	2015	2014
	HRK '000	HRK '000
Cash flows from operating activities		
<i>Profit before tax</i>	51.179	49.254
Adjustments for:		
Depreciation and amortisation	24.959	21.954
Impairment losses and reversals	761	4.441
Net increase of provisions	1.186	-272
Gain on sale of property, plant and equipment	-153	-39
Net gain on remeasurement of financial assets	-11	-350
Amortisation of discount	0	-161
Interest income	-2.059	-4.018
Interest expense	161	1
Foreign exchange losses/(gains)	3.127	5.210
Equity-settled transactions	-2.972	4.429
	76.179	80.449
<i>Changes in working capital</i>		
In receivables	-8.085	52.304
In inventories	-747	10.488
In payables	-23.764	-70.604
<i>Cash generated from operations</i>	43.582	72.636
Interest paid	-161	-1
Income taxes paid	-1.258	-3
Net cash from operating activities	42.163	72.633
Cash flows from investing activities		
Interest received	2.117	4.994
Proceeds from sale of property, plant and equipment	267	165
Purchases of property, plant and equipment, and intangible assets	-34.983	-24.521
Deposits collected with financial institutions - net	25	0
Purchases of financial assets at fair value through profit and loss	64.158	95.000
Proceeds from sale of financial assets at fair value through profit and loss	-62.000	-25.900
Net cash generated/(used) in investing activities	-30.415	49.738
Cash flows from financing activities		
Dividends paid	-119.714	-424.919
Net cash used in financing activities	-119.714	-424.919
Effects of exchange rate changes on cash and cash equivalents	-3.521	-4.579
Net increase/decrease in cash and cash equivalents	-111.488	-307.127
Cash and cash equivalents at the beginning of the year	186.963	411.328
Cash and cash equivalents at the end of the year	75.476	104.201