

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 the first nine months of 2019

Highlights:

- Sales revenue: MHRK **1,253.3**
- Gross margin: **11.4 %**
- Operating profit: MHRK **89.9**
- Profit before tax: MHRK **93.5**
- Net profit: MHRK **80.8**
- Cash flow from operating activities: MHRK **86.0**

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

„In the first nine months of 2019, Ericsson Nikola Tesla Group sales revenue increased in all markets and amounted to MHRK 1,253.3, up by 16% year-over-year.

The leading global and Croatian operators have been significantly investing in network modernization, digital transformation and preparation for 5G. Globally, 5G technology is developing faster than expected. In Croatia dynamics of investments in 5G development will depend on the model and conditions of the spectrum allocation. 5G is the next generation of mobile networks that will enable greater data transfer speeds, low latency and better network safety characteristics. With 5G technology, we are creating a new platform for innovations that will revolutionize business and society at large and enable new revenue streams and business optimization to our customers.

With the operator A1 Hrvatska we have been successfully cooperating ever since they entered the Croatian market. This September we signed a frame agreement till the end of 2023 that encompasses modernization and expansion of their radio access network by using the latest technology solutions from Ericsson Radio System (ERS) portfolio. With the operator Hrvatski Telekom intensive activities are ongoing on the modernization of the entire mobile network, which will significantly increase network capacity and enable the introduction of 5G technology. So far, more than 90% of the network was modernized and significantly higher transfer speeds were achieved.

In the segment of ICT for Industry & Society, we continued our activities in the field of e-Health, e-Business (Land Registry and Cadaster) and Public Safety (State Border Control).

In export markets, the implementation of mobile networks modernization projects is ongoing for our customers in Bosnia and Herzegovina, Montenegro, Kosovo, and Belarus. I would like to highlight a frame agreement with the strategic partner HT Eronet for the expansion of LTE network across the entire territory of Bosnia and Herzegovina. Ericsson Nikola Tesla is a single vendor of radio access network to HT Eronet, and owing to radio system equipment which is ready for 5G and IoT, HT Eronet will be able to transit smoothly to 5G in the future.

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Business performance in Ericsson market has been continuously growing owing to new responsibilities in the field of 4G/5G mobile systems, quality of performed activities and competencies of our experts from R&D Center and Services and Solutions Expert Centers.

For five years, our daughter company, Ericsson Nikola Tesla Servisi, has been providing services of design, rollout, monitoring and maintenance of telecommunications network infrastructure of Hrvatski Telekom, within the Managed Services segment. Until now many demanding goals were achieved in the area of planning and rollout, connecting users to optical infrastructure as well as on expanding capacities and coverage of Mobile Broadband (MBB).

In terms of financial results, gross profit is up by 7.2% year-over-year as a result of growth in sales revenue. Operating profit is up by 9.9% as a result of gross profit increase, while maintaining total sales and administrative costs almost at the same level year-over-year. Gross margin is 0.9 percentage points lower due to intensive engagement of working capital on projects with key customers. Profit before tax increased by 11.2% as a result of increase in operating profit and a positive financial impact of foreign exchange differences, while net profit, along with the mentioned impacts and the impact of tax relief, increased by 29.6%, amounting to MHRK 80.8. Cash flow from operating activities amounted to MHRK 86, and at the end of Q3, total cash and cash equivalents, including short-term financial assets amounted to MHRK 157.8. Working Capital Efficiency, expressed in Working Capital Days (WCD), was 40 days, and if we exclude services to Ericsson, Working Capital Efficiency was 102 days. Cash conversion rate was 54%.

During Q3, Ericsson Nikola Tesla held its 19th Summer Camp where 54 students from Croatia and neighboring countries participated, 13 of whom from ERASMUS++ project BENEFIT in which our company is the industry partner. With the help of their mentors, the students worked on projects concerning 5G Radio Access, Artificial Intelligence, Automation, Robotics and IoT. Furthermore, within the cooperation with scientific and educational institutions, I would like to highlight the activities on founding a new joint Traffic and Logistics Data Science Lab with the Faculty of Transport and Traffic Sciences (FPZ), University of Zagreb.

Our strategy is focused on long-term strengthening the market leader position in the existing and new segments. We continue to invest in new technologies and competencies strengthening in order to provide quality support to our customers. In Q3, we have closed several important business deals that will strengthen our market position in the upcoming period.

We continue to implement the Digital Transformation program at Ericsson Nikola Tesla Group level, with the aim to additionally simplify the Company's processes and managing business/projects by using advanced technologies and automation.

In order to secure further business development and remain competitive, we continue to focus on cost and operating efficiency, and strategic risk management.“

Financial Highlights for the Group:

- Sales revenue amounted to MHRK 1,253.3 (first nine months 2018: MHRK 1,080.5), up by 16% year-over-year. Of the total sales revenue, domestic market accounts for 24.4%, services to Ericsson account for 60.6% (of which 11.2% is related to Managed Services in Croatia), while other export markets account for 15.0%.
- Sales in the Networks segment amounted to MHRK 729.4 (first nine months 2018: MHRK 651.7), Digital Services amounted to MHRK 380.0 (first nine months 2018: MHRK 299.5), Managed Services amounted to MHRK 140.6 (first nine months 2018: MHRK 128.6), and the segment Emerging Business and Other amounted to MHRK 3.3 (first nine months 2018: MHRK 0.7).

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- Gross profit amounted to MHRK 142.8 (first nine months 2018: MHRK 133.2), which is up by 7.2% year-over-year as a result of increase in sales revenue. Gross margin decreased to 11.4% (first nine months 2018: 12.3%) due to intensive engagement of working capital on projects with key customers.
- Sales and administrative costs increased by 1.8% year-over-year, amounting to MHRK 52.9 (first nine months 2018: MHRK 52). Our focus on cost and operating efficiency resulted in slight increase in sales and administrative costs, although sales revenue increased by 16% year-over-year.
- As a result of gross profit increase, and at the same time retaining total sales and administrative costs at almost the same level year-over-year, operating profit increased by 9.9% year-over-year to MHRK 89.9 (first nine months 2018: MHRK 81.9).
- Gain from financial activities was MHRK 3.6 (first nine months 2018: MHRK 2.2), primarily as a result of positive foreign exchange differences.
- Profit before tax increased by 11.2% year-over-year to MHRK 93.5 (first nine months 2018: MHRK 84.1), as a result of increased operating profit and positive financial impact of foreign exchange differences.
- Net profit increased by 29.6% year-over-year and amounted to MHRK 80.8 (first nine months 2018: MHRK 62.3), primarily as a result of increased gross profit and decrease in tax liability based on tax reliefs on employment according to Investment Promotion Act. Return on Sales (ROS) is 6.4% (first nine months 2018: MHRK 5.8%).
- Cash flow from operating activities was MHRK 86.0 (first nine months 2018: MHRK 22.4). In Q3, cash flow was positively impacted by slightly higher customer receivables collection and somewhat lower VAT payables. Cash conversion rate was 54% (first nine months 2018: MHRK 17%).
- Working Capital Efficiency, expressed in WCD, was 40 days (first nine months 2018: 30 days), and excluding services to Ericsson, Working Capital Efficiency was 102 days (first nine months 2018: 85 days). Increase in WCD was due to an increased engagement on network modernization projects.
- Total cash and cash equivalents, including short-term financial assets, as at September 30, 2019 amounted to MHRK 157.8 (16.9% of the total assets), while at the end of 2018, it amounted to MHRK 236.4 (28.1% of the total assets). Total dividend payments, amounting to MHRK 94, were paid out on July 17, 2019. The financing of the Energy Efficiency Project of the Company's premises in Zagreb has been ongoing. Additionally, decrease in cash was influenced by the replacement/ upgrade of IT equipment in line with the mandatory compliance with the information security standard at Corporate level. Furthermore, intensive engagement of working capital has continued on network modernization projects with key customers.
- The Company has a lean balance sheet with the total assets of MHRK 936.3 as at September 30, 2019, up by 11.4% compared to the end of 2018. Along with the expected increase in inventory and the effect of right-of-use assets (IFRS 16), we should also mention investment in company premises (energy efficiency project), as well as net impact of good payment collection of short-term receivables at the end of 2018, and invoicing of certain completed phases of the network modernization projects in Q3 2019 in the domestic and export markets.

Due to increased engagement on network modernization projects in the domestic market, the inventory and work in progress are still significantly higher compared to the end of 2018. Due to the application of new International Financial Reporting Standards (IFRS 16 Leases), in force as of January 1, 2019, at the beginning of the year the Company acknowledged MHRK 65 of the right-of-use assets and lease

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commitments in the same amount, which resulted in additional increase of balance sheet in 2019 as compared to the end of 2018.

- Equity ratio amounted to 31.2% (first nine months 2018: MHRK 36.3%).
- With related parties, the transactions were as follows: sales of products and services amounted to MHRK 767.3 (first nine months 2018: MHRK 707.7), while procurement of products and services amounted to MHRK 328.2 (first nine months 2018: MHRK 255.7).
- As at September 30, 2019, balances outstanding with related parties were as follows: receivables amounted to MHRK 99.1 (end of 2018: MHRK 113.2), and payables amounted to MHRK 83.8 (end of 2018: MHRK 40.4).

Business situation in major markets

In the domestic market, sales revenue amounted to MHRK 306.3 (first nine months 2018: MHRK 231.8), up by 32.1% year-over-year.

With strategic partner Hrvatski Telekom, intensive activities on mobile network modernization are ongoing. So far, more than 90% of the network was modernized, which enables significantly higher transfer speeds. Until the end of 2019, network modernization will be completed on the entire territory of the Republic of Croatia, and the network will be fully ready for the implementation of 5G. Pilot projects of 5G network testing (Zagreb, Samobor, Krk) in 3.5 GHz spectrum are ongoing in order to analyze 5G operation in real environment.

Additionally, Ericsson Nikola Tesla and Hrvatski Telekom continue to cooperate in the fields of fixed telecommunication network and delivery of services of telecommunication infrastructure rollout and maintenance.

With strategic partner A1 Hrvatska we continued long-term successful partnership by signing a frame agreement until the end of 2023 that encompasses radio network modernization and expansion.

This collaboration will enable for the users of A1 Hrvatska in all parts of Croatia to have an excellent user experience of services which are getting more and more data demanding. Based on Ericsson Radio System portfolio, A1 Hrvatska will have a flexible 5G-ready solution at its disposal.

With the mobile operator Tele2 we have contracted the delivery, implementation and support of solutions for data traffic shaping, which increases the average downlink speed per user. We have delivered the equipment for microwave transport network expansion and increased the capacity of database with 4G user information and continued to provide support services for voice core network.

In the field of ICT solutions for Industry & Society, activities continue on the project of upgrade of the Central Healthcare Information System of the Republic of Croatia (CEZIH), implementation and upgrade of the Joint Information System of Land Registry and Cadaster (JIS) and the implementation of the State Border Control project. We have delivered the IT Controlling System for Hospitals (CUS) to the Ministry of Healthcare, a system for automatic daily gathering of all health indicators and data analysis for all the hospital in Croatia.

With the Ministry of the Interior of the Republic of Croatia, in consortium with the company KING ICT, a frame agreement was signed for a three-year period, as well as a supply agreement for the year 2019 for the integration of 112-192 system and upgrade of the operations of the Operational and Communications Center (OKC) of the Ministry of the Interior.

With Croatian Health Insurance Fund (HZZO) we signed a project on creating a concept of exchanging „Patient Summary“ within the Connected Europe Facility (CEF).

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In export markets (excluding Ericsson market) sales revenue increased by 22% year-over-year to MHRK 187.4 (first nine months 2018: MHRK 153.6).

With HT Eronet we have continued successful cooperation by signing a frame agreement on expanding LTE network across Bosnia and Herzegovina. The contracted work relates to LTE network (800MHz and 1800 MHz), services of project management and integration of new nodes in the network, as well as training for the employees. As the radio system equipment is ready for 5G and IoT, HT Eronet will be able to transit smoothly to 5G technology. We continued a good cooperation with the operators Crnogorski Telekom (Montenegro), and IPKO (Kosovo) on modernization and maintenance of telecommunication networks. With the operator beCloud (Belarus), we continue the project of LTE network expansion (turn-key) in four regions (1800 MHz and 2600 MHz), and continue activities to win new deals.

The activities on the project of healthcare system informatization in Kazakhstan, in cooperation with the Ministry of Healthcare of the Republic of Kazakhstan, continue.

In Ericsson market, sales revenue amounted to MHRK 759.6 (first nine months 2018: MHRK 695.1), up by 9.3% year-over-year. The contribution of Ericsson Nikola Tesla Servisi d.o.o., a daughter company of Ericsson Nikola Tesla d.d., to the revenue in this market segment amounted to MHRK 140.5 (first nine months 2018: MHRK 129.2).

The projects of Research and Development Center are ongoing as planned in all domains. A regular half-yearly overview of our R&D's business performance was held in September with the representatives of all development and service organizations of Ericsson Corporation with which the Center is cooperating. According to evaluations, all key performance indicators were highly rated. The quality of performed activities, and the achieved results represent a good foundation for further business development.

Experts from Services and Solutions Center for Networks, along with projects for the customers of Ericsson Nikola Tesla Group, have worked on projects for Ericsson customers in Germany, Switzerland, Qatar, Saudi Arabia, Pakistan, South African Republic, Brazil, Mexico, etc. There is a great demand for Ericsson Nikola Tesla's experts by Ericsson global/regional organizations. Our experts are included in activities of integration and optimization of various technologies, with a higher focus on 5G in key markets (USA, Japan, China). We have continued to work on the development and implementation of software tools for mobile networks management and optimization.

Experts from Services and Solutions Center for Digital Services and Operations, along with working on projects for our customers, were engaged on projects for Ericsson customers in Austria, Belgium, Denmark, France, Greece, Italy, Ireland, Luxembourg, Germany, the Netherlands, Norway, Slovenia, Serbia, Sweden, Switzerland, United Kingdom, Qatar, Libya, Mexico, USA, etc. These activities include complex projects of introducing 5G technology, operational and business support systems, as well as numerous projects of introducing core solutions in Cloud.

The teams working in units for IT& Engineering Services, and Industry and Society segment are achieving quality results on projects of test environment management, IT operations management, IoT platforms, and Connected Urban Traffic.

We continue with the activities regarding innovations, and would like to highlight Ericsson Shark Tank event, where our experts participated with the idea „Crowdsourced user experience“, as the best innovative idea from the market area Europe and Latin America. Furthermore, within the framework of a global innovation competition, Ericsson Innovation Award, we have cooperated with students from the Faculty of Science in Split, Faculty of Electrical Engineering, Mechanical Engineering and Naval Architecture, and University Department of Marine Science on developing the idea „IntelliShell“, which was listed among top 15, out of 2000 ideas.

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Ericsson Nikola Tesla Servisi have been successfully delivering the services of monitoring, maintenance and rollout of telecommunication network of Hrvatski Telekom. In Q3 2019, the works on optical distribution networks have been intensified in order to secure broadband Internet for users.

Other information

Ericsson Nikola Tesla major shareholders (as at September 30, 2019)

	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
OTP banka d.d. / Erste Plavi mandatory pension fund, B category	56,013	4.21
Addiko Bank d.d. / PBZ Croatia mandatory pension fund, B category	16,810	1.26
PBZ d.d. / The Bank of New York as Custodian	12,338	0.93
Zagrebačka banka d.d. / State Street Bank and Trust Company, Boston	10,206	0.77
Zagrebačka banka d.d. / Unicredit Bank Austria AG – clients account	9,657	0.73
OTP banka d.d. /OTP Index fund - open-end alternative investment fund with public offering	9,225	0.69
PBZ d.d. / custodian client account	8,736	0.66
Addiko Bank d.d. / Raiffeisen voluntary pension fund	8,094	0.61
Other shareholders	423,584	31.81

Share price information in Q3 2019:

Highest (HRK)	Lowest (HRK)	Closing (HRK)	Market cap. (In MHRK)
1,205.00	1,100.00	1,185.00	1,578.01

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Ericsson Nikola Tesla d.d.
Krapinska 45
Zagreb

OIB: 84214771175

Pursuant to the Articles 462 to 468 of the Capital Market Law (Official Gazette 65/18) 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.

Unaudited financial statements for the period January 1, 2019 to September 30, 2019 present a true and fair view of the financial position of the Company and the Group and of the financial performance and 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 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 September 2019

	2019	2018
	HRK '000	HRK '000
Sales revenue	1,253,298	1,080,542
Cost of sales	-1,110,527	-947,370
Gross profit	142,771	133,172
Selling expenses	-30,083	-28,613
Administrative expenses	-22,829	-23,379
Other operating income	0	605
Other operating expenses	84	76
Operating profit	89,944	81,861
Finance expense/income – net	3,591	2,240
Profit before tax	93,535	84,101
Income tax	-12,778	-21,763
Profit for the year	80,757	62,338
Other comprehensive income	76	-71
Total comprehensive income for the year	80,833	62,267

Ericsson Nikola Tesla d.d.
Consolidated statement of financial position
as at 30 September 2019

	2019 HRK '000	2018 HRK '000
ASSETS		
Non-current assets		
Property, plant and equipment	110,162	114,654
Right-of-use assets	75,849	-
Intangible assets	4,529	5,070
Loans and receivables	53,698	51,657
Deferred tax assets	21,359	21,358
Total non-current assets	265,596	192,739
Current assets		
Inventories	187,051	110,695
Trade receivables	202,350	160,724
Contract assets	3,335	3,335
Receivables from related parties	95,727	109,900
Other receivables	9,314	14,170
Income tax receivable	200	472
Financial assets at fair value through profit or loss	50,745	48,490
Prepayments and accrued income	14,863	12,086
Cash and cash equivalents	107,079	187,888
Total current assets	670,664	647,760
TOTAL ASSETS	936,260	840,499
EQUITY AND LIABILITIES		
Equity		
Share capital	133,165	133,165
Treasury shares	-241	-241
Legal reserves	6,658	6,658
Retained earnings	152,512	165,396
Total equity	292,095	304,979
Non-current liabilities		
Borrowings	7,824	5,734
Lease liability	35,658	-
Employee benefits	8,912	8,662
Other non-current liabilities	6,825	6,520
Total non-current liabilities	59,218	20,916
Current liabilities		
Payables to related parties	78,328	33,306
Borrowings	1	36
Lease liability	23,460	-
Trade and other payables	183,243	178,908
Contract liabilities	173,481	171,645
Income tax payable	1,794	270
Provisions	15,079	16,023
Accrued charges and deferred revenue	109,562	114,416
Total current liabilities	584,947	514,604
Total liabilities	644,165	535,520
TOTAL EQUITY AND LIABILITIES	936,260	840,499

Ericsson Nikola Tesla d.d.
Consolidated statement of cash flows
for the period ended 30 September 2019

	2019	2018
	HRK '000	HRK '000
Cash flows from operating activities		
<i>Profit before tax</i>	93,535	84,101
Adjustments for:		
Depreciation and amortisation	46,578	26,491
Impairment losses and reversals	2,897	1,504
Net increase in provisions	25,933	26,949
Gain on sale of property, plant and equipment	-2,251	-51
Net loss/(gain) on remeasurement of financial assets	-368	1,009
Amortisation of discount	-910	-1,871
Interest income	-3,969	-1,960
Interest expense	1,246	214
Foreign exchange losses/(gains)	-1,957	-3,349
	<u>160,735</u>	<u>133,037</u>
<i>Changes in working capital</i>		
In receivables	-18,709	61,925
In inventories	-76,356	-124,434
In payables	22,082	-42,315
	<u>87,752</u>	<u>28,213</u>
<i>Cash generated from operations</i>	<u>87,752</u>	<u>28,213</u>
Interest paid	-1,312	-214
Income taxes paid	-405	-5,644
	<u>-1,717</u>	<u>-5,858</u>
Net cash from operating activities	86,035	22,355
Cash flows from investing activities		
Interest received	1,217	1,726
Dividends received	70	70
Proceeds from sale of property, plant and equipment	2,246	114
Purchases of property, plant and equipment, and intangible assets	-53,943	-26,739
Deposits given to financial institutions - net	-3,261	0
Purchases of financial assets at fair value through profit and loss	-2,027	15,989
	<u>-55,699</u>	<u>-8,841</u>
Net cash used in investing activities	-55,699	-8,841
Cash flows from financing activities		
Repayment of borrowings	-	770
Dividends paid	-94,000	-43,291
Lease liabilities	-17,662	-
	<u>-111,662</u>	<u>-42,521</u>
Net cash used in financing activities	-111,662	-42,520
Effects of exchange rate changes on cash and cash equivalents	516	-1,306
	<u>-80,809</u>	<u>-30,312</u>
Net decrease/(increase) in cash and cash equivalents	-80,809	-30,312
Cash and cash equivalents at the beginning of the year	187,888	159,261
Cash and cash equivalents at the end of the year	107,079	128,949