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## ERICSSON NIKOLA TESLA D.D.

The Management Report on the Ericsson Nikola Tesla Company and the Group business position and comments on the financial reports for H1 2014

### Highlights:

- Sales revenues: MHRK **656.2**
- Gross margin: **15.0%**
- Operating profit: MHRK **48.8**
- Net profit: MHRK **49.3**
- Cash flow from operating activities: MHRK **72.6**

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

“Despite the demanding market environment, during H1 2014 our business performance was solid. Sales were driven by growth in the domestic and Ericsson markets, while other export markets decreased.

Total sales revenues decreased by 3% year-over-year. Sales revenues in the domestic market increased 19%, as a result of a good market position and a proactive approach in working with our customers. With Hrvatski Telekom, activities in network managed services segment are ongoing. Furthermore, a non-binding Letter of Intent on outsourcing services regarding HT infrastructure construction and maintenance was signed at the end of June. Vipnet and Ericsson Nikola Tesla were recognized and awarded by *Global Telecom Business Innovation Award 2014* in London in May, for their innovativeness in the radio access network segment, by introducing Psi coverage energy efficiency solution. I would also like to highlight the successful realization of the *One Stop Shop* project for Joint Information System of Land Registry and Cadaster, financed by the European Union Programme IPA 2008.

A significant part of our activities and the income achieved refers to research and development activities and other expert contributions in the global organization. In H1 2014, this market segment recorded an

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additional growth, and thus accounts for 45% of sales revenues. We have succeeded to achieve this by expanding our portfolio and due to responsibilities we were awarded in realization of numerous complex projects.

During the second quarter, the situation in other export markets has not improved. Due to political and economic uncertainty, the operators' investments slowdown and postponement is still present. Intensive marketing and sales activities and arrangements regarding further projects with our customers are ongoing, which will gradually impact the sales in the second half of this year.

A net profit of MHRK 49.3 was achieved, which represents 7.5% return on sales. The gross margin is lower year-over-year, primarily due to price pressure and investments in product and services development. The end of H1 2014 was concluded with a solid balance sheet and an equity ratio of 49.4%. A positive cash flow from operating activities was achieved, amounting to MHRK 72.6. After the dividend payment, of MHRK 424.9, total cash balances, including short term financial assets at the end of H1 2014 amount to MHRK 145.3, which is 23.9% of the total assets.

In line with our strategic agenda, we continue to strengthen our position and sales in new and targeted areas for telecom operators and in the Industry & Society segment. Furthermore, we are strategically focused to gain new responsibilities, new projects and strengthening competitiveness in the global market. Accordingly, we adjust our organization, employ new experts and invest in competence development.

It is certain that economic uncertainty and business challenges will mark the second half of the year as well. Thus, a continuous adjustment to market conditions, as well as managing risks, is in the center of our attention. In a transforming ICT market, we are well positioned to continue supporting our customers and partners in recognizing new market opportunities."

### Financial Highlights:

- Sales revenues decreased by 3% YoY to MHRK 656.2 (H1 2013: MHRK 673.6). In total sales revenues, the domestic market accounts for 30%, export to Ericsson market accounts for 45%, while export to other markets accounts for 25%.
- Network infrastructure amounts to MHRK 360.7 (55% of total Sales revenues), Professional Services amount to MHRK 270.9 (41% of total Sales revenues), and Support Solutions amount to MHRK 24.6 (4% of total Sales revenues).

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- Gross profit amounts to MHRK 98.1 (H1 2013: MHRK 128.2), a decrease by 23% YoY. Gross margin decreased to 15% (H1 2013: 19%) primarily due to price pressure and investments in new products and services.
- Distribution and administrative expenses increased to MHRK 51.1 YoY (H1 2013: MHRK 45.5), as a result of activities focused to new business opportunities.
- Operating profit declined by 42% to MHRK 48.8 (H1 2013.: MHRK 84), due to gross margin decrease and a slight increase in operative expenses.
- Net finance income decreased to MHRK 0.5 (H1 2013: MHRK 3.9) as a result of lower interest revenues and lower exchange rate gains.
- Net profit decreased by 44% YoY to MHRK 49.3 (H1 2013: MHRK 88). ROS is 7.5% (H1 2013: 13.1%).
- Cash flow from operating activities is MHRK 72.6 (H1 2013: MHRK 10.7)
- After the dividend payment, amounting to MHRK 424.9, total cash balances, including short term financial assets at the end of H1 2014 amount to MHRK 145.3, which accounts for 23.9% of total assets (end of 2013: MHRK 521.2, i.e. 49.7% of total assets).
- The Company has a stable balance sheet with total assets of MHRK 607.4. The value of total assets decreased by 42% compared to the end of 2013, as a result of decrease in cash and cash equivalents and short term financial assets. The equity ratio is 49.4%.
- With related parties, the transactions were as follows: sales of products and services amount to MHRK 280.7 (H1 2013: MHRK 292.9), while the purchase of products and services amount to MHRK 198.2 (H1 2013: MHRK 263.8).
- Balances outstanding with related parties as at June 30, 2014 were as follows: receivables amounted to MHRK 66.4 (end of 2013: MHRK 71.8), and payables amounted to MHRK 56.8 (end of 2013: MHRK 60.9).

### Business situation in major markets

[In the domestic market](#), sales revenues amounted to MHRK 197.5, a 19% increase YoY.

An intensive collaboration with the strategic partner Vipnet continues. The package core network upgrade and modernization was successfully finished. In addition, the expansion and modernization of mobile telecom network is ongoing, including the fourth generation of mobile networks (LTE) and testing

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new functionalities, which contribute to an enhanced quality, as well as to the new services for end users. Furthermore, Vipnet and Ericsson Nikola Tesla are the winners of the *Global Telecom Business Innovation Award 2014* for the project PSI Coverage.

The business collaboration with HT continues in the segment of strategic migration to all-IP environment and on other projects, which will enhance this operator's business efficiency. In a very demanding multivendor environment, and in the role as the prime integrator, we successfully implemented the RCS (Rich Communication Suite) service. We soon expect a sequel of successful collaboration throughout the RCS second phase. RCS will enable advanced services to mobile users, such as chat, presence and file sharing services.

In late June, a non-binding Letter of Intent on outsourcing services regarding HT infrastructure construction and maintenance was signed, with the intent to increase HT infrastructure quality and efficiency, as well as the equipment associated to it, while at the same time optimizing costs related to construction and maintenance.

During the second quarter, we continued activities on improving mobile operator Tele2 telecommunication network. A special attention was given to further expansion of the radio access infrastructure capacity and introduction of new functionalities. This resulted in an increase of speed and coverage of mobile broadband service.

In ICT for Industry and Society Segment, major activities concern upgrading the national ICT healthcare system, continued informatization of Land registry administration and upgrade/ expansion of communal and transport companies' communication infrastructure.

Within the contract regarding "Maintenance and Upgrade of the Central Healthcare Information System of the Republic of Croatia", signed with the Croatian Health Insurance Fund (HZZO), the solution for HZZO Information system for Doctors was delivered during this June. HZZO Information system for Doctors is the largest closed doctors' social network in Croatia, designated for acquiring and exchanging knowledge, experience and information, necessary for medical professionals' lifelong learning.

The project One Stop Shop for Joint Information System of Land Registry and Cadaster is a project worth MHRK 4.2, financed by the EU IPA Programme for Croatia – IPA 2008. The project was implemented by Ericsson Nikola Tesla with partners, and the main beneficiaries are the Ministry of Justice of the Republic of Croatia and the State Geodetic Administration. The One Stop Shop system enables an improved quality and speed of providing services of real estate registration in the Registry for key stakeholders and citizens.

[In export markets \(except for Ericsson market\)](#) sales revenues amount to MHRK 162.7, a decrease by 26% YoY.

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In the markets of Southeast Europe (Bosnia and Herzegovina, Montenegro and Kosovo) sales revenues decreased by 22% YoY and amount to MHRK 87.3.

In Bosnia and Herzegovina market, the collaboration with BH Telecom and HT Mostar is continued in the segment of providing support services. It is certain that the political and economic uncertainty affects the operators' investment cycles. In line with that investments in further mobile and fixed networks are prolonged for the second half of the year.

In CIS market, sales revenues amounted to MHRK 75.4, representing a decrease by 30% YoY. Sales activities and arrangements related to mobile network modernization with several key customers are ongoing.

[In the Ericsson market](#), sales revenue amounted to MHRK 296, which is an increase by 2% YoY.

Ericsson Nikola Tesla Research and Development Center (R&D) continues a successful development of the state-of-the-art products. Moreover, the Center continuously gains new responsibilities within the Ericsson Corporation.

In line with the agenda, the teams working on User data management have been expanded. Our experts participated in development and implementation support of the 100th node of the latest product generation, that was commissioned in the global market in June.

The Unit for Radio Platform Development also enhanced its performance scope, and currently employs new experts, who will work on developing new generation of base stations.

In fixed core network segment, we have the global responsibility for development, implementation and support, and accordingly would like to highlight several successful projects for A1 Austria, Maroc Telecom International, Etisalat Egypt and a continued collaboration on projects for Telia Sonera, France Telecom, Eircom Ireland, Telefonica Spain and Telenor Norway.

The Cloud Computing research and development as well as other research activities, which enjoy the support from the EU funds, are successfully ongoing.

At the competition for the most innovative application in Sustainability and Corporate Responsibility (SCR) segment in Region Western and Central Europe, the application developed in our research center won the first prize. A way was designed, on how each individual can, by using a smartphone, estimate energy consumption and carbon dioxide emission in its working activities, and thus act more rationally.

Service Delivery Center experts have been engaged in numerous projects for the following customers: A1 Austria, Avea Turkey, Deutsche Telecom, KPN Netherlands, Orange Switzerland, O2 Great Britain, Post Luxemburg, Telekom Austria, Vodafone Germany, Vodafone Great Britain, Vodafone Netherlands. We can highlight the activities related to the implementation of IP RAN project for A1 Austria, IPTV

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project for Telenor Sweden, VoLTE projects for Vodafone Great Britain and Deutsche Telecom, LTE Broadcast demo for Vodafone Germany. The Centers' experts have also been providing consulting services and services of configuration and dimensioning for Telefonica Great Britain, Magyar Telecom Hungary, MTN Sudan, Turkcell Turkey, Vodafone Netherlands, Zain Sudan. Additional responsibilities were confirmed to Global Competence Center. Our Global Center is the leader of Deep drive partnership programme for mobile network performance scanning for Ericsson key customers. The Center is recognized as a driver of activities that create added value in sales and innovation segment.

### Other information

At Ericsson Nikola Tesla Annual General Meeting, held on May 27, 2014, a decision was passed on the regular dividend payment of HRK 20, and an extraordinary dividend payment of HRK 300 per share. The dividend was paid on June 17, 2014, to all the Company shareholders, who, on June 3, 2014 had the Company shares registered on their securities account in the Central Depository & Clearing Company. It was decided that the Company's profit for the financial year 2013, amounting to HRK 143,859,131.22 is allocated for dividend payment, to the amount lacking after the use of unallocated retained earnings, treasury shares reserves amounting to HRK 10,000,000.00 and that the rest is allocated to retained earnings. The shareholders have decided that, after his mandate expired, a member of the Supervisory Board, Dubravko Radošević, is re-elected to the same function, with a mandate renewed for the next four years.

The shareholders gave a discharge from liability to Gordana Kovačević, the Company's Managing Director, as well as to the Chairman and the members of the Company Supervisory Board, on how they managed the Company in 2013.

It was decided that PricewaterhouseCoopers d.o.o., is re-appointed as the Company Auditor for the year 2014.

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Ericsson Nikola Tesla's major shareholders (as at June 30, 2014)

	Number of shares	% of share capital
Telefonaktiebolaget LM Ericsson	653.473	49.07
Hypo Alpe-Adria-Bank d.d. / Raiffeisen Mandatory Pension Fund	123.514	9.28
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
PBZ d.d. / State Street client account	25.047	1.88
PBZ d.d. / The Bank of New York as custodian	22.507	1.69
Zagrebačka banka d.d. / State Street Bank and Trust Company, Boston	12.350	0.93
Zagrebačka banka d.d. / Custodian client account for Unicredit Bank Austria AG	10.440	0.78
PBZ d.d. / Custodian Client Account	9.597	0.72
Hypo Alpe-Adria-Bank d.d. / Voluntary Pension Fund	7.934	0.60
Other shareholders	403.212	30.27

Information on share price in Q2 2014:

Highest (HRK)	Lowest (HRK)	Closing (HRK)	Market cap. (in MHRK)
1,630.00	1,271.00	1,366.15	1,819.23

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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 2014 to 30 June 2014 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 blue ink, appearing to read "Gordana Kovačević".

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*Communication*

*Ericsson Nikola Tesla*

Ericsson Nikola Tesla d.d.  
Consolidated statement of comprehensive income  
for the period ended 30 June 2014

	2014	2013
	HRK '000	HRK '000
Sales revenue	656.159	673.578
Cost of sales	-558.041	-545.411
<b>Gross profit</b>	<b>98.119</b>	<b>128.167</b>
Selling expenses	-33.425	-29.901
Administrative expenses	-17.693	-15.571
Other operating income	2.290	1.334
Other operating expenses	-506	0
<b>Operating profit</b>	<b>48.784</b>	<b>84.030</b>
Finance income	470	3.977
Finance expense	-1	-40
Finance income – net	470	3.938
<b>Profit before tax</b>	<b>49.254</b>	<b>87.968</b>
Income tax	0	0
<b>Profit for the year</b>	<b>49.254</b>	<b>87.968</b>
Other comprehensive income	25	0
<b>Total comprehensive income for the year</b>	<b>49.279</b>	<b>87.968</b>

Ericsson Nikola Tesla d.d.  
Consolidated statement of financial position  
as at 30 June 2014

	<b>2014</b>	<b>2013</b>
	<b>HRK '000</b>	<b>HRK '000</b>
<b>ASSETS</b>		
<b>Non-current assets</b>		
Property, plant and equipment	136.410	131.616
Intangible assets	1.470	2.112
Loans and receivables	14.588	18.801
Other non-current assets	60	40
<b>Total non-current assets</b>	<b>152.528</b>	<b>152.569</b>
<b>Current assets</b>		
Inventories	41.018	51.506
Trade receivables	191.651	246.152
Receivables from related parties	66.387	71.819
Other receivables	2.822	3.715
Income tax receivable	3	-
Financial assets at fair value through profit or loss	41.074	109.845
Prepayments and accrued income	7.718	1.156
Cash and cash equivalents	104.201	411.328
<b>Total current assets</b>	<b>454.875</b>	<b>895.521</b>
<b>TOTAL ASSETS</b>	<b>607.403</b>	<b>1.048.090</b>
<b>EQUITY AND LIABILITIES</b>		
<b>Equity</b>		
Share capital	133.165	133.165
Treasury shares	-9.571	-9.571
Legal reserves	6.658	6.658
Retained earnings	169.677	540.884
<b>Total equity</b>	<b>299.929</b>	<b>671.136</b>
<b>Non-current liabilities</b>		
Interest-bearing borrowings	68	68
Employee benefits	5.077	4.697
<b>Total non-current liabilities</b>	<b>5.145</b>	<b>4.766</b>
<b>Current liabilities</b>		
Payables to related parties	56.797	60.936
Interest-bearing borrowings	189	309
Trade and other payables	91.349	148.426
Provisions	9.060	13.458
Accrued charges and deferred revenue	144.934	149.059
<b>Total current liabilities</b>	<b>302.329</b>	<b>372.188</b>
<b>Total liabilities</b>	<b>307.474</b>	<b>376.954</b>
<b>TOTAL EQUITY AND LIABILITIES</b>	<b>607.403</b>	<b>1.048.090</b>

Ericsson Nikola Tesla d.d.  
Consolidated statement of cash flows  
for the period ended 30 June 2014

	2014	2013
	HRK '000	HRK '000
<b>Cash flows from operating activities</b>		
<i>Profit before tax</i>	49.254	87.968
Adjustments for:		
Depreciation and amortisation	21.954	18.947
Impairment losses and reversals	4.441	946
Net increase of provisions	-272	1.048
(Gain)/loss on sale of property, plant and equipment	-39	-346
Net loss/(gain) on remeasurement of financial assets	-350	-99
Amortisation of discount	-161	-874
Interest income	-4.018	-6.504
Interest expense	1	40
Foreign exchange (gains)/losses	5.210	4.122
Equity-settled transactions	4.429	1.095
	80.449	106.342
(Increase)/decrease in receivables	52.304	-23.868
(Increase)/decrease in inventories	10.488	-28.656
Increase/(decrease) in payables	-70.604	-43.090
<i>Cash generated from operations</i>	72.636	10.728
Interest paid	-1	-40
Income taxes (paid)/refunded	-3	0
<b>Net cash from operating activities</b>	<b>72.633</b>	<b>10.688</b>
<b>Cash flows from investing activities</b>		
Interest received	4.994	6.466
Proceeds from sale of property, plant and equipment	165	346
Purchases of property, plant and equipment, and intangible assets	-24.521	-23.270
Deposits collected/(placed) with financial institutions - net	0	94
Disposal/(purchases) of financial assets at fair value through profit and loss	69.100	-11.660
<b>Net cash used in investing activities</b>	<b>49.738</b>	<b>-28.025</b>
<b>Cash flows from financing activities</b>		
Repayment of interest-bearing borrowings	0	-314
Purchase of treasury shares	0	0
Dividends paid	-424.919	-218.450
<b>Net cash used in financing activities</b>	<b>-424.919</b>	<b>-218.764</b>
Effects of exchange rate changes on cash and cash equivalents	-4.579	-2.890
<b>Net decrease in cash and cash equivalents</b>	<b>-307.127</b>	<b>-238.991</b>
Cash and cash equivalents at the beginning of the year	411.328	511.639
<b>Cash and cash equivalents at the end of the year</b>	<b>104.201</b>	<b>272.648</b>