

# 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 H1 2019

## Highlights:

- Sales revenue: MHRK **821.7**
- Gross margin: **14.5 %**
- Operating profit: MHRK **83.9**
- Profit before tax: MHRK **85.1**
- Net profit: MHRK **71.1**
- Cash flow from operating activities: MHRK **32**

Gordana Kovačević, the President of Ericsson Nikola Tesla, commented:

„In H1 2019, Ericsson Nikola Tesla Group sales revenue amounted to MHRK 821.7, up by 7.8% year-over-year. In accordance with our plans, services to Ericsson increased as a result of business expansion and gaining of new responsibilities, primarily in 4G/5G. In line with that, we continue hiring, investing in equipment and testing systems, and development of our employees' competencies in R&D Center, as well as in Solution and Services Expert Centers.

Sales revenue decreased in the domestic market year-over-year due to project execution dynamics. Intensive activities with Hrvatski Telekom are ongoing on radio access network modernization, which will significantly increase network capacity and enable the introduction of 5G technology, once the necessary radio frequency spectrum is assigned. With A1 Hrvatska, we have continued to cooperate on the realization of a multi-year frame agreement which encompasses modernization and expansion of their radio access network in order to be ready for efficient and fast 5G deployment. Moreover, A1 Hrvatska put into service the NB-IoT (Narrowband Internet of Things) service for business users, based on Ericsson's solution in radio access network. This is a technology for secure and reliable wireless connection of a large number of devices, which, due to advanced characteristics, is categorized as 5G technology.

Industry & Society projects have a significant positive impact on the business result in the domestic market. Numerous activities are ongoing on projects of informatization of healthcare system, Joint Information System of Land Registry and Cadaster and state border control.

Sales revenue in export markets increased year-over-year. The implementation of mobile networks modernization projects with the customers in Bosnia and Herzegovina, Montenegro, Kosovo and Belarus remain in focus. In line with our strategy and in order to strengthen our market position, we continue with planned sales and marketing activities in targeted business areas. At the International Business Fair – Mostar 2019, we presented the solutions for digital society. Furthermore, the promotion of 4G network of our customer, HT Eronet, was especially important for us, since the long-awaited licenses for introduction of the fourth generation of mobile telecommunications were

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only recently issued in Bosnia and Herzegovina. It should be highlighted that HT Eronet put 4G network into commercial operation immediately after obtaining the license.

Gross margin decreased by 1 percentage point year-over-year due to further increase of engagement and working capital on projects with key customers. Operating profit remains at the same level year-over-year. Profit before tax went up by 2.5%, while net profit increased by 15.6%. A positive cash flow from operating activities was realized, amounting to MHRK 32, and total cash and cash equivalents, including short term financial assets at the end of H1 2019 amounted to MHRK 221.5. Working Capital Efficiency, expressed in Working Capital Days (WCD), was 42 days, and if we exclude services to Ericsson, Working Capital Efficiency was 113 days. Cash conversion rate was 23%.

In line with our strategy, we remain focused on development of solutions and sales in the field of mobile broadband Internet access (4G/5G mobile solutions), digital transformation and network management, Industry & Society (healthcare, public safety, e-Business), and on strengthening our position by providing services to Ericsson. We have also initiated a Digital Transformation program on Ericsson Nikola Tesla Group level, in order to additionally simplify the Company's processes and business/project management by applying advanced technologies and automation. Accelerated technology changes and end-user needs require continued transformation and adaptation both for us and our customers. These processes are further intensified by the introduction of 5G, Internet of Things and Cloud. We have been intensively working on strategic contracts, and have been investing in 5G, which will impact margins short term, but will strengthen our market position in the long term.

In order to secure further business development and stay competitive, we remain focused on cost and operating efficiency and strategic risk management. “

### Financial Highlights for the Group:

- Sales revenue amounted to MHRK 821.7 (H1 2018: MHRK 762.4), up by 7.8% year-over-year. Of the total sales revenue, domestic market accounts for 21.5%, services to Ericsson account for 64.4% (of which 12% is related to Managed Services in Croatia), while other export markets account for 14.1%.
- Sales in the Networks segment amounted to MHRK 451.7 (H1 2018: MHRK 463.2), Digital Services amounted to MHRK 270.1 (H1 2018: MHRK 206.4), Managed Services amounted to MHRK 98.5 (H1 2018: MHRK 92.4), and the segment Emerging Business and Other amounted to MHRK 1.6 (H1 2018: MHRK 0.3).
- Gross profit amounted to MHRK 119.4 (H1 2018: MHRK 118.5). Gross margin decreased to 14.5% (H1 2018: 15.5%) due to an increased engagement and working capital on projects with key customers.
- Sales and administrative costs remained at the same level year-over-year and amounted to MHRK 35.5 (H1 2018: MHRK 35.3).
- Operating profit remained at the same level year-over-year and amounted to MHRK 83.9 (H1 2018: MHRK 83.9).
- Gain from financial activities was MHRK 1.3 (H1 2018: loss from financial activities amounted to MHRK – 0.9), mainly due to positive foreign exchange differences.
- Profit before tax increased by 2.5% year-over-year to MHRK 85.1 (H1 2018: MHRK 83.0) as a result of positive financial impact of exchange differences on receivables and financial assets in foreign currency.

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- Net profit increased by 15.6% year-over-year and amounted to MHRK 71.1 (H1 2018: MHRK 61.5). The increase of net profit is a result of decrease in tax liability based on tax reliefs on employment according to Investment Promotion Act. Return on Sales (ROS) is 8.6% (H1 2018: 8.1%).
- Cash flow from operating activities was MHRK 32.0 (H1 2018: MHRK 6.3), primarily due to the application of International Financial Reporting Standard (IFRS 16 Leases) and release of provisions on receivables from prior years. Cash conversion rate was 23% (H1 2018: 5%).
- Working Capital Efficiency, expressed in WCD, was 42 days (H1 2018: 24 days), and excluding services to Ericsson, Working Capital Efficiency was 113 days (H1 2018: 67 days). The increase in WCD was due to an increased engagement on network modernization projects.
- Total cash and cash equivalents, including short term financial assets, as at June 30, 2019, amounted to MHRK 221.5 (21.8% of the total assets), while at the end of 2018, it amounted to MHRK 236.4 (28.1% of the total assets).
- The Company has a lean balance sheet with the total assets of MHRK 1,017.8 as at June 30, 2019, up by 21.1% compared to the end of 2018. Along with the expected increase in inventory and the effect of right-of-use assets (IFRS 16), the increase of short-term receivables is a result of good payment collection at the end of 2018 and completion of certain phases of the network modernization projects in Q2 2019 in the domestics and neighboring markets.  
Due to continuation of an increase engagement on network modernization projects in the domestic market, the inventory and work in progress are currently recording a significant growth compared to the end of 2018. Due to the application of new International Financial Reporting Standards (IFRS 16 Leases), in force as of January 1, 2019, the Company acknowledged MHRK 65 of the right-of-use assets and acknowledged lease commitments in the same amount, which resulted in additional increase of balance sheet in 2019 as compared to the end of 2018.
- Equity ratio amounted to 37.0% (end of 2018: 36.3%).
- With related parties, the transactions were as follows: sales of products and services amounted to MHRK 533.9 (H1 2018: 486.7), while procurement of products and services amounted to MHRK 199 (H1 2018: 153.2).
- As at June 30, 2019, balances outstanding with related parties were as follows: receivables amounted to MHRK 135.6 (end of 2018: MHRK 113.2), and payables amounted to MHRK 68.4 (end of 2018: MHRK 40.4).

### Business situation in major markets

**In the domestic market,** sales revenue amounted to MHRK 177.0 (H1 2018: MHRK 190.6), down by 7.1% year-over-year.

With strategic partner A1 Hrvatska, we continue the successful 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. The collaboration in the field of core network and transport telecom network also continues. During Q2 2019, A1 Hrvatska put into service NB-IoT network available in the entire territory of the Republic of Croatia, which represents one of significant technological steps forward in the last few years, important for further development of IoT. This is a radio technology that enables a large number of devices (sensors) to send the information necessary for a certain system to function, and from locations that were unavailable until now.

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With strategic partner Hrvatski Telekom, activities on mobile network modernization are ongoing. This project encompasses the complete modernization of infrastructure, transport capacities and radio equipment according to SRAN concept – a technology which ensures coexistence of 2G, 3G, 4G and 5G network on the same equipment, triples the capacity of 4G network and secures the support for IoT. So far, the network has been modernized in Istria region, Zagreb County, City of Zagreb, and along the entire coastline, and enables significantly higher speeds in these areas. Additionally, Ericsson Nikola Tesla and Hrvatski Telekom continue to cooperate in the fields of fixed telecommunication network and delivery of services of telecommunication infrastructure rollout and maintenance.

With the mobile operator Tele2 we have contracted the delivery, implementation and support of software for data traffic shaping, which increases the average downlink speed per user. We have delivered the equipment for microwave transport network expansion and increased the capacity of database with 4G user information and continued to provide support services for voice core network.

With the company RUNE Crow, a contract was signed for the implementation of access to broadband optical network in rural areas in Istria County and Primorje-Gorski Kotar County, which are currently not covered by such infrastructure and where the existing Internet service providers have no commercial interest.

In the field of ICT solutions for Industry & Society, activities continue on the project of upgrade of the Central Healthcare Information System of the Republic of Croatia (CEZIH), implementation and upgrade of the Joint Information System of Land Registry and Cadaster (JIS) and the implementation of the State Border Control project. With the Ministry of Justice and State Geodetic Administration (SGA), a two-year frame agreement was signed related to the services of maintaining the JIS (basic maintenance, adaptive and perfective maintenance, special services and support of digital geodetic technical report). In cooperation with SGA, a new portal, katastar.hr, was also developed, which provides an insight into various spatial information based on the current location.

With the Ministry of Interior of the Republic of Croatia, a contract was signed to continue implementing the „Green Borders“ project, which aims to establish the state border control system in line with the Schengen standards.

**In export markets (excluding Ericsson market)** sales revenue increased by 28.6% year-over-year and amounted to MHRK 115.7 (H1 2018: MHRK 90.0).

With the operator HT Eronet (Bosnia and Herzegovina), we have contracted an expansion and modernization of the system for mobile network monitoring, expansion of IMS system, as well as new expansion of radio access network. We continued a good cooperation with the operators Crnogorski Telekom (Montenegro), and IPKO (Kosovo) on modernization and maintenance of telecommunication networks. With the operator IPKO, the project of changing the country code was successfully finished. With the operator beCloud (Belarus), we contracted the LTE network expansion (*turn-key*) in four regions.

The activities on the project of healthcare system informatization in Kazakhstan, in cooperation with the Ministry of Healthcare of the Republic of Kazakhstan, continue.

**In Ericsson market**, sales revenue amounted to MHRK 529.0 (H1 2018: MHRK 481.8), up by 9.8% 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 98.6 (H1 2018: MHRK 92.9).

The projects of Research and Development Center are ongoing as planned in all domains. In the Networks segment, R&D Center successfully delivered a series of new functionalities for the state-of-the-art radio systems to the market. The Center has been continuously expanding its responsibilities and has gained additional responsibilities within the Cloud platform. Along with the responsibilities for 4G and 5G technologies, we have been

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selected as the consolidation point for 2G and 3G radio access network services, which strengthened the portfolio of long-term activities related to sun-set products.

Experts from Services and Solutions Center for Networks, along with projects for Ericsson Nikola Tesla Group, have worked on projects for Ericsson customers in Brazil, Qatar, Nigeria, Germany, Pakistan, Switzerland, Saudi Arabia, etc. These are complex activities in the field of expert analytics, creation of new innovative solutions, optimization and upgrading of the existing networks, and consulting. We have 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 on projects for Ericsson customers in Austria, Denmark, France, Greece, Italy, Ireland, Luxembourg, Germany, the Netherlands, Norway, Switzerland, the USA, Slovenia, Serbia, Sweden, United Kingdom, etc. These activities include complex projects of introducing 5G technology, operational and business support systems, as well as numerous projects of introducing core solutions in Cloud. Our experts have participated in numerous transformation projects for the biggest operators in Europe, and one of the latest examples is the assignment of an important role in the transformation of Telenor's core network, according to virtual 5G solutions in Sweden, Denmark, and Norway.

The teams working in units for IT& Engineering Services, and Industry and Society segment are achieving quality results on projects of test environment management, IT operations management, IoT platforms, and Connected Urban Traffic.

Experts of Ericsson Nikola Tesla Servisi have been working on delivery of services of monitoring, maintenance and rollout of HT's telecommunication network. In Q2 2019, the works on optical distribution networks have been intensified in order to secure broadband Internet for users.

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### Other information

At the Annual General Meeting of Ericsson Nikola Tesla joint stock company, held on June 13, 2019, among other decisions, a decision was adopted on dividend payment, amounting to HRK 70.60 per share from retained earnings from 2017 and 2018, to all the Company shareholders who have the Company shares registered on their securities account in the Central Depository & Clearing Company on June 19, 2019. Dividend was paid on July 12, 2019. Shareholders also reelected Vidar Mohammar as the member of the Supervisory Board and Olgica Spevec as the new member of the Supervisory Board.

Ericsson Nikola Tesla major shareholders (as at June 30, 2019)

	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	54,012	4.06
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	14,451	1.09
Zagrebačka banka d.d. / Unicredit Bank Austria AG – clients account	11,452	0.86
Zagrebačka banka d.d. / State Street Bank and Trust Company, Boston	10,804	0.81
OTP banka d.d. / OTP Index fund - open-end alternative investment fund with public offering	8,462	0.64
PBZ d.d. / custodian client account	8,426	0.63
Addiko Bank d.d. / Raiffeisen voluntary pension fund	7,934	0.60
Other shareholders	422,312	31.70

Share price information in Q2 2019:

Highest (HRK)	Lowest (HRK)	Closing (HRK)	Market cap. (In MHRK)
1,180.00	1,075.00	1,105.00	1,471.5

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Krapinska 45  
Zagreb

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 January 1, 2019 to June 30, 2019 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 dark 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>



Ericsson Nikola Tesla d.d.  
Consolidated statement of comprehensive income  
for the period ended 30 June 2019

	2019 HRK '000	2018 HRK '000
Sales revenue	821,749	762,374
Cost of sales	-702,362	-643,844
<b>Gross profit</b>	<b>119,387</b>	<b>118,530</b>
Selling expenses	-20,598	-19,692
Administrative expenses	-14,950	-15,561
Other operating income	20	591
Other operating expenses	8	52
<b>Operating profit</b>	<b>83,867</b>	<b>83,921</b>
Finance expense/income – net	1,263	-890
<b>Profit before tax</b>	<b>85,130</b>	<b>83,031</b>
Income tax	-14,077	-21,554
<b>Profit for the year</b>	<b>71,053</b>	<b>61,477</b>
Other comprehensive income	129	-47
<b>Total comprehensive income for the year</b>	<b>71,183</b>	<b>61,430</b>

Ericsson Nikola Tesla d.d.  
Consolidated statement of financial position  
as at 30 June 2019

	2019 HRK '000	2018 HRK '000
<b>ASSETS</b>		
<b>Non-current assets</b>		
Property, plant and equipment	107,239	114,654
Right-of-use assets	74,326	-
Intangible assets	4,649	5,070
Loans and receivables	48,984	51,657
Deferred tax assets	21,358	21,358
<b>Total non-current assets</b>	<b>256,556</b>	<b>192,739</b>
<b>Current assets</b>		
Inventories	203,190	110,695
Trade receivables	176,387	160,724
Contract assets	3,335	3,335
Receivables from related parties	132,291	109,900
Other receivables	7,350	14,170
Income tax receivable	456	472
Financial assets at fair value through profit or loss	68,784	48,490
Prepayments and accrued income	16,778	12,086
Cash and cash equivalents	152,671	187,888
<b>Total current assets</b>	<b>761,240</b>	<b>647,760</b>
<b>TOTAL ASSETS</b>	<b>1,017,797</b>	<b>840,499</b>
<b>EQUITY AND LIABILITIES</b>		
<b>Equity</b>		
Share capital	133,165	133,165
Treasury shares	-241	-241
Legal reserves	6,658	6,658
Retained earnings	236,579	165,396
<b>Total equity</b>	<b>376,162</b>	<b>304,979</b>
<b>Non-current liabilities</b>		
Borrowings	5,954	5,734
Lease liability	37,307	-
Employee benefits	8,779	8,662
Other non-current liabilities	6,652	6,520
<b>Total non-current liabilities</b>	<b>58,692</b>	<b>20,916</b>
<b>Current liabilities</b>		
Payables to related parties	64,113	33,306
Borrowings	90	36
Lease liability	25,570	-
Trade and other payables	160,063	178,908
Contract liabilities	172,687	171,645
Income tax payable	11	270
Provisions	29,781	16,023
Accrued charges and deferred revenue	130,627	114,416
<b>Total current liabilities</b>	<b>582,943</b>	<b>514,604</b>
<b>Total liabilities</b>	<b>641,635</b>	<b>535,520</b>
<b>TOTAL EQUITY AND LIABILITIES</b>	<b>1,017,797</b>	<b>840,499</b>

Ericsson Nikola Tesla d.d.  
Consolidated statement of cash flows  
for the period ended 30 June 2019

	2019 HRK '000	2018 HRK '000
<b>Cash flows from operating activities</b>		
<i>Profit before tax</i>	85,130	83,031
Adjustments for:		
Depreciation and amortisation	31,568	18,217
Impairment losses and reversals	2,613	648
Net increase in provisions	25,686	18,037
Gain on sale of property, plant and equipment	-2,156	-36
Net loss/(gain) on remeasurement of financial assets	-397	766
Amortisation of discount	-909	-
Interest income	-1,077	-1,034
Interest expense	853	214
Foreign exchange losses/(gains)	856	-2,505
	142,166	117,337
<i>Changes in working capital</i>		
In receivables	-31,209	18,802
In inventories	-92,495	-34,627
In payables	14,664	-73,386
<i>Cash generated from operations</i>	33,127	28,126
Interest paid	-890	-214
Income taxes paid	-245	-21,613
<b>Net cash from operating activities</b>	<b>31,992</b>	<b>6,299</b>
<b>Cash flows from investing activities</b>		
Interest received	897	1,258
Dividends received	34	-
Proceeds from sale of property, plant and equipment	2,109	95
Purchases of property, plant and equipment, and intangible assets	-36,717	-21,624
Deposits given to financial institutions - net	-1,662	-
Purchases of financial assets at fair value through profit and loss	-20,000	24
<b>Net cash used in investing activities</b>	<b>-55,340</b>	<b>-20,247</b>
<b>Cash flows from financing activities</b>		
Repayment of borrowings	112	-
Dividends paid	-	-19
Lease liabilities	-11,684	-
<b>Net cash used in financing activities</b>	<b>-11,572</b>	<b>-19</b>
Effects of exchange rate changes on cash and cash equivalents	-298	-2,014
<b>Net decrease/(increase) in cash and cash equivalents</b>	<b>-35,217</b>	<b>-15,981</b>
Cash and cash equivalents at the beginning of the year	187,888	159,261
<b>Cash and cash equivalents at the end of the year</b>	<b>152,671</b>	<b>143,281</b>