
ERICSSON NIKOLA TESLA

The Management Report on Ericsson Nikola Tesla Group business performance and comments on 2014 financial results

Highlights:

- Sales revenue: MHRK **1,314.9**
- Gross margin: **13.7%**
- Operating profit: MHRK **81.4**
- Net profit: MHRK **87.4**
- Cash flow from operating activities: MHRK **176**
- Proposed dividend: HRK **20** ordinary and HRK **70** extraordinary dividend per share

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

„Ericsson Nikola Tesla business results in 2014 show a continuous stable business performance. Sales revenues decreased by 2% year-over-year. Ericsson market records a significant increase in sales revenues, while the revenues are stable in the domestic market, thus neutralizing the revenue decrease in CIS and Southeast Europe markets. We have maintained our position among the Croatian leading exporters, especially when it comes to the export of knowledge/services.

A significant part of our activities relates to research&development and professional services in Ericsson market. This business segment records a continuous growth, and accounts for 48% of sales revenues. In 2014, our Research and Development Center was evaluated as one of the best and most reliable research centers within the Ericsson Group. The evaluation of the collaboration and achieved results represents an excellent foundation for further partnership, increased responsibility and sales growth. I would like to highlight that during 2014 we employed 174 new professionals, primarily in this segment.

In the domestic market, a stable sales trend was achieved, despite an unfavorable economic situation. The operators' capital expenditure was directed towards core network modernization and optimization, 3G and 4G radio access network expansion, fixed access network modernization, as well as investments in additional radio spectrum. The operators' focus on increased efficiency in running the business indicates a trend towards outsourcing of construction and maintenance of telecommunications infrastructure (managed services).

As one of main activities in 2014, I would like to highlight the successfully finished negotiations with Hrvatski Telekom (HT) on collaboration in managed services segment. Ericsson Nikola Tesla Servisi d.o.o. (EHR), a newly

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founded Ericsson Nikola Tesla daughter company, provides maintenance of HT fixed and mobile network, within a five year contract. With 638 employees transferred from HT into the newly established company Ericsson Nikola Tesla Group now employs around 2,500 employees.

During 2014, a successful collaboration with strategic partner Vipnet continued, primarily in the segment of mobile telecom network expansion and modernization, including the mobile networks fourth generation (LTE). Vipnet and Ericsson Nikola Tesla are the winners of the *Global Telecom Business Innovation Award 2014* for introducing PSI coverage energy efficient solution in the radio access network segment.

I would also like to highlight a successful realization of the project One Stop Shop for Joint Information System of Land Registry and Cadaster, as well as the project realization for the Agency for Medicinal Products and Medical Devices of Croatia. Both projects were financed by the European Union IPA programs. The service ePrescription, which we implemented in the health care system, is the winner of the "ICERIAS Customers' Friend" recognition, and thus this service also positioned Croatia among the best countries in Europe, according to the "European Health Consumer Index" for 2014.

Despite unfavorable economic and political developments in our major export markets, we have managed to use new business opportunities. I would like to highlight the continuous quality collaboration with the customers in the Bosnia and Herzegovina market in the segment of providing support service and upgrades of mobile and fixed networks, and in Belarus with our long time customer Velcom.

Net profit amounting to MHRK 87.4 was achieved, representing a 6.6% return on sales. The gross margin is lower year-over-year, as a result of changes in business mix and continuous price pressure. The selling and administrative expenses were decreased year-over-year. We had clear business and financial goals, focused on improvements of working capital, cash conversion and risk management. Pursuant to that, we finalized the year with a solid balance sheet, and equity ratio of 48%. A strong cash flow from operating activities was also realized, amounting to MHRK 176, so that, despite an extraordinary dividend paid in 2014, cash assets, including short term financial assets, amount to MHRK 231.

In line with our strategic plan, we stay focused on strengthening our position/ sales in new and targeted areas: IP networks, Cloud, TV and media, Industry & Society and OSS (Operations Support System) and BSS (Business Support System). We have started several strategic initiatives for 2015, focused on business development in all markets and improvement of profitability through cost efficiency and business excellence.

Our solid balance sheet enables us to continue to implement our strategy and quality returns to our shareholders. The Supervisory Board of Ericsson Nikola Tesla approved the Managing Director's proposal to propose to the Annual General Meeting of Shareholders ordinary dividend payout in the amount of 20 HRK per share and extraordinary dividend to the amount of 70 HRK per share. "

Financial summary:

- Sales revenues amount to MHRK 1,314.9 (2013: MHRK 1,345.2), 2% less year-over-year. In total sales revenues the domestic market accounts for 25.4%, services to Ericsson 47.7% and other export markets

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account for 26.9%. Increased share of Ericsson market in the total sales leads to lower business and financial risks.

- Sales in the network infrastructure segment amounts to MHRK 700.2 (53.3% of total sales revenue), service segment amounts to MHRK 569.3 (43.3% of total sales revenue), and solution support segment amounts to MHRK 45.4 (3.4% of total sales revenue).
- The gross profit amounts to MHRK 179.6 (2013: MHRK 220.1), a decrease by 18.4% year-over-year. The gross margin decreased to 13.7% (2013: 16.4%), due to changes in business mix and price pressure.
- Selling and administrative expenses decreased by 3.1% to MHRK 90.5 (2013: MHRK 93.4).
- The operating profit decreased by 36% and amounts to MHRK 81.4 (2013: MHRK 127.2).
- Financial income decreased by 59.7% year-over-year, and amounts to MHRK 6.9 (2013: MHRK 17.1), primarily due to less yielding assets put at work. The financial risk has been reduced due to discontinuation of using balance sheet for customer financing.
- Net profit decreased by 39.5% year-over-year and amounts to MHRK 87.4 (2013: MHRK 144.4). Return on sales (ROS) is 6.6% (2013: 10.7%).
- Cash flow from operating activities amounts to MHRK 176 (2013: MHRK 141.2). The cash conversion is 117%.
- Total cash and cash equivalents, including short term financial assets as at December 31, 2014 amount to MHRK 231 (33% of total assets), compared to MHRK 521.2 as at December 31, 2013 (49.7% of total assets).
- The Company has a solid balance sheet with total assets of MHRK 699.6. The equity ratio is 48%.
- With related parties, sales of products and services amounted to MHRK 634.5 (2013: MHRK 576.4), while purchase of products and services amounted to MHRK 367.9 (2013: 477.7).
- As at December 31, 2014 Ericsson Nikola Tesla outstanding receivables amounted to MHRK 86.6 (end of 2013: MHRK 71.8), and outstanding payables were MHRK 46.5 (end of 2013: MHRK 60.9).

Business situation in major markets

In the domestic market, a total of MHRK 333.8 sales revenue was realized, 2% decrease year-over-year.

During 2014, successful collaboration was continued with strategic partner Vipnet, primarily through the expansion and modernization of mobile telecom network and testing new functionalities, which contribute to the increased quality, as well as new services for end users. The upgrade and modernization of package core network and the upgrade of IMS system were successfully finished, which opens numerous possibilities for introducing new convergent solutions.

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Business collaboration with HT continued, through a number of strategic projects for development of HT network and services. Thus, an exceptionally important project started, regarding introducing international DT IMS technology center that will provide services to other DT Group operators in the region. Thus, HT additionally strengthened its position within DT Group, as a technology leader in advanced communication technologies. Business collaboration with HT in Q4 was marked by a successful continuous implementation of MPLS (Multi-Protocol Label Switching) architecture in core and access IP network. Moreover, the quarter was marked by a successful delivery of services, regarding construction and maintenance of telecommunications infrastructure.

With mobile operator Tele2 the collaboration continued by introducing new functionalities and increasing capacity of the existing core network, which allowed the operator to efficiently introduce new services within the Networked Society. Furthermore, collaboration was on improving the access network, with a special emphasis on speed increase and introduction of new functionalities of mobile broadband Internet access.

In ICT solutions for Industry and Society business segment, during Q4 several contracts were signed for further business processes computerization in eHealth. The project "mHealth" is one of the first commercial projects, with the aim to monitor chronic patients' health via mobile solution delivery. A new modern integration platform for CEZIH (Central Healthcare Information System of the Republic of Croatia system) was also delivered, which will enable a faster and an easier integration of all applications and ensure the highest level of authorization and authentication within the system.

[In export markets \(except for Ericsson market\)](#) sales revenue amounts to MHRK 353.1, a decrease by 19% year-over-year. The political and economic uncertainty in the region and beyond, impacts the operators' investment cycle, and thus, investments are partially reduced.

In the markets of Southeast Europe (Bosnia and Herzegovina, Montenegro and Kosovo), sales revenues decreased by 19% year-over-year, and amount to MHRK 207.5.

In Bosnia and Herzegovina market, the collaboration was continued with operators BH Telecom and HT Mostar, on providing support services, upgrade and expansion of mobile and fixed networks. In Q4 2014, a contract with BH Telecom was signed on 2G radio network expansion and multimedia upgrade, by which prerequisites are realized for M2M communication.

In Kosovo market, the collaboration on expanding Ipko mobile networks continued, and in Montenegro with Crnogorski Telekom.

In CIS market, sales revenues amounted to MHRK 145.5, a decrease by 19% year-over-year. The activities on projects of mobile networks modernization and construction with several key customers are ongoing. There is no financial exposure to Russia and Ukraine.

[In the Ericsson market](#), sales revenue amounted to MHRK 628, an increase by 10.4% year-over-year.

Ericsson Nikola Tesla Research and Development Center (R&D) continues its successful work. At the end of 2014, new deals have been agreed, related to cloud computing, i.e. verification deals for new Ericsson cloud platform.

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In line with the plans, the teams working on user data management have been expanded. At the end of 2014, 150th node of the latest product generation was released to commercial operation in the global market. Our Center experts participated in its development and implementation support.

The Radio Platform Development Unit also expanded its work scope in the segment of new generation base station development.

Our global and regional centers show excellent results. In fixed core network segment, where we have the global responsibility for development, implementation and support, we would like to highlight several successful projects for A1 Austria, Etisalat Egypt, and the continued cooperation on projects for Telia Sonera, France Telecom, Eircom Ireland, Telefonica Spain and Telenor Norway.

The Service Delivery Center experts have been engaged in numerous projects in the markets worldwide. We can highlight the activities related to IP RAN project for A1 Austria, IPTV project for A1 Austria, Telenor Sweden and Vodafone Ireland, 2G „swap“ project for A1 Austria, VoLTE projects for Deutsche Telekom, Vodafone Great Britain and Vodafone Netherlands, LTE Broadcast for Vodafone Germany, IMS “Pasau“ program for Deutsche Telekom, network optimization projects for Mobistar Belgium and British Telecom network modernization. The Centers' experts have also been providing consulting services and services of configuration and dimensioning for A1 Austria, Deutsche Telekom, KPN Netherlands, Slovak Telekom, Magyar Telecom Hungary, MCCI Iran, MTN Iran, MTN Nigeria, MTN Sudan, Mobilink Pakistan, Mobily Saudi Arabia, Mosaic Ireland, O2 Great Britain, STC Saudi Arabia, Slovak Telekom, Telefonica Great Britain, Telekom Slovenia, Turkcell Turkey, Vodafone Netherlands, Vodafone Germany and Zain Sudan.

The Global Competence Centre experts are working on the realization of several strategic global projects. Our Global Center is the leader of Deep drive partnership programme for mobile network performance scanning for Ericsson key customers. It is also the leader of Ericsson Customer Experience Management program. This is a service development project with the aim to improve the perception of end users while using mass social services (Facebook, Twitter, WhatsApp...). For this project the Croatian team was also assigned the responsibility of the prime global center for service delivery. The software tool, Smart Rollout Support, for network optimization, developed in our global center, was successfully implemented worldwide.

Our collaboration with the universities in the county and abroad continues. One of the forms of cooperation in 2014 was the Summer Camp, 14th in a row. During Summer Camp, a total of 82 students from Croatia and abroad participated. Assisted by mentors from Ericsson Nikola Tesla and colleagues from Ericsson R&D centers from Sweden, China and Hungary they worked on development projects. A total of 28 projects were realized, regarding support to company's laboratory for the networked society, IPTV, VisualCom and m-commerce, telecommunication network visualization and related services, research&development tools as well as software engineering and development.

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Other information

Ericsson Nikola Tesla major shareholders (as at Dec 31, 2014)

| | No. of shares | % of share capital |
|---------------------------------------------------------------------------------------|---------------|--------------------|
| Telefonaktiebolaget LM Ericsson | 653.473 | 49.07 |
| Hypo Alpe-Adria-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 | 32.961 | 2.48 |
| Hypo Alpe-Adria-Bank d.d. / PBZ Croatia osiguranje Mandatory Pension Fund, B category | 30.615 | 2.30 |
| PBZ d.d. / State Street client account | 30.274 | 2.27 |
| PBZ d.d. / The Bank of New York as custodian | 22.407 | 1.68 |
| Zagrebačka banka d.d. / Custodian Account for Unicredit Bank Austria AG | 13.558 | 1.02 |
| Zagrebačka banka d.d. / State Street Bank and Trust Company, Boston | 12.350 | 0.93 |
| PBZ d.d. / Custodian Client Account | 9.347 | 0.70 |
| Hypo Alpe-Adria-Bank d.d. / Raiffeisen Voluntary Pension Fund | 7.934 | 0.60 |
| Other shareholders | 395.217 | 29.67 |

Share price information in 2014:

| Highest (HRK) | Lowest (HRK) | Closing (HRK) | Market cap. (in MHRK) |
|---------------|--------------|---------------|-----------------------|
| 1,659.00 | 1,250.02 | 1,299.00 | 1,729.8 |

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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 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.

Financial statements for the period 1 Jan 2014 to 31 Dec 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 black ink, appearing to read "Gordana Kovačević".

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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.hr>

Communication

Ericsson Nikola Tesla

Ericsson Nikola Tesla d.d.
 Consolidated statement of comprehensive income
 for the period ended 31 December 2014

| | 2014 | 2013 |
|------------------------------------------------|-----------------|-----------------|
| | HRK '000 | HRK '000 |
| Sales revenue | 1.314.868 | 1.345.226 |
| Cost of sales | -1.135.261 | -1.125.093 |
| Gross profit | 179.607 | 220.133 |
| Selling expenses | -56.330 | -60.694 |
| Administrative expenses | -34.125 | -32.676 |
| Other operating income | 3.772 | 2.120 |
| Other operating expenses | -11.488 | -1.644 |
| Operating profit | 81.436 | 127.239 |
| Finance income | 6.903 | 17.284 |
| Finance expense | -8 | -163 |
| Finance income – net | 6.895 | 17.121 |
| Profit before tax | 88.331 | 144.360 |
| Income tax | -981 | -5 |
| Profit for the year | 87.350 | 144.355 |
| Other comprehensive income | 78 | 13 |
| Total comprehensive income for the year | 87.428 | 144.368 |

Ericsson Nikola Tesla d.d.
Consolidated statement of financial position
as at 31 December 2014

| | 2014 | 2013 |
|-------------------------------------------------------|-----------------|------------------|
| | HRK '000 | HRK '000 |
| ASSETS | | |
| Non-current assets | | |
| Property, plant and equipment | 135.715 | 131.616 |
| Intangible assets | 5.481 | 2.112 |
| Loans and receivables | 19.153 | 18.801 |
| Equity securities | 40 | 40 |
| Total non-current assets | 160.389 | 152.569 |
| Current assets | | |
| Inventories | 30.946 | 51.506 |
| Trade receivables | 190.572 | 246.152 |
| Receivables from related parties | 81.849 | 71.819 |
| Other receivables | 2.820 | 3.715 |
| Income tax receivable | 8 | - |
| Financial assets at fair value through profit or loss | 44.081 | 109.845 |
| Prepayments and accrued income | 1.956 | 1.156 |
| Cash and cash equivalents | 186.963 | 411.328 |
| Total current assets | 539.195 | 895.521 |
| TOTAL ASSETS | 699.584 | 1.048.090 |
| EQUITY AND LIABILITIES | | |
| Equity | | |
| Share capital | 133.165 | 133.165 |
| Treasury shares | -8.462 | -9.571 |
| Legal reserves | 6.658 | 6.658 |
| Retained earnings | 204.106 | 540.884 |
| Total equity | 335.467 | 671.136 |
| Non-current liabilities | | |
| Interest-bearing borrowings | 32 | 69 |
| Employee benefits | 5.622 | 4.697 |
| Other non-current liabilities | 8.933 | - |
| Total non-current liabilities | 14.587 | 4.766 |
| Current liabilities | | |
| Payables to related parties | 41.661 | 60.936 |
| Interest-bearing borrowings | 356 | 309 |
| Trade and other payables | 147.559 | 148.426 |
| Provisions | 11.073 | 13.458 |
| Accrued charges and deferred revenue | 148.881 | 149.059 |
| Total current liabilities | 349.530 | 372.188 |
| Total liabilities | 364.117 | 376.954 |
| TOTAL EQUITY AND LIABILITIES | 699.584 | 1.048.090 |

Ericsson Nikola Tesla d.d.
Consolidated statement of cash flows
for the period ended 31 December 2014

| | 2014 | 2013 |
|------------------------------------------------------------------------------|-----------------|-----------------|
| | HRK '000 | HRK '000 |
| Cash flows from operating activities | | |
| <i>Profit before tax</i> | 88.331 | 144.360 |
| Adjustments for: | | |
| Depreciation and amortisation | 46.280 | 40.282 |
| Impairment losses and reversals | 13.971 | 955 |
| Net increase of provisions | 3.670 | 5.178 |
| Gain on sale of property, plant and equipment | -53 | -448 |
| Net gain on remeasurement of financial assets | -336 | -1.479 |
| Amortisation of discount | -330 | -2.003 |
| Interest income | -6.459 | -10.036 |
| Interest expense | 8 | 163 |
| Foreign exchange losses/(gains) | 768 | -1.332 |
| Equity-settled transactions | 4.568 | 3.645 |
| | 150.418 | 179.285 |
| Decrease in receivables | 31.403 | 10.632 |
| Decrease/(Increase) in inventories | 20.560 | -18.238 |
| Decrease in payables | -25.889 | -30.333 |
| <i>Cash generated from operations</i> | 176.492 | 141.346 |
| Interest paid | -8 | -163 |
| Income taxes paid | -100 | -5 |
| Net cash from operating activities | 176.384 | 141.178 |
| Cash flows from investing activities | | |
| Interest received | 5.951 | 11.800 |
| Proceeds from sale of property, plant and equipment | 193 | 4.957 |
| Purchases of property, plant and equipment, and intangible assets | -45.259 | -63.806 |
| Deposits collected with financial institutions - net | 999 | - |
| Purchases of financial assets at fair value through profit and loss | -45.900 | -103.000 |
| Proceeds from sale of financial assets at fair value through profit and loss | 112.000 | 140.000 |
| Net cash generated/(used) in investing activities | 27.984 | -10.049 |
| Cash flows from financing activities | | |
| Repayment of interest-bearing borrowings | - | -1.669 |
| Purchase of treasury shares | -2.768 | -5.754 |
| Dividends paid | -424.933 | -225.851 |
| Net cash used in financing activities | -427.701 | -233.274 |
| Effects of exchange rate changes on cash and cash equivalents | -1.032 | 1.835 |
| Net decrease in cash and cash equivalents | -224.365 | -100.311 |
| Cash and cash equivalents at the beginning of the year | 411.328 | 511.639 |
| Cash and cash equivalents at the end of the year | 186.963 | 411.328 |