
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 2016

Highlights:

- Sales revenues: MHRK **730.3**
- Gross margin: **12.5%**
- Operating income: MHRK **51**
- Net profit: MHRK **51**
- Cash flow from operating activities: MHRK **38.2**

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

„Business results in H1 2016 show a continuation of stable business performance. Sales revenues grew by 7% year-on-year as a result of sales growth in the Ericsson market and in the Commonwealth of Independent States (CIS) market. The Ericsson market registers a continued growth due to business expansion and taking on of new responsibilities in Research & Development and Managed Services segments. In view of that, we continued hiring and employed 119 experts in Ericsson Nikola Tesla Group in H1 2016.

I am glad that our investments into development of new solutions and strong marketing and sales activities bring us success in the Commonwealth of Independent States (CIS). The recently completed implementation of the national healthcare information system of the Republic of Armenia that is entirely cloud-based is a particularly important additional reference for us. We continue to be successful in this market in the operator segment as well with the further expansion of Ucom's LTE network and the modernization of its 3G network. With the new big eHealth contract in Kazakhstan we reaffirm our leadership in realization of complex ICT solutions in the healthcare segment, which is one of the company's strategic domains.

In the local market and in the markets of Southeast Europe we record a fall in sales revenue due to negative economic and political trends. Tough competition and consolidation and centralization of procurement processes of global customers/operators pose additional challenges.

Net profit of MHRK 51 is in line with H1 2015 results, and corresponds to 7.0% return on sales. Gross margin continues to be under pressure in comparison to the same period of last year, due to changing business mix and continued price pressure from customers. We exercise firm cost control. Selling and administrative expenses have

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been reduced by 1.7% YoY. We closed H1 with a healthy balance sheet and a solid equity ratio of 30.2%. Cash flow from operating activities is positive amounting to MHRK 38.2. Following payment of MHRK 132.8 dividend in June, total cash including short-term financial assets amounted to MHRK 163.2 at the end of H1. Working capital efficiency remains strong, expressed in working capital days (turnover) of 27. The cash conversion rate is 47%.

In line with our strategy, we continue to strengthen our position in core business and targeted areas for telecom operators and customers in the Industry & Society segment. We continue to invest into development of new products and solutions. Our strategic focus is also on acquisition of new responsibilities, new projects and strengthening of our global Ericsson market competitiveness. Consequently, and taking into account the need for constant transformation and Ericsson's organizational and structural changes, we have been adapting our organization, employing new experts and investing into our competence development.

It is expected that economic uncertainty and current sales trends will also prevail in the second half of the year. Therefore, continuing adaptation to market conditions coupled with responsible risk management and cost efficiency remain in the focus of our attention.

Digitalization opens new opportunities with existing and potential customers and we trust that our Networked Society strategy and ongoing activities will create future value for all our stakeholders."

Financial highlights for the Group:

- Sales revenues amounts to MHRK 730.3 (H1 2015: MHRK 679.4), 7% increase year-over-year. Of the total sales revenues, the domestic market accounts for 18.1%, services to Ericsson account for 60% (of which 12.5% relates to Managed Services in Croatia), while other export markets participate with 21.9%.
- Sales in the network segment amounts to MHRK 367.9 (50.4% of the total sales revenue), services segment amounts to MHRK 350.6 (48% of the total sales revenue), and support solutions segment accounts for MHRK 11.8 (1.6% of the total sales).
- Gross profit amounts to MHRK 91.3 (H1 2015: MHRK 93.6), down by 2.5% year-over-year. Due to changing business mix and continued price pressure, gross margin decreased to 12.5% (H1 2015: 13.8%).
- Distribution and administrative expenses decreased by 1.7% year-over-year and amount to MHRK 39.4 (H1 2015: MHRK 40.1).
- Operating income decreased by 2.4% year-over-year and amounts to MHRK 51 (H1 2015: MHRK 52.3).
- Net finance income is MHRK 2.2 (H1 2015: MHRK -1.1) primarily due to revaluation of financial assets.
- Net profit is at the previous year level amounting to MHRK 51 (H1 2015: MHRK 51). Return on Sales (ROS) is 7% (H1 2015: 7.5%).
- Cash flow from operating activities is MHRK 38.2 (H1 2015: MHRK 42.2). The cash conversion rate is 47%.

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- Total cash and cash equivalents, including short term financial assets, as at June 30, 2016 amount to MHRK 163.2 (21.8% 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 749.7 (H1 2015: MHRK 723.9). The equity ratio is at 30.2%.
- With related parties, the transactions were as follows: sales of products and services amounted to MHRK 441 (H1 2015: MHRK 393.7), while procurement of products and services amounted to MHRK 193.2 (H1 2015: MHRK 153.9).
- As at June 30, 2016, balances outstanding with related parties were as follows: receivables amounted to MHRK 89.4 (end 2015: MHRK 117.0), and payables MHRK 86.9 (end 2015: MHRK 52.7).

Business situation in main markets

In the domestic market the total sales revenues amounted to MHRK 131.9, which is a decrease by 14% year-over-year.

Cooperation with a strategic partner Vipnet has continued on the modernization of radio access network and transport telecom network as well as in the 3G and 4G capacity increase. Further testing of new functionalities in different areas of core and access networks that contribute to quality increase and new services for end users are ongoing.

Business cooperation with Hrvatski Telekom has continued in the segment of modernization of the fixed telecom network and the delivery of solutions for Hrvatski Telekom's access IP network and transport network. Activities in the segment of telecom infrastructure build and maintenance have intensified. Q2 2016 also saw continued cooperation and activities in identification and realization of future projects with companies Optima and Iskon, both parts of T-HT Group. Local activities on the international Pan-European IP project of Deutsche Telekom (DT Pan-Net) have also begun.

With the mobile operator Tele2 we worked on the upgrade of program support and modernization of core network, as well as on the transport network upgrade in the microwave and optical segments to ensure sufficient network capacity for introduction of new services and fast user activation. We also provide support and maintenance services for the entire telecom network.

In the field of ICT solutions for Industry & Society we have continued the healthcare digitalization (eHealth). We have signed contracts for the delivery of the hospital information systems to the University Hospital Center Split, the University Hospital for Infectious Diseases Fran Mihaljević, MD, and the Specialized Medical Rehabilitation Hospital Biokovka.

The implementation of the Joint Information System of Land Registry and Cadaster continues with success.

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In export markets (the Ericsson market excluded) sales revenues amounted to MHRK 159.8, which is a growth by 15% year-over-year.

In Southeast Europe markets (Bosnia and Herzegovina, Montenegro and Kosovo) sales revenues decreased by 30.5% year-over-year and amount to MHRK 66.4. The unfavorable economic 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.

A cooperation agreement related to the new investment cycle until end 2018 was signed with Crnogorski Telekom. The cooperation agreement covers the areas of radio access network, mobile core network, IMS platform upgrade and new functionalities and Call Centre platform upgrade.

In the Commonwealth of Independent States market sales revenues amounted to MHRK 93.4, which is a growth by 117.6% year-over-year.

The contract for the digitalization of healthcare encompassing the delivery of an interoperable platform was signed with the Ministry of Health and Social Development of the Republic of Kazakhstan. The implementation that includes analysis, design, tailoring to local needs and installation, will last for one year approximately, whereas support services will continue for three years. The introduction of this system will enable better medical service for the citizens of Kazakhstan whilst ensuring savings and improving the national healthcare system management.

Continued cooperation was agreed with the Armenian operator Ucom for the expansion of their LTE network, introduction of new functionalities, increasing the capacity of core network and 3G network modernization.

In the Ericsson market the sales revenue amounted to MHRK 438.6, which is a growth by 13% year-over-year.

In the Research & Development area, activities related to software application and platform development for mobile systems within development units (PDU Radio, PDU Mobile Core, PDU User Data Management and PDU Infrastructure & Hardware), as well as activities of development and services in the so-called installed base of fixed network are ongoing as planned. Radio software design business has been significantly expanded engaging approximately 100 employees. The first phase of development of the new data platform HDS8000 was followed by customer support activities during installation (Telefonica, Swisscom, Vimplecom and others).

Activities related to virtualization and cloud solutions are ongoing within research framework. Ericsson Garage Croatia was set up as a new type of innovation incubator.

Our engagement with students in their final years of studies has been intense to provide them with a better guidance regarding competence requirements. Preparation of projects related to business expansion for this and the next year has also been intensified. In line with that, the topics for the new Ericsson Nikola Tesla Summer Camp 2016 have been defined.

Service and Solutions Delivery center experts have been engaged in various projects for customers worldwide: A1(Austria), BASE (Belgium), POST (Luxembourg), Tango (Luxembourg), Telefonica O2 (Germany), KPN (the Netherlands), Vodafone (Czech Republic), Vodafone (United Kingdom), Translink (the Netherlands), Motorola (United Kingdom), Telecom Makedonija (the Republic of Macedonia), Orange (Poland), Polkomtel (Poland),

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Swisscom (Switzerland), Telekom Slovenia (Slovenia), Turk Telecom (Turkey) and others. We would like to highlight the activities related to the Cloud project for Telefonica O2 (Germany), vIMS for Tango (Luxembourg), Cloud Digital Video Recorder for A1 (Austria) and LTE roaming for Vodafone (Czech Republic). A further step was made in competence development in the cloud domain which has resulted in an intense regional cooperation and support to Ericsson teams in the Region Central and Western Europe. Our teams are leading all relevant regional projects in this area and are recognized as the key delivery center for the cloud domain.

Experts from our center have also provided e2e solutions design and consultancy services for Telefonica O2 (United Kingdom), T-Mobile (Czech Republic), Vodafone (Egypt), MTN (Afghanistan), Orange (Senegal) and Slovak Telekom (Slovakia).

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

Experts in the GCD (the Global Competence Domain for RAN, OSS) have been working on several of Ericsson's strategic projects. We would like to highlight the cooperation with Unicom China on the network traffic optimization project and with Saudi Telecom on the e2e service quality verification project.

The contribution of 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 91. Further company transformation aimed to align the company with new business models and all relevant standards in the field of telecommunications network build and maintenance services is ongoing. This process includes activities related to the implementation of the solution for introduction of the remaining global MSDP (Managed Services Delivery Platform) tools and MSTOP (Managed Services Total Operations Practice) processes.

Other information

At the Annual General Meeting held on May 31, 2016, the decision was made to pay out the regular dividend in the amount of HRK 20.00 per share and the irregular dividend amounting to HRK 80.00 per share, that is the total of HRK 100.00 per share. The dividend was paid out on June 17, 2016 to all shareholders who had Ericsson Nikola Tesla shares listed in their securities account at the Central Depository & Clearing Company on June 6, 2016.

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Overview of major shareholders of Ericsson Nikola Tesla (as at June 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	1.69
PBZ d.d. / The Bank of New York as custodian	21,298	1.59
Zagrebačka banka d.d. / custodian account for Unicredit Bank Austria AG	17,080	1.28
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	0.59
PBZ d.d. / custodian client account	6,935	0.52
OTP BANKA d.d./INS683	6,225	0.46
Other shareholders	416,969	31.31

Share prices in Q2 2016:

Highest (HRK)	Lowest (HRK)	Closing (HRK)	Market cap. (MHRK)
1,129.00	990.00	1,008.97	1,343.6

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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 1 Jan 2016 to 31 June 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", is written below the printed name.

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For additional information, please contact:

Snježana Bahtijari

Company Communications Director

Ericsson Nikola Tesla d.d.

Krapinska 45

HR-10 002 Zagreb

Tel.: + 385 1 365 4556

Mob.: +385 91 365 4556

Fax: +385 1 365 3156

E-mail: snjezana.bahtijari@ericsson.com

Orhideja Gjenero

Investor Relations Manager

Ericsson Nikola Tesla d.d.

Krapinska 45

HR-10 002 Zagreb

Tel.: +385 1 365 4431

Mob.: +385 91 365 4431

Fax: +385 1 365 3156

E-mail: orhideja.gjenero@ericsson.com

E-mail: odnosi.investitori@ericsson.com

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