

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 2018

Highlights:

- Sales revenue: MHRK **1,080.5**
- Gross margin: **12.3 %**
- Operating profit: MHRK **81.9**
- Profit before tax: MHRK **84.1**
- Net profit: MHRK **62.3**
- Cash flow from operating activities: MHRK **22.4**

Gordana Kovačević, the President of Ericsson Nikola Tesla commented:

“In the first nine months of 2018, Ericsson Nikola Tesla Group sales revenue amounted to MHRK 1,080.5, up by 1% year-over-year. Increased investments in mobile networks modernization and digital transformation have enabled a strong sales growth in the domestic market. In addition to operators’ segment, we also recorded good results in Industry & Society segment. Export markets showed lower sales revenue affected primarily by the ramping down of network modernization projects and challenges related to political and economic situation. Opposed to the sales decline in export markets, Ericsson internal market once again recorded a solid growth and contributed to the stability of financial performance.

We are proud that our experts, together with colleagues from global Ericsson, create technologies that provide opportunities for personal growth and development to individuals, and open new opportunities for globally competitive development to industry and society. Globally, Ericsson collaborates with key partners to enable 5G mobile networks that will offer higher data transfer rates, facilitating services such as 4K/8K video content, solutions based on augmented and virtual reality to end-users. Low network latency and faster data transfer will also enable various industry segments to reduce costs through automation, remote control and Artificial Intelligence in Cloud.

Ericsson Nikola Tesla follows global trends, and this March at the Company’s headquarters we were the first in Croatia to demonstrate the possibilities of 5G technology. During summer, we supported leading Croatian operators in their 5G demos in real environment, focusing on end-user services. Furthermore, we have extended our research and development activities, and opened an office in Osijek where approximately thirty employees work on development of 4G and 5G mobile communications. Further employment and expansion of responsibilities is planned.

We also marked the 18th anniversary of Ericsson Nikola Tesla’s Summer Camp, which confirms that over the years, numerous young experts have recognized Ericsson Nikola Tesla as a company that offers both advanced technologies and the possibility for career development. From the very beginning, when we initiated Summer Camp in cooperation with the Faculty of Electrical Engineering and Computing of the University of Zagreb, our goal has

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been to enable graduate students to gain their first work experience by working on interesting projects where their talent and innovativeness are recognized. Students from different faculties from Zagreb, Split, Osijek, Rijeka, and neighboring countries participated in this year's Summer Camp and with the help of their mentors worked in teams on projects related to the Internet of Things (IoT), 5G technology, machine learning, radio networks, and R&D tools.

According to the Croatian national report of the recently finished European LIFE Clim'Foot project, Ericsson Nikola Tesla is the only private company in Croatia that calculated its carbon footprint and based on that analysis created a corresponding plan to reduce the Company's impact on the environment and has already undertaken a range of activities. Thus, the Company has started an energy efficiency improvement project co-financed by European Union under the operational program "Competitiveness and cohesion 2014 – 2020".

In terms of financial results, gross profit is up by 4.3%, while operating profit increased by 16.2%, due to slightly increased sales revenue and gross margin, lower sales and administrative costs and less impact of currency deviations compared to the first nine months of the previous year. Net profit rose by 20.2% to MHRK 62.3. End of Q3 was concluded with a lean balance sheet and an equity ratio of 30%. A positive cash flow from operating activities was achieved due to proactive collection of customer receivables. At the end of Q3, total cash and cash equivalents, including short-term financial assets, amounted to MHRK 197.5. Working capital efficiency remained strong, and expressed in Working Capital Days (WCD), was 30. Cash conversion rate was 17%.

In Q3 we have initiated a new strategic planning cycle for the period until 2023, based on continuous analysis of the situation on all relevant markets and projections of ICT industry trends. We remain focused on the following strategic segments: 4G/5G mobile solutions, digital transformation solutions, Managed Services, and solutions in the Industry & Society segment. Furthermore, our strategic focus is placed on gaining new responsibilities and projects and strengthening competitiveness on the global Ericsson market. Our goal is to keep the position as a quality Ericsson center, by efficient service delivery based on key competencies, automation, and advanced solutions for analysis and network management.

In response to challenging market environment, we closely cooperate with customers, adapt our organization and ways of working, and invest in competence development and our technology leadership with a focus on 5G. We stay focused on cost and operating efficiency, capital efficiency and risk management to strengthen the already solid financial foundation of the Company."

Financial Highlights for the Group:

- Sales revenue amounted to MHRK 1,080.5 (first nine months 2017: MHRK 1,069.4), up by 1% year-over-year. Of the total sales revenue, domestic market accounted for 21.5%, services to Ericsson accounted for 64.3% (of which 12.0% related to Managed Services in Croatia), while other export markets accounted for 14.2%.
- Sales in the Networks segment amounted to MHRK 651.7 (first nine months 2017: MHRK 536.6), Digital Services accounted for MHRK 299.5 (first nine months 2017: MHRK 401.7), Managed Services amounted to MHRK 128.6 (first nine months 2017: MHRK 129.2), and the segment Emerging Business and Other amounted to MHRK 0.7 (first nine months 2017: MHRK 1.9).
- Gross profit amounted to MHRK 133.2 (first nine months 2017: MHRK 127.6), up by 4.3% year-over-year. Gross margin increased to 12.3% (first nine months 2017: 11.9%).
- Sales and administrative costs were 14.6% lower year-over-year and amounted to MHRK 52 (first nine months 2017: MHRK 60.9).

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- Operating profit amounted to MHRK 81.9 (first nine months 2017: MHRK 70.4), up by 16.2% year-over-year.
- Gain from financial activities amounted to MHRK 2.2 (first nine months 2017: loss from financial activities was MHRK -2.6).
- Profit before tax increased by 24% year-over-year to MHRK 84.1 (first nine months 2017: MHRK 67.8).
- Net profit was 20.2% higher year-over-year and amounted to MHRK 62.3 (first nine months 2017: MHRK 51.9). Return on Sales (ROS) was 5.8% (first nine months 2017: 4.9%).
- Cash flow from operating activities amounted to MHRK 22.4 (first nine months 2017: MHRK 39). Despite proactive collection of receivables from customers, cash flow from operating activities is lower due to higher inventory in connection with the ongoing networks modernization projects. Cash conversion rate was 17 % (first nine months 2017: 31%).
- Total cash and cash equivalents, including short term financial assets, as at 30 September 2018 amounted to MHRK 197.5 (23.4% of the total assets), while at the end of 2017, it amounted to MHRK 243.8 (29.7% of the total assets).
- As at September 30, 2018, the Company had a lean balance sheet with total assets of MHRK 844.5, 2.7% higher compared to end-2017. The level of inventory significantly increased primarily as a result of ongoing network modernization projects, while other assets are lower compared to end-2017. Equity ratio amounted to 30% (end-2017: 28.7%).
- With related parties, the transactions were as follows: sales of products and services amounted to MHRK 707.7 (first nine months 2017: MHRK 667.0), while procurement of products and services amounted to MHRK 255.7 (first nine months 2017: MHRK 184.8).
- As at 30 September 2018 balances outstanding with related parties were as follows: receivables amounted to MHRK 108 (end of 2017: MHRK 105.6), and payables to MHRK 98.1 (end of 2017: MHRK 124.4).
- It is estimated that the effects of the adoption of International Financial Reporting Standards, IFRS 15 and IFRS 9, effective for reporting periods as of January 1, 2018, will not significantly affect the retained or current earnings of the Company in relation to previous years. The cumulative effect of the adoption is recognized in retained earnings as at January 1, 2018 and the comparative data will not be restated.

Business situation in major markets

In the domestic market sales revenue amounted to MHRK 231.8, up by 27.1% year-over-year.

With strategic partner A1 Hrvatska, we continue to cooperate on implementing a multi-year frame agreement that encompasses modernization and expansion of radio access network by using the latest products from Ericsson's portfolio. Furthermore, this July in Zagreb, with the use of Ericsson equipment, A1 demonstrated fully functional 5G technology by achieving data transfer speeds faster than 20Gbit/s in real environment. At the same time, along with record-breaking data transfer speeds, 4 demos were held showing how the upcoming 5G technology will make the life of citizens easier in the field of medicine, traffic, gaming, and video streaming.

The collaboration in the field of transport telecom network and core network continues, which contributes to increased quality and new services for end-users.

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With the operator Hrvatski Telekom (HT), the activities on radio access network modernization in Zagreb are ongoing. HT plans to upgrade radio access network on the entire territory of the Republic of Croatia by the end of 2019. The project encompasses modernization of infrastructure, transport capacities and radio equipment. The first step has already been achieved in Istria by replacing all the existing base stations with 5G compatible base stations. A public demo of 5G functionalities in real environment on the first 5G equipment at the 3.5 GHz frequency spectrum was held in mid-July in Pula. HT has thus demonstrated realistic possibilities of 5G technology expected in Croatia in 2020.

Furthermore, business cooperation in the segment of fixed telecommunication network modernization, and the delivery of telecommunication infrastructure build and maintenance services continues.

With the mobile operator Tele2, we have been working on increasing the voice core network capacity and have contracted the expansion of microwave transport network. Furthermore, we have continued to provide support services for voice core network.

In the segment of ICT solutions for Industry & Society, activities on the implementation and upgrade of the Joint Information System for Land Registry and Cadaster are ongoing. Additionally, during Q3 a contract was signed with the State Geodetic Administration encompassing the service of developing an application solution and implementing a system of cadaster of infrastructure (HR-KI) and One Stop Shop.

In export markets (except Ericsson market) sales revenue amounted to MHRK 153.5, down by 28.4% year-over-year.

In the markets of Southeast Europe (Bosnia and Herzegovina, Montenegro and Kosovo) sales revenue amounted to MHRK 84.4, down by 13% year-over-year. Currently, there are challenges in Bosnia and Herzegovina due to unfavorable economic and political situation. Results achieved on other markets are in line with plans. We would like to highlight the continuation of good cooperation with the operators HT Mostar, Crnogorski Telekom and Ipko on modernization and maintenance of telecommunication networks.

In CIS market, sales revenue amounted to MHRK 69.1, down by 41.2% year-over-year due to fewer new network modernization projects. The main activities are related to LTE network build for the operators beCloud in Belarus and IDC in Moldova. Furthermore, the activities on a complex project of healthcare system informatization in Kazakhstan, in cooperation with the Ministry of Healthcare of the Republic of Kazakhstan, are ongoing. We are also focused on marketing and sales activities with the existing and new customers.

In Ericsson market sales revenue amounted to MHRK 695.2, an increase by 3.4% year-over-year. The contribution of Ericsson Nikola Tesla Servisi d.o.o., a daughter company of Ericsson Nikola Tesla d.d., to revenue in this market segment amounted to MHRK 129.2 (first nine months 2017: MHRK 128.7).

Ericsson Nikola Tesla's R&D Center remains focused on expansion of responsibilities for the development of 5G network systems, strengthening competencies and technology transfer. Over the years, the fastest growing activities and responsibilities have been related to radio development, on 3G/4G/5G projects that are important to Ericsson's strategic plans within the Networks segment. In the segment of User Data Management, we successfully continue working on the development of telecommunication nodes. Currently, transfer of responsibilities for UDM network integration and verification is ongoing. In Development Unit Cloud, we are working on the verification and quality control of HDS products and NFVi solutions. Our experts are also working on virtualization projects for MSC (Mobile Switching Centre) for numerous customers, such as: A1 Slovenia, Vodafone Czech Republic, Sprint IoT USA, TIM Italy, O2 United Kingdom, Alfa MIC1 Lebanon, etc.

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Moreover, the representatives of Ericsson's units that collaborate with our R&D Center (members of the so-called Operative Steering Group) have once again highly evaluated the work of our R&D Center at the meeting held in September. This is a result of our employees' engagement in all business segments, innovativeness and good R&D's strategic positioning, as well as continuous and dedicated team work.

Within Ericsson ONE, a global innovation platform, we continue to work on projects in Segments of Analytics and IoT, with the aim to secure new business growth areas.

Services and Solutions Center for Networks & Media have been engaged in projects for the customers worldwide: A1 Telekom Austria Group, LIGI Group, Swisscom Switzerland, Vodafone Netherlands. These are complex activities in the field of expert analysis, creating new innovative solutions, optimizing and upgrading the existing networks, and consulting. We continued to work on the development and implementation of software tools for mobile networks management and optimization.

Services and Solutions Center for Digital Services was engaged in various projects for the customers, such as: A1 Slovenia, British Telecom UK, Deutsche Telekom Germany, DoCoMo Japan, EURO Information Telecom France, KDDI Japan, KPN Netherlands, Melita Malta, Ogero Lebanon, Post Luxembourg, Swisscom Switzerland, Telekom Slovenije, Slovak Telekom, TIM Italy, Telefonica Spain, Telenor Hungary, Veon Russia, Vodafone Netherlands, Turkcell Turkey, Wind Italy and Wind Greece. The projects include design, network applications, cloud infrastructure, and digital business systems.

Ericsson Nikola Tesla Servisi successfully realized the services of monitoring, maintenance and build of the telecommunication network of HT. The activities on mobile infrastructure modernization and projects regarding fixed infrastructure are ongoing.

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Other information

Ericsson Nikola Tesla major shareholders (as at September 30, 2018)

	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	42,453	3.19
Addiko Bank d.d. / PBZ Croatia osiguranje mandatory pension fund, B category	16,810	1.26
Zagrebačka banka d.d. / Unicredit Bank Austria AG – clients account	15,828	1.19
PBZ d.d. / The Bank of New York as Custodian	14,427	1.08
Zagrebačka banka d.d. / State Street and Trust Company, Boston	13,050	0.98
PBZ d.d. / custodian client account	9,826	0.74
Splitska banka d.d. /OTP Index fund - open-end alternative investment fund with public offering	8,412	0.63
Addiko Bank d.d. / Raiffeisen voluntary pension fund	7,934	0.60
Other shareholders	425,923	31.98

Share price information in Q3 2018:

Highest (HRK)	Lowest (HRK)	Closing (HRK)	Market cap. (In MHRK)
1,095.00	1,010.00	1,045.00	1,391.57

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Ericsson Nikola Tesla d.d.
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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 Jan 1, 2018 to Sep 30, 2018 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>