
ERICSSON NIKOLA TESLA D.D.

The Management Report on the Company's business situation and comments on the 2012 consolidated financial results

Highlights:

- Sales revenue: MHRK **1,913.3**
- Gross margin: **11.1%**
- Operating profit: MHRK **116.6**
- Net profit: MHRK **126.9**
- Cash flow from operating activities: MHRK **297.8**
- Proposed dividend: HRK **20** ordinary and HRK **150** extraordinary dividend per share

Gordana Kovačević, the President of Ericsson Nikola Tesla commented on the Company's performance:

“The company's focus on strategic projects, technology leadership and partnership with customers generated excellent business results. The total sales revenue increased by 64% year-over-year as a result of the revenue growth in both the CIS and Ericsson markets. Sales in the domestic market slightly increased year-over-year, while sales in the regional markets decreased due to unfavorable economic trends, political instability and postponed customer investments. In export markets, Ericsson Nikola Tesla generated 86% of total sales revenue.

The net profit of MHRK 126.9 increased by 353% year-over-year. The strong cash flow from operating activities amounted to MHRK 297.8. Accordingly, the total cash and cash equivalents, including current financial assets increased by 10.7% year-over-year, amounting to MHRK 657. The Company has a balance sheet with total assets of MHRK 1,169.7 and equity ratio of 64.5%.

The activities focused on operational and cost efficiency as well as risk management contributed to good results.

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Despite demanding business environment, we strengthened our market share and realized several strategic projects. In the Russian market, we successfully completed a demanding project on 2G and 3G mobile networks for Rostelecom. With the new mobile network, Rostelecom becomes a convergent operator that will offer its users a full range of converged information and telecommunications services in mobile and fixed networks across the Russian Federation. It is the largest deal the Company has signed in the past several years, and a new contract of such volume cannot be expected every year. In the domestic market, Ericsson Nikola Tesla became a sole supplier of the state-of-the-art radio access network to Vipnet and thus strengthened its position as a leading supplier of the state-of-the-art solutions. Furthermore, our business with T-Hrvatski Telekom (T-HT) continued by signing a long-term agreement on implementation of IP/MPLS core network, which is a cornerstone of future T-HT business performance as a convergent operator, and a way towards all-IP environment. As of ICT solutions for the business segment of industry and society, we signed contracts on maintenance and upgrading of the Central Information Healthcare System in Croatia. In Bosnia and Herzegovina, we signed a contract with BH Telecom on the extension of mobile network, covering 2G/3G technologies and being also preparation for the transition to LTE technology.

The major part of our activities and generated revenue has been related to research and development and other expert activities. Ericsson Nikola Tesla has been continually expanding its portfolio and responsibilities, and has been engaged on complex and demanding projects. The performance of our Research & Development Centre in 2012 was highly ranked by Ericsson's R&D Operational Steering Group. Having in mind the importance of this segment for the future of the company, in the period to come we shall focus, as much as possible, on the given area, thus improving our competitiveness in the global organization.

ICT industry will continue to be of the utmost importance in the business development and the society as a whole. The introduction of new devices and applications results in greater users' expectations regarding network quality and performance what increases demand for our technological solutions and services. Therefore our strategic priorities have been focused on areas with growth potential, such as mobile broadband access, services and operational and business support systems. Higher profitability and cost reduction remain in our strategic focus.

There is no doubt that economic uncertainty and business challenges will also mark the year 2013. Therefore, a constant adjustment to technological and market conditions, as well as responsible risk management will be in our focus. We shall continue to develop partnership with our customers and use technology leadership, skills and competences of our employees as a significant competitive advantage“.



Financial summary:

- Sales of MHRK 1,913.3 (2011: MHRK 1,165.8) increased by 64% year-over-year, primarily due to the revenue growth in the Russian market. The revenue structure by markets has been considerably changed in favor of export markets. The domestic market accounts for 14%, export to Ericsson market 29%, and export to other countries 57% of total sales.
- Network infrastructure including the Network rollout services amounted to MHRK 1,248.4 (65% of total sales), Professional services MHRK 518.5 (27%), and Multimedia solutions MHRK 146.4 (8%).
- The gross profit of MHRK 211.6 (2011: MHRK 133.9) increased by 58.1% year-over-year. However, gross margin dropped slightly to 11.1% (2011: 11.5%) due to business mix offset by efficiency and improved project performance.
- Distribution and administrative expenses of MHRK 97.2 (2011: MHRK 91.4), increased by 6.4% year-over-year, reflecting higher business volume.
- The operating profit amounted to MHRK 116.6 (2011: MHRK -11.2), reflecting improved efficiency, focus on risk management and higher business volume.
- Net finance income amounted to MHRK 24.4 (2011: MHRK 33.6), reflecting lower gains on currency deviations and higher interest income year-over-year.
- Due to re-evaluated tax position, the Company assessed its tax asset position resulting in removing deferred tax assets, which negatively impacted net income by MHRK 14.
- Net profit increased by 353.4% year-over-year to MHRK 126.1 (2011: MHRK 28). Return on sales (ROS) increased to 6.6% (2011: 2.4%).
- Cash flow from operating activities amounted to MHRK 297.8 (2011: MHRK 134.8) as a result of strong focus on working capital. Total cash and cash equivalents, including current financial assets as at December 31, 2012 amounted to MHRK 657 (56.2% of total assets) compared to MHRK 593.6 (49.8% of total assets) as at December 31, 2011.
- The Company has a balance sheet with total assets of MHRK 1,169.7 and equity ratio of 64.5%.
- As at December 31, 2012 Ericsson Nikola Tesla receivables outstanding amounted to MHRK 385.3 (end of 2011: MHRK 461.1).

During 2012 extensive cooperation with the Croatian Bank for Reconstruction and Development (HBOR) played an important role in the Company's mitigation of risks related to export markets.

- As regards major transactions with related parties, sales of products and services amounted to MHRK 567.1 (2011: MHRK 496.7), while purchase of products and services more than tripled to MHRK 1,088.3 (2011: MHRK 391.9) as a result of realization of contracts in the Russian market.
- As at December 31, 2012, receivables outstanding with related parties amounted to MHRK 81.2 (end of 2011: MHRK 87.5), and payables outstanding were MHRK 115.7 (end of 2011: MHRK 50.7).
- As of financial year 2012, the Company submits consolidated financial statements including ETK BH d.o.o., its recently established subsidiary in Bosnia and Herzegovina, 100% owned by Ericsson Nikola Tesla.

Business situation in major markets

In the domestic market, sales of MHRK 268.1 increased by 2% year-over-year. Negative economic trends and permanently growing competition influence the Croatian telecom market (end-user behavior and operator's income). Furthermore, the government investments into strategic ICT projects in Croatia have been continually postponed.

Vipnet selected Ericsson Nikola Tesla as a strategic partner for further development of radio transmission network. By signing a contract, Ericsson Nikola Tesla remains a sole supplier of the state-of-the-art radio transmission network based on Ericsson ML (MiniLink) portfolio. During 2012, the collaboration continued on the expansion and modernization of 2G, 3G and 4G infrastructure, as well as in the segment of a core network modernization, where new functionalities have been introduced and tested.

The collaboration with T-HT continued on projects covering the network transformation into the next generation network and the expansion of the broadband Internet access. The implementation of IP/MPLS backbone project has been in full swing, thus paving the way to future T-HT performance, as a convergent operator, and heading towards all-IP environment. The Company is an active participant in the mobile network modernization, through extension of capacities in the microwave radio-relay systems, needed because of the increased data traffic volume. In addition, the migration of PSTN network has continued in line with planned schedule.

We have also continued the long-term cooperation with the mobile operator Tele2 on introduction of new functionalities and modernization of the current network.

According to the present trends in telecommunications, the focus remains on the increase of transmission rates and coverage by the mobile broadband Internet access service.

The major focus in ICT for industry and society segment was on upgrading the national ICT healthcare system, the realization of Cadastre and Land Database joint information system (JIS), as well as on the modernization and expansion of the communications network of the Croatian Electricity Company (HEP).

In export markets (except for Ericsson market), the sales revenue amounted to MHRK 1,093.2, an increase of 161% year-over-year.

In the regional markets (Bosnia and Herzegovina, Montenegro and Kosovo), sales revenue amounted to MHRK 204.9, a decrease of 24% year-over-year. The negative economic trends and instable political situation impacted the operators' investments in the region.

At the beginning of 2012, Ericsson Nikola Tesla signed a two and a half year agreement with Kosovo operator Ipko. The agreement covered the usage of the latest SW releases in Ericsson network elements implemented in Ipko's network. This agreement is of strategic importance for Ericsson Nikola Tesla since it paves the way to future upgrades of Ipko's networks by Ericsson state-of-the-art technology.

With HT Mostar the Company contracted an extension of the 2G and 3G networks, which covers the latest generation equipment delivery as well as installation and integration services. As of BH Telecom, the signed agreement covers the support and maintenance of its fixed and mobile networks.

In Q4 the company signed with BH Telecom contracts on expansion of mobile network related to GSM/UMTS technologies and the expansion of its fixed network. The implementation of the given contracts will enable the expansion of BH Telecom 2G and 3G networks and the strategic preparation for the transition to LTE technology by software upgrade.

In CIS market, sales revenue amounted to MHRK 888.1, an increase of 501.7% year-over-year, primarily due to the realization of contracts in the Russian market.

The leading Russian telecom service provider, Rostelecom, was delivered equipment for 2G and 3G mobile networks, including multi-standard radio base stations of RBS 6000 type for the channel and packed switching networks, as well as the architecture for the new Evolved Packet Core (EVO) and Operating Support Systems (OSS). The activities on the implementation of solutions based on Ericsson media content delivery network (MDN) are ongoing.

In the Russian and other CIS markets, the presales activities are currently in the full swing.

[In the Ericsson market](#), the sales revenue amounted to MHRK 552, an increase of 14% year-over-year.

Ericsson Nikola Tesla R&D Center, by applying the innovative, agile (Lean & Agile) way of working, has continued with its activities on development of new functionalities and has been continuously expanding its products portfolio and responsibilities at the global level.

In the core network segment, development of new functionalities for the next generation of Mobile Softswitch products (MSS) is ongoing. With that, activities on the development of new functionalities in segments such as the Session Initiation Protocol (SIP) and Voice over LTE (Vo-LTE) have been intensified. Good business collaboration has been achieved with numerous customers worldwide.

In the fixed core networks segment and AXE platforms, as well as in the part of Wireline Switching Operations organization (WSO), we were awarded a global responsibility for the delivery and maintenance of software packages and offering services to demanding customers around the globe and in different time zones. The majority of our deliveries were directed to customers in Europe, North Africa, Near East, America and Asia.

An important achievement in the platform development was the completion and implementation of EVO ET solution. Such an extensive and complex project required a development of the completely new HW and SW with an application of a large number of innovations. Thanks to the continuous focus on the quality, the trial operation of a product in Telstra Australia network was carried out smoothly and without any problem reported. Thus, the global acceptance (GA) of the project is to be launched.

Also, a number of other software deliveries have been carried at the top quality level. The company was awarded an enviable recognition and the corresponding positioning in the Ericsson organization for the platform development by achieving the status of a strategic partner. This achievement resulted from the proved flexibility and an excellent performance that was additionally empowered by an agile way of working.

Experts from the Service Delivery Center have been engaged in numerous projects in the markets worldwide. The largest and most important ones are for: O2 Great Britain, Vodafone Great Britain, Vodafone Ireland, KPN the Netherlands, Vodafone Netherlands, Telekom Austria, Swiscomm Switzerland and Polkomtel Poland. In addition, activities on the expansion of LTE network for Vodafone Germany have been continued during the whole year.

The experts have been also providing consulting and dimensioning services to A1 Austria, T-Mobile Austria, Mobitel Slovenia, Slovak Telekom, Orange Romania, Monaco Telecom, Vodafone Spain, MTN IranCell, Magticom Georgia and services related to new generation mobile network optimization and management for Softbank Japan.

The Global Competence Centre professionals for radio access networks were engaged in LTE optimization and on “Heterogeneous network” strategic projects.

Business outlook for 2013

The telecom market will remain extremely dynamic in 2013 as well. A further strong growth of data traffic, generated by a significant increase in the number of mobile smart devices (smartphone, i-pad,...) as well as by increased internet usage, is expected. Consequently, further expansion of fixed broadband access to xDSL technologies as well as introduction of high rate technologies based on optics (FTT-x) are expected.

Intensive growth of mobile broadband access will be continued through further implementation of 3 and 3.5 mobile technology generations (HSPA, HSPA+), while in Croatia the intensified implementation of LTE technology is expected. We also expect a significant modernization of the existing mobile networks applying SRAN concept (Single Radio Access Network), enabling the operators to be more efficient and optimize costs.

As regards edge and core networks, transformation towards „all-IP“ Next Generation Convergent Networks based on IMS architecture will be continued.

We also expect OSS (Operation Support System) and BSS (Business Support System) modernization and all this will, in the end, enable operators to provide a wide range of convergent services regardless of the location or the user approach.

ICT implementation should be continued in Industry and Society segment as well, no matter whether enterprise or state administration is in question, taking into account effects and benefits achieved by development, implementation and usage of ICT solutions and services.

The first steps in the area of m2m (machine-to-machine) communications are also expected, as well as gradual implementation of cloud solutions and business models based on them.

Other information

At the meeting of February 19, 2013 the Supervisory Board of Ericsson Nikola Tesla approved the Managing Director's proposal to General Assembly (scheduled for 28 May 2013) about ordinary dividend payout to the amount of 20 HRK per share and extraordinary dividend to the amount of 150 HRK per share.

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Ericsson Nikola Tesla major shareholders (as at Dec 31, 2012)

	No. of shares	% of share capital
Telefonaktiebolaget LM Ericsson	653,473	49.07
Hypo Alpe-Adria-Bank d.d. / Raiffeisen Mandatory Pension Fund	123,444	9.27
Societe Generale-Splitska banka d.d. / Erste Plavi Mandatory Pension Fund	32,961	2.48
Hypo Alpe-Adria-Bank d.d. / PBZ Croatia osiguranje Mandatory Pension Fund	30,615	2.30
Zagrebačka banka d.d. / Custodian Account for Unicredit Bank Austria AG	29,994	2.25
PBZ d.d. / State Street client account	25,375	1.91
PBZ d.d. / The Bank of New York as custodian	17,164	1.29
Societe Generale-Splitska banka d.d. / AZ Mandatory Pension Fund	15,376	1.15
PBZ d.d. / Custodian Client Account	10,431	0.78
Hypo Alpe-Adria-Bank d.d. / Raiffeisen Voluntary Pension Fund	8,254	0.62
Other shareholders	384,563	28.88

Share price information in 2012:

Highest (HRK)	Lowest (HRK)	Closing (HRK)	Market cap. (in MHRK)
1,386	870.01	1,385	1,844.3

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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 2012 to 31 Dec 2012 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



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For additional information, please contact:

Snježana Bahtijari

Company Communication Director

Ericsson Nikola Tesla d.d.

Krapinska 45

HR-10 002 Zagreb

Phone: + 385 1 365 4556

Mobile: +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

Phone: +385 1 365 4431

Mobile: +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 performance, please visit: <http://www.ericsson.com/hr>

Communication

Ericsson Nikola Tesla