
ERICSSON NIKOLA TESLA

Report on the Company's business situation and comments on the financial results for the year ending Dec 31, 2011

Highlights*:

- Orders booked: MHRK **1,161.3**
- Sales revenues: MHRK **1,165.7**
- Gross margin: **12.2%**
- Operating loss: MHRK **12**
- Net profit: MHRK **28**
- Cash flow from operating activities: MHRK **135**
- Proposed dividend: HRK **20** ordinary and HRK **150** extraordinary dividend per share

* As of Q1 2012, the Company will be reporting key financial indicators in line with Corporate recommendations. Highlights will include sales revenues, gross margin, operating profit, net finance income, net profit and cash flow from operating activities.

In the evaluation of the Company's performance, Gordana Kovačević, the President of Ericsson Nikola Tesla underlined the following:

„We have left behind another challenging year characterized by negative economic trends that have affected the entire ICT industry. This was especially evident in the slowdown and decrease of capital investments by telecom operators and decreased government investments into infrastructure projects within the ICT segment accompanied by continued price pressure. It is evident that, due to macroeconomic and other uncertainties in our main export markets, the operators have become more cautious. Despite these challenges the company maintained and in some markets increased its market share and continued with stable operations.

Accordingly, Ericsson Nikola Tesla business results show year-over-year decline in Orders booked and Net sales by 11% and 4% respectively. The overall Sales result reflects growth in regional and Ericsson markets, offset by a decline in domestic and CIS markets.

A negative impact of crisis in the domestic market was experienced through lower business volumes and postponed big ICT infrastructure projects thus threatening successful realization of these projects

and achievements made so far. Furthermore, the continued recession and a special tax on mobile services have negatively affected operators' investments. We were also faced with challenges in our export markets. The CIS markets were especially demanding due to consolidation of big operators and centralization of authority and responsibility for further network modernization, what additionally postponed strategic decisions. The situation was better, implying also better results, in Bosnia & Herzegovina and Montenegro markets. There was a positive situation in the Ericsson market as well where, despite adjustments to our pricing in order to remain competitive in the demanding global market, sales revenue increased through activities in R&D and other expert centres.

The gross margin declined considerably year-over-year due to 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.

The operating loss was influenced by MHRK 42.9 impairment of withholding tax receivables in Q3 and Q4 2011. Namely, the tax liability forecasts for the following years showed that the Company will again be in a position of no income tax liability due to other tax reliefs (existing R&D supports as well as considerable tax loss carried forward), and will not be able to use the already approved tax certificates from previous years for the income tax paid abroad. In line with the above mentioned forecasts and taking into account the precautionary principle, it was necessary to impair these time limited receivables.

In 2011 the Company realized net income of MHRK 28. Cash flow from operating activities amounted to MHRK 135. After the dividend payment for 2010, totaling MHRK 251.3, the total cash balances, including short-term financial assets at the end of 2011, amounted to MHRK 593.5. The Company has a stable balance sheet with total assets of MHRK 1,191 and equity ratio of 71.4%.

The Company has been continuously, for a number of years, making significant investments into R&D activities. The investment into the development, research and innovations, in the long run, should result in competitiveness and significant benefits to the whole economy. So, our Government should determine the strategy for activities in R&D& innovation and should support them by introducing new incentive models, because the ones applied so far have not been enough in the time of crisis and lower profitability, to provide investments and competitiveness in the given segment.

In the forthcoming period, we shall seek to strengthen our position in all business segments and in all Company markets. We shall focus on growth, improvement of existing business and cost optimization. Innovativeness and a proactive approach towards users of our products and services, constant

technology shift, adjustment to market and competitive conditions as well as strong discipline with regard to risk management and investments, are the basis of our future business development.“

Financial Summary:

- Orders booked decreased by 11% year-over-year, and totaled MHRK 1,161.3, while sales revenue decreased by 4% and totaled MHRK 1,165.7.
- Domestic market accounts for 22.6% and export markets account for 77.4% (export to Ericsson market accounts for 39.6% and to other countries 37.8%) of the total sales revenue.
- Sales revenue can be further analyzed by business segments as follows: Network infrastructure including network rollout services MHRK 658.7 (56.5% of the total sales revenue), Professional services MHRK 467 (40.1% of the total sales revenue), and Multimedia solutions MHRK 40 (3.4% of the total sales revenue).
- The gross margin amounts to 12.2% (2010:16.9%). The decrease in the gross margin year-over-year was due to the continuous price pressure in all markets as well as 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 ICT projects within the Industry and Society segment and investment into development projects.
- Distribution and administrative expenses have been under control at the level of MHRK 91.6. The mild increase in expenses of 0.6% year-over-year was mainly due to intensive pre-sales activities.
- Due to lower gross margin and MHRK 42.9 withholding tax impairment, the Company recorded an operating loss of MHRK 12 (2010: MHRK -15.2, including the write-off of Kazakhstan receivables amounting to MHRK126.5).
- Net finance income totaled MHRK 34.3 (2010: MHRK 41.2). The decrease in net finance income was due to lower interest income, lower net gains on remeasurement of financial assets as well as lower release of impairment reserves into finance income (discount amortization) while positive currency deviations were higher year-over-year.
- The Company recorded a net profit of MHRK 28 (2010: MHRK 24.1) including MHRK 5.6 tax income gained from temporary tax differences based on impairment of receivables and inventories.
- Cash flow from operating activities totaled MHRK 135. The total cash balances including financial assets as of Dec 31, 2011 amounted to MHRK 593.5, which is 49.8% of the total assets.

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- The Company has a stable balance sheet with total assets of MHRK 1,191 and an equity ratio of 71.4%.
 - Major transactions with related parties were as follows: sales of products and services MHRK 496.7 (2010: MHRK 445.1), purchase of products and services MHRK 391.9 (2010 MHRK 418).
 - Balances outstanding with related parties on Dec 31, 2011 were as follows: receivables totaled MHRK 87.5 (end 2010: MHRK 75.4), payables MHRK 50.7 (end 2010: MHRK 94.8).
 - Disclosure on credit risk exposure:
Following the impairment of withholding tax receivables in the amount of MHRK 42.9 in Q3 and Q4 2011, as well as impairment of other doubtful receivables, the Company's risks related to collection of receivables have been significantly reduced.

As of Dec 31, 2011 receivable balances outstanding totaled MHRK 461.0 (end 2010: MHRK 517.5). The Company will continue to monitor credit risk and try to secure that all future credit arrangements with the customers are managed with as low credit risk exposure as possible.

Business situation in major markets

Domestic market sales totaled MHRK 264, a decrease by 21% year-over-year.

The partnership with Vipnet has continued during 2011 in the segment of extension and modernization of 2G and 3G infrastructure, with a special attention paid to the implementation and testing of new technology solutions (e.g. wireless broadband data transmission at rates exceeding 100 Mbit/s). The cooperation has also continued on the core network modernization including implementation and testing of new functionalities as well as in the transmission systems segment.

The cooperation with Croatian Telecom (HT) continued with the project of network transformation into the new generation network and extension of the broadband Internet access. HT and Ericsson Nikola Tesla successfully ended the testing phase of the most advanced wireless access technology. By continuing the user migration to IMS architecture, HT has been proceeding with transition to the full implementation of fixed and mobile convergent architecture.

As of the mobile operator Tele2, we have been considerably engaged in further building of 2G and 3G infrastructure, and in implementing new functionalities, especially focusing on transmission rate increase and the service of mobile broadband Internet access coverage. The successful cooperation with this operator was confirmed at the beginning of 2011 by concluding the contract for mobile network support and maintenance services.

The major focus in ICT for Industry and Society business segment was on upgrading the national ICT primary healthcare system, realization of Cadastre and Land Database joint information system (ZIS) and the project for modernization of Croatian Railways (HŽ) infrastructure.

The implementation of ICT infrastructure as a prerequisite for introduction of Care4U-HIS (Care for You- Hospital Information System) in the General Hospital in Gospić has been completed. Thus, this hospital joins several others, such as the Children's Hospital Srebrnjak, Zadar General Hospital and the University Clinical Hospital in Mostar, where the given system has been successfully implemented.

In export markets (except for Ericsson market) sales totaled MHRK 440.4, a decrease by 3% year-over-year. These revenues include sales in export markets for Industry and Society business segment amounting to MHRK 23.2. In the previous year, revenues from this business segment were classified within Ericsson market.

In the regional markets (Bosnia and Herzegovina, Montenegro and Kosovo) sales revenues increased by 31% totaling MHRK 269.6, primarily due to the increase of sales revenues in the Bosnia and Herzegovina market. The sales to Crnogorski Telecom in Montenegro also increased year-over-year. The expected investments into the Industry and Society segment were not realized due to postponed projects.

Ericsson Nikola Tesla made a contract with HT Mostar on an extension and modernization of the current mobile network in 2G and 3G part. This contract, signed in Q2, is of special importance since it made Ericsson Nikola Tesla the single provider for the radio part of HT Mostar network. The contract is also the basis for introduction of attractive 3G functionalities to this operator end users, as well as better quality, higher rate and availability of services in the whole territory of Bosnia and Herzegovina. In addition, the contract on delivery and implementation of the service „Transferability of Numbers in the Fixed Network“, and the contract on “Support Service Providing for Fixed and Mobile Network” have been signed.

Several valuable contracts were signed with BH Telecom on the modernization and extension of the mobile network as well as the modernization and capacity increase of the fixed network. These contracts enable faster and simpler administration of mobile BH Telecom network users, advanced services and better coverage of users, higher speeds in 3G networks as well as the attractive broadband services of high quality. They also provide BH Telecom with the possibility to introduce new services to the Bosnia and Herzegovina market, thus following the trends of the leading world operators.

As of ICT solutions in the Industry and Society segment, the project of initial implementation of the unique emergency system number 112 in Bosnia and Herzegovina was completed.

Concerning Crnogorski Telekom, a contract was made on the upgrade, extension and modernization of the mobile and fixed networks as well as the implementation of the telephone number portability in mobile and fixed networks. It is to be pointed out that on the basis of the given contract T-Mobile users have access to HSDPA+ technology that enables the data transmission rate of 42 Mb/s. Also, a contract was made on the modernization of the Multimedia Messaging Service Center with the modern Messaging-In-One solution.

In Q4 frame agreement was signed, defining the cooperation in the radio access network for the next five years. Within this agreement, Crnogorski Telekom will be supplied Ericsson EVO RAN solution, which enables a multi-standard radio transmission that will cover the second and the third generation of mobile telephony and LTE technology, too. The agreement also covers the new equipment implementation service, measurements “drive” tests and continuous monitoring of the key network performance indicators.

Sales revenues in CIS markets totaled MHRK 147.6, 37% less year-over-year, primarily due to decreased investment of telecom operators in Belarus reflecting economic and political crisis in the country. Due to consolidation of big operators and centralization of authority related to network modernization, strategic decisions in the CIS markets have been postponed.

During 2011, the Company signed several contracts in Belarus, Russia, Moldova and Kazakhstan concerning modernization and extension of mobile and fixed networks as well as IP-oriented solution for business customers. Among these contracts, there is also one made with a new customer MTS, the international operator from Minsk, Belarus.

As of ICT solutions for Industry and Society business segment in other export markets, a number of pilot projects (in the UAE, Armenia, Sri Lanka, Malaysia, Japan, India) related to mobile health applying EMH solution have been initiated.

[In Ericsson market](#), the sales revenues totaled MHRK 461.2, an increase of 7% year-over-year.

The Research and Development Center continued with the development of new functionalities in the fixed and radio networks during 2011. Our centre was awarded new activities and global customers responsibility. It is to mention the intensified activities for France Telecom and new operators in Kuwait and Morocco for which advanced system solutions have been prepared. At the global level, a continued support in the modernization of fixed network has been provided for leading operators, such as Virgin Media, UK Gamme, GTS Poland, RINA India, Eircom Ireland, Tele2 and Telenor.

In the Core Network Unit, activities have been continued on design, servers’ functionality improvement for mobile network and numerous customizations in compliance with customers’ needs. It is to point out comprehensive and large projects, such as the market project solution for the network

modernization of the Japanese operator Softbank Mobile, Vfe Egypt, MTN Nigeria, Etisalat/Mobily Saudi Arabia, Bouygues Telecom France, Vfe Spain, TIM and WIND/Orange from Italy.

As of the platform segment of activities, it is to mention intensified work on development of hardware and software solutions for LTE generation of EVO IT network. Further on, a large step forward in the area of fixed broadband access was enabled by the construction of the state-of-the art laboratory, thus extending the range of service offering for Ericsson products integration. The new testing laboratory for Connectivity Packet Platform (CPP) activities was built, which due to its high standards, was selected the demo centre for Region Western & Central Europe and some other areas.

The continuous focus on innovations in Ericsson Nikola Tesla resulted in the increased number of innovations and proposed patents, which has been recognized at the global level. One proposal has won the award at the Corporate level and another one has been recognized as the best RWCE innovation idea.

Service delivery center experts were engaged in numerous projects, such as: IMS Deutsche Telekom (the largest IMS project in the Region Western and central Europe, the full migration of DT fixed network from PSTN to IMS), IMS Telefonica Germany, LTE projects for Vodafone Germany and Vodafone Great Britain, 3G project for Vodafone India, Service management for Mobistar Belgium transport network, delivery of the project Messaging in One for Vodafone Great Britain, MSC-S BC upgrade for Vodafone Check Republic, IMS upgrade and SGSN swap for Telecom Austria Group, IPTV projects for Telecom Austria i Telefonica, TSS 4.0 project for Netia Poland, Deployment for Smart laptop in US and NCELL management system automatic tool for SBM Japan. The Company was awarded the regional responsibility for Vodafone Application Support Office. It was about the advanced testing of RAN OSS functionalities prior to FOA (First Office Application).

[Business outlook 2012](#)

Telecommunications market will remain dynamic in 2012 as well. A further strong growth of data traffic, generated by a significant increase in the number of mobile smart devices (smartphone, i-pad,...) as well as by increased internet usage, is expected. Consequently, further expansion of fixed broadband access to xDSL technologies as well as introduction of high rate technologies based on optics (FTT-x) are expected.

Intensive growth of mobile broadband access will be continued through further implementation of 3 and 3.5 mobile technology generations (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.

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

We also expect OSS (Operation Support System) and BSS (Business Support System) modernization and all this will, in the end, enable operators to provide 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.

Other information

Ericsson Nikola Tesla major shareholders (as at Dec 31, 2011)

	No. of shares	% of share capital
Telefonaktiebolaget LM Ericsson	653,473	49.07
Hypo Alpe-Adria-Bank d.d. / Raiffeisen Mandatory Pension Fund	121,486	9.12
Societe Generale-Splitska banka d.d. / Erste Plavi Mandatory Pension Fund	32,961	2.48
Zagrebačka banka d.d. / custodian client account for Unicredit Bank Austria AG	32,298	2.43
Hypo Alpe-Adria-Bank d.d. / PBZ Croatia osiguranje Mandatory Pension Fund	30,615	2.30
PBZ d.d. / State Street client account	22,810	1.71
Societe Generale-Splitska banka d.d. / AZ Mandatory Pension Fund	15,376	1.15
PBZ d.d. / custodian client account	14,902	1.12
PBZ d.d. / The Bank of New York as custodian	12,927	0.97
Societe Generale-Splitska banka d.d.	8,062	0.61
Other shareholders	386,740	29.04

2011 share price information:

Highest (HRK)	Lowest (HRK)	Closing (HRK)	Market cap. (in MHRK)
1,650	1,000.04	1,080	1,438.2

Ericsson Nikola Tesla d.d.
Krapinska 45
Zagreb

OIB: 84214771175
Tax No.: 03272699

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 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 2011 to 31 Dec 2011 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



For additional information, please contact:

Snježana Bahtijari

Company Communication Director

Ericsson Nikola Tesla d.d.

Krapinska 45

HR-10 002 Zagreb

Phone: + 385 1 365 4556

Mobile: +385 91 365 4556

Fax: +385 1 365 3156

E-mail: snjezana.bahtijari@ericsson.com

Orhideja Gjenero

Investor Relations Manager

Ericsson Nikola Tesla d.d.

Krapinska 45

HR-10 002 Zagreb

Phone: +385 1 365 4431

Mobile: +385 91 365 4431

Fax: +385 1 365 3156

E-mail: orhideja.gjenero@ericsson.com

E-mail: odnosi.investitori@ericsson.com

For more information about Ericsson Nikola Tesla's business performance, please visit:

<http://www.ericsson.com/hr>

Communication

Ericsson Nikola Tesla