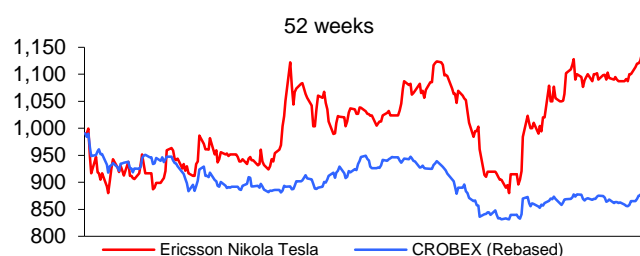


Ericsson Nikola Tesla

from Hold to Accumulate

HRK mn	2011	2012e	2013e	2014e
Net sales	1,165.7	2,315.0	1,248.6	1,278.0
EBITDA	36.5	166.9	134.7	139.7
EBIT	-12.0	121.5	92.7	101.8
Net result after min.	28.0	146.5	111.4	118.4
EPS (HRK)	21.11	110.34	83.93	89.21
CEPS (HRK)	53.76	145.02	114.85	117.58
BVPS (HRK)	640.95	581.29	465.21	454.42
Div./share (HRK)	170.00	200.00	100.00	100.00
EV/EBITDA (x)	18.3	6.0	8.2	7.9
P/E (x)	44.7	10.3	13.6	12.8
P/CE (x)	17.5	7.9	9.9	9.7
Dividend Yield	18.0%	17.5%	8.8%	8.8%
Share price (HRK) close as of 18/09/2012			1,140.0	
Number of shares (mn)			1.3	
Market capitalization (HRK mn / EUR mn)			1,515 / 205	
Enterprise value (HRK mn / EUR mn)			1,003 / 136	



Performance	12M	6M	3M	1M
in HRK	13.5%	9.8%	28.1%	4.6%
Reuters	ERNT.ZA	Free float		41.9%
Bloomberg	RNTRA CZ	Shareholders		Ericsson (49.1%)
Div. Ex-date	28/06/12	HAA / Raiffeisen MPF		(8.55%)
Target price	1,313.0	Homepage:	http://www.ericsson.com/hr	

Strong quarters and nice total return ahead

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The contract with Rostelecom prompted us to increase our top line estimates for 2012 by almost 100%, as we estimate the entire contract to be in the neighborhood of HRK 1.1bn. On the EBIT level, this contract should add nicely in absolute terms. However, given an estimated low single-digit margin, it should drag down operating profitability.

A dividend increase is anticipated, providing a strong trigger for the stock. We anticipate a dividend payout of HRK 200 per share (2011: HRK 170), translating into a **DY of 17.5%**, fuelled by the nice additional cash intake from the Rostelecom contract.

From 2013 on, we expect a rather stable business development at a somewhat low business level in the regional (BiH, MAZ, MTN, KOS) and CIS markets. There is also some potential in CRO from T-HT and Tele2, which are far behind in terms of their investment levels compared to previous years.

The fundamental upside and dividend yield add to the attractive total return. We see the upcoming quarterly figures and dividend as the main triggers and anticipate an impressive positive share price development as the dividend payout date approaches, starting in autumn. Our new recommendation is Accumulate (up from Hold), with a target price of HRK 1,313 (from HRK 1,294).

Contract with Rostelecom

RT contract impact on 2012

2012	ERNT old	RT contract	ERNT new
Revenues	1,215.0	1,100.0	2,315.0
EBITDA	129.4	37.5	166.9
EBIT	84.0	37.5	121.5
EBITDA %	10.6%	3.4%	7.2%
EBIT %	6.9%	3.4%	5.2%

Source: Erste Group Research

At the end of 2Q12, ERNT announced a new contract regarding the delivery of equipment for new Rostelecom (RT) 2G and 3G networks, including multi-standard RBS 6000 radio base stations, circuit and packet switched networks with Evolved Packet Core and Operation Support Systems (OSS). ERNT aims to finalize the delivery by YE12.

The value of the contract has not been disclosed. However, although the announcement was made only in late 2Q (June 29), there has already been a significant contribution to the 2Q12 results – about HRK 300-350mn, based on our estimates. As the contract is said to have a significant impact on 2H12 as well, we estimate the entire contract amount at about HRK 1.1bn, which means it will almost double our previously estimated revenues for ERNT in 2012. Based on the 2Q12 results, we expect the contract to be in a single-digit range margin-wise.

Further potential from Rostelecom

Rostelecom is the fixed-line, broadband and pay TV leader in the Russian market, with plans to invest about 20% of its revenues p.a. until 2015. This translates into EUR 2bn (RUR 82.8bn; HRK 15bn) p.a., out of which about RUR 15bn is dedicated to the annual LTE network expansion. Consequently, we believe that there is a realistic potential for follow-up contracts for ERNT. These may not come close to the contract ERNT is dealing with now, but could definitely help to increase its business in the CIS segment in the coming years. For now, we have not included any significant follow-up contracts, but rather a return to the revenue levels seen ahead of this contract in CIS.

Change in estimates

Consolidated, IFRS (HRK, mn)	2012e			2013e			2014e		
	Now	Before	Change	Now	Before	Change	Now	Before	Change
Revenues	2,315.0	1,187.8	94.9%	1,248.6	1,221.8	2.2%	1,278.0	1,250.7	2.2%
EBITDA	166.9	115.4	44.6%	134.7	126.0	6.9%	139.7	134.2	4.1%
EBITDA margin	7.2%	9.7%	-25.8%	10.8%	10.3%	4.6%	10.9%	10.7%	1.9%
EBIT	121.5	69.3	75.3%	92.7	86.4	7.2%	101.8	95.2	6.9%
EBIT margin	5.2%	5.8%	-10.0%	7.4%	7.1%	4.9%	8.0%	7.6%	4.6%
Net profit	146.5	85.0	72.4%	111.4	101.1	10.2%	118.4	109.4	8.2%
Net margin	6.3%	7.2%	-11.5%	8.9%	8.3%	7.8%	9.3%	8.8%	5.9%
EPS	110.34	64.24	71.8%	83.93	76.46	9.8%	89.21	82.76	7.8%
EPS adjusted	110.34	64.24	71.8%	83.93	76.46	9.8%	89.21	82.76	7.8%

Source: Erste Group Research

Dividend likely to be increased due to RT

With the additional cash from the RT contract and further potential coming from Russia, we expect the dividend to reflect this development. Consequently, we double our previous dividend estimate to HRK 200 (including an HRK 180 bonus dividend), which translates into a DY of 17.5%, based on the current share price of HRK 1,140.

Good timing for investment

We see the upcoming 3Q12 (October 30) as a share price trigger, as we anticipate a strong result, which should also help to assess the real volume of the RT contract. In previous years, the best investment timing to derive the greatest benefit from the share price development ahead of the dividend has been September to December. Further news flow regarding new business will definitely help the share price further.

Target price composition

	DCF	Multiple	Weight	12-month target price	act. shareprice	upside to target price	Recommendation
Ericsson Nikola Tesla	1,254.0	1,451.0	70/30	1,313.0	1,140	15.2%	Accumulate

Source: FactSet, Erste Group Research

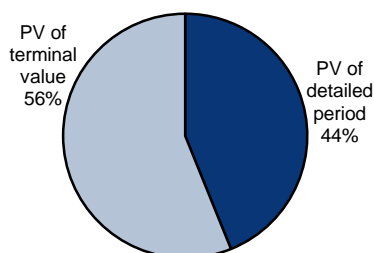
WACC calculation

	2013e	2014e	2015e	2016e	2017e	2018e (TV)
Risk free rate	5.8%	5.8%	5.8%	5.8%	5.8%	5.0%
Equity risk premium	6.1%	6.1%	6.1%	6.1%	6.1%	5.8%
Beta	1.1	1.1	1.1	1.1	1.1	1.0
Cost of equity	12.2%	12.2%	12.2%	12.2%	12.2%	10.8%
Cost of debt	8.3%	8.3%	8.3%	8.3%	8.3%	7.5%
Effective tax rate	0.0%	0.0%	0.0%	0.0%	0.0%	20.0%
After-tax cost of debt	8.3%	8.3%	8.3%	8.3%	8.3%	6.0%
Equity weight	100%	100%	100%	100%	100%	100%
WACC	12.2%	12.2%	12.2%	12.2%	12.2%	10.8%

DCF valuation

(HRK mn)	2013e	2014e	2015e	2016e	2017e	2018e (TV)
<i>Sales growth</i>	-46.1%	2.4%	2.4%	1.6%	1.6%	2.0%
EBIT	92.7	101.8	110.9	117.2	122.9	112.9
<i>EBIT margin</i>	7.4%	8.0%	8.5%	8.8%	9.1%	8.2%
<i>Tax rate</i>	0.0%	0.0%	0.0%	0.0%	0.0%	20.0%
Taxes on EBIT	0.0	0.0	0.0	0.0	0.0	-22.6
NOPLAT	92.7	101.8	110.9	117.2	122.9	90.3
+ Depreciation	42.0	38.0	35.2	33.4	32.2	32.2
<i>Capital expenditures / Depreciation</i>	68.2%	75.7%	81.9%	86.6%	90.1%	100.0%
+/- Change in working capital	43.2	-2.2	-2.5	-1.7	-1.7	-2.7
<i>Chg. working capital / chg. Sales</i>	-4.1%	-7.6%	-8.3%	-8.3%	-8.3%	-10.0%
- Capital expenditures	-28.7	-28.8	-28.8	-28.9	-29.0	-32.2
Free cash flow to the firm	149.2	108.7	114.8	119.9	124.3	87.6
<i>Terminal value growth</i>						2.0%
Terminal value						1,015.1
Discounted free cash flow - Dec 31 2012	133.0	86.4	81.3	75.7	69.9	570.7
Enterprise value - Dec 31 2012	1,016.9					
Minorities	0.0					
Non-operating assets	0.0					
Net debt	-510.8					
Other adjustments	0.0					
Equity value - Dec 31 2012	1,527.7					
Number of shares outstanding (mn)	1.3					
Cost of equity	12.2%					
12M target price per share (HRK)	1,253.5					
Current share price (HRK)	1,140.0					
<i>Up/Downside</i>	10.0%					

Enterprise value breakdown



Source: Factset, Erste Group Research

Sensitivity (per share)

WACC	Terminal value EBIT margin				
	7.2%	7.7%	8.2%	8.7%	9.2%
9.8%	1,247.1	1,280.3	1,313.5	1,346.7	1,379.9
10.3%	1,219.3	1,250.5	1,281.7	1,312.9	1,344.1
10.8%	1,194.6	1,224.1	1,253.5	1,282.9	1,312.4
11.3%	1,172.6	1,200.5	1,228.3	1,256.2	1,284.0
11.8%	1,152.9	1,179.3	1,205.7	1,232.2	1,258.6

WACC	Terminal value growth				
	1.0%	1.5%	2.0%	2.5%	3.0%
9.8%	1,248.9	1,279.3	1,313.5	1,352.5	1,397.1
10.3%	1,224.0	1,251.2	1,281.7	1,316.1	1,355.2
10.8%	1,201.6	1,226.2	1,253.5	1,284.1	1,318.7
11.3%	1,181.4	1,203.7	1,228.3	1,255.8	1,286.6
11.8%	1,163.1	1,183.4	1,205.7	1,230.5	1,258.1

Peer group comparison

	EV/sales		EV/EBITDA		EV/EBIT		P/E		P/BV	
	12e	13e	12e	13e	12e	13e	12e	13e	12e	13e
Sygnity	0.3	0.3	11.9	7.5	118.7	16.4	57.8	22	0.7	0.7
Alcatel-Lucent	0.5	0.5	5.0	4.4	8.4	7.6	12.8	10.9	2.2	1.9
Cisco Systems Inc.	1.5	1.3	4.5	4.0	5.4	4.6	10.3	9.8	2.0	1.7
Juniper Networks	2.8	2.0	9.8	6.9	11.0	8.2	20.8	18.0	2.6	2.8
F5 Networks	5.6	4.6	14.1	12.1	14.3	12.1	23.9	20.6	5.5	4.4
Ericsson	0.7	0.7	6.1	4.9	8.6	6.8	15.8	12.1	1.3	1.3
Secunet Security Networks AG	0.8	0.7	8.3	6.8	10.2	8.2	20.3	16.8	0.6	0.3
Median Peer Group	0.8	0.7	8.3	6.8	10.2	8.2	20.3	16.8	2.0	1.7
Ericsson Nikola Tesla	0.4	0.9	6.0	8.2	8.3	11.9	10.3	13.6	2.0	2.5
<i>Premium/discount</i>	<i>-44%</i>	<i>31%</i>	<i>-28%</i>	<i>20%</i>	<i>-19%</i>	<i>45%</i>	<i>-49%</i>	<i>-19%</i>	<i>-1%</i>	<i>42%</i>
Implied equity value per share	1,743	950	1,429	1,001	1,320	881	2,234	1,410	1,156	805
Per ERNT share (HRK) Dec 2011	1,576									
Per ERNT share (HRK) Dec 2012		1,009								
Period weight	50%	50%								
Net present value as of Sept 2012	1,293									
Cost of Equity	12.2%									
Net present value as of Sept 2013	1,451									

Source: Factset, Erste Group Research

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Income Statement	2009	2010	2011	2012e	2013e	2014e
(IFRS, HRK mn, 31/12)	31/12/2009	31/12/2010	31/12/2011	31/12/2012	31/12/2013	31/12/2014
Net sales	1,400.01	1,218.86	1,165.66	2,314.95	1,248.61	1,278.01
Invent. changes + capitalized costs	-27.31	21.82	-10.15	-10.15	-10.15	-10.15
Total revenues	1,372.70	1,240.68	1,155.51	2,304.81	1,238.47	1,267.87
Other operating revenues	17.33	15.41	14.66	28.65	15.45	15.82
Material costs	-789.84	-636.14	-637.46	-1,729.27	-680.49	-700.35
Personnel costs	-441.93	-432.42	-419.49	-420.23	-424.88	-429.63
Other operating expenses	-27.79	-145.95	-76.74	-17.11	-13.85	-13.98
EBITDA	130.47	41.58	36.49	166.85	134.69	139.72
Depreciation/amortization	-64.79	-56.83	-48.44	-45.37	-42.04	-37.96
EBIT	65.68	-15.25	-11.95	121.48	92.66	101.76
Financial result	61.14	41.22	34.30	25.00	18.76	16.67
Extraordinary result	0.00	0.00	0.00	0.00	0.00	0.00
EBT	126.82	25.97	22.35	146.48	111.42	118.43
Income taxes	1.63	-1.91	5.63	0.00	0.00	0.00
Result from discontinued operations	0.00	0.00	0.00	0.00	0.00	0.00
Minorities and cost of hybrid capital	0.00	0.00	0.00	0.00	0.00	0.00
Net result after minorities	128.45	24.06	27.98	146.48	111.42	118.43
Balance Sheet	2009	2010	2011	2012e	2013e	2014e
(IFRS, HRK mn, 31/12)						
Intangible assets	4.43	4.81	3.42	3.35	3.34	3.39
Tangible assets	146.35	128.64	134.11	132.41	119.04	109.79
Financial assets	120.92	63.30	68.29	68.29	68.29	68.29
Total fixed assets	271.69	196.76	205.83	204.05	190.68	181.47
Inventories	24.06	44.77	22.70	23.05	12.38	12.68
Receivables and other current assets	828.09	494.03	418.32	600.75	372.34	381.18
Other assets	13.67	15.67	18.80	18.44	17.34	17.75
Cash and cash equivalents	414.94	673.93	525.22	449.61	352.13	344.84
Total current assets	1,280.75	1,228.40	985.04	1,091.85	754.20	756.45
TOTAL ASSETS	1,552.44	1,425.16	1,190.87	1,295.90	944.88	937.92
Shareholders'equity	1,200.22	1,071.02	850.91	771.70	617.61	603.28
Minorities	0.00	0.00	0.00	0.00	0.00	0.00
Hybrid capital and other reserves	0.00	0.00	0.00	0.00	0.00	0.00
Pension and other LT personnel accruals	5.13	4.89	4.53	5.03	5.09	5.14
LT provisions	0.00	0.00	0.00	0.00	0.00	0.00
Interest-bearing LT debts	4.97	3.35	1.44	0.00	0.00	0.00
Other LT liabilities	0.00	0.00	0.00	0.00	0.00	0.00
Total long-term liabilities	4.97	3.35	1.44	0.00	0.00	0.00
Interest-bearing ST debts	1.66	1.67	2.05	2.05	2.05	2.05
Other ST liabilities	340.47	344.23	332.08	517.24	320.27	327.58
Total short-term liabilities	194.83	208.00	163.02	357.95	186.08	190.16
TOTAL LIAB. , EQUITY	1,552.44	1,425.16	1,191.00	1,296.02	945.01	938.05
Cash Flow Statement	2009	2010	2011	2012e	2013e	2014e
(IFRS,HRK mn, 31/12)						
Cash flow from operating activities	284.05	366.36	135.00	220.11	215.47	170.88
Cash flow from investing activities	-84.97	47.12	-41.15	-43.59	-28.67	-28.75
Cash flow from financing activities	-102.44	-154.49	-242.56	-252.13	-284.28	-149.43
CHANGE IN CASH , CASH EQU.	96.63	258.99	-148.71	-75.61	-97.48	-7.30
Margins & Ratios	2009	2010	2011	2012e	2013e	2014e
Sales growth	-22.2%	-12.9%	-4.4%	98.6%	-46.1%	2.4%
EBITDA margin	9.5%	3.4%	3.2%	7.2%	10.9%	11.0%
EBIT margin	4.8%	-1.2%	-1.0%	5.3%	7.5%	8.0%
Net profit margin	9.4%	1.9%	2.4%	6.4%	9.0%	9.3%
ROE	10.9%	2.1%	2.9%	18.1%	16.0%	19.4%
ROCE	11.2%	-0.9%	-3.0%	46.2%	39.8%	50.7%
Equity ratio	77.3%	75.2%	71.4%	59.5%	65.4%	64.3%
Net debt	-524.1	-727.3	-585.5	-510.8	-413.3	-405.9
Working capital	1,072.3	1,004.7	803.2	715.5	550.8	548.5
Capital employed	676.2	343.8	265.5	260.9	204.4	197.4
Inventory turnover	20.5	18.5	18.9	75.6	38.4	55.9

Source: Company data, Erste Group estimates

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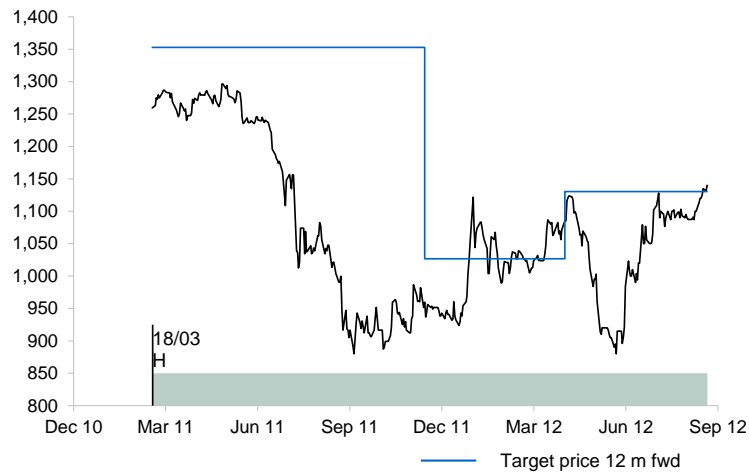
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Ericsson Nikola Tesla



Rating history

Date	Rating	Price	Target Price
11. Mar 10	Hold	1100.90	1353.00
31. Jul 09	Not rated	1039.44	
31. Mar 08	Hold	1995.59	2459.21
25. Jan 08	Under review	2150.34	
06. Nov 06	Hold	1822.96	2101.28
09. Jun 04	Buy	462.99	

Company description

Ericsson Nikola Tesla, as an integral part of the Ericsson Group, supports the modern ways of communicating. The company's activities include marketing and sales, research and development, design of the total communications solution, services in the multi-service and mobile networks area including the mobile Internet and complex system integration in all business areas. The company provides innovative ICT solutions that constantly improve people's life and create new value.

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Disclosure Checklist

Company	ISIN	Disclosure
Ericsson Nikola Tesla	HRERNTRA0000	

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Recommendation	Coverage universe		Inv. banking-relationship	
	No.	in %	No.	in %
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Accumulate	42	23.5	11	22.9
Hold	43	24.0	13	27.1
Reduce	11	6.1	4	8.3
Sell	8	4.5	1	2.1
N.R./UND.REV./RESTR.	9	5.0	0	0.0
Total	179	100.0	48	100.0

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20 September 2012

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