

ANNUAL REPORT ON GROUP PERFORMANCE _Company President Report

2018 was a dynamic year for Ericsson Nikola Tesla Group in terms of business and technology, full of challenges and important achievements. A significant growth in sales revenue was achieved in the domestic market, primarily owing to customers' investments in mobile networks modernization and digital transformation projects. Export markets recorded lower sales revenue due to ramping down of network modernization projects, and challenging economic and political environment in some markets. Services to Ericsson continuously record growth and contribute to the overall stability of financial performance.

5G remains a hot topic, globally and locally. Ericsson has been investing significantly in research and development of 5G and collaborates with key customers and partners to define the future development of 5G mobile networks. 5G is much more than one of the generations in mobile technology development; it is an integral part of the digital transformation that opens new means of communication and ways of working/living for people, enables better business performance for other industries and overall economic growth.

5G will enable end users to enjoy higher data transfer speeds and services such as 4K/8K video content, as well as solutions based on augmented and virtual reality. Simultaneously, due to low latency and greater data transfer speeds, various industry segments will be able to reduce costs using automation, remote management, and artificial intelligence in Cloud.

Our company is included in global technology trends and consequently, we were the first in Croatia to demonstrate the possibilities offered by 5G in March 2018, only one month after the global presentation at the Mobile World Congress in Barcelona. During summer we supported the leading Croatian operators in their 5G demos in real environment, focusing on end-user services. We have expanded our research and development activities in 4G/5G mobile communications in Zagreb and Split and opened an R&D office in Osijek.

Market overview

In 2018, Ericsson Nikola Tesla Group's sales revenue amounted to MHRK 1,558.2, up by 5.2% year-over-year.

The leading Croatian operators significantly invested in networks modernization and preparation for the upcoming 5G technology, and it is expected that this trend will intensify in the future. Hrvatski Telekom (HT) won an independent international "P3 - Best in Test" certificate for the best mobile network in Croatia, for network quality and customer satisfaction. The results of P3 measurements for A1 Hrvatska are slightly lower compared to HT's results, which places HT and A1 Hrvatska mobile networks among the best worldwide, which confirms the quality of our solutions and services. In ICT Industry and Society segment, we have been working on projects in the area of eHealth, e-Business (land registry and cadaster) and Public Safety (State Border Control).

In the markets of Southeast Europe, our continuous focus on customers' requirements resulted in several contracts with the operators related to modernization of the radio network and networks maintenance. I would like to highlight the continuation of good cooperation with the operators HT Mostar (Bosnia and Herzegovina), Crnogorski Telekom (Montenegro) and Ipko (Kosovo).

In the market of the Commonwealth of Independent States, the project of healthcare system informatization in Kazakhstan has a significant impact on business. In 2018, we delivered the latest eHealth software solution for modernization of the healthcare sector and we continue to work with the Ministry of Healthcare of the Republic of Kazakhstan on Electronic Health Passport project. In operator segment, I would like to highlight the activities on mobile network rollout and modernization with beCloud (Belarus), Ucom (Armenia), and IDC (Moldova).

Business in Ericsson market keeps growing. Ericsson Nikola Tesla's R&D Center currently employs approximately 1,400 out of total 3,200 Ericsson Nikola Tesla Group's employees and is the largest R&D Center in Croatia. The Center is focused on expansion of its responsibilities in 4G/5G, competence development and maintaining high quality of delivered services. Owing to R&D activities, as well as activities of our expert centers for Networks, Digital services, Media, Industry & Society and IT & Engineering Services, Ericsson Nikola Tesla is well positioned within the Ericsson Corporation and has been Croatia's leading exporter of knowledge for many years.

Ericsson Nikola Tesla Servisi d.o.o. successfully realized services of monitoring, maintenance and rollout of telecommunication networks.

Key performance indicators

In terms of financial results, gross profit increased by 7% year-over-year, while operating profit increased by 56.3% year-over-year. A strong growth in operating profit is a result of higher gross profit, lower sales and administrative costs and projects realized in line with the Investment Promotion Act. Net profit rose by 67.4% year-over-year to MHRK 113.6. We closed the year with a lean balance sheet and an equity ratio of 36.3%. A positive cash flow from operating activities (amounting to MHRK 75.2) was realized primarily as a result of proactive collection of customer receivables. At the end of 2018, total cash and cash equivalents, including short-term financial assets, amounted to MHRK 236.3. The Group's Working Capital Efficiency, expressed in Working Capital Days (WCD), was 34, however, if we exclude services to Ericsson, Working Capital Efficiency was 87. Cash conversion rate was 38.9%.

Main business risks

The risks which marked our business in 2018 are still present. The demand and prices of our products and services were impacted by a challenging global environment and economic and political uncertainty in some markets. Also, industry convergence and consolidation among providers of products and services and new IT companies entering the telecommunication market, lead to increased competition. The demand for customer financing continues, as well as an increased credit and commercial risks exposure should our customers face adverse financial conditions. The impact of negative foreign exchange differences on business results should also be taken into consideration, given that the greater part of Ericsson Nikola Tesla Group's revenue is generated in EUR and USD.

Ethics and compliance

Responsible business practice is the foundation of corporate culture and strategy of Ericsson Nikola Tesla Group. We have been continuously working to strengthen Ethics and Compliance, focusing on trust, transparency and integrity. To constantly meet our strong commitment to conducting business responsibly, the Group demands that all employees and leaders apply the Code of Conduct and Code of Business Ethics in fulfilling their duties and responsibilities. This is also required from all other stakeholders which are in a contractual relation with the Group. In 2018, we additionally improved processes and policies which define our anticorruption orientation and all employees have completed the latest version of anticorruption training.

Sustainability and corporate responsibility

Sustainable business performance represents one of Ericsson Nikola Tesla Group's key goals. Therefore, the Group is committed to create positive sustainability impact and reduce business risks through our technology, solutions, and the expertise of our employees. Sustainability and corporate responsibility are integrated into our business strategy and are an integral part of this Annual Report.

Each year the company implements many projects focused on United Nation Sustainable Development Goals. As one of the examples of our care for resources and the environment, I would like to highlight the energy efficiency project concerning the Company's buildings and plants worth more than MHRK 73. The project is co-funded by the EU "Competitiveness and Cohesion" Operational Program 2014-2020, as per the call for proposals "Increasing Energy Efficiency and Renewable Energy Sources in Manufacturing Industries", for which the Company received the maximum grant amount of MHRK 20. Furthermore, within the European LIFE Clim'Foot project, completed towards the end of 2018, Ericsson Nikola Tesla was the only private company in Croatia that calculated its carbon footprint and, based on that analysis, created a plan to reduce the Company's impact on the environment and has undertaken a range of activities.

I am satisfied with the achievements of Ericsson Nikola Tesla Group in the area of sustainability and corporate responsibility in 2018. I will continue to encourage all employees to be more engaged in achieving sustainability and corporate responsibility goals, as strategic directions of our business.

Conclusion and strategic direction

In 2018 we initiated a cycle of strategic planning for the period 2019 – 2023. We remain focused on the following strategic segments: end-to-end solutions for 4G/5G networks, digital transformation solutions, Managed Services and solutions in the Industry & Society segment. Furthermore, our strategic focus is placed on gaining new responsibilities and projects and strengthening of competitiveness on the global Ericsson market.

We continue to develop partnerships with our customers in order to fully understand their needs. Furthermore, we have been continuously working on adaptation of our organization and ways of working, encouraging innovative organizational culture and have been investing in competence development and our technology leadership. Taking into consideration the demanding projects in 2019, we will remain focused on cost and operating efficiency and strategic risk management. Even though costs related to strategic contracts and 5G investments will impact profitability short term, they will strengthen our business and market position in the long term.

Towards the end of this year, we will mark 70 years of stable business performance. We believe this confirms that we have been a reliable company that achieves clearly defined goals and has been continuously transforming to ensure business competitiveness and sustainability, recognizes new business opportunities and is a reliable partner to our customers and suppliers. We believe that this trend of positive business results will continue in 2019.

All other data comprising the annual company report pursuant to Article 250a of the Companies Act can be found in the enclosed 2018 Annual Report, consisting of General Report, Non-Financial Report, and the Consolidated and Non-Consolidated Financial Statements as at December 31, 2018.

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