

# 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 H1 2018

## Highlights:

- Sales revenue: MHRK **762.4**
- Gross margin: **15.5%**
- Operating profit: MHRK **83.9**
- Profit before tax: MHRK **83**
- Net profit: MHRK **61.5**
- Cash flow from operating activities: MHRK **6.3**

Gordana Kovačević, the President of Ericsson Nikola Tesla comments:

In H1 2018, Ericsson Nikola Tesla Group sales revenue amounted to MHRK 762.4, up by 7.5% year-over-year, mainly driven by higher sales revenue in the domestic market. In line with expectations, services to Ericsson record a growth, primarily due to new responsibilities in R&D as well as in the Services and Solutions Expert Centers. We have continued to invest in preparation for introducing 5G mobile communication systems, in competence development, and in testing systems. During H1, we hired 142 new experts, primarily in R&D in the field of 5G, and thus at the end of H1 Ericsson Nikola Tesla Group had 3,113 employees.

Sales revenue in the domestic market are growing since the operators have increased investments in the modernization of telecommunication networks, in order to respond to the demands of the exponential data traffic growth, while at the same time improving quality and reducing costs. At the beginning of the year, we started activities on modernization of Hrvatski Telekom's radio access networks, which will enable the introduction of 5G technology after the necessary radio frequency spectrum is assigned. We continued to cooperate with Vipnet on the implementation of a multi-year framework agreement that also includes modernization and expansion of radio access network prepared for introduction of 5G. We have achieved good results in the Industry & Society segment as well.

The export markets showed somewhat lower sales revenue, affected primarily by the ramping down of network modernization projects and difficulties in the political and economic environment. In order to strengthen our market position, we continue with intense marketing and sales activities. During the International Economy Fair – Mostar 2018, we have presented our technology solutions for digital economy. Furthermore, with the University of Mostar we have signed an agreement on cooperation in the field of ICT, as well as in science and research activities. We have continued a successful

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cooperation with HT Mostar by signing further expansion and modernization of radio access network, and in order to provide an efficient support to HT Mostar, Ericsson Nikola Tesla has also opened an office in Mostar.

All key performance indicators show a positive trend. Gross profit increased by 23% year-over-year. Operating profit increased by 58.7% due to higher sales revenue, gross margin improvement, lower sales and administrative expenses and lower impact of currency development compared to previous year. Our focus on operational excellence has enabled further cost reduction and an even better utilization of resources. Net profit rose by 64.6% to MHRK 61.5. End of H1 was concluded with a lean balance sheet and an equity ratio of 36.2%. Working capital efficiency, expressed in Working Capital Days (WCD), was 24 days. A positive cash flow from operating activities was realized as a result of proactive collection of receivables from customers. At the end of H1, total cash, including short-term financial assets, amounted to MHRK 227.9.

The Company is using state aids, which are based on registering investment projects and the employment related to these projects, in line with the Investment Promotion and Development of Investment Climate Act from 2012, and the Investment Promotion Act from 2015. In parallel, the Company was granted the maximum amount of MHRK 20 for a project of energy renewal of our buildings and plants, in the framework of financing selected project proposals submitted under the invitation "The increase of energy efficiency and renewable energy sources in manufacturing industries". The funds are to be used by the end of 2020. This project will enable annual savings of more than 4.6 million kWh and at the same time reduce CO2 emission by nearly 1400 tonnes. The project is worth more than MHRK 73 and will be completed within three years.

In line with our business strategy, we continue to strengthen our position in strategic areas: 4G/5G mobile solutions, OSS/BSS, Digital Transformation, Managed Services, IoT and Industry & Society segment. We work closely with our customers to define the optimal business models to enable them new sources of revenue and high quality of end user experience.

Furthermore, our strategic focus is placed on gaining new responsibilities and projects as well as strengthening competitiveness on the global Ericsson market.

In order to respond to a challenging market environment, we adapt our organization and our ways of working, encourage innovativeness and invest in new technologies and the development of new knowledge and skills. We will continue to focus on strategic risk management, cost and operating efficiency."

### Financial Highlights for the Group:

- Sales revenue amounted to MHRK 762.4 (H1 2017: MHRK 709), up by 7.5% year-over-year. Of the total sales revenue, domestic market accounted for 25%, services to Ericsson accounted for 63.2% (of which 12.2% relate to Managed Services in Croatia), while other export markets accounted for 11.8%.

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- Sales in the Networks segment amounted to MHRK 463.2 (H1 2017: MHRK 363.4), Digital Services amounted MHRK 206.4 (H1 2017: MHRK 258.1), Managed Services amounted to MHRK 92.4 (H1 2017: MHRK 85.8), and Emerging Business and Other amounted to MHRK 0.3 (H1 2017: MHRK 1.7).
- Gross profit amounted to MHRK 118.5 (H1 2017: MHRK 96.3), up by 23% year-over-year. Gross margin increased to 15.5% (H1 2017: 13.6%).
- Sales and administrative costs were 18.3 % lower year-over-year and amounted to MHRK 35.3 (H1 2017: MHRK 43.1).
- Operating profit amounted to MHRK 83.9 (H1 2017: MHRK 52.9), an increase by 58.7% year-over-year.
- The loss from financial activities was significantly lower year-over-year and amounted to MHRK -0.9 (H1 2017: loss from financial activities was MHRK -4.0).
- Profit before tax increased by 69.8% year-over-year and amounted to MHRK 83 (H1 2017: MHRK 48.9).
- As the State Aid for Research and Development Projects has not yet entered into force, there were no tax incentives for R&D in H1 2018, and the income tax liability was calculated amounting to MHRK 21.6 (H1 2017: MHRK 11.5).
- Net profit increased by 64.6% year-over-year to MHRK 61.5 (H1 2017: MHRK 37.4). ROS was 8.1% (H1 2017: 5.3%).
- Cash flow from operating activities amounted to MHRK 6.3 (H1 2017: MHRK -59.3) due to proactive collection of receivables. Cash conversion rate was 5% (H1 2017: -65%).
- Total cash, including short term financial assets, as at June 30, 2018 amounted to MHRK 227.9 (27.9% of the total assets), while at the end of 2017 it amounted to MHRK 243.8 (29.7% of the total assets).
- As at June 30, 2018, the Company had a lean balance sheet with total assets of MHRK 817.7, 1% lower compared to end-2017, mainly due to lower long-term receivables. At the same time, in line with forecast, the level of inventory increased due to an increased number of ongoing projects. Equity ratio is 36.2% (end 2017: 28.7%).
- With related parties, the transactions were as follows: sales of products and services amounted to MHRK 486.7 (H1 2017: MHRK 450.1), while procurement of products and services amounted to MHRK 153.2 (H1 2017: MHRK 127).
- As at June 30, 2018 balances outstanding with related parties were as follows: receivables amounted to MHRK 114.7 (end of 2017: MHRK 105.6), and payables to MHRK 64.7 (end of 2017: MHRK 124.4).
- New International Financial Reporting Standards, IFRS 15 and IFRS 9 are effective for annual periods beginning on or after January 1, 2018. It is estimated that the effects of the adoption will

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not significantly affect the retained or current earnings of the Company in relation to previous years. The cumulative effect of the adoption is recognized in retained earnings as at January 1, 2018 and the comparative data will not be revised.

### Business situation in major markets

**In the domestic market** sales revenue amounted to MHRK 190.6, an increase by 38% year-over-year.

With strategic partner Vipnet, we continue to cooperate on implementing a multi-year frame agreement that encompasses modernization and expansion of radio access network by using the state-of-the-art products from Ericsson's portfolio. The collaboration in the field of transport telecom network and core network continues, which contributes to an increased quality and new services for end users, such as VoLTE. Continuous testing of new functionalities is ongoing.

During H1, in cooperation with Hrvatski Telekom, the activities on radio access network modernization in the Istrian region were finished, thus creating prerequisites for implementing 5G network in this region. Thus, Istria became the first region in Croatia where HT installed the state-of-the-art equipment, which includes additional capacities of 4G network, as well as the latest functionalities (IoT). Business cooperation in the segment of fixed telecommunication network modernization, and the delivery of telecommunication infrastructure build and maintenance services continues.

For the mobile operator Tele2 we increased the capacity of core and transport network with the aim to ensure sufficient capacities for introducing new services and quick user activation. Furthermore, we have been continuously working on providing support services for voice core network.

In ICT for Industry & Society, we have successfully finished the upgrade of Operational and Communication Center (OKC) of the Ministry of the Interior of the Republic of Croatia. A new, one-year contract was signed with the Ministry of Justice and the State Geodetic Administration on the maintenance of the Joint Information System for Land Registry and Cadaster. With the Ministry of Healthcare of the Republic of Croatia the delivery of a solution for an efficient healthcare system management is ongoing.

**In export markets (except Ericsson market)** sales revenue amounted to MHRK 90, down by 14% year-over-year.

In the markets of Southeast Europe (Bosnia and Herzegovina, Montenegro and Kosovo) sales revenue amounted to MHRK 45.9, down by 7.6% year-over-year. During Q2, the collaboration with the operators on maintenance and modernization of fixed and mobile networks continued.

In CIS market, sales revenue amounted to MHRK 44.1, down by 19.4 % year-over-year. The results in H1 are in line with expectations. The activities on LTE network build in Belarus are ongoing. Moreover, marketing and sales activities continue with the existing and new customers in telecom segment and e-Health segment.

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**In Ericsson market** sales revenue amounted to MHRK 481.8, up by 3.3% 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 amounts to MHRK 92.9 (H1 2017: MHRK 85.1).

Ericsson Nikola Tesla's R&D Center continues its activities as planned for 2018, with a focus on expanding the responsibilities for the development of 5G network systems in radio access network, strengthening competencies and technology transfer. The Data Management Unit was focused on establishing the granted global responsibilities for network verification for new products. The activities within other development units were ongoing as planned with a focus on the development of network functions virtualization, with the aim to enable new solutions on the cloud platform.

As part of Ericsson global reorganization, Ericsson Garage Croatia will be transformed into Ericsson ONE. Through Ericsson ONE, a global innovation platform, Ericsson intends to unify and make more efficient all the innovation initiatives within the corporation, and our company, due to numerous innovative solutions, continues to have an important role in Ericsson ONE community.

The experts of Center for Services and Solutions for Networks & Media have been engaged in projects for numerous customers worldwide, such as: A1 Telekom Austria Group, LIGI Group, Swisscom Switzerland, Vodafone Netherlands. These are complex activities of expert analysis, creation of new innovative solutions, optimization and upgrading of the existing networks, and consulting. There are ongoing activities related to development and implementation of software tools for mobile networks management and optimization.

Experts from Services and Solutions Center for Digital Services were engaged in various projects for the customers, such as: A1 Slovenija, British Telecom United Kingdom, DoCoMo Japan, KPN Netherlands, Ogero Lebanon, Post Luxembourg, Swisscom Switzerland, Telekom Slovenije Slovenia, Slovak Telekom Slovakia, TIM Italy, Telefonica Spain, Telenor Hungary, Veon Russia, Vodafone Netherlands, Wind Italy, and Wind Greece. These activities include design, network applications, cloud infrastructure and digital business systems.

Ericsson Nikola Tesla Servisi successfully provided the services of monitoring, maintenance and build of Hrvatski Telekom's telecommunication network. In H1, the realization of key projects regarding fixed infrastructure was finished, and the mobile infrastructure modernization started. An additional progress was achieved in automation of network monitoring, thus realizing the prerequisite for increasing additional value for the strategic customer, as well as to end users of the customer's telecommunication services.

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### Other information

At the Annual General Meeting of Ericsson Nikola Tesla joint stock company, held on June 20, 2018, among other decisions, a decision was adopted on dividend payment, amounting to HRK 32.50 per share from retained earnings from 2016 and 2017. The total dividend payment amounting to MHRK 43.3 was paid on July 10, 2018. Shareholders also elected Franck Pierre Roland Bouétard as a new member of the Supervisory Board and reelected Dubravko Radošević as the member of the Supervisory Board.

### Ericsson Nikola Tesla major shareholders (as at June 30, 2018)

	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
Societe Generale-Splitska banka d.d. / Erste Plavi mandatory pension fund, B category	42,453	3.19
Zagrebačka banka d.d. / Unicredit Bank Austria AG – clients account	17,000	1.28
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	15,971	1.20
Zagrebačka banka d.d. State Street and Trust Company, Boston	13,050	0.98
PBZ d.d. / custodian client account	9,826	0.74
Addiko Bank d.d. / Raiffeisen mandatory pension fund	7,934	0.60
Splitska banka d.d. /OTP Index fund - open-end alternative investment fund with public offering	7,521	0.56
Other shareholders	424,098	31.85

### Share price information in H1 2018:

Highest (HRK)	Lowest (HRK)	Closing (HRK)	Market cap. (In MHRK)
1,240.00	1,035.00	1,045.00	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 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 1 January 2018 to 30 June 2018 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", is written over a thin horizontal line.

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For additional information, please contact:

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