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## 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 2016

### Highlights:

- Sales revenues: MHRK **330.8**
- Gross margin: **14.7 %**
- Operating profit: MHRK **29.2**
- Net profit: MHRK **28.2**
- Cash flow from operating activities: MHRK **-25.3**

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

„Business results in Q1 2016 show a continuation of stable business performance. Sales revenues grew by 7% year-over-year. We continue to register a significant growth of revenue in the Ericsson market due to expansion of business activities and taking over of new responsibilities, thus neutralizing the revenue decrease in other markets. Revenue from research & development activities and sale of services in the Ericsson market, including Managed Services, account for 64.2% of total revenue. In Q1, we continued hiring and at Ericsson Nikola Tesla Group level employed 53 experts to work on projects that are relevant to the realization of the Networked Society strategy.

Unfavorable economic trends in the local and foreign markets, delays and a cautious approach of our customers when it comes to capital expenditures, continue to significantly burden our business. These are precisely the reasons why we recorded a decrease in sales revenue in the markets of Southeast Europe and in the local market. Fierce competition, consolidation & centralized procurement of our global customers/operators, present additional challenges to our business.

Despite a demanding business environment, new opportunities have emerged in the operator segment and in the e-health segment in the market of the Commonwealth of Independent States (CIS). I would like to point out that we have contracted new business related to LTE network construction with our customer the Moldavian operator Interdnestrom (IDC) and with a new customer, the Armenian operator Ucom. The implementation of the national eHealth system in Armenia was successfully completed during the first quarter.

Almost all the Key Financial Performance Indicators show positive movements in Q1 2016. Operating profit increased by 20.6% year-over-year to MHRK 29.2, while net profit grew by 12.3% to MHRK 28.2. Gross margin is slightly lower year-over-year due to business mix changes. Our continuous focus on cost efficiency has brought solid cost savings. Sales and administrative costs decreased by 10.9% year-over-year, thus ensuring a solid

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operating profit growth. Cash and cash equivalents, including short term financial assets amount to MHRK 250.2. The working capital efficiency, measured by the performance indicator Working Capital Days (WCD) is 31 days. In line with expectations, a negative cash flow from operations was recorded amounting to MHRK 25.3, mainly due to variable compensation payment to employees and decreased inflows from customers. Given its quarterly volatility, the cash flow should be viewed on a full-year basis. We expect to return to a positive cash conversion rate in the coming quarters.

The company continues its partner collaboration with universities and scientific institutions through joint projects, including EU co-funded projects. In Q1, two of the EU co-funded projects from the Operational Program "Regional Competitiveness 2007-2013" within the call RC.2.2.08 "Capacity Building for Research, Development and Innovation" were completed. Both projects, with the combined value of almost MHRK 11 had 16 months duration during which participants demonstrated that the efficient collaboration of the scientific research community and business gives creative and useful results.

In line with our strategy, we are focused on increasing sales revenue in our core business (radio access, core and transport networks and telecom services) and in targeted growth areas (IP networks, Cloud, TV & Media, OSS and BSS and Industry & Society – healthcare, public safety, transport, utilities). At the recently held Mobile World Congress (MWC) in Barcelona, Ericsson presented new solutions that drive digital transformation in the Networked Society thus demonstrating its technology leadership in 5G and the Internet of Things (IoT). It should be noted that, once again, our experts significantly contributed to the presented solutions. We are particularly pleased that presentations in Barcelona included our HDS 8000, Hyper-scale Datacenter System, the state-of-the-art scalable system for data centers based in the cloud that was developed, integrated and tested in our Research & Development Centre located in Zagreb and Split. Furthermore, in cooperation with our partner Deutsche Telekom, the latest solution for virtualization of Customer Premises Equipment (CPE) that enables advanced services in the cloud and completely new business models was showcased.

Accelerated technological changes and end-user needs require continued transformation and adaptation both for us and our customers. These processes are further intensified by the introduction of 5G, Internet of Things and Cloud technologies that are drivers of the new phase of industrial development. Ericsson announced a series of organizational and structural changes aimed at securing a more efficient Networked Strategy implementation and business and profitability growth. Our company, as a part of the global Ericsson, will continue the implementation of transformation processes to respond to needs of diverse business and market segments, secure further business development and remain competitive."

### Financial summary:

- Sales revenue amount to MHRK 330.8 (Q1 2015: MHRK 309.2), 7% increase year-over-year. Of the total sales revenue, the domestic market accounts for 16.7%, services to Ericsson account for 64.2%, while other export markets participate with 19.1%.
- Sales in the network segment amounts to MHRK 159.1 (48.1% of the total sales revenue), services segment amounts to MHRK 165.8 (50.1% of the total sales revenue), and support solution segment accounts for MHRK 5.9 (1.8% of the total sales).
- Gross profit amounts to MHRK 48.6 (Q1 2015: MHRK 46.1), up by 5.6% year-over-year. Due to business mix changes, gross margin decreased slightly to 14.7% (Q1 2015: 14.9%).

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- Distribution and administrative expenses decreased by 10.9% year-over-year and amount to MHRK 18.7 (Q1 2015: MHRK 21).
- Operating income increased by 20.6% year-over-year and amounts to MHRK 29.2 (Q1 2015: MHRK 24.2).
- Finance loss is MHRK 0.6 (Q1 2015: MHRK 1) primarily due to net foreign exchange losses on cash and short-term financial assets.
- Net income increased by 12.3% year-over-year and amounts to MHRK 28.2 (Q1 2015: MHRK 25.2). Return on Sales (ROS) is 8.5% (Q1 2015: 8.1%).
- Cash flow from operating activities is MHRK -25.3 (Q1 2015: MHRK 50.7). The cash conversion rate is -61%.
- Total cash and cash equivalents, including short term financial assets, as at March 31, 2016 amount to MHRK 250.2 (34.3% of the total assets), while at the end of 2015 amounted to MHRK 287.1 (39.7% of the total assets).
- The Group has a lean balance sheet with total assets of MHRK 728.9. The equity ratio is at 46.1%.
- With related parties, the transactions were as follows: sales of products and services amounted to MHRK 202.7 (Q1 2015: MHRK 167.7), while the purchase of products and services amounted to MHRK 74.6 (Q1 2015: MHRK 80.9. )
- As at 31 March 2016, balances outstanding with related parties were as follows: receivables amounted to MHRK 116.9 (end 2015: MHRK 117.0), and payables MHRK 72.7 (end 2015: MHRK 52.7).

### Business situation in main markets

In the domestic market total sales revenue amounted to MHRK 55.4, which is a decrease by 6.1% year-on-year.

Cooperation with our strategic partner Vipnet was continued on the modernization of radio access network and transport telecom network as well as on the increase of the capacity of 3G and 4G technologies. The first Radio Dot system was successfully integrated into Vipnet's commercial network, whereby the quality and end-user experience of the services, both voice and data, have been raised to the level that is currently among highest ones globally. Radio Dot system is designed to provide operators a continued high performance related to indoor calls and data traffic and a high-quality user experience to end-users.

With Hrvatski Telekom we continued collaboration on network modernization. Modernization of transport network started with the delivery of solution based on Multi-Protocol Label Switching (MPLS) architecture that has already been successfully implemented in Hrvatski Telekom's IP network. Furthermore, activities in the area of Managed Services, that is, the build and maintenance services of Hrvatski Telekom's telecommunications infrastructure have increased.

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Continued cooperation and activities in the identification and realization of future projects with Optima and Iskon should also be noted.

With the mobile operator Tele2 we worked on the modernization of core and transport networks to secure smooth operation of all systems at the time of the commercial launch of LTE service. The operator was mainly focused on securing sufficient network capacity to enable quality provision of the new service and fast user activation. Also, we continue to provide support and maintenance services for the entire telecommunications network.

In the area of ICT solutions for Industry & Society, Q1 shows continued digitalization of healthcare (eHealth). Digitalization of the approval process for particularly expensive medications started. The introduction of Integrating the Health Enterprise (IHE) profile was also contracted, which will standardize the existing eHealth system in line with the current European norms. The expansion of the Joint Information System of Land Registry and Cadaster was also successfully continued. Approximately 75% of regional offices throughout Croatia are currently covered by the new application.

[In export markets \(the Ericsson market excluded\)](#) the sales revenue amount to MHRK 63.1, 6.7% lower year-over-year.

In the markets of Southeast Europe (Bosnia and Herzegovina, Montenegro and Kosovo) sales revenues decreased by 32.4% year-on-year, amounting to MHRK 29.9. The unfavorable economic situation affects the operators' investment dynamics making it extremely slow. The cooperation with operators in the areas of fixed and mobile networks maintenance continued.

The sales revenues in CIS market amount to MHRK 33.2, an increase by 41.6% year-over-year. New business opportunities have emerged in the operator and e-health segments.

A contract comprising the LTE network construction, accompanying services and required software updates was signed with the Moldavian operator Interdnestrcom (IDC), whereby long-term successful collaboration was continued.

A framework contract on the national LTE network construction that includes the capital city of Yerevan was signed with the Armenian operator Ucom. The contract includes the supply of radio and core network equipment and relevant services. Ericsson Expert Analytics, a solution that allows operators to automatically take action relevant to customer satisfaction is also included.

[In the Ericsson market](#) sales revenue amount to MHRK 212.3, an increase by 16.3% year-over-year.

At the meeting of the management of Ericsson Nikola Tesla's Research & Development Centre in which representatives of global Ericsson units with which we collaborate were present, the work of our center received high marks and readiness for further more intense collaboration was expressed. Application and platform software development for mobile systems within development units (DU Radio, PDU Mobile Core, PDU User Data Management and PDU Infrastructure & Hardware) proceed as planned. Development and services business in the area of the so-called already installed fixed network base are also in line with plans. In Q1, our experts have taken over the full responsibility for Ericsson's Identification Register (EIR) within User Data Management. Radio software design business was expanded and our expert base in this area was increased with 40 newly hired experts.

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Our experts from Centers for Services and Solutions have been engaged in numerous projects for customers worldwide: BASE (Belgium), Proximus (Belgium), Telenet (Belgium), DT (Germany), KPN (the Netherlands), Slovak Telekom (Slovakia), T-Mobile (Czech Republic), Vodafone (Czech Republic), Telefonica O2 UK (United Kingdom), A1 (Austria), MCI (Iran), POST (Luxembourg), Omantel (Oman), Swisscom (Switzerland), T-Mobile US (USA), Telekom Slovenija (Slovenia), MTN (Republic of South Africa) and others. Their work involves complex expertise activities ranging from detailed analysis of the existing networks and solutions, defining and creation of new solutions, consultancy support, to optimization and upgrade of tools and functionalities in the areas of LTE, VoLTE, IPTV, IMS and other technologies. A further step was also made in the increase of competencies in the domain of Cloud, which resulted in intense regional cooperation and high-quality support to realization of customer projects to Ericsson teams in the Region Western and Central Europe.

Activities are intense in the areas of development and implementation of software tools for management and optimization of mobile networks such as: Smart Laptop, Ericsson Network Engineer, Extended Support Request, Smart Rollout Support, Rehomeing Automation Management Tool, Radio Network Proposal Tool and others.

The contribution of Ericsson Nikola Tesla Servisi d.o.o., daughter company of Ericsson Nikola Tesla d.d., to revenue in this market segment amounts to MHRK 40. Further company transformation aimed at alignment with new business models and all relevant standards in the field of telecommunications network build and maintenance services is ongoing.

### Other information

Ericsson Nikola Tesla's Annual General Meeting will be held on May 31, 2016. Shareholders and their proxies who register their attendance by May 24, 2016 at the latest are entitled to participate in this meeting.

Shareholders who have Ericsson Nikola Tesla shares listed in their securities account at the Central Depository & Clearing Company on June 6, 2016 (record date) are entitled to a dividend in the amount of HRK 100.00 per share (HRK 20.00 regular dividend and HRK 80.00 extraordinary dividend). Date on which shares of the company will be traded without dividend payment right is June 3, 2016 (ex-dividend date).

The dividend shall be paid out on June 17, 2016.

The convocation notice for Ericsson Nikola Tesla's Annual General Meeting, including all proposed decisions has been published at the Company's Internet site <http://www.ericsson.hr/20160421-notice>.

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Overview of major shareholders of Ericsson Nikola Tesla (as at March 31, 2016)

	Number of shares	% of share capital held
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	41,890	3.15
Hypo Alpe-Adria-Bank d.d. / PBZ Croatia osiguranje Mandatory Pension Fund, B category	27,054	2.03
PBZ d.d. / The Bank of New York as custodian	20,998	1.58
Zagrebačka banka d.d. / custodian account for Unicredit Bank Austria AG	16,950	1.27
Zagrebačka banka d.d. / State Street Bank and Trust Company, Boston	12,350	0.93
Hypo Alpe-Adria-Bank d.d. / Raiffeisen Voluntary Pension Fund	7,934	0.60
PBZ d.d. / State Street client account	6,935	0.52
OTP BANKA D.D./INS683	6,225	0.47
Other shareholders	414,327	31.11

Share prices in Q1 2016:

Highest (HRK)	Lowest (HRK)	Closing (HRK)	Market cap. (in MHRK)
1,134.89	940.00	1,117.00	1,487.5

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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 Jan 1, 2016 to March 31, 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 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>*



Ericsson Nikola Tesla d.d.  
 Consolidated statement of comprehensive income  
 for the period ended 31 March 2016

	<b>2016</b>	<b>2015</b>
	<b>HRK '000</b>	<b>HRK '000</b>
Sales revenue	330.789	309.182
Cost of sales	-282.140	-263.097
<b>Gross profit</b>	<b>48.649</b>	<b>46.086</b>
Selling expenses	-10.527	-12.375
Administrative expenses	-8.206	-8.657
Other operating income	154	667
Other operating expenses	-886	-1.528
<b>Operating profit</b>	<b>29.184</b>	<b>24.192</b>
Finance income	0	1.050
Finance expense	-617	-2
Finance income – net	-617	1.048
<b>Profit before tax</b>	<b>28.566</b>	<b>25.240</b>
Income tax	-319	-83
<b>Profit for the year</b>	<b>28.247</b>	<b>25.157</b>
Other comprehensive income	-127	70
<b>Total comprehensive income for the year</b>	<b>28.120</b>	<b>25.226</b>

Ericsson Nikola Tesla d.d.  
Consolidated statement of financial position  
as at 31 March 2016

	<b>2016</b>	<b>2015</b>
	<b>HRK '000</b>	<b>HRK '000</b>
<b>ASSETS</b>		
<b>Non-current assets</b>		
Property, plant and equipment	131.531	137.667
Intangible assets	7.246	6.532
Loans and receivables	42.186	19.235
Other non-current assets	40	40
<b>Total non-current assets</b>	<b>181.003</b>	<b>163.474</b>
<b>Current assets</b>		
Inventories	31.950	21.187
Trade receivables	144.102	131.800
Receivables from related parties	116.071	113.949
Other receivables	856	3.396
Income tax receivable	1.365	1.204
Financial assets at fair value through profit or loss	59.421	53.917
Prepayments and accrued income	3.353	1.744
Cash and cash equivalents	190.812	233.195
<b>Total current assets</b>	<b>547.930</b>	<b>560.392</b>
<b>TOTAL ASSETS</b>	<b>728.933</b>	<b>723.866</b>
<b>EQUITY AND LIABILITIES</b>		
<b>Equity</b>		
Share capital	133.165	133.165
Treasury shares	-3.434	-3.434
Legal reserves	6.658	6.658
Retained earnings	199.992	171.539
<b>Total equity</b>	<b>336.381</b>	<b>307.928</b>
<b>Non-current liabilities</b>		
Interest-bearing borrowings	503	0
Employee benefits	9.382	9.060
Other non-current liabilities	12.354	12.345
<b>Total non-current liabilities</b>	<b>22.239</b>	<b>21.405</b>
<b>Current liabilities</b>		
Payables to related parties	60.937	40.087
Interest-bearing borrowings	22	32
Trade and other payables	124.008	164.477
Provisions	8.032	10.003
Accrued charges and deferred revenue	177.313	179.934
<b>Total current liabilities</b>	<b>370.313</b>	<b>394.533</b>
<b>Total liabilities</b>	<b>392.552</b>	<b>415.938</b>
<b>TOTAL EQUITY AND LIABILITIES</b>	<b>728.933</b>	<b>723.866</b>

Ericsson Nikola Tesla d.d.  
Consolidated statement of cash flows  
for the period ended 31 March 2016

	2016	2015
	HRK '000	HRK '000
<b>Cash flows from operating activities</b>		
<i>Profit before tax</i>	28.566	25.240
Adjustments for:		
Depreciation and amortisation	12.870	11.925
Impairment losses and reversals	-101	321
Net increase of provisions	257	2.296
Gain on sale of property, plant and equipment	-38	-97
Net gain on remeasurement of financial assets	-504	-65
Amortisation of discount	0	0
Interest income	-854	-1.066
Interest expense	20	2
Foreign exchange losses, net	1.058	-327
Equity-settled transactions	316	668
	41.590	38.898
<i>Changes in working capital</i>		
In receivables	-32.498	17.788
In inventories	-10.763	-24.678
In payables	-23.382	18.648
<i>Cash generated from operations</i>	-25.053	50.655
Interest paid	-20	-2
Income taxes paid	-204	-2
<b>Net cash (used in)/from operating activities</b>	<b>-25.277</b>	<b>50.652</b>
<b>Cash flows from investing activities</b>		
Interest received	508	1.287
Proceeds from sale of property, plant and equipment	34	197
Purchases of property, plant and equipment, and intangible assets	-7.920	-13.091
Deposits collected with financial institutions - net	-3.392	10
Purchases of financial assets at fair value through profit and loss	-5.000	-
Proceeds from sale of financial assets at fair value through profit and loss	0	9.248
<b>Net cash (used in)/generated from investing activities</b>	<b>-15.771</b>	<b>-2.349</b>
<b>Cash flows from financing activities</b>		
Purchase of treasury shares	0	-
Dividends paid	0	-
<b>Net cash used in financing activities</b>	<b>0</b>	<b>0</b>
Effects of exchange rate changes on cash and cash equivalents	-1.334	-473
<b>Net increase/decrease in cash and cash equivalents</b>	<b>-42.382</b>	<b>47.830</b>
Cash and cash equivalents at the beginning of the year	233.195	186.963
<b>Cash and cash equivalents at the end of the year</b>	<b>190.812</b>	<b>234.793</b>