
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 2016.

Highlights:

- Sales revenue: MHRK **1,591.6**
- Gross margin: **11.9%**
- Operating income: MHRK **113.6**
- Income before tax: MHRK **118.8**
- Net profit: MHRK **110.7**
- Cash flow from operating activities: MHRK **187**
- Information on dividend proposal will be subsequently published

Gordana Kovačević, President of Ericsson Nikola Tesla, comments:

"In 2016 Ericsson Nikola Tesla Group continued with a series of its successful business years. Sales revenue increased by 16.7% year-over-year due to strong revenue growth in CIS market and continued growth of revenue in Ericsson market.

2016 will be remembered by signing of important contracts in export markets with three new customers: beCloud in Belarus, Ucom in Armenia and the Ministry of Healthcare in Kazakhstan. All three are very demanding projects regarding LTE technology and healthcare informatization. Furthermore, our Research and Development Center, Global and Regional Expert Centers for Services and Customer Solutions Centers received new responsibilities within the global corporation, which shows that the quality and added value that we deliver have been recognized by the corporation and among customers worldwide. In line with that, we continued to hire, employing 318 experts in 2016. We remain the largest Research and Development center in Croatia, currently employing more than 1200 people, while Ericsson Nikola Tesla Group has almost 3000 employees. We have kept our position of the largest Croatian ICT exporter, and the largest exporter of knowledge.

In Southeast Europe markets, sales revenue decreased due to negative economic trends and political turmoil, which slowed down operators' investments. Competition and pervasive trends of consolidation and centralization of sourcing processes by global customers/operators are main challenges on domestic market.

We are pleased to have kept strong position and customers' trust in Croatia and the region, above all by working with our traditional partners, such as: Vipnet, Hrvatski Telekom, HT Mostar, BH Telecom, Crnogorski Telekom and Ipko.

In the domestic market, I would like to highlight a surge in ICT Solutions for Industry & Society. Among key projects, we should mention continuing collaboration with the Ministry of Healthcare of the Republic of Croatia on implementing new functionalities, such as eHealth Record and Portal for Patients. We are proud of the Joint Information System of Land Registry and Cadaster project, which was fully realized at the end of the year, meaning that all land-registry and cadaster offices in Croatia have been connected in a single information system. One of the last signed projects in 2016 is a strategically important project in the field of public safety. It is the project of building the Republic of Croatia border control system, which was realized in record time in mid-January 2017. All these activities demonstrate that our Networked Society Strategy is not just a vision, but real projects changing the world we live in.

Our daughter company, Ericsson Nikola Tesla Servisi d.o.o., records solid business results. In the last two years, the company went through demanding transformation processes, whilst implementing complex network build and maintenance projects for Hrvatski Telekom.

Risk Management is very high on our list of priorities and is essential for sustainability of our business as a whole. In order to mitigate business, market and financial risks in the export business, we have successfully expanded cooperation with the Croatian Bank for Reconstruction and Development (HBOR) and commercial banks. In this way, we have met our customers' needs for financing and, at the same time, significantly reduced our exposure to long term receivables.

Financial performance continues to be very strong. Operating profit increased by 24.3% year-over-year while net profit increased by 21.2% year-over-year. Gross margin continues to be under pressure due to business mix, continuous price pressure and challenging projects on export markets. Our continuous focus on cost control through Cost Efficiency and Operational Excellence program has brought good savings. Sales and administrative costs decreased by 5.5% year-over-year. A solid cash flow of MHRK 187 was realized from operating activities, which allowed the total cash funds, including short term financial assets, to remain on the same level as the previous year, amounting to MHRK 287.7. The working capital efficiency, measured by the performance indicator Working Capital Days (WCD) further improved to 26 days. Cash conversion rate is at high 97%.

We achieved excellent business results, primarily due to professionalism and knowledge of our leaders and employees, which is increasingly being recognized as the key differentiator in the market. A high level of customer satisfaction was confirmed once again by annual survey of our largest customers/partners. The opening of innovation incubator "Ericsson Garage Croatia", made ours one of the eight global sites for agile and quick customer oriented innovations.

Digital transformation is becoming our reality. Those who want to develop their business, irrespective of their business field, use ICT as the foundation to achieve their competitive advantages. Our numerous customers in Croatia and the region, as well as globally, are embarking on digital transformation projects. In the operator segment, these are primarily telecom network virtualization projects and implementation of Cloud solutions. Special emphasis here is on OSS and BSS transformation, which entails changes in their organizations, as well as in their market and end user approach.

We live in the digital revolution age, in which ICT fundamentally changes our way of working, living and doing business. Big transformation processes are happening in the entire corporation, including our company. I believe that the results we achieved in 2016, as well as our ongoing strategic transformation processes, represent a quality and sound foundation for the Company's future development. “

Financial highlights for the Group:

- Sales revenue amounts to MHRK 1,591.6 (2015: MHRK 1,364.3), 16.7% increase year-over-year. Of the total sales revenue, the domestic market accounts for 16.9%, services to Ericsson account for 54.8% (of which 11.5% relates to managed services in Croatia), while other export markets participate with 28.3%.
- Sales in the network segment amounts to MHRK 776.5 (48.8% of the total sales revenue), services segment amounts to MHRK 779.2 (48.9% of the total sales revenue), and support solutions segment accounts for MHRK 35.9 (2.3% of the total sales revenue).
- Gross profit amounts to MHRK 189.8 (2015: MHRK 177.2), an increase by 7.1% year-over-year. Gross margin decreased to 11.9% (2015: 13%) due to change in business mix, continued price pressure and demanding projects in export markets.
- Sales and administrative costs decreased by 5.5% to MHRK 77.7 (2015: MHRK 82.2).
- Operating profit increased by 24.3% and amounts to MHRK 113.6 (2015: MHRK 91.4).
- Profit from financial activities has significantly increased year-over-year, and amounts to MHRK 5.2 (2015: MHRK 1.6), as a result of financial assets revaluation and positive currency deviations effect.
- Profit before tax increased by 27.9% to MHRK 118.8 (2015: MHRK 92.9). The remaining accumulated tax reliefs from R&D projects have been completely used in 2016. Income tax accrued at MHRK 8.1 (2015: MHRK 1.6) comprises current income tax charge of HRK 22.3 million (2015: MHRK 1.6) which is partially offset by deferred income tax recognized in the amount of MHRK 14.2 (2015: HRK nil).
- Net profit increased by 21.2% year-over-year and amounts to MHRK 110.7 (2015: MHRK 91.3). ROS is 7% (2015: 6.7%).
- Cash flow from operating activities is at solid MHRK 187 (2015: MHRK 243.1) due to good collection of trade receivables especially in Q4. The cash conversion rate is at 97% (2015: 153%), while WCD is 26 days (2015: 32 days).

- Total cash and cash equivalents, including short term financial assets, as at December 31, 2016 amount to MHRK 287.7 (35.6% of the total assets), while at the end of 2015 amounted to MHRK 287.1 (39.7% of the total assets).
- The Group has a lean balance sheet with total assets of MHRK 808.1 (2015: MHRK 723.9), 11.6% increase year-over-year, as a result of increased trade receivables. Equity ratio is 35.5% (2015: 42.5%).
- With related parties, the transactions were as follows: sales of products and services amounted to MHRK 894.9 (2015: MHRK 868.5), while procurement of products and services amounted to MHRK 396.9 (2015: MHRK 253.3).
- As at December 31, 2016, balances outstanding with related parties were as follows: receivables amounted to MHRK 90.9 (end of 2015: MHRK 117.0), and payables MHRK 89.3 (end of 2015: MHRK 52.7).

Business situation in major markets

In the domestic market sales revenue amounted to MHRK 268.8 (2015: MHRK 293.5), which is a decrease by 8.4% 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 the increase of the capacity of 3G and 4G technologies. In Q1, the first Radio Dot system was successfully integrated into Vipnet's commercial network, thus increasing the service quality and end-user experience, to the level which is globally considered to be one of the best. The testing of new functionalities, contributing to increased quality and new services for end users in various areas of core and access network, is ongoing.

Business cooperation with Hrvatski Telekom (HT) was expanded in the segment of fixed telecommunication network modernization by delivering solutions for IP access network and transport network. Activities in the area of Managed Services, that is, the build and maintenance services of telecommunications infrastructure have been intensified. Preparation activities related to identification and realization of future HT Group (HT, Iskon, Optima) projects have been completed.

With the mobile operator Tele 2 we worked on software support improvements, core network modernization as well as transport network upgrade in the microwave and fiber optic segment. Furthermore, we provided support and maintenance services for the entire telecommunication network. Business volume decrease year-over-year as a result of another vendor selection for telecom network modernization.

In the segment of ICT solutions for Industry & Society, there is a continuation of numerous activities in the healthcare informatization and joint information system for land registry and cadaster. In Q4, a strategically important contract was signed with the Ministry of Interior of the Republic of Croatia, regarding the delivery of the state border control system.

In export markets (the Ericsson market excluded) sales revenue amounted to MHRK 450.4 (2015: MHRK 249.4), 80.6% increase year-over-year.

In the markets of Southeast Europe (Bosnia and Herzegovina, Montenegro and Kosovo) sales revenue amounted to MHRK 149.3 (2015: MHRK 176.7), 15.5% decrease year-over-year. Slow economic development and political uncertainty have affected the level and the dynamics of operators' investments.

In Bosnia and Herzegovina, we continued providing technical support for BH Telecom mobile and fixed network maintenance. With the operator, HT Mostar, we worked on fixed and mobile network modernization, with an emphasis on broadband Internet access. In Q4, with HT Mostar, further 3G network expansion was agreed, which will enable better coverage and network capacity.

In Montenegro, a frame agreement was signed with Crnogorski Telekom regarding a new investment cycle in radio access network and mobile core network until the end of 2018. Within the agreement, at the end of 2016, the state of the art technology LTE Advanced 3CA (*Three-Carrier Aggregation*) was commissioned.

In Kosovo, with the operator IPKO, we continued the collaboration on radio access and microwave network modernization and expansion, with an emphasis on mobile broadband expansion, based on LTE technology. We have also signed agreements on the modernization of this operator's core network, thus creating conditions for the introduction of new services based on IP technology.

In CIS market, sales revenue increased by 314.7% year-over-year, amounting to MHRK 301.1 (2015: MHRK 72.6). Our investments in new solutions development, as well as strong marketing and sales activities resulted in several significant contracts in operators and eHealth segments.

With Moldova operator IDC, a contract comprising the LTE network construction was signed. After successful implementation of packet core network, the activities on LTE network build, including corresponding services and necessary software upgrades are ongoing. This project includes swap of the existing LTE commercial network of another vendor with Ericsson network, with the addition of new functionalities.

In cooperation with Belarussian company beCloud, LTE technology was commissioned in all regional centers of the Republic of Belarus. The plan is to cover all densely-populated cities with LTE by the end of 2017. In the capital city of Armenia, Yerevan, in cooperation with the operator Ucom, an advanced LTE network based on Ericsson multi-standard radio equipment and Antenna Integrated Radio (AIR) system was commissioned.

The implementation of strategically important contract on the healthcare system informatization of the Republic of Kazakhstan is ongoing. This contract will enable the Ministry of Healthcare of the Republic of Kazakhstan and related healthcare institutions to introduce international standards and to support key reforms of healthcare sector. Within the contract, National Electronic Health Record System and Business Intelligence System will be designed.

In the [Ericsson market](#), sales revenue amounted to MHRK 872.4 (2015: MHRK 821.4), an increase by 6.2% year-over-year.

In Ericsson Nikola Tesla Research & Development Center (R&D) the jobs related to application and platform software development for radio systems within the Radio Development Unit have been expanded. Respectively, hiring and competence development of new experts is ongoing. Activities within the development units Mobile Core, User Data Management and Cloud are ongoing as planned.

Research projects related to virtualization and Big Data processing continue. A significant focus is placed on developing network function virtualization, with the aim of enabling new solutions on Cloud platform. Ericsson Nikola Tesla's new innovation cycle was supported.

At the end of 2016, Ericsson Garage Croatia was officially opened, acting as an incubator for innovations in the areas related to our current research and sales segments. It was designed to respond to a wide range of projects - from spontaneous ideas to big concepts.

Service and Solutions Delivery Center experts have been engaged in numerous projects for the customers worldwide, such as: BASE Belgium, China Telecom China, China Unicom, DIGI Hungary, Deutsche Telekom Group, Irancell Iran, KPN Netherlands, MTN Iran, POST Luxembourg, Robi Bangladesh, Swisscom Switzerland, Tango Luxembourg, Telefonica Germany, Telekom Austria Group, Telekom Slovenije, Turk Telekom Turkey, Vodafone Netherlands, Vodafone United Kingdom and Vimpelcom Russia. These are complex expert activities in defining and creating new solutions, analyzing existing networks and providing consulting support in optimization and upgrade of tools and functionalities in convergent communication networks.

Furthermore, we are positioned as the leading center in the Region Western and Central Europe for all services and solutions in the Cloud domain.

There is substantive engagement in the development and implementation of software tools for mobile network management and optimization such as: Smart Laptop, Smart Rollout Support, Rehoming Automation Management Tool, Radio Network Proposal Tool, Ericsson Network Engineer, and Extended Support Request.

The contribution of Ericsson Nikola Tesla Servisi to revenue in this market segment amounts to MHRK 182.7 (2015: MHRK 181.8). We would like to highlight some of the key goals and business results towards Hrvatski Telekom during Q4:

- fulfilling the goal of developing and building optical networks (*Fibre to the Home and Fibre to the Cabinet*), as well as preparation for continuation of project in 2017;
- successful project realization regarding mobile broadband access capacity and coverage expansion;
- additional engagement on the program to accelerate the realization of customer service request (so called small projects), with the aim to additionally reduce the total number of open requests and improve satisfaction of Hrvatski Telekom end users;
- providing a greater level of service quality of management, monitoring and maintenance of Hrvatski Telekom fixed and mobile network, in line with the results of the key network performance indicators.

Activities towards other customers in Europe in the area of radio access network modernization, as well as design and fiber optic network build, continues.

Other information

Ericsson Nikola Tesla's major shareholders (as at December 31, 2016)

	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
Societe Generale-Splitska banka d.d. / Erste Plavi Mandatory Pension Fund, B category	41,890	3.15
Addiko bank d.d. / PBZ Croatia osiguranje Mandatory Pension Fund, B category	22,627	1.70
PBZ d.d. / The Bank of New York as custodian	18,569	1.39
Zagrebačka banka d.d. / Custodian client account for Unicredit Bank Austria AG	17,230	1.29
Zagrebačka banka d.d. / State Street Bank and Trust Company, Boston	13,935	1.05
Addiko bank d.d. / Raiffeisen Voluntary Pension Fund	7,934	0.60
PBZ d.d. / Custodian client account	7,376	0.55
PBZ d.d. / State Street client account	6,256	0.47
Other shareholders	418,846	31.45

Information on share price in 2016:

Highest (HRK)	Lowest (HRK)	Closing (HRK)	Market cap. (in MHRK)
1,177.99	940.00	1,164.00	1,550.0

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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:

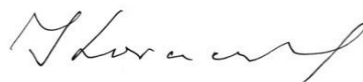
Statement of the Management Board responsibility

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 2016 to 31 Dec 2016 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



PRESS INFO

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