
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 H1 2017

Highlights:

- Sales revenue: MHRK **709**
- Gross margin: **13.6%**
- Operating profit: MHRK **52.9**
- Income before tax: MHRK **48.9**
- Net profit: MHRK **37.4**
- Cash flow from operating activities: MHRK **-59.3**

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

“In H1 2017, sales revenue of Ericsson Nikola Tesla Group decreased by 2.9 percent year-over-year. Despite continuous sales revenue growth from services in Ericsson market and an increase in sales revenue in the domestic market, we were not able to fully neutralize the decline in sales in CIS market and markets of Southeast Europe. Despite numerous business challenges, we have maintained the position of the largest ICT exporter and the leading exporter of knowledge in Croatia. In line with our expectations, Ericsson market records a positive trend and an increase in revenue, primarily due to expansion of our responsibilities and new competencies of our R&D experts and our other expert centers. We have successfully entered into new technology areas, which resulted in high value added job openings. In H1 2017, we hired 145 new experts. At the end of H1, Ericsson Nikola Tesla Group had 3017 employees.

Gross profit increased by 5.5 percent, while operating profit increased by 3.7 percent year-over-year. Due to operational and financial negative currency effects, profit before tax is lower by 8.2 percent year-over-year, and amounts to MHRK 48.9. Net profit has declined by 26.8 percent to MHRK 37.4. The absence of tax incentives for R&D activities has directly impacted the decrease in net profit year-over-year.

Gross margin increased year-over-year to 13.6 percent. We closed H1 with a healthy balance sheet and an equity ratio of 40.7 percent. Working capital efficiency, expressed in Working Capital Days (WCD), is 32 days. Total cash and cash equivalents, including short term financial assets at the end of Q2 amount to MHRK 205.4. In line with expectations, we had a negative cash flow from operating activities, mainly due to a decreased inflow from customers. Regardless of quarterly volatility, the annual cash flow projection is as planned.

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Sales revenue realized in the domestic market record growth due to an increase in sales revenue in the Industry & Society segment. We are proud to actively participate in national projects, such as the State Border Control, healthcare digitization and the Joint Information System of Land Registry and Cadaster. The growth in domestic sales has partially neutralized the decline in sales in CIS and Southeast Europe markets.

With the aim to create new business opportunities in export markets, we continue with intense marketing and sales activities. At the 20th International Economy Fair – Mostar 2017, we presented the latest technology solutions for the digital economy, with a focus on IoT solutions for agriculture and tourism and at the largest Belarusian International Forum on Telecommunications, Information and Banking Technologies “TIBO-2017” jointly with beCloud operator we presented an innovative corporate ICT transport solution.

Comprehensive transformation is ongoing across Ericsson corporation as well as in our company. Ericsson Nikola Tesla is intensively engaged in transformation and is implementing organizational and structural changes in line with both market and our customers' demands. We want to strengthen our position in strategic areas: 4G/5G, Managed Services, Operations Support Systems and Business Support Systems (OSS and BSS), Cloud solutions, Industry& Society solutions, and services for Ericsson internal market. To be able to meet the requirements of a very demanding global market in a timely and quality manner, the company has been investing intensely in knowledge, skills and competencies of our experts, and shall continue to do so in the future. We expect that economic and political uncertainty will continue throughout 2017. Therefore, we will focus on strengthening profitability, cost efficiency and responsible risk management. “

Financial Highlights for the Group:

- Sales revenue amounts to MHRK 709 (H1 2016: MHRK 730.3), a decrease by 2.9% year-over-year. Of the total sales revenue, the domestic market accounts for 19.5%, services to Ericsson account for 65.8% (of which 12% relates to Managed Services in Croatia), while other export markets participate with 14.7%.
- Sales in the Networks segment amount to MHRK 440.6 (62.1% of the total sales revenue), in IT & Cloud segment it amounts to MHRK 266.7 (37.6% of the total sales revenue), and in the Media segment it is MHRK 1.7 (0.2% of the total sales revenue).
- Gross profit amounts to MHRK 96.3 (H1 2016: MHRK 91.3), an increase by 5.5% year-over-year. Gross margin increased year-over-year, amounting to 13.6 % (H1 2016: 12.5%).
- Sales and administrative costs increased by 9.5% year-over-year to MHRK 43.1 (H1 2016: MHRK 39.4), primarily as a result of variable compensation to employees and intensified marketing and sales activities.
- Operating profit amounts to MHRK 52.9, an increase by 3.7% year-over-year (H1 2016: MHRK 51).
- Loss from financial activities amounts to MHRK 4 (H1 2016: gain from financial activities amounted to MHRK 2.2), primarily due to negative currency effects.
- Profit before tax decreased by 8.2% year-over-year to MHRK 48.9 (H1 2016: MHRK 53.3).

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- All tax losses carried forward on the basis of tax reliefs from R&D projects have been used in 2016. In line with that, in H1 2017, income tax liability amounting to MHRK 11.5 was calculated (H1 2016: MHRK 2.2).
- Net profit is MHRK 37.4 (H1 2016: MHRK 51), a decrease by 26.8% year-over-year. Return on Sales (ROS) is 5.3 % (H1 2016: 7%).
- Cash flow from operating activities amounts to MHRK – 59.3 (H1 2016: MHRK 38.2). The cash conversion rate is – 65%.
- Total cash and cash equivalents, including short term financial assets, as at June 30, 2017 amount to MHRK 205.4 (25.8% 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 solid balance sheet with the total assets of MHRK 797.3. Equity ratio is 40.7%.
- With related parties, the transactions were as follows: sales of products and services amounted to MHRK 450.1 (H1 2016: MHRK 441), while procurement of products and services amount to MHRK 127 (H1 2016: MHRK 193.2).
- As at June 30, 2017 balances outstanding with related parties were as follows: receivables amounted to MHRK 121.5 (end of 2016: MHRK 90.9), and payables to MHRK 58.8 (end of 2016: MHRK 89.3).

Business situation in major markets

In the domestic market, sales revenue amounted to MHRK 138.5, an increase by 5 % year-over-year.

Cooperation with strategic partner Vipnet continued with modernization of radio access network and transport telecom network, and increasing of the 3G and 4G capacity. We continuously test new functionalities in various segments of core and access network to contribute to an increased service quality and new services for end users.

Business cooperation with Hrvatski Telekom (HT) was extended with a three-year contract on telecommunication equipment maintenance, and, in the segment of fixed telecommunication network modernization, by upgrading of the core IMS system. Furthermore, we delivered solutions for modernization of access, core and transport IP network of HT Group. The implementation of a part of MPLS access network within the TeraStream project started. We also continued delivering build and maintenance services for Hrvatski Telekom's telecommunication infrastructure.

With the mobile operator Tele2, we signed a contract for the core network upgrade, and already implemented it in part of the network. In line with requirements for capacity building in transport network, additional capacity of transport network in the segments of microwave and fiber optics were ordered, and delivered in a part of the network.

In the ICT solutions for Industry & Society segment, numerous activities continue in healthcare digitization. At the beginning of 2017, the Republic of Croatia Border Control System was successfully delivered. Seven border locations were equipped with the latest sensor equipment and connected into a joint "green border" surveillance system. A new

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contract for further digitization of the Joint Information System for Land Registry and Cadaster was signed, including the continuation of activities on the OSS project (One Stop Shop).

In export markets (Ericsson market excluded), sales revenue amounted to MHRK 104.3, a decrease by 34.7 percent year-over-year.

In the markets of Southeast Europe (Bosnia and Herzegovina, Montenegro and Kosovo) sales revenue decreased by 25.3% year-over-year, amounting to MHRK 49.6. Long-term unfavorable economic and political situation in these markets has a negative impact on the level and the dynamics of operator investments. The collaboration with operators is ongoing in the segment of maintenance and modernization of fixed and mobile networks. With HT Mostar, we signed contracts related to mobile network management system extension and modernization and extension and modernization of radio access network. With BH Telecom, we signed a contract for modernization and extension of Operations Support System. The modernization and upgrade of 112 system for the Ministry of Security of Bosnia and Herzegovina was successfully implemented.

In CIS market, sales revenue amounted to MHRK 54.7, a decrease by 41.4 percent year-over-year. We are currently engaged in implementation of projects contracted during 2016. Strong marketing and sales activities continue, with the aim of improving and developing business with existing and new customers.

In Ericsson market, sales revenue amounts to MHRK 466.2, an increase by 6.3% year-over-year. Ericsson Nikola Tesla Servisi d.o.o., a daughter company of Ericsson Nikola Tesla d.d., contributed to this market segment with MHRK 85.1.

In Ericsson Nikola Tesla Research & Development Center (R&D) the activities within the Development Unit Networks related to radio systems software development have been significantly extended. The activities within Mobile Core, User Data Management and Cloud development units are carried out as planned. Operations' management and other heads of Ericsson development confirm that the organizational strength of our Research and Development Center is reflected in its continuous expansion in new activities and responsibilities with no risks to the work quality and delivery. Moreover, both sides have always expressed the readiness to further continue and intensify cooperation, which was particularly highlighted after Ericsson Corporation announced the new strategic guidelines. In line with that, recruitment and education of new experts is underway to facilitate our easier and more successful inclusion into current research and development projects. The research projects are ongoing on developing the network functions virtualization with the aim to enable new solutions on the Cloud platform. Experimental development within Ericsson Garage Croatia includes network security projects and projects that apply machine learning algorithms, for example, in elderly care.

The experts of Center for Services and Solutions for Networks & Media have been engaged in numerous complex projects for our customers worldwide, such as: Swisscom (Switzerland), Slovak Telekom (Slovakia), Vodafone, Three, and O2 (United Kingdom), A1 (Austria), China Unicom (China), MTN (Rwanda), Orange (Togolese Republic), Smartone (Hong Kong), TMO (USA), Alfa (Lebanon), Robi (Bangladesh). These are complex activities of expert

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analysis, creation of new innovative solutions, optimization and upgrade of existing networks and consultancy services. Intense work on the development and implementation of software tools for mobile networks management and optimization, such as: Smart Laptop, Smart Rollout Support, Rehome Automation, and Ericsson Network Engineer, is ongoing.

Experts from Digital Services and Solutions Center were engaged in various demanding projects for customers worldwide, such as: Tango and Post from Luxembourg, Vodafone, O2, British Telecom/Everything Everywhere from the United Kingdom, Telekom Austria Group (TAG), Telecom Italy, Telekom Slovenije, T-Mobile and Vodafone Czech Republic, DIGI Hungary, DT Germany, Vimpelcom Russia, Orange Belgium, GO Malta, TMO USA, and DoCoMo Japan. These activities include design, network applications, Cloud and digital business systems infrastructure. We are proud that our customers on projects worldwide have given a positive feedback and congratulated our Services and Solutions Center experts on their engagement.

Ericsson Nikola Tesla Servisi d.o.o., a daughter company of Ericsson Nikola Tesla d.d., was given an extension of the contract for telecom network build, maintenance and monitoring with key customer and an extension in business volume in the segment of geodesy and documentation. In H1 2017, key projects of building mobile broadband network, as well as projects of designing and building of optical networks were successfully implemented. Delivery of high quality services continued in the segment of telecommunication network monitoring and maintenance. The quality of service realization was confirmed by ISO 9001:2015 certificate awarded in the segment of planning, design, geodesy, installation, testing, monitoring and maintenance of IT and electronic communications infrastructure and network.

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Other information

Ericsson Nikola Tesla major shareholders (as at 30 June, 2017)

	Number of shares	% of share capital
Telefonaktiebolaget LM Ericsson	653.473	49.07
Addiko d.d. / Raiffeisen mandatory pension fund, B category	123.514	9.28
Splitska banka d.d. / Erste Plavi mandatory pension fund, B category	41.890	3.15
Addiko d.d. / PBZ Croatia Insurance mandatory pension fund, B category	22.627	1.70
Zagrebačka banka d.d. / Unicredit Bank Austria AG – clients account	17.230	1.29
PBZ d.d. / The Bank of New York as Custodian	17.141	1.29
Zagrebačka banka d.d. / State Street and Trust Company, Boston	13.935	1.05
PBZ d.d. / custodian client account	9.069	0.68
Addiko d.d. / Raiffeisen voluntary pension fund	7.934	0.60
OTP BANKA d.d./INS683	6.944	0.52
Other shareholders	417.893	31.37

Share price information in Q2 2017:

Highest (HRK)	Lowest (HRK)	Closing (HRK)	Market cap. (In MHRK)
1,399.00	1,150.00	1247.00	1660.6

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Ericsson Nikola Tesla d.d.

Krapinska 45

Zagreb

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 January 2017 to 30 June 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 over a light gray rectangular background.

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

Ericsson Nikola Tesla d.d.
Consolidated statement of comprehensive income
for the period ended 30 June 2017

	2017	2016
	HRK '000	HRK '000
Sales revenue	709.044	730.288
Cost of sales	-612.695	-638.963
Gross profit	96.349	91.326
Selling expenses	-24.794	-22.312
Administrative expenses	-18.350	-17.089
Other operating income	260	217
Other operating expenses	-579	-1.139
Operating profit	52.887	51.002
Finance income	-	2.327
Finance expense	-3.990	-79
Finance expense/income – net	-3.990	2.248
Profit before tax	48.897	53.251
Income tax	-11.544	-2.224
Profit for the year	37.353	51.026
Other comprehensive income	-89	-124
Total comprehensive income for the year	37.263	50.902

Ericsson Nikola Tesla d.d.
Consolidated statement of financial position
as at 30 June 2017

	2017	2016
	HRK '000	HRK '000
ASSETS		
Non-current assets		
Property, plant and equipment	114.743	122.897
Intangible assets	6.721	7.285
Loans and receivables	82.699	81.160
Equity securities	386	40
Deferred tax assets	14.250	14.250
Total non-current assets	218.799	225.632
Current assets		
Inventories	68.515	9.796
Trade receivables	173.304	174.952
Receivables from related parties	104.434	88.858
Other receivables	11.500	14.325
Income tax receivable	4.854	1.172
Financial assets at fair value through profit or loss	62.843	62.993
Prepayments and accrued income	10.480	5.671
Cash and cash equivalents	142.587	224.725
Total current assets	578.517	582.492
TOTAL ASSETS	797.315	808.124
EQUITY AND LIABILITIES		
Equity		
Share capital	133.165	133.165
Treasury shares	-1.630	-1.630
Legal reserves	6.658	6.658
Retained earnings	186.083	148.686
Total equity	324.276	286.879
Non-current liabilities		
Interest-bearing borrowings	8.761	8.962
Other non-current liabilities	17.311	24.288
Employee benefits	8.621	8.560
Total non-current liabilities	34.694	41.810
Current liabilities		
Payables to related parties	44.975	73.215
Interest-bearing borrowings	43	0
Trade and other payables	179.074	156.413
Income tax payable	11.541	21.659
Provisions	16.848	16.011
Accrued charges and deferred revenue	185.864	212.137
Total current liabilities	438.345	479.435
Total liabilities	473.039	521.245
TOTAL EQUITY AND LIABILITIES	797.315	808.124

Ericsson Nikola Tesla d.d.
Consolidated statement of cash flows
for the period ended 30 June 2017

	2017 HRK '000	2016 HRK '000
Cash flows from operating activities		
<i>Profit before tax</i>	48.897	53.251
Adjustments for:		
Depreciation and amortisation	21.789	25.620
Impairment losses and reversals	1.140	1.016
Net increase of provisions	6.936	2.426
Gain on sale of property, plant and equipment	-87	-45
Net gain on remeasurement of financial assets	158	-2.003
Amortisation of discount	-3	-288
Interest income	-2.317	-1.429
Interest expense	12	79
Foreign exchange losses	14.102	2.126
Equity-settled transactions	134	631
	90.761	81.384
<i>Changes in working capital</i>		
In receivables	-21.035	-95.220
In inventories	-58.719	-51.118
In payables	-51.044	104.456
<i>Cash generated from operations</i>	-40.037	39.503
Interest paid	-12	-79
Income taxes paid	-19.215	-1.219
Net cash from operating activities	-59.264	38.204
Cash flows from investing activities		
Interest received	1.202	1.510
Acquisition of subsidiaries	-346	0
Proceeds from sale of property, plant and equipment	100	40
Purchases of property, plant and equipment, and intangible assets	-19.977	-21.393
Deposits collected with financial institutions - net	19	-10.167
Purchases of financial assets at fair value through profit and loss	0	-89.000
Proceeds from sale of financial assets at fair value through profit and loss	-8	51.932
Net cash generated/(used) in investing activities	-19.010	-67.078
Cash flows from financing activities		
Dividends paid	-82	-132.846
Net cash from financing activities	-82	-132.846
Effects of exchange rate changes on cash and cash equivalents	-3.781	-1.303
Net increase/decrease in cash and cash equivalents	-82.138	-163.022
Cash and cash equivalents at the beginning of the year	224.725	233.195
Cash and cash equivalents at the end of the year	142.587	70.173