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## COMPANY POSITION REPORT

Dear shareholders,

The telecom industry is facing the most challenging times. Both economy and society expect us, technology and innovation/thought leader, to enter a new communications and networked society era. Our growth and development potential depends on three major forces: broadband, mobility and the cloud. They affect business, people and environment in the best possible way. Ericsson Nikola Tesla supports this agenda.

The year 2011 was yet another demanding and tough one characterized by negative economic trends that considerably affected Ericsson Nikola Tesla's performance and achievements. This was especially evident in the slowdown and decrease in capital investments by telecom operators as well as decreased government investments into infrastructure projects within the ICT segment accompanied by continued price pressure. All this additionally slowed down the realization of our planned activities and strategic goals.

A decline in net sales resulted in the considerable decrease of business volume both in the domestic and CIS markets. This was partly compensated by better situation and results achieved in our export markets, primarily in Bosnia and Herzegovina and Montenegro, as well as Ericsson market. The Ericsson market remains strong despite adjustments to our pricing in order to stay competitive in the demanding global market. In the total sales revenue, the share of domestic market was 23%, and export represented 77% (export to Ericsson market accounted for 39.6% and to other countries 37.8%). Despite the challenging business environment, the Company maintained and in some markets increased its market share.

The gross margin is lower compared to 2010, reflecting continuous price pressure in all markets and investments into export markets aiming at securing new business and strengthening market share. In addition, the gross margin was impacted by the product/service mix, lower margins on certain projects in the Industry and Society segment as well as investments into development projects. It is important to point out that following the impairment of withholding tax receivables as well as impairment of other doubtful receivables, the Company's risk related to collection of receivables has been significantly reduced.

Under such challenging market conditions, our focus on strategic programs/key deals has helped us to somewhat offset the effects of crisis. In partnership with our customers, at home and abroad, we realized a number of significant projects. I would like to underline our activities in transformation and modernization of the existing networks into new generation networks. Along with these activities, Ericsson Nikola Tesla achieved significant results in terms of our responsibilities assigned in the global organization in the areas of Research and Development, Service Delivery Center and other centers of expertise. ICT implementation continued also in a non-operator segment, both in business systems and government administration with strong focus on well-selected areas. The best illustration for this is e-Health solution, our recognizable high-tech-product. However, last year we witnessed the negative impact of crisis, which resulted in reduced volume of business activities and postponement in realization of large ICT

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infrastructure projects. Furthermore, in the domestic market the continued recession and 6% tax imposed on mobile services had a negative impact on operators' investments.

In the last few Company reports, I emphasized the importance of innovations not only to our current operations but also to secure our competitiveness in the future. The present industrial and technological revolution that will take us into networked society can be survived, in terms of business operations, only with individuals and teams/organizations that are innovative, motivated and committed to common goals.

In 2011 Ericsson Nikola Tesla yielded the following business results (2010 figures in brackets):

- Orders booked MHRK 1,161.3 (MHRK 1,311.3)
- Sales revenues MHRK 1,165.7 (MHRK 1,218.9)
- Net profit MHRK 28 (MHRK 24)
- Cash flow from operating activities MHRK 135 (MHRK 366.4)
- Motivational Company culture and strong employee engagement- confirmed by the annual employee questionnaire (Dialog)
- Customer satisfaction- confirmed by the annual customer satisfaction questionnaire (Customer satisfaction Survey)
- Satisfaction of shareholders, investors and general public- confirmed by the awards granted by the Zagreb Stock Exchange and Poslovni dnevnik for transparent business operations and best relations with investors in Croatia.

In brief, in 2011 we achieved solid net income, and sound cash flow from operating activities, thus providing the stable balance sheet. This is of strategic importance since it is a firm base on which we continue to invest into market/customers, development projects as well as our employees' knowledge and skills in order to strengthen our market position.

## OUTLOOK

We live in extraordinary times, characterized by uncertain economic climate and strong competition, technological innovation and data growth, all happening simultaneously. All of this places particular pressures on the market and our customers, which presents us with both challenges and opportunities.

The telecom and ICT market will continue with dynamic development in 2012. A further strong growth of data traffic, generated by a significant increase in the number of mobile smart devices (smartphone, i-pad, etc.) as well as by increased internet usage, is expected. Consequently, further expansion of fixed broadband access to xDSL technologies and introduction of high-rate technologies based on optics (FTT-x) are expected. The mobile broadband access technology will continue the intensive development by implementation of 3G and 3.5G mobile technologies (HSPA, HSPA+) while in Croatia the first steps in LTE commercial implementation are expected. We also expect a significant modernization of the existing mobile networks applying SRAN concept (Single Radio Access Network), enabling the operators to be more efficient and optimize costs.

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As regards edge and core networks, transformation towards „all IP“ Next Generation Convergent Networks based on IMS architecture will be continued.

We also expect, in all our markets, the modernization of Operation Support System (OSS) and Business Support System (BSS), thus enabling operators to offer a wide range of convergent services regardless of the location or the user approach.

ICT implementation should be continued in Industry and Society segment as well, no matter whether enterprise or state administration is in question, taking into account effects and benefits achieved by development, implementation and usage of ICT solutions and services.

Bearing in mind all business challenges and need for quick adaptation, there is no doubt that in 2012 we shall continue to focus on business stability by fully analyzing and reacting to all business risks and by ensuring optimal utilization and continual development of our resources. Having assessed operational risks for Ericsson Nikola Tesla in 2012, I would like to point out the following:

- Challenging global economic conditions may adversely impact the demand and pricing regarding our products and services;
- Operators' and other customers' reduced capital expenditures;
- Intense competition from our existing competitors as well as new entrants, incl. IT companies entering ICT market;
- Customers' and competitors' consolidation may have further impact on product and service prices;
- Continued political uncertainty and instability in some markets;
- If our customers' financial conditions decline, we will be exposed to increased credit and commercial risk;
- Having the majority of our revenues in EUR and USD, our business is exposed to foreign exchange fluctuations;
- In order to remain competitive, we need to retain highly qualified and extraordinary employees.

Ericsson Nikola Tesla operates in line with the current corporate policies and directives, the Croatian legislative regulations as well as principles of corporate governance and business ethics.

In the forthcoming period, respecting all changeable business circumstances, we shall seek to strengthen our position in strategic business segments and strategic Company markets. The mission and strategy of Ericsson Nikola Tesla as well as our wanted position by 2015 are directed towards key stakeholders: customers, employees and shareholders. It is all about value creation, understanding the needs, sharing knowledge and the partnership among those included in various processes and activities in the Company, global organization, our markets and the society as a whole. The key Company programs are strongly focused on growth, business improvement and appropriate cost base, efficiency and wise investments.



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On the way towards the networked society, for which it is estimated that some 50 billion devices will be networked by 2020, we are now at the mid point of revolutionary changes that we in Ericsson community describe as follows: "When one person gets connected, their life changes. When everything connects, the world changes. And we are in the midst of this as an industry".

Ericsson Nikola Tesla needs to continue with creating and delivering best-in-class solutions, understanding market and customers' needs, focusing on innovative/thought leadership and knowledge sharing, what will be a firm ground for the Company's future development.

All other data, which is an integral part of the annual Company report, pursuant to Article 250 (a) of the Company Act, can be found in the enclosed 2011 Annual Report, comprising the General Report, Social Report and Financial Statements, as at December 31 2011.

Gordana Kovačević

President

Ericsson Nikola Tesla d.d.

A handwritten signature in black ink, appearing to read "Gordana Kovačević".