

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 2019

Highlights:

- Sales revenue: MHRK **1,779.3**
- Gross margin: **9.2 %**
- Operating profit: MHRK **102.6**
- Profit before tax: MHRK **108.2**
- Net profit: MHRK **102.6**
- Cash flow from operating activities: MHRK **68.9**

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

“In 2019, Ericsson Nikola Tesla Group total sales revenue amounted to MHRK 1,779.3, up by 14.2% year-over-year, with sales revenue growth in all markets. During 2019, we focused on network modernization for our customers in Croatia and abroad, development of new solutions in 5G, and strengthening of our technological leadership.

One of the main trends that marked 2019 is the implementation of 5G network, started by the leading European and global operators, which opened a new chapter in ICT industry. Ericsson is a global leader in 5G, and Ericsson Nikola Tesla Group, with more than 1400 R&D experts (out of total 3224 employees), is a part of this global story. Through its activities in 5G technology development it supports Ericsson in global development of the state-of-the-art solutions and services.

The leading Croatian operators follow global trends and last year was marked by investments in network modernization as the preparation for 5G introduction. The start of 5G implementation is expected in H2 2020, following the announcement of conditions and assigning of the necessary radio-frequency spectrum by the regulator. We successfully completed a complex project of radio access network modernization with Hrvatski Telekom (HT), which significantly improved and evened the quality of HT's mobile services in the entire network and has created preconditions for 5G introduction. Successful cooperation was continued with A1 Hrvatska, by signing a framework agreement that encompasses modernization and expansion of the operator's radio access network by using the latest technology solutions from Ericsson Radio System (ERS) portfolio. A strong increase in sales revenue in the domestic market was realized also in ICT Industry & Society segment, primarily on the projects in the field of e-Health, e-Business (Land Registry and Cadaster) and Public Safety (State Border Control).

Export markets also recorded growth in sales revenue. Good cooperation with the operators HT Eronet, Crnogorski Telekom, Ipko and beCloud was continued on modernization, expansion and maintenance of telecommunication networks. In ICT segment Industry & Society we contracted the continuation of healthcare system maintenance for

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the Ministry of Healthcare of Armenia. After completing the phase of managed services of the healthcare system informatization project in Kazakhstan, we started system maintenance.

Year-over-year, gross profit increased by 16%, amounting to MHRK 164.5, while gross margin remained almost the same amounting to 9.2%. Operating profit amounted to MHRK 102.6, down by 14.5%, primarily due to lack of incentives based on the Investment Promotion Act, although positive impacts of this Act in 2019 are visible in the decrease of tax liability, i.e. effective tax rate. Operating profit was lower also due to increased selling expenses for activities related to seizing new business opportunities. Net profit amounted to MHRK 102.6, while return on sales (ROS) was 5.8%. We concluded the year with a lean balance sheet and an equity ratio of 33%. A positive cash flow from operating activities was realized amounting to MHRK 68.9, primarily as a result of realization of strategic projects. At the end of 2019, total cash and cash equivalents, including short-term financial assets, amounted to MHRK 135.8. Group's Working capital efficiency, expressed in Working Capital Days (WCD), was 41 days, and if we exclude services to Ericsson, working capital efficiency was 110 days as a result of increased engagement on network modernization projects, primarily in the domestic market. Cash conversion rate was 36%.

As a socially responsible company, we pay special attention to sustainable business. An excellent example is an extensive project of energy efficiency of the part of the Company's buildings and plants, co-funded by the EU. Once the project is completed, the Company shall realize annual energy savings of more than 4.6 million kWh, with the simultaneous reduction of CO2 emissions by almost 1400 tonnes. This project is in line with the conclusions of Ericsson Nikola Tesla's action plan to reduce its carbon footprint, which was created within the European LIFE Clim'Foot project, in which the Company previously participated.

As part of the Company's cooperation with universities, Ericsson Nikola Tesla held its 19th Summer Camp, in which 54 students from Croatia and neighboring countries participated, 13 of whom from ERASMUS++ project BENEFIT, in which our company is the industry partner. The Summer Camp follows global ICT trends so that students worked on projects regarding Artificial Intelligence, Automation, Robotics, 5G and the Internet of Things (IoT), with the help of their mentors. Within the cooperation with scientific and educational institutions, we would like to highlight the activities on founding of new joint Traffic and Logistics Data Science Lab with the Faculty of Transport and Traffic Sciences (FPZ), University of Zagreb.

In line with our strategy, we are focused on the development of solutions and services and sales in the field of mobile broadband Internet access (4G/5G mobile solutions), digital transformation, Managed Services and Industry & Society segment (healthcare, public safety, e-Business). We have been intensively working on strategic contracts and have been investing in 5G and new business models, which will impact our margins short term, but will also strengthen our market position in the long term. During January 2020 Ericsson Nikola Tesla Group took over from Ericsson corporation the full responsibility for the Managed Services of build and maintenance of HT's telecommunications infrastructure.

Furthermore, we have been working on strengthening of our position in Ericsson market through activities of R&D center as well as our expert centers for services and solutions, by focusing on achieving high quality, innovation and cost efficiency. In line with the above, we continue hiring and investing in equipment and development of strategic knowledge and skills. During 2020 we continue to implement the Digital Transformation program at Ericsson Nikola Tesla Group level, with the aim to simplify the Company's key processes and further automation. In order to secure further business development and remain competitive, we shall continue to focus on cost and operating efficiency, working capital efficiency and strategic risk management.

In 2019, our company marked its 70th anniversary and I would like to thank all employees, customers and partners for their contribution to our successful operation. “

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Financial Highlights for the Group:

- Sales revenue amounted to MHRK 1,779.3 (2018: MHRK 1,558.2), up by 14.2% year-over-year. Of the total sales revenue, domestic market accounts for 28%, services to Ericsson account for 57.7% (of which 10.4% is related to Managed Services in Croatia), while other export markets account for 14.3%.
- Sales in the Networks segment amounted to MHRK 1,012.0 (2018: MHRK 939.8), Digital Services amounted to MHRK 570.8 (2018: MHRK 439.8), Managed Services amounted to MHRK 189.3 (2018: MHRK 177.1), and the segment Emerging Business and Other amounted to MHRK 7.2 (2018: MHRK 1.4).
- Gross profit amounted to MHRK 164.5 (2018: MHRK 141.7), up by 16% year-over-year as a result of higher sales revenue. Gross margin remained at 9.2% (2018: 9.1%), thus showing the stability of gross margins of the ongoing and completed projects.
- Due to an increased engagement on the development of new and existing markets selling and administrative expenses increased by 12.3% year-over-year and amounted to MHRK 81.8 (2018: MHRK 72.9).
- Operating profit amounted to MHRK 102.6 (2018: MHRK 120.0), down by 14.5% year-over-year. In 2018, operating profit was positively impacted by the incentives based on the Investment Promotion Act, while in 2019, the positive impacts of this Act are visible exclusively in the tax liability decrease, i.e. effective tax rate. Lower operating profit was additionally impacted by increased selling expenses related to seizing new business opportunities.
- Gain from financial activities was MHRK 5.7 (2018: MHRK 0.6), which is an increase year-over-year, primarily as a result of positive exchange differences and increased income from customer financing.
- As a result of decrease in operating profit, profit before tax is lower 10.3% year-over-year and amounts to MHRK 108.2 (2018: MHRK 120.6).
- Net profit amounts to MHRK 102.6 (2018: MHRK 113.6), down by 9.7% year-over-year. Return on Sales (ROS) is 5.8% (2018: 7.3%).
- Cash flow from operating activities was MHRK 68.9 (2018: 75.2). Cash flow was positively impacted by higher customer receivables collection and lower VAT payables. Cash conversion rate was 36% (2018: 39%).
- Working Capital Efficiency, expressed in WCD, on Group level was 41 days (2018: 34 days), and excluding services to Ericsson, Working Capital Efficiency was 110 days (2018: 87 days). The increase of Working Capital Days is the result of an increased engagement on network modernization projects, primarily in the domestic market.
- Total cash and cash equivalents, including short-term financial assets, as at December 31, 2019 amounted to MHRK 135.8 (14.2% of the total assets), while at the end of 2018, it amounted to MHRK 236.4 (28.1% of the total assets). Total dividend payments, amounting to MHRK 94, were paid out on July 17, 2019. The decrease in cash was additionally influenced by the continuation of intensive engagement of working capital on network modernization projects with key customers.
- The Company has a lean balance sheet with the total assets of MHRK 954.8 as at December 31, 2019, up by 13.6% compared to the end of 2018. Along with the expected increase in inventory and the effect of right-of-use assets (IFRS 16), we should also mention investments related to energy efficiency project of the part of the Company's buildings and plants, as well as net impact of good payment collection of short-term

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receivables at the end of 2018, and invoicing of certain completed phases of the network modernization projects in 2019.

At the end of 2019, the Group has a right-of-use assets amounting to MHRK 51.9, and lease commitments amounting to MHRK 52.6, which resulted in additional increase of balance sheet in 2019 as compared to the end of 2018.

- Equity ratio amounted to 33% (end of 2018: 36.3%).
- With related parties, the transitions were as follows: sales of products and services amounted to MHRK 1,035.0 (2018: MHRK 973.7), while procurement of products and services amounted to MHRK 459.9 (2018: MHRK 413.7).
- As at December 31, 2019, balances outstanding with related parties were as follows: receivables amounted to MHRK 116.1 (end of 2018: MHRK 113.2), and payables amounted to MHRK 95.4 (end of 2018: MHRK 40.4).

Reclassification of 2018 financial data:

- Compared to the results published in 2018, the Group modified its presentation of Annual Reports to comply with the reporting as per the Capital Market Act (65/18 Article 470). The key changes include Other Group's revenues, which were previously presented as the decrease of Direct expenses of sales of products and services, while now they are presented as Other business revenue.

Business situation in major markets

In the domestic market, sales revenue amounted to MHRK 497.0 (2018: MHRK 372.5), up by 33.4% year-over-year.

The radio access network modernization project, consisting in the replacement of Hrvatski Telekom (HT) equipment with the latest Ericsson solutions in the segment of mobile telecommunication networks, agreed with HT in H1 2018, was successfully completed within the planned deadline during Q4 2019. The project's key performance indicators are a significantly increased capacity of HT's radio network, including a better population coverage of the overall HT's 4G network, amounting to 98% in outdoor coverage. The cooperation between Ericsson Nikola Tesla and HT in the field of radio access network continues with the aim to secure further capacity increase. In addition, by completing this project, the prerequisites have been made in HT's network infrastructure for the commercial introduction of 5G technology after the necessary radio-frequency spectrum is assigned for it.

Ericsson Nikola Tesla supported HT in noncommercial testing of 5G network in 3.5 GHz in Zagreb, Samobor, Krk, and Osijek with the aim of analyzing 5G technology operations in real conditions.

In addition to the mobile telecommunication network, we have continued the long-term successful cooperation in the segments of fixed telecommunication network, as well as delivering services of rollout and maintenance of HT's telecommunication infrastructure.

We have been successfully cooperating with A1 Hrvatska since they entered the Croatian market, more than 20 years ago. A1 Hrvatska crowned their anniversary with a prestigious P3 certificate as the best network in Croatia, relying on Ericsson technology and partnership with Ericsson Nikola Tesla since the beginning of operations in Croatia. In September 2019, a multi-year framework agreement was signed (until the end of 2023) for additional modernization and expansion of radio access network. Based on ERS (Ericsson Radio System) portfolio, A1 will have a flexible 5G -ready solution at their disposal.

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Furthermore, A1 Hrvatska put into operation NB-IoT (Narrowband Internet of Things) service for business users, based on Ericsson solution in the field of radio access network. This technology enables secure and reliable wireless connectivity of a large number of devices, which, due to advanced characteristics, is considered 5G technology. During 2019, 5G test network, based on commercially available Ericsson products, and integrated with other network elements was also put into operation, which placed A1 Hrvatska among the most advanced operators in Europe and worldwide. Moreover, we have continued the cooperation in the field of core network and transport telecommunication network, which contributes to an increased network quality and new services for end users.

With the mobile operator Tele2, we worked to increase the database capacity with 4G user information and upgrade of the entire core network to the latest software release. We have continued to provide support services for voice core network and software solution for data traffic shaping. During 2019, we also delivered the equipment for microwave transport network expansion.

With the company RUNE Crow, the activities are ongoing on project documentation preparation related to the implementation of the ultra-fast broadband fiber network for users in Croatian rural areas (Istria County and Primorje-Gorski Kotar County).

In ICT Industry & Society segment, we delivered a range of new functionalities on the upgrade of the Central Healthcare Information System of the Republic of Croatia (CEZIH). Furthermore, an Annex to the agreement for the project of upgrade of the Central Healthcare Information System of the Republic of Croatia (CEZIH) for 2020 was also signed. We delivered an IT solution for the exchange of „Patient Summary“ within the Connected Europe Facility (CEF) for the Croatian Health Insurance Fund (HZZO). We have continued the upgrade of the Central Information System of Land Registry and Cadaster (JIS). The last phase of the delivery of the project of State Border Control was completed, as well as the delivery of the solution for the integration of 112-192 system, i.e. improvement of the operations of the Operational and Communications Center (OKC) of the Ministry of the Interior.

In export markets (excluding Ericsson market) sales revenue increased by 10.8% year-over-year to MHRK 254.6 (2018: MHRK 229.8).

In Bosnia and Herzegovina, 2019 was marked by the issuing of the long-awaited licenses for introduction of the fourth generation of mobile communications. With the operator HT Eronet, we have been working on the expansion of LTE network across Bosnia and Herzegovina. We have continued to cooperate on modernization and maintenance of telecommunication networks with the operators Crnogorski Telekom (Montenegro) and IPKO (Kosovo). In the market of Belarus, we have continued our cooperation with the operator beCloud on the project of LTE network expansion.

In ICT Industry & Society segment we signed an agreement on the continuation of healthcare system maintenance for the needs of the Ministry of Healthcare of Armenia. Within the project of healthcare system informatization in Kazakhstan, in cooperation with the Ministry of Healthcare of the Republic of Kazakhstan, we successfully completed the managed services phase and started the maintenance of the national information healthcare system.

In Ericsson market, sales revenue amounted to MHRK 1,027.8 (2018: MHRK 955.8), up by 7.5% year-over-year. The contribution of Ericsson Nikola Tesla Servisi d.o.o., a daughter company of Ericsson Nikola Tesla d.d., to the revenue in this market segment amounted to MHRK 188.5 (2018: MHRK 178.0).

Ericsson Nikola Tesla's R&D Center was focused on expansion of responsibilities for the development of 5G network systems, competence strengthening and technology transfer. The major part of activities concerns radio development within the business segment Networks. We should highlight that the Center is especially recognized within Ericsson global R&D community for its end2end competencies and advanced knowledge in software

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development on Multi Standard Ericsson Radio Base Station. In addition, the Center has responsibilities for some of the key Ericsson R&D projects.

Last year, many significant functionalities for 5G and the evolution of 4G system were developed and implemented in Ericsson's global customers' networks. Moreover, our experts have been working on virtualization and modernization projects for Mobile Switching Centre (MSC). In addition to global projects related to Unified Data Management (UDM) systems, we should mention the development of demo systems for multiple operators. For the development unit Cloud, we have been working on verification and quality control of the new platform solutions. Along with all these activities, the focus on the quality of the deliveries continued, which led to another important achievement: the year was concluded with excellent results and evaluations of our R&D Center.

Experts from Services and Solutions Center for Networks, along with projects for the customers of Ericsson Nikola Tesla Group, have worked on projects for Ericsson customers in Germany, Switzerland, United Kingdom, France, Qatar, Saudi Arabia, Pakistan, Egypt, South African Republic, Brazil, Mexico, etc. There is still a great demand for Ericsson Nikola Tesla's experts by Ericsson global/regional organizations. Our experts are included in activities of integration and optimization of various technologies, with an increasing focus on 5G in key markets (USA, Japan, China). We have continued to work on the development and implementation of software tools for mobile networks management and optimization.

Experts from Services and Solutions Center for Digital Services and Operations (including Media), along with working on projects for our customers, were engaged on projects for Ericsson customers in Austria, Germany, Sweden, Switzerland, United Kingdom, the Netherlands, Belgium, Denmark, France, Ireland, Norway, Greece, Italy, Luxembourg, Slovenia, Czech Republic, Moldova, Albania, Serbia, Qatar, Libya, Mexico, USA, etc. These activities include complex projects of introducing 5G technology, operational and business support systems, as well as projects of introducing core solutions in Cloud.

The teams working in the unit for IT& Engineering Services are achieving excellent results on projects of test environment management and IT operations management and have been recognized within Ericsson for the quality of the delivered services. Industry & Society segment records good results on projects in the field of IoT platforms and Connected Urban Traffic.

Ericsson Nikola Tesla Servisi have been successfully delivering the services of monitoring, maintenance and rollout of telecommunication network of Hrvatski Telekom. Planned goals on optical distribution networks rollout have been realized and optical access for 37,374 users was enabled. Modernization of mobile infrastructure comprised nearly 1,500 locations that are now enabled for new technology introduction.

Innovations still play a key role in the Company's strategy. The main interest areas encompass 5G, services based on 5G, Artificial Intelligence and IoT. Based on our rich experience in innovations, our employees' competencies, and solutions, we have been continuously contributing to Ericsson's global innovation platform - Ericsson ONE. Within the EU program for research and innovations, Horizon 2020, we have been successfully working on several research projects. Furthermore, we have been successfully cooperating with the local and international academic community by working on joint projects and support to student activities.

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Other information

Ericsson Nikola Tesla major shareholders (as at December 31, 2019)

	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
OTP banka d.d. / Erste Plavi mandatory pension fund, B category	56,013	4.21
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	12,728	0.96
OTP banka d.d. / OTP Indeksni fond - open-end alternative investment fund with public offering	9,827	0.74
PBZ d.d. / custodian client account	9,736	0.73
Zagrebačka banka d.d. / Harding Loevner Frontier Emerging markets portfolio	9,318	0.70
Zagrebačka banka d.d. / State Street Bank and Trust Company, Boston	8,630	0.65
Addiko Bank d.d. / Raiffeisen voluntary pension fund	8,094	0.61
Other shareholders	423,507	31.80

Share price information in 2019:

Highest (HRK)	Lowest (HRK)	Closing (HRK)	Market cap. (In MHRK)
1,415.00	972.00	1,400.00	1,864.3

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Ericsson Nikola Tesla d.d.
Krapinska 45
Zagreb

OIB: 84214771175

Pursuant to the Articles 462 to 468 of the Capital Market Law (Official Gazette 65/18) 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 January 1, 2019 to December 31, 2019 present a true and fair view of the financial position of the Company and the Group and of the financial performance and 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 additional information, please contact:

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