

# 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 2018

## Highlights:

- Sales revenue: MHRK **1,558.2**
- Gross margin: **10.4 %**
- Operating profit: MHRK **118.3**
- Profit before tax: MHRK **120.6**
- Net profit: MHRK **113.6**
- Cash flow from operating activities: MHRK **75.2**

Gordana Kovačević, the President of Ericsson Nikola Tesla commented:

“Ericsson Nikola Tesla Group sales revenue in 2018 amounted to MHRK 1,558.2, up by 5.2 percent year-over-year, despite a very demanding business year. Other key performance indicators also showed growth. Domestic market recorded a significant growth in sales revenue due to operators’ investment in mobile networks modernization and digital transformation projects. Export markets recorded lower sales revenue affected primarily by the ramping down of network modernization projects and challenging economic and political environments in some markets. Ericsson market continuously records solid growth and contributes to the overall stability of financial performance. Export accounts for 65% of the Group’s total sales revenue.

In terms of business and technology, last year was dynamic, full of challenges and important achievements. In 2018, ICT Industry strongly focused on mobile networks modernization and preparation for the upcoming 5G technology, revealing a trend that will intensify in the period to come. In line with global trends and domestic market demands, in March 2018, we were the first in Croatia to demonstrate the possibilities of 5G technology, only a month after the global presentation at the Mobile World Congress in Barcelona. Furthermore, during summer we supported the leading Croatian operators, Hrvatski Telekom and A1 Hrvatska in their 5G demos in real environment, focusing on end-user services. In non-operator segment, we continued to cooperate with numerous customers in state administration bodies, primarily in the area of eHealth, land registry and cadaster, and on the implementation of the state border control project.

In the markets of Southeast Europe, our continuous focus on customer requirements resulted in several new agreements in the operator segment, primarily related to modernization and maintenance of the radio network. I would like to highlight the continuation of good cooperation with the operators HT Mostar, Crnogorski Telekom, and Ipko. Furthermore, we opened an office in Mostar, to provide more efficient customer support, and signed an agreement with the University of Mostar on collaboration in ICT and R&D segment.

In the market of the Commonwealth of Independent States, the project of healthcare system informatization in Kazakhstan stands out by its significance and business impact. In 2018, we delivered the latest eHealth software solution aimed at modernization of the healthcare sector, and we continue to work with the Ministry of Healthcare

## PRESS INFO

February 20, 2019



of the Republic of Kazakhstan on Electronic Health Passport pilot project. In operator segment, I would like to highlight the activities on mobile networks build and modernization with beCloud (Belarus), Ucom (Armenia), and IDC (Moldova).

Ericsson market shows a continuous growth. Ericsson Nikola Tesla's R&D Center currently employs approximately 1,400 out of total 3,200 Group's employees and is the largest R&D Center in Croatia. The Center is focused on expanding responsibilities in the field of 5G, competencies development, and technology transfer. Over the years, the largest increase in activities and responsibilities was recorded in the radio segment on the development of 3G/4G/5G functionalities which are important for Ericsson's strategic plans within the Networks segment. In 2018, along with extension of our R&D activities in Zagreb and Split, we opened an office in Osijek, which is in line with our gaining of new responsibilities for global Ericsson. Owing to R&D activities, as well as expert centers for Networks and Digital services, Ericsson Nikola Tesla has been Croatia's leading exporter of knowledge for many years.

Apart from marketing and R&D activities, Ericsson Nikola Tesla fosters long term cooperation with universities and the academia, with the aim to raise interest in STEM among young people. An example of good practice, and one of the most successful projects of collaboration between business and academia is Ericsson Nikola Tesla's Summer Camp, which was launched in cooperation with the Faculty of Electrical Engineering and Computing in Zagreb in 2001. In 2018, 57 students from 16 different universities from Croatia and abroad participated in Ericsson Nikola Tesla's Summer Camp. Assisted by their mentors, the students worked in teams on projects regarding Internet of Things (IoT), 5G technology, machine learning, radio networks, and tools for faster software development and testing. Furthermore, we continue to work on projects in the field of analytics and Internet of Things (IoT) within Ericsson ONE, a global innovation platform, with the aim to secure new areas for business growth.

As a socially responsible company, we pay special attention to sustainable business. One of the examples is an energy efficiency project concerning the Company's buildings and plants, worth more than MHRK 73. The project is co-funded by the EU "Competitiveness and Cohesion" Operational Program 2014-2020, as per the call for proposals "Increasing Energy Efficiency and Renewable Energy Sources in Manufacturing Industries", for which the Company received the maximum grant amount of MHRK 20. After project completion (end of 2020), the Company's annual energy savings are projected to amount to more than 4.6 million kWh, with the simultaneous CO2 emissions reduction by almost 1400 tonnes. Furthermore, within the European LIFE Clim'Foot project, completed towards the end of 2018, Ericsson Nikola Tesla was 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 undertaken a range of activities.

In terms of financial results, gross profit is up by 7%, while operating profit increased by 56.3%. A strong growth in operating profit is due to higher gross profit, lower sales and administrative costs, and projects realized in line with the Investment Promotion Act. Net profit rose by 67.4% to MHRK 113.6. End of year was concluded with a lean balance sheet and an equity ratio of 36.3%. A positive cash flow from operating activities was realized primarily as a result of proactive collection of customer receivables. At the end of 2018, total cash and cash equivalents, including short-term financial assets, amounted to MHRK 236.3. Group's Working capital efficiency, expressed in Working Capital Days (WCD), was 34, however if we exclude services to Ericsson, working capital efficiency was 87. Cash conversion rate was 38.9%.

During Q3, we initiated a new cycle of strategic planning for the period 2019 – 2023. In the upcoming period we expect new business opportunities, as well as challenges. As a response to a demanding market environment, we closely cooperate with customers to fully understand their needs, we adjust our organization and ways of working, and invest in our employees' competencies development and our technology leadership. We remain focused on

## PRESS INFO

February 20, 2019



cost and operating efficiency, capital efficiency and strategic risk management. Even though costs related to strategic contracts and 5G field trials will impact profitability short term, they will strengthen our business and market position in the long term.

Towards the end of this year, we will mark the 70th anniversary of Ericsson Nikola Tesla. We believe this confirms that we are a reliable company that has been continuously drawing on its thought leadership and has been achieving highly set goals, which makes us ready for new challenges.”

### Financial Highlights for the Group:

- Sales revenue amounted to MHRK 1,558.2 (2017: MHRK 1,481.6), up by 5.2% year-over-year. Of the total sales revenue, domestic market accounts for 23.9%, services to Ericsson account for 61.3% (of which 11.4% relate to Managed Services in Croatia), while other export markets account for 14.8%.
- Sales in the Networks segment amounted to MHRK 939.8 (2017: MHRK 739.3), Digital Services account for MHRK 439.8 (2017: MHRK 559.6), Managed Services amounted to MHRK 177.1 (2017: MHRK 178.9), and the new segment, Emerging Business and Other, amounts to MHRK 1.4 (2017: MHRK 3.8).
- Gross profit was MHRK 161.4 (2017: MHRK 150.9), up by 7% year-over-year as a result of increased sales revenue, operational efficiencies and cost base reduction, and lower negative currency deviations. Gross margin increased slightly to 10.4% (2017: 10.2%).
- Sales and administrative costs were 14.6% lower year-over-year and amounted to MHRK 68 (2017: MHRK 79.6).
- Operating profit increased by 56.3% year-over-year, amounting to MHRK 118.3 (2017: MHRK 75.7), as a result of higher gross profit, lower sales and administrative costs, and projects realized in line with the Investment Promotion Act.
- Gain from financial activities amounted to MHRK 2.3 (2017: loss from financial activities amounted to MHRK -2.6).
- Profit before tax increased by 65.2% year-over-year and amounted to MHRK 120.6 (2017: MHRK 73).
- Net profit was higher by 67.4% year-over-year and amounted to MHRK 113.6 (2017: MHRK 67.9). Return on Sales (ROS) was 7.3% (2017: 4.6%).
- Cash flow from operating activities amounted to MHRK 75.2 (2017: MHRK 108.2) as a result of proactive collection of receivables from customers and projects realized in line with the Investment Promotion Act. The cash conversion rate is 38.9% (2017: 68%). Group's Working Capital Efficiency, expressed in Working Capital Days (WCD) was 34 (2017: WCD was 31), and excluding services to Ericsson, WCD was 87 (2017: 72).
- Total cash and cash equivalents, including short term financial assets, as at December 31, 2018 amounted to MHRK 236.3 (28.1% of the total assets), while at the end 2017, it amounted to MHRK 243.8 (29.7% of the total assets).
- As at December 31, 2018, the Company had a lean balance sheet with total assets of MHRK 840.5, up by 2.3% compared to end 2017. We should highlight that the level of inventory significantly increased due to network modernization projects. Equity ratio amounted to 36.3% (end of 2017: 28.7%).

## PRESS INFO

February 20, 2019



- With related parties, the transactions were as follows: sales of products and services amounted to MHRK 973.7 (2017: MHRK 926.1), while procurement of products and services amounted to MHRK 413.7 (2017: MHRK 231.1).
- As at December 31, 2018, balances outstanding with related parties were as follows: receivables amounted to MHRK 113.2 (end 2017: MHRK 105.6), and payables amounted to MHRK 40.4 (end 2017: MHRK 124.4).

### Business situation in major markets

**In the domestic market**, sales revenue amounted to MHRK 372.6 (2017: MHRK 276.6), up by 34.7% year-over-year.

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

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

In 2018, main activities with the operator Hrvatski Telekom (HT) were related to radio access network modernization. During 2018, the networks in Zagreb, Zagreb County and Istria region were fully modernized and network modernization will continue in 2019. The goal of this project, which includes the modernization of infrastructure, transport capacities and radio equipment, is to replace all existing radio base stations, and make HT ready to offer Gigabit mobile Internet to users and to implement 5G technology as soon as the required radio frequency spectrum is assigned. At the end of 2018, HT's mobile network won the "P3 - Best in Test" certificate for the best mobile network in Croatia. HT had 948 out of 1000 points, which has been the best result achieved in the P3 measurement history in Croatia, listing HT's network among the best worldwide.

With the mobile operator Tele2, we have been working on increasing the voice core network capacity, with an emphasis of increasing the register of 4G users. We have also contracted the expansion of microwave transport network. Furthermore, we have continued to provide support services for voice core network.

In ICT solutions for Industry & Society, activities continue on the implementation and upgrade of the Joint Information System for Land Registry and Cadaster. The project of upgrading the Central Healthcare Information System of the Republic of Croatia continues. With the Ministry of Interior of the Republic of Croatia, an Agreement was signed on further implementation of the State Border Control System towards Bosnia and Herzegovina. Also, an agreement was signed for 112 system maintenance and upgrade in the Republic of Croatia. The IT system for "Price Blocks" was successfully developed and implemented in the existing Real estate IT system of the Ministry of Construction and Physical Planning. We are in the final phase of implementation of the Central Management System for hospitals. The informatization of IT solution for the Agency for Medicinal Products and Medical Devices of Croatia (HALMED) continues.

## PRESS INFO

February 20, 2019



**In the export markets (except Ericsson market)** sales revenue decreased by 17.7% year-over-year, amounting to MHRK 229.8 (2017: MHRK 279.2).

In the markets of Southeast Europe (Bosnia and Herzegovina, Montenegro and Kosovo) sales revenue amounted to MHRK 121.8 (2017: MHRK 136.3), down by 10.6% year-over-year. Currently, the greatest challenges are in the market of Bosnia and Herzegovina due to unfavorable economic and political situation. BH Telecom has awarded a multiyear agreement for radio access network modernization and expansion, as well as LTE introduction to another vendor.

We should highlight the continuation of good cooperation with the operators HT Mostar, Crnogorski Telekom and Ipko on telecommunication networks modernization and maintenance. At the end of 2018, a three-year agreement was signed with Crnogorski Telekom on the expansion of radio access and core network, worth MHRK 50. We have also signed contracts for 112 system upgrade and maintenance in Bosnia & Herzegovina and Montenegro.

In the market of the Commonwealth of Independent States, sales revenue amounted to MHRK 108 (2017: MHRK 142.9), down by 24.4% year-over-year due to ramping down of new network modernization projects. Main activities encompass LTE networks build with the operators beCloud (Belarus) and IDC (Moldova) and mobile network modernization for the operator Ucom (Armenia). Furthermore, activities on a complex project of healthcare system informatization in Kazakhstan in cooperation with the Ministry of Healthcare of the Republic of Kazakhstan continue.

**In the Ericsson market**, sales revenue amounted to MHRK 955.8 (2017: MHRK 925.8), up by 3.2% 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 178 (2017: MHRK 178.5).

Ericsson Nikola Tesla's R&D Center was awarded an expansion of responsibilities in the development of 5G network systems. Towards the end of 2018, we completed the knowledge and technology transfer project, important for Networks' strategic development plans. In the segment of User Data Management, we have successfully continued the activities on the development of telecommunication nodes. The work on modernizing Equipment Identification Register node was completed, and the work on 5G CUDB nodes started. Furthermore, an important transfer of responsibilities for UDM network integration and verification was finished. For the Development Unit Cloud, we have been working on verification and quality control of HDS product and NFVi solution. Our experts have also been working on virtualization projects for Mobile Switching Centre (MSC), Home Location Register (HLR) and Equipment Identification Register (EIR) for numerous customers. Our R&D Center concluded the year with excellent results.

Ericsson ONE is a central place and a platform for fostering innovation culture and support to implementation and monetization of innovative ideas. Owing to rich experience in innovation, employees' competences, and solutions, Ericsson Nikola Tesla significantly contributes to Ericsson ONE platform. Main areas of activities encompass 5G, analytics and IoT, and the monetization of solutions based on the mentioned technologies.

Experts from Services and Solutions Center for Networks along with providing services for Ericsson Nikola Tesla's customers, worked for global customers in Austria, Switzerland, Germany, Netherlands, the United States, South African Republic, Ghana, Indonesia, Malaysia, South Korea, Bangladesh, etc. These are complex activities in the field of expert analytics, creation of new innovative solutions, optimization and upgrading of the existing networks, and consultancy services. We 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 were engaged in various projects for the customers in Austria, United Kingdom, Germany, Japan, France, the Netherlands, Ireland, Switzerland, Slovakia, Italy, Luxembourg, Spain, Hungary, Slovenia, Serbia, Poland, Russia, Turkey, etc. These activities include

## PRESS INFO

February 20, 2019



the most complex projects of introducing 5G technology, operational and business support system, as well as numerous projects of introducing core solutions in cloud.

Our teams from IT&Engineering Services and Industry and Society have been achieving good results on projects of Test environment management, IT Operations management, IoT platform and Connected Urban Traffic.

Ericsson Nikola Tesla Servisi successfully provided services of monitoring, maintenance and build of HT's telecommunication network. In 2018, key projects regarding fixed infrastructure (exceeding plans for the entire year) and mobile infrastructure modernization were realized.

### Other information

Ericsson Nikola Tesla's major shareholders (as at December 31, 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               |
| OTP banka d.d. / Erste Plavi mandatory pension fund, B category                            | 44,415           | 3.34               |
| Addiko Bank d.d. / PBZ Croatia osiguranje mandatory pension fund, B category               | 16,810           | 1.26               |
| PBZ d.d. / The Bank of New York as Custodian   | 13,752           | 1.03               |
| Zagrebačka banka d.d. / Unicredit Bank Austria AG – clients account                        | 12,981           | 0.97               |
| Zagrebačka banka d.d. / State Street and Trust Company, Boston                             | 12,428           | 0.93               |
| PBZ d.d. / custodian client account  | 9,734            | 0.73               |
| OTP banka d.d. /OTP Index fund - open-end alternative investment fund with public offering | 8,312            | 0.62               |
| Addiko Bank d.d. / Raiffeisen voluntary pension fund                                       | 7,934            | 0.60               |
| Other shareholders   | 428,297          | 32.17              |

Share price information in 2018:

| Highest (HRK) | Lowest (HRK) | Closing (HRK) | Market cap. (In MHRK) |
|---------------|--------------|---------------|-----------------------|
| 1,240.00      | 976.00       | 1,010.00      | 1,344.7               |

## PRESS INFO

February 20, 2019



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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 Dec 31, 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".

## PRESS INFO

February 20, 2019



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