
ANNUAL REPORT ON GROUP PERFORMANCE Gordana Kovačević,
President of Ericsson Nikola Tesla d.d.

Dear readers,

Information Communication Technology (ICT) continues to contribute to transformation processes in our society more strongly and rapidly than ever. The digital economy, digital society and digital transformation have become common topics for discussion. Digitalization has become the synonym for development, and the Networked Society's potential lies in transformation, primarily through mobility. In its business strategy, Ericsson recognized not only the importance of technological development, but also the need to use it to benefit society at large.

DIGITAL TRANSFORMATION IS GAINING SPEED

The digital infrastructure of modern society implies constant investment in research and development, fast implementation of the fifth generation of mobile networks (5G), connecting everything that benefits from being connected (Internet of things - IoT), and using a large number of data present in digital space (Big Data). The above mentioned infrastructure is the technological foundation required, but it is not the only prerequisite for the Networked Society we are building. More precisely, it is important to combine technology leadership with motivated and creative experts who responsibly contribute to mutual goals.

Ericsson Nikola Tesla Group takes an active part in the technological development and is a relevant partner in the digital transformation of society through innovative ICT products, solutions and services. We apply the highest global standards in our day to day operations, as well as the principles of corporate governance and responsibility. Our sustainable development is based on sound relations, trust and collaboration among all our stakeholders (customers/partners, employees, society and shareholders).

BUSINESS SITUATION IN MAJOR MARKETS

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

2016 will be particularly remembered by our 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 demanding projects in the areas of LTE technology and healthcare digitalization. We also continued our collaboration with the operator IDC (Moldova) by signing a contract for LTE network build.

The quality and added value that we deliver have been recognized by the Ericsson Corporation and customers worldwide as demonstrated by newly gained responsibilities in the global organization for our Research and Development Center and the Global and Regional Expert Centers for solutions and services. In line with that, we added 318 experts during 2016. We remain the largest R&D center in Croatia, currently employing over 1200 employees, while Ericsson Nikola Tesla Group has almost 3000 employees. We retained the position as the largest ICT exporter and are surely the largest exporter of knowledge in Croatia.

In the markets of Southeastern Europe, we recorded a decrease in sales revenue, due to negative economic trends and political turmoil slowing down operators' investment dynamics. The main challenges we face in the domestic market are consolidation and centralization of procurement by global customers/operators, postponed strategic investments and growing competition.

I am pleased that we have kept our strong position and our customers' trust in Croatia and the region during 2016, primarily by continuing quality collaboration with our traditional partners, such as Vipnet, Hrvatski Telekom (HT), HT Mostar, BH Telecom, Crnogorski Telekom and Ipko.

Furthermore, I would like to highlight the growth in the business segment ICT Solutions for Industry & Society in the domestic market. Among key projects in this area, we should mention the continuing activities with the Ministry of Healthcare of the Republic of Croatia on implementing new functionalities, such as eHealth Record and the Portal for Patients. We are proud of the Joint Information System of Land Registry and Cadaster project, which was fully



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implemented at the end of 2016, connecting all land-registry and cadaster offices in Croatia into a single information system. A strategically important project in the public safety area was among the last projects that we signed for at the close of 2016. The project concerned the building of the state border control system of the Republic of Croatia and was completed in record time in mid-January 2017.

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

Risk Management is one of our key priorities, and we consider it an important element of stability of our operations. 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 meet our customers' needs for financing and, at the same time, significantly reduce long-term receivables.

Taking into consideration the above mentioned, we estimate that the Group's main business risks are:

- Impacts of the challenging economic environment and political uncertainty on demand and prices of our products and services
- Reduction and slowdown in operators' capital investments, as well as postponing of strategic investments in the public and private sectors
- Industry convergence and consolidation among suppliers of equipment and services
- Increased competition and new IT companies entering telecommunication market
- Business mix impact on gross margin
- Increased credit and commercial risk exposure in case of deterioration of our customers' financial conditions
- Increased demand for customer financing
- Negative foreign exchange impact on business results given the greater part of our revenue is generated in EUR and USD

- Retaining of highly qualified/top performing employees in order to stay competitive.

KEY PERFORMANCE INDICATORS

Ericsson Nikola Tesla Group business results are as follows (the information in brackets refers to 2015):

- Sales revenue is MHRK 1,591.6 (MHRK 1,364.3), an increase by 16.7% YoY
- Gross profit amounts to MHRK 189.8 (MHRK 177.2), an increase by 7.1% YoY. Gross margin records a slight decrease to 11.9% (13%).
- Sales and administrative costs decreased by 5.5% to MHRK 77.7 (MHRK 82.2).
- Operating profit increased by 24.3% to MHRK 113.6 (MHRK 91.4).
- Net profit increased by 21.2% YoY to MHRK 110.7 (MHRK 91.3).
- Return on Sales (ROS) is 7% (6.7%).
- Cash flow from operating activities is MHRK 187 (MHRK 243.1).

Strong business results were achieved in 2016 primarily due to professionalism and knowledge of our leaders and experts, which is increasingly being recognized as our competitive advantage. A high level of satisfaction among our largest customers/partners was confirmed yet again by our annual survey.

All other key performance indicators grouped in four Scorecard perspectives (Customer, Employee, Society and Shareholder) were excellent.

By opening of the innovation incubator “Ericsson Garage Croatia”, we became one of several global sites for agile and fast innovations oriented towards the needs of both existing and new customers.

STRATEGIC DIRECTION

All business entities, irrespective of industry they belong to, use ICT as their basic infrastructure. Our customers in Croatia, 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. In these projects a special focus is placed on Operations Support Systems (OSS) and Business Support Systems (BSS) transformation, which results in organizational efficiency, as well as in new market and end user approaches.

In the course of 2016, we have started a new strategic planning cycle for the period up to 2019, based on facts that describe the current status in all business and technology segments and on analysis of future trends in the ICT market. Our aim is to strengthen business performance in strategic segments through transformation programs (4G/5G, Managed Services, OSS and BSS, Cloud solutions, Industry & Society) and the Ericsson's internal market. Risk management, effective cost management and efficiency have important roles in our strategy.

Significant transformation is taking place throughout the Ericsson Corporation, our company included. I believe that the results we achieved in 2016, as well as our ongoing strategic transformation initiatives, represent a strong and vital foundation for the Company's future development.

All other data comprising the annual company report pursuant to Article 250a of the Companies Act can be found in the enclosed 2016 Annual Report, consisting of the General Report, the Social Report and Consolidated Financial Statements as at December 31, 2016.

Gordana Kovačević



President

Ericsson Nikola Tesla d.d.

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