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## 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 Q1 2017

### Highlights:

- Sales revenue: MHRK **360.4**
- Gross margin: **14.75%**
- Operating income: MHRK **29.2**
- Income before tax: MHRK **26.2**
- Net profit: MHRK **19.9**
- Cash flow from operating activities: MHRK – **65.9**

Gordana Kovačević, President of Ericsson Nikola Tesla, comments:

„In Q1 2017, sales revenue of Ericsson Nikola Tesla Groups increased by 9% year-over-year due to continuous revenue growth in services for Ericsson and a significant growth in revenue in the domestic market. This neutralized the decline in revenue in CIS markets and the markets of South East Europe. We have kept the position of the largest Croatian ICT exporter and the largest exporter of knowledge. In line with our expectations, Ericsson market records a positive trend, primarily due to expanding responsibilities as well as competences of our experts in new technological areas.

Gross profit increased by 9.3%, while operating profit equals the profit level realized in Q1 2016. Profit before tax decreased by 8.4% year-over-year to MHRK 26.2 due to negative currency deviations. Although operating profit is at the same level as in Q1 2016 amounting to MHRK 29.2, net profit declined by 29.4 to MHRK 19.9. Unfavorable current legislation regarding R&D incentives, i.e. the absence of tax incentives, has directly impacted the decrease in net profit.

The end of Q1 was concluded with a lean balance sheet and equity ratio of 41.2 percent. Working capital efficiency, measured by the Working Capital Days (WCD) performance indicator further improved to 26 days. Total cash and cash equivalents, including short term financial assets, at the end of Q1 amount to MHRK 208.8. In line with expectations, a negative cash flow from operating activities was realized, mainly due to decreased inflows from customers and variable compensation payment to employees related to Company's good performance in 2016.

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Given the quarterly volatility, the cash flow should be observed at the annual level. We expect a return to a positive cash conversion rate in the upcoming quarters.

In the domestic market, a significant increase in sales revenue was recorded, mainly due to successful implementation of the Republic of Croatia border control system. This project, as well as our solutions for healthcare digitalization and the Joint Information System of Land Registry and Cadaster (JIS), is one of those projects that provide the platform for the wider structural reforms in Croatia. Sales growth on the domestic market neutralized the decline in sales on CIS and Southeast Europe markets. In these export markets, we continue with intense marketing and sales activities and expect new business in the upcoming period.

As part of our marketing and sales activities, the delegation of Ericsson Nikola Tesla, accompanied by numerous customers, visited Mobile World Congress 2017 (MWC) in Barcelona. I would like to highlight that also this year, our experts have contributed significantly to Ericsson solutions related to digital transformation. Their contribution was related to backbone of Ericsson's offer aimed at datacenters for work in a cloud characterized by high scalability. Another solution that was presented was the optimization of video content within the framework of Ericsson's cooperation with the leading Chinese video streaming service (iQIYI) and the most important telecom operator China Unicom.

Our company, as well as global Ericsson, continues with transformation processes and organizational and structural changes. By efficiently implementing transformation programs, we aim to strengthen business performance in strategic segments (4G/5G, Managed Services, OSS and BSS, Cloud solutions, Industry& Society) and on Ericsson's internal market and continuously invest in development of knowledge and competences. We have established a model of firm compliance between innovative ideas and strategic initiatives to support business growth and improve our way of working. Strengthening profitability and cost reductions continue to be our key priorities.

It is expected that economic uncertainty and business challenges will continue throughout 2017. Therefore, continuous adjustments to technological and market conditions, responsible risk management and optimal use of all resources remains in our focus."

### Financial highlights for the Group:

- Sales revenue amounts to MHRK 360.4 (Q1 2016: MHRK 330.8), 9% increase year-over-year. Of the total sales revenue, the domestic market accounts for 24.4%, services to Ericsson account for 61.6% (of which 10.7% relates to Managed Services in Croatia), while other export markets participate with 14%.
- Sales in the Network segment amount to MHRK 212.3 (58.9% of the total sales revenue), IT&Cloud segment amount to MHRK 147.1 (40.8% of the total sales revenue), and Media segment is MHRK 1 (0.3% of the total sales revenue).
- Gross profit amounts to MHRK 53.2 (Q1 2016: MHRK 48.6), an increase by 9.3% year-over-year. Gross margin is at the level realized in Q1 2016, amounting to 14.7% (Q1 2016: 14.7%).

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- Sales and administrative costs increased by 29.3% year-over-year to MHRK 24.2 (Q1 2016: MHRK 18.7), primarily as a result of variable compensation to employees and intensified marketing and sales activities.
- Operating profit equals profit realized in Q1 2016, amounting to MHRK 29.2 (Q1 2016: MHRK 29.2).
- Loss from financial activities amounts to MHRK 3 (Q1 2016: loss from financial activities was MHRK 0.6), primarily due to negative currency deviations.
- Profit before tax decreased by 8.4% year-over-year to MHRK 26.2 (Q1 2016: MHRK 28.6).
- All tax losses carried forward on the basis of tax reliefs from R&D projects have been used in 2016. Respectively, in Q1 2017, income tax liability was calculated amounting to MHRK 6.2 (Q1 2016: MHRK 0.3).
- Net profit is MHRK 19.9 (Q1 2016: MHRK 28.2), and is lower 29.4% year-over-year. ROS is 5.5% (Q1 2016: 8.5%).
- Cash flow from operating activities amounts MHRK – 65.9 (Q1 2016: MHRK -25.3). The cash conversion rate is -137%.
- Total cash and cash equivalents, including short term financial assets, as at March 31, 2017 amount to MHRK 208.8 (28% 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 with the total assets of MHRK 745.2. Equity ratio is 41.2%.
- With related parties, the transactions were as follows: sales of products and services amount to MHRK 204.1 (Q1 2016: MHRK 202.7), while procurement of products and services amount to MHRK 60.1 (1 Q1 2016: MHRK 74.6).
- As at March 31, 2017 balances outstanding with related parties were as follows: receivables amounted to MHRK 134.1 (end of 2016: MHRK 90.9), and payables to MHRK 64.9 (end of 2016: MHRK 89.3).

### Business situation in major markets

In the domestic market, sales revenue amounted to MHRK 87.9, 59% increase year-over-year.

Cooperation with our strategic partner Vipnet was continued on the modernization of radio access network and transport telecom network, as well as on increasing the capacity of 3G and 4G technologies. Testing of new functionalities in various areas of core and access network, contributing to increased quality of service and new services for end users, is ongoing.

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 IMS system upgrade. Furthermore, we delivered solutions for modernization of access, core and transport IP network of HT Group (HT, Iskon, Optima).

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With the mobile operator Tele2, cooperation was agreed regarding core network upgrade. We increased their transport network capacity in the microwave and fiber optics segments. Furthermore, we provided core network support services, as well as maintenance services for their network.

In the segment of ICT solutions for Industry & Society, numerous activities regarding of healthcare digitalization are ongoing. In January 2017, the Republic of Croatia border control system was successfully delivered. Seven border locations (six in the east, and one in the south of Croatia) were equipped with the latest sensor equipment (radar and cameras) and connected into a joint "green border" surveillance system.

[In export markets \(Ericsson market excluded\)](#) sales revenue decreased by 20% year-over-year to MHRK 50.3.

In the markets of Southeast Europe (Bosnia and Herzegovina, Montenegro and Kosovo) sales revenue decreased by 33.4% year-over-year, amounting to MHRK 19.9. Unfavorable economic and political situation impacts the level and the dynamics of operator's investments. The collaboration with the operators in the segment of maintenance and modernization of fixed and mobile networks is ongoing.

With HT Mostar, contracts were signed for the extension and modernization of the mobile network monitoring systems, as well as for maintenance services for Ericsson equipment in HT Mostar network.

In CIS market, sales revenue amounts to MHRK 30.4, decrease by 8.4% year-over-year. Implementation of projects contracted in 2016 is ongoing. Strong marketing and sales activities continue, with the aim of further business development with existing and new customers.

[In Ericsson market](#), sales revenue amounts to MHRK 222.2, an increase by 5% year-over-year. Ericsson Nikola Tesla Servi d.o.o. (daughter company of Ericsson Nikola Tesla d.d.) contributed to revenue in this market segment with MHRK 38.5.

During the management meeting of Ericsson Nikola Tesla Research and Development Center (attended by representatives of all Ericsson Corporation units with which we cooperate), our Center was given recognition for its performance. Furthermore, the readiness for even more intense cooperation in the future was expressed. During Q1, in line with our expectation, increased business volume in network radio products and products related to user data was approved. All development projects were realized as planned.

Research projects in developing network virtualization functionalities have continued, with the aim of enabling new solutions on Cloud platform. We strengthen competencies in the segment of Data science through research projects as well as Ericsson Garage Croatia projects. Machine learning algorithms are being applied in the area of care for elderly citizens and network security.

The experts of Center for Services and Solutions for Network & Media have been engaged in numerous projects for our customers worldwide, such as: A1 Austria, Swisscom Switzerland, Slovak Telekom Slovakia, Vodafone Global, Vodafone United Kingdom, O2 United Kingdom, Three United Kingdom, China Unicom China, MTN Rwanda, and Orange Togolese Republic. These are complex activities in defining and creating new solutions, analysis, optimization and upgrade of existing networks, as well as providing consulting services. Furthermore, there was substantive engagement in the development and implementation of software tools for management and

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optimization of mobile networks, such as: Smart Laptop, Smart Rollout Support, Rehomeing Automation, and Ericsson Network Engineer.

The experts of Center for Solutions and Services for IT&Cloud have been engaged in numerous projects for the customers worldwide, such as: Tango Luxembourg, Vodafone United Kingdom, O2 United Kingdom, Motorola United Kingdom, British Telecom/Everything Everywhere, Telekom Austria Group (TAG), DT Pan-Net, Telekom Slovenije Slovenia, T-Mobile Czech Republic, Vodafone Czech Republic, DIGI Hungary, TMO USA and DoCoMo Japan. In the listed projects, the Network Applications & Cloud Infrastructure and Digital Business Systems experts were the most engaged ones. Furthermore, the Center's Project Office was engaged in activities for the needs of the following customers: Telekom Slovenije, TAG, A1 Austria, Post Luxembourg, Orange Belgium, DT Germany, etc.

### Other information

Ericsson Nikola Tesla Annual General Meeting shall be held on June 6, 2017. The right to participate at the Annual General Meeting have all shareholders, or their proxies, respectively, who register to participate until May 30, 2017, at the latest.

The shareholders who have the Company shares registered on their securities account in the Central Depository & Clearing Company on June 12, 2017 are entitled for dividend payment in total amount of HRK 90 per share (HRK 20 regular dividend and HRK 70 extraordinary dividend). Ex-dividend date is June 9, 2017. The dividend shall be paid on July 6, 2017.

Notice of Ericsson Nikola Tesla Annual General Meeting, including the proposals of all decisions, was published on the Company's web page <http://www.ericsson.hr/20170426-notice>.

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Ericsson Nikola Tesla's major shareholders (as at March 31, 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
Societe Generale-Splitska banka d.d. / Erste Plavi Mandatory Pension Fund, B category	41.890	3.15
Addiko d.d. / PBZ Croatia osiguranje Mandatory Pension Fund, B category	22.627	1.70
Zagrebačka banka d.d. / Custodian Account for Unicredit Bank Austria AG – clients account	17.230	1.29
PBZ d.d. / The Bank of New York as Custodian	16.504	1.24
Zagrebačka banka d.d. / State Street Bank and Trust Company, Boston	13.935	1.05
PBZ d.d. / Custodian client account	8.979	0.67
Addiko d.d. / Raiffeisen Voluntary Pension Fund	7.934	0.60
OTP BANKA d.d./INS683	6.119	0.46
Other shareholders	419.445	31.50

Share price information in Q1 2017:

Highest (HRK)	Lowest (HRK)	Closing (HRK)	Market cap. (in MHRK)
1,444.00	1,164.99	1,364.00	1,816.4

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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 31 March 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>



Ericsson Nikola Tesla d.d.  
Consolidated statement of comprehensive income  
for the period ended 31 March 2017

	<b>2017</b>	<b>2016</b>
	<b>HRK '000</b>	<b>HRK '000</b>
Sales revenue	360.399	330.789
Cost of sales	-307.243	-282.140
<b>Gross profit</b>	<b>53.156</b>	<b>48.649</b>
Selling expenses	-13.317	-10.527
Administrative expenses	-10.912	-8.206
Other operating income	207	154
Other operating expenses	58	-886
<b>Operating profit</b>	<b>29.192</b>	<b>29.183</b>
Finance income	662	0
Finance expense	-3.700	-617
Finance expense – net	-3.039	-617
<b>Profit before tax</b>	<b>26.154</b>	<b>28.566</b>
Income tax	-6.206	-319
<b>Profit for the year</b>	<b>19.948</b>	<b>28.247</b>
Other comprehensive income	-68	-127
<b>Total comprehensive income for the year</b>	<b>19.879</b>	<b>28.120</b>

Ericsson Nikola Tesla d.d.  
Consolidated statement of financial position  
as at 31 March 2017

	<b>2017</b>	<b>2016</b>
	<b>HRK '000</b>	<b>HRK '000</b>
<b>ASSETS</b>		
<b>Non-current assets</b>		
Property, plant and equipment	118.318	122.897
Intangible assets	7.002	7.285
Loans and receivables	78.999	81.160
Equity securities	386	40
Deferred tax assets	14.250	14.250
<b>Total non-current assets</b>	<b>218.955</b>	<b>225.632</b>
<b>Current assets</b>		
Inventories	24.227	9.796
Trade receivables	151.675	174.952
Receivables from related parties	121.036	88.858
Other receivables	13.196	14.325
Income tax receivable	1.406	1.172
Financial assets at fair value through profit or loss	62.980	62.993
Prepayments and accrued income	5.940	5.671
Cash and cash equivalents	145.794	224.725
<b>Total current assets</b>	<b>526.253</b>	<b>582.492</b>
<b>TOTAL ASSETS</b>	<b>745.208</b>	<b>808.124</b>
<b>EQUITY AND LIABILITIES</b>		
<b>Equity</b>		
Share capital	133.165	133.165
Treasury shares	-1.630	-1.630
Legal reserves	6.658	6.658
Retained earnings	168.632	148.686
<b>Total equity</b>	<b>306.825</b>	<b>286.879</b>
<b>Non-current liabilities</b>		
Interest-bearing borrowings	8.657	8.962
Other non-current liabilities	24.155	24.288
Employee benefits	8.804	8.560
<b>Total non-current liabilities</b>	<b>41.616</b>	<b>41.810</b>
<b>Current liabilities</b>		
Payables to related parties	49.795	73.215
Interest-bearing borrowings	65	0
Trade and other payables	122.224	156.413
Income tax payable	27.863	21.659
Provisions	16.865	16.011
Accrued charges and deferred revenue	179.956	212.137
<b>Total current liabilities</b>	<b>396.767</b>	<b>479.435</b>
<b>Total liabilities</b>	<b>438.383</b>	<b>521.245</b>
<b>TOTAL EQUITY AND LIABILITIES</b>	<b>745.208</b>	<b>808.124</b>

Ericsson Nikola Tesla d.d.  
Consolidated statement of cash flows  
for the period ended 31 March 2017

	2017 HRK '000	2016 HRK '000
<b>Cash flows from operating activities</b>		
<i>Profit before tax</i>	26.154	28.566
Adjustments for:		
Depreciation and amortisation	11.009	12.870
Impairment losses and reversals	-24	-101
Net increase of provisions	5.704	257
Gain on sale of property, plant and equipment	-37	-38
Net gain on remeasurement of financial assets	13	-504
Amortisation of discount	-3	0
Interest income	-1.761	-854
Interest expense	6	20
Foreign exchange losses	7.177	1.058
Equity-settled transactions	-67	316
	48.170	41.590
<i>Changes in working capital</i>		
In receivables	-8.887	-32.498
In inventories	-14.431	-10.763
In payables	-90.373	-23.382
<i>Cash generated from operations</i>	-65.521	-25.053
Interest paid	-6	-20
Income taxes paid	-354	-204
<b>Net cash from operating activities</b>	<b>-65.881</b>	<b>-25.277</b>
<b>Cash flows from investing activities</b>		
Interest received	705	508
Acquisition of subsidiaries	-346	0
Proceeds from sale of property, plant and equipment	41	34
Purchases of property, plant and equipment, and intangible assets	-10.250	-7.920
Deposits collected with financial institutions - net	10	-3.392
Purchases of financial assets at fair value through profit and loss	0	-5.000
<b>Net cash generated/(used) in investing activities</b>	<b>-9.840</b>	<b>-15.771</b>
<b>Net cash from financing activities</b>	<b>0</b>	<b>0</b>
Effects of exchange rate changes on cash and cash equivalents	-3.209	-1.334
<b>Net increase/decrease in cash and cash equivalents</b>	<b>-78.931</b>	<b>-42.382</b>
Cash and cash equivalents at the beginning of the year	224.725	233.195
<b>Cash and cash equivalents at the end of the year</b>	<b>145.794</b>	<b>190.812</b>