
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 2017

Highlights:

- Sales revenue: MHRK **1,481.6**
- Gross margin: **10.2** %
- Operating profit: MHRK **75.7**
- Profit before tax: MHRK **73.0**
- Net profit: MHRK **67.9**
- Cash flow from operating activities: MHRK **108.2**

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

„In 2017, Ericsson Nikola Tesla Group sales revenue amounted to MHRK 1,481.6, 6.9% lower year-over-year. We continued to work on implementation of key projects, leaning on our technology leadership, employees' knowledge, and partnerships with customers. At the same time, we were implementing measures to cut costs at all organizational levels. Significant investments were made in new business opportunities to secure business sustainability in target areas. The year 2017 was also marked by increased investments related to new technology changes as a preparation for 5G mobile communication systems.

The percentage of export in Group's total sales revenue is around 70%, which makes us the largest Croatian ICT exporter, especially when it comes to export of knowledge.

In the domestic market, sales revenue increased year-over-year. I would like to highlight the continuation of excellent cooperation with our strategic partners. Vipnet selected our company for further development of their radio access network, thus allowing us to maintain sole vendor position in this business segment. With Hrvatski Telekom we expanded cooperation in Managed Services and are currently working on several strategic projects. The operators increase their focus on the demands of end-users, who want faster access to mobile Internet, “anytime, anywhere, any device”. Accordingly, capital investments are focused on network infrastructure, capacity increase and increase of speed in both fixed and mobile networks, creating prerequisites for the introduction of 5G networks, quality and digital transformation. I would like to highlight excellent results in the Industry & Society segment in Croatia, where we contracted important projects during 2017, some of which were fully implemented. These are

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projects related to digitization of healthcare, Joint Information System of Land Registry and Cadaster, and the build of the system for monitoring the borders of the Republic of Croatia.

We continued successful cooperation with the operators in neighboring countries, which resulted in signing several contracts in 2017. However, some projects were postponed, and thus sales revenue decreased year-over-year. We expect an increase in sales revenue in 2018, primarily in Bosnia and Herzegovina, after the regulatory framework for the introduction of 4G networks becomes effective.

In CIS market, sales revenues are significantly lower year-over-year, primarily driven by ramp-down of network modernization projects and unfavorable currency fluctuations. During the year, we focused on implementation of previously contracted projects.

Due to the complexities of a large strategic project, provisions and project adjustments were made in Q4 based on existing circumstances and in anticipation of future events, which had an impact on profit in 2017. The perceptual return on sales is higher compared to the previous year, if currency effects and provisions are excluded.

The Group's financial position remains good and represents a solid base for the realization of all set goals. Gross margin is 10.2% and operating profit is MHRK 75.7. A positive cash flow from operating activities was achieved, amounting to MHRK 108.2. Total cash and cash equivalents, including short term financial assets, at the end of the year amounted to MHRK 243.8. Working capital efficiency, expressed in Working Capital Days (WCD), was 31. Cash conversion was at 68%. There were no tax incentives for R&D in 2017, however, we hope that in 2018, after the State Aid Act for R&D Projects comes into force, we will be able to use these incentives.

Business performance in Ericsson market continues to grow, due to new responsibilities and competencies of our experts in Research and Development as well as solutions and services expert centers. The percentage of this market segment increased in total sales revenue. Ericsson Corporation recognized the quality, knowledge and innovativeness of our experts in various areas, from research and development to digital services and operations, convergent network solutions, professional services and managed services.

Furthermore, in 2017 we continued to hire experts, primarily in research and development, due to additional responsibilities for 4G and 5G mobile networks. At the end of 2017, our Research and Development Center had 1,267 employees, thus representing the biggest concentration of R&D experts in Croatia, while Ericsson Nikola Tesla Group had a total of 3,060 employees.

Our innovation capacity is our main advantage and we further strengthen it through various projects. Among other, attention is given to the technology incubator *Ericsson Garage Croatia*, which serves as a place for developing and testing new technologies and solutions. The innovations which are being developed within *Ericsson Garage Croatia* encompass both the ideas of our employees and the ideas which are a result of cooperation with scientific and research institutions. Our aim is also to establish the cooperation with the start-up community in Croatia. I would also like to mention Ericsson Nikola Tesla Summer Camp, which had good results this year as well. In the past seventeen years, in cooperation with the Faculty of Electrical Engineering and Computing (Zagreb), the Faculty of Electrical Engineering, Mechanical Engineering and Naval Architecture (Split), as well as many other scientific institutions from Croatia and abroad, we hosted more than 800 top students, mostly STEM students, who created

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studies, prototypes, analysis and solutions related to current ICT trends. Through these activities, Ericsson Nikola Tesla has an important role in Ericsson's innovations, and encourages young people to focus their professional development towards ICT industry.

Our daughter company, Ericsson Nikola Tesla Servisi d.o.o., continued to provide high quality services of monitoring, maintenance, and build of telecommunication network to Hrvatski Telekom. During the year, key projects in build of mobile broadband network were realized, as well as projects in optical networks design and build. Furthermore, the growth trend in the segment of providing services towards other operators in Europe continued.

We are approaching the new business cycle aware of the complexity and the dynamics of ICT industry trends. Therefore, by implementing strategic initiatives/ transformation programs, we continue to strengthen our position in key areas: 4G/5G, OSS/BSS and Digital Transformation, Managed Services, and IoT, by using the latest technology and business models and concepts, such as Cloud solutions, Network Functions Virtualization (NFV), Software-Defined Networking (SDN), X as a service model (XaaS), etc. In Ericsson internal market, our aim is to keep the existing responsibilities and expand them, while maintaining high quality of delivered services. The strong focus remains on cost and operating efficiency, as well as strategic risk management.

Our long-term strategy remains focused on the mentioned strategic initiatives with the aim to achieve excellence and support our customers on their transformation journeys.

Financial highlights for the Group:

- Sales revenue amounts to MHRK 1,481.6 (2016: MHRK 1,591.6), down by 6.9% year-over-year. Of the total sales revenue, the domestic market accounts for 18.7%, services to Ericsson account for 62.5% (of which 12.1% relates to Managed Services in Croatia), while other export markets participate with 18.8%.
- Sales in the Networks segment amounts to MHRK 739.3 (2016.: MHRK 806.5), Digital Services segment amounts to MHRK 559.6 (2016.: MHRK 593.1), Managed Services segment amounts to MHRK 178.9 (2016.: MHRK 185.9) and segment Other amounts to MHRK 3.8 (2016.: MHRK 6.1).
- Gross profit amounts to MHRK 150.9 (2016: MHRK 189.8), down by 20.5% year-over-year. Gross margin decreased to 10.2% (2016: 11.9%), mainly due to provisions and customer project adjustments, as well as negative currency deviations.
- Sales and administrative costs amount to MHRK 79.6 (2016: MHRK 77.1), an increase by 2.4% year-over-year, mainly due to intensified marketing and sales activities.
- Operating profit decreased by 33.4% and amounts to MHRK 75.7 (2016: MHRK 113.6), due to lower sales volumes and gross profit.
- Loss from financial activities is MHRK -2.6 (2016: gain from financial activities MHRK 5.2), primarily due to negative currency deviations.
- Profit before tax decreased by 38.5% to MHRK 73.0 (2016: MHRK 118.8).

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- Net profit decreased by 38.7% year-over-year to MHRK 67.9 (2016: MHRK 110.7). Return on sales (ROS) is 4.6% (2016: 7%).
- Adjusted ROS (excluding currency impact and provisions) is 8.2% and is higher compared to 2016 in percentage as well as in absolute amount.
- A solid cash flow from operating activities was realized, amounting to MHRK 108.2 (2016: MHRK 187), due to good collection of trade receivables. Cash conversion rate is at 68% (2016: 97%), while WCD is 31 (2016: 26 days).
- Total cash and cash equivalents, including short term financial assets, as at December 31, 2017 was MHRK 243.8 (29.7% of the total assets), while at the end of 2016, they amounted to MHRK 287.7 (35.6% of the total assets).
- The Company has a lean balance sheet. Total assets amounted to MHRK 822, an increase by 1.7% year-over-year. Equity ratio was 28.7%.
- With related parties, the transactions were as follows: sales of products and services amounted to MHRK 896.4 (2016: MHRK 894.9), while procurement of products and services amounted to MHRK 312.9 (2016: MHRK 396.9).
- As at December 31, 2017, balances outstanding with related parties were as follows: receivables amounted to MHRK 105.6 (end of 2016: 90.9), and payables to MHRK 124.4 (end of 2016: MHRK 89.3).

Business situation in major markets

[In the domestic market](#), sales revenue amounted to MHRK 276.6 (2016: MHRK 268.8), an increase by 3% year-over-year.

With strategic partner Vipnet, a long-term frame agreement was signed, which encompasses modernization and expansion of radio access network by using the state-of-the-art technologies from Ericsson's extensive portfolio. This partnership will enable the transformation of Vipnet's 4G network towards LTE Advanced Pro and 5G networks, based on advanced radio functionalities. The agreed activities will enable further increase in transfer speed and enhance customer experience of Vipnet users.

Business cooperation with Hrvatski Telekom was continued in the segment of fixed telecommunication network modernization by signing a contract on IMS core system upgrade to the latest technology. The solutions for the modernization of access, core and transport IP network of HT Group were delivered. The implementation of access devices within TeraStream project was completed. The successful collaboration in the segment of telecommunication infrastructure build and maintenance services continues.

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With the mobile operator Tele2, activities regarding upgrade of core and transport networks continue. During Q4 2017, we increased the core network capacity and delivered equipment for extension of microwave transport network. We have also continued to provide core network support services.

In the field of ICT solutions for Industry & Society, we continued numerous activities regarding national security, digitization of state administration business processes, and eHealth. In 2017, we realized contracts worth more than MHRK 80 for the implementation of the Schengen Border Control System. Thirteen border locations were equipped with the state-of-the-art sensor equipment and connected in the joint monitoring system - Green Borders. Our flagship in the field of ICT solutions for Industry & Society – JIS (Joint Information System for Land Registry and Cadaster) was enriched with new functionalities. We have been continuously working on building services towards all other state bodies to connect JIS, as one of the basic registers, to their systems. In the field of eHealth, we have realized the first phase of monitoring the approval of especially expensive medications. We are also working on the implementation of Hospital Information Systems within several medical institutions. Furthermore, we cooperate with the pharmaceutical industry, where, quality patient support program has been enabled by using our solutions.

[In export markets \(Ericsson market excluded\)](#) sales revenue amounted to MHRK 279.2 (2016: MHRK 450.4), down by 38% year-over-year.

In the markets of Southeast Europe (Bosnia and Herzegovina, Montenegro and Kosovo) sales revenue amounted to MHRK 136.3 (2016: MHRK 149.3), down by 9% year-over-year. Slow economic development and regulatory environment impacted the level and dynamics of operators' investments.

With HT Mostar, contracts were signed for the extension and modernization of the system for mobile network monitoring, as well as the extension and modernization of radio access network. With BH Telecom, a contract was signed for modernization and extension of OSS, and the extension of radio access network. The modernization and upgrade of 112 system for the Ministry of Security of Bosnia and Herzegovina was completed. With Ipko, we continued the cooperation in the field of maintenance, modernization, and extension of mobile network. The virtual Evolved Packet Core solution was implemented and put into operation in the network of Crnogorski Telekom, as well as the solution User Data Consolidation in a Box, which ensures the flexibility and the speed necessary for efficient introduction of new services. In 2017, the mobile network of Crnogorski Telekom was awarded P3 certificate as the best mobile network in Montenegro for the third consecutive time.

In CIS market, sales revenue amounted to MHRK 142.9 (2016: MHRK 301.1), down by 53% year-over-year. Apart from focusing on implementation of previously contracted projects, we continue with the marketing and sales activities with the aim of acquiring new customers. In these markets, customer financing is key, therefore, to take advantage of these business opportunities, there is an increased need to cooperate with the Croatian Bank for Reconstruction and Development (HBOR) and commercial banks.

[In Ericsson market](#), sales revenue amounted to MHRK 925.8 (2016: MHRK 872.4), up by 6% year-over-year.

In Ericsson Nikola Tesla Research & Development Center, activities have been extended regarding the development of 4G and 5G systems (Radio Development). Accordingly, we have been employing and educating new experts. The activities within other development units, Mobile Core, User Data Management, and Cloud, have

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been ongoing as planned. Research projects regarding virtualization and Big Data processing are ongoing. There is a significant focus on developing network functions virtualization, with the aim of enabling new solutions on the Cloud platform. During 2017, our R&D Center received acknowledgment for excellent performance from Ericsson colleagues, who also highlighted the possibility of extending current activities and responsibilities.

Ericsson Garage Croatia, a technology incubator, is focused on monetization of innovative proposals and creating advanced solutions in the field of analytics, IoT, Virtual Reality/Augmented Reality, Machine Learning, etc.

The experts in Center for Services and Solutions for Networks & Media have been working on projects for numerous customers worldwide, such as: A1 (Austria), Alfa (Lebanon), Bouygues Telekom (France), China Unicom (China), Deutsche Telekom (Germany), MTN (Rwanda), O2 (United Kingdom), Orange (France), Orange (Togolese Republic), Polkomtel (Poland), Robi (Bangladesh), Slovak Telekom (Slovakia), Smartone (Hong Kong), Swisscom (Switzerland), Three (United Kingdom), TMO (USA), and Vodafone in Germany, Netherlands, Portugal, and United Kingdom. These are complex activities of expert analysis, creating new innovative solutions, optimization and upgrade of existing networks and consultancy services. The work on development and implementation of software tools for managing and optimization of mobile networks, such as: Smart Laptop, Smart Rollout Support, Rehomeing Automation Management Tool, and Ericsson Network Engineer, continued.

The experts in Digital Services and Solutions Center were engaged in various demanding projects for customers, such as: AsiaCell (Iraq), British Telecom (United Kingdom), Deutsche Telekom (Germany), DIGI (Hungary), DoCoMo (Japan), GO (Malta), Motorola (United Kingdom), Mobistar (Belgium), Orange (Belgium), O2 (Ireland), Panasonic (United Kingdom), Post (Luxembourg), Slovak Telekom (Slovakia), Swisscom (Switzerland), Simobil (Slovenia), Telekom Austria Group (TAG), TMO USA, Telenor Scandinavia, T-Mobile (Czech Republic), Telefonica (United Kingdom), Telefonica (Germany), Telefonica (Colombia), Tele2 (Sweden), Telenet (Belgium), Telekom Slovenije (Slovenia), Tango (Luxembourg), Telecom Italy Mobile, Telekom Egypt, Vodafone (Ireland), Veon (Russia), Vivacom (Bulgaria), Vodafone (Czech Republic), Wind3 Italy, and Wind Greece. These are activities related to design, network applications, infrastructure for Cloud and Digital Business Systems.

The contribution of Ericsson Nikola Tesla Servisi d.o.o., a daughter company of Ericsson Nikola Tesla d.d., to sales revenue in this market segment amounts to MHRK 178.5 (2016: MHRK 182.7).

The Managed Services contract with key customer Hrvatski Telekom was extended and expanded to cover geodetic and documentation services.

We highlight the following key goals and business results:

- fulfilling of all planned operating goals – successfully providing services of monitoring, maintenance and build of telecommunication network towards Hrvatski Telekom, as well as towards other telecommunication companies in Europe.
- apart from realizing business performance in the segment of design and build, and realizing a high level of successful corrective maintenance, the plan of preventive maintenance was also achieved, with the aim of increasing the satisfaction and loyalty of HT's telecommunication services users.
- fulfilling of a very demanding goal of building optical networks, especially in FTTH (*Fiber to the Home*).

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The company Ericsson Nikola Tesla Servisi successfully participated in the realization of Ericsson projects abroad, where high performance and quality of employees were recognized.

Other information

Ericsson Nikola Tesla major shareholders (as at December 31, 2017)

	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	41,890	3.15
Addiko bank d.d. / PBZ Croatia Insurance mandatory pension fund, B category	20,744	1.56
Zagrebačka banka d.d. / Unicredit Bank Austria AG – clients account	16,700	1.25
PBZ d.d. / The Bank of New York as custodian	16,601	1.25
Zagrebačka banka d.d. / State Street Bank and Trust Company, Boston	13,935	1.05
PBZ d.d. / custodian client account	9,069	0.68
OTP Banka d.d./INS683	8,099	0.61
Addiko bank d.d. / Raiffeisen voluntary pension fund	7,934	0.60
Other shareholders	419,691	31.50

Share price information in 2017:

Highest (HRK)	Lowest (HRK)	Closing (HRK)	Market cap. (in MHRK)
1,444.00	1,066.51	1,203.99	1,603.3

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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 2017 to 31 Dec 2017 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 more information about Ericsson Nikola Tesla's business, please visit <http://www.ericsson.hr>