Consolidated financial statements as of December 31, 2018, and Group management report

TRANSLATION – AUDITOR'S REPORT

H&K AG
Oberndorf/Neckar

KPMG AG Wirtschaftsprüfungsgesellschaft

H&K AG

Consolidated Statements According to IFRS for the Financial Year 2018

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

AS OF

EUR '000	Note	31.12.18	31.12.17
Property, plant & equipment	17	45,629	43,428
Intangible assets - goodwill	16	5,149	5,149
Intangible assets - other	16	35,419	33,317
Other investments & derivatives	18	4,061	2,295
Deferred tax assets	15	14,888	13,953
Total non-current assets		**105,146**	**98,141**
Inventories	19	87,680	75,102
Prepayments for inventories	20	81	14
Prepayments for other current assets	20	1,475	738
Other loans, investments & derivatives	18,36	13,841	2,733
Current tax assets		399	370
Trade receivables	20	31,064	21,156
Other receivables	20	1,022	5,702
Cash & cash equivalents	21	22,278	18,812
Total current assets		**157,840**	**124,625**
Total assets		**262,986**	**222,767**

Equity			
Share capital		27,641	27,641
Additional paid in capital		53,025	53,025
Reserves & consolidated retained earnings		(199,366)	(189,986)
Total equity	22	**(118,699)**	**(109,320)**
Liabilities			
Loans & borrowings	25	230,688	182,235
Finance lease obligations	25	27	-
Employee defined benefit obligations	23	61,600	62,101
Provisions	24	2,979	2,582
Deferred tax liabilities	15	20,943	20,853
Total non-current liabilities		**316,238**	**267,771**
Trade payables	26	21,855	21,180
Other payables	26	11,933	10,771
Contract liabilities (2017: Advanced & stage payments received)	27	17,495	6,910
Deferred income		-	46
Provisions for income taxes		140	5,958
Other provisions & accruals	24	14,025	19,452
Total current liabilities		**65,448**	**64,316**
Total liabilities		**381,685**	**332,087**
Total equity & liabilities		**262,986**	**222,767**

CONSOLIDATED INCOME STATEMENT

FOR THE PERIOD JANUARY 1 TO DECEMBER 31

EUR '000	Note	2018	2017
Revenue	6	220,946	182,038
Cost of sales	7	(167,193)	(112,415)
Gross profit		**53,753**	**69,623**
Research & development expenses	8	(7,370)	(5,724)
Sales, marketing & distribution expenses	9	(22,751)	(24,853)
Administration expenses	10	(16,661)	(21,301)
Other operating income	11	2,860	4,562
Other operating expenses	12	(1,540)	(1,245)
Impairment loss on trade receivables and contract assets net of reversals	12,20	1,418	(97)
Results from operating activities		**9,709**	**20,965**
Interest income		79	108
Gains on translation of foreign currencies		1,521	52
Total financial income	**14**	**1,601**	**160**
Interest expense		(14,420)	(19,623)
Accretion of non-current liabilities		(4,035)	(2,507)
Valuation of bond early repayment clauses		-	(1,360)
Losses on valuation of investments		-	(51)
Losses on translation of foreign currencies		332	(5,056)
Other financial expense		(102)	(52)
Total financial expense	**14**	**(18,225)**	**(28,648)**
Net financial result	**14**	**(16,625)**	**(28,488)**
Profit / (loss) before income tax		**(6,916)**	**(7,523)**
Income tax expense	15	(1,136)	(5,862)
Profit / (loss) for the period		**(8,052)**	**(13,385)**
Attributable to the shareholders of H&K AG		**(8,052)**	**(13,385)**
Earnings per share (€)	**22.0**	**(0.29)**	**(0.59)**

CONSOLIDATED STATEMENT OF PROFIT OR LOSS
AND OTHER COMPREHENSIVE INCOME
FOR THE PERIOD JANUARY 1 TO DECEMBER 31

EUR '000	Note	2018	2017
Profit / (loss) for the period		**(8,052)**	**(13,385)**
Other comprehensive income			
DBO actuarial gains / (losses)	23	(1,445)	1,314
Related deferred tax	15	406	(369)
Items that will never be reclassified to profit or loss		**(1,040)**	**945**
Forex translation differences for foreign operations	22	(288)	(243)
Items that are or may be reclassified to profit or loss		**(288)**	**(243)**
Other comprehensive income / (expense), net of tax	**22**	**(1,327)**	**702**
Total comprehensive income for the period		**(9,379)**	**(12,683)**
Attributable to the shareholders of H&K AG		**(9,379)**	**(12,683)**

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

FOR JANUARY 1 TO DECEMBER 31, 2018

EUR '000	Share Capital	Additional Paid in Capital	Translation Reserve	Reserve for Defined Benefit Obligations	Consolidated Retained Earnings	Shareholders' Equity
As of 01.01.2017	**21,000**	**9,920**	**21**	**(15,376)**	**(161,949)**	**(146,384)**
Issue of new shares	6,641	43,105	-	-	-	49,746
Total recognised income & expense	-	-	(243)	945	(13,385)	(12,683)
As of 31.12.2017	**27,641**	**53,025**	**(222)**	**(14,431)**	**(175,334)**	**(109,320)**
Total recognised income & expense	-	-	(288)	(1,040)	(8,052)	(9,379)
As of 31.12.2018	**27,641**	**53,025**	**(510)**	**(15,470)**	**(183,386)**	**(118,699)**

CONSOLIDATED STATEMENT OF CASH FLOWS

FOR THE PERIOD JANUARY 1 TO DECEMBER 31

EUR '000	Note	2018	2017
Cash flows from operating activities			
Profit / (loss) for the period		(8,052)	(13,385)
Adjustments for:			
Depreciation	17	6,371	6,498
Amortisation of intangible assets	16	2,567	2,465
(Reversal of) impairment losses on intangible assets	16	1,986	39
Revaluation of investments	14,18	(0)	51
Net interest expense	14	18,478	22,074
Change in fair value of derivatives	14	-	1,360
(Gain) / loss on disposal of property, plant & equipment	11,12	(18)	762
Income tax expense	15	1,136	5,862
		22,468	25,726
Change in inventories		(12,022)	(18,686)
Change in trade & other receivables		(5,057)	3,124
Change in prepayments		(798)	(156)
Change in trade & other payables		10,214	15,509
Change in provisions & employees' defined benefits		(8,080)	(4,510)
		6,725	21,008
Income tax paid	15	(7,204)	(3,933)
Net cash from / (used in) operating activities		**(479)**	**17,075**
Cash flows from investing activities			
Interest received	36	79	108
Proceeds from sale of property, plant & equipment		19	50
Acq'n of property, plant, equipment & intangibles	16,17	(8,367)	(12,888)
Net investment in loans and other	36	2	10
Capitalised development expenditure	16	(6,255)	(6,466)
Net cash from / (used in) investing activities	**30**	**(14,522)**	**(19,186)**
Cash flows from financing activities			
Proceeds from issue of new shares	22	-	49,637
Proceeds from loans / issue of notes	25	80,000	185,688
Payment of transaction costs	25	-	(4,008)
Repayment of own bond	25	(35,000)	(220,323)
Interest paid	25	(13,740)	(18,651)
Payment of finance lease liabilities		(16)	-
Net cash from / (used in) financing activities		**31,244**	**(7,657)**
Net cashflows	**30**	**16,243**	**(9,768)**
Bank balances at January 1	30	23,837	33,942
Effect of exchange rate fluctuations on cash held		100	(337)
Bank balances at December 31	**30**	**40,180**	**23,837**
Less security deposits with terms >3 months	25,30	(17,903)	(5,025)
Cash & cash equivalents at December 31	**21**	**22,278**	**18,812**

Notes to the consolidated financial statements for the year 2018

Contents

General disclosures

(1) Presentation of the consolidated financial statements

H&K AG, the parent company of the Group, is registered under HRB 748522 at the Stuttgart district court. The company's registered office is in Oberndorf/Neckar, Germany, and the postal address is H&K AG, Heckler & Koch-Str. 1, 78727 Oberndorf/Neckar, Germany. The articles of incorporation are from March 18, 2014 with an addendum from March 21, 2014 and last changed by a resolution on September 21, 2018; the registered name of the company is H&K AG. Since July 28, 2015 H&K AG's shares have been listed under ISIN DE000A11Q133 on the Euronext free market ("Marché Libre") in Paris; approx. 0.03% are tradable, the remaining 99.97% are held by our main shareholders. The financial year is the calendar year.

The purpose of H&K AG is to invest in any way in other domestic and foreign companies, to acquire other domestic and foreign companies, in particular to invest in and acquire Heckler & Koch GmbH (HKO), Oberndorf/Neckar, to hold, manage and sell its own companies and investments in companies, to determine the strategy of the company and the Group, and to manage and acquire land, buildings, leasehold rights and other assets for the above objectives.

The H&K AG Group is defined by both the defence and commercial business activities of HKO and has subsidiaries in the US, England and France. HKO develops, manufactures, markets and distributes, together with its subsidiaries, infantry and sidearms primarily for governmental security forces and is one of the leading businesses in this market segment in NATO and Europe; the companies also provide related services. For the commercial market we are concentrating on the development and introduction of new products. In alignment with the "Principles of the German Federal Government governing the export of small arms and light weapons, corresponding ammunition and production equipment to third countries" from March 18, 2015 (the "Small Arms Principles"), the executive directors have focussed HK's sales strategy on so-called "Green Countries". The Green-Country-Strategy that we have chosen to implement is a clear commitment to our values. We are a significant part of the security architecture for the Federal Republic of Germany, many European countries, NATO members and countries associated with NATO, as well as several countries that share European values. In principle, we will only serve these countries. Providing applicable valid export licences are received, the remaining contractual order book for other countries will be fulfilled, but for new tenders we are only seeking to serve "Green Countries". We will only complete transactions after open, transparent and close coordination with, and the approval of, the appropriate German authorities.

The consolidated financial statements have been prepared in euro. Unless otherwise stated, all financial information presented in euro has been shown to the nearest thousand (€k, EUR '000). As a result, the totals in this report may vary slightly from the exact arithmetic aggregation of the figures that precede them.

For the income statement, expenses have been classified by function. In order to enhance the clarity of presentation, various items in the balance sheet and in the income statement have been aggregated.

(2) Executive board approval

The board of directors of H&K AG finalised & approved the consolidated financial statements on April 10, 2019.

(3) Statement of compliance with applicable law and IFRS

The consolidated financial statements of H&K AG (H&K AG Group / Group) as at December 31, 2018, have been prepared in accordance with the International Financial Reporting Standards (IFRS) of the International Accounting Standards Board (IASB) as applicable in the EU, together with interpretations of the International Financial Reporting Interpretation Committee (IFRIC) and the supplementary German commercial law regulations pursuant to § 315a (1) HGB. All IFRS's and IFRIC's which were effective for the financial year 2018 have been applied. Except for the changes below, the Group has consistently applied the policies described in Note 5 to all periods presented in these consolidated statements.

Certain amended standards and interpretations were mandatory in the EU for the first time in 2018 and, where relevant, were applied in preparing these consolidated financial statements; the nature and effects of those changes that are material for the Group are set out below:

IFRS 9 Financial Instruments
The Group has adopted IFRS 9 from January 1, 2018.

IFRS 9 sets out requirements for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial contracts. This standard replaces IAS 39 Financial Instruments: Recognition and Measurement.

Due to the transition method chosen by the Group for the adoption of this standard, with the exception of the separate position for impairment of trade receivables and contract assets, the comparative information in these financial statements has not been adjusted to be in line with the requirements of the new standard. Therefore, there were no changes to the opening values for other reserves or revenue reserves in the 2017 comparative numbers.

The effects of the adoption of the standard are primarily due to the increase in impairment expenses for financial assets.

As a result of the adoption of IFRS 9, the Group has adopted consequential amendments to IAS 1 Presentation of Financial Statements, which require impairment of financial assets to be presented in a separate line item in the consolidated income statement. Previously, the Group's approach was to include the impairment of trade receivables in other expenses. Consequently, the Group reclassified impairment amounts recognised under IAS 39 in the income statement for 2017 to "impairment loss on trade receivables and contract assets net of reversals"; these were impairment losses amounting to €196k from "other operating expenses" and impairment reversals amounting to €99k from "other operating income".

Additionally, the Group has adopted consequential amendments to IFRS 7 Financial Instruments: Disclosures that are applied to disclosures about 2018 but have not been generally applied to comparative information.

i. Classification and measurement of financial assets and financial liabilities

IFRS 9 contains three principal classification categories for financial assets:

- measured at amortised cost,
- fair value through other comprehensive income (FVOCI) and
- fair value through profit or loss (FVTPL).

The classification of financial assets under IFRS 9 is generally based on the business model in which a financial asset is managed and its contractual cash flow characteristics. IFRS 9 eliminates the previous IAS 39 categories of

- held to maturity,
- loans and receivables and
- available for sale.

Under IFRS 9, derivatives embedded in contracts where the host is a financial asset in the scope of the standard are never separated. Instead, the hybrid financial instrument as a whole is assessed for classification.

IFRS 9 largely retains the existing requirements in IAS 39 for the classification and measurement of financial liabilities. The adoption of IFRS 9 has not had a significant effect on the Group's accounting policies related to financial liabilities.

For an explanation of how the Group classifies and measures financial instruments and accounts for related gains and losses under IFRS 9, see Note 5).

The following notes explain the original measurement categories under IAS 39 and the new measurement categories under IFRS 9 for each class of the Group's financial assets and financial liabilities as at January 1, 2018.

Trade and other receivables and cash and cash equivalents that were classified as loans and receivables under IAS 39 are now classified and valued at amortised cost. The review of the allowance for the impairment of receivables at January 1, 2018 on transition to IFRS 9 did not result in any required revaluations. No additional trade receivables had to be recognised at January 1, 2018 on the adoption of IFRS 15.

ii. Impairment of financial assets

IFRS 9 replaces the "incurred loss" model in IAS 39 with an "expected credit loss" (ECL) model. The new impairment model applies to financial assets measured at amortised cost and, if held, debt investments at FVOCI, but not to investments in equity instruments. Under IFRS 9, credit losses are recognised earlier than under IAS 39; additional information on the determination of the impairment allowances for the Group are provided in Notes 5, 20.

For assets in the scope of the IFRS 9 impairment model, impairment losses are generally expected to increase somewhat and become more volatile. The H&K AG Group has determined that, based on the actual risk structure, the application of IFRS 9's new impairment requirements at January 1, 2018 did not result in any material additional allowances for impairment, however due to credit losses during the year following the insolvency of a commercial customer, the expected value had to be updated.

iii. Hedge accounting

The Group has in the past used, and will in future use, forward foreign exchange contracts to hedge the variability in cash flows arising from changes in foreign exchange rates relating to foreign currency trade receivables and trade payables. Since we had no forward foreign exchange contracts during 2017 or 2018, we will not go into further detail in this report.

iv. Transition

With regard to a possible retrospective application, changes in accounting policies resulting from the adoption of IFRS 9 have been applied as described below:

— The Group has used an exemption not to restate comparative information for prior periods with respect to classification and measurement (including impairment) requirements. Therefore, comparative periods have not been restated. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 are recognised in retained earnings and reserves as at January 1, 2018; however, these were not material for the Group. Accordingly, the information presented for 2017 does not generally reflect the requirements of IFRS 9, but rather those of IAS 39.

— The determination of the business model within which a financial asset is held have been made on the basis of the facts and circumstances that existed at the date of initial application.

IFRS 15 - Revenue from Contracts with Customers; Amendments to IFRS 15 – Clarifications to IFRS 15 Revenue from Contracts with Customers

IFRS 15 provides a comprehensive framework for the determination of whether, with what value and when revenues may be recognised. It replaced the guidelines for the recognition of sales revenues included in IAS 18 - Revenue, IAS 11 – Construction Contracts and IFRIC 13 – Customer Loyalty Programmes. Under IFRS 15, revenue is recognised when a customer obtains control of the goods or services. Determining the timing of the transfer of control – at a point in time or over time – requires judgement.

The Group adopted IFRS 15 for the first time from January 1, 2018.

Due to the transition method chosen, the comparative information presented in these financial statements has not been restated in line with the new standard.

For the transition, the Group used the cumulative effect method (with practical expedients for all contract changes prior to the adoption date), so that cumulative application effects were recognised as at January 1, 2018. Accordingly, the information presented for 2017 has not been restated – i.e. it is presented, as previously reported, under IAS 18, IAS 11 and related interpretations. Additionally, the disclosure requirements in IFRS 15 have not generally been applied to comparative information.

There were no material effects on the Group’s statement of financial position as at December 31, 2018 (just the renaming of “advanced and stage payments received” as “contract liabilities”) or on the Group’s statement of cash flows for 2018. In the consolidated income statement for 2018, the main effect resulted from the reclassification of liquidated damages to revenue reductions; this reduced revenues by €1.8 million in 2018; in the previous year comparable expenses of around €3 million were classified as other operating expenses.

See Note 5 for additional information on the Group’s accounting methods relating to revenue recognition.

Changes due to other IFRS that were mandatory in the EU for the first time in 2018 are not material for the Group and are therefore not detailed here.

A number of new or amended standards and interpretations are only mandatory for later accounting periods and have not been applied in preparing these consolidated financial statements. Those that may have a material effect on the Group’s consolidated financial statements are set out below; unless otherwise indicated, the effects are currently being determined. The Group does not plan to adopt these standards early.

a) Endorsed by the EU

IFRS 16 - Leases

IFRS 16 will be effective from the first reporting period of annual periods beginning on or after January 1, 2019.

The Group has assessed the estimated impact that initial application of IFRS 16 will have on its consolidated financial statements, as described below. The actual impacts of adopting the standard on January 1, 2019 may change because the new accounting policies are subject to change until the Group presents its first financial statements that include the date of initial application.

IFRS 16 introduces a single, on-balance lease sheet accounting model for lessees. A lessee recognises a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. There are simplification rules for short-term leases and leases of low value items. Lessor accounting remains similar to the current standard – i.e. lessors continue to classify leases as finance or operating leases.

IFRS 16 replaces existing leases guidance including IAS 17 Leases, IFRIC 4 Determining whether an arrangement contains a lease, SIC-15 Operating leases – incentives and SIC-27 Evaluating the substance of transactions involving the legal form of a lease.

i. Leases in which the Group is a lessee

The Group will recognise new assets and liabilities for its material operating leases. The nature of expenses related to those leases will now change because the Group will recognise a depreciation charge for right-of-use assets and interest expense on lease liabilities.

Previously, the Group recognised operating lease expense on a straight-line basis over the term of the lease, and recognised assets and liabilities only to the extent that there was a material timing difference between actual lease payments and the expense recognised.

No significant impact is expected for the Group's finance leases.

Based on the information currently available, the Group estimates that it will recognise additional right-of-use assets of around €1.5 million and lease liabilities of around €1.7 million as at January 1, 2019.

The Group does not expect the adoption of IFRS 16 to negatively impact its ability to comply with the Financial Covenants described in Note 25.

ii. Leases in which the Group is a lessor

Since we had no such leases during 2017 or 2018, we will not go into further detail in this report.

iii. Transition

The Group plans to apply IFRS 16 initially on January 1, 2019, using the modified retrospective approach. Therefore, the cumulative effect of adopting IFRS 16 will be recognised as an adjustment to the opening balance of retained earnings at January 1, 2019, with no restatement of comparative information.

The Group plans to apply the practical expedient to retain the definition of a lease on transition. This means that it will apply IFRS 16 to all contracts entered into before January 1, 2019 and identified as leases in accordance with IAS 17 and IFRIC 4.

b) EU endorsement pending

At present the the Group does not expect material effects to result from the current new or amended standards and interpretations for which an EU endorsement is still pending; these changes to IFRS are therefore not covered here.

(4) Group entities

Apart from the single entity statements of H&K AG, the consolidated financial statements of H&K AG as at December 31, 2018, include the annual financial statements of seven (2017: seven) foreign and domestic subsidiaries. Subsidiaries are companies, which the parent enterprise can control due to voting rights or for other reasons and for which it is exposed to positive and negative variable returns and has the ability to affect such returns through its control position.

The following table shows a list of the subsidiaries included in the consolidation, together with their total equity and profit for the year figures from their financial statements, as prepared for consolidation purposes under IFRS, in their functional currencies:

			Ownership Interest					
				2018			2017	
	Abbreviation	Functional Currency	%	Equity	Profit	%	Equity	Profit
Direct holdings								
Heckler & Koch Management GmbH	HKM	EUR '000	100%	351,299	(79,017)	100%	351,299	2,057
Heckler & Koch GmbH	HKO	EUR '000	5.1%	123,842	10,385	5.1%	115,931	6,221
Indirect holdings								
Heckler & Koch GmbH	HKO	EUR '000	94.9%	123,842	10,385	94.9%	115,931	6,221
NSAF Limited, Nottingham, England	NSAF	GBP '000	100%	2,539	1,229	100%	2,810	1,899
Heckler & Koch France S.A.S., Paris, France	HKF	EUR '000	100%	1,845	1,004	100%	2,841	1,237
Small Arms Group Holding Inc., Ashburn VA, USA	SAGH	USD '000	100%	17,019	-	100%	17,019	-
Heckler & Koch Defense Inc., Ashburn VA, USA	HKD	USD '000	100%	(19,131)	(1,183)	100%	(17,948)	(1,976)
Heckler & Koch, Inc., Columbus GA, USA	HKI	USD '000	100%	10,334	(5,301)	100%	15,635	(4,255)

HKO and HKM, each located in Oberndorf a.N., have availed themselves of the German commercial law option §264 Abs. 3 HGB to not publish single entity accounts. This exemption clause was also applied by HKO regarding the preparation of a management report.

Due to lack of materiality, a fully allowed for 26% holding in a foreign company recognised at a net book value of nil (2017: nil) has not been recognised and valued at equity in the consolidation; instead it is included in the other non-current investments (Note 18).

(5) Summary of significant accounting policies and basis of measurement

The consolidated financial statements have been prepared on a historical cost basis; where IFRS requires recognition at fair value, this has been applied.

The significant accounting policies and measurement methods applied in preparing the consolidated financial statements are described below:

Consolidation methods

The assets and liabilities of the domestic and foreign companies included in the consolidated financial statements are recognised and measured using the accounting and measurement methods that apply uniformly for the H&K AG Group.

On the acquisition of a company, the assets and liabilities of the subsidiaries concerned are measured at their fair value at the time of acquisition. If the acquisition costs for the participation exceed the net fair value of the identified assets and debts, the difference is capitalised as goodwill. If the acquisition costs are lower, the fair value of the assets and liabilities and the amount of the acquisition costs are reassessed. Any remaining negative goodwill (lucky buy) is recorded immediately in the income statement.

In subsequent periods, the associated fair value adjustments to assets and liabilities are maintained, written off or released in accordance with the corresponding assets and liabilities. Capitalised goodwill is not amortised, but is subject to an annual impairment test in accordance with IFRS 3 instead.

The financial year of all companies included corresponds to the financial year of the parent company.

All receivables, liabilities, sales revenues, other income and expenses, including interest and dividends, within the scope of consolidation are eliminated. Unrealised profits from intra-group supplies are eliminated from inventories or fixed assets as appropriate.

Currency translation

The H&K AG Group reporting currency is the euro (€).

Foreign currency transactions are translated in the individual financial statements of H&K AG and its consolidated companies at the rates pertaining at the time of the transactions. As at the balance sheet date, assets and liabilities in foreign currency are measured at the spot rate on the balance sheet date. Differences arising on translation are recorded in the income statement.

The financial statements of the foreign companies are translated from their functional currencies into euro. Since subsidiaries operate their business independently, their functional currency is their individual local currency. In the consolidated financial statements, income and expenses from the financial statements of subsidiaries that are prepared in foreign currency are translated at the average rate for the year calculated from the daily rates. This method is used for simplicity since usually the local currency income and expenditure involved are fairly evenly spread throughout the year and consequently any potential variances are not material. Assets and liabilities are translated at the spot rate on the balance sheet date. Foreign currency translation variances are taken directly to the foreign currency translation reserve in equity. In the event of the disposal of a consolidated entity, associated accumulated foreign currency translation variances are recorded as part of the profit or loss on disposal.

The rates used for currency translation are shown in the table below:

Currency	Abbr.	Rate on balance sheet date 31.12.2018	Rate on balance sheet date 31.12.2017	Average exchange rate 2018	Average exchange rate 2017
US Dollar (USA)	USD	1.1450	1.1993	1.1810	1.1297
Pound (Great Britain)	GBP	0.8945	0.8872	0.8847	0.8767

Significant accounting policies

Goodwill

Goodwill is an asset representing the future economic benefits that cannot be individually identified and separately recognised from the net assets obtained through a business combination. Goodwill is allocated to the following cash generating units (segments):

EUR '000		
Site location: Germany	4,016	4,016
Site location: France	1,133	1,133
Total	**5,149**	**5,149**

Goodwill is capitalised and subjected to an annual impairment test as of the balance sheet date. If the carrying value is no longer recoverable, impairment is charged. Otherwise the prior year carrying value is retained. Any impairment charge against goodwill is not reversed, even if the valuation exceeds the carrying value.

Goodwill from acquisitions is capitalised; negative goodwill from acquisitions prior to the IFRS transition on January 1, 2006 has been offset against reserves. On divestment of a consolidated company any goodwill relating to it, other than negative goodwill, is included in the computation of the deconsolidation result.

Intangible assets

Purchased intangible assets, mainly trademarks, patents, licences and software, are capitalised at acquisition cost. Internally generated intangible assets, with the exception of goodwill, are capitalised if it is sufficiently probable that a future economic benefit will flow from the use of the asset and the costs of the asset can be determined reliably. The manufacturing costs of internally generated intangible assets are determined on the basis of directly attributable individual costs as well as a proportion of directly allocated overheads. Financing costs are only capitalised to the extent that they are directly attributable to the acquisition or production of a qualifying asset.

With the exception of goodwill and trademarks, all intangible assets have finite useful lives and are amortised using the straight-line method over this period. The €8,393k (2017: €8,393k) trademark is allocated to the cash-generating unit (segment) Site Location Germany and is subject to an annual impairment test in line with that described for goodwill. Licences and software usually have useful lives of 1 - 10 years. Capitalised development costs usually have useful lives of 8 years from the date that sales of the developed product commence. If the expected useful life for an individual asset is materially longer or shorter than these standard periods, the expected useful life is used.

Property, plant and equipment

Tangible assets which will be used in the business for more than one year are capitalised and valued at acquisition or manufacturing costs less depreciation calculated using the straight-line, use-related method, together with impairment if appropriate. The manufacturing costs of internally generated tangible assets are determined on the basis of directly attributable individual costs as well as a proportion of directly allocated overheads. Financing costs are generally not capitalised. (Financing costs are only capitalised to the extent that they are directly attributable to the acquisition, construction or production of a qualifying asset). The permitted alternative method of revaluation is not applied.

The following useful lives are applied for scheduled depreciation Group-wide:

Category of tangible asset	years
Buildings	25 - 40
Plant and machinery	3 - 10
Tooling	3
Vehicles	3 - 9
Fixtures, fittings and office equipment	3 - 15

The useful lives and methods of depreciation are reviewed regularly, and in individual cases, in order to ensure that these are in line with the actual expected economic use.

Impairment of tangible assets and of intangible assets

As at each balance sheet date, if there are triggering events for impairment, material tangible assets and intangible assets are submitted to an impairment test in accordance with IAS 36. If the carrying value of an asset exceeds its recoverable amount, an impairment loss is recognised. The recoverable amount is the higher of (i) fair value less costs to sell and (ii) value in use. If the recoverable amount for an individual asset cannot be determined, an estimate is made of the recoverable amount at the level of next higher cash generating unit.

If, in the following periods the recoverable amount exceeds the carrying value, reversal of impairment is only made for the lower of the amount necessary to (i) bring the carrying value of the asset to its recoverable amount or (ii) to restore the asset to its pre-impairment carrying amount less subsequent depreciation or amortisation that would have been recognised.

The impairment and any reversal of impairment are recorded in the income statement.

Financial instruments

i. Recognition and initial measurement

Trade receivables and debt securities issued etc. are initially recognised when they are originated. All other financial assets and financial liabilities are initially recognised when the Group becomes a party to the contractual provisions of the instrument. A financial asset (unless it is a trade receivable without a significant financing component) or financial liability is initially measured at fair value plus, for an item not at FVTPL, transaction costs that are directly attributable to its acquisition or issue. A trade receivable without a significant financing component is initially measured at the transaction price.

ii. Classification and subsequent measurement

On initial recognition, a financial asset is classified as being measured at: amortised cost; FVOCI – debt investment; FVOCI – equity investment; or FVTPL.

Financial assets are not reclassified subsequent to their initial recognition unless the Group changes its business model for managing financial assets, in which case all affected financial assets are reclassified on the first day of the first reporting period following the change in the business model.

A financial asset is measured at amortised cost if it meets both of the following conditions and is not designated as at FVTPL:

- it is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

For 2018 the financial assets are primarily cash and cash equivalents, trade receivables, other credit granted and receivables and deposit accounts. The financial liabilities include trade payables, liabilities to lenders, bondholders and other financial liabilities. Trade receivables and payables result from the delivery / receipt of goods and or services to / from third parties in the normal course of business.

As a result, in line with IFRS 9, all of the financial instruments held by the Group during 2018 were classified and measured “at amortised cost”. In the past in line with IAS 39 these were classed as “loans and receivables”.

Financial assets at amortised cost

These assets are subsequently measured at amortised cost using the effective interest method. The amortised cost is reduced by impairment losses. Interest income, foreign exchange gains and losses and impairment are recognised in profit or loss. Any gain or loss on derecognition is recognised in profit or loss.

Financial liabilities

Financial liabilities are in particular trade payables, liabilities to lenders, bondholders or credit institutes, and other financial liabilities.

All of the Group’s financial liabilities in the reporting period are subsequently measured at amortised cost using the effective interest method. Interest expense and foreign exchange gains and losses are recognised in profit or loss. Any gain or loss on derecognition is also recognised in profit or loss.

iii. Impairment

The Group recognises loss allowances for ECLs on financial assets measured at amortised cost and contract assets.

When determining whether the credit risk of a financial asset has increased significantly since initial recognition and when estimating ECLs, the Group considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information and analysis, based on the Group's historical experience and informed credit assessment and including forward-looking information.

Lifetime ECLs are the ECLs that result from all possible default events over the expected life of a financial instrument.

12-month ECLs are the portion of ECLs that result from default events that are possible within the 12 months after the reporting date (or a shorter period if the expected life of the instrument is less than 12 months).

Impairment allowances for trade receivables and contract assets are always measured as lifetime ECLs.

The maximum period considered when estimating ECLs is the maximum contractual period over which the Group is exposed to credit risk.

The gross carrying amount of a financial asset is written down when the Group has no reasonable expectations of recovering a financial asset in its entirety or a portion thereof. For commercial market customers, based on historical experience of recoveries of similar assets, the Group has a policy of writing down the gross carrying amount when the financial asset is 90 days past due. For governmental agency customers, the Group individually makes an assessment with respect to the timing and amount of write-downs based on whether there is a reasonable expectation of recovery. The Group expects no significant recovery from the amount written down. However, financial assets that are written down could still be subject to enforcement activities.

Impairment allowances against financial assets that are held at amortised cost are deducted from the gross carrying amounts of these assets.

iv. Derecognition

Financial assets

The Group derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards of ownership of the financial asset are transferred. A derecognition also occurs if the Group neither transfers nor retains substantially all of the risks and rewards of ownership and it does not retain control of the financial asset.

Financial liabilities

The Group derecognises a financial liability when its contractual obligations are discharged or cancelled, or expire. The Group also derecognises a financial liability when its terms are modified and the cash flows of the modified liability are substantially different, in which case a new financial liability based on the modified terms is recognised at fair value.

On derecognition of a financial liability, the difference between the carrying amount extinguished and the consideration paid (including any non-cash assets transferred or liabilities assumed) is recognised in profit or loss.

iv. Offsetting

Financial assets and financial liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Group currently has a legally enforceable right to set off the amounts and it intends either to settle them on a net basis or to realise the asset and settle the liability simultaneously.

Inventories

The inventories are recognised at acquisition or manufacturing costs or, if lower, their net realisable value. Raw materials, supplies and consumables as well as merchandise are measured at their adjusted average acquisition costs. The manufacturing costs of work in progress and finished goods are determined on the basis of directly attributable individual costs as well as a proportion of production-related overheads. The manufacturing costs do not include selling expenses, general and administrative expenses or financing costs. The net realisable value is the estimated selling price less the estimated cost of completion and the estimated costs necessary to make the sale. Provisions are made to recognise impairment of slow-moving inventories or to reduce to net realisable value.

Non-current assets held for sale

Non-current assets (or disposal groups comprising assets and liabilities) that are expected to be recovered primarily through sale rather than through continuing use are classified as held for sale. These assets are held at the lower of their carrying values and their fair value less costs to sell. These assets are not depreciated.

Provisions for pensions and similar defined benefit obligations

The provisions for defined benefit obligations are computed using the projected unit credit method in accordance with IAS 19. Under this method, in addition to the pensions and vested rights known at the balance sheet date, expected future increases in pensions and salaries, with estimates of the demographic variances are also taken into consideration. The actuarial valuation is carried out by an actuary.

Actuarial gains and losses are recognised outside profit or loss, in the period in which they occur, in accordance with IAS 19. These are shown in the statement of comprehensive income.

In determining the discount interest rates in accordance with IAS 19, the actuaries refer to market yields on high quality corporate bonds at the balance sheet date.

Other non-current and current provisions

Other general liability provisions are recognised when a past event gives rise to a present obligation, it is probable that the obligation will be claimed and a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the expenditure required to settle the present obligation at the balance sheet date, or, if the effect of the time value of money is material, the present value thereof. Reimbursement claims are recognised separately if it is virtually certain that reimbursement will be received if the Group settles the obligation.

Leases

For leasing agreements under which the Group is lessee, if the lease transfers substantially all the risks and rewards incidental to ownership of the asset (finance leases), then the assets are capitalised by the Group in accordance with IAS 17. At the commencement of the lease term, finance leases are recognised as assets and liabilities in the balance sheets at amounts equal to the fair value of the leased property or, if lower, the present value of the minimum lease payments, each determined at the inception of the lease. Any initial direct costs of the lessee are added to the amount recognised as an asset. The depreciation methods and useful lives used are in line with those of comparable owned assets; if there is no reasonable certainty that the leasee will obtain ownership by the end of the lease term, then the asset is fully depreciated over the shorter of the lease term and its useful life.

If the lease does not transfer substantially all the risks and rewards incidental to ownership of the asset, then the assets are capitalised by the lessor (operating leases). Leasing fees for operating leases are recognised in the income statement. Leasing expenses are recognised on a straight-line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit or the variance between these methods and the actual leasing fees is immaterial.

Recognition of income and expense

Sale of goods and services

The Group adopted IFRS 15 for the first time from January 1, 2018. The effects due to the adoption are described in Note 3.

Revenue is measured based on the compensation agreed in a contract with a customer. The Group recognises revenue when control of the goods or services is transferred to a customer.

In principle, customers obtain control over our products when the goods are collected by the customer or his representative or are delivered to the customer's property. At this time, the invoice is generated. Revenues are recognised when the goods are collected by the customer or delivered to the customer's property.

Occasionally a customer may request that we store their goods separately for them for a while; in such cases ("bill-and-hold"), revenues are recognised when the goods are ready for shipment and are to be stored separately on our site. Such transactions are always for products produced specially for, approved by and registered to that customer.

Interest and other income

Interest income is accrued based on the loan outstanding and the applicable interest rate. The applicable interest rate is specified in the loan agreement and discounts the estimated future inflows of funds over the term of the financial asset to the net carrying value.

Other income is recognised in the period to which it relates, in accordance with the associated contract.

Other expenses

Other expenses are recognised on the basis of a direct link between the costs incurred and the related income in the income statement, either when the benefit is used or when the costs are caused.

Expenses for research and development

Research costs are expensed as they are incurred. Development costs are also expensed as they are incurred, unless they satisfy the criteria for recognition as internally generated intangible assets according to IAS 38.

Borrowing costs

Borrowing costs as defined in IAS 23 are capitalised to the extent that they are directly attributable to the acquisition, construction or production of a qualifying asset; the remaining borrowing costs are recognised as an expense in the period in which they are incurred. No borrowing costs were capitalised during the business year.

Income taxes and deferred taxes

The income tax expense represents the sum of current tax expense and deferred tax expense.

The current tax expense is determined on the basis of the taxable income for the relevant year. The taxable income is different from the pre-tax result shown in the income statement since it excludes expenses and income which will be tax deductible / taxable in other years or which will never be tax deductible or taxable. The liability of the group for current tax expense is computed on the basis of the valid tax rates or of tax rates which have been enacted by the balance sheet date.

Deferred taxes are the expected tax charge or relief arising from differences between the carrying values of assets and debts in the Group IFRS consolidated financial statements and their values in the tax accounts of the individual companies. The balance sheet oriented liability method is applied. In general, deferred tax liabilities are recorded for all taxable temporary differences, and deferred tax assets are recorded to the extent that it is probable that taxable profits will be available for which the deductible temporary differences can be used. Such assets and liabilities are not recognised if the temporary difference arises from (i) the initial recognition of goodwill or (ii) from the initial recognition of other assets and liabilities in a transaction that affects neither the accounting profit / (loss) nor taxable profit / (loss). In addition, deferred taxes are recognised for the carry forward of unused tax losses to the extent that it is probable that it will be possible to utilise them in the future.

The carrying amount of deferred tax assets is reviewed each year at the balance sheet date and is reduced if it is no longer probable that sufficient taxable income will be available to allow the benefit of all or part of the deferred tax asset to be utilised.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date.

The changes in deferred taxes are recognised in the income statement as tax income or expense unless they relate to transactions recognised in other comprehensive income or directly in equity; in this case the deferred taxes are recognised in other comprehensive income and the associated equity position.

Contingent liabilities and contingent assets

Contingent liabilities are not recognised. If any are identified, they are disclosed in the notes unless the possibility of an outflow of resources embodying economic benefits is remote. Contingent assets are not recognised. They are disclosed in the notes, where an inflow of economic benefits is probable.

The use of estimates and assumptions

The preparation of the consolidated financial statements in compliance with the pronouncements of the IASB requires estimates to be made affecting the values recognised in the balance sheet, the nature and extent of contingent assets and liabilities identified at the reporting date and the value of income and expenses in the reporting period. The main assumptions and estimates for the H&K AG Group concern the annual impairment tests for goodwill and trademarks, the setting of useful lives, the recoverability of accounts receivable, the valuation of inventories, the recognition and measurement of provisions and the probability of future utilisation of deferred tax assets. Changes in estimates are recognised in the income statement prospectively.

Guarantee and warranty obligations can arise from legal or contractual requirements. Provisions are recognised for the expected cost of meeting claims under guarantee or warranty obligations. Claims are particularly likely if the warranty period has not yet expired, if warranty costs have been incurred in the past or if particular warranty claims are known. The evaluation of the risk of warranty claims is based on past experience and is used in determining the level of provision required. (Note 24).

Provisions for litigation risks are recognised if a company in the Group is a defendant in a law suit and a judgement against the defendant is more likely than not. A provision is made for the amount likely to be incurred by the company if the judgement is against it. This figure includes the payments likely to be made by the company, in particular compensation, damages and settlements, as well as the expected legal expenses. If a company in the Group is a defendant in a law suit and a judgement for the defendant is more likely than not, or if the company is the claimant, only litigation fees are provided for. (Note 24).

The use of estimates in other positions in the Group balance sheet and income statement are described in the notes relating to the individual positions. In particular, these relate to: impairment of goodwill and trademarks, impairment of non-current tangible and intangible assets, provisions for doubtful debts, allowances for inventories, the valuation of deferred tax assets and of the pension provision.

Notes on the income statement

(6) Revenue

The effect of implementing IFRS 15 for the first time on the recognition of income from contracts with the Group's customers is described in Note 3. Due to the transition method, the comparative information has not been changed to be in line with the new requirements.

Net revenue increased by €38,908k to €220,946k compared with revenue of €182,038k in 2017. Due to IFRS 15, late delivery penalties are now included in sales reductions (discounts, bonuses etc.). The revenue of the Group was made up as follows:

EUR '000	2018	2017
Sale of goods	222,473	181,588
Sale of services	1,975	2,066
Gross revenue	**224,448**	**183,655**
Discounts, bonuses, etc.	(3,501)	(1,617)
Net revenue	**220,946**	**182,038**

Breakdown by customer location:

EUR '000	2018	2017
Domestic (Germany)	78,330	39,560
Foreign - other "Green Countries"	129,677	140,083
Foreign - rest of the world	16,440	4,012
Gross revenue	**224,448**	**183,655**
Discounts, bonuses, etc.	(3,501)	(1,617)
Net revenue	**220,946**	**182,038**

All revenues result from transactions recognised at a point in time in line with IFRS 15.38.

The following table provides information about receivables, contract assets and contract liabilities from contracts with customers:

TEUR	31.12.2018	01.01.2018
Receivables, which are included in "trade receivables"	31,064	21,156
Contract assets	-	-
Contract liabilities	(17,495)	(6,910)
Gesamt	**13,569**	**14,246**

The contract assets would be recognised for the Group's rights to consideration for work completed but not billed at the reporting date. Contract assets are transferred to receivables when the rights become unconditional. This usually occurs when the Group issues an invoice to the customer.

The contract liabilities primarily relate to advance consideration received from customers. An amount of €5,146 thousand recognised in contract liabilities at the beginning of the period has been recognised as revenue for the period ended December 31, 2018. The amount of revenue recognised in the period ended December 31, 2018 from performance obligations satisfied (or partially satisfied) in previous periods is nil.

As allowed by IFRS 15, no information is provided about remaining performance obligations at December 31, 2018 that have an original expected duration of one year or less.

(7) Cost of sales

The cost of sales includes materials and production labour and overhead expenses relating to the revenue. The cost of sales increased by €54,778k to €167,193k compared with €112,415k cost of sales in 2017; this was primarily due to the higher revenues, a change in product mix and higher costs for purchasing bottleneck items from suppliers.

(8) Research and development expenses

The research and development expenses comprise those personnel expenses and depreciation relating to these activities, together with the costs of test materials and tools that do not meet the criteria for capitalisation under IAS 38. In addition the amortisation or retirement of capitalised development costs are included. The expenses increased by €1,647k to €7,370k compared with €5,724k in 2017, primarily due to the retirement of capitalised development costs relating to projects that have been cancelled because of changed market conditions.

(9) Sales, marketing & distribution expenses

The sales, marketing & distribution expenses mainly comprise personnel expenses, material and marketing costs as well as depreciation relating to the sales function and project related costs. They decreased by €2,102k to €22,751k compared €24,853k in 2017; primarily due to lower payroll costs.

(10) Administration expenses

General administration expenses include personnel expenses and overheads as well as the depreciation relating to the administration function. They decreased by €4,640k to €16,661k compared with €21,301k in 2017, primarily due to lower provisions for litigation and consultancy fees for various projects.

(11) Other operating income

EUR '000	2018	2017
Release and utilisation of provisions	97	13
Insurance benefits	404	1,050
Income from the provision of administration services	-	21
Profit on disposal of non-current assets	17	41
Licence fee income	483	404
Fuel sales to employees	1,288	1,120
Other	571	1,913
Total	**2,860**	**4,562**

As a result of the implementation of IFRS 9, the Group has adopted consequential amendments to IAS 1 Presentation of Financial Statements, which require impairments of financial assets and the reversal of these to be presented in a separate line item in the consolidated income statement. Consequently, the Group reclassified certain impairment reversals recognised under IAS 39 amounting to €99 thousand for the year ended December 31, 2017, from "other operating income" to "impairment loss on trade receivables and contract assets net of reversals" in the consolidated income statement (Notes 3, 12).

The other operating income includes out-of-period income of €534k (2017: €1,327k). This primarily relates to income from refunds, expiries and insurance benefits amounting to €419k (2017: €1,272k).

(12) Other operating expenses impairment loss on trade receivables and contract assets net of reversals

The other operating expenses include the following material items:

EUR '000	2018	2017
Provision for the possible calling of bank guarantees	(86)	4,690
Prior year credit notes	(21)	(125)
Loss on disposal of non-current assets	0	(803)
Other taxes	(610)	(306)
Liquidated damages and similar penalties	415	(3,237)
Petrol for employees and company vehicles	(1,270)	(1,098)
Other	32	(366)
Total	**(1,540)**	**(1,245)**

The other operating expenses include out-of-period net income of €517k (2017: €3,342k net income). In 2018, these relate mainly to the release of provisions for potential liquidated damages. In 2017, these primarily related to the partial release and the revaluation of the provision for the possible calling of bank guarantees that more than offset net expenses for losses on the disposal of non-current assets, credit-notes relating to prior years and other out-of-period operating expenses.

As a result of the implementation of IFRS 9, the Group has adopted consequential amendments to IAS 1 Presentation of Financial Statements, which require impairments of financial assets to be presented in a separate line item in the consolidated income statement. Previously, the Group's approach was to include the impairment of trade receivables in other operating expenses. Consequently, the Group reclassified certain amounts recognised for the year ended December 31, 2017 under IAS 39 to “impairment loss on trade receivables and contract assets net of reversals” in the consolidated income statement; these amounted to €196 thousand impairment expenses, from “other operating expenses” and €99 thousand impairment reversals, from “other operating income” (Notes 3, 11).

In 2018, the new position “impairment loss on trade receivables and contract assets net of reversals” relates primarily to the reversal of an impairment following a related receipt, together with impairments determined in accordance with IFRS 9 (Note 20).

(13) Analysis of expenses by nature, showing EBITDA

The income statement shows operating expenses analysed by function; the following table shows operating profit, with expenses analysed by nature, and EBITDA.

As a result of the implementation of IFRS 9, certain items have been reclassified from other operating income and expenses into “impairment loss on trade receivables and contract assets net of reversals”; (Notes 3, 11, 12).

EUR '000	**2018**	**2017**
Net sales	220,946	182,038
Material costs and movement in inventories	(110,867)	(67,687)
Capitalised costs	4,281	6,151
Other operating income	2,860	4,562
Payroll	(67,144)	(58,962)
Other operating expenses	(32,848)	(36,077)
Impairment loss on trade receivables and contract assets net of reversals	1,418	(97)
EBITDA	**18,646**	**29,928**
Depreciation and amortisation	(8,938)	(8,963)
Results from operating activities	**9,709**	**20,965**

No definition of EBITDA is given in IFRS; various methods can therefore be used to determine EBITDA.

(14) Financial result

EUR '000	2018	2017
Financial income		
Interest income	79	108
Gains on translation of foreign currencies	1,521	52
Total financial income	**1,601**	**160**
Financial expenses		
Interest expenses	(14,420)	(19,623)
Accretion of non-current liabilities	(4,035)	(2,507)
Valuation of bond early-repayment clauses	-	(1,360)
Losses on valuation of investments	-	(51)
Losses on translation of foreign currencies	332	(5,056)
Other	(102)	(52)
Total financial expense	**(18,225)**	**(28,648)**
Financial result	**(16,625)**	**(28,488)**

The interest income includes interest on bank balances and tax refunds. The gains and losses on translation of foreign currencies include gains and losses on unhedged transactions together with translation differences for balance sheet positions held by Group companies in currencies other than their own functional currency. The result of the valuation of bond early-repayment clauses in 2017 relates to changes in the current value of derivatives embedded in a bond indenture that expired in 2017 as a result of its early redemption; (Note 18, 25). The interest expenses are primarily due to interest on the bonds, on other long-term loans and on tax payments relating to prior years. The accretion of non-current liabilities relates to defined benefit and other long-term provisions, the bonds and the SFA-loan; (Note 25). Other financial expenses relate to guarantee costs, primarily for the provision of guarantees to our customers.

(15) Income taxes

Income taxes include German corporation tax ("Körperschaftsteuer"), trade income tax ("Gewerbesteuer") and associated reunification surcharges ("Solidaritätszuschlag") for the German companies, together with similar income taxes for the foreign subsidiaries. Through the German companies' fiscal unity, from 2013 income taxes are due from the top-level company, H&K AG.

The companies in Germany have a calculated statutory tax rate of 28.075% (2017: 28.075%). Foreign taxation is calculated at the rates valid in each country; these vary between 19.0% and 33.3% (2017: between 19.0% and 35.0%). Deferred taxes are calculated on the basis of statutory tax rates, or of tax rates which have been enacted as of the balance sheet date in each country, that are expected to be in place on realisation.

The income tax expense comprises:

EUR '000	2018	2017
Current tax income / (expense)	(1,361)	(3,134)
Deferred tax income / (expense)	225	(2,728)
Tax expense in income statement	**(1,136)**	**(5,862)**

In spite of the slightly better result before taxes of €6,916k loss (2017: €7,523k loss), the current income tax expense recognised decreased to €1,361k (2017: €3,134k). Deferred tax expenses significantly decreased; in 2017 these primarily included the revaluation of deferred tax assets following the tax rate reduction in the USA and also included the tax effects of the transactions costs for the equity increase (2017: €109k; 2018: nil).

The following table shows a reconciliation of the expected tax using the current statutory tax rate for the parent company of 28.075% (2017: 28.075%) and the actual income tax shown for the Group:

EUR '000	2018	2017
Profit / (loss) before income tax	(6,916)	(7,523)
Expected tax rate (current German statutory rate)	**28.075%**	**28.075%**
Expected tax income	**1,942**	**2,112**
Adjustments to expected tax expense due to:		
- change in tax rates	(0)	(3,112)
- non-tax-deductible expenses	(3,808)	(4,037)
- non-taxable income	(44)	(51)
- taxes relating to other periods	(24)	(1,436)
- differences in foreign tax rates	(191)	232
- change in valuation adjustments for tax losses	-	704
- utilisation of tax losses not previously recognised	733	-
- change in valuation adjustments for temporary diff.	(0)	0
- other effects	256	(274)
Actual tax expense / income	**(1,136)**	**(5,862)**
Effective tax rate	**-16.4%**	**-77.9%**

Deferred tax relates to the following positions:

Balance Sheet Item EUR '000	Deferred tax assets 31.12.2018	Deferred tax assets 31.12.2017	Deferred tax liabilities 31.12.2018	Deferred tax liabilities 31.12.2017
Intangible non-current assets	-	-	15,974	15,373
Tangible non-current assets	150	136	4,015	4,238
Inventories	874	1,425	254	186
Trade accounts receivable	199	-	19	15
Other current assets	94	691	-	-
Employee defined benefit obligations	7,544	7,605	-	-
Other non-current provisions	717	245	-	-
Non-current financial liabilities	-	-	679	1,041
Current provisions	144	134	-	-
Trade accounts payable	1	-	-	0
Other current liabilities	855	789	2	-
Carryforward of unused tax losses	4,310	2,927	-	-
Total	**14,888**	**13,953**	**20,943**	**20,853**

During 2018, a net increase in deferred tax assets of €406k (2017: €369k net decrease) was recognised through other comprehensive income into equity since it related to the actuarial variances on defined benefit schemes. The variances due to the effects of changing exchange rates on the translation of deferred tax assets and liabilities in foreign subsidiaries' accounts are also recognised within "Forex translation differences for foreign operations" in other comprehensive income (2018: €213k net increase; 2017: €439k net decrease). Apart from these, all other changes in deferred tax assets and liabilities were recognised in the income statement.

Balance Sheet Item EUR '000	Deferred Tax 01.01.2017	Recognised in profit or loss	Recognised in other comprehensive income	Deferred Tax 31.12.2017	Recognised in profit or loss	Recognised in other comprehensive income	Deferred Tax 31.12.2018
Intangible non-current assets	(14,464)	(909)	-	(15,373)	(601)	-	(15,974)
Long term financial investments & derivatives	-	-	-	-	-	-	-
Tangible non-current assets	(3,154)	(992)	44	(4,102)	277	(40)	(3,865)
Inventories	5,404	(4,031)	(133)	1,240	(645)	25	620
Trade accounts receivable	(14)	(1)	-	(15)	189	6	180
Other current assets	(692)	1,383	-	691	(597)	-	94
Employee defined benefit obligations	8,243	(250)	(387)	7,605	(449)	387	7,544
Other non-current provisions	221	6	18	245	453	18	717
Non-current financial liabilities	(715)	(326)	-	(1,041)	362	-	(679)
Current provisions	311	(148)	(28)	134	3	6	144
Trade accounts payable	3	(3)	-	(0)	1	-	1
Other current liabilities	1,384	(454)	(141)	789	26	38	853
Carryforward of unused tax losses	-	3,107	(180)	2,927	1,207	177	4,310
Total	**(3,473)**	**(2,619)**	**(808)**	**(6,900)**	**225**	**619**	**(6,056)**

Potential deferred tax assets of €245k (2017: €234k) relating to tax-losses carried forward by US subsidiaries have not been recognised. Potential deferred tax assets of the parent company amounting to €27,796k (2017: €24,877k) relating to the tax carry-forward of interest expenses, have also not been recognised.

In 2018 income tax payments amounted to €7.2 million (2017: €3.9 million). Of these, €1.3 million (2017: €1.3 million) relate to advance payments for current year German income taxes, €4.8 million net payments (2017: €1.8 million net payments) relate to German income taxes for prior years while foreign income taxes account for €1.1 million net payments (2017: for €0.8 million net payments).

Notes on the balance sheet

(16) Intangible assets

EUR '000	Development costs (self-generated)	Goodwill (acquired)	Trade marks Patents, licences, software (acquired)	Total
Net carrying value at 01.01.2017	**19,723**	**5,149**	**9,067**	**33,939**
Acquisition / manufacturing costs Balance at 01.01.2017	**30,983**	**6,649**	**22,963**	**60,595**
Effect of movement in exchange rates	(70)	-	(58)	(127)
Additions	6,466	-	643	7,109
Disposals / retirements	(39)	-	(17)	(56)
Balance at 31.12.2017	**37,340**	**6,649**	**23,531**	**67,520**
Amortisation & depreciation Balance at 01.01.2017	**(11,260)**	**(1,500)**	**(13,895)**	**(26,656)**
Effect of movement in exchange rates	-	-	50	50
Amortisation for the year	(2,224)	-	(241)	(2,465)
Disposals / retirements	-	-	17	17
Balance at 31.12.2017	**(13,485)**	**(1,500)**	**(14,069)**	**(29,054)**
Net carrying value at 31.12.2017	**23,855**	**5,149**	**9,462**	**38,466**
Acquisition / manufacturing costs Balance at 01.01.2018	**37,340**	**6,649**	**23,531**	**67,520**
Effect of movement in exchange rates	(992)	-	1,055	64
Additions	6,255	-	355	6,609
Disposals / retirements	(1,986)	-	-	(1,986)
Balance at 31.12.2018	**40,617**	**6,649**	**24,941**	**72,208**
Amortisation & depreciation Balance at 01.01.2018	**(13,485)**	**(1,500)**	**(14,069)**	**(29,054)**
Effect of movement in exchange rates	986	-	(1,004)	(18)
Amortisation for the year	(2,304)	-	(263)	(2,567)
Balance at 31.12.2018	**(14,803)**	**(1,500)**	**(15,336)**	**(31,639)**
Net carrying value at 31.12.2018	**25,815**	**5,149**	**9,605**	**40,568**

As described in Note 5, goodwill and other intangible assets with indefinite lives are subject to annual impairment testing. Goodwill is allocated to the individual companies within the Group, which represent the segments of the H&K AG Group and are also the lowest level within the Group at which goodwill is monitored for internal management purposes.

As shown in the above table, aggregate goodwill is unchanged from the previous year at €5,149k. This is the portion of the net book value of the goodwill, through acquisitions from independent third parties, at which it was held under German GAAP at the date of transition to IFRS (January 1, 2006) as shown in the Defence Technology Sub-Group's consolidated financial statements (excluding trademarks). Originally, the parent company of this Sub-Group was called Heckler & Koch Wehrtechnik Holding GmbH. This company acquired the design, manufacturing and distribution company Heckler & Koch Gesellschaft mit beschränkter Haftung, at the end of 2003. In 2004 the two companies were merged and renamed Heckler & Koch GmbH. As a result, the Group has goodwill of €4,016k allocated to the merged company, Heckler & Koch GmbH. The balance of €1,133k is allocated to Heckler & Koch France SAS since this relates to its acquisition in 2004. On the acquisition of Heckler & Koch Gesellschaft mit beschränkter Haftung, at the end of 2003, the trademark was also recognised as an intangible asset (2018: €8,393k; 2017: €8,393k) and allocated to the merged company, Heckler & Koch GmbH. Since the Group's reputation is associated with this trademark, like goodwill, it is also treated as being of indefinite life. These individual intangible assets are material for the Group (IAS 38.22(b)).

The Group conducts an impairment test of goodwill and trademarks at least annually. Since only a small proportion of H&K AG's shares are traded on a stock exchange, and comparable companies have not been bought or sold regularly on an active market during the past year, it was not possible to base impairment tests on market value. Instead for the test, the recoverable value – the value in use – of the cash-generating unit is compared with its carrying value. The value in use of the cash generating units is determined by discounting future cash flows. The computation is based on the following material assumptions:

> A detailed plan is made of the cash flows for the cash-generating unit for the forecast period of five years. Subsequent periods are accounted for by a terminal value determined on the basis of the final year, adjusted for material one-off events and effects in the current order book and applying a 1% growth rate. The key assumptions for the determination of the value in use are the composition and value of planned sales. Plans are based on past experience and available information over future requirements. The fulfilment of these plans assumes that the current regulation of market access continues and that the Group can maintain its strong competitive position. IAS 36.134(f) does not apply.
>
> The discount rates used for December 31, 2018 are pre-tax cost of capital rates, being the main cash-generating unit's annual equity costs. These are determined using the CAPM, based on the target capital structure, which includes a further reduction in indebtedness (2018: on average 8.93%; 2017: 9.5%). Changes within the reasonably possible interest range at the balance sheet date would not lead to an impairment of goodwill or of trademarks.

Under a security assignment agreement certain patents, trademarks and domains have been pledged as security for a long-term financing loan (*Senior Facilities Agreement*, "SFA-loan") (net book value 2018: €8,393k; 2017: €8,393k); (Note 25).

The amortisation and impairment of intangible assets is included in the following income statement positions; the impairments relate to the retirement of capitalised development costs for projects that have been cancelled due to changed market conditions (2018: €1,986k; 2017: €39k):

EUR '000	2018	2017
Cost of sales	85	58
Research and development expenses	4,337	2,310
Sales, marketing & distribution expenses	27	18
Administration expenses	103	118
Total	**4,553**	**2,504**

As at December 31, 2018 the Group had a balance of €73k (2017: €35k) on order for intangible assets.

(17) Property, plant and equipment

EUR '000	Land and buildings	Plant and machinery	Fixtures, fittings and other assets	Assets under construction	Total
Net carrying value at 01.01.2017	**21,350**	**11,392**	**5,790**	**662**	**39,194**
Acquisition / manufacturing costs					
Balance at 01.01.2017	**33,002**	**57,633**	**54,656**	**662**	**145,954**
Effect of movement in exchange rates	(601)	(271)	(330)	(20)	(1,221)
Additions	4,591	3,539	4,082	33	12,244
Reclassifications	271	74	9	(354)	-
Disposals	-	(1,421)	(1,048)	-	(2,469)
Balance at 31.12.2017	**37,263**	**59,555**	**57,369**	**321**	**154,508**
Amortisation & depreciation					
Balance at 01.01.2017	**(11,652)**	**(46,242)**	**(48,866)**	**-**	**(106,760)**
Effect of movement in exchange rates	129	120	272	-	521
Depreciation for the year	(818)	(3,162)	(2,518)	-	(6,498)
Disposals	-	777	880	-	1,657
Balance at 31.12.2017	**(12,340)**	**(48,507)**	**(50,233)**	**-**	**(111,080)**
Net carrying value at 31.12.2017	**24,923**	**11,048**	**7,136**	**321**	**43,428**
Acquisition / manufacturing costs					
Balance at 01.01.2018	**37,263**	**59,555**	**57,369**	**321**	**154,508**
Effect of movement in exchange rates	317	149	125	120	710
Additions	42	2,060	3,275	2,585	7,962
Reclassifications	-	(1,289)	49	1,240	-
Disposals	-	(2,150)	(408)	-	(2,558)
Balance at 31.12.2018	**37,622**	**58,325**	**60,410**	**4,265**	**160,622**
Amortisation & depreciation					
Balance at 01.01.2018	**(12,340)**	**(48,507)**	**(50,233)**	**-**	**(111,080)**
Effect of movement in exchange rates	(44)	(52)	(96)	-	(192)
Depreciation for the year	(903)	(2,717)	(2,750)	-	(6,371)
Disposals	-	2,150	500	-	2,650
Balance at 31.12.2018	**(13,288)**	**(49,126)**	**(52,579)**	**-**	**(114,993)**
Net carrying value at 31.12.2018	**24,334**	**9,199**	**7,831**	**4,265**	**45,629**

Under various floating charges and other security agreements almost all of the Group's property, plant and equipment has been pledged as security for a long-term financing loan ("SFA-loan"); (Note 25).

The fixtures, fittings and other assets include net carrying values of €37k (2017: nil) for certain assets acquired on finance leases, in particular forklift trucks. See Note 25 for details of the lease obligations and the reconciliation between the total minimum lease payments at the balance sheet date and their present values.

As at December 31, 2018 the H&K AG Group had a balance of €3,196k (2017: €3,509k) on order for tangible non-current assets.

(18) Non-current investments and derivatives, current loans, investments and derivatives

The “**Other non-current investments & derivatives**” and the “**Other loans, investments and derivatives**” include bank deposits of €4,061k (2017: €2,295k) recognised as non-current assets and bank deposits of €13,841k (2017: €2,731k) recognised as current assets since they have terms of more than three but less than twelve months. These deposits serve as security for certain bank guarantees and similar.

A non-current investment of nil (2017: nil) relates to a 26% participation in a foreign company, which is not material and has therefore not been included in the consolidation at equity (Note 4). In 2017 a further non-current investment of nil related to a 50% participation in a foreign company, which was not material and therefore not included in the consolidation at equity; this investment was derecognised in 2018 since the company was liquidated and shown as dissolved in the companies register. In 2017 the position “other loans, investments and derivatives” also included a short-term loan to this company of €2k that was repaid in 2018 (Note 36). The H&K AG Group has loan receivables to other related parties that are impaired and therefore, as in prior years, fully allowed for.

(19) Inventories

EUR '000	31.12.2018	31.12.2017
Raw materials, consumables and supplies	36,442	24,666
Work in progress	44,696	39,968
Finished goods and merchandise	6,542	10,468
Total	**87,680**	**75,102**

Under inventories, provisions of €14,932k (2017: €13,832k) have been made to account for marketability risks and slow-moving items. These provisions reduce certain items of inventory to carrying values in line with their net realisable values as at December 31, 2018 of €8,550k (2017: €7,627k). Impairment losses of €1,119k (2017: €308k) were recognised as an expense. Impairment losses recorded in prior years have been reversed within cost of sales (2018: €110k; 2017: €11,751k) due to the disposal of related items (special sales etc.) and to improved inventory movements.

Under various floating charges and other security agreements almost all of the Group’s inventories have been pledged as security for the SFA-loan; (Note 25).

(20) Receivables, prepayments and other assets

EUR '000	31.12.2018	31.12.2017
Trade accounts receivable	31,064	21,156
Prepayments for inventories	81	14
Prepayments for other current assets	1,475	738
Other assets	1,022	5,702
Total	**33,642**	**27,609**

Trade accounts receivable are not interest-bearing; they usually have due dates between 30 and 60 days. Under various floating charges and other security agreements certain of the Group's pledgeable receivables have been pledged as security for the SFA-loan; (Note 25).

The other assets are mainly for VAT & other tax claims arisen in the normal course of business and receivables from employees & directors (travel and salary advances).

If there is an indication that a receivable may be impaired, at the latest if it is over 90 days overdue, the possibility of an impairment is reviewed by the finance, sales and legal departments. In addition, due to the adoption of IFRS 9, for 2018 general provisions for doubtful debts have been recognised; these relate to trade accounts receivable from our US commercial market customers, since our other receivables are primarily against governmental authorities with very good credit-standing. Consequently provisions have been made for identifiable doubtful debt risks within trade accounts receivable; all impairments in the allowance account for this are determined on the basis of the expected lifetime credit losses. The account has had the following movements during the reporting period (the comparative numbers for 2017 were determined in accordance with IAS 39):

EUR '000	**2018**	**2017**
Opening balance January 1	3,083	3,569
Creations	876	27
(Release) / (utilisation)	(2,369)	(512)
Effects of foreign currency conversion	28	(1)
Closing balance December 31	**1,617**	**3,083**

Expenses from the impairment of trade receivables and income from the reversal of such impairments are shown under a separate position, "impairment loss on trade receivables and contract assets net of reversals", in the consolidated income statement; (Note 12). The impairment expenses and income from impairment reversals in 2018 primarily relate to the release of a provision following the receipt of a payment, the recognition of impairment for a specific receivable and the recognition of a general allowance for doubtful debts for our trade receivables against US commercial customers. Trade receivables with specific impairment allowances at the end of 2018 are still subject to collection procedures.

The aging of financial instruments that are trade accounts receivable is as follows:

EUR '000	31.12.2018	31.12.2017
Neither overdue nor impaired:	**22,912**	**16,128**
Overdue, not impaired:		
- within 30 days	3,631	2,283
- between 30 and 60 days	402	831
- between 60 and 90 days	413	260
- between 90 and 180 days	1,007	987
- after more than 180 days	3,002	667
Total:	**8,456**	**5,028**
General allowance in accordance with IFRS 9	**(304)**	**-**
Impaired (net)	**-**	**-**
Book value	**31,064**	**21,156**

As at the balance sheet date, no evidence had been identified to suggest that any of the accounts receivable that were neither overdue nor impaired were doubtful.

(21) Cash and cash equivalents

The position cash and cash equivalents includes cash balances, cheques, bank balances on current accounts and short-term deposits, the original term of which is less than three months. These are valued at nominal value.

One of the prerequisites for the provision of certain guarantee lines etc. is that we are required to maintain a varying level of deposits as security (Note 25). As at December 31, 2018 we had €0.6 million (2017: €0.1 million) such security deposits included in cash and cash equivalents. The remaining Group bank accounts have been pledged as security for the SFA-loan (2018: €21.7 million; 2017: €18.7 million); (Note 25).

(22) Shareholders' equity and earnings per share

The following table shows the changes in the individual items of equity in the Group:

EUR '000	Share Capital	Additional Paid in Capital	Translation Reserve	Reserve for Defined Benefit Obligations	Consolidated Retained Earnings	Shareholders' Equity
As of 01.01.2017	**21,000**	**9,920**	**21**	**(15,376)**	**(161,949)**	**(146,384)**
Issue of new shares	6,641	43,105	-	-	-	49,746
Total recognised income & expense	-	-	(243)	945	(13,385)	(12,683)
As of 31.12.2017	**27,641**	**53,025**	**(222)**	**(14,431)**	**(175,334)**	**(109,320)**
Total recognised income & expense	-	-	(288)	(1,040)	(8,052)	(9,379)
As of 31.12.2018	**27,641**	**53,025**	**(510)**	**(15,470)**	**(183,386)**	**(118,699)**

Following the capital increase completed in 2017, H&K AG has a share capital of €27.6 million (2017: €21 million), divided into 27.6 million (2017: 27.6 million) no-par shares.

Since July 28, 2015 the H&K AG shares have been listed under ISIN DE000A11Q133 on the Euronext free market in Paris; approx. 0.03% are tradable, the remaining 99.97% are held by our main shareholders.

The calculation of the basic earnings per share of €0.29 loss (2017: €0.59 loss) is based on the following earnings attributable to ordinary shareholders and weighted-average number of ordinary shares outstanding:

TEUR	2018	2017
Profit / (loss) for the year attributable to the owners of the parent company	(8,052)	(13,385)
of which not attributable to ordinary shareholders	-	-
Profit / (loss) attributable to ordinary shareholders	**(8,052)**	**(13,385)**

Thousands of shares	2018	2017
Issued ordinary shares at 01.01.	27,641	21,000
Effect of 6,638k shares issued related to a contribution in kind 04.10.2017	-	1,600
Effect of 3k shares issued related to cash contributions 04.10.2017	-	1
Weighted average number of ordinary shares at 31.12.	**27,641**	**22,601**

A calculation of diluted earnings per share would be based on the earnings attributable to ordinary shareholders and the weighted-average number of ordinary shares outstanding after adjustment for the effects of all dilutive potential ordinary shares. There were no dilutive effects for the reporting period.

The additional paid in capital arises from additional capital contributions from the shareholders.

The translation reserve comprises all foreign currency differences arising from the translation of the financial statements of foreign operations.

The reserve for defined benefit obligations comprises the cumulative actuarial gains and losses arising on the employee defined benefit obligation provisions, net of tax. The net increase is due to actuarial losses of €1,445k (2017: €1,314k gains) net of €406k (2017: €369k) deferred taxes.

The consolidated retained earnings include a reduction of €62,333k arising from the effects of the transition to IFRS on January 1, 2008, mainly due to the valuation difference on the acquisition of treasury stock in November 2007. An additional reduction of €2,857k arose from the difference between the acquisition price and the associated net assets for each of the common control transactions involving the acquisition of Suhler USA, Inc., that took place in April 2009, and Suhler Jagd- und Sportwaffen Holding

GmbH, that took place in May 2009, but have been shown as if they had taken place prior to the beginning of 2008.

The H&K AG Group shows a negative equity of €118.7 million (2017: €109.3 million) at the balance sheet date. The going concern status for the individual companies and therefore the Group is not, however, affected by the negative equity. The current H&K AG Group business plan shows an improvement in the equity position and assumes the reduction of debt.

Under the German companies act (AktG), the distributable dividend is determined by the retained earnings in the annual financial statements of the parent company, H&K AG, prepared in accordance with German accounting principles (HGB). The executive directors and supervisory board will propose that the shareholders' meeting resolve to carry forward that company's €35.8 million cumulative profits as at December 31, 2018.

(23) Provisions for pensions and similar employee defined benefit obligations

The pension schemes at the Group's foreign companies are defined contribution plans, while HKO has both defined benefit and defined contribution plans. The defined benefit schemes for employees were finally closed to new entrants in 2002. In addition contributions are made to the applicable state pension schemes.

Under the **Defined Contribution Plans** the company pays contributions to state or private pension schemes on the basis of statutory or contractual obligations or on a voluntary basis. Having paid the contributions, the company has no further obligations. The current contribution payments are shown as payroll expense for the relevant year: they amounted to a total of €4,354k (2017: €3,819k) for the Group.

The **Defined Benefit Plans** are accounted for in the Group by setting up provisions for pensions and death benefits determined by the Projected Unit Credit Method in accordance with IAS 19. Under this method, in addition to the pensions and vested rights known at the balance sheet date, expected future increases in pensions and salaries, with realistic estimates of the demographic variables are also taken into consideration. The value is obtained from an actuarial report calculated using biometric actuarial assumptions (Prof. Dr. Klaus Heubeck's 2018 G guideline tables). Together with the state pension, the company pension entitlement may not exceed 75% of the employee's average monthly salary for the final year.

Under the defined benefit schemes, on reaching the retirement age of 65, employees are entitled to benefits based on their length of service. The defined benefit schemes in operation before 1995 entitle members to benefits for the first ten years' service of 8% of the average monthly salary for the final year, plus 0.25% for each additional year of service. Increases are no longer possible since these schemes are closed and members' entitlements remain fixed.

Under the defined benefit scheme from January 1, 1995, members are entitled to benefits of a fixed sum per year of service depending on the member's grade. The relevant grade for active members is the grade on retirement. This scheme was closed to new entrants on November 30, 2002.

The following table shows the development of the defined benefit liability for asset-backed and non-asset-backed obligations:

EUR '000	Defined benefit obligation 2018	Defined benefit obligation 2017	Fair value of plan assets 2018	Fair value of plan assets 2017	Net obligation for defined benefit plans 2018	Net obligation for defined benefit plans 2017
Balance at 01.01.	**62,986**	**66,094**	**(885)**	**(865)**	**62,101**	**65,230**
Included in profit or loss						
Current service cost	463	506	-	-	463	506
Past service credit	-	-	-	-	-	-
Interest cost (income)	1,097	1,075	(16)	(14)	1,081	1,061
Total recognised in profit or loss	**1,560**	**1,581**	**(16)**	**(14)**	**1,544**	**1,567**
Included in other comprehensive income						
Actuarial loss (gain) arising from:						
- demographic assumptions	698	-	-	-	698	-
- financial assumptions	130	(972)	-	-	130	(972)
- experience adjustments	533	(402)	-	-	533	(402)
Return on plan assets exc. interest income	-	-	(6)	(5)	(6)	(5)
Total recognised in OCI	**1,361**	**(1,374)**	**(6)**	**(5)**	**1,355**	**(1,380)**
Other						
Contributions paid by employer			-	-	-	-
Contributions paid by employees			-	-	-	-
Benefits paid	(3,400)	(3,315)	-	-	(3,400)	(3,315)
Total other	**(3,400)**	**(3,315)**	**-**	**-**	**(3,400)**	**(3,315)**
Balance at 31.12.	**62,507**	**62,986**	**(907)**	**(885)**	**61,600**	**62,101**
represented by:						
Net defined benefit obligation for funded plan	906	893	(907)	(885)	(0)	9
Defined benefit obligation for unfunded plans	61,600	62,093	-	-	61,600	62,093
Balance at 31.12.	**62,507**	**62,986**	**(907)**	**(885)**	**61,600**	**62,101**

The current service costs are shown within functional areas and the annual net interest expense is shown within the interest result. Actuarial gains and losses are not recognised in the income statement but are shown in the statement of comprehensive income and taken to reserves.

The fair market value of the plan assets relates solely to asset values from reinsurance policies and associated credit balance. The expected long-term returns from these plan assets are calculated at 1.86% (2017: 1.79%). This is based on the discount rate for the associated pension obligations. The actual earnings from the plan assets were €22k (2017: €20k). Contributions of about €39k are expected to be paid during 2019.

The calculated average duration of the pensions schemes is 12.1 years (2017 12.6 years). The following table shows the principle actuarial assumptions at the reporting date:

	31.12.2018	31.12.2017
Discount rate	1.86%	1.79%
Future salary growth for active plan members	0.00%	0.00%
Future pension growth	1.60%	1.50%
Longevity rates according to	RT 2018 G	RT 2005 G
Invalidity rates according to	RT 2018 G	RT 2005 G

Reasonably possible changes at the reporting date to one of the relevant actuarial assumptions, holding other assumptions constant, would have affected the defined benefit obligation by the amounts shown below:

31.12.2018 Effect in EUR '000	Defined benefit obligation Increase	 Decrease
Discount rate (0.5% movement)	(3,699)	4,135
Future pension growth (0.25% movement)	1,730	(1,659)

Although the analysis does not take account of the full distribution of cash flows expected under the plan, it does provide an approximation of the sensitivity of the assumptions shown.

(24) Other current and non-current general liability provisions

The current and non-current general liability provisions are as follows:

EUR '000	31.12.2018	31.12.2017
Current provisions & accruals	14,025	19,452
Non-current provisions	2,979	2,582
Total	**17,004**	**22,034**

The provisions comprise:

EUR '000	Personnel obligations	Warranty obligations	Other obligations relating to sales	Other risks	Total
Balance at 01.01.2018	**2,799**	**1,447**	**5,924**	**11,864**	**22,034**
Exchange rate difference / reclassification	-	(1)	83	(0)	83
Utilisation	(1,996)	(1,173)	(2,428)	(6,207)	(11,803)
Release	(70)	-	(631)	(156)	(857)
Creation	1,614	1,589	2,275	2,068	7,547
Balance at 31.12.2018	**2,348**	**1,863**	**5,224**	**7,569**	**17,004**

Provisions for the German early retirement scheme ("Altersteilzeit") are included in the personnel obligations (€319k; 2017: €178k). These include the reduced pay taken by employees in this scheme during the working phase together with the accumulated additional costs to the company during the remainder of the early retirement period. The value is based on the associated contractual obligations and is obtained from actuarial reports, calculated using biometric actuarial assumptions (Prof. Dr. Klaus Heubeck's 2018 G guideline tables), discounted at 1.86% (2017: 2.80%). There are no material uncertainties with regard to the value of these provisions. These obligations are secured by certain securities; these plan assets are offset against the associated provisions. The current early retirement scheme agreements are for between two and six years. In the working phase (first half of early retirement agreement term) the provision is created; the outflows of economic benefits occur in the non-working phase (second half). Accordingly the outflows of economic benefits for early retirement agreements are expected over up to six years, currently however primarily within the next five years.

Other personnel obligations also include provisions for long-service anniversary benefits, similar obligations and bonuses. These personnel provisions are determined based on the associated contractual obligations and the outflows of economic benefits are generally expected within twelve months, although the outflows for anniversary benefits (€596k; 2017: €558k) could be over a period of up to forty years. There are no material uncertainties with regard to the value of these provisions.

The provisions for warranties were recognised on the basis of past experience with regard to the Group liability for a warranty period of two years. Accordingly the outflows of economic benefits are expected within two years. There are no material uncertainties with regard to the value of these provisions.

Provisions relating to sales include provisions for offset obligations, onerous conditions, late delivery and other contractual penalties, costs to complete and price-audits on certain contracts. These provisions have been recognised in line with the probability of their incidence, based on the associated contractual obligations and the current status; the outflows of economic benefits are generally expected within twelve months. There are no material uncertainties with regard to the value of these provisions.

The provisions for other risks relate mainly to litigation risks, recognised in line with the probability of their incidence. In the previous year, the outcome of most of the litigation was dependant on associated legal proceedings and accordingly these provisions were based on particular uncertainties. As at December 31, 2018, the provision relates mainly to settlement agreements or verdicts of the first instance and consequently the degree of uncertainty is lower. The outflows of economic benefits are generally expected within twelve months. The provision for litigation risks includes the following cases:

> On January 26, 2017 the US company Orbital ATK Inc. filed a complaint against HKO with the US District Court in Minnesota. In this complaint Orbital ATK Inc. sought damages in excess of $27 million together with the transfer of technology. Orbital ATK Inc. is the US Army's main contractor so it is our sole contractual partner. The lawsuit was closed through a settlement agreement. The economic effects of the settlement agreement have been recognised in the consolidated financial statements.
>
> In October 2012, we commenced proceedings against Faxtech Pty Ltd (trading as "Point Trading"), an Australian entity, demanding the return of a product owned by us. Point Trading raised a counterclaim against HKO and the Australian Commonwealth in December 2012 to assess damages for loss of opportunity and reliance loss. The lawsuit was closed through a settlement agreement. The economic effects of the settlement agreement have been recognised in the consolidated financial statements.
>
> As a result of the Stuttgart Public Prosecutor's Office's preliminary investigation into former HKO employees, commenced in 2010, in which allegations of unauthorised export of rifles to Mexico between 2006 and 2009 are being probed, criminal charges have been made in the Stuttgart District Court against five former employees and the former agent in Mexico. HKO has cooperated fully with the authorities, both during the initial investigation and during the court case. The verdict by the court of first instance was that three former employees were found not guilty and two former employees were given suspended sentences of 1 year and 5 months and 1 year and 10 months respectively. The accused also included two former directors, who were both found not guilty. Both not guilty verdicts are now legally binding. HKO was sentenced to pay over €3.7 million; this has been recognised in the consolidated financial statements. HKO has appealed this verdict; the Public Prosecutor and the two accused who were sentenced have also appealed. The completion of the

proceedings on appeal on questions of law before the Federal Court of Justice is not expected before 2021.

In addition to this, the Public Prosecutor initiated investigations into allegations of the bribery of domestic public officials and foreign decision-makers in Mexico. The first of these investigations, relating exclusively to a former director was officially discontinued by the Stuttgart Public Prosecutor’s Office on January 20, 2017. However the investigation into the allegations of the bribery of foreign decision-makers is continuing. The risk for HKO resulting from this investigation is considered to be low.

Another preliminary investigation into unnamed employees and managers at Heckler & Koch was pending at the Stuttgart Public Prosecutor’s Office. This preliminary investigation related to an accusation of illegal transfer of technology to Mexico. The company engaged external lawyers to clarify the matter in detail and made the results available to the Stuttgart Public Prosecutor’s Office. In the interim, as a result the investigation has been closed.

The effects of accretion and changes in discount rates were material for the valuations of certain non-current general liability provisions. The financial result includes €25k net expense (2017: €72k net expense) due to discounting and accreting these other non-current provisions; this led to a corresponding increase in the value recognised for these provisions.

(25) Financial liabilities and credit lines

Following the refinancing during 2017 the H&K AG Group has two material non-current financial liabilities, also held at December 31, 2018: a secured financing loan amounting to €95 million (December 31, 2017: €130 million) and a €60 million unsecured bond listed on the Luxembourg Euro MTF. The €95 million financing loan relates to a private €150 million financing agreement (“SFA-loan”) from July 24, 2017, maturing on August 21, 2022, under which a total of €130 million was drawn down on August 21, 2017 (€80 million by H&K AG and €50 million by HKO) and in November 2018 €35 million was repaid by H&K AG. The interest rate is 7.25% plus EURIBOR (if this is positive) and interest is payable half yearly. The €60 million financing relates to a private note purchaser loan that was converted into a listed bond on December 15, 2017. This bond, maturing April 30, 2023 has a fixed interest rate of 6.5% payable on April 30 and October 31. Together with a €50 million short-term shareholder loan that was converted into equity as a contribution in kind in October 2017, the funds from the refinancing were primarily used on August 24, 2017 for the early redemption of HKO’s 2011 bond, due May 2018, with accrued interest (€226 million).

Under the SFA-loan agreement H&K AG and its subsidiaries are subject to strict limitations on certain transactions; the Group must also meet specified ratios between net debt and the contractually defined EBITDA (“Financial Covenants”) and make partial repayments for example dependent upon the annual contractually defined “Excess Cashflow”. H&K AG is permitted to partially or fully redeem its SFA-loan liability. Once the SFA-loan amount drawn by H&K AG has been fully redeemed, HKO will be permitted to partially or fully redeem its SFA-loan liability. However the voluntary redemptions must comply with contractual conditions, including in some cases prepayment premia.

As security for liabilities under the SFA-loan (nominal €98.2 million including accrued interest), the direct and indirect subsidiaries of H&K AG have also entered into the agreement as guarantors. In addition all shares in HKM and all of its direct and indirect subsidiaries together with, through floating charges and other security agreements, certain non-current assets, inventories, receivables and bank accounts (all other bank accounts serve as security deposits for bank guarantees and similar) are pledged to the agent for the lenders; (Notes 16, 17, 19, 20, and 21).

In March and December 2018, the SFA agreement was amended inter alia to permit H&K AG to draw unsecured bridging loans from a main shareholder, to set a minimum cash resource level for the Group of €10 million and to make adjustments to the required ratios of net debt to contractually defined EBITDA ("Financial Covenants") for the quarters ending December 2017 through June 2018.

Loans from related companies

On March 28, 2018 one of H&K AG's main shareholders agreed a €30 million interest-free, unsecured bridging loan to H&K AG with a term until July 15, 2019; funds were received in late April. In November 2018 the duration was extended until July 15, 2023; in another amendment, an interest rate of 2% was agreed, charged retrospectively from the initial loan payment with accrued interest added to the loan principal quarterly.

At the end of November 2018 this main shareholder of H&K AG agreed and paid out an additional €50 million unsecured bridging loan with a term until July 15, 2023. The interest rate is 2%; accrued interest will be added to the loan principal quarterly.

Overview of the development of the financing liabilities

The bond and the SFA-loan are recognised in the statement of financial position at their amortised amounts totalling €150,163k (2017: €182,235k). The associated accrued interest liabilities totalling €3,898k (2017: €3,640k) are recognised within other liabilities. There were no material transaction costs for the bridging loans so their amortised amounts, amounting to €80,524k (2017: nil), are identical to their nominal values (including quarterly reclassification of accrued interest, see below).

EUR '000	2018 Nominal	2018 Book value	2018 Associated interest liabilities	2017 Nominal	2017 Book value	2017 Associated interest liabilities
Balance at 01.01.	**190,000**	**182,235**	**3,640**	**220,323**	**219,503**	**2,616**
Accretion of 2011 bond	-	-	-	-	820	-
Interest expense for 2011 bond	-	-	-	-	-	13,605
Interest payments for 2011 bond	-	-	-	-	-	(16,221)
Repayment of 2011 bond	-	-	-	(220,323)	(220,323)	-
Funds from refinancing - SFA loan and 2017 bond	-	-	-	190,000	185,688	-
Transaction costs	-	-	-	-	(4,008)	-
Accretion of SFA loan and 2017 bond	-	2,928	-	-	555	-
Interest expense for SFA loan and 2017 bond	-	-	13,281	-	-	4,866
Interest payments for SFA loan and 2017 bond	-	-	(13,023)	-	-	(1,226)
Partial repayment of SFA loan	(35,000)	(35,000)	-	-	-	-
Funds from refinancing - bridging loans	80,000	80,000	-	-	-	-
Interest expense for bridging loans	-	-	524	-	-	-
Transfer of interest to principal for bridging loans	524	524	(524)			-
Repayment of bridging loans	-	-	-	-	-	-
Balance at 31.12.	**235,524**	**230,688**	**3,898**	**190,000**	**182,235**	**3,640**

Other Group credit lines

The other credit lines are only for the issue of advance payment or performance guarantees, including bid bonds and similar. The value of guarantees currently outstanding is not recognised in the statement of financial position. As of December 31, 2018 a total of €18.6 million (2017: €6.9 million) guarantees to customers were outstanding. As a prerequisite for the provision and maintenance of these and other guarantee lines, deposits must be provided as security. As at December 31, 2018 there were €0.6 million (2017: €0.1 million) such pledged security deposits included in cash and cash equivalents. Additional security for these lines is provided through bank deposits with terms in excess of three months recognised within other current investments (2018: €13.8 million; 2017: €2.7 million) (Note 18), and within other non-current investments (2018: €4.1 million; 2017: €2.3 million) (Note 18).

Group finance lease obligations

As mentioned in Note 17, the Group has acquired certain assets on finance leases, in particular forklift trucks. The finance lease liabilities are payable as follows:

EUR'000	Future minimum lease payments 31/12/2018	Interest effects 31/12/2018	Present value of minimum lease payments 31/12/2018	Future minimum lease payments 31/12/2017	Interest effects 31/12/2017	Present value of minimum lease payments 31/12/2017
Less than one year	15	2	13	-	-	-
Between one and five years	16	2	14	-	-	-
More than five years	-	-	-	-	-	-
Total finance lease liabilities	**31**	**3**	**27**	**-**	**-**	**-**

(26) Trade and other payables

Trade and other payables include outstanding liabilities from trade and operating costs, together with interest payable on the SFA-loan and the bond.

EUR '000	31.12.2018	31.12.2017
Trade payables	21,855	21,180
Interest payables	3,898	3,640
Other liabilities	8,035	7,131
Total	**33,788**	**31,951**

With the exception of normal trading ownership retention clauses and the-security agreements for the SFA-loan, the trade payables and other liabilities are not secured.

(27) Contract liabilities

The €17,495k (2017: €6,910k) contract liabilities comprise payments received from customers in advance of the delivery of the associated products or services.

Other disclosures

(28) Financial risk management

Market risk

Market risk is the risk that the fair value or the future cash flows of a financial instrument may change depending on market rates. Market risk includes three types of risk: currency risk, interest rate risk and other rate risks. These risks for the Group are covered individually below.

Currency risk

The H&K AG Group is exposed to currency risk on sales and purchases that are denominated in a currency other than the respective functional currencies of Group entities, primarily the euro (EUR), but also US dollars (USD) and Sterling (GBP). The majority of both costs and sales are in euro, so we only have foreign exchange transaction exposure for those sales in currencies different to the associated costs. H&K AG Group policy is, dependent upon the exchange rates on offer and the conditions of potential forward cover contracts and taking expected USD developments into consideration, to cover a proportion of the expected USD ($) income and the associated foreign exchange transaction exposure with hedging transactions. During the periods covered by this reports and at December 31, 2018 there were no forward cover contracts in place.

Group policy is not to speculate with loans or deposits in foreign currencies. Financing and investing within the Group usually take place in the appropriate functional currency and any financial instruments are purely for operating purposes.

Four subsidiaries of H&K AG are outside the Euro zone. Since the H&K AG Group reporting currency is the euro, the income and expenses of these subsidiaries are converted to euro for consolidation. Through these subsidiaries the Group has assets and liabilities in local currencies outside the Euro zone that are also converted to euro for Group reporting. The conversion of these positions to euro is also affected by fluctuations in foreign exchange conversion rates. The change in valuation of these positions is reflected in the Group reserves.

The rates used for the consolidation are shown in the following table:

Currency	Abbr.	Rate on balance sheet date 31.12.2018	Rate on balance sheet date 31.12.2017	Average exchange rate 2018	Average exchange rate 2017
US Dollar (USA)	**USD**	1.1450	1.1993	1.1810	1.1297
Pound (Great Britain)	**GBP**	0.8945	0.8872	0.8847	0.8767

In order to quantify the possible effects of foreign exchange rate fluctuations on the Group EBITDA, sales and equity, a sensitivity analysis has been carried out:

If the euro had been 5% weaker against the US dollar compared to the rates used for the 2018 consolidation, (i.e. had been an average of €1 = $1.1220 and a spot of €1 = $1.0878), then 2018 sales would have been approximately €2.5 million higher, EBITDA would have been approximately €0.7 million lower and equity and reserves would have been approximately €2.7 million lower.

If the euro had been 5% weaker against the pound sterling compared to the rates used for the 2018 consolidation, (i.e. had been an average of €1 = £0.8405 and a spot of €1 = £0.8498), then 2018 sales would have been approximately €0.2 million higher, EBITDA would have remained roughly unchanged and equity and reserves would have been approximately €0.1 million lower.

Interest rate risk

Interest rate risk is the risk that the fair value or the future cash flows of a financial instrument may change depending on market interest rates. As at December 31, 2018 the Group's interest profile of its interest-bearing financial instruments consisted of fixed-rate instruments with a nominal value of €140.5 million (2017: €60 million) and variable rate instruments with a total nominal value of €95 million (2017: €130 million).

The Group's €95 million SFA-loan has a variable interest rate of 7.25% plus EURIOBR (if this is positive); the applicable rate is set at the beginning of each interest period (currently six months). A 100 basis point (Bp) reduction in EURIBOR at each of the interest-fixing dates (August 21, 2017, February 21, 2018 August 21, 2018) would not have affected equity or profit or loss. A 100 basis point (Bp) increase in EURIBOR at each of the interest-fixing dates would have reduced equity and profit or loss by approx. €1.0 million. This analysis assumes that all other variables, in particular tax-deductibility, remain constant.

The Group's €60 million bond is an interest-bearing liability with a fixed interest rate of 6.5%; the bridging loans totalling €80 million bear interest at fixed rates of 2.0 %. The fair values of the bond and the bridging loans are dependent on market interest rates but these liabilities are not recognised at fair value and a change in interest rates at the balance sheet date would therefore not have had an effect on profit or loss or equity. This analysis assumes that all other variables remain constant.

The advance payment and performance guarantees we procure from banks in favour of our customers are not interest-bearing.

Commodity risk

The element of material costs relating to commodities is relatively small so the H&K AG Group's exposure to changes in purchase prices for raw materials is limited: for example an increase in steel prices of 1% would have resulted in EBITDA being approx. €0.2 million lower while equity and reserves would have been around €0.1 million lower.

Credit risk

Credit risk is the risk of financial loss to the H&K AG Group if a customer or counter-party to a financial instrument fails to meet its contractual obligations, and arises principally from the Group's trade receivables. Risk concentrations arise for financial instruments of a similar nature, which react similarly to economic and other changes. Risk concentrations are determined per counterparty.

Trade accounts receivable

Because the majority of the Group's accounts receivable at the balance sheet date relate to sales to customers that are federal, state or local governmental agencies of NATO countries and NATO-equivalent countries, Group exposure to credit risk is limited. Goods are sold subject to retention of title clauses so that, in the event of a customer failing to pay, the H&K AG Group has a secured claim. Where management is of the opinion that the risk is not sufficiently secured by the retention of title clauses, we require letters of credit or prepayments. The Group has internal credit management processes to review and manage overdue positions and if necessary stop further deliveries or initiate legal action.

In addition, provisions are held for doubtful debts. The maximum risk is the value shown as trade accounts receivable in the balance sheet. The book values of trade accounts receivable analysed according to their aging, together with the associated provisions, are shown in Note 20. To assess risk concentrations, all of a country's authorities are treated as a single counterparty. The largest risk concentration for trade receivables and other assets as at December 31, 2018 was €3.3 million owed by one counterparty; this receivable was for the main part not yet due and had been almost fully received by the beginning of March 2019.

Cash and cash equivalents

Cash and cash equivalents include cash balances, cheques, bank balances on current accounts and short-term deposits. The H&K AG Group is exposed to credit risks if the banks holding our deposits default on their obligations. To minimise this risk, the banks are selected with care and deposits are held by several banks in Germany and abroad. The largest risk concentration for cash and cash equivalents as at December 31, 2018 is a German bank where the Group had accounts totalling €12.1 million. This bank is a member of the German banks' mutual fund to provide assurance of such accounts.

Liquidity risk

Liquidity risk is the risk that the H&K AG Group may not be able to meet its financial obligations as they fall due. The target of the Group's approach to managing liquidity is to ensure that there will always be sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation.

Usually the Group mainly generates cash through its operating activities and the operating liquidity surplus is primarily used to finance fluctuations in working capital and capital expenditure, together with servicing the interest payment obligations from the SFA-loan and the bond. In 2018 however, the net cashflow from operating activities after tax payments and the financing of changes in working capital was slightly negative so that the investments in fixed assets, the servicing of interest obligations from the SFA-loans and the bond needed to be financed by two bridging loans from a main shareholder (Note 25). For 2019, a positive net cashflow from operating activities is expected. With regard to the going concern risk due to uncertainties relating to the achievement of the plans for 2019 and the following years, please see the comments in the Group's Management Report section 2.4.5.2.

The following table shows the timing of contractual payments due for financial instruments that are accounts payable or loan interest or repayments.

EUR '000	Trade payables	Borrowings inc. interest	Other financial liabilities
Balance at 31.12.2018			
Book value	21,855	234,586	55
Related payments	21,855	289,647	55
Payments due:			
- within one month	14,893	-	27
- between one and three months	3,931	1,907	28
- between three & twelve months	2,621	8,898	-
- between one and five years	410	278,842	-
- after more than five years	-	-	-
Balance at 31.12.2017			
Book value	21,180	185,875	35
Related payments	21,180	259,245	35
Payments due:			
- within one month	17,326	-	0
- between one and three months	2,515	2,125	34
- between three & twelve months	933	10,766	-
- between one and five years	406	184,392	-
- after more than five years	-	61,961	-

Variances between book value and related payments arise where certain non-current liabilities, in particular the SFA-loan and the bond, are held at their amortised costs and cause additional interest payments. Additional information on the financial liabilities is given in Note 25.

Capital management

The objective of the capital management is to secure the financing of current business activities, taking into account the obligations and the regular interest payments due to the SFA-loan and the bond, and in the medium-term to reduce the leverage significantly. The Group's internal policies require that return on capital is reviewed on all investments and generally all contract bid decisions. The Group aims to have a corporate and capital structure, without material off-balance sheet financing. In the normal course of business, performance and advance payment guarantees are issued to our customers by banks and insurers on our behalf (Note 25).

In 2017 the Group was refinanced through a €50 million equity increase, the draw-down of €130 million from the SFA-loan and the issue of €60 million fixed rate Notes. These proceeds were mainly used for the early redemption of the 2011-Notes with a maturity of May 2018 and accrued interest (€226 million); (Note 22, 25). In 2018 a main shareholder granted us long-term unsecured bridging loans totalling €80 million; €35 million of which were used to partially redeem the SFA-loan.

All legal capital requirements were complied with during the period covered by these statements.

The Group's capital structure is as follows:

EUR '000	31/12/2018	31/12/2017
Equity	**(118,699)**	**(109,320)**
as a percentage of total financing	-45%	-49%
Long-term liabilities	316,238	267,771
Short-term liabilities	65,448	64,316
Debt	**381,685**	**332,087**
as a percentage of total financing	145%	149%
Total equity & liabilities	**262,986**	**222,767**

(29) Additional disclosures on financial instruments

This note provides an overview of the significance of financial instruments and provides additional information on the balance sheet positions containing financial instruments. The following asset positions in the statement of financial position include financial instruments:

TEUR	31.12.2018	31.12.2017
Non-current assets		
Other investments & derivatives	4,061	2,295
Current assets		
Other loans, investments & derivatives	13,841	2,733
Trade receivables	31,064	21,156
Other receivables	1,022	5,702
Asset positions containing financial instruments	**49,989**	**31,885**
of which non-financial instruments	825	4,915
of which financial instruments	**49,164**	**26,970**

The following table shows the book values (BV) and fair values (FV) of the financial assets:

EUR '000	Cash and equivalents BV	Cash and equivalents FV	Trade accounts receivable BV	Trade accounts receivable FV	Loans including interest BV	Loans including interest FV	Other financial instruments BV	Other financial instruments FV
Balance at 31.12.2018								
Recognised at amortised cost	22,278	22,278	31,064	31,064	-	-	(4,178)	(4,178)
Recognised at fair value through other comprehensive income	-	-	-	-	-	-	-	-
Recognised at fair value through profit or loss	-	-	-	-	-	-	-	-
Total financial assets	**22,278**	**22,278**	**31,064**	**31,064**	**-**	**-**	**(4,178)**	**(4,178)**
Balance at 31.12.2017								
Loans & receivables	18,812	18,812	21,156	21,156	2	2	(13,000)	(13,000)
Held to maturity	-	-	-	-	-	-	-	-
Held for trading	-	-	-	-	-	-	-	-
Available for sale	-	-	-	-	-	-	-	-
Held at fair value	-	-	-	-	-	-	-	-
Total financial assets	**18,812**	**18,812**	**21,156**	**21,156**	**2**	**2**	**(13,000)**	**(13,000)**

The fair values of accounts receivable are in line with their book values. This is mainly due to the short terms of these instruments. Loans relate primarily to loan receivables, for which the book values are in line with the fair values.

The other financial instruments relate primarily to short and long-term bank deposits as security for certain bank guarantee lines etc. (2018: €17,903k; 2017: €5,025k).

The aging of financial instruments that are not trade accounts receivable (Note 20) is as follows:

EUR '000	Loans and interest 31.12.2018	Loans and interest 31.12.2017	Other financial instruments 31.12.2018	Other financial instruments 31.12.2017
Neither overdue nor impaired:	**-**	**2**	**18,100**	**5,812**
Overdue, not impaired:	**-**	**-**	**-**	**-**
Impaired (net)	**-**	**-**	**-**	**-**
Book value	**-**	**2**	**18,100**	**5,812**

As at the balance sheet date, no evidence had been identified to suggest that any of the above financial instruments that were neither overdue nor impaired were doubtful. During the reporting period there were no reclassifications of financial assets between the IFRS 9 categories recognised “at amortised cost”, “at fair value through profit or loss” and “at fair value through other comprehensive income”.

The following liability positions in the statement of financial position include financial instruments:

TEUR	31.12.2018	31.12.2017
Non-current liabilities		
Loans & borrowings	230,688	182,235
Finance lease obligations	27	-
Current liabilities		
Trade payables	21,855	21,180
Other payables	11,933	10,771
Liability positions containing financial instruments	**264,502**	**214,186**
of which non-financial instruments	8,007	7,097
of which financial instruments	**256,496**	**207,089**

The following table shows the book values (BV) and fair values (FV) of financial liabilities:

EUR '000	Trade payables BV	Trade payables FV	Bond and SFA loan BV	Bond and SFA loan FV	Other financial liabilities BV	Other financial liabilities FV
Balance at 31.12.2018						
Held at amortised cost	21,855	21,855	230,688	235,524	3,953	3,953
Held at fair value through profit or	-	-	-	-	-	-
Financial liabilities	**21,855**	**21,855**	**230,688**	**235,524**	**3,953**	**3,953**
Balance at 31.12.2017						
Held at amortised cost	21,180	21,180	182,235	190,000	3,675	3,675
Held for trading	-	-	-	-	-	-
Held at fair value	-	-	-	-	-	-
Financial liabilities	**21,180**	**21,180**	**182,235**	**190,000**	**3,675**	**3,675**

The fair values of the trade payables are in line with the book values. This is mainly due to the short terms of these instruments. The bond is held at amortised cost; its fair value at the balance sheet date is determined using its market price. The SFA-loan is held at amortised cost; its fair value at the balance sheet date is its nominal value. The bridging loans are held at amortised cost (identical to nominal values); their fair values at the balance sheet date are their nominal values. The other financial liabilities mainly relate to the interest liabilities for the SFA-loan and for the bond (2018: €3,898k; 2017: €3,640k).

Net income / (expenses) due to financial instruments:

EUR '000	2018	2017
Recognised at amortised cost	3,272	(5,151)
Held at fair value through profit or loss	-	(1,360)

The net income / (expense) from loans and receivables and financial liabilities held at amortised cost include exchange gains and losses, impairments and reversals of previous impairments. The net income / (expense) from financial instruments held at fair value (derivatives) relates to the recognition of changes in the valuation of embedded derivatives in the bond indenture.

The total interest income and expenses relating to financial assets and liabilities not held at fair value through profit and loss, including guarantee fees, are as follows:

EUR '000	2018	2017
Interest income	59	29
Accretion of non-current financial liabilities	(2,928)	(1,375)
Other interest expenses	(13,913)	(19,140)

(30) Cash flow statement

The Group cash flow statement shows the change in the H&K AG Group's cash and cash equivalents due to cash inflows and outflows during the year. Cash and cash equivalents include cash balances, cheques and bank balances; these last also include amounts serving as security for certain forward-cover and guarantee lines and for the SFA-loan (Note 21, 25).

As required by IAS 7, cash flows are analysed between operating, investing and financing activities. Cash flows from investing and financing activities are determined directly while those from operating activities are calculated indirectly from the net results. The changes in balance sheet positions used in the indirect calculation are adjusted to exclude the effects of foreign exchange rate variances and changes in the companies consolidated into the Group. The changes in the balance sheet positions shown in the cash flow are therefore different to the euro changes in the Group balance sheet.

Interest received is classified as a cash flow from investing activities. Interest paid is shown as cash flows from financing activities. The interest payments to our bondholders are shown net.

In the previous Group financial statements, changes in security deposits with terms longer than three months were shown in net cash flows for investing activities. Because these deposits serve as security for bank guarantess etc (Note 25), rather than for investment purposes, we now show them separately at the end of the statement of cash flows. Consequently the net cash flow for investment activities in 2017 increased by €4,214k from €14,972k net outflow in the previous format to €19,186k, with a corresponding effect on net cashflows; the effect of exchange rate fluctuations on cash held increased by €54k from negative €283k (relating to net cahs values) to negative €337k (relating to gross cash values). Following the reclassification, the opening value as at December 31, 2016 is €33,942k (previously €24,648k) and the closing position at December 31, 2017 is €23,837k; from this we deduct security deposits with terms longer than three months to obtain the cash and cash equivalents figure recognised in the statement of financial position of €18,812k.

(31) Segment reporting

The organisation and reporting structure of the H&K AG Group is marked by its operating activities being solely directed to the defence technology line of business. The investments in the other investment activities line of business ("holding activities" segment) suffered in the financial and economic crisis and consequently were recognised as being fully impaired in previous reporting periods.

The Defence division is organised around five (2017: five) operating companies, three of which serve customers in the defence and law enforcement sector, whilst the fourth (HKI) serves the US commercial market and the fifth (HKO) serves customers in the defence and law enforcement sector, the other Group companies and the commercial markets in certain other countries. Correspondingly, the segments analysed are the site locations in Germany Great Britain, France and the United States, split into Defence and Commercial. Since these segments mainly represent legal entities, the figures shown for each segment are the values for the companies as included in the H&K AG Group's consolidated figures.

The activities in reporting segment Germany relate to the design, manufacture and distribution of defence and security products together with the provision of associated services. Reporting segment Germany mainly supplies to NATO member states and NATO-equivalent countries in which no Group subsidiaries are located and to Group companies and manufactures, sells and distributes commercial and security products to customers outside the US. The reporting segment "USA - commercial" has production, sales and distribution activities for commercial and security products and provides related services in the US.

The other reporting segments all have sales and distribution activities for defence and security products and provide related services. The sites located in the USA and France supply to these countries. The site located in Great Britain sells primarily to the United Kingdom; in the past it also served the British Commonwealth of Nations and certain other NATO allies. Due to the new strategic direction to focus on so-called "Green Countries" (Note 1), only the remaining order book for these countries will be served via site location Great Britain.

The "Other holding activities" reporting segment relates to H&K AG and HKM. As this reporting segment contains several companies, the figures reflect the amounts recognised for individual companies in the consolidated financial statements as well as certain consolidation adjustments within the segment.

Operating segments

Site Location	Germany		USA - Commercial		USA - Defence		Great Britain		France		Holding activities		**Total pre-consolidation**		Consolidation transactions		**H&K AG Group**	
EUR '000	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017
Net external revenues	117,682	85,164	42,527	50,192	4,285	3,065	21,312	15,703	35,140	27,913	-	-	220,946	182,038	-	-	220,946	182,038
Inter-segment revenue	58,699	51,494	282	367	204	406	73	111	-	-	-	-	59,257	52,378	(59,257)	(52,378)	-	-
Depreciation and amortisation	(8,157)	(8,422)	(639)	(406)	(108)	(117)	(18)	(12)	(7)	(5)	(10)	(1)	(8,938)	(8,963)	-	-	(8,938)	(8,963)
Interest income	164	10,398	-	-	1	1	4	0	21	7	1,594	2,534	1,783	12,941	(1,704)	(12,833)	79	108
Interest expense	(6,931)	(18,709)	(2)	-	(130)	(139)	-	-	-	-	(13,199)	(16,167)	(20,261)	(35,015)	1,704	12,833	(18,557)	(22,182)
Income taxes	(1)	150	1,282	836	351	(388)	(330)	(516)	(496)	(629)	(1,347)	(2,193)	(540)	(2,740)	(596)	(3,121)	(1,136)	(5,862)
Profit / (loss) after tax	10,385	6,221	(4,489)	(3,767)	(1,002)	(1,749)	1,389	2,166	1,004	1,237	(93,801)	(15,778)	(86,514)	(11,670)	78,462	(1,715)	(8,052)	(13,385)
Other material non-cash items																		
- Impairment of assets	-	(182)	(1,002)	-	-	-	(41)	(204)	-	-	(81,074)	-	(82,118)	(385)	81,074	-	(1,044)	(385)
- Impairment losses reversed	2,343	71	-	-	-	-	2	8	-	-	-	24	2,344	103	-	-	2,344	103
Non-current assets other than deferred taxes and financial instruments	147,477	146,070	11,972	9,128	1,252	1,295	94	79	13	16	91	8	160,899	156,596	(74,702)	(74,702)	86,197	81,894
Capital expenditure, excluding capitalised development costs	(5,105)	(4,740)	(3,125)	(8,282)	(7)	(108)	(33)	(39)	(4)	(2)	(93)	(9)	(8,367)	(13,180)	-	292	(8,367)	(12,888)
Provisions and liabilities	201,261	173,481	22,410	19,807	25,141	22,297	2,839	2,695	6,408	5,025	309,613	187,636	567,671	410,942	(185,986)	(78,855)	381,685	332,087

The above table shows the revenues and results together with the assets and liabilities of the individual Group segments. With the exception of sales from the German segment to the other segments, trading between segments is minimal. The trade relationships between segments have been consolidated. Trade between the segments is conducted at ‘arm’s-length’ prices, as would have been agreed with informed and willing parties outside the Group. Due to the fiscal unity (“Organschaft”), the German taxes are all incurred by the parent entity, H&K AG.

Geographical and product group segments

The value of revenues from customers in different regions of the world and the proportions of revenues due to the different product groups are shown in the following tables:

Region		Revenues EUR '000	Percentage of revenues
Germany (Domestic)	**2018**	**76,838**	**35%**
	2017	**39,361**	**22%**
USA	2018	46,759	21%
	2017	53,202	29%
UK	2018	11,955	5%
	2017	14,666	8%
France	2018	35,428	16%
	2017	29,203	16%
Other "Green Countries"	2018	33,528	15%
	2017	41,594	23%
Rest of world	2018	16,439	7%
	2017	4,012	2%
Total export	**2018**	**144,108**	**65%**
	2017	**142,677**	**78%**
Total	**2018**	**220,946**	**100%**
	2017	**182,038**	**100%**
of which "Green Countries"	2018	204,507	93%
	2017	178,025	98%

Product group		Percentage of revenues
Rifles	2018	29%
	2017	26%
Sub-machine guns & machine guns	2018	29%
	2017	23%
Pistols	2018	25%
	2017	34%
Development services	2018	0%
	2017	0%
Other products & services	2018	17%
	2017	16%
Total	2018	100%
	2017	100%

Major customers

IFRS requires customers known to be under common control to be treated as one customer. Since the H&K AG Group sells to government agencies, which include law enforcement agencies and armed forces, in various countries this requirement leads to all governmental agencies in a particular country being treated as one single joint customer.

On this basis the H&K AG Group's major customers, to whom more than 10% of sales were made in 2018, are the German governmental authorities (2018: €67 million; 2017: €33 million) shown in the segment Germany and the French governmental authorities (2018: €35 million; 2017: €28 million) shown in the segment France.

(32) Contingent liabilities and pledged assets

There are no material contingent liabilities as of December 31, 2018 or December 31, 2017; based on the current business plan (covering five years) no related claim is expected in this period. For information on bank guarantees for customers and the related security deposits see Note 25. Almost all of the other Group assets are pledged for the SFA-loan from July 24, 2017 under various floating charges and other security agreements. For details of pledged assets see Notes 16, 17, 18, 19, 20, 21 and 25.

(33) Operating leases

Our expenses include €562k (2017: €531k) due to rental and €265k (2017: €276k) due to other operating leases.

As at the balance sheet date, the group had outstanding obligations arising from binding operating leases that fall due as follows:

EUR '000	31.12.2018	31.12.2017
Up to one year	393	495
More than one and up to five years	1,039	1,141
More than five years	338	465
Total	**1,769**	**2,101**

(34) Full-time equivalent number of employees

The workforce in the H&K AG Group, as an annual average of full-time equivalents ("FTE"), was as follows:

	2018	2017
Manufacturing	608	496
Research & development	110	97
Sales, marketing & distribution	82	85
Administration	85	75
Total FTE employees excluding apprentices	**885**	**753**
Apprentices	38	37
Total FTE employees including apprentices	**923**	**789**

(35) Personnel expenses

Personnel expenses in 2018 were €67,144k (2017: €58,962k). Of these expenses, €4,354k (2017: €3,819k) relate to employer's contributions to social security pension funds and similar defined contribution plans for pensions.

(36) Related party disclosures

Parent and ultimate controlling party

H&K AG is the parent of the H&K AG Group and is owned by private investors. It holds 94.9% of HKO indirectly and the 5.1% balance directly.

Other related party transactions

Transactions between the parent company and related parties that are its subsidiaries were eliminated in the course of consolidation and are not described in these disclosures in the Notes. Transactions with members of the governing bodies are covered in Note 38.

In addition, there are arm's-length business relationships between H&K AG Group companies and related parties as defined by IAS 24, as follows:

- On October 11, 2016 NSAF made an unsecured loan of £50k to its then joint venture for an indefinite period, in accordance with the joint venture agreement. During 2017 it was decided to end the joint venture and the loan was partially repaid (£9k) and the balance written down to the amount received in January 2018 (£2k). The investment in this joint venture was fully written down in 2017 and was derecognised in 2018 following the liquidation and dissolution of the company (net book value 2018: nil; 2017: nil); (Note 18).
- In 2018, a main shareholder granted H&K AG a €30 million unsecured bridging loan and a €50 million unsecured bridging loan. Both loans have terms to July 15, 2023 and agreed interest at 2%; accrued interest is added to these loans quarterly (Note 25).

Transactions with related parties are generally carried out as if between willing, informed and independent third parties.

(37) Governing bodies of the Group

Executive Board of H&K AG

Dr.-Ing. Jens Bodo Koch	CEO (from May 1, 2018)
Dr. Björn Krönert	CFO (from October 1, 2018)
Wolfgang Hesse	CFO (until August 11, 2018)

Supervisory Board of H&K AG

Dieter John	Chairman
Nicolaus Bocklandt	Deputy Chairman
Jean-Christoph Arntz	Board Member

(38) Transactions with the members of the governing bodies

In 2018 the remuneration recognised for the supervisory board's services, including expenses was €145k (2017: €108k). The net balance due for these services was €34k (2017: €108k) at the year-end.

The remuneration of the H&K AG executive board in the reporting year was €1,016k (2017: €652k).

(39) Auditor's remuneration

EUR '000	2018	2017
Audit of the financial statements	293	192
Other confirmation services	9	-
Tax services	201	185
Other services	5	2,273
Total	**509**	**2,650**

The "Other services" were primarily fees for support on the refinancing projects and the post-transaction support (2018: €32k; 2017: €1,431k) and relating to a national lawsuit (2018: €40k refund; 2017: €598k) and an international law suit (2018: €3k; 2017: €179k).

(40) Subsequent events

As a result of the Stuttgart Public Prosecutor's Office's preliminary investigation into former HKO employees, commenced in 2010, in which allegations of unauthorised export of rifles to Mexico between 2006 and 2009 are being probed, criminal charges have been made in the Stuttgart District Court against five former employees and the former agent in Mexico. HKO has cooperated fully with the authorities, both during the initial investigation and during the court case. The verdict by the court of first instance was that three former employees were found not guilty and two former employees were given suspended sentences of 1 year and 5 months and 1 year and 10 months respectively. The accused also included two former directors, who were both found not guilty. Both not guilty verdicts are now legally binding. HKO was sentenced to pay over €3.7 million. HKO has appealed this verdict; the Public Prosecutor and the two accused who were sentenced have also appealed. The completion of the proceedings on appeal on questions of law before the Federal Court of Justice is not expected before 2021.

No other material operating or structural changes or transactions have occurred in the H&K AG Group between December 31, 2018 and the approval of these consolidated financial statements.

Oberndorf/Neckar, April 10, 2019

The Executive Board

Dr. Jens Bodo Koch   Dr. Björn Krönert

Group Management Report 2018

H&K AG, Oberndorf/Neckar

1. Trend in business and overall situation

1.1 Trend in business and corporate structure

The H&K AG Group with its parent company H&K AG is defined by both the military & law enforcement and the commercial business areas of Heckler & Koch GmbH (HKO), its subsidiary in Oberndorf/Neckar, Germany, and HKO's subsidiaries in the US, England and France. US law enforcement and military customers are served by Heckler & Koch Defense Inc., Ashburn/Virginia, USA, while Heckler & Koch, Inc., Columbus/Georgia, USA, serves the American commercial market.

HKO develops, manufactures and, together with its subsidiaries, markets and distributes infantry and sidearms primarily for governmental security forces, in particular in NATO countries and the EU, and is one of the leading businesses in this market segment; the operating companies also provide related services. In both business areas, we are concentrating on the development and introduction of new products.

H&K AG was formed in March 2014 through the change in legal status of the former Heckler & Koch Beteiligungs GmbH; this was entered into the commercial register on April 7, 2014.

Since July 28, 2015 the shares in H&K AG (ISIN DE000A11Q133) were listed on the Euronext stock exchange in Paris (free market); of these approx. 0.03% are tradable, the remaining 99.97% are held by our main shareholders.

The product portfolio comprises portable infantry weapons such as pistols, machine pistols, assault rifles and machine guns as well as grenade launchers and specialist equipment, together with numerous training systems in various construction variants for almost all weapon categories enabling realistic training. This provides a complete and flexible product range for military and police personnel that is specifically tailored to suit a large number of user scenarios and is unique worldwide in covering all military and police small calibre small arms at this high quality level.

H&K AG Group stands for state-of-the-art products and the highest quality. To secure this position, 11% (2017: 11%) of our employees worked in Quality Assurance and 11% (2017: 13%) in Research and Development. HKO and its quality management system are certified to DIN EN ISO 9001:2015 and take account of the requirements of NATO AQAP quality standards.

As members of the defence industry located in Germany, due to manufacturing and selling fire arms and fire arms components, H&K AG and its German subsidiaries are subject to current German weapons and export regulations. All exports of controlled goods, including manufacturing and technology documentation, are governed by Germany's Foreign Trade and Payments Act (AWG) and Foreign Trade and Payments Regulation (AWV). If deliveries include weapons of war, authorisation pursuant to the Military Weapons Control Act (KWKG) must be obtained in addition to the authorisation pursuant to the

AWG and the AWV. Compliance with these regulations is of existential importance to the company. For more information on the associated organisational processes, please see section 3.3.5 'Legal risks'.

1.2 Group entities

H&K AG's consolidated financial statements comprise the following companies:

- H&K AG, Oberndorf/Neckar, Germany (H&K AG)
- Heckler & Koch Management GmbH, Oberndorf/Neckar, Germany (HKM)
- Heckler & Koch GmbH, Oberndorf/Neckar, Germany (HKO)
- NSAF Ltd, Nottingham, United Kingdom (NSAF)
- Heckler & Koch France S.A.S., Paris, France (HKF)
- Small Arms Group Holding Inc., Ashburn, Virginia, USA (SAGH)
- Heckler & Koch Defense Inc., Ashburn, Virginia, USA (HKD)
- Heckler & Koch, Inc., Columbus, Georgia, USA (HKI)

1.3 Internal planning and control system

H&K AG Group is managed based on a comprehensive internal reporting system and covers all departments and activities. A core element of this is a detailed five-year plan, which is updated each year. For the current financial year, the plan is detailed and reported at a monthly level. Current results are compared to target figures. Any variances and their causes are analysed with a view to defining and carrying out any necessary mitigation measures. In addition to the financial elements, the reports include operating performance indicators used for the precision control of individual departments and processes on much shorter timescales, for example days or shifts.

1.3.1 Financial performance indicators

The main objectives are to meet the planned revenue and earnings targets and to manage cash flows and investments. To this end, status reports are prepared for the Group’s executive board and the individual functions. This information is also used inter alia as a basis for the monthly management meetings, where current business developments, and potential budget variances and their causes are analysed, and decisions on any necessary measures are made. These performance indicators are also used by individual departments for their daily fine-tuning.

In addition to revenue and operating performance (defined as revenues plus inventory movements and own work capitalised), the key internal control measures for the H&K AG Group include in particular earnings before depreciation, amortisation, financial result and taxes (EBITDA).

H&K AG Group also uses order intake and order book as performance measures. These figures are updated regularly. They provide an indication of expected production capacity utilisation and revenue trends.

As part of the Group's liquidity management, in addition to the monthly cash flow data, a thirteen-week forecast is prepared regularly so that any necessary measures can be identified in good time. The analysis and control of cash flows for operating activities are a central element of liquidity management. The performance indicators used for this are operating cash flow (defined as net cash flows from operating activities according to the statement of cash flows), net working capital (defined as inventories, prepayments for inventories, trade receivables and prepayments for other current assets less trade accounts payable and contract liabilities) together with the resulting level of cash and cash equivalents in the cash flow statement.

1.3.2 Non-financial performance indicators

The main non-financial performance indicator within the meaning of the accounting standards is the headcount.

In addition, the following are used to aid decision-making:

	Performance indicators
Operations	e.g. total plant efficiency, scrap,output quantities, down-times
Personnel	e.g. absentee levels due to illness
Quality management	e.g. weapons shot, scrap
Purchasing	e.g. delays, supplier scrap

Further additional information about non-financial performance indicators can be found in the ‘Research and development', ‘Non-financial performance indicators’ and ‘Opportunities and risks report’ sections.

1.4 Research and development

By continuously developing its new and current small arms products, the H&K AG Group is one of the most innovative players in this branch in the world. This contributes significantly to the Group's strong market position. The R&D department is correspondingly pivotal to safeguarding the Group's future and essential to the corporate strategy.

Heckler & Koch is a leading developer of infantry weapons systems technology with a focus on long firearms, grenade launchers and grenade launcher modules, machine guns and sidearms. The need to push for further development is evident from the competition in the market in general as well as the specific requirements of the military and law enforcement agencies, and in particular the special armed forces and special operation forces, in the EU and the US. The needs of the commercial market have to be met as well, which calls for the constant development of products specifically for this market. All in all, our aim is to offer our customers products of the greatest reliability, safety and utility. The H&K AG Group is therefore investing increasingly in research and development.

The primary factors for success in the market are the specialist knowledge and continual training and development, together with the motivation and commitment, of our employees. At the year-end, about 11% (2017: 13%) of our employees worked in Research and Development.

As an innovative group, Heckler & Koch protects key developments against copying by registering patents and industrial property rights as well as having internal procedures for the consequent protection of expertise, to contribute to maintaining a technological advantage.

2. Business situation

2.1 Macro-economic situation and business trends

The German economy grew in 2018 although the economic situation in Germany was constrained by a difficult external economic environment and temporary special effects in the automobile industry. The global economic environment also lost momentum, due to increasing trade conflicts and the resultant uncertainty, together with the tightening of US monetary policy.

The German defence budget for 2019 amounts to about €43 billion (previous year: about €39 billion); the expected expenditure on federal police in 2019 amount to about €3.6 billion (previous year: about €3.4 billion). Changes in the overall economic environment generally have a delayed effect on our business activities. In addition, the military and law enforcement part of our business hinges on public spending. Public sector customers usually have planning and implementation horizons stretching over many years and their tenders are therefore largely unaffected by short-term economic trends.

The market environment is defined by the defence policies of the Western nations and the resulting requirement for state-of-the-art weapons systems on the one hand but existing budget restrictions on the other hand. In addition, our market access is limited by weapons export regulations. Armed forces have to be highly mobile and carry the best possible equipment in order to make an effective military contribution, from humanitarian aid, stabilisation operations, monitoring missions and advice and support right up to combat missions. The increasing destabilisation of the Middle East and North Africa, the conflict in Ukraine and the terrorist attacks in Europe call for security forces to refocus their equipment and training. The only way to ensure the most effective protection for a country's own soldiers during foreign deployment and peacekeeping missions is to keep investing in equipment. Because of the changed security situation, especially in Europe, we expect the relevant budgets to continue to increase, or at least to remain stable.

Access to the US market in general, and the sale of weapons in the USA in particular, subject to both greater restrictions on export licences from Germany and changing legislation in the USA and individual US states. It cannot be ruled out that the regulations for this market will be tightened in the future as well, making it more difficult to sell our products in this market - which is the largest commercial market in the world by far - from Germany.

2.2 Business trend

For the H&K AG Group, 2018 was influenced by a significant increase in revenues compared to the previous year (21.4%); this can be explained by the numerous new projects acquired for governmental agency weapons and the increasing military business – including projects with the French military. The increased revenues were linked to significantly increased quantities, and therefore to higher production volumes, resulting in an increase in headcount in almost all departments and a significant increase in purchase volumes for raw materials and bought-in parts.

Unfortunately, once again in 2018, the increased organisational complexity of employees and quantities resulted in lower than expected deliverable quantities from the main site in Oberndorf. The new production processes implemented in 2017 were not able to reach their full potential under these circumstances. In the medium-term however, the positive effects of this restructuring will lead to a sustained increase in efficiency and therefore to an improved delivery situation.

Business development in the US commercial market was also influenced by delays in the supply of commercial products from Oberndorf and negatively affected revenues and profits. Results were also burdened by the build-up of a production facility in the USA for the manufacture of commercial products specifically for the US commercial market; due to the build-up, the headcount there was significantly increased. The market launch of the first pistol developed in the USA has been considerably delayed and as a result, revenues have not yet been generated by this product.

In line with the forecast in the prior year report, the €220.9 million revenue generated in 2018 was significantly higher than the €182.0 million generated in 2017. In contrast to the slight decrease forecast, order intake and order book increased significantly compared to the prior year. The concentration on so-called "Green Countries" continued to have a positive effect on orders received and the resultant predictable and low export licence risk order book at the end of 2018.

Operating performance also improved as a result of the higher revenues. Due to a reduction in the income from inventory movements and capitalisation of development costs, together with the retirement of capitalised development costs, the effect of the revenue increase was not fully reflected in the performance indicator "operating performance". The operating performance in 2018 was €225.6 million, €28.8 million higher than in the prior year (€196.8 million).

The EBITDA of €18.6 million (2017: €29.9 million) was lower than in the prior year, primarily due to several low-margin products, the high start-up costs and the very poor result from the US commercial market subsidiary, and was therefore lower than the prior year forecast.

The result from operating activities (EBIT) also decreased by €11.3 million to €9.7 million (2017: €21.0 million).

Consequently, the result before income tax was a loss of €6.9 million (2017: €7.5 million).

Contrary to the forecast slight reduction, working capital prior to allowances increased by €11.7 million from the prior year figure of €85.8 million to a year-end 2018 figure of €97.5 million. The gross inventories within these figures increased to €102.6 million (2017: €88.9 million).

Contrary to the forecast, unrestricted cash and cash equivalents (after deduction of security deposits for bank guarantees etc.) increased slightly from €18.7 million to €21.7 million at the end of 2018 due to two loans from a main shareholder with a net effect of €45 million.

As forecast, the number of employees (FTEs) including trainees as at the balance sheet date increased by 96 from 861 for the prior year to 957 for the current year. Due to the build-up of the US production facility and the US sales department, the US headcount increased by 9 to 111 employees (2017: 102). In Oberndorf the HKO headcount increased by 87 from 738 to 825 at the end of 2018; of this increase, 78 relates to the production, logistics and quality assurance departments. In 2017 in order to increase capacity, an extended shift model was introduced; this is also a primary contributory factor for the headcount increase during 2018 in production and related areas such as quality assurance, warehouse and logistics.

During the year the number of agency staff in the Group decreased by 17 to 81 (2017: 99).

2.3 Financial performance

2.3.1 Overview

Overall, the H&K AG Group’s 2018 revenue was in line with expectations, however, primarily due to low-margin revenues, EBITDA was lower than projected and lower than for the previous year.

2.3.2 Trend in revenue and orders received

In 2018, H&K AG Group recorded revenue, net of sales deductions, of €220.9 million (2017: €182.0 million).

Group revenue (net of sales deductions) can be analysed as follows:

Region		Revenues EUR '000	Percentage of revenues
Germany (Domestic)	**2018**	**76,838**	**35%**
	2017	**39,361**	**22%**
USA	2018	46,759	21%
	2017	53,202	29%
UK	2018	11,955	5%
	2017	14,666	8%
France	2018	35,428	16%
	2017	29,203	16%
Other "Green Countries"	2018	33,528	15%
	2017	41,594	23%
Rest of world	2018	16,439	7%
	2017	4,012	2%
Total export	**2018**	**144,108**	**65%**
	2017	**142,677**	**78%**
Total	**2018**	**220,946**	**100%**
	2017	**182,038**	**100%**
of which "Green Countries"	2018	204,507	93%
	2017	178,025	98%

Domestic revenue increased year-on-year by approximately 95% and generated 35% of Group revenue in the period under review (2017: 22%). The increase was primarily generated by our military and governmental agency business.

The market in the USA, which is mainly served by our subsidiaries HKD and HKI, generated 21% (2017: 29%) of revenue. The reduction was mainly due to delayed deliveries from HKO resulting from delivery requirements for domestic police and governmental authorities; demand remained fairly stable.

The proportion of Group revenue generated in “Green Countries” reduced to 93% compared to 98% in 2017; this reduction was primarily due to the processing of an old contract, together with the delivery of goods that do not require export licences, for the rest of the world.

Of the €221 million (2017: €182 million) Group revenue, 61% (2017: 53%) was to the military market, 16% (2017: 14%) to the police and governmental agencies market and 23% (2017: 33%) to the commercial market.

The H&K AG Group's order intake in 2018 was €290 million (2017: €215 million), significantly above the 5 year average level.

The resultant 2018 closing order book, excluding contracts with export licence risks, was €222 million (2017: €156 million). Of this order book, €201 million is scheduled for delivery in 2019 (2017: €132 million was scheduled for delivery in 2018).

2.3.3 Trend in earnings, variances and significant changes

Net revenue increased from €182.0 million in the prior year by 21.4% to €220.9 million, while EBITDA of €18.6 million (2017: €29.9 million) was generated.

The positions in the income statement can be presented as follows:

Revenue (net of sales deductions) increased by €38.9 million (+21.4%) to €220.9 million in the period under review compared to €182.0 million in 2017.

The cost of sales includes the costs of materials, direct labour costs and overheads incurred to achieve the revenue. Cost of sales increased from €112.4 million in the prior year to €167.2 million in the year under review (+48.7%). The higher revenues, a change in product mix and higher costs for purchasing bottleneck items from suppliers contributed to this. The ratio of cost of sales to revenue increased to 75.7% (2017: 61.8%).

The research and development expenses comprise those personnel expenses and depreciation relating to these activities together with the costs of test materials and tools, to the extent that these costs do not meet the criteria for capitalisation as intangible assets under IAS 38, together with the amortisation or retirement of capitalised development costs. R&D expenses increased by €1.6 million to €7.4 million compared with the previous year (€5.7 million). The gross expenses, prior to capitalisation, of €13.6 million (2017: €12.2 million) include the retirement of previously capitalised development costs (€2.0 million; 2017: €0.0 million) relating to projects that have been cancelled because of changed market conditions. Deducting the capitalisation of €6.3 million development costs (2017: €6.5 million) results in net research and development expenses of €7.4 million (2017: €5.7 million).

Sales, marketing & distribution expenses decreased by €2.1 million to €22.8 million (2017: €24.9 million), primarily due to lower payroll costs.

General administration expenses decreased by €4.6 million to €16.7 million (2017: €21.3 million). They include personnel expenses and office material costs as well as depreciation relating to the administration function. The decrease in costs is primarily due to lower provisions for litigation and lower consultancy fees for various projects.

Other operating income decreased by €1.7 million to €2.9 million (2017: €4.6 million); reasons for this include lower insurance benefits.

Other operating expenses increased by €0.3 million to €1.5 million (2017: €1.2 million).

As a result of the implementation of IFRS 9, the Group has adopted consequential amendments to IAS 1 Presentation of Financial Statements, which require impairments of financial assets to be presented in a separate line item in the consolidated income statement. Previously, the Group's approach was to include the impairment of trade receivables in other operating expenses. Consequently, the Group reclassified certain amounts recognised for the year ended December 31, 2017 under IAS 39 to “impairment loss on trade receivables and contract assets net of reversals” in the consolidated income statement; these amounted to €0.2 million impairment expenses, from “other operating expenses” and €0.1 million impairment reversals, from “other operating income”.

In 2018, the new position “impairment loss on trade receivables and contract assets net of reversals” relates primarily to the reversal of an impairment following a related receipt, together with impairments determined in accordance with IFRS 9 and amounts to €1.4 million net income (2017: €0.1 million net expense).

The EBITDA of €18.6 million was lower than for the prior year (2017: €29.9 million). As a result, in 2018 EBIT decreased by €11.3 million to a profit of €9.7 million compared with a profit of €21.0 million in the prior year.

The net financial expense in the year under review was €16.6 million (2017: €28.5 million). 2018 includes interest expenses of €14.4 million (2017: €19.6 million) primarily relating to interest-bearing financing with a total nominal value of €235.5 million (2017: €190 million). These include the long-term financing loan (Senior Facilities Agreement, “SFA-loan”; nominal as at December 31: 2018: €95 million; 2017: €130 million), the €60 million bond (2017: €60 million and, during that year, the 2011-bond with a nominal value of €220 million) together with two loans from a main shareholder (original nominal €80 million, plus capitalised interest since of €0.5 million; 2017: nil). In 2018 we recognised accretion for the bond, the SFA-loan, defined benefit and other obligations of €4.0 million (2017: €2.5 million). The net effect of foreign exchange gains and losses was a gain of €1.9 million (2017: loss of €5.0 million).

In the year under review, earnings before income tax were €6.9 million loss (2017: €7.5 million loss).

Income tax expenses (including deferred taxes) amounted to €1.1 million in 2018 (2017: €5.9 million). Deferred taxes are calculated on the basis of statutory tax rates, or of tax rates which have been enacted as of the balance sheet date in each country, that are expected to be in place on realisation.

Due to the above developments, the Group recorded a consolidated result for the period of €8.1 million loss (2017: €13.4 million loss).

The trends in the different segments are illustrated by the following table (prior to consolidation):

Site Location	Germany		USA - Commercial		USA - Defence		Great Britain		France		Holding activities	
€ millions	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017
Net revenues	176.4	136.7	42.8	50.6	4.5	3.5	21.4	15.8	35.1	27.9	-	-
Order Intake (inc. order book adjustments)	219.3	167.8	46.1	51.4	17.3	4.9	16.4	9.6	55.7	28.5	-	-
Order book	194.6	153.9	6.6	4.5	15.0	2.3	7.6	12.5	44.9	24.3	-	-
EBITDA	19.7	24.9	(5.1)	(4.1)	(1.1)	(1.1)	1.8	2.7	1.5	1.9	(0.8)	(1.7)
EBT	10.4	6.1	(5.8)	(4.6)	(1.4)	(1.4)	1.7	2.7	1.5	1.9	(92.5)	(13.6)
Employees (FTE) including trainees (At year-end)	825	738	104	86	7	16	14	15	3	3	3	2

2.4 Financial position

2.4.1 Capital management policies and aims

The objective of the capital management is to secure the financing of current business activities, taking into account the obligations and the regular interest payments due to the SFA-loan and the bond, and in the medium-term to reduce the leverage significantly. The Group's internal policies require that return on capital is reviewed on all investments and generally all contract bid decisions. The Group aims to have a corporate and capital structure, without material off-balance sheet financing. In the normal course of business, performance and advance payment guarantees are issued to our customers by banks and insurers on our behalf.

2.4.2 Funding sources and use of funds

Following the refinancing during 2017 the H&K AG Group has two material non-current financial liabilities, also held at December 31, 2018: a secured financing loan amounting to nominal €95 million (December 31, 2017: €130 million) and a €60 million unsecured bond listed on the Luxembourg Euro MTF free market. The €95 million financing loan relates to a private €150 million financing agreement (SFA-loan) from July 24, 2017, maturing on August 21, 2022, under which a total of €130 million was drawn down on August 21, 2017 (€80 million by H&K AG and €50 million by HKO) and in November 2018 €35 million was repaid by H&K AG. The interest rate is 7.25% plus EURIBOR (if this is positive) and interest is payable half yearly. The €60 million financing relates to a private note purchaser loan that was converted into a listed bond on December 15, 2017. This bond, maturing April 30, 2023 has a fixed interest rate of 6.5% payable on April 30 and October 31. Together with a €50 million short-term shareholder loan that was converted into equity as a contribution in kind in October 2017, the funds from the refinancing were primarily used on August 24, 2017 for the early redemption of HKO's 2011 bond, due May 2018, with accrued interest (€226 million).

Under the SFA-loan agreement, H&K AG and its subsidiaries are subject to strict limitations on certain transactions; the Group must also meet specified ratios between net debt and the contractually defined EBITDA ("Financial Covenants") and make partial repayments for example dependent upon the annual contractually defined "Excess Cashflow". H&K AG is permitted to partially or fully redeem its SFA-loan liability. Once the SFA-loan amount drawn by H&K AG has been fully redeemed, HKO will be permitted to partially or fully redeem its SFA-loan liability. However the voluntary redemptions must comply with contractual conditions, including in some cases prepayment premia.

In March 2018 and December 2018, the SFA agreement was amended inter alia to permit H&K AG to draw unsecured bridging loans from a main shareholder, to set a minimum cash resource level for the Group of €10 million and to make adjustments to the required ratios of net debt to contractually defined EBITDA (Financial Covenant) for the quarters ending December 2017 through June 2018.

As security for liabilities under the SFA-loan, the direct and indirect subsidiaries of H&K AG have also entered into the agreement as guarantors. In addition the shares in HKM and its direct and indirect subsidiaries together with, through floating charges and other security agreements, certain non-current assets, inventories, receivables and bank accounts (all other bank accounts serve as security deposits for bank guarantees and similar) are pledged to the trustee for the lenders.

On March 28, 2018 one of H&K AG's main shareholders agreed a €30 million interest-free, unsecured bridging loan to H&K AG with a term until July 15, 2019; funds were received in late April. In November

2018, the duration was extended until July 15, 2023; in another amendment, an interest rate of 2% was agreed, charged retrospectively from the initial loan payment with accrued interest added to the loan principal quarterly.

At the end of November 2018, this main shareholder of H&K AG agreed and paid out an additional €50 million unsecured bridging loan with a term until July 15, 2023. The interest rate is 2%; accrued interest will be added to the loan principal quarterly. This additional loan was granted as part of a healing agreement relating to a financial covenant in the SFA loan agreement as at September 30, 2018. Of the €50 million loan received, €35 million was used by H&K AG for a partial repayment of its SFA-loan drawings.

H&K AG Group's financial expenses of €18.2 million (2017: €28.6 million) are primarily interest expenses totalling €13.8 million (2017: €18.5 million) relating to the bonds, the SFA-loan and the loans from a main shareholder; accretion for the bonds, SFA-loan, defined benefit and other obligations amounting to €4.0 million (2017: €2.5 million); and net foreign exchange effects of €1.9 million gain (2017: €5.0 million loss).

The funds relating to the H&K AG Group's defined benefit obligations in the amount of €61.6 million (2017: €62.1 million) are available to the company in the long term.

2.4.3 Off-balance-sheet financing

In the period under review, as in the previous period, H&K AG Group did not make use of any significant off-balance sheet financing. Details of bank guarantees for customers and operating leases are explained in the notes to the financial statements.

2.4.4 Capital expenditure

The H&K AG Group's capital expenditure on property, plant and equipment and intangible assets (excluding capitalised development costs) amounted to €8.3 million in 2018 (2017: €12.9 million).

Amortisation and depreciation (excluding amortisation of capitalised development costs) amounted to €6.6 million in the year under review (2017: €6.7 million).

Detailed information is provided in Notes 16 and 17 to the Group’s accounts.

Capitalised development costs in 2018 amounted to €6.3 million (2017: €6.5 million); the amortisation of capitalised development costs was €2.3 million (2017: €2.2 million).

The capital expenditure was mainly in the segment Germany and also in the segment USA - commercial.

2.4.5 Cash and cash equivalents

2.4.5.1 Cash inflows and outflows, including effects of particular factors

On December 31, 2018, the Group's cash and cash equivalents amounted to €22.3 million (2017: €18.8 million).

Details of cash inflows and outflows are provided in the Consolidated Statement of Cash Flows in the Group's accounts. The performance indicator "operating cash flow" was negative in 2018 (€0.5 million outflow), €17.6 million below the prior year figure (€17.1 million inflow).

Main drivers for the change in operating cash flow were the increased liquidity requirements for an increase in net working capital compared to the prior year, for payments relating to litigation risk provisions and for tax payments.

Due to the net cash outflow for operating activities, the planned capital expenditure on property, plant and equipment and intangible assets was only partially carried out. To maintain current business activities, a main shareholder provided two loans.

2.4.5.2 Solvency / going concern considerations

The available cash and cash equivalents taking into account the additional financial measures described in section 2.4.2 were sufficient so that the H&K AG Group companies were able to meet their payment obligations during 2018.

The unrestricted liquidity (cash and cash equivalents less security deposits) as at December 31, 2018 provides sufficient scope to cover payments that are due. On December 31, 2018, this amounted to €21.7 million (2017: €18.7 million).

The business plan includes a cash inflow from operating activities for 2019, which is expected to be sufficient to cover capital expenditure and interest payments. The continued existence of H&K AG and therefore of the H&K AG Group is dependent on the actual occurrence of the assumptions on which the liquidity movements included in this business plan were based, so that the cash inflows for 2019 and the following years are significantly higher than for 2018. This can only be achieved if production processes are sustainably improved to enable the planned output quantities to be produced, with a higher margin product mix. Should this not be achieved, there would be additional financing requirements, needing external sources. To the extent that it were not possible to use external sources accordingly, there would be a going concern risk.

2.5 Financial position

2.5.1 Significant changes in financial position

Compared to December 31, 2017, the net assets at December 31, 2018 increased by €40.2 million to €263.0 million.

Non-current assets as at the balance sheet date increased to €105.1 million (2017: €98.1 million).

Current assets were €157.8 million; a increase of €33.2 million compared to the prior year. Inventories and prepayments for inventories increased by €12.7 million to €87.8 million (2017: €75.1 million). As at the balance sheet date, trade accounts receivable had increased by €9.9 million year-on-year to €31.1 million (2017: €21.2 million). This balance sheet item depends on the date of delivery and order-specific payment conditions and is therefore subject to significant fluctuations. Other loans, investments and derivatives increased by €11.1 million to €13.8 million (2017: €2.7 million), due to the increase in security deposits for bank guarantees and similar.

Group equity at December 31, 2018 amounts to negative €118.7 million (2017: negative €109.3 million). The going concern status for the individual companies and therefore the Group is not, however, affected by the negative equity. The current H&K AG Group business plan for the next few years shows an improvement in the equity position and assumes the reduction of debt.

Non-current liabilities increased by €48.5 million to €316.2 million (2017: €267.8 million).The bond, the SFA-loan and the loans from a main shareholder are recognised in the balance sheet at their net amortised costs of €230.7 million (2017: €182.2 million). The associated accrued interest payables of €3.9 million (2017: €3.6 million) are recognised within other liabilities.

Current liabilities increased by €1.1 million to €65.4 million (2017: €64.3 million). Within this, an increase in contract liabilities (advanced and stage payments received) of €10.6 million almost entirely offset the €5.8 million reduction in provisions for income taxes (primarily due to tax payments) and the €5.4 million reduction in other provisions and accruals (primarily relating to provisions for litigation risks).

The performance indicator net working capital increased from €68.9 million in the previous year to €80.9 million on December 31, 2018. This was primarily due to increases of €12.7 million in inventories and prepayments for inventories and €9.9 million in trade receivables; these were only partially compensated for by a €10.6 million increase in contract liabilities (advanced and stage payments received).

2.5.2 Non-financial performance indicators

Ensuring the sustainability of its business model is a central strategic task at H&K AG Group. In addition to achieving our economic targets, this means being a responsible employer, a law-abiding member of society and a reliable partner for our customers and suppliers. Having a sustainable business model is essential for the Group, so as to be able to capitalise on business potential and minimise risks.

Our key activities in terms of sustainability are described in the following sub-sections.

2.5.2.1 Production and innovation

In order to improve business processes and reduce their complexity, it is important to Heckler & Koch to obtain the active involvement of our current employees and the input from new employees. The reduction of manufacturing throughput-times and the improvement of inventory turn as well as innovations and new technologies are the cornerstones of the Group's continued strategic development. Employees are always welcome to submit suggestions for process optimisation or innovative ideas for new products. To manage the following areas, ratios are available in the SAP system and sub-systems covering for example for production: inventory turn and range as well as throughput-times and machine utilisation.

2.5.2.2 Employees

At the H&K AG Group, sustainability also means taking responsibility for our employees. Qualified, highly motivated and committed employees are essential for achieving top performance and are therefore the bedrock of our economic success. Values such as honesty, legal compliance, fairness, acceptance and trust, helpfulness and regard for others, a sense of duty and reliability are understandably of utmost importance for the Group's workforce. In the light of our company's duties to society, whilst securing both facilities and jobs, our business activities across all company locations are shaped by the company's social, environmental and economic responsibilities. Besides profitability and efficiency, our corporate governance principles lay the basis for our actions and commitment.

See section 2.2 for information on movements in the headcount.

2.5.3 Conclusion on the overall assertion regarding the financial position, financial performance and cash flows at the time the management report was prepared

Overall, 2018 revenue was higher compared to the prior year. Due to low-margin revenues however, EBITDA was lower than in the prior year. The increased inventories and unplanned poor cost structures led to a tight liquidity situation. The net asset and financial position worsened, making it necessary to obtain loans from a main shareholder.

The liability for the bond, the SFA-loan and the loans from a main shareholder increased to nominal €236 million at the year-end (2017: €190 million). Despite this, the interest burden was reduced by €5.2 million compared to the prior year.

3. Forecast and opportunities and risks report

3.1 Outlook

3.1.1 Introduction

This report contains forward looking statements on business trends, which are based on the judgements, estimates and assumptions of the management. A number of factors, many of which are beyond Heckler & Koch's control, have an impact on its operating activities, success, business strategy and results of operations. These forward-looking statements are based on current business plans, targets, estimates and projections and take into account the state of knowledge up to the date that this report was prepared, but not beyond. If the assumptions on which the projections are based prove to be incorrect, actual results may differ from these estimates. These elements of uncertainty include changes in the political and economic environment, changes to national and international laws and regulations, swings in the market, fluctuations in foreign currency and interest rates, the impact of competing products and prices, the effect of changes in customer structures as well as changes in the company's business strategy.

3.1.2 Economic outlook

According to IMF forecasts, in 2019 the growth in the global economy is expected to slow. The forecast for Germany and the Eurozone is also for a lower growth rate.

The critical factor for the H&K AG Group will be the changing local security situations and the military engagements of the individual countries in our main customer nations and the impact on their budgets for the infantry arms for individual soldiers. The continuing conflicts round the world together with the threat of terrorism require for a large number of international military interventions and a higher level of police capabilities. This makes it imperative to modernise the armed and law enforcement forces’ equipment and to ensure continuity of responsible security policies.

Heckler & Koch supplies the Lithuanian armed forces with additional G36 and the new 40 mm grenade launcher attachment HK269. A follow-on contract was awarded by the Lithuanian defence ministry at the end of August 2016; the contract value was about €12.5 million and deliveries were completed in 2017. Another contract was awarded in October 2018 for delivery in 2019. The new contract value is about €11 million.

On September 22, 2016 Heckler & Koch was awarded a large contract by the French department of defence "Direction Générale de l'Armement (DGA)" for the delivery of the new French standard assault rifle HK416F. After over 30 years' service, the FAMAS assault rifle is being replaced by the modern HK416F from Heckler & Koch as the "Arme Individuelle Future (AIF)". From 2017 onwards members of the Army, Air Force and Navy are being equipped with the new service weapon. The contract calls for the supply of 102,000 HK416 assault rifles together with HK269 grenade launchers, accessories, ammunition, spares and support services over a period of up to fifteen years. The total volume of the contract is about €140 million.

In April 2016, Heckler & Koch was awarded the US Army's Compact Semi-Automatic Sniper System (CSASS) program. As a result the H&K product G28-E110 will be introduced in the US Army and will replace the M110. Once the required tests have been successfully completed, the US Army can exercise options for the delivery of up to 3,600 series weapons with an order value of up to $44 million.

Heckler & Koch has won the tender to provide the German Special Commando Forces and Naval Special Commando Forces with the HK416 A7 assault rifle. The new assault rifle is expected to be introduced by the Special Forces in mid-2019, and designated the G95K. The HK416 A7 replaces the long-serving G36 K as the standard weapon for the German Special Forces. The HK416 A7 is a 5.56 mm x 45 NATO calibre gas operated weapon with a 14.5" barrel and weighs around 3.7 kg. The new weapon impresses with its high precision, secure function and reliability. The contract is for a total of 1,745 HK417 A7 including accessories.

To strengthen its alliance and self- defence capabilities, Latvia has awarded Heckler & Koch a major contract covering the complete product range. The Latvian Armed Forces signed a contract including the supply of G36 assault rifles to the country's National Guard and Border Guard. In 2018 under an order amounting to over €13 million, products from Heckler & Koch's full product range will be supplied. The G36 has proved itself for the Latvian Land Forces since 2006. In future the National Guard and Border Guard will also be able to trust the quality and reliability of the G36. This will result in Latvia having unified NATO standard equipment.

Heckler & Koch was able to beat the models offered by three competitors to win the Bavarian Ministry of the Interior's invitation to tender. By the end of 2019 around 40,000 pistols with accessories and training weapons are to be delivered. The SFP9 TR will replace the P7, also from Heckler & Koch, that has been in service in Bavaria since 1979. Heckler & Koch continues to be an important supplier and partner of the Bavarian police.

Heckler & Koch was also successful with the SFP9 TR for the invitation to tender for the Berlin police, a new customer. Heckler & Koch was awarded the contract for the delivery of a total of 24,000 new service pistols; from the first quarter of 2018 these will gradually replace the previous pistols that were not from Hecker & Koch.

All in all, Heckler & Koch is well positioned to continue for the foreseeable future as the main supplier for spare parts for firearms and related services for the NATO and NATO-equivalent countries. However requirements may be lower, depending on actual deployment for foreign operations.

3.1.3 Expected financial performance in 2019 and forecast for non-financial performance indicators

Order intake and order book

For 2019, a slightly lower order intake and order book at year-end are planned, due to a return to normal levels from the very high order book at the end of 2018.

Revenue, operating performance and EBITDA

For 2019, a slightly higher level of revenue and operating performance together with a significantly higher EBITDA are expected. The reorganisation of the production and logistics processes and the restructuring in the US factory will lead to improved efficiency and performance and therefore to increased revenue and profits.

Operating cash flow

According to the budget for 2019, compared to 2018 (negative €0.5 million), the operating cash flow is expected to be positive and significantly better.

Net working capital

According to the budget for 2019, net working capital is expected to be slightly less than as at December 31, 2018 (€80.9 million).

Cash and cash equivalents

At the end of 2019, cash and cash equivalents are expected to be slightly higher than at the end of 2018 (€22.3 million). We believe that we will be able to fulfil our payment obligations throughout 2019.

Number of employees

The main workforce in 2019 is expected to be at a similar level to 2018.

3.1.4 Overall assertion

For 2019 the executive board expects that compared to 2018 revenues will be slightly higher and the EBITDA will improve significantly.

3.2 Opportunities

The H&K AG Group's market potential depends on the one hand, on the military procurement plans of customer countries. Opportunities arise from changes in the military equipment required by the armed and security forces in “Green Countries”, together with the need to replace equipment, which in some cases has not been renewed for years, with modern equipment. The changing threats and deployment scenarios also require the equipment used to have better mobility and increased performance capabilities. High performance armament is central to affording security forces and soldiers the highest level of personal security and giving them the technical capability to accomplish their mission. As technological leader in the small arms market segment, this development offers the H&K AG Group the opportunity to build on its position as an industrial technological partner for highly developed armies, security forces and special forces and thereby to increase its revenue potential.

We believe that the sporting arms product segment has growth potential, particularly in the US commercial market for pistols. An optimised sales and service structure as well as new products specially developed for the US commercial market aim to continuously increase the sales volume. This theoretical market potential cannot currently be fully achieved. This is due to the large order book for the military and governmental authority customers that have priority. However preparatory activities are taking place, which the H&K AG Group can build-on at the appropriate time.

At the end of 2018, the executive directors and function managers began to implement an improvement programme involving numerous initiatives. From January 1, 2019, these different improvement projects will be anchored in a programme organisation known as “HK2020”. The new function “programme and project management” will ensure that the agreed initiatives for the promised improvements and savings are sustainably implemented and completed by the responsible project managers, within the functions, in the planned timescales. The supervisory board expressly supports this programme. The HK2020 cross-departmental initiatives serve to optimise various processes and procedures and so to improve profitability and liquidity.

The overall opportunities for the H&K AG Croup are estimated as high.

3.3 Risks

3.3.1 External risks

Heckler & Koch's market access is restricted both geographically - to Germany, the EU, the NATO countries and NATO-equivalent countries - and because its customers are government authorities. It is paramount for the H&K AG Group to have the right technological and economic product developments to participate in the future procurement programmes of NATO countries. In addition, it is also important to grow in the US commercial market.

Changes to the export licence approval policy can complicate or prevent the export of defence technology products and related realisation of revenue potentials and therefore negatively affect the revenue situation. However, this risk is judged to be low for the sales markets to NATO countries.

In alignment with the “Principles of the German Federal Government governing the export of small arms and light weapons, corresponding ammunition and production equipment to third countries” from March 18, 2015 (the “Small Arms Principles”), the executive directors have focussed HK's sales strategy on so-called "Green Countries". The Green-Country-Strategy that we have chosen to implement is a clear commitment to our values. We are a significant part of the security architecture for the Federal Republic of Germany, many European countries, NATO members and countries associated with NATO, as well as several countries that share European values. In principle, we will only serve these countries. Providing applicable valid export licences are received, the remaining contractual order book for other countries will be fulfilled, but for new tenders we are only seeking to serve “Green Countries”. We will only complete transactions after open, transparent and close coordination with, and the approval of, the appropriate German authorities.

It cannot be ruled out that in the USA too, the regulations for this market will be tightened, making it more difficult to sell our products in this commercial market, which is the largest in the world by far; this applies particularly to semi-automatic rifles. This is also the case for the future development of German export controls. Heckler & Koch is currently working on suitable measures to mitigate this negative scenario.

As an internationally operating group, the company is exposed to risks arising from fluctuations in foreign currency exchange rates. The foreign currency risk in the company's operating activities arises primarily from USD-denominated invoices for sales in the USA. A renewed appreciation of the euro against the US dollar could have a negative effect on earnings from sales invoiced in US dollars. Heckler & Koch on a occasionally uses derivative financial instruments to partially hedge the expected receivables from these planned, but primarily not yet concluded, transactions from USD-denominated contracts against the exposure to changes in exchange rates. In its management of foreign currency risks, the group only uses generally accepted instruments to hedge existing transactions and planned sales, but never for speculative purposes. To reduce the risk of default, these hedges are contracted from prominent German financial institutions. The company had no forward exchange contracts at the year-end.

Procurement risks arise from the fact that the raw materials, parts and components needed for the manufacturing process may not be sufficiently available in the required quality or quantity, or cannot be obtained in a timely manner. To ensure the security of supply and enable a prompt response to any changes, a close watch is kept on the procurement markets. In addition, procurement risks are mitigated by identifying alternative sources, monitoring supplier quality and reliability and holding suitable minimum inventory levels of raw materials.

Overall, the external risks for the H&K AG Group are considered to be at the same level as for the prior year.

3.3.2 Internal risks

The fulfilment of H&K AG's obligations depends on whether sufficient profits are transferred by HKO to H&K AG and thus on the continuing high operational earnings power of the companies. In our estimation, the internal risks for the H&K AG Group remain low.

3.3.3 Financial risks

As described in section 2.4.2, as at December 31, 2018 the H&K AG Group has the following material non-current financial liabilities: a €95 million financing loan (2017: €130 Mio. EUR) (maturing on August 21, 2022), a €60 million bond listed on the Luxembourg Euro MTF (maturing on April 30, 2023) and two bridging loans from a main shareholder for €30 million and €50 million (maturing on July 15, 2023).

The bond, the SFA-loan and the loans from a main shareholder are recognised in the statement of financial position at their amortised amounts totalling €230.7 million (2017: €182.2 million). The associated accrued interest liabilities totalling €3.9 million (2017: €3.6 million) are recognised within other liabilities.

Under the SFA-loan agreement H&K AG and its subsidiaries are subject to strict limitations on certain transactions; the Group must also meet specified ratios between net debt and the contractually defined EBITDA (“Financial Covenants”) and make partial repayments for example dependent upon the annual contractually defined “Excess Cashflow”. H&K AG is permitted to partially or fully redeem its SFA-loan liability. Once the SFA-loan amount drawn by H&K AG has been fully redeemed, HKO will be permitted to partially or fully redeem its SFA-loan liability. However the voluntary redemptions must comply with contractual conditions, including in some cases prepayment premia.

In March 2018 and December 2018, the SFA agreement was amended inter alia to permit H&K AG to draw unsecured bridging loans from a main shareholder, to set a minimum cash resource level for the Group of €10 million and to make adjustments to the required ratios of net debt to contractually defined EBITDA ("Financial Covenants") for the quarters ending December 2017 through June 2018.

As security for liabilities under the SFA-loan, the direct and indirect subsidiaries of H&K AG have also entered into the agreement as guarantors. In addition all shares in HKM and all of its direct and indirect subsidiaries together with, through floating charges and other security agreements, certain non-current assets, inventories, receivables and bank accounts (all other bank accounts serve as security deposits for bank guarantees and similar) are pledged to the trustee for the lenders. In the case of a contractually defined "Event of Default", one of the options available to the trustee would be the disposal of the pledged shares and / or other assets to cover overdue principal or interest payments.

As reported in the notes on the financial position in section 2.5.1, the H&K AG Group has negative equity of €118.7 million (2017: €109.3 million). The going concern status for the individual companies and therefore the Group is not, however, affected by the negative equity. The current H&K AG Group business plan shows a further improvement in the equity position and assumes a reduction in leverage.

With regard to the going concern risk due to uncertainties relating to the achievement of the plans for 2019 and the following years, please see the comments in section 2.4.5.2.

3.3.4 Risks arising from organisation and structure

For the H&K AG Group, active risk management is important for the control and monitoring of business processes. The aim of our risk management and monitoring processes is to facilitate the timely identification of potential risks that could hinder the achievement of business targets and to implement suitable mitigating strategies and measures. Since October 2017 the registration and evaluation of opportunities has been added to our risk management to improve achievement of business targets.

The new Heckler & Koch Group Risk Management Policy issued on September 30, 2016 by the H&K AG executive board governs the Groups revised Risk Management System. This policy was adopted by H&K AG executive board and affirmed by the supervisory board in September 2016. The objective of this policy and the binding rules within it is to achieve a Group-wide standard approach for Risk Management, together with the related topics Compliance Management, Corporate Governance, Internal Control System and Internal Audit, for all companies within the H&K AG Group. At the same time as this policy was issued, the Group implemented a new risk management application ("RMS application") in order to ease the management of the diverse risks to which the Group is exposed. In October 2017 the system was expanded to include EBIT and liquidity.

The Compliance Management Policy is now included within the Risk Management Policy. The Compliance Management System ("CMS") includes the abidance with laws and regulations and the adherence to company policies and procedures. Compliance is a significant element of the management and supervisory responsibility of the executive and supervisory boards. Being a business in the defence sector, Heckler & Koch is subject to particularly strict compliance requirements. The CMS is divided into culture, targets, risks, programme, organisation, communication, surveillance and improvement.

We regard “Corporate Governance” as being “responsible business management”. In addition to legislators and shareholders, the stakeholders influencing corporate governance include employees, customers, suppliers, investors, NGOs or overall society through politics and the media. The precise form of our corporate governance is the responsibility of the executive board in close cooperation with its governing body, the supervisory board. The supervisory board is responsible for monitoring the adequacy and effectiveness of the corporate governance. This is done on the basis of information from the executive board. Management regularly reports the current developments in the Group’s material risks to the supervisory board.

Overall, the risks arising from organisation and structure for the H&K AG Group are considered to be low.

3.3.5 Legal risks

These risks mainly include risks arising from product liability, competition and anti-trust laws, export law, weapons law, anti-corruption regulations, patent law, tax law and labour law. Any cases of damage and liability risks arising from ordinary activities are recognised in the balance sheet.

Heckler & Koch is engaged in the manufacture and distribution of small arms, particularly for governmental customers such as the German federal and state police and customs authorities, and domestic and foreign armed forces. The sale of small arms outside Germany takes place largely in the Member States of the European Union, NATO countries and NATO-equivalent countries. Heckler & Koch does not intend to generate new business with countries outside NATO’s sphere of influence; only so-called “Green Countries” should be served.

The supply of weapons to the law enforcement agencies and armed forces of other foreign countries (so-called “third countries”) only takes place – as is basically the case for all weapons sales – with the approval of the German government, whereby supply to critical countries is banned. In particular, when small arms are sold to foreign countries for military use, the recipient countries are required, before an export licence can be granted, to submit officially signed end-user certificates to the Federal Republic of Germany in which the recipient countries pledge not to re-export the proposed weapon supplies to other countries. In relation to the manufacture and sale of small arms, our company is subject to the constant control and regular monitoring of the following authorities: the Federal Ministry of Economics and Energy (“BMWi”), the Federal Office of Economics and Export Control (“BAFA”), the Wiesbaden Federal Office of Criminal Investigation, the Karlsruhe Regional Finance Office and the Rottweil District Administration Office. The underlying prerequisite for obtaining weapons and export approvals depends on the reliability of our company; for this reason complying with the law is a top priority. Absolute compliance with the weapons and export regulations forms the basis of our company. We have therefore implemented strict monitoring procedures and control systems to monitor the operating, production, supply and approval processes. In particular, this includes the careful selection of staff, regular training, continuous monitoring, precise operating instructions and the use of an IT-supported control system which is integrated into our working processes. In view of this, export risks are considered to be low.

On January 26, 2017 the US company Orbital ATK Inc. filed a complaint against HKO with the US District Court in Minnesota. In this complaint Orbital ATK Inc. is seeking damages in excess of $27 million together with the transfer of technology. Orbital ATK Inc. is the US Army’s main contractor so it is our sole contractual partner. The lawsuit was closed due to a settlement agreement with ATK based on the payment of $7.5 million compensation.

In October 2012, we commenced proceedings against Faxtech Pty Ltd (trading as “Point Trading”), an Australian entity demanding the return of a product owned by us. Point Trading raised a counterclaim against HKO and the Australian Commonwealth in December 2012 to assess damages for loss of opportunity and reliance loss. The lawsuit was closed through a settlement agreement. This included the return of the product to HKO and a payment by HKO equivalent to €0.9 million.

As a result of the Stuttgart Public Prosecutor’s Office’s preliminary investigation into former HKO employees, commenced in 2010, in which allegations of unauthorised export of rifles to Mexico between 2006 and 2009 are being probed, criminal charges have been made in the Stuttgart District Court against five former employees and the former agent in Mexico. HKO has cooperated fully with the authorities, both during the initial investigation and during the court case. The verdict by the court of first instance was that three former employees were found not guilty and two former employees were given suspended sentences of 1 year and 5 months and 1 year and 10 months respectively. The accused also included two former directors, who were both found not guilty. Both not guilty verdicts are now legally binding. HKO was sentenced to pay over €3.7 million. HKO has appealed this verdict; the Public Prosecutor and the two accused who were sentenced have also appealed. The completion of the proceedings on appeal on questions of law before the Federal Court of Justice is not expected before 2021.

The Public Prosecutor is investigating people involved with Heckler & Koch relating to allegations of the bribery of foreign decision-makers in Mexico. The risk for HKO resulting from this investigation is considered to be low.

Another preliminary investigation into unnamed employees and managers at Heckler & Koch was pending at the Stuttgart Public Prosecutor’s Office. This preliminary investigation related to an accusation of illegal transfer of technology to Mexico. The company engaged external lawyers to clarify the matter in detail and made the results available to the Stuttgart Public Prosecutor’s Office. In the interim, as a result the investigation has been closed.

Suitable provisions were created to cover legal risks. The H&K AG Group recognises provisions for legal actions when the resulting liabilities are probable and their amount can be reliably measured. Because of uncertainties and the difficulty of predicting the outcome of court decisions, there is always the chance of costs being incurred which exceed the provisions and can have an impact on the company and its results.

The results of tax audits could lead to the additional payment of taxes. There is also the risk that changes to tax law or case law could have a negative effect on Heckler & Koch's tax expense. Overall, these risks are considered to be low.

3.4 H&K AG Group's accounting-related internal control system

Approval processes and internal audit

The company has had its own internal binding regulations and guidelines for the areas of procurement, capital expenditure, product development, tenders, order intake, IT-security, data protection, accounting and travelling expenses for many years. Policies pertinent to employees are posted on the intranet.

Accounting-related IT-systems

Management controls in all areas require the timely availability of accurate information. The business information and reporting system is therefore very important. The SAP information system (VIS) provides numerous reports and performance indicators which can be accessed daily by the finance department as well as all operational areas.

One of the main reporting instruments in the finance department is the extensive monthly reporting package. As part of the Group reporting system, all Heckler & Koch companies provide detailed information on key items in their statement of financial position and income statement as well as ratios and explanations. These are requested, analysed and consolidated by the corporate finance department, which then reports them to Heckler & Koch's management.

Accounting organisation and policies

All subsidiaries must comply with the applicable issue of the Group’s accounting manual; this ensures the consistent recognition and valuation of all business transactions across the Group. Apart from the management, who are responsible for business operations in the particular market, the head of finance is responsible for the compliance with the legal and internally agreed accounting standards. The regular monitoring of key indicators, monthly reporting of financial results to the corporate finance department and the preparation of the five-year plan for each market are also part of the head of finance's remit.

Within the Group, besides supporting all group companies, HKO's corporate finance department is also responsible for developing and updating policies and job instructions for accounting-related processes. This mainly relates to the accounting manual and intercompany reconciliation instructions. Specific accounting or measurement questions of importance to the H&K AG Group are also centrally processed, analysed, documented and communicated.

Overall assertion

The aim of the internal control and risk management system in relation to the accounting process and preparation of the H&K AG Group financial statements, as highlighted above, is the proper recording, processing and valuation of transactions. The clear definition of responsibilities in the H&K AG Group's finance function and the appropriate training and further education of its staff, together with the use of suitable software and the issue of uniform accounting policies, form the basis for a sound, efficient and consistent accounting process.

Overall, it should serve to ensure that the assets and liabilities in the financial statements are completely and accurately recognised, measured and presented and thus to provide a fair and true view of the company's financial position, financial performance and cash flows.

3.5 Overall statement on the opportunities and risk situation

As in the previous periods, and as described in detail above, the Group's main risks arise from the volatility of revenue potentials and completely regulated market access opportunities, together with the interest payable and refinancing obligations due to the company's high leverage, combined with the limited cash reserves.

Through the HK2020 project that is underway, the value-adding functions, production, logistics and quality, will be optimised in order to further reduce delivery bottlenecks and enable the delivery of the high order book on time and the achievement of the sales potentials.

With its highly innovative product portfolio, the H&K AG Group is well prepared for the future. In our current plans, we anticipate a significant increase in output, an improvement of the equity position and a reduction in leverage. For 2019, we expect further increases in output and a positive result for the year.

As a technological leader in the provision of small arms, the Group sees opportunities to expand its market position arising through the changing requirements for the deployment of military, law enforcement and special forces, due to its high-performance products, and in the US commercial market, with new product developments.

Oberndorf/Neckar, April 10, 2019

H&K AG

Executive board

Dr. Jens Bodo Koch | Dr. Björn Krönert

Independent auditor's report

To the H&K AG, Oberndorf/Neckar

Opinions

We have audited the consolidated financial statements of H&K AG, Oberndorf/Neckar, and its subsidiaries (the Group), which comprise the consolidated statement of financial position as at December 31, 2018, and the consolidated income statement, consolidated statement of profit or loss and other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows and the group segment reporting for the financial year from January 1, 2018 to December 31, 2018 and notes to the consolidated financial statements, including a summary of significant accounting policies. In addition, we have audited the group management report of H&K AG, Oberndorf/Neckar, for the financial year from January 1, 2018 to December 31, 2018.

In our opinion, on the basis of the knowledge obtained in the audit,

- the accompanying consolidated financial statements comply, in all material respects, with the International Financial Reporting Standards (IFRS) as adopted in the EU, and the additional requirements of German provisions of commercial law pursuant to Section 315e (1) of the German Commercial Code (HGB) and in compliance with these requirements give a true and fair view of the assets, liabilities, and financial position of the Group as at December 31, 2018 and
- the accompanying group management report as a whole provides an appropriate view of the Group's position. In all material respects, this group management report is consistent with the consolidated financial statements, complies with German legal requirements and appropriately presents the opportunities and risks of future development.

Pursuant to Section 322 (3) sentence 1 HGB, we declare that our audit has not led to any reservations relating to the legal compliance of the consolidated financial statements and of the group management report.

Basis for the Opinions

We conducted our audit of the consolidated financial statements and of the group management report in accordance with Section 317 HGB and the German Generally Accepted Standards of Financial Statement Audits promulgated by the Institut der Wirtschaftsprüfer [Institute of Public Auditors in Germany] (IDW). Our responsibilities under those requirements and principles are further described in the "Auditor's Responsibilities for the Audit of the Consolidated Financial Statements and of the Group Management Report" section of our auditor's report. We are independent of the group entities in accordance with the requirements of German commercial and professional law, and we have fulfilled our other German professional responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinions on the consolidated financial statements and on the group management report.

Material uncertainty related to going concern

We refer to the comments included in the section "other disclosures" of the notes to the consolidated financial statements in item (28) Financial risk management and sub-topic "Liquidity risk" as well as to the comments included in the section "2.4.5.2 Solvency / going concern considerations" in the management report. In these comments management explains, that continued existence of H&K AG and therefore of the H&K AG Group is dependent on the actual occurrence of the assumptions on which the liquidity movements included in the liquidity plan were based, so that the cash inflows for 2019 and the following years are significantly higher than for 2018. This can only be achieved if production processes are sustainably improved to enable the planned output quantities to be produced, with a higher margin product mix. Should this not be achieved, there would be additional financing requirements, needing external sources. To the extent that it were not possible to use external sources accordingly, there would be a going concern risk. As explained in these comments, the events and conditions indicate a material uncertainty that may cast significant doubt on the company's ability for a continued existence and therefore form a going concern risk within the meaning of Section 322 (2) sent. 3 HGB for the Heckler & Koch GmbH as well as for the parent company of the Group. Our audit opinion is not modified with this regard.

Responsibilities of Management and the Supervisory Board for the Consolidated Financial Statements and the Group Management Report

Management is responsible for the preparation of the consolidated financial statements that comply, in all material respects, with IFRS as adopted by the EU and the additional German commercial law pursuant to Section 315e (1) HGB and that the consolidated financial statements, in compliance with these requirements, give a true and fair view of the assets, liabilities, financial position, and financial performance of the Group. In addition, management is responsible for such internal control as they, in accordance with German Legally Required Accounting Principles, have determined necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Group's ability to continue as a going concern. They also have the responsibility for disclosing, as applicable, matters related to going concern. In addition, they are responsible for financial reporting based on the going concern basis of accounting unless there is an intention to liquidate the Group or to cease operations, or there is no realistic alternative but to do so.

Furthermore, management is responsible for the preparation of the group management report that, as a whole, provides an appropriate view of the Group's position and is, in all material respects, consistent with the consolidated financial statements, complies with German legal requirements, and appropriately presents the opportunities and risks of future development. In addition, management is responsible for such arrangements and measures (systems) as they have considered necessary to enable the preparation of a group management report that is in accordance with the applicable German legal requirements, and to be able to provide sufficient appropriate evidence for the assertions in the group management report.

The supervisory board is responsible for overseeing the Group's financial reporting process for the preparation of the consolidated financial statements and of the group management report.

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements and of the Group Management Report

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and whether the group management report as a whole provides an appropriate view of the Group's position and, in all material respects, is consistent with the consolidated financial statements and the knowledge obtained in the audit, complies with the German legal requirements and appropriately presents the opportunities and risks of future development, as well as to issue an auditor's report that includes our opinions on the consolidated financial statements and on the group management report.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Section 317 HGB and in compliance with German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (IDW) will always detect a material misstatement. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements and this group management report.

We exercise professional judgement and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements and of the group management report, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinions. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls.
- Obtain an understanding of internal control relevant to the audit of the consolidated financial statements and of arrangements and measures (systems) relevant to the audit of the group management report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of these systems.
- Evaluate the appropriateness of accounting policies used by management and the reasonableness of estimates made by management and related disclosures.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in the auditor's report to the related disclosures in the consolidated financial statements and in the group management report or, if such disclosures are inadequate, to modify our respective opinions. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to be able to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements present the underlying transactions and events in a manner that the consolidated financial statements give a true and fair view of the assets, liabilities, financial position and financial performance of the Group in compliance with IFRSs as adopted by the EU and the additional requirements of German commercial law pursuant to Section 315e (1) HGB.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express audit opinions on the consolidated financial statements and on the group management report. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our opinions.
- Evaluate the consistency of the group management report with the consolidated financial statements, its conformity with German law, and the view of the Group's position it provides.
- Perform audit procedures on the prospective information presented by management in the group management report. On the basis of sufficient appropriate audit evidence we evaluate, in particular, the significant assumptions used by management as a basis for the prospective information, and evaluate the proper derivation of the prospective information from these assumptions. We do not express a separate opinion on the prospective information and on the assumptions used as a basis. There is a substantial unavoidable risk that future events will differ materially from the prospective information.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Stuttgart, April 10, 2019

KPMG AG
Wirtschaftsprüfungsgesellschaft
[Original German version signed by:]

Schwebler Wirtschaftsprüfer [German Public Auditor]	Hagg Wirtschaftsprüfer [German Public Auditor]