KONTRON GROUP

ANNUAL REPORT 2016

KONTRON IN FIGURES

		2016	2015
RESULTS OF OPERATIONS AND PROFITABILITY			
Revenues	Mio. €	385.1	467.7
EBITDA [1]	Mio. €	– 47.6	29.9
EBITDA margin [2]	%	– 12.4	6.4
EBIT [3]	Mio. €	– 141.7	6.2
EBIT [4] (adjusted)	Mio. €	– 58.8	14.5
EBIT margin [2] (adjusted)	%	– 15.3	3.1
EBT	Mio. €	– 143.9	4.1
Net income / loss	Mio. €	– 147.6	– 2.7
Earnings per share	€	– 2.71	– 0.05
STATEMENT OF FINANCIAL POSITION			
Total assets	Mio. €	291.1	441.9
Equity	Mio. €	137.0	258.9
Equity ratio	%	47.1	58.6
Financial debt	Mio. €	0.6	57.3
CASH FLOW			
Cash flow from operating activities	Mio. €	60.5	14.2
EMPLOYEES			
Number of employees (as of 12/31)		1,215	1,286

[1] EBITDA is EBIT before depreciation and amortization as well as any impairments of intangible assets and property, plant and equipment.
[2] Margins refer to revenues.
[3] EBIT is defined as earnings before financial income and taxes.
[4] EBIT is adjusted for cost of restructuring and reorganization of the company.

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LETTER TO THE SHAREHOLDERS

Ladies and gentlemen, dear shareholders,

The 2016 fiscal year was disappointing and was without doubt the weakest for Kontron in terms of revenue and earnings since the IPO in April 2000. In June 2016, we had to reduce our guidance and additionally recognize significant impairment losses. In the end, revenue in the 2016 fiscal year dropped by approximately 18 % to € 385 million compared to the prior year. This resulted in operating losses, which together with the necessary impairment losses, resulted in a net loss for the year of approximately € 148 million. Equity was therefore nearly halved as a result. We face immense challenges.

I have been Chairman of the Management Board of Kontron since December 2016, the third in the fiscal year 2016. Upon taking up my position I immediately began to analyze the root cause of the dilemma and we are now right in the middle of measures necessary for a turnaround. We believe the strategy to increase value added by means of more software and a focus on the "Internet of Things" and "Industry 4.0" will be decisive. We want to pursue and implement this strategy further. I believe that there were two clear problems: Firstly, the structure and costs implemented by Kontron for revenue over one billion were adjusted too late to reflect the decrease in revenue to € 385 million. We are going to have to lower our sights in future. Secondly, and more importantly, Kontron has been undergoing restructuring measures for four years and the resulting costs for too many advisors have been high. At the same time, we have been more preoccupied with ourselves than running the business. As a result, we have lost focus on our customers and technology.

However, the situation provides an opportunity for a new beginning. This is the second time that a company that I manage has come on board as an investor in Kontron. 1999 was also a very difficult year for the company. The company was reporting enormous losses at that time and the former owner, BMW AG, was planning on closing or selling the loss maker, Kontron. However, with a great deal of hard work, cost awareness and innovative technology,

Kontron once again became stronger, indeed it went on to become global market leader in the embedded computer market.

We want to repeat this success as of 2017. Strict cost savings of € 15 million, primarily in the administration and for external advisors should allow Kontron to break even as early as the second quarter of 2017. We want to effect a technology boost by means of the merger with S&T Group. S&T employs 1,800 software engineers worldwide: an important requirement to be able to offer joint IoT and Industry 4.0 solutions. S&T has already acquired about 29.9 % of all Kontron shares, filled key positions and has consolidated Kontron since December 2016. We would ask you, dear shareholders, to agree to a merger of both companies at this year's Annual General Meeting of Shareholders.

Together, the two companies should generate revenue between € 860 to 890 million with EBITDA of over € 50 million in 2017. In 2018, we should already be generating revenue of over € 1 billion. We have the potential to become technology and market leader in the key market Industry 4.0.

Yours,

Hannes Niederhauser
Chairman of the Management Board of Kontron AG

REPORT OF THE SUPERVISORY BOARD

Dear Shareholders,

In the following report I would like to give you an overview of the activities of the Supervisory Board of Kontron AG and its committees as well as the audit of the separate and consolidated financial statements for the fiscal year 2016.

COOPERATION BETWEEN THE SUPERVISORY BOARD AND THE MANAGEMENT BOARD

The Supervisory Board performed the duties and responsibilities with which it was entrusted in the 2016 fiscal year with utmost diligence and dedication. It monitored the leadership provided by the Management Board on an ongoing basis. In terms of overseeing the management, the benchmark used by the Supervisory Board was primarily whether the Management Board had acted duly, expediently and efficiently at all times. The Supervisory Board reviewed the performance of the Management Board at all meetings on the basis of its reporting.

In addition to the realignment of Kontron AG's business operations, the focus of the Supervisory Board in the 2016 fiscal year was primarily on the strategic goals of the company. The Supervisory Board's activities focused on the expansion of the software business as well as on the strategy in Asia and the strategic partnership with Ennoconn, the investment of S&T AG (Linz, Austria) as new anchor shareholder and the changes in the management of Kontron AG.

After thorough examination and discussion, the Supervisory Board voted on the reports of the Management Board and its proposed resolutions where required to by the law and the Articles of Association.

MEETINGS OF THE SUPERVISORY BOARD

The Supervisory Board convened a total of 16 times in the 2016 fiscal year and also passed resolutions by circulation six times outside of its meetings. Generally, all members of the Supervisory Board were present at the meetings of the Supervisory Board and its committees as well as when the respective resolutions were passed. Mr. Harald Joachim Joos excused himself from one meeting of the Supervisory Board and Dr. Harald Schrimpf from two.

The company is not aware of any conflict of interest affecting the Management Board that would be subject to mandatory disclosure to the Supervisory Board or the Annual General Meeting of Shareholders. A Group Committee was set up as part of the Supervisory Board in response to changes in the shareholder structure.

MAIN TOPICS OF DISCUSSION

At its meetings, the Supervisory Board was regularly informed by the Chairman of the Management Board of the status of the Group and by the Management Board member for Corporate Finance on the net assets, financial position and results of operations of the Group. In addition to monitoring the current development of business, the Supervisory Board focused on the following issues:

In the first quarter of 2016 the Supervisory Board convened three times to discuss issues including in particular the company's operating and strategic activities, the Kontron Group's budget planning and the approval of the budget for the 2016 fiscal year, as well as the strategic partnership with Ennoconn. At the meeting on

March 15, 2016, the Supervisory Board ratified the financial statements of the company for the 2015 fiscal year. The auditors declaration of independence was provided to the Supervisory Board by the date on which it passed the applicable resolution to elect the auditor, as required by Art. 7.2.1 of the German Corporate Governance Code.

In the second quarter the Supervisory Board convened twice and passed resolutions by circulation three times outside of its meetings. These discussions focused on the change in the Management Board member responsible for finance, the company's strategy and economic development, and preparations for the ordinary Annual General Meeting of Shareholders on June 9, 2016.

In the third quarter the Supervisory Board convened three times and passed resolutions by circulation three times outside of its meetings. In particular, it dealt at length with changes in the Management Board, a comprehensive program of measures aimed at realigning the Kontron Group in order to combat the negative revenue trend on the one hand while also making corresponding adjustments on the cost side, as well as with the financing of the Kontron Group.

The Supervisory Board convened eight times in the fourth quarter, and the focus of those meetings was on the changes in the shareholder structure and associated strategic questions, changes in the administration of Kontron AG and the restructuring program and financing of the Kontron Group. The Supervisory Board received assistance from external consultants in connection with its extensive discussions regarding the strategic issues associated with the changes in the shareholder structure. The Supervisory Board also discussed the budget planning process for the 2017 fiscal year as well as corporate governance issues and the declaration of compliance by the Management Board and the Supervisory Board.

COMMITTEE WORK

The Supervisory Board delegated some of its tasks to three committees during the 2016 fiscal year: the Audit Committee, the Nomination Committee and the Strategy Committee.

The Audit Committee is composed of four members. Mr. Sten Daugaard served as Chairman of the Audit Committee until he stood down from the Supervisory Board on July 25, 2016, and he was succeeded by

Dr. Dieter Düsedau. Mr. Martin Bertinchamp and Mr. Harald Joachim Joos were members of the Audit Committee until their departure on November 30, 2016. Mr. Richard Neuwirth (MMag.) was appointed Chairman of the Audit Committee and Dr. Valerie Barth and Mr. Michael Jeske as members on December 14, 2016. Since then the Audit Committee has consisted of Mr. Richard Neuwirth (MMag.)(Chairman), Dr. Dieter Düsedau (Deputy Chairman), Dr. Valerie Barth and Mr. Michael Jeske.

The Audit Committee met five times in the course of the 2016 fiscal year. The main points addressed by the committee were the development of the net assets, financial position and results of operations of the Group and the presentation of the interim reporting and notifications and the financial statements of Kontron for the 2016 fiscal year as well as the invitation to tender for the audit of the 2017 financial statements. The Audit Committee worked closely together with the external auditor in this regard. Moreover, the effectiveness of the internal control system, the risk management system, and the internal audit system was monitored and compliance issues discussed.

- At the first meeting in February of the 2016 fiscal year, the Audit Committee called upon the external auditor to report on the status of the audit for the financial statements for the 2015 fiscal year.

- At its second meeting in March 2016, the separate financial statements of the company and the consolidated financial statements of the Group for the 2015 fiscal year were discussed. The audit report issued by Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft was provided to the Audit Committee. The auditor also attended this meeting. In addition, the Audit Committee addressed legal and compliance issues.

- At its meeting in April 2016 the Audit Committee discussed at length the report for the first quarter and the process of issuing an invitation to tender for the audit of the 2017 financial statements.

- The focus of the fourth meeting held in July 2016 was on the internal auditing system and the risk report of the Group as well as the Q2-report issued at the end of the second quarter.

- The third quarter report was discussed at the fifth meeting in October 2016. Other topics addressed by the meeting included the risk report, law and compliance and issues related to the hedging of interest risks and foreign exchange exposures.

The task of the Nomination Committee was to select suitable candidates for appointment to the Supervisory Board. Until November 30, 2016, the members of the Nomination Committee were Mr. Rainer Erlat as its Chairman and Messrs. Harald Joachim Joos and Martin Bertinchamp. In the 2016 fiscal year the Nomination Committee met once and advised the Supervisory Board to propose the appointment of Dr. Dieter Düsedau as a member of the company's Supervisory Board to the Annual General Meeting of Shareholders. The Nomination Committee was dissolved by the Supervisory Board in December 2016 and its functions were assigned to the full Supervisory Board.

The Strategy Committee, set up in the 2015 fiscal year, was unanimously dissolved on March 15, 2016. Its members had been Mr. Rainer Erlat as Chairman, Mr. Sten Daugaard, Mr. Martin Bertinchamp, Mr. Harald Joachim Joos and Dr. Harald Schrimpf. On June 08, 2016, the Supervisory Board again set up a Strategy Committee to look closely at matters relating to the company's strategy outside the ordinary meetings of the Supervisory Board. The Strategy Committee consisted of Dr. Dieter Düsedau as Chairman as well as Messrs. Martin Bertinchamp and Harald Joachim Joos, the latter both until November 30, 2016. The new Strategy Committee convened five times in the 2016 fiscal year, and discussed issues including the changes in the shareholder structure, the management of Kontron AG, the restructuring program and financing. The Strategy Committee was dissolved by the Supervisory Board on December 14, 2016 and its functions were assigned to the full Supervisory Board.

Due to changes in the shareholder structure, the decision was made at the meeting of the Supervisory Board on December 14, 2016 to set up a Group Committee. The Group Committee is responsible for advising on and approving certain transactions between the Kontron Group and the S&T Group. The Supervisory Board appointed Dr. Valerie Barth as Chairperson of the Group Committee and Dr. Dieter Düsedau and Mr. Richard Neuwirth (MMag.) as its other members.

PERSONNEL CHANGES WITHIN THE MANAGEMENT BOARD AND SUPERVISORY BOARD

In June 2016, Mr. Michael Boy, the member of the Management Board responsible for Finance until that point, left the company. Mr. Boy stood down from his position and terminated his service contract at his own request, for personal reasons and by mutual and amicable agreement with the company. The Supervisory Board and Management Board would like to thank Mr. Boy for his work and dedication, as well as his accomplishments in managing and representing the company.

Mr. Rolf Schwirz and Mr. Andreas Plikat were dismissed from their positions as Chairman and member of the Management Board respectively with immediate effect for due cause by means of a resolution of the Supervisory Board taken on July 25, 2016, and their employment contracts were terminated with immediate effect for due cause. Mr. Sten Daugaard assumed the position of Chairman of the Management Board with effect as of July 25, 2016, and stood down as a member of the Supervisory Board for this reason. Dr. Thomas Riegler, who had previously served as the provisional head of Kontron AG's Finance function, was now appointed to the Management Board. Messrs. Schwirz and Plikat both appealed against their dismissal and the termination of their employment contracts. There are no legally binding decisions, and the company assumes that the actions will be dismissed.

After Mr. Sten Daugaard transferred from the Supervisory Board to the Management Board, Dr. Valerie Barth was appointed as the sixth member of Kontron AG's Supervisory Board by means of a district court order dated October 26, 2016.

After Messrs. Rainer Erlat (Chairman), Harald Joachim Joos and Martin Bertinchamp stood down from the Supervisory Board with effect as of November 30, 2016, Messrs. Richard Neuwirth (MMag.), Michael Jeske and Michael Roider (Dipl. Ing.) were appointed to the Supervisory Board of Kontron AG with effect as of December 2, 2016 by court order. At its meeting on December 5, 2016, the Supervisory Board elected Mr. Richard Neuwirth (MMag.) as its new Chairman and Dr. Dieter Düsedau as his Deputy. Dr. Harald Schrimpf stood down from his position with effect as of December 5, 2016.

At its meeting on December 6, 2016, the Supervisory Board appointed Mr. Hannes Niederhauser to the Management Board. Following Mr. Daugaard's mutually agreed resignation from the Management Board, Mr. Niederhauser was appointed as Chairman of Kontron AG's Management Board with effect as of December 14, 2016.

The Supervisory Board had five members at the end of the reporting period.

AUDIT OF THE SEPARATE AND CONSOLIDATED FINANCIAL STATEMENTS

Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft audited the separate financial statements compiled by the Management Board in accordance with the German Commercial Code and the underlying bookkeeping and management report for the period and rendered an unqualified audit opinion. The consolidated financial statements and the group management report were prepared in accordance with International Financial Reporting Standards (IFRSs) as endorsed by the EU, as required by Sec. 315 a (1) HGB. Here, too, the auditor rendered an unqualified audit opinion. The audit engagement was awarded pursuant to a resolution of the Annual General Meeting of Shareholders on June 9, 2016.

The auditor of the financial statements also reported on whether the Management Board had complied with Sec. 91 AktG and established a suitable early warning system for the detection of any risks to the ability of the company to continue as a going concern. The audit revealed that the risk management system established by the company complied with the statutory requirements.

The audit also included the Management Board's dependent company report for the 2016 fiscal year, covering the period from January 1 to December 31, 2016. The auditor rendered the following unqualified opinion on the dependent company report: "Based on our audit and assessment in accordance with professional standards, we confirm that the information given in the report is correct, the payments made by the company in the transactions listed in the report were not unreasonably high, and there are no circumstances that would require a materially different assessment of the measures listed in the report than that of the management board."

The documents relating to the financial statements, including the dependent company report, and the auditor's report were submitted to the Audit Committee in good time. They were extensively discussed with the Management Board and the auditors at the meeting of the Audit Committee and the meeting of the Supervisory Board that ratified the financial statements on April 5, 2017. The auditor reported on the significant findings of the audit and was available to both the Audit Committee and the full Supervisory Board to respond to any questions. All questions posed by the Supervisory Board were comprehensively answered. After conducting our own review and discussing the financial statements, management report, dependent company report and audit reports at length, we do not have any objections and concur with the findings made by the auditor of the financial statements. We approved both the separate financial statements and management report and the consolidated financial statements and group management report compiled by the Management Board for the year ending December 31, 2016 at the meeting of the Supervisory Board on April 5, 2017 and subsequently ratified the financial statements and management report of Kontron AG. The Supervisory Board discussed the proposal made by the Management Board for the appropriation of the result for the year and concurs with the proposal.

The Supervisory Board would like to thank all of the Kontron Group's employees around the world and their elected representatives for their efforts and achievements in the challenging 2016 fiscal year, and wish the Kontron team all the best for the future.

Richard Neuwirth (MMag.)
Chairman of the Supervisory Board

MEMBERS OF THE SUPERVISORY BOARD

RICHARD NEUWIRTH (MMAG.)
Chairman of the Supervisory Board
Appointed by order of Augsburg district court on December 2, 2016
Since December 5, 2016:
Chairman of the Supervisory Board
Since December 14, 2016:
Chairman of the Audit Committee
Since December 14, 2016:
Member of the Group Committee

DR. DIETER DÜSEDAU
Deputy Chairman of the Supervisory Board
From August 17, 2016 to December 14, 2016:
Chairman of the Audit Committee
From June 8, 2016 to December 14, 2016:
Chairman of the Strategy Committee
Since December 14, 2016:
Member of the Audit Committee
Since December 14, 2016:
Member of the Group Committee

DR. VALERIE BARTH
Member of the Supervisory Board
Appointed by order of Augsburg district court on October 26, 2016
Since December 14, 2016:
Chairperson of the Group Committee
Since December 14, 2016:
Member of the Audit Committee

MICHAEL JESKE
Member of the Supervisory Board
Appointed by order of Augsburg district court on December 2, 2016
Since December 14, 2016:
Member of the Audit Committee

MICHAEL ROIDER (DIPL. ING.)
Member of the Supervisory Board
Appointed by order of Augsburg district court on December 2, 2016

THE FOLLOWING MEMBERS STOOD DOWN FROM THE SUPERVISORY BOARD DURING THE REPORTING YEAR:

RAINER ERLAT
Until November 30, 2016:
Chairman of the Supervisory Board
Until that date also
Chairman of the Nomination Committee

STEN DAUGAARD
Until July 25, 2016:
Member of the Supervisory Board
Until that date also Chairman of the Audit Committee

MARTIN BERTINCHAMP
Until November 30, 2016:
Member of the Supervisory Board
Until that date also member of the Audit Committee, Nomination Committee and Strategy Committee

HARALD JOACHIM JOOS
Until November 30, 2016:
Member of the Supervisory Board
Until that date also member of the Audit Committee, Nomination Committee and Strategy Committee

DR. HARALD SCHRIMPF
Until December 5, 2016:
Member of the Supervisory Board
Until March 15, 2016:
Member of the Strategy Committee

THE KONTRON SHARE

The Kontron share developed in the fiscal year 2016 in line with the unsatisfactory revenue and earnings figures. With a consistently weak performance the share reached its annual high of € 3.85 at the beginning of March 2016. The share then recorded significant losses, particularly after the 2016 half-yearly financial statements and the associated reduction in guidance, falling to its annual low of € 2.31 by mid-September 2016.

Following notification of the involvement of S&T AG, Linz, Austria in Kontron AG by means of the purchase of about 29.9 % of the shares in Kontron AG in October 2016, the share price rose slightly above the € 3 mark, only to fall below it again following the publication of the figures for the third quarter of 2016 and the announcement of the continuing weakness of revenue at the end of the year. The Kontron share ended the year with a closing price of € 2.85 (December 31, 2015: € 3.02), a minus of 6 % year-on-year. Compared to the TecDAX, which lost 1 % year-on-year, the performance of the share was thus not satisfactory.

KEY DATA ON THE KONTRON SHARE

German securities identification number (WKN)	605 395
ISIN	DE 000 605 395 2
Bloomberg code	KBC GR

TABLE 002

KEY FIGURES OF THE KONTRON SHARE AT A GLANCE

		2016	2015
Share capital	€	55,683,024	55,683,024
Number of shares as of the reporting date	shares	55,683,024	55,683,024
Market capitalization as of 12/31/2016	€ million	158.69	167.88
Closing price (Xetra year-end)	€	2.85	3.02
Closing price high (Xetra)	€	3.85	6.30
Closing price low (Xetra)	€	2.31	2.46
Earnings per share	€	– 2.71	– 0.05
Equity per share	€	2.46	4.65
Operating cash flow per share	€	1.09	0.26
Dividend per share	€	0.00	0.00
Trading volume (Xetra)	million shares	23.4	33.76

Source: Bloomberg

TABLE 003

ANALYST RECOMMENDATIONS

Over the course of the fiscal year 2016, four analysts followed the Kontron share. At the end of the 2016 fiscal year, one analyst recommended buying the Kontron share and three recommended holding it.

PUBLIC LISTING AND TRADING VOLUME

The Kontron share is listed on the Regulated Market of the Frankfurt stock exchange and meets the transparency requirements of Deutsche Börse's Prime Standard. It is also traded over the counter at the regional stock exchanges in Berlin, Düsseldorf, Hamburg, Hanover, Munich and Stuttgart.

In total, 23.4 million shares were traded during the reporting period (prior year: 33.76 million). This corresponds to an average daily trading volume of 91,794 shares (prior year: 133,429).

SHAREHOLDER STRUCTURE

At the end of the 2016 fiscal year, S&T AG, with registered offices in Linz, Austria, through its wholly owned subsidiary S&T Deutschland Holding AG, Ismaning, is the largest shareholder with a holding of about 29.9 % in Kontron AG. Approximately 63 % of the shares are in free float.

SHAREHOLDER INFORMATION

The investor relations pages of Kontron AG are available to the most important group of shareholders, private investors, on the Company's website to use as a practical and central point of contact. We report comprehensively and promptly on any business developments on these pages. In addition, all relevant information on the Kontron share, financial reports, publications, dates and presentations are available on the Company's website online or to download:

www.kontron.com/investor

GROUP MANAGEMENT REPORT

CORPORATE INFORMATION

Business model of the Group

ESTABLISHED PLAYER IN THE ECT MARKET AND FOR THE "INTERNET OF THINGS"

Kontron is a leading global provider of embedded computer technology. As a pioneer in the field of secure platform solutions for the "Internet of Things" (IoT), we offer a coordinated portfolio of hardware, middleware and services. With our ground-breaking standard products and solution-specific platforms, we facilitate the development of new technologies and applications for a wide variety of sectors. Our customers benefit from a reduced time to market, a lower total cost of ownership, products with longer useful lives and comprehensively optimized applications based on leading, reliable embedded technology.

As an internationally renowned company with many long-standing and trusting relationships with our customers and partners, we are constantly striving to offer our customers the most innovative, high-quality and secure products. In connection with the "Internet of Things", for example, these are solutions that allow our customers to network securely with their products. We also offer advisory services relating to the implementation of business models and applications for the "Internet of Things". This is how we are tapping into promising potential for growth and pioneering prospects in these relevant market segments.

GLOBAL PRESENCE

Together with its subsidiaries and sales offices, Kontron AG maintains a global presence. At the end of 2016, the Augsburg-based company had subsidiaries in twelve different countries including Germany, France, the US, Canada, China, India and Malaysia. Our subsidiaries and the international sales offices put us in close proximity to our customers and regional markets at all times.

GLOBAL ORGANIZATION

Kontron AG's business was divided into the following three segments in the 2016 fiscal year:

- "Industrial" focuses on the markets for industrial automation, medical technology and infotainment.
- "Communication" covers the telecommunications market.
- "Avionics / Transportation / Defense" bundles the activities on the markets for civil aviation, transport, security and defense.

NEW RESTRUCTURING PROGRAM LAUNCHED

The new restructuring program was ratified and announced on November 30, 2016. Among other things, the program will realign the company's structure with the regions in the future. At the same time, the individual regions are now assuming responsibility for their results. The purpose of the new structure is to improve access to the market as well as to reinforce the customer base. Many of the measures have already been introduced and implemented.

PLANNED INTEGRATION OF KONTRON INTO THE S&T GROUP

The S&T Group has been Kontron AG's biggest shareholder since November 2016, with a share of about 29.9 % of the voting rights and share capital. At the beginning of December 2016 there were changes in the Management Board and Supervisory Board associated with the entry of the S&T Group in order to reflect the new shareholdings. S&T has around 2,500 employees and branches in 20 countries around the world. With its comprehensive portfolio of solutions, the group is one of the leading providers of IT services and solutions in central and eastern Europe. As a renowned producer of information technology, S&T has a substantial portfolio of proprietary technologies, for example in the fields of appliances, cloud security and smart energy. In February 2017 it was announced that the Management Board of Kontron AG and the Management Board of S&T Deutschland Holding AG, a wholly owned subsidiary of the listed company S&T AG, had signed a letter of intent providing for Kontron AG's merger with the non-listed company S&T Deutschland Holding AG. A merger agreement is to be concluded between Kontron AG and S&T Deutschland Holding AG for this purpose. To take effect, this agreement is subject to the approval of the shareholder meetings of both Kontron AG and S&T Deutschland Holding AG.

Legal structure

GROUP ORGANIZATION

Kontron AG is the parent company of the Kontron Group. It steers the Group and performs the classical management functions of a corporate headquarters, such as corporate strategy, mergers and acquisitions, corporate accounting, controlling, finance, risk management, internal auditing, legal and compliance, treasury, human resources, IT, marketing, corporate communication and investor relations.

As of December 31, 2016, Kontron AG holds a direct or indirect equity investment in 13 entities (prior year: 14 entities). All of these entities were included in the consolidated financial statements and consolidated in full in the reporting year.

CHANGES TO THE LEGAL STRUCTURE OF THE GROUP

The following changes were made to the legal and organizational structure of the Group led by Kontron AG in the 2016 fiscal year:

A strategic partnership was entered into with Ennoconn Corporation in Taiwan in January 2016. The investment in Kontron Canada Inc. was reduced from 100 % to 51 % as a result. Please refer to the "Strategic partnership with Ennoconn" section for further details.

Kontron AG sold all its shares in Railway Infrastructure and Integration Services sp. z o.o. in Poland, which had previously been consolidated in full, by means of a contract dated May 04, 2016.

TAKEOVER LAW DISCLOSURES

Details according to Secs. 289 (4), 315 (4) HGB and at the same time explanatory report:

a) Composition of issued capital

The issued capital of Kontron AG totaled € 55,683,024 as of the reporting date of December 31, 2016 (unchanged on the prior year). It is split into 55,683,024 (unchanged on the prior year) no-par bearer shares with an imputed share in capital of € 1.00 each.

All shares of the company have the same rights and duties attached. Each share entitles the bearer to one vote at the Annual General Meeting of Shareholders and determines the bearer's share in the profits of the company. In addition, the shareholders have administrative rights, e. g., the right to attend the Annual General Meeting of Shareholders, and the right to pose questions and to table motions. Other rights and duties enjoyed by the shareholders are founded in the German Stock Corporation Act, in particular, Secs. 12, 53 et seq. and 118 et seq. AktG.

b) Restrictions relating to the voting rights or the transfer of shares

There are no restrictions of any kind on the exercise of voting rights and the transfer of shares which can therefore be carried out within the normal framework of the law and Articles of Association. The Management Board is not aware of any agreements between shareholders that give rise to restrictions on voting rights or the transferability of shares.

c) Direct or indirect participations in the capital, which exceed 10 % of the voting rights

The largest shareholder is S&T AG, Linz, Austria, which according to its securities notification dated October 27, 2016 held about 5.10 % of the voting rights and on November 14, 2016 about 29.90 % of the voting rights in Kontron AG via S&T Deutschland Holding AG (formerly Blitz 15-575 AG), Ismaning, Germany. This coresponds to 16,649,224 voting rights.

d) Appointing and dismissing members of the Management Board, changes to the Articles of Association

The appointment and dismissal of members of the Management Board complies with the legal provisions of Secs. 84 and 85 AktG. These legal requirements have been further specified in Art. 8 of the Articles of Association of Kontron AG. According to the Articles, the Management Board comprises at least two members. The Supervisory Board may appoint a larger number of members to the Management Board and also appoint a chairman (or spokesman) and a deputy chairman (deputy spokesman) of the Management Board. In addition, the Supervisory Board can appoint deputies for the members of the Management Board.

The shareholders pass resolutions to amend the Articles of Association at the Annual General Meeting of Shareholders. In accordance with the option provided for by Sec. 179 AktG, Art. 26 of Kontron AG's Articles of Association stipulates the following: Resolutions of the Annual General Meeting of Shareholders are passed by simple majority of the votes cast or, where a capital majority is required, by simple majority of the voting rights present at the meeting, unless the law or the Articles of Association require otherwise. Resolutions to amend the Articles of Association and to implement capital adjustments may be passed by simple majority, where permitted by the law. Art. 18 (4) of the Articles of Association of Kontron AG authorizes the Supervisory Board to amend the Articles of Association where only the wording is involved. The current Articles of Association of Kontron AG can be inspected at the website of the company at *www.kontron.com/investor/corporate-governance*.

e) Authorizations of the Management Board for the issue and repurchase of shares

Kontron AG's Management Board has the following authorizations to issue shares:

- According to the resolution of the Annual General Meeting of Shareholders of June 11, 2015 the Management Board is authorized to increase the nominal capital of the company with the approval of the Supervisory Board by June 10, 2020 once or in partial installments by a total of up to € 27,841,512.00 by issuing up to 27,841,512 new individual share certificates denominated in the holder's name in exchange for cash contributions and / or contributions in kind (authorized capital 2015). The shareholders are principally entitled to a subscription right to the new shares that, according to the provisions of Art. 4 (3) of the Articles of Association, can be excluded with the approval of the Supervisory Board. The Management Board has so far not exercised the authorization to increase the nominal capital from authorized capital.

- The nominal capital is increased conditionally by up to € 22,200,000.00 by the issue of up to 22,200,000 individual share certificates denominated in the holder's name (conditional capital 2015). The conditional capital increase serves to grant shares to the holders or creditors of option bonds, convertible bonds, participation rights and / or income bonds or combinations of these instruments. Said instruments are issued by the company or an entity in which the company holds a direct majority interest on the basis of the authorization issued under agenda item 7 of the Annual General Meeting of Shareholders held on June 11, 2015, and grant a conversion or option right for the bearer shares or specify a conversion / option obligation. The issue of new shares is carried out at the conversion or option price, which is to be determined according to the authorization in each case. So far, the Management Board has not exercised the authorization granted by the Annual General Meeting of Shareholders on June 11, 2015 under agenda item 7 to issue option bonds, convertible bonds, participation rights and / or income bonds (or a combination of these instruments) with a total nominal value of up to € 260,000,000.00 and with or without a limit on their terms (referred to collectively as "bonds") in accordance with the specified requirements and with the consent of the Supervisory Board by June 10, 2020, and in so doing granting the holders or creditors of bonds option or conversion rights for a total of up to 22,200,000 no-par bearer shares in the company with a share of the company's nominal capital of up to € 22,200,000.00 in accordance with the more detailed specifications of the respective option or convertible bond conditions. The Management Board has also not made use of the conditional capital 2015 created to service these.

- In addition, the nominal capital of the company is increased conditionally by up to € 1,104,850.00 by the issue of a total of up to 1,104,850 new individual share certificates denominated in the holder's name (conditional capital 2003 I). The conditional capital increase exclusively serves to fulfill options, which were issued within the framework of the 2003 stock option program. With the resolution of the Annual General Meeting of Shareholders of June 09, 2010 the term of the issued and not yet exercised stock options was extended until December 31, 2013. Some of the stock options issued under the 2003 stock option program have already lapsed, been forfeited or settled in cash or, in some cases, settled by issue of treasury shares. No stock options are outstanding as of the reporting date.

- Finally the nominal capital of the company is increased conditionally by up to € 1,500,000.00 by the issue of a total of up to 1,500,000 new individual share certificates denominated in the holder's name (conditional capital 2007 I). The conditional capital increase is only carried out to the extent that the holders of options, which were issued within the framework of the stock option program 2007, exercised their option. With the resolution of the Annual General Meeting of Shareholders of June 09, 2010 the term of the stock options issued and not yet exercised within the framework of the stock option program 2007 has been extended until December 31, 2013. No stock options are outstanding as of the reporting date.

Kontron AG's Management Board has the following authorization to acquire treasury shares:

- The Annual General Meeting of Shareholders of June 11, 2015 authorized the company up to and including June 10, 2020 to acquire up to 10% of the share capital existing as of the date of the resolution, subject to the proviso that at no time may the acquired shares together with other treasury shares in the possession of the company or attributable to the company pursuant to Secs. 71a et seq. AktG account for more than 10% of share capital. The acquisition of treasury shares can be carried out via the stock exchange or by means of a public purchase offer, which is directed at all shareholders of the company. The Management Board is authorized to use, with the approval of the Supervisory Board, treasury shares acquired based on the above authorization or any prior authorization, for one or several purposes as provided for in the authorization resolved by the Annual General Meeting of Shareholders of June 11, 2015 under agenda item 8, which includes the following uses: They can be sold through an offer to all shareholders or via the stock exchange, or they can be canceled or they can be offered to third parties as consideration in connection with mergers, the acquisition of other companies, participations in other companies or parts of other companies or the purchase of receivables owed by the company. Further, such treasury shares can be sold to third parties against cash or used within the scope of employee stock option programs. As of the reporting date, the company held a total of 111,976 treasury shares (prior year: 111,976) on the basis of earlier authorizations. The company has not exercised the authorization to acquire treasury shares, granted by the Annual General Meeting of Shareholders of June 11, 2015, so far.

f) Significant agreements subject to the condition of a change of control for the event of a takeover bid

Some of the agreements made with former members of Kontron AG's Management Board include change-of-control clauses. These are described in the section "Basic features of the remuneration system and remuneration report" starting on page 20.

Governance and control

Kontron AG has a dual system of governance, consisting of a Management Board and a Supervisory Board, in keeping with the German Stock Corporation Act and its provisions. The Management Board comprised the following members during the reporting period: Mr. Rolf Schwirz until July 25, 2016, Mr. Michael Boy until June 30, 2016 and Mr. Andreas Plikat until July 25, 2016, Mr. Sten Daugaard from July 25 to December 14, 2016, Dr. Thomas Riegler from July 25, 2016 to January 31, 2017, Mr. Hannes Niederhauser from December 06, 2016 and Mr. Stefan Franke from February 01, 2017.

COMPOSITION OF THE MANAGEMENT BOARD AS OF DECEMBER 31, 2016

Hannes Niederhauser	Chairman of the Management Board
Dr. Thomas Riegler	Member of the Management Board

TABLE 004

The composition of Kontron AG's Supervisory Board changed as follows during the reporting year: Dr. Dieter Düsedau, who had already been appointed to the Supervisory Board by court order on September 22, 2015, was elected to the company's Supervisory Board at the Annual General Meeting held on June 09, 2016. Mr. Sten Daugaard stood down from Kontron AG's Supervisory Board and assumed the position of Chairman of the Management Board on July 25, 2016. After Mr. Sten Daugaard transferred from the Supervisory Board to the Management Board, Dr. Valerie Barth was appointed as the sixth member of Kontron AG's Supervisory Board by means of a district court order dated October 26, 2016. After the Supervisory Board members Rainer Erlat (Chairman), Harald Joachim Joos and Martin Bertinchamp all stood down from their positions as of November 30, 2016, Messrs. Richard Neuwirth (MMag.), Michael Jeske and Michael Roider (Dipl. Ing.) were appointed to the Supervisory Board by court order on December 02, 2016. At its meeting held on December 05, 2016, the Supervisory Board elected Mr. Neuwirth (MMag.) as its new Chairman. Dr. Harald Schrimpf also left the Supervisory Board as of December 05, 2016.

The Supervisory Board had five members at the end of the reporting period.

Declaration of compliance and corporate governance report

The declaration of compliance and corporate governance report can be viewed on Kontron AG's web site by following this link: *www.kontron.com/investor/corporate-governance* in accordance with Sec. 315 V HGB in conjunction with Sec. 289a I HGB.

Remuneration report

The remuneration report is published in compliance with the provisions of the law and largely follows the current recommendations of the German Corporate Governance Code. Please refer to the declaration of compliance published on Kontron AG's home page regarding deviations in this context (*www.kontron.com/investor/corporate-governance*). The remuneration report describes the principles used to set Management Board and Supervisory Board remuneration at Kontron AG and the income of the individual members of the Management Board and Supervisory Board. The information pursuant to IAS 24 is included in the notes to the consolidated financial statements.

BASIC FEATURES OF THE REMUNERATION SYSTEM

The remuneration system for the Management Board of Kontron AG and the remuneration paid to individual members of the Management Board was set by the Supervisory Board and was reviewed regularly over the course of the fiscal year. The criteria on which Management Board remuneration is measured include the responsibilities and performance of the individual members as well as the global alignment and economic position of the company. Management Board remuneration at peer group entities in Germany and abroad is also considered when setting compensation levels. The basic features of the remuneration system are described in detail below.

Report on the remuneration paid to the members of the Management Board

The full Supervisory Board is responsible for setting Management Board remuneration. In detail, the remuneration comprises the following main elements:

The components not related to performance (fixed) correspond to the annual salary that is paid out in equal monthly installments after deducting the statutory levies, together with the contractually agreed fringe benefits.

Performance-related remuneration (variable, short-term) is linked to the company's performance and is paid out in the form of a bonus. The amount paid out is dependent on certain predefined earnings targets being met and is also capped. The earnings targets for the individual members of the Management Board are set each year in advance by the Chairman of the Supervisory Board. The point of departure is a target bonus. The actual bonus can be higher or lower than this. In the reporting year, variable compensation was pegged to the adjusted group operating result (EBIT), as well as the Group's figures for revenue and net debt.

The appointment of Messrs. Rolf Schwirz and Andreas Plikat as members of the company's Management Board was revoked with immediate effect on July 25, 2016 for due cause. The employment contracts between the company and Messrs. Schwirz and Plikat were terminated with immediate effect for due cause at the same time. As a result, all claims to variable components of remuneration are forfeited for the 2016 fiscal year. There are court proceedings pending in connection with the terminations. Further claims to remuneration may arise depending on their outcome.

Dr. Thomas Riegler was appointed as an interim member of the Management Board and held this position from July 25, 2016 to January 31, 2017. In order to fulfil the institutional position of the Management Board, Kontron AG has concluded an interim and project management agreement with a company that sources interim management services. The amount shown in table 095 includes the remuneration paid to said company for Dr. Riegler's activities in the 2016 fiscal year as well as fixed allowances for travel and accommodation costs. There were no variable components of remuneration.

Mr. Hannes Niederhauser has waived any remuneration. He will only receive the fringe benefits agreed by contract. Severance payment caps were also agreed in accordance with the German Corporate Governance Code. This means that severance payments to be paid in the event of premature termination of the respective service agreements for no due cause may not exceed the sum of total remuneration paid to the Management Board member in two years or the total remuneration paid for the remainder of the service agreement.

The members of the Management Board received the following total remuneration in the 2016 fiscal year:

MANAGEMENT BOARD REMUNERATION

	2016			2015		
IN €K	fixed*	variable current	variable non-current	fixed*	variable current**	variable non-current***
Hannes Niederhauser (since December 06, 2016)	0	–	–	–	–	–
Dr. Thomas Riegler (since July 25, 2016 to January 31, 2017)	534	–	–	–	–	–
Sten Daugaard (from July 25, 2016 to December 14, 2016)	286	120	0	–	–	–
Rolf Schwirz (until July 25, 2016)	388	0	0	685	155	85
Michael Boy (until June 30, 2016)	158	0	–	362	47	–
Andreas Plikat (until July 25, 2016)	166	0	0	289	65	35
TOTAL	1,532	120	0	1,336	267	120

* Including fringe benefits and non-pecuniary benefit of other incentives.
** Short-term, performance-related remuneration based on the achievement of earnings targets.
*** Fair value of long-term remuneration at the time it is paid out.

TABLE 005

The short-term variable remuneration component for Mr. Sten Daugaard corresponds to the amount agreed on upon his departure. At the start of the fiscal year Messrs. Rolf Schwirz and Andreas Plikat were granted performance-related variable remuneration that would have amounted to € 311k for Mr. Schwirz and € 78k for Mr. Plikat based on the achievement of earnings targets. All claims to variable remuneration in the 2016 fiscal year have been forfeited on account of their dismissal for due cause.

Until 2016, the performance options served as variable compensation and have the character of a long-term incentive and risk sharing model. They were extended to the members of the Management Board within the framework of a "Performance Options Plan" (POP) as well as "Basis Performance Options" and "Premium Performance Options". Mr. Rolf Schwirz was granted 200,000 "Basis Performance Options" and 100,000 "Premium Performance Options" with a fair value of € 211k in the 2016 reporting year. As a result of the dismissal of Messrs. Schwirz and Plikat from the Board of Management for due cause, all "Performance Options" granted in the 2016 fiscal year were forfeited.

The 500,000 "Basis Performance Options" with a fair value of € 294k granted to Mr. Sten Daugaard in the 2016 fiscal year were also forfeited upon his departure on December 14, 2016, as were all of Mr. Michael Boy's stock options upon his departure on June 30, 2016. Messrs. Riegler and Niederhauser were not granted stock options at any time.

The corresponding provisions for variable remuneration components serving as long-term incentives of € 250k were released through profit or loss.

The long-term variable remuneration component in the form of a Performance Share Unit (PSU) plan expired in the 2016 fiscal year.

Mr. Michael Boy stood down from the Management Board on June 30, 2016. He received a severance payment of € 300k. Mr. Sten Daugaard, who stood down from the Management Board on December 14, 2016, received compensation of € 430k.

The company has taken out D & O insurance for the Management Board. In the event of a claim, the Management Board member must pay a deductible of 10% of the loss limited to one and a half times the annual fixed remuneration.

Severance caps in accordance with the German Corporate Governance Code were agreed with Messrs. Rolf Schwirz and Andreas Plikat when they were appointed to the Management Board. On this basis, severance payments to be paid in the event of premature termination of the respective service agreements for no due cause may not exceed the sum of total remuneration paid in two years or the total remuneration paid for the remainder of the service agreement.

Both gentlemen also had the right under a change-of-control arrangement to terminate their service agreements prematurely in the event of a takeover. In this event, they were entitled to continue receiving salary payments up to the regular end of the term of each Management Board member's contract. The two Management Board members would then have received a severance payment of up to two years' total remuneration.

Report on the remuneration paid to the members of the Supervisory Board

The remuneration paid to the Supervisory Board is oriented towards the size of the company, the tasks and responsibilities of the members of the Supervisory Board and economic position and development of the company. The remuneration of the Supervisory Board is governed in Art. 20 of the Articles of Association of Kontron AG. On this basis, each member of the Supervisory Board receives basic remuneration of € 48k per fiscal year (Art. 20 (1) of the Articles of Association) that is not related to performance. In addition, any out-of-pocket expenses incurred by board members in the performance of their duties are reimbursed.

The chairman of the Supervisory Board receives an additional bonus of € 48k per year (Art. 20 (2) of the Articles of Association), the chairman of the Audit Committee receives an additional € 20k and the other members of the Audit Committee receive € 12k (Art. 24 (3) of the Articles of Association). If a member of the Supervisory Board sits on the board for only part of the fiscal year, he or she receives a portion of the remuneration (Art. 20 (4) of the Articles).

The members of the Supervisory Board are covered to a suitable extent by the D & O insurance in the company's own interests. The company pays the respective premiums (Art. 20 (7) of the Articles of Association). At present, the D&O insurance does not include any deductible – as explained in the Declaration of Compliance issued by the Management Board and Supervisory Board on January 30, 2017 – as the members of the Management Board and Supervisory Board do not believe that a deductible could improve the motivation or enhance the sense of responsibility with which the Supervisory Board performs its duties.

If members of the Supervisory Board are entitled to charge statutory VAT in addition (Art. 20 (6) of the Articles of Association), they will be reimbursed for the VAT on any out-of-pocket expenses they are reimbursed for and on their remuneration as board members.

The members of the Supervisory Board received the following total remuneration (including travel and accommodation expenses) in the 2016 fiscal year:

SUPERVISORY BOARD REMUNERATION

IN €K	2016	2015
MEMBER OF THE SUPERVISORY BOARD		
Richard Neuwirth (MMag.) (since December 05, 2016)	–	–
Michael Jeske (since December 05, 2016)	–	–
Michael Roider (Dipl. Ing.) (since December 05, 2016)	–	–
Dr. Valerie Barth (since November 03, 2016)	13	–
Dr. Dieter Düsedau (since September 22, 2015)	61	19
Rainer Erlat (until November 30, 2016)	95	137
Sten Daugaard (until July 25, 2016)	39	74
Martin Bertinchamp (until November 30, 2016)	55	71
Harald Joachim Joos (until November 30, 2016)	70	79
Dr. Harald Schrimpf (until December 05, 2016)	52	59
TOTAL	385	439

TABLE 006

None of the Supervisory Board's remuneration is performance-related.

The Supervisory Board members Richard Neuwirth (MMag.), Michael Jeske and Michael Roider (Dipl. Ing.) have waived the remuneration owed to them in accordance with the Articles of Association.

No further payments were made to former members.

Objectives and strategies

Thanks to our solid position in the market, our global positioning and our innovative products, we will be able to benefit from the potential growth of the ECT market around the world. We are very familiar with our clients' sectors and have extensive knowledge of a wide variety of technologies and technological trends. This expertise stems in part from our long-standing and close partnerships and relationships with our customers. These core skills and our diversification between a large number of different markets make us one of the few globally active full-line suppliers in the ECT market.

The increasing networking of embedded systems and the "Internet of Things" are making the issue of security more and more important in every market. That is why, in the future, we will offer our customers suitable security solutions in order to help us stand out from the competition. We will integrate an additional security chip into our standard modules and boards that protects the IP of the customer's applications against unauthorized copying and reverse engineering. The first products have now been equipped with this security solution and introduced onto the market under the "Kontron APPROTECT" name. In combination with the "Kontron APPROTECT Licensing" software / service, this allows our customers to implement and use new business models such as pay-per-use.

MID TO LONG-TERM GOALS

Our aim is always to be the global market leader for ECT products and solutions. Against this backdrop, we intend to not only build on and reinforce leading position in the strategically important segments, but also to significantly increase revenues and our EBIT margin in the future.

STRATEGIC PARTNERSHIP WITH ENNOCONN

In the 2016 fiscal year we entered into the strategic partnership with Ennoconn Corporation in Taiwan, as announced on January 22, 2016. Ennoconn is a subsidiary of Foxconn, one of the world's largest producers of electronics and hardware. Once all regulatory and company permissions had been granted in April 2016, Ennoconn acquired a 49 % share in Kontron Canada Inc. (KCI) in return for the payment of $ 57.3 million (about € 50.3 million) to Kontron AG. Kontron AG retains the remaining 51 % share in KCI. As part of the partnership, Ennoconn and Kontron agreed that Kontron will procure a significant proportion of its production volume from Ennoconn.

This partnership helps us in our goal of becoming a leading provider of combined hardware / software solutions in the medium term, for example by significantly improving our access to markets in the APAC region. We also expect the partnership to reduce our costs for materials and production, and this is also likely to improve our market opportunities in the field of Communication in particular. In addition to access to additional production capacities in Asia, this also opens up new opportunities for the development of our channel-based business.

NEW RESTRUCTURING PROGRAM LAUNCHED

In the second half of the 2016 fiscal year, the Management Board of Kontron AG started defining measures to combat the weak trend for revenue and profit in the reporting year. On November 30, 2016, the Supervisory Board and Management Board then ratified an extensive restructuring program aimed at significantly improving the company's profits by a figure in the high tens of millions, restoring it to profitability, over the next one and a half years. Among other things, the program envisions cutting 300 jobs, mainly in administration.

Another of the program's main thrusts is the regional alignment of the company's structure, as a result of which the individual regions have been given corresponding responsibility for their results since January 01, 2017. The purpose of this realignment is to improve access to the market as well as to reinforce the customer base.

SYNERGIES FROM FUTURE COLLABORATION WITH S&T AG

S&T AG has been Kontron AG's biggest shareholder since November 2016, with a share of about 29.9 % of the voting rights and share capital. In February 2017 it was announced that the Management Board of Kontron AG and the Management Board of S&T Deutschland Holding AG, a wholly owned subsidiary of the listed company S&T AG, had signed a letter of intent providing for Kontron AG's merger with the non-listed company S&T Deutschland Holding AG. The two groups (Kontron and S&T) have a complementary portfolio of hardware, software and services, and also complement each other in terms of the markets in which they operate. We therefore expect any future partnership or merger with S&T to produce a number of positive effects and synergies such as the joint application of expertise in the field of research and development in order to develop innovative new products, solutions and services.

In the long term we aim to consistently develop our business model and make the most of the opportunities available in the dynamic ECT market.

For this and other measures involving S&T companies, the management of Kontron AG will take strict account of the legal conditions within the group. Additional support will be provided by the Group Committee formed specifically for this purpose.

Corporate management

To steer its operations, Kontron uses a system of financial and non-financial indicators that provide insight into the current status of operations and allow the right decisions to be made regarding the company. These take account of both short-term and long-term factors.

The Management Board of Kontron AG is responsible for the overall planning and measures taken to realize operating and strategic corporate goals. Our primary aim is to increase the company's value in the long term by means of profitable growth. The long-term planning is mainly based on technological developments and trends, market studies and analyses of the competition, but also developments on the procurement markets and the recent performance of our three business units. The heads of the business units make assumptions as part of their planning for each forecasting period. Thereafter, the Management Board and management accounting then check the plausibility of the assumptions and methods used, also in planning meetings with the respective heads, before drawing up a plan for all units of the Kontron Group.

The main performance indicators used in the 2016 fiscal year were revenue, gross margin, EBIT, net debt (financial liabilities less cash and cash equivalents) and EBIT adjusted for restructuring costs and non-recurring effects. Against the backdrop of the company's restructuring, net debt and adjusted EBIT will no longer be used as performance indicators from the 2017 fiscal year. The operating planning also incorporates other performance indicators, including sales-related figures such as the order intake and order backlog and non-financial indicators such as the number of employees.

We completed the introduction of the SAP-ERP system in the reporting year, giving us a powerful and standardized IT system at all of the Group's main entities. The standardization of the company's business processes and opportunities for analysis above all enhances transparency and productivity.

We measure and evaluate the achievement of our clearly defined targets using plan / actual analyses in monthly reports. This is an important source of information for the Management Board, the Supervisory Board and the respective executives when monitoring the current development of the company. Deviation analyses reveal the main causes for exceeding or falling short of projected figures, and also make it possible to promptly counteract serious deviations.

The Treasury provides weekly reports on the Kontron Group's financial situation, containing information on the ongoing development of important financial indicators such as liquidity and net debt.

We prepare a quarterly risk management report as a supplement to the corresponding monthly report. The entities and functions assess their risks in both quantitative and qualitative terms. The risk management report allows us to react promptly and effectively to changes in the risks and opportunities we face.

With all these elements, we have a management and reporting system in place that makes the monthly business development transparent.

DEVELOPMENT OF RELEVANT PERFORMANCE INDICATORS

		2016	2015
Revenue	€ million	385.1	467.7
Gross margin	€ million	56.1	121.8
EBIT	€ million	– 141.7	6.2
Conversion to EBIT (adjusted)			
+ Impairment losses on goodwill	€ million	60.9	0
+ Restructuring cost	€ million	17.2	8.3
+ Other non-recurring effects*	€ million	4.8	0
EBIT (adjusted)	€ million	– 58.8	14.5
Conversion to Net debt			
= Current liabilities	€ million	0.6	0.7
+ Non-current liabilities	€ million	0.0	56.5
– Cash and cash equivalents	€ million	–43.8	–27.8
Net debt	€ million	– 43.2	29.4

* Other non-recurring effects: costs for one-off projects to improve efficiency, primarily personnel adjustments and consulting services.

TABLE 007

Research and development

Kontron is a leading technology provider in the embedded computing market. The experienced and dedicated employees in our research and development (R&D) departments throughout the Group and around the world are crucial to our success. Their capacity for innovation and technical expertise enable us to stand out in an increasingly competitive global market, and give us various USPs. Our global presence also enables us to identify any key trends at an early stage and use this knowledge to develop competitive products for our customers.

In the 2016 fiscal year we continued to develop innovative modularization and platform concepts. The most impressive aspects of these standardized products and platform solutions impress is their reusability, flexibility and interoperability. The trend among our customers toward networked machines and appliances is gathering pace. That is why, in addition to hardware, we also aim to further expand and reinforce the software side. Moreover, S&T possesses a wealth of expertise and development capacity in software that we can profit from within the framework of a cooperation and which will support expansion in the fields of embedded systems and IoT. All of the available capacity in the R&D department was directed toward these most important market trends in the 2016 fiscal year. We are for example currently developing a latest-generation INTEL processor platform that will be launched onto the market in 2017.

The main challenge in the field of development lies in coordinating intelligent devices that have so far been developed in isolation in terms of their connectivity, programming, data formats and security. For our R&D department this means developing reliable, scalable and energy-efficient products and solutions for our customers, or optimizing existing ones accordingly. IoT products and services are becoming a key segment for our company – and therefore a decisive innovation factor that facilitates significant growth.

An effective service organization is equally important for our success in both the embedded and IoT lines of business because it promotes customer loyalty and satisfaction. Our services will therefore remain an important success factor in the future. After all, they help our customers to use our hardware and software products.

We are actively working with important partners on other research projects, for example in connection with IoT security as well as self-learning and therefore forward-looking hardware and software platforms. We expect positive effects in this context from the partnership or potential merger with S&T Deutschland Holding AG. The combination of the two companies' development expertise, particular with respect to software and products, will add to the range of solutions that we offer our customers.

GLOBAL DEVELOPMENT APPROACH

In the reporting year we worked on harmonizing our R&D databases around the world in the field of software. The aim was to allow all software development teams around the world to work in a single database in order to expedite the development of higher-quality software for our platforms. As part of these harmonization activities, we also improved the coordination of processes and planning of resources between the various global development teams, as well as their cross-border collaboration. Experts work on projects in close proximity to the customers in order to provide better support.

We continued to expand our ECT solution development capacities in Asia in 2016. The field of software in particular was enlarged in order to support local motherboard developments and our development capacities in other regions on the one hand while also pushing forward our IoT software strategy on the other.

We employed 405 people group-wide in our research and development function as of December 31, 2016 (prior year: same). Cost cuts implemented in the restructuring program launched in November 2016 are also likely to affect the headcount in the research and development function.

HIGHLIGHTS: INNOVATIONS AND DEVELOPMENTS IN THE 2016 FISCAL YEAR

2016 saw a number of innovations in the fields of hardware and software. We expanded our portfolio in the field of board-level products in order to be able to offer our customers an even broader range of products and build up our strong position in the market for modular processor boards. We substantially expanded our successful product lines with the introduction of the new Intel Atom E3900 series as well as other formats for the established Intel Atom E3800 family, the 6th-generation Intel Core and the Intel XEON D server product lines.

Another new development are the expanded security features for all new platforms, such as TPM2.0 to ensure reliable software execution or Kontron's "APPROTECT" security mechanisms for the protection of applications and prevention of copying. Both of these are important in order to offer users protection and security in an increasingly challenging IoT environment. We are making a lot of progress on our developments in the fields of technology and standardization, and actively participating in standardization bodies such as the PICMG and SGET to this end.

ECONOMIC SITUATION

General economic conditions

The overall trend for the global economy was modest in 2016. It was impacted significantly by political and economic uncertainty such as the conflict in Syria and the discussions surrounding Brexit. Europe was also unable to buck this trend. According to the European Commission the EU's GDP was at 1.9 % in 2016, which is a decline of 0.3 % in comparison to the previous year.

The German economy defied this trend with a slight increase in growth in 2016. According to the German Federal Statistical Office, Germany's GDP rose 1.9 % in the reporting year (prior year: 1.7 %).

The economic trend in the US was weaker than anticipated due to the impact of the strong US dollar on the country's exports.

The growth of China's economy fell short of expectations in 2016 but stabilized for the most part. The Chinese government is attempting to combat this trend by means of various measures.

DEVELOPMENTS AND TRENDS IN THE ECT MARKET

The traditional ECT market continues to grow at rates that are consistently in the high single-digit range around the world. Growth is even in double digits in certain regions (Asia in particular). There is still strong momentum from the trends relating to the “Internet of Things” (IoT) and “Industry 4.0”. We are in a good position in this respect: We provide our customers with innovative products and solutions that meet the rising demands for the secure and effective networking of smart devices and machinery.

The market for IoT concepts and solutions in particular offers a wide array of opportunities for us. McKinsey estimates that this market had a total volume of $ 900 million in 2015, and that this will grow to $ 3.7 billion by the year 2020 (which represents an annual growth rate of around 32 %). Our main focus is on the Cyber Security segment. We aim to develop a complete embedded software / middleware solution for this segment and make targeted efforts to gain market share in the medium term. In this way, we are also responding to our customers’ rising demand for ECT / IoT software solutions, which is a trend that we see as an important source of growth.

Networking in an industrial setting poses significant challenges for our customers. They need to rapidly develop (or commission the development of) suitable software in order to network their devices quickly and securely so that they can focus on their core areas of expertise. However, the development and integration of software in ECT solutions often proves highly complex, frequently leading to delays in the introduction of new products. New and increasingly complex generations of multi-core processors, high-speed buses and storage media require extensive expertise, and the associated substantial investment in development is less and less worthwhile for individual customers on account of the relatively low unit volumes and the steady shortening of innovation cycles. To sum up: low total operating costs are crucial for make-or-buy decisions and rapid introduction onto the market.

Since the growing volume of data also increases the need for bandwidth for the purposes of connectivity as well as the requirements for server-class performance in smaller formats, in 2016 the PICMG standardization body defined a new standard for computer-on-modules: COM Express Type 7 with up to 4x10 gigabit ethernet ports. Kontron played a key role in this, and has already developed a product with 16 Intel Xeon cores for server and high-performance computing applications. Connectivity is a key trend on the whole. This also involves the development and proliferation of new wireless communications standards, which we follow on the market and support through partnerships.

The trend toward miniature formats such as SMARC, COM Express Mini or Pico-ITX is also having a positive impact on market growth. The SGET standardization association released a new version of SMARC (SMARC 2.0) in 2016. Kontron once again played a key role in this. Interfaces such as MIPI CSI camera and three independent displays also specifically address markets in the field of artificial intelligence (AI). Two development projects for SMARC 2.0 were already launched in 2016. We also introduced a module featuring the Intel Atom E3900 processor, and an ARM-based module is to be presented in 2017. Both of these offer us new opportunities for growth. We are registering rising demand for ARM-based solutions for low-end / high-volume applications, for example. The SMARC format plays an in important role in this respect. The demands for energy-efficient and compact device design are rising, and in addition to increased complexity, this also increases the demands placed on the processors used. Kontron has adopted an exceptionally good position in this regard. We offer a full range of modular and cost-effective products that can be integrated seamlessly into IoT products. This is another area where platforms with full scalability are particularly successful.

TRENDS IN THE BUSINESS UNITS AND STRATEGICALLY RELEVANT MARKETS

Until December 31, 2016, Kontron had three divisions, all of which operate at a global level and supply different markets. The Industrial division focuses on industrial automation, medical equipment and infotainment, Communication covers the telecommunications market, and we bundle our activities in the fields of civil aviation, transportation, security and defense in Avionics / Transportation / Defense.

INDUSTRIAL

The market for industrial products saw renewed growth during the reporting year, as anticipated. We benefited to some extent from this trend. Order intake for our Industrial division remained virtually unchanged year-on-year, despite the pronounced (and anticipated) decline in order intake in the infotainment business. In the strategically important business line of industrial automation, we outperformed the market as a whole with growth of 15 %, which meant that we increased our share of the market.

We can attribute the encouraging growth in the industrial automation to the successful implementation of our strategy. We were able to position ourselves (with increasing success) as a technology partner to the major automation providers and OEMs. As the largest non-Asian based embedded computer vendor we continue to make inroads into the three main industrial countries: Germany, Japan and the US. In 2016 we continued to leverage our Industrial Computer Platform strategy. The main value propositions of this strategy are “Smart Automation”, “Maintenance-free” and “Forever Young”. With these propositions we are meeting the expectations of our industrial customers and help them reduce their operating costs. We won important projects for our revolutionary new FusionClient HMI platform, which we brought onto the market in 2015. We expect this business line to continue growing slightly faster than the average for the market in 2017, firstly due to the ongoing trend of outsourcing CPU technology, and secondly on account of the fact that the “Internet of Things” makes new applications necessary.

Our medical equipment business line consolidated its position in 2016 following strong gains in the preceding year. We are seeing a shift in logistics concepts here, however. Long-term master agreements are increasingly being replaced by vendor-managed inventory (VMI) models, which for us as suppliers means a reduced range for our order backlog. We expect growth in the year in progress to at least be on a par with the market as a whole. Unique lifecycle management combined with a flexible and controlled supply chain continues to deliver customer value in this respect. We expect to launch new product programs that are initiated in partnership with our customers in 2017 as well.

The infotainment business line consists of the sub-segments of gaming and solutions for weighing and checkout systems in retail. Out of these two, the gaming market in particular was already significantly short of expectations in 2015 due to the weak market for replacement parts and the lack of new casinos, which were still a problem in the reporting year. As a result we chose to substantially reduce our costs in 2016 rather than initiating any new development. We do not expect any significant innovations from this segment in the near future. Skill-based gaming is a potential catalyst, but not likely for another few years. We expect the gaming segment to remain weak for the time being, and will plan accordingly.

The trends toward Industry 4.0 and the IoT continue unabated. Kontron sees disproportionately good potential for growth in this regard in the industrial segment in particular. With APPROTECT, we introduced a technology in 2016 at the board and module level that allows our customers to protect networked systems against unauthorized access in a way that is efficient and cost-effective. We will be integrating this technology into our systems solutions in the 2017 fiscal year. We also expect a partnership or merger with S&T to offer synergies with respect to fog and cloud computers for industrial applications – a field that is key to Industry 4.0 solutions.

AVIONICS / TRANSPORTATION / DEFENSE

The legacy Defense business consisting of predominately customized business decreased sharply in 2016, due to a significant number of government programs being stopped or ending. However, we have continued to pursue our strategy in the Defense division, providing our series-produced or customized COTS (commercial off-the-shelf) products to companies in the defense sector. These are very cost-effective solutions that meet minimum requirements – a concept that sold COTS products to traditional defense companies. The business line made progress in 2016 with new high performance embedded computing platforms being released to support customer applications. The interest in these platforms will enable future order intake and corresponding increases in revenue which will develop in a direct sales and channel strategy over the coming quarters.

In 2016, the Avionics business line was the only one to exhibit an encouraging trend, and benefited from the release of the next generation Wi-Fi cabin connectivity for narrow body airplanes and business jets. The In-Flight Entertainment (IFE) market continues to demand increased wireless bandwidth using faster CPUs, increased memory and next generation wireless technology. Kontron's performance and experience in FAA certifications has been a critical success factor for the Avionics business. As a result, it gained significant momentum in 2016. Our “value” positioning as the leading solutions provider for on-board retrofit aircraft connectivity continues.

The transportation market in North America showed limited growth in investment and deployment of PTC (positive train control) and video surveillance in 2016. We were, however, unable to participate in this market growth and in fact suffered a significant decline in revenue due to the expiry of long-term contracts with customers. However, we also achieved some successes, such as the full market launch of our rail product line and BAA (Buy America Act) approval for our rail technology products. The latter improves our chances when bidding on projects put out to tender in accordance with those regulations. The acceleration of AV (autonomous vehicle) technology will provide many opportunities in adjacent markets for the AI (artificial intelligence) as embedded technology becomes the centerpiece for these solutions. We expect this business line to grow in the years ahead.

In summary, we will see the benefits of the innovation / positioning as we stay diligent executing on our future strategy.

COMMUNICATION

During 2016, the shift in the communications market towards virtualized and open solutions has accelerated. From the network core to its edges, applications are moving from dedicated servers and appliances into general-purpose equipment running virtualized network services. This trend has created a gap between the large operators, who have the critical mass to develop, test and integrate new ways of deploying network services, and the smaller operators, who are getting less and less support from the legacy equipment vendors but do not have the means to create new solutions. This landscape has imperiled pure hardware embedded suppliers, as equipment manufacturers shift from dedicated platforms towards IT-standard equipment. This, and the continuation of the declining trend from hardware-based products to software-based solutions, also led to a substantial contraction of business in 2016. We were unable to make up this shortfall with successor products.

Kontron’s approach to provide application-specific platforms pre-integrated with open virtualization software stacks allows us to solve the problems of the small-to-mid-size operators, however, as well as to offer a compelling platform for software vendors. We believe this strategy will allow Kontron to offset some of its OEM business against higher-growth solutions revenue, to generate top-line growth in the Communications vertical.

The strategic partnership with Ennoconn will benefit our position in the Communications segment in the future. First, it has created a clearly focused global team in Kontron with the right level of resources to deliver the solutions that the customers need. Second, the Ennoconn Group and its affiliates will increasingly give Kontron access to a large portfolio of products that has allowed Kontron to significantly widen its offer to the market: top-of-rack Ethernet switches, server and storage boxes have, for instance, already been added into our portfolio. Third, we have already rationalized our electronics assembly services supplier base through Ennoconn, improving our unit cost position; most of the products offered in the Communications market will be assembled by Ennoconn in the future. And finally, the Ennoconn Group has provided new sales channels for Kontron’s products in Asia, helping further our presence in this important market. On the whole, we firmly believe that the combination of our products, solutions and services strategy with the benefits of the partnership with Ennoconn in Kontron’s Communications business brings compelling competitive advantages in this rapidly changing market.

Results of operations, net assets and financial position

The revenue generated for the full year amounted to € 385.1 million (prior year: € 467.7 million) putting it well below the original forecast for the year as a whole. The gross margin fell sharply to 14.6 %, which is down by around 11.5 % in relation to the prior year. This is mainly due to write-downs on capitalized development projects and inventories as well as provisions for potential losses from procurement transactions as a result of the sharp fall in revenue as well as provisions relating to the risks associated with individual contracts. The impairment of goodwill and expenses relating to the restructuring program initiated in the second half of 2016 also impacted profits and resulted in EBIT of € – 141.7 million (prior year: € 6.2 million) and adjusted EBIT of € – 58.8 million (prior year: € 14.5 million).Equity has fallen substantially on account of the results of operations. Reserves of cash and cash equivalents were up on the cut-off date thanks to inflows stemming from the strategic partnership with Ennoconn as well as the factoring program. Since the existing credit facility was repaid and terminated in the 2016 fiscal year, the company depends on finance from S&T AG as the anchor shareholder.

The fiscal year was disappointing on the whole as a result.

RESULTS OF OPERATIONS

Development of revenues

Revenue fell 17.7 % in the 2016 fiscal year to € 385.1 million (prior year: € 467.7 million). This was mainly due to weaknesses in the company's focus with respect to certain groups of customers and technologies. The decline was observed in all three divisions over the course of the year.

The Industrial division’s revenue fell 15.6 % to € 198.4 million in the reporting year (prior year: € 234.7 million). The Avionics / Transportation / Defense division generated revenue of € 96.6 million (prior year: € 127.2 million), which is a decrease of 24.3 % relative to the prior year. This can above all be attributed to the scaling down of government programs in the Defense business line as well as the expiry of long-term contracts with customers in the Transportation business line. Communications also saw declining revenues, which at € 90.1 million were below the level of the prior year (€ 105.8 million). This is a reflection of the decline in business with hardware-based solutions for the telecommunications market.

Revenue trends varied from one region to the other. The EMEA and North America regions suffered sharp declines in revenue, while the APAC region was able to maintain the same level of revenue as in the prior year. With revenue of € 194.1 million (prior year: € 232.9 million), the EMEA region was still the group’s biggest contributor to revenue despite suffering a decline of € 38.8 million. It therefore accounted for 50.4 % of total revenue (prior year: 49.8 %). Revenue in the North America region fell by € 44.2 million to € 160.9 million, which corresponds to a 41.8 % share of total revenue (prior year: 43.9 %). The APAC region generated revenue that was roughly on a par with the prior year. The actual figure was € 30.1 million (prior year: € 29.7 million, which caused its share of total revenue to increase slightly by 1.5 percentage points to 7.8 % (prior year: 6.3 %).

REVENUES BY BUSINESS UNIT

	2016		2015	
	€ million	%	€ million	%
Industrial	198.4	51.5	234.7	50.2
Communication	90.1	23.4	105.8	22.6
Avionics / Transportation / Defense	96.6	25.1	127.2	27.2
TOTAL	385.1		467.7	

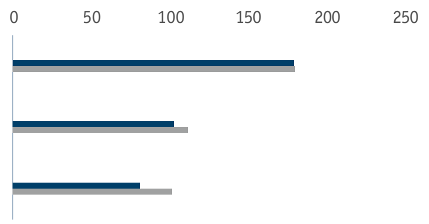
TABLE 008

Order situation

Both the order intake and order backlog were once again unsatisfactory in the reporting year of 2016. Order intake fell again to € 361.5 million (prior year: € 391.8 million). This trend had been anticipated to some extent because customers are increasingly switching to consignment warehouse management, resulting in no orders being received under framework agreements. However, the aforementioned weaknesses in the company's focus are also reflected here.

ORDER INTAKE

IN € MILLION	2016	2015
INDUSTRIAL	178.5	179.4
AVIONICS / TRANSPORTATION / DEFENSE	102.3	111.3
COMMUNICATION	80.7	101.1



■ 2016
■ 2015

GRAPHIC 001

Gross profit margin reduced by write-downs on inventories and capitalization of development projects

The cost of materials rose significantly in relation to revenue on account of the necessary impairment of inventories (€ 24.4 million). These therefore amounted to € 279.2 million in the reporting year, compared to € 303.1 million in the prior year. This increased the cost of materials as a percentage of sales from 64.8 % in 2015 to 72.5 %. We were able to reduce other production costs from € 27.5 million to € 26.2 million in the 2016 fiscal year. In relation to revenue, however, this represents a 0.9 percentage point deterioration to 6.8 %.

Depreciation and amortization on capitalized development projects increased by € 8.5 million to € 23.7 million (prior year: € 15.2 million). This includes impairment losses of € 13.4 million (prior year: € 2.3 million) arising from the impairment test of development projects that have already been capitalized, which mainly stemmed from the sharp fall in revenue as well as the revised projections for revenue. This amount also includes impairment losses of around € 1.0 million for projects that are no longer being pursued due to the alteration of the technology road map.

Production costs therefore came to € 329.0 million, compared to € 345.8 million in the prior year. Gross profit fell from € 121.8 million to € 56.1 million as a result, a decline of 53.9 % in relation to the baseline period. This meant that the gross profit margin was 14.6 %, around 11.5 % lower than the figure of 26.1 % for the prior year.

Increase in operating costs

Operating costs increased by € 11.7 million to € 123.3 million (prior year: € 111.6 million) in the reporting year. Their share of total revenue therefore rose sharply from 23.9 % to 32.0 % in 2016.

While selling costs rose only slightly by 2.9 % to € 46.7 million (prior year: € 45.4 million), general and administrative costs increased 29.3 %, from € 36.2 million to € 46.8 million. This increase stems partly from an increase in personnel costs and expenses for third-party services (€ + 5.8 million) and partly from an increase in legal and consulting costs (€ + 4.1 million). Research and development costs decreased by € 0.1 million to € 29.9 million (prior year: € 30.0 million). The overall cost of research and development (i. e., prior to the capitalization of development cost) rose by € 1.2 million to € 43.2 million (prior year: € 42.0 million). Depreciation and amortization on capitalized development projects increased by € 1.3 million to € 13.3 million (prior year: € 12.0 million). The ratio of research and development cost (excluding order-related development cost) to revenues came to 7.8 % in the reporting year (prior year: 6.4 %).

Impact of costs from new restructuring program

Restructuring costs amounted to € 17.2 million in the reporting year (prior year: € 8.3 million), of which € 0.9 million still stems from implementation measures associated with the cost-cutting and efficiency program initiated in 2013. The restructuring program launched in the second half of 2016 incurred expenses amounting to € 18.0 million. These mainly relate to personnel-related measures providing for the elimination of around 300 jobs, mainly in administration. By contrast, provisions of € 1.8 million for the previous restructuring program that are no longer needed were reversed.

Impairment of goodwill

An impairment test was carried out on June 30, 2016 in response to changes in the outlook for revenue and income in mid-2016. This test revealed a need to record impairment losses on goodwill of € 60.9 million. Of these write-downs, € 50.7 million relate to Avionics / Transportation / Defense and € 10.2 million to Communication.

Other operating income and expenses, financial result and taxes

Other operating income amounted to € 19.8 million in 2016, down from € 26.7 million in the prior year, and mainly stemmed from exchange rate gains (2016: € 15.9 million / 2015: € 23.0 million) and income from the reversal of provisions that are no longer required (2016: € 1.9 million / 2015: € 0.0 million). Other operating expenses fell from € 22.4 million to € 16.1 million, with exchange rate losses of € 15.0 million (prior year: € 22.2 million) accounting for the majority. The figure for the 2016 fiscal year also includes an expense of € 0.3 million relating to the consolidation of a subsidiary for the first time.

In sum, operating income before the financial result and income taxes (EBIT) fell by € 147.9 million, closing the year at € – 141.7 million, compared to a profit of € 6.2 million in the prior year. EBIT came to € – 58.8 million after adjusting for restructuring costs and non-recurring costs (prior year: € 14.5 million).

The financial result was roughly on a par with the prior year at € – 2.2 million (prior year: € – 2.1 million), and primarily consisted of interest, financing costs, and guarantee and commitment fees.

The tax expense decreased € 3.1 million year-on-year to € 3.7 million.

The Group's net loss came to € 147.6 million (prior year: net loss of € 2.7 million). The share of this loss attributable to the equity holders of Kontron AG comes to € – 150.8 million compared to € – 2.5 million in the 2015 fiscal year. The amount attributable to shares without a controlling influence comes to € 3.2 million, following € – 0.2 million in the prior year. Accordingly, earnings per share came to € – 2.71 (prior year: € – 0.05).

FINANCIAL POSITION

Principles and goals of financial management

Our Group's financial management is monitored and steered centrally by the global treasury department. The main goals of our financial management are to ensure the solvency of the Group at all times by efficiently managing liquidity, continually improving the financial strength of the Group and minimizing foreign currency exposures by using financial instruments.

The Group's credit facility, which has been in place since April 2012 and was originally supposed to run until April 2017, was adjusted to suit requirements several times in the 2016 fiscal year before being prematurely terminated by Kontron in December 2016. The former syndicate of banks also returned all of the collateral provided in this context. In addition to the minor, bilateral overdraft facilities of two subsidiaries with local banks, the Group is now mainly financed by means of the factoring program of a subsidiary, with a maximum volume of financing of € 30.0 million. This factoring program was initially concluded for the period up to November 2018. The factoring, which started in December 2016, has generated an inflow of around € 27.1 million thus far. The cash generated in this way is passed on to Kontron AG as part of the Group's cash management process. Kontron AG finances its subsidiaries as necessary using intercompany loans, which are generally granted in the form of internal overdraft facilities. At the time that these financial statements were prepared, another factoring program was in preparation for a subsidiary with a volume of financing amounting to € 10.0 million.

The Group also has access to financing commitment in the form of a letter of comfort from S&T AG, Linz, Austria, with a volume of € 20.0 million. This letter of comfort expires at the end of 2018. In a letter dated February 17, 2017, the Management Board of Kontron AG claimed a portion of this sum amounting to € 15.8 million. In a letter dated February 21, 2017, S&T AG declared its willingness to fulfill its obligation. The Management Board of Kontron AG assumes that the company will receive sufficient liquidity to cover its financing requirements for the planning period up to the end of 2018. Due to the tense liquidity situation, the continuation of the company as a going concern depends on Kontron AG being provided with the liquidity pledged to it in the letter of comfort; see also "Risk report – liquidity risk".

COMMENTS ON THE STATEMENT OF CASH FLOWS

Increase in cash flow from operating activities

Despite a € 144.9 million decline in net profit for the period, cash flow from operating activities rose by € 46.2 million during the reporting year to a total of € 60.5 million (2015: € 14.2 million). This is mainly due to the following three factors: Firstly, the amortization, depreciation and impairment of non-current assets with no effect on cash, which rose by € 70.4 million in comparison to the same period in the prior year. Secondly, the restructuring costs and future receipt obligations relating to the partnership with Ennoconn, which are reflected in the € 54.7 million increase in provisions and liabilities. Thirdly, the net income from impairments and cash inflows from reduced inventories (€ + 14.6 million) and the decline in trade receivables (€ + 57.9 million). The decline in trade receivables includes the funds received from the factoring that commenced in the fourth quarter of 2016. There was, however, a negative effect from an increase in tax payments, mainly stemming from the tax field audit that was concluded in the 2015 fiscal year.

Reduced investment

The reduction of € 9.6 million in cash flows from investing activities in comparison to the prior year can largely be explained by lower capital expenditures on intangible assets (global SAP system and IT infrastructure). The sale of properties classified as assets held for sale led to a cash inflow in both reporting periods.

Significant reduction in cash flow from financing activities

Cash flow from financing activities amounted to € – 30.4 million in 2016, € 51.3 million below the figure of € 20.9 million for the prior year. The amount of € 50.3 million received in the first quarter of 2016 as a result of the sale of the 49 % share in Kontron Canada Inc. (€ 26.2 million – reported as a transaction with shareholders with no controlling influence) and the associated purchase commitments (€ 24.1 million – reported in cash flow from onging operations) were used to repay bank loans. As a result, on balance, new bank liabilities in the 2015 fiscal year amounting to € 21.2 million were offset by repayments amounting to € 56.6 million in the 2016 fiscal year.

Comments on net debt

As of December 31, 2016, the Group carried cash and cash equivalents of € 43.8 million, up € 16.0 million on the amount carried on December 31, 2015 (2015: € 27.8 million). While short-term liabilities to banks remained almost unchanged at € 0.6 million, the long-term liabilities to banks from the prior year were repaid in full. Net debt of € 29.4 million at the end of 2015 contrasted with surplus liquidity of € 43.2 million as of December 31, 2016. This figure therefore exceeded our expectations at the time, mainly due to the inflow of liquidity from factoring. However, we expect the surplus of cash and cash equivalents to fall significantly during the months ahead.

NET ASSETS

Total assets in decline

The statement of financial position as of December 31, 2016 and compared with the prior year, classified by maturity:

STATEMENT OF FINANCIAL POSITION CLASSIFIED BY MATURITY

	12/31/2016		12/31/2015		Change	
	€ million	%	€ million	%	€ million	%
Current assets	186.6	64.1	250.5	56.7	– 63.9	25.5
Non-current assets	104.5	35.9	191.4	43.3	– 86.9	– 45.4
	291.1		**441.9**		**150.8**	**– 34.1**
Current liabilities	131.8	45.3	114.4	25.9	17.4	15.2
Non-current liabilities	22.3	7.7	68.6	15.5	– 46.3	– 67.5
	154.1	**52.9**	**183.0**	**41.4**	**– 28.9**	**– 15.8**
Equity	137.0	47.1	258.9	58.6	– 121.9	– 47.1
	291.1		**441.9**		**– 150.8**	**– 34.1**

TABLE 009

Total assets as of December 31, 2016 came to € 291.1 million (prior year: € 441.9 million), a decrease of 34.1 % in comparison to 2015. Both current and non-current assets have fallen year-on-year. The overall volume of liabilities has also fallen. Wile there was an increase in current liabilities, non-current liabilities have fallen sharply. The reduction in equity was mainly due to the net loss for the period.

COMMENTS ON CURRENT AND NON-CURRENT ASSETS

Decrease in current assets

Cash and cash equivalents increased by € 16.0 million, and amounted to € 43.8 million as of December 31, 2016 (prior year: € 27.8 million).

The volume of inventories fell to € 60.5 million (prior year: € 83.3 million) due to further improvements in the management of working capital as well as the necessary adjustments due to reduced expectations for revenue. The write-downs recorded for the year in progress amounted to € 24.4 million. Trade receivables of € 67.4 million were down € 55.3 million on the prior year when they came to € 122.7 million. This decline is mainly due to a reduction in revenue at the end of the year as well as the factoring.

Income tax receivables were carried at € 1.7 million on December 31, 2016 (prior year: € 2.8 million) and were therefore € 1.1 million below the level of the prior year. Other current receivables and assets rose slightly by € 2.7 million to € 13.2 million, mainly due to security deposits paid to contract manufacturers that were reported under inventories in the prior year.

The property in Germany that had no longer been in use on account of the consolidation of locations and was reported under assets held for sale as of December 31, 2015 was sold during the calendar year in progress.

Decrease in fixed assets

Property, plant and equipment fell by € 0.9 million to € 10.8 million, mainly due to a volume of investment that was lower than the volume of ordinary depreciation. In addition to assets related to the new IT system, intangible assets primarily consist of capitalized development expenses. The € 14.5 million reduction in the volume of intangible assets to € 52.9 million (prior year: € 67.4 million) can primarily be attributed to the impairment of development projects that had already been capitalized following the impairment test, which can in turn be attributed to the sharp fall in revenue and the forecasts for revenue. Goodwill also fell from € 94.5 million to € 33.1 million due to impairment.

The balance of deferred tax assets and deferred tax liabilities fell from € 8.5 million in the prior year to € 6.6 million as of December 31, 2016, mainly due to the impairment of unused tax losses.

DEVELOPMENT OF CURRENT AND NON-CURRENT LIABILITIES

Increase in current liabilities

At € 59.6 million, trade payables were down € 11.3 million on the figure for the prior year due to the reduced volume of materials purchased. Current provisions rose € 22.5 million to € 30.7 million, mainly due to additions to the restructuring provision (2016: € 19.5.0 million, prior year: € 3.7 million) as well as provisions for warranty obligations (2016: € 3.5 million, 2015: € 2.7 million). Other current liabilities also rose by € 22.5 million to € 30.7 million, mainly due to current accruals for receipt obligations in connection with the partnership entered into with Ennoconn in the 2016 fiscal year as well as obligations relating to the forwarding of incoming payments to the factoring company. As part of its negotiations with Ennoconn, Kontron undertook to process a certain volume of procurement via Ennoconn. Tax liabilities fell € 5.9 million to € 3.9 million, mainly on account of tax payments for tax field audits concluded in the 2015 fiscal year.

Substantial decrease in non-current liabilities

Non-current liabilities, which still included the loans to banks in connection with the credit facility as of December 31, 2015, fell by € 46.3 million to € 22.3 million, mainly on account of the reduction of the facility to zero. Other non-current liabilities as of December 31, 2016 include receipt obligations relating to the partnership with Ennoconn as well as provisions for risks associated with individual contracts.

Equity ratio at 47 %

The carrying amount of equity on the reporting date for 2016 came to € 137.0 million, a year-on-year decrease of € 121.9 million (prior year: € 258.9 million). This change in total equity was offset by the addition of Ennoconn as a minority shareholder of the subsidiary KCI. This increased equity by a total of € 26.1 million, which increased retained earnings by € 14.0 million. The equity ratio stood at 47.1 %, 11.5 percentage points lower than in the prior year.

Non-financial performance indicators

EMPLOYEES

On the reporting date of December 31, 2016, the Kontron Group employed a total of 1,215 people around the world plus 23 trainees. For comparison: At the end of 2015 there were 1,286 employees and 27 trainees.

EMPLOYEES BY FUNCTION

	2016	2015*	Change
Production	309	336	– 27
Research & Development (R&D)	405	405	0
Sales & Marketing	333	359	– 26
Administration & IT	168	186	– 18
Group	**1,215**	1,286	– 71

* Headcount as of December 31 (per capita)

TABLE 010

EMPLOYEES BY REGION

	2016*	2015*	Change
EMEA	637	682	– 45
North America	352	409	– 57
APAC	226	195	+ 31
Group	**1,215**	1,286	– 71

* Headcount as of December 31 (per capita)

TABLE 011

The change in the headcount mainly stemmed from initial measures as part of the new restructuring program (which provides for around 300 job cuts). As of December 31, 2016, the job cuts mainly affected the EMEA and North America regions. Only the APAC region saw a slight increase in headcount in 2016, mainly due to the expansion of the research and development team in Malaysia.

The persistently challenging business trend also forced us to postpone or temporarily suspend certain personnel measures. Nevertheless, the skills and promotion of our employees are and will remain important on our journey back to sustainable success. We consider them to be key requirements for us to be able to continue offering high-quality solutions in the future in our core business: developing innovative technical solutions.

More intensive communication with employees

Communication with employees was intensified in connection with the approaching restructuring and associated changes. We regularly publish notices in the company's intranet in order to keep them up to date with current developments and decisions. The Management Board and top management also hold regular informative events at Kontron's various locations. Our employees can pose questions in the run-up to these events that are then answered at the events themselves.

Training as an entry opportunity

We actively promote vocational training for young people. Our aim is to develop motivated and talented young people from within our own ranks and entrust them with challenging new responsibilities. A total of 23 young men and women received training in five different vocations at our facilities in 2016, and most of them trained as electronic technicians for devices and systems, industrial clerks and warehouse logistics specialists.

Representation of women

In 2015, the Supervisory Board and Management Board defined targets for the proportion of women at our company. The Supervisory Board of Kontron AG has set a target of 30 % for the proportion of women on both the Supervisory Board and Management Board, and specified June 30, 2017 as the deadline for implementation. The Management Board also set a target of 30 % female representation for the first and second levels of management below the Management Board, and specified June 30, 2017 as the deadline for implementation.

SUSTAINABILITY

For us, sustainability means that we pursue constant global growth while also taking the needs of the environment, society and general economic development into account. Aspects of ecology in particular are becoming an increasingly important factor in our development activities and business decisions, and we consider conserving natural resources to be fundamental to sustainable global growth.

In light of these premises, we strive to develop products and services that stand out on account of their low energy consumption, and that can be produced both cost-effectively and in a way that conserves resources. We also aim to minimize our impact on the environment and natural resources in other fields as well. For example, we try to avoid waste as much as possible while making use of efficient recycling solutions.

ENVIRONMENTAL PROTECTION AND MANAGEMENT

Our management is constantly aware of its responsibility for the environment. Another very important corporate goal of ours is taking a responsible approach to environmental and climate protection, which are integral to our corporate strategy. As a result, our management have defined clear environmental policy guidelines for our company, and targeted work is carried out to raise employees' awareness of environmental issues in their daily work. We want to reinforce this awareness and develop effective solutions with which to protect natural resources, our employees and the people who work with our products – for example by using non-harmful substances.

We have developed an environmental management system for all of our important operations in Europe and North America to evaluate and continuously improve their performance with respect to the protection of the environment. The system is based on our environmental strategy, which is used to derive both overriding and specific environmental targets. Our most important production facilities around the world are also certified in accordance with ISO 14001, which includes processes that have been outsourced to external companies. The certification process will be rolled forward and reviewed indefinitely into the future. Identifying and analyzing significant issues relating to the environment at each of our locations is an important part of our environmental management system. The fulfillment of the relevant requirements is assessed for each location, and this is used as the basis for classifying the locations to allow the targeted implementation of improvement measures. This assessment will be reviewed and updated at least once a year.

Our environmental management system is structured so that it helps us to identify and control all relevant changes in environmental and statutory requirements in a particular country or location, and ensure compliance with the applicable laws. We use an online legal registry, for example, to receive automatic notifications about changes to laws or directives such as RoHS, EMC, WEEE, REACH and regulations regarding conflict minerals. We also conduct internal audits in order to identify the strengths and weaknesses of environmental management at each location. We also expect our suppliers to comply with ecological and social standards, which we monitor by means of on-site audits.

It is our stated goal to continuously improve our environmental performance. To this end we derive annual environmental targets for each location on the basis of our environmental strategy. Management reviews and assesses to what extent these goals have been reached. In this way we monitor the effectiveness of the program, initiate countermeasures as needed and define appropriate new goals. We are also currently working on defining performance indicators for all of our environmental targets in order to make them even more measurable. Examples include power consumption per employee, heating requirements per square meter, or the carbon footprint of business trips per employee.

Kontron has implemented various energy-saving measures as a result of the energy audit carried out at the end of 2015. In 2016, for example, we completely switched the lighting in our production hall to modern and environmentally-friendly LED light sources. This has more than doubled the brightness of the lighting while reducing electricity consumption by up to 38 %.

CDP – Carbon Disclosure Project

As a global player, we are aware of our responsibility to society with regard to climate change and greenhouse gas emissions. We have therefore participated conscientiously in the public reporting forum, the Carbon Disclosure Projects (CDP), since 2010. This program reveals at an early stage any risks and opportunities for our company arising from climate change and thus allows us to take counteraction.

In the course of our CDP reporting, we measure our global CO2 emissions that are caused either directly, by devices such as air conditioners, the vehicle fleet and stationary heating, or indirectly by heating and power purchased from external suppliers as well as business trips and logistics. This also involves communicating measurable information, key figures and planned/implemented measures. All participating companies are assessed following analysis by the CDP. Kontron has attained assessment category C ("Awareness") for the first time, compared to the average D category ("Disclosure") for the "Information Technology" sector in the DACH region. We view this encouraging result as affirmation of our commitment, and indicative of the success of our efforts to reduce greenhouse gas emissions and actively combat climate change. You can read the full report at *www.cdp.net*.

PRODUCT-RELATED ENVIRONMENTAL PROTECTION

We offer our customers reliable, integrated and self-contained embedded solution platforms for unique technical solutions. We aim to develop highly innovative, energy-efficient solutions. Our portfolio already heavily features energy-saving ECT solutions, and their share of the portfolio is set to continue growing due in no small part to the constant rise in demand from customers. We also attach great value to production methods that are both economical and conserve resources.

Declaration of materials

One of our main aims for our products is to achieve an environmentally conscious design that avoids the use of hazardous materials. For this reason, we obtain information from our suppliers regarding the composition of components we use in our products, and we communicate this information to our customers at all times. In cases where our customers have specific requirements, we naturally endeavor at all times to comply with the relevant statutory requirements such as the German Electrical and Electronic Equipment Act (ElektroG) and the Restriction of Hazardous Substances (RoHS) Directive. Kontron also reports in connection with the EU's REACH chemical regulations and on conflict minerals. You can find out more about this topic on our website: *www.kontron.com/about-kontron/corporate-responsibility*.

QUALITY MANAGEMENT

We know how important the outstanding quality of our products and solutions is to our customers. We are constantly striving to achieve an impeccable standard of quality for our entire portfolio. We assess and improve the quality of our products, solutions and services at every stage of the supply chain. This desire to continuously improve the development and production process is what drives us forward every day.

Kontron has established a global quality management system, in which group-wide uniform standards and processes on the topics of quality, safety and environmental protection are defined. The quality management system is a decisive factor for our operating processes, and ensures that we always offer the best possible quality to our customers.

Our group management system is evaluated and certified on a standardized basis by global certification companies in accordance with the ISO 9001 (quality) and ISO 14001 (environmental protection) standards. Our US production facility in Poway, California has also been certified in accordance with the medical device standard ISO 13485 since 2013. All of our products meet the relevant standards and specifications such as UL (computer-on-modules), CSA, CQC, VDE and TÜV tested safety.

Procurement

Prices in the procurement market for electronic parts and components remained largely stable again in 2016. We were able to further improve our global purchasing and procurement structures during the reporting year. Our procurement team was reinforced in Asia in particular, and at the same time we also improved the efficiency of our teams around the world by means of constant process optimization and by expanding the technical support available.

We maintained close and constructive partnerships with our suppliers, seeking ongoing and intense dialog on the rising demands of the market with respect to quality, delivery performance, innovation and costs. It goes without saying that our suppliers are also required to meet the high standard of quality that Kontron applies to its own processes and technical solutions, but environmental and sustainability issues also play a major role in achieving a productive partnership. This is why we conduct annual audits of key suppliers, which covered all Electronic Manufacturing Services around the world that work for Kontron in the past fiscal year, as well as all strategically important distributors and the most important regional suppliers.

Brand building

The Kontron brand stands for reliability, safety, longevity and quality. We use our flagship brand, Kontron, on the ECT market and the other markets we target to market our goods to OEM customers (i. e. the companies that use our products in their end products) and also to market standard products via indirect distribution channels. Our standard products, on the other hand, and all of our customized and bespoke products are integrated into the products, solutions and applications of our customers and marketed under their own brands.

SUBSEQUENT EVENTS

On February 15, 2017, the Management Board of Kontron AG signed a letter of intent with the Management Board of S&T Deutschland Holding AG, a wholly-owned subsidiary of the listed S&T AG, on the planned merger between Kontron AG and the non-listed S&T Deutschland Holding AG.

RISK AND OPPORTUNITY REPORT

Basic principles of risk and opportunity management

For Kontron, risk and opportunity management is an integral aspect of corporate governance.

Kontron is exposed to risks that are directly related to its business activities. We have set up a group-wide risk management system in order to identify risks at an early stage, evaluate them appropriately and limit them using suitable measures. The risk management system also helps us achieve our corporate goals. It raises awareness of risks, promotes confidence in the company among our stakeholders and puts our planning and decision-making on a firmer footing. By closely integrating risk management into our financial processes and constantly refining the evaluation, management and reporting of risks, we ensure that the Management and Supervisory Boards are kept promptly and fully informed about our company's current risk situation.

Business activity also involves recognizing opportunities, taking advantage of them and in so doing safeguarding and improving the company's ability to compete. We consider this to be a fundamental component of our strategy. Our systematic risk and opportunity management allows us to also assess opportunities in addition to risks.

RISK MANAGEMENT SYSTEM

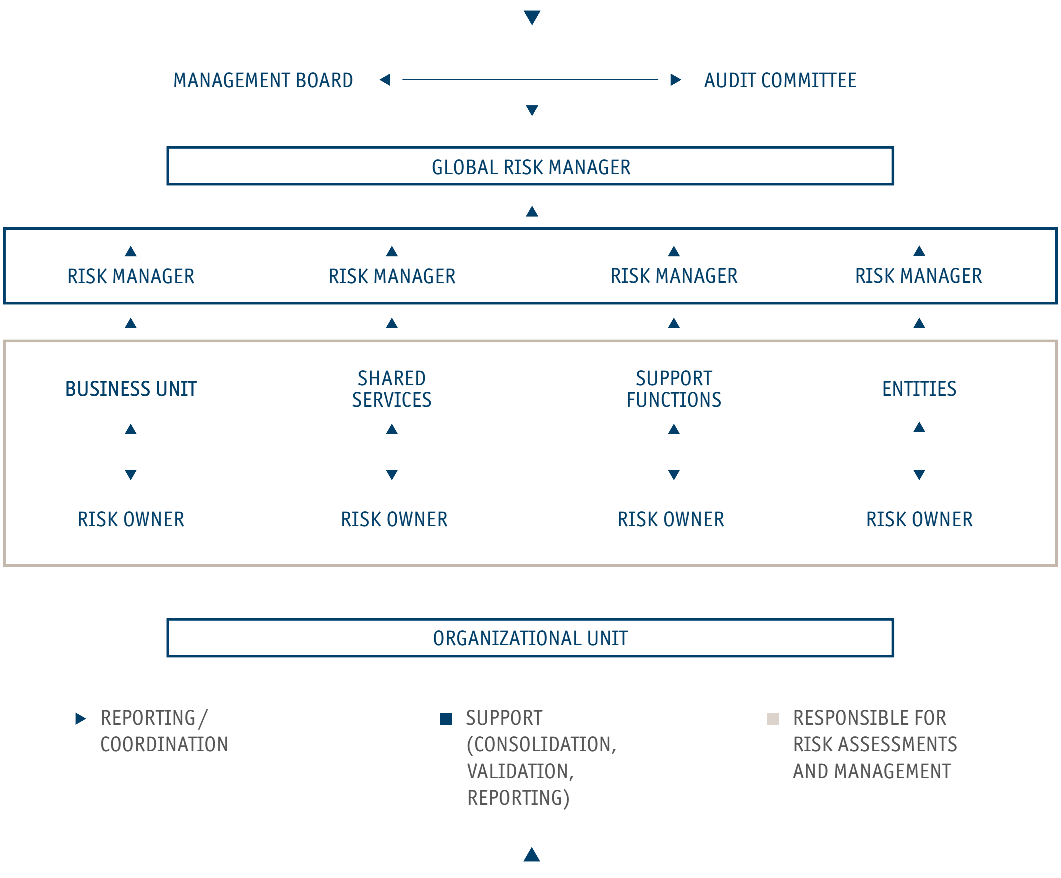
Our internal risk management system complies with the policies for dealing with corporate risks as agreed with the Supervisory Board and Management Board, and is assigned for organizational purposes to the internal audit function, which reports directly to the Management Board Member for Corporate Finance.

The Group's risk management organization is headed by a Risk Manager. He coordinates regularly with the Management Board, those officers within the company with organizational responsibility (heads of business units, shared and support functions and the executive managers) and local risk owners, and monitors compliance with the implemented risk management processes and reporting routines.

Once every quarter, all operating units and entities evaluate and report on their risks and designate a "risk owner" for their main risks. This person is responsible for the risk in question, and monitors the measures aimed at managing that risk. The risk assessments are updated and followed up on via quarterly reporting to the group risk manager, before being aggregated and discussed with the Management Board. The Supervisory Board is also informed about the main risks.

THE ORGANIZATION AND METHODOLOGY OF RISK MANAGEMENT AT THE KONTRON GROUP

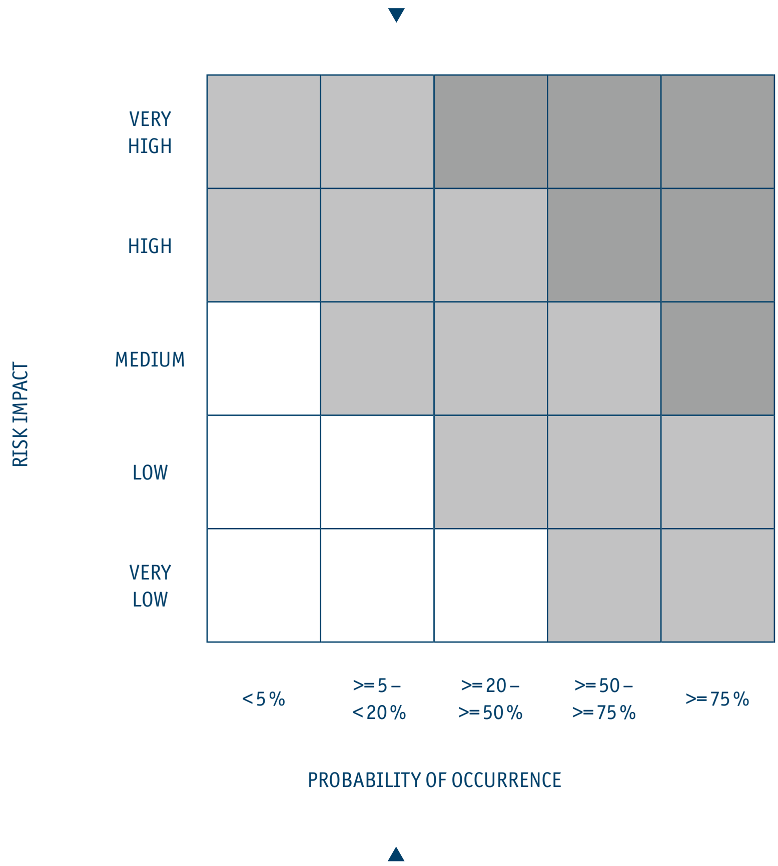
THE ORGANIZATION OF RISK MANAGEMENT AT THE KONTRON GROUP



GRAPHIC 002

Where possible, risks are quantified by identifying the probability that they will occur and their potential impact on our income and assets. We assign equivalent risk values to risks that are difficult to quantify or cannot be quantified at all. This also allows us to assign a weighting to these risks, and position them within our company's risk landscape. The probability of risks as well as their possible financial impact are rated on a scale of very high, high, medium, low and very low.

RISK ASSESSMENT MATRIX



GRAPHIC 003

SUMMARY OF THE SPREAD OF POSSIBLE FINANCIAL LOSSES PER CATEGORY

IN €K	Impact
Very high	≥ 5,000
High	≥ 2,000 < 5,000
Medium	≥ 500 < 2,000
Low	≥ 100 < 500
Very low	≤ 100

TABLE 012

THE CHART DISPLAYS THE RISK CATEGORIES DISCUSSED BELOW AND THEIR POSITION IN THE RISK MATRIX

Risk area development		
Risk area	Risk impact	Probability of occurrence
Supply chain and procurement risks	Very high	Very high
Market and sector-specific risks	Very high	High
Risks associated with restructuring	Very high	Medium
Liquidity risk	Very high	Low
Technological risks	High	High
Product-related risks	High	Medium
Legal risks	High	Medium
Financial risks: currency risks	Medium	High
Regional risks	Medium	Medium
IT risks	Medium	Medium
Personnel risks	Medium	Medium
Financial risks: debtors	Medium	Medium
Financial risks: impairment-related risks	Medium	Low

TABLE 013

Appropriate measures are defined and implemented for all of our risks in order to minimize important risks over time and reduce the probability of them occurring and / or the severity of their impact. Individual risks are transferred to insurance providers in order to limit the financial consequences in the event that they occur. As part of our risk management activities, we are constantly monitoring our company's risk profile and seeking to improve it using targeted measures.

Main risk categories

The passages that follow deal with the most important areas of risk during the reporting year from a current perspective. The risks described have a material influence on the achievement of our company's strategic and operating goals, as well as its net assets, financial position and results of operations. In addition to these risks, our business activities could also be impacted by other factors that we are currently still unaware of or do not perceive to be important.

SUPPLY CHAIN AND PROCUREMENT RISKS

We have identified multiple risks in the operating field of supply chain and procurement. Our procurement of materials for the supply chain and warehouse storage is based on projections of requirements. If the quality of the forecast is poor, warehouse inventories may be either too high or too low. We combat this risk by means of a wide range of measures to improve our sales and production planning process, as well as to offer incentives to all employees involved in the process.

Procurement risks mainly relate to the loss of important suppliers, defects in the quality of supplied components or failure to meet important procurement and delivery deadlines. These risks mainly relate to components and electronic assemblies, but also the production services that we procure from various suppliers. We also endeavor to engage multiple suppliers for critical components.

Some of the components we require are subject to strong fluctuations in demand due to economic factors, resulting in correspondingly strong price volatility. We have set up dedicated storage for critical components at multiple locations in order to protect ourselves against this risk. Some of our products are sold unchanged on the market for very long stretches of time (more than ten years), and in some cases replacement parts have to be supplied for correspondingly long periods due to contractual obligations to our customers. We address this risk by regularly analyzing critical components. We try to adjust our inventories of important supplied components to match the demand we anticipate for the remainder of the product life cycle before they are discontinued. Despite these measures, in the past fiscal year there was a significant risk that we would not be able to meet our delivery obligations. In this case the risk was covered by creating a provision.

We also constantly monitor the ranges of value-adding components and assemblies in order to minimize the risks associated with outdated or excessive inventories. We had to recognize significant impairments in our inventories during the past fiscal year due to the significant declines in revenue and the forecasts for revenue.

MARKET AND SECTOR-SPECIFIC RISKS

Europe and North America are out main sales markets. Negative developments (including the changed political landscape in the US) could impact demand. In the gaming and entertainment sector in particular we are currently seeing significant consolidation among potential customers who are also active in the contract manufacturing business. This risk is reflected in the decline in revenues seen in 2016. In the Asian markets there is a risk that the pace of growth will slow.

The possibility of consolidation among our customers could also have an impact on the margins that can be achieved. Large customers can increase the pressure on margins on account of their power over the market. In order to combat this we have continued to optimize our international supply chain by working with Ennoconn as well as our development units. The focus of our sales activities is currently on placing even greater emphasis on the benefits of our products for customers, as well as identifying further strategically important customers and generating orders.

At the same time, large companies that had previously operated exclusively as upstream suppliers are increasingly moving into the market with end customers, while our customers are also expanding their value-added chain by handling certain production processes themselves. We are combating this trend with our technological experience as well as additional services (e. g. maintenance, software).

Insufficient familiarity with the market and analyses of the competition can constitute a risk for both sales and development. We aim to improve the application and use of sales tools and standardize our internal sales processes as much as possible in order to reduce sales-related risks.

Finally, we see a risk that the rate at which prices on the market are falling could quicken as a result of progressive standardization and commoditization, particularly for modular and board products. We address this risk by continuously improving our procurement and supply chain processes, including in connection with our strategic partnership with Ennoconn Corporation that was concluded in April 2016 and is constantly being optimized.

RISKS ASSOCIATED WITH RESTRUCTURING

We launched a comprehensive restructuring process in the 2016 fiscal year with the aim of achieving a lasting reduction in costs over the next few years. The measures that were identified and launched comprised a strategic realignment process, structural and capacity adjustments, reducing the cost of materials, optimizing processes and securing liquidity by reducing the volume of net debt. In connection with the implementation, there is a risk that not all measures will be implemented as planned, and that it will therefore not be possible to achieve the necessary savings.

We address this risk by closely monitoring the implementation of measures and cost-cutting initiatives. In the event of deviations, the consequences are analyzed and alternative measures are implemented if necessary.

LIQUIDITY RISK

Kontron had cash and cash equivalents amounting to € 43.8 million as of the reporting date. Changes in cash and cash equivalents are regularly analyzed by our central treasury department. This item did not change significantly prior to the authorization of the financial statements for issue.

The credit facility was adjusted to a volume of € 35 million by amendment to the contract dated October 26, 2016. This amount breaks down into a cash line of € 25 million and a bank guarantee of € 10.0 million. At the same time, the term of the credit facility was shortened to December 14, 2016. This agreement provides Kontron AG the option of extending the term of the facility twice by one month in each case. On the basis of this option the credit facility was prolonged until January 14, 2017. Kontron AG terminated the credit facility on December 21, 2016 and repaid it in full.

Since this date, long-term financing is obtained by factoring up to a financing limit of € 30.0 million. At the time that these financial statements were prepared, another factoring program was in preparation to provide for additional liquidity of € 3.0 million. Furthermore, Kontron received a letter of comfort from S&T AG for € 20.0 million to secure additional liquidity. The Management Board of Kontron AG called for this support by letter dated February 17, 2017, as without this financing the liquidity of Kontron AG and thus of the Kontron Group would not have been secured as of the second quarter of 2017. In a letter dated February 21, 2017, S&T AG declared its willingness to fulfill its obligation. The Management Board of Kontron AG assumes that sufficient liquidity will flow to the company to cover its financing needs in the 2018 planning period and therefore believes that the probability of liquidity risks eventuating is low.

Due to the tight liquidity situation, the ability of the company to continue as a going concern is at risk and depends on Kontron AG being provided with the funds pledged to it by S&T AG by letter of comfort. On account of the current restructuring, the Management Board of Kontron AG does not see any other financing alternative and is therefore compelled to rely on the letter of comfort.

The ability of the company to continue as a going concern is due to the tense liquidity situation at risk. This depends on Kontron AG being provided with the liquidity pledged to it by S&T AG by letter of comfort. On account of the situation with respect to restructuring, the Management Board of Kontron AG does not see any alternative source of financing which means it is forced to rely on the letter of comfort.

TECHNOLOGICAL RISKS

Technological risks stem from the possibility that technologies developed by us could be rendered obsolete or supplanted by new developments, or that we could fail to react quickly enough to the progress of technology. That is why, over the course of the reporting year, we continued to optimize our analysis of the market and in so doing improve our responsiveness to the latest trends and developments on the market. In this way, we hope to prevent our standard products from getting to the market later than those of our competitors, or being rendered obsolete by unexpected technological innovation. Other technological risks can arise as a result of the introduction of costly new technologies, for example in the field of IoT-related security.

With respect to our development activities there is a risk that external parties will violate our intellectual property (IP). Although we are constantly assessing whether we are violating existing patents and whether anyone is violating our intellectual property, including through the involvement of external lawyers and consultants, patent violation claims have been asserted against Kontron. We have hedged ourselves sufficiently against this risk by creating a corresponding provision.

We have optimized our development organization in order to avoid delays to projects. Continuous project controlling supports the project management system and the structured processing of development projects. This allows us to identify deadline and budget overruns at an early stage and take appropriate measures in good time.

PRODUCT-RELATED RISKS

With respect to product quality, there is always a risk that defective products could lead to claims for damages from Kontron's customers. We address this risk using a number of measures which include comprehensive technical quality assurance in the development and manufacturing of products. Kontron also has its own professional quality management function that regularly audits all important suppliers.

With our global service and repair centers, we also make sure that defective Kontron products are repaired and sent back to our customers quickly and effectively. We also hedge our product-related risks by taking out corresponding insurance policies.

It is equally important for the relationship between customer-specific development orders and standard product orders to be managed so as to strike a balance between the two. In the past, business activities in which a lot of the input came from customers resulted in an uneven distribution, and therefore substantial expenses on account of the complexity involved. The large number of variants for the individual products makes handling more difficult on the operating side. We will address this risk by achieving closer coordination between the various different parts of the company in the future.

LEGAL RISKS

Legal risks can arise, among other things, as a result of third-party claims and lawsuits against the parent company or its subsidiaries, especially if insufficient contractual safeguards are in place and the material risks described in this report actually occur. We mitigate contractual risks by having our internal lawyers review the clauses of contracts and support us when negotiating contracts, also involving external specialists if necessary, and by constantly expanding our internal contract management function.

Other legal risks may stem from official proceedings. Our in-house lawyers monitor court and out-of-court legal disputes, with the support of external lawyers if necessary. A significant need for external advisory services (with corresponding costs) may arise, particularly in cases where foreign legal systems apply.

There are also fundamental risks associated with the fields of competition and antitrust law, export / cross-border trade law, customs and tax law, and environmental law. We protect and monitor patents and brands by involving external patent and brand lawyers.

Specific risks arising from ongoing legal proceedings (as defendant or plaintiff) are evaluated by our risk management function. We recognize provisions in cases where compulsory payments are considered likely and we can reliably estimate their amount.

FINANCIAL RISKS: CURRENCY RISKS

Kontron operates in technology markets around the world. Our business relationships are therefore subject to exchange rate (transaction) risks. That is why, as part of our currency hedging strategy, we seek to offset obligations entered into in foreign currencies with transactions going in the other direction as much as possible (natural hedging). Our treasury department attempts to hedge spikes that cannot be offset where possible. We also hedge planned revenues and expenses in foreign currencies that are highly likely to be incurred be applying various different hedging instruments.

REGIONAL RISKS

Kontron produces and sells its products all over the world. This results in various regional risks for our ongoing business operations. One of these is the risk of coming into conflict with international regulations. We take steps to address the resulting potential legal and financial consequences by consistently monitoring the relevant international regulations and taking all necessary measures to ensure compliance with them. One of the areas to which this applies is the field of export controls.

We have optimized our management team in Asia on account of the attractive prospects for growth in the APAC region. In addition to China, Kontron operates independent units / sales offices in Malaysia, India and Japan. This also allows us to learn more about the opportunities and risks in these markets, and act in accordance with local conditions.

In order to keep regional risks to a minimum, we take aspects such as the number of regional and multi-regional production facilities into account when selecting suppliers (please also refer to the section on "Supply chain and procurement risks"). Nevertheless, we may not be able to prevent delays to our deliveries in the event of outages at important production facilities.

IT RISKS

The second phase of the implementation of the SAP-ERP rollout was completed in April 2016. The main group entities have been working with the new, template-based SAP system since then. This was preceded by a comprehensive, multi-stage testing process in order to ensure that all systems and operating processes (including the inherited business data) reliably facilitate error-free ERP operation when they go live. Extensive prior training for all users combined with a detailed, role-based authorization concept also ensured a largely smooth transition from the existing SAP system to the new one. At the same time, not all of the expectations of the new SAP system were met. Additional adjustments are required in order to be able to realize all of the benefits in full.

We mitigate any potential general operating risks by outsourcing the SAP system management. Central IT systems are also located in a secure, professional data processing center. We are also working as part of various projects on introducing uniform global software and hardware standards such as global virus scanners, global VPN access, standardized software distribution etc. This also includes the implementation of a global software license management system. There is also a generic risk (as there is for any company) that sensitive data transactions could be accessed without authorization by third parties due to mobile data carriers.

PERSONNEL RISKS

The restructuring announced at the end of 2016 will significantly reduce the number of people employed around the world. This entails a risk that employees could take their own, alternative career paths, independently of the planned job cuts. This could lead to a loss of expertise or key personnel. The job cuts are being planned very carefully and monitored in order to prevent this. Regular communication is also being provided in the form of meetings with employees in order to give workers prompt and direct information regarding the progress of the restructuring program. As part of this reduction of the workforce, the possibility that some departing employees will appeal against Kontron cannot be ruled out.

FINANCIAL RISKS: DEBTORS

We consider our company to be well equipped to cope with the possibility of one or more customers defaulting on their payments under normal conditions: We have a very large customer base, and our ten biggest customers in terms of sales account for less than 40 % of our total sales.

Kontron has a modern dunning and customer credit system in place, and is sufficiently secured against defaults on payments as a result.

We already have long-standing business relationships with many of our customers. This gives us a reliable track record regarding their payment patterns. We also obtain external ratings if necessary, We also regularly analyze the payment behavior of our customers. We define a credit limit and payment conditions on the basis of this profile, and compliance with them is monitored by the relevant functions. Despite these efforts, customers can still experience financial bottlenecks that cause them to default on their payments. Bad debt allowances are recognized for specific risks.

In December 2016, a subsidiary concluded a factoring program with a volume of up to € 30.0 million. Under this program, those receivables of the company that meet a specific requirements profile are sold to the purchaser of the receivables without recourse.

FINANCIAL RISKS: IMPAIRMENT-RELATED RISKS

The impairment test of goodwill resulted in the adjustment of the corresponding carrying amounts of the cash-generating units at the end of the second quarter of 2016. If future business develops differently to the forecasts or the other assumptions underlying the calculation, there may be a need to record another impairment loss on goodwill, which would negatively impact the company's efforts to raise debt capital or equity.

Inventory write-down risks and risks in connection with the capitalization of intangible assets from the R&D unit materialized at the end of 2016. Nevertheless, another deterioration in the projections for revenue could lead to further write-downs.

CONTROLLING AND RISK MANAGEMENT SYSTEM FOR ACCOUNTING PURPOSES (DISCLOSURES IN ACCORDANCE WITH SECS. 289 (5) AND 315 (2) NO. 5 HGB) AND EXPLANATORY REPORT

Kontron AG has an adequate internal control system (ICS) that ensures that our group accounting is carried out properly. Various functions including the legal and accounting departments monitor the regulatory landscape, in some cases with external support.

In the field of finance, the material elements of the ICS are the group-wide accounting policies and the Group's standardized chart of accounts. A financial calendar that applies throughout the Group ensures that the preparation of the monthly, quarterly and annual financial statements is reliable and complete. The ICS comprises organizational, controlling and monitoring measures that cover all group entities. These measures are designed to allow prompt, standardized and proper accounting.

The financial statements of our group entities, which are prepared uniformly in accordance with IFRSs, are consolidated centrally using standard software. System-based and manual validation checks and plausibility tests are carried out as part of the ICS. The managers and employees responsible for group financial reporting regularly conduct additional manual checks, ensuring a clear segregation of duties.

In connection with the ICS, the group controlling function is responsible for ensuring through regular reporting that deviations from the company's financial targets are recognized as early as possible so that appropriate measures can be promptly taken. The internal audit function assesses the functioning of the ICS, conducts analyses and makes use of additional, external expertise for specialized audits if necessary, on the basis of a risk-based plan. Our Management Board also receives regular reports on the adequacy of the ICS. If corrective measures are required, we specify corresponding areas of responsibility and implementation deadlines, and assess the impact of the measures using a standardized tracking process.

Opportunities report

Our business policy is aimed at systematically identifying and exploiting opportunities in order to constantly improve the company's performance and earning power. The basis for this is the transparent investigation of opportunities in order to then incorporate them into our business decision-making processes. The following opportunities reflect our current appraisal of potential future developments and events that could lead to a positive deviation from our forecast.

FOCUS ON MIDDLEWARE / SOFTWARE AND THE IOT

We see huge potential in the consistent implementation of our software / middleware strategy as part of our focus on the industrial IoT. A new middleware range will be added to the existing hardware portfolio in the future. This enables us to offer innovative and self-contained products, solutions, platform solutions and innovations in connection with the "Internet of Things". The improved integration of hardware-based security solutions allows us to give consideration to the requirements of the market with respect to systems and data security. We also now offer the protection of technology (copy & IP protection) ex works in our hardware and systems platforms. We are working constantly to develop new technologies and improve existing ones in this field for the benefit of our customers.

PARTNERSHIPS

The strategic partnership entered into with Ennoconn Corporation in 2016 could present additional opportunities. For example, the partnership could allow us to further improve our global procurement processes, which would in turn have a positive impact on our earnings.

With the involvement of S&T AG and the previously announced intensification of the collaboration with S&T AG, we expect positive input on the development side thanks to the S&T Group's many years of expertise. At the same time, there is significant potential for us to be able to offer our products in combination with S&T's know-how with existing or new customers.

REINFORCEMENT OF STANDARD PRODUCTS

We will continue to optimize our standard products business (i. e. products with limited or no customer-specific modifications) in the 2017 fiscal year. To this end, we are planning to assign sales of standard products to a dedicated "Entrepreneur Profit Center" and intensify our activities in our regional markets. It is also hoped that increasing the proportion of standard products will reduce complexity-related costs. One of the focus areas for the measures from the restructuring program is the implementation of standard product platforms as well as the prompt market launch of new standard products in order to boost competitiveness.

SERVICES

Expanding the range of services we offer also presents opportunities for the company. Our primary goal is to use services to make our products and solutions even more beneficial for our customers while also developing comprehensive new services relating to our products and solutions. This allows us to provide more lasting support to our customers, throughout the entire product life cycle. Our market analyses and the positive response from our customers promise substantial potential growth for our services. The portfolio of services, which was expanded in 2015, continued to generate broad interest among customers in 2016 and resulted in a large number of new projects.

OPPORTUNITIES ARISING FROM THE STRATEGIC REALIGNMENT

The implementation of the restructuring program presents a number of opportunities. The optimization of costs, including on the basis of the adjustment of the organization and capacities, the ongoing improvement of processes and the strategic realignment reinforce the focus on our customers and technologies, and therefore provide the foundation for the positive ongoing development of Kontron.

Overall statement from the Management Board regarding the risk situation

The overall statement from the Management Board regarding the risk situation is the result of a consolidated evaluation of all known sources of risk that could have a material impact on the Kontron Group's net assets, financial position and results of operations.

As mentioned in the section on the liquidity risk, the Managament Board considers the company's ability to continue as a going concern to be due to the tense liquidity situation at risk. This depends on Kontron AG being provided with the liquidity pledged to it by S&T AG by letter of comfort.

At the time that this report was published, the Management Board of Kontron AG considers the identified risks to be manageable and sees high-quality potential for growth for the company's future.

We will make our organization more stable and efficient in the 2017 fiscal year. The Management Board firmly believes that thanks to its optimized business model (including the implementation of the measures from the restructuring concept), the strategic partnership with Ennoconn and above all the merger with the S&T Group, Kontron will be able to tackle new strategic challenges and develop ground-breaking technological solutions.

FORECAST – OVERALL STATEMENT REGARDING FUTURE DEVELOPMENTS

The Management Board expects revenue and the seasonality of business in 2017 to follow that of the 2016 fiscal year and has issued the following forecast:

The embedded computer market is expected to grow by about 7 % in 2017. We therefore assume that there will be no growth based on the trend for order intake, and expect Kontron's revenue to be on a par with the prior year as a result. The gross profit margin is expected to rise to well above 25 % on account of the partnerships with Ennoconn and S&T.

Based on the new restructuring program, we expect annual savings of € 15 million that will already start to take effect in the second quarter of 2017. Provisions were recognized for much of the restructuring costs incurred in 2016. We expect EBIT to be positive in 2017. This includes any further restructuring expenses incurred in 2017.

As part of the restructuring program, the complex, business unit-based structure will be abandoned from 2017 and returned to a regional alignment, with corresponding responsibility for results transferred to the individual regions. As mentioned in the risk and opportunities report, the safeguarding of liquidity depends on the inflow of the funds totaling € 20 million promised by the letter of comfort issued by S&T AG. The Management Board of Kontron AG claimed these funds in February 2017. A corresponding inflow of liquidity is anticipated.

CLOSING STATEMENT OF THE MANAGEMENT BOARD REGARDING THE DEPENDENT COMPANY REPORT PURSUANT TO SEC. 312 (3) AKTG

Pursuant to Sec. 312 (3) AktG, we, the Management Board of Kontron AG, declare that the company received appropriate compensation in connection with the legal transactions conducted and the measures implemented or omitted as described in the dependent company report based on the circumstances of which we were aware at the time that the legal transaction was conducted or the measure was implemented or omitted, and did not suffer any disadvantage as a result of the implementation or omission of the measure.

CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF INCOME (IFRS)

IN €K	Notes	01 – 12 / 2016	01 – 12 / 2015
REVENUES	(1)	385,125	467,651
Cost of materials		– 279,236	– 303,099
Other production cost		– 26,154	– 27,499
Amortization of capitalized development projects		– 23,658	– 15,229
Cost of goods sold		– 329,048	– 345,827
GROSS MARGIN		56,077	121,824
Selling and marketing cost		– 46,682	– 45,403
General and administrative cost		– 46,758	– 36,188
Research and development cost		– 29,861	– 29,999
SUBTOTAL OPERATING COSTS	(3)	– 123,301	– 111,590
Restructuring cost	(4)	– 17,213	– 8,305
Impairment losses on goodwill		– 60,939	0
Other operating income	(5)	19,816	26,702
Other operating expenses	(5)	– 16,117	– 22,441
OPERATING INCOME / LOSS BEFORE FINANCIAL RESULT AND INCOME TAXES		– 141,677	6,189
Finance income	(6)	23	145
Finance expense	(6)	– 2,215	– 2,237
Income taxes	(7)	– 3,740	– 6,797
NET INCOME / LOSS FOR THE PERIOD		– 147,609	– 2,700
Thereof attributable to non-controlling interests		3,194	– 173
Thereof attributable to equity holders of Kontron AG		– 150,803	– 2,527
Earnings per share (basic / diluted) in €	(33)	– 2.71	– 0.05

TABLE 014

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (IFRS)

IN €K	01 – 12 / 2016	01 – 12 / 2015
NET INCOME / LOSS FOR THE PERIOD	– 147,609	– 2,700
OTHER COMPREHENSIVE INCOME		
Other comprehensive income to be reclassified to profit or loss in subsequent periods:		
Exchange differences on translation of foreign operations	– 474	11,233
Reclassification adjustment for foreign operations, which were discontinued in the fiscal year	– 93	– 2,568
	– 567	8,665
Other comprehensive income not to be reclassified to profit or loss in subsequent periods		
Actuarial gains / losses from pension obligations before tax	60	122
Income tax effects	– 17	– 38
	43	85
OTHER COMPREHENSIVE INCOME AFTER TAXES	– 524	8,749
TOTAL COMPREHENSIVE INCOME	– 148,133	6,049
Thereof attributable to non-controlling interests	3,418	– 273
Thereof attributable to equity holders of Kontron AG	– 151,551	6,322

TABLE 015

CONSOLIDATED STATEMENT OF FINANCIAL POSITION (IFRS) ASSETS

IN €K	Notes	12/31/2016	12/31/2015
ASSETS			
Cash and cash equivalents	(9)	43,787	27,823
Inventories	(10)	60,499	83,333
thereof prepayments		401	2,152
Trade receivables	(11)	67,420	122,684
Income tax receivables		1,693	2,751
Other current receivables and assets	(12)	13,241	10,535
Assets held for sale	(8)	0	3,357
TOTAL CURRENT ASSETS		**186,640**	**250,482**
Financial assets		602	640
Property, plant and equipment	(14)	10,845	11,758
Other intangible assets	(15)	52,934	67,395
Goodwill	(15)	33,102	94,454
Other non-current receivables and assets	(12)	437	1,407
Deferred income taxes	(7)	6,566	15,772
TOTAL NON-CURRENT ASSETS		**104,486**	**191,425**
ASSETS		**291,126**	**441,907**

TABLE 016

CONSOLIDATED STATEMENT OF FINANCIAL POSITION (IFRS) LIABILITIES AND EQUITY

IN €K	Notes	12/31/2016	12/31/2015
LIABILITIES AND EQUITY			
Trade payables	(16)	59,628	70,928
Liabilities to banks	(19)	613	702
Current portion of finance lease obligation	(19)	0	31
Current provisions	(20)	30,686	8,159
Deferred income		2,917	2,421
Obligations from construction contracts	(10)	0	8
Income tax payable		3,852	9,720
Other current liabilities	(17)	34,117	22,396
TOTAL CURRENT LIABILITIES		**131,813**	**114,366**
Long-term borrowings	(19)	0	56,513
Non-current provisions	(20)	6,749	1,045
Pension provisions	(20)	1,835	1,850
Non-current portion of finance lease liability	(19)	0	27
Other non-current liabilities	(17)	13,698	1,954
Deferred income taxes	(7)	0	7,229
TOTAL NON-CURRENT LIABILITIES		**22,282**	**68,617**
Issued capital	(22) – (24)	55,683	55,683
Additional paid-in capital	(28)	200,048	200,048
Retained earnings		– 118,890	17,862
Other components of equity	(26)	– 12,526	– 12,728
Treasury shares	(25)	– 1,813	– 1,813
Equity attributable to equity holders of the parent		**122,502**	**259,052**
Non-controlling interests	(27)	14,529	– 128
TOTAL EQUITY		**137,031**	**258,924**
LIABILITIES AND EQUITY		**291,126**	**441,907**

TABLE 017

CONSOLIDATED STATEMENT OF CASH FLOWS (IFRS)

IN €K	Notes	01 – 12 / 2016	01 – 12 / 2015
NET INCOME / LOSS FOR THE PERIOD		**– 147,609**	– 2,700
Depreciation and amortization of fixed assets		33,134	23,666
Impairment losses on goodwill		60,939	0
Net gain / loss in connection with investing activities		– 276	129
Change in deferred taxes		1,859	– 1,237
Interest income	(6)	– 23	– 38
Interest expense	(6)	1,029	1,062
Other non-cash items		214	– 2,532
Change in assets / liabilities:			
Trade receivables		52,271	– 5,702
Inventories		22,766	8,215
Other receivables		– 2,331	4,408
Liabilities and provisions		45,321	– 9,356
Interest paid		– 919	– 1,327
Interest received		83	86
Income taxes paid		– 7,212	– 1,697
Income taxes refunded		1,267	1,252
NET CASH USED IN / PROVIDED BY OPERATING ACTIVITIES	(31)	**60,513**	14,229
Purchases of property, plant and equipment		– 2,706	– 4,524
Purchases of intangible assets		– 15,422	– 24,055
Proceeds from the disposal of property, plant and equipment		110	784
Proceeds from the sale of subsidiaries, net of cash		– 440	– 188
Proceeds from the sale of assets formerly classified as held for sale		4,200	4,118
NET CASH USED IN / PROVIDED BY INVESTING ACTIVITIES	(31)	**– 14,258**	– 23,865
Change in current account / overdrafts	(19)	– 89	759
Repayment of long-term debt	(19)	– 56,513	0
Proceeds from long-term debt		0	20,430
Transactions with non-controlling interests	(27)	26,173	– 296
NET CASH USED IN / PROVIDED BY FINANCING ACTIVITIES		**– 30,429**	20,894
Effect of exchange rate changes on cash		138	929
NET CHANGE IN CASH AND CASH EQUIVALENTS		**15,964**	12,186
Cash and cash equivalents at the beginning of the period		27,823	15,637
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	(9)	**43,787**	27,823

TABLE 018

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (IFRS)

		Equity attributable to equity holders of the parent		
IN €K	Notes	Issued capital	Additional paid-in capital	Retained earnings
JANUARY 01, 2015		55,683	200,048	20,554
Net income / loss for the period				– 2,527
Other comprehensive income				85
TOTAL COMPREHENSIVE INCOME		0	0	– 2,442
Dividend payment				
Deconsolidation of subsidiaries and purchase of non-controlling interests				– 249
DECEMBER 31, 2015		55,683	200,048	17,862
JANUARY 01, 2016		55,683	200,048	17,862
Net income / loss for the period				– 150,803
Other comprehensive income				43
TOTAL COMPREHENSIVE INCOME		0	0	– 150,760
Sale of non-controlling interests	(27)			14,008
Other				
DECEMBER 31, 2016		55,683	200,048	– 118,890

TABLE 019

Equity attributable to equity holders of the parent				
Foreign currency translation reserve	Treasury shares		Non-controlling interests	**Total equity**
–21,492	–1,813	**252,980**	–282	**252,698**
		–2,527	–173	–2,700
8,764		8,849	–100	8,749
8,764	0	**6,322**	–273	**6,049**
		0	–82	–82
		–249	509	260
–12,728	–1,813	259,052	–128	258,924
–12,728	–1,813	259,052	–128	258,924
		–150,803	3,194	–147,609
–791		–748	224	–524
–791	0	**–151,551**	3,418	**–148,133**
993		15,001	11,174	26,175
		0	65	65
–12,526	–1,813	**122,502**	14,529	**137,031**

CONSOLIDATED STATEMENT OF CHANGES IN NON-CURRENT ASSETS 2016 (IFRS)

	Acquisition and production cost					
IN €K	Carried forward 01/01/2016	Exchange rate effects	Deconsoli-dation	Additions	Disposals	As of 12/31/2016
I. INTANGIBLE ASSETS						
1. Other intangible assets	62,562	733	123	2,435	520	65,087
2. Internally generated intangible assets	143,698	1,720		13,331	7,335	151,414
3. Goodwill	160,311	621				160,932
	366,571	3,074	123	15,766	7,855	377,433
II. PROPERTY, PLANT AND EQUIPMENT						
1. Land, land rights and buildings including buildings on third-party land	6,024	40		349	4	6,409
2. Plant and machinery	18,067	195	8	1,350	468	19,136
3. Other equipment, furniture and fixtures	16,672	186	47	1,021	366	17,466
4. Leased assets	706	–4	90	0	57	555
	41,469	417	145	2,720	895	43,566
	408,040	3,491	268	18,486	8,750	420,999

TABLE 020

	Depreciation and amortization							Carrying amounts	
	Carried forward 01/01/2016	Exchange rate effects	Deconsoli-dation	Additions	Impairment losses	Disposals	As of 12/31/2016	As of 01/01/2016	As of 12/31/2016
	41,415	731	123	4,781	1,221	499	47,526	21,147	17,561
	97,451	1,669		10,242	13,416	6,737	116,041	46,247	35,373
	65,858	1,033			60,939		127,830	94,453	33,102
	204,724	**3,433**	**123**	**15,023**	**75,576**	**7,236**	**291,397**	**161,847**	**86,036**
	2,077	54		527			2,658	3,947	3,751
	14,646	217	7	1,649		422	16,083	3,421	3,053
	12,364	145	47	1,288		325	13,425	4,308	4,041
	625	– 1	52	10		27	555	81	0
	29,712	**415**	**106**	**3,474**	**0**	**774**	**32,721**	**11,757**	**10,845**
	234,436	**3,848**	**229**	**18,497**	**75,576**	**8,010**	**324,118**	**173,604**	**96,881**

CONSOLIDATED STATEMENT OF CHANGES IN NON-CURRENT ASSETS 2015 (IFRS)

	Acquisition and production cost						
IN €K	Carried forward 01/01/2015	Exchange rate effects	Deconsoli-dation	Reclassifi-cation	Additions	Disposals	As of 12/31/2015
I. INTANGIBLE ASSETS							
1. Other intangible assets	53,347	2,844	4,087		12,167	1,709	62,562
2. Internally generated intangible assets	126,656	5,078			11,964		143,698
3. Goodwill	157,073	3,238					160,311
	337,076	11,160	4,087	0	24,131	1,709	366,571
II. PROPERTY, PLANT AND EQUIPMENT							
1. Land, land rights and buildings including buildings on third-party land	4,482	254	12	45	1,255		6,024
2. Plant and machinery	18,397	654		−75	1,216	2,125	18,067
3. Other equipment, furniture and fixtures	15,845	607	65	29	2,012	1,756	16,672
4. Leased assets	746		40				706
	39,470	1,515	117	0	4,483	3,881	41,469
	376,546	12,675	4,204	0	28,614	5,590	408,040

TABLE 021

Depreciation and amortization								Carrying amounts	
Carried forward 01/01/2015	Exchange rate effects	Deconsoli-dation	Reclassifi-cation	Additions	Impairment losses	Disposals	As of 12/31/2015	As of 01/01/2015	As of 12/31/2015
40,390	2,161	4,083		4,689		1,742	41,415	12,957	21,147
78,528	3,694			12,911	2,318		97,451	48,128	46,247
65,852	6						65,858	91,221	94,453
184,770	**5,861**	**4,083**	**0**	**17,600**	**2,318**	**1,742**	**204,724**	**152,306**	**161,847**
1,392	165	5	45	480			2,077	3,090	3,947
14,810	617		−71	1,437		2,147	14,646	3,587	3,421
11,751	468	50	26	1,796		1,627	12,364	4,094	4,308
615	−1	25		36			625	131	81
28,568	**1,249**	**80**	**0**	**3,749**	**0**	**3,774**	**29,712**	**10,902**	**11,757**
213,338	**7,110**	**4,163**	**0**	**21,349**	**2,318**	**5,516**	**234,436**	**163,208**	**173,604**

NOTES TO THE 2016 CONSOLIDATED FINANCIAL STATEMENTS OF KONTRON AG

General information

The legal form of Kontron AG is a German stock corporation. It has its registered offices at 86156 Augsburg, Lise-Meitner-Strasse 3 – 5, Germany, and is filed with the commercial register of the Augsburg district court under HRB 28913.

The Kontron Group develops and produces embedded computer systems at various locations worldwide. Embedded computers (EC) are "electronic brains" based on hardware and software in order to equip a wide range of systems and devices with intelligence. Embedded computers are used in medical devices, telecommunications facilities, infotainment, transport systems, energy, the aerospace industry, security technology and industrial control systems. As a global provider, Kontron is active in the core markets in North America, Europe and Asia.

Financial reporting

Kontron AG prepared its consolidated financial statements for 2016 in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. All pronouncements of the International Accounting Standards Board (IASB) whose adoption is mandatory for the 2016 fiscal year were considered. New or amended standards are described in the section "New and amended standards and interpretations".

The financial statements give a true and fair view of the net assets, financial position and results of operations of the Kontron Group in accordance with International Financial Reporting Standards (IFRSs).

The consolidated financial statements have been prepared in euros. Unless otherwise specified, all amounts are stated in thousands of euro (€ k). Due to rounding differences, figures in tables and cross-references may differ slightly from the actual figures.

The consolidated financial statements and the group management report as of December 31, 2016 and 2015 were prepared in accordance with Sec. 315a (1) HGB ["Handelsgesetzbuch": German Commercial Code]. The consolidated financial statements and the group management report as of December 31, 2015 were submitted to and published in the *Bundesanzeiger* [German Federal Gazette].

New and amended standards and interpretations

The consolidated financial statements were prepared in euro and in accordance with the IFRSs as adopted by the EU. The accounting policies remained unchanged compared to the consolidated financial statements for the 2015 fiscal year.

The new or amended standards listed below must be applied for the first time in the 2016 fiscal year, but will not have significant effects on the net assets, financial position or results of operations of the Group.

- Amendments to IFRS 10, IFRS 12 and IAS 28: Investment Entities - Applying the Consolidation Exception
- Amendment to IAS 27: Equity Method in Separate Financial Statements.
- Amendment to IAS 1: Disclosure Initiative
- Annual Improvements to IFRS – 2012 – 2014
- Amendments to IAS 16 and IAS 38: Clarification of Acceptable Methods of Depreciation and Amortization
- Amendment to IFRS 11: Accounting for Acquisitions of Interests in Joint Operations

The standards and interpretations that are issued, but not yet mandatory, up to the date of issuance of the Group's financial statements are disclosed below.

IFRS 15 – IFRS 15 was issued on May 28, 2014 and contains new requirements on revenue recognition. IFRS 15 sets out a five-step model according to which revenues are recognized in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In addition, IFRS 15 results in new comprehensive disclosure requirements. The new standard replaces IAS 18 "Revenue", IAS 11 "Construction Contracts" as well as all related interpretations and is effective for fiscal years beginning on or after January 01, 2018. At present, the Group expects a modified retrospective application in the 2018 fiscal year. In the 2016 fiscal year, the Group carried out an initial preliminary and indicative assessment of IFRS 15 which may change in the course of a more detailed analysis. In the 2017 fiscal year, the Group will carry out an assessment of individual contracts in order to determine the specific effects that the introduction of IFRS 15 will have.

- Sale of ECT systems

The conversion of contracts with customers, in which the sale of embedded computers is generally expected to be the only performance obligation, is not expected to have any significant effects on revenue recognition under IFRS 15. Kontron expects the revenue recognition to occur at a point in time when control of the asset is transferred to the customer. As in the past, this is generally the case on delivery of the goods. Under IFRS 15, rights of return, trade discounts or volume rebates give rise to variable remuneration, which must be determined at the commencement of the contract. Under IFRS 15, the estimated variable consideration must be limited to prevent excessive revenue recognition. Due to application of the limitation rule under IFRS 15, it is expected that more revenues will be deferred than is currently the case.

- Rendering of services

The Group also generates revenues from technology consulting as well as service and maintenance agreements. The Group has preliminarily assessed that these services are rendered over time given that the customer simultaneously receives and consumes the benefits provided by the Group. On this basis, revenues are expected to continue to be recognized over a period of time, although the method for measuring progress must be analyzed.

- Brokerage services

Kontron concludes contracts with suppliers under which end customers are supplied directly in certain cases. Under IFRS 15, a distinction must be made in these cases whether the entity is acting as the principal or the agent. In the latter case, the revenues recognized are merely the "net" amount to which the entity is entitled to retain in return for its brokerage services.

- Warranties

The Group provides standard warranties for products and services supplied. In many cases, it can be assumed that these warranties provide assurance that the relevant product or service corresponds to the agreed specifications (assurance-type warranty) and must therefore be accounted for under IAS 37 in the future as well. If customers are offered additional, extended guarantees or maintenance services, these must be treated as separate performance obligations under IFRS 15, the revenues for which must be recognized over the period of the guarantee or warranty. In effect, revenue recognition is shifted into the future as a result. If such a service is offered as a package together with the sale of goods to customers, the total remuneration must be allocated to the performance obligations based on relative individual sales prices.

- Presentation and disclosure requirements

Under IFRS 15, quantitative and qualitative disclosures must be made on the reclassification of revenues, on performance obligations and contract balances as well as on significant estimates and capitalized contract costs, although many of these disclosure requirements are completely new. The Group will develop appropriate systems, policies and processes as well as internal controls in order to record and present the necessary information.

IFRS 9 – The final version of IFRS 9 Financial Instruments, which regulates the accounting for and measurement of financial instruments, was issued on July 24, 2014. This version of IFRS 9 now contains all sections pertaining to the classification and measurement, impairment and hedge accounting and becomes effective for fiscal years beginning on or after January 01, 2018. The sections that are new compared to previous versions comprise impairment regulations with respect to financial instruments and amended regulations concerning measurement categories for financial assets. The new IFRS 9 also contains guidance on the classification of financial assets. In connection with the application of classification and measurement methods as well as hedge accounting, which is currently not applied, the Group does not expect significant effects on the consolidated financial statements. Any effects in connection with the impairment of assets will be analyzed over the course of the 2017 fiscal year.

IFRS 16 – IFRS 16 Leases was released on January 13, 2016. According to this, the lessee must recognize the leased asset and the lease liability for most types of leases. The new standard on leases applies to all reporting years beginning on or after January 01, 2019 and replaces IAS 17. To date, payment obligations for operating leases merely had to be disclosed in the notes. However, the rights and obligations under these leases must be recognized as an asset (right of use granted for the leased item) and as a liability (lease liability) in the future. The Group does not expect this to lead to a significant increase in total assets at the date of first-time application. With regard to the amount related to the leases which must be recognized by the lessee in future periods, we also refer to note 30.

IAS 7 – In January 2016, IASB published amendments to IAS 7 Statement of cash flows in its disclosure initiative. The amendment requires entities to make disclosures that allow users of financial statements to understand cash and non-cash changes to liabilities resulting from financing activities. This amendment is effective for fiscal years beginning on or after January 01, 2017. Kontron will include the required reconciliation in the 2017 financial statements.

Early adoption of the above-mentioned releases is not currently planned.

The new regulations listed below will not have any effects on the net assets, financial position or results of operations of the Group.

- Amendments to IAS 12: Recognition of Deferred Tax Assets for Unrealized Losses
- Amendments to IFRS 2: Classification and Measurement of Share-based Payment Transactions

Basis of consolidation

Including Kontron AG, the basis of consolidation comprises a total of 14 companies (prior year: 15). The basis of consolidation was reduced by one company compared to the prior-year reporting date as a result of the sale of Railway Infrastructure and Integration Services Sp. z o.o., Warsaw, Poland.

In addition to Kontron AG, the following subsidiaries have been included in the consolidated financial statements as of December 31, 2016 in accordance with the regulations governing full consolidation:

BASIS OF CONSOLIDATION

IN % NAME AND REGISTERED OFFICE OF ENTITY	Share in capital
EMEA	
Kontron UK Ltd., Chichester, UK	100
Kontron ECT design s.r.o., Pilsen, Czech Republic	100
Kontron Europe GmbH, Augsburg	100
Kontron Modular Computers S.A.S., Toulon, France	100
Kontron Modular Computers AG, Cham, Switzerland	100
Kontron Technology A/S, Hørsholm, Denmark	100
Kontron Management GmbH, Augsburg	100
NORTH AMERICA	
Kontron America Inc., San Diego, USA	100
Kontron Canada Inc., Boisbriand, Canada	51
APAC	
Kontron Asia Pacific Design Sdn. Bhd., Penang, Malaysia	100
Kontron (Beijing) Technology Co. Ltd., Beijing, China	100
Kontron Hongkong Technology Co. Ltd., Hong Kong, China	100
Kontron Technology India Pvt. Ltd., Mumbai, India	100

TABLE 022

Joint ventures and associates are currently not included in Kontron AG's consolidated financial statements.

CHANGES IN BASIS OF CONSOLIDATION IN THE 2016 FISCAL YEAR

Railway Infrastructure and Integration Services Sp. z o.o., Warsaw, Poland

On May 04, 2016, Kontron Europe GmbH sold all of its shares in its subsidiary Railway Infrastructure and Integration Services Sp. z o.o., Warsaw, Poland. A purchase price of € 1 was paid for the shares. Taking into account the agreement concluded between the two contracting parties not to offset reciprocal outstanding receivables and liabilities, the deconsolidation of the company resulted in a loss of € 274k, which is reported under other operating expenses.

Accounting policies

The financial statements of Kontron AG and its German and foreign entities are prepared using uniform accounting policies in accordance with IFRS 10 *Consolidated Financial Statements*.

CONSOLIDATION PRINCIPLES

The assets and liabilities of German and foreign subsidiaries included in the consolidated financial statements are stated using the uniform accounting policies for the Kontron Group. Subsidiaries are fully consolidated from the date of acquisition, being the date on which the Group obtains control. The Group controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee. In addition, the Group must have the ability to affect those returns through its power over the investee. Control is generally assumed from the date on which the majority of voting rights are held and continue to be consolidated until the date that such control ceases.

Identifiable assets, liabilities and contingent liabilities of subsidiaries consolidated for the first time are recognized at their fair values as of the acquisition date. In the course of subsequent consolidation, identifiable assets, liabilities and contingent liabilities are carried forward, amortized or reversed. The cost of an acquisition is the aggregate of the consideration transferred, measured at acquisition date fair values and the amount of any non-controlling interest in the acquiree. For each business combination, the Group elects whether it measures the non-controlling interest in the acquiree either at fair value or at the proportionate share of the acquiree's identifiable net assets. Acquisition-related costs are expensed as incurred and included in general and administrative cost. Any contingent consideration to be transferred by the acquirer is recognized at fair value at the acquisition date. Subsequent changes to the fair value of the contingent consideration which is deemed to be an asset or liability is recognized either in profit or loss in other operating income / expenses or as a change to other comprehensive income.

Goodwill arising from consolidation is tested regularly for impairment as of the reporting date and impairment losses recorded as necessary. Each impairment loss is immediately recorded as an expense. The impairment cannot be reversed. Changes in the parent's ownership interest in a subsidiary that do not result in a loss of control are accounted for as an equity transaction.

All intra-group balances, income and expenses and unrealized gains and losses resulting from intra-group transactions are eliminated in full.

Group inventories and non-current assets are adjusted for intercompany profits and losses.

Effects of consolidation on income taxes are accounted for by recognizing deferred taxes.

CURRENCY TRANSLATION

The Group's consolidated financial statements are presented in euros, which is also the parent company's currency. Each entity in the Group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency. Transactions in foreign currencies are initially recorded at the functional currency rate prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the closing rate. All exchange differences are taken to profit or loss. Net assets, financial position and results of operations of foreign operations are translated into euros as follows: On consolidation, the assets and liabilities of foreign operations are translated to euro at the rate of exchange prevailing as of the reporting date. Income and expenses are translated at the annual average rate. Any resulting exchange differences are recognized separately in equity.

On disposal of a foreign operation, the component of other comprehensive income relating to that particular foreign operation is reclassified to profit or loss. The exchange rates for the Kontron Group's most important currencies changed as follows on the prior year:

EXCHANGE RATES

	Closing rate (based on € 1)		Average rate (based on € 1)	
	12/31/2016	12/31/2015	**2016**	2015
US dollar	1.05	1.09	1.11	1.11
Pound sterling	0.86	0.73	0.82	0.73
Danish krone	7.43	7.46	7.45	7.46
Swiss franc	1.07	1.08	1.09	1.07
Chinese yuan	7.32	7.06	7.35	6.97
Polish zloty	4.41	4.26	4.37	4.18
Czech koruna	27.02	27.02	27.03	27.28
Malaysian ringgit	4.73	4.70	4.58	4.33
Indian rupee	71.59	72.02	74.35	71.16

TABLE 023

RECOGNITION OF REVENUES AND EXPENSES

Revenues are recognized to the extent that it is probable that the economic benefits will flow to the Group and the revenues can be reliably measured. Revenues are measured at the fair value of the consideration received excluding discounts, rebates, and VAT or other dues.

If an acquirer is required to issue a declaration of acceptance, the corresponding revenues will only be recognized once such a declaration has been made. Where sales of products or services involve the provision of multiple elements which may contain different remuneration arrangements such as upfront, milestone and other payments, they are assessed to determine whether individual elements of such arrangements have to be recognized at different points in time. Contractually agreed prepayments and other non-recurring expenses are deferred and released over the period of the contractually agreed counterperformance through profit or loss.

The specific recognition criteria described below must also be met before revenues are recognized:

Sale of goods

Revenues from the sale of goods are recognized when the significant risks and rewards of ownership of the goods have passed to the buyer. This is generally the case upon delivery of the goods and merchandise, as real net output concludes for the company at this point in time. Revenues are presented net of discounts, rebates and returns.

Rendering of services

Revenues from services and technology consulting are recognized when the services have been rendered. Revenues from maintenance agreements are released on a straight-line basis over the term of the maintenance agreement.

Interest income

Interest income is recognized using the effective interest method.

Operating expenses

Operating expenses are recognized through profit or loss when services are used or at the time they are incurred.

GOVERNMENT GRANTS

Government grants are recognized where there is reasonable assurance that the grant will be received and all attached conditions will be complied with. When the grant relates to an expense item, it is recognized as income over the period necessary to match the grant on a systematic basis to the costs that it is intended to compensate. Government grants in connection with fixed assets are deducted from the carrying amount of the asset in accordance with the option in IAS 20.

BORROWING COSTS

Borrowing costs directly attributable to the acquisition, construction or production of an asset that necessarily takes a substantial period of time to get ready for its intended use or sale are capitalized as part of the cost of the respective assets. All other borrowing costs are expensed in the period they occur. Borrowing costs consist of interest and other costs that an entity incurs in connection with the borrowing of funds.

TRADE RECEIVABLES

Trade receivables are measured at nominal value. Recognizable individual risks are accounted for by bad debt allowances that are recorded separately using an allowance account. Write-downs on receivables are charged directly in the actual event of default.

INVENTORIES

Inventories are stated at the lower of cost or net realizable value, typically using the weighted average cost method. In addition to directly allocable costs, production cost also includes production and materials overheads and depreciation. Fixed overheads are included based on the normal utilization of production facilities. Write-downs are recorded on inventories when the costs of purchase or costs of conversion exceed the estimated net realizable value.

FINANCIAL INSTRUMENTS

A financial instrument is any contract that gives rise to a financial asset at one entity and a financial liability or equity instrument at another entity. This includes both non-derivative financial instruments such as trade receivables and trade payables or financial receivables and financial liabilities as well as derivative financial instruments that are used to hedge against interest rate and currency risks. For regular way purchases and sales, non-derivative financial instruments are recognized on the trade date, i.e., the date on which an asset is delivered to or by an entity. By contrast, derivative financial instruments are recognized upon the inception of the agreement.

IAS 39 classifies financial assets into the following categories:

- Financial assets at fair value through profit or loss
- Held-to-maturity investments
- Loans and receivables
- Available-for-sale financial assets

Financial liabilities are classified into the following categories:

- Financial liabilities at fair value through profit or loss
- Financial liabilities measured at amortized cost

Kontron recognizes financial instruments at amortized cost or at fair value. The amortized cost of a financial asset or financial liability is the amount at which the

- financial asset or liability is measured at initial recognition
- net of any principal repayment
- plus or minus the cumulative amortization of any difference between that initial amount and the maturity amount using the effective interest method.

The amortized cost of current receivables and payables generally corresponds to the nominal value or settlement amount. Fair value is generally the market value. If no active market exists, fair value is calculated using valuation models, for example by discounting future cash flows using the market interest rate.

Derivative financial instruments are measured at fair value through profit or loss. Forward exchange contracts concluded within the Kontron Group serve to economically hedge transactions in foreign currency. The gain or loss arising from fair value measurement is presented in the operating result but not as a hedge in the sense of IAS 39 Financial Instruments: Recognition and Measurement.

Financial assets comprise available-for-sale financial assets. After initial measurement, available-for-sale financial assets are measured at fair value in subsequent periods. Unrealized gains or losses are recognized as other comprehensive income in the available-for-sale reserve. When the investment is derecognized, the cumulative gain or loss is reclassified to other operating income. If the investment is determined to be impaired, the cumulative loss is reclassified from the available-for-sale reserve to finance expense through profit or loss.

DERECOGNITION OF FINANCIAL INSTRUMENTS

Financial assets

A financial asset is derecognized when one of the three following requirements is met:

- The contractual rights to the cash flows from the financial asset expire.
- The Group retains the contractual rights to receive cash flows from financial assets, but assumes a contractual obligation to pay those cash flows to a third party without material delay as part of an agreement that fulfills the conditions in IAS 39.19 (“pass-through arrangement”).
- The Group has transferred the contractual rights to receive cash flows of a financial asset and (a) has transferred substantially all the risks and rewards of ownership of the financial asset or (b) has neither transferred nor retained substantially all risks and rewards of ownership of the asset, but has transferred control of the asset.

Financial liabilities

A financial liability is derecognized when the obligation under the liability is discharged or canceled or expires.

When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as the derecognition of the original liability and the recognition of a new liability. The difference in the respective carrying amounts is recognized through profit or loss.

PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment is stated at cost, net of any depreciation. The Kontron Group typically applies straight-line depreciation. Cost includes acquisition cost, incidentals and cost reductions. If the cost of certain components of property, plant and equipment proves material as a percentage of total cost, these components are then recognized separately and written down.

Depreciation is primarily based on the following useful lives:

USEFUL LIVES OF PROPERTY, PLANT AND EQUIPMENT

YEARS	
Buildings and leasehold improvements	4 – 25
Plant and machinery	3 – 10
Other equipment, furniture and fixtures	3 – 10

TABLE 024

Assets that have been written down in full will continue to be included under cost and accumulated depreciation until they have been taken out of operation. If an asset is sold, the cost and accumulated depreciation are deducted and gains or losses on the disposal of assets (disposal income less net carrying amount) are recognized in the statement of income under other operating income or other operating expenses. Depreciation of property, plant and equipment is allocated to the respective function. The residual value, useful lives and methods of depreciation are reviewed, and adjusted if appropriate, at each fiscal year end.

NON-CURRENT ASSETS AND DISPOSAL GROUPS HELD FOR SALE

The Group classifies non-current assets and disposal groups as held for sale if their carrying amounts will be recovered through a sale transaction rather than through continuing use. Non-current assets and disposal groups classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell. The conditions to be classified as held for sale are only regarded as met when the sale is highly probable and the asset or disposal group is available for immediate sale in its present condition. Management must be committed to the sale, which should be expected to qualify for recognition as a completed sale within one year from the date of classification.

Property, plant and equipment and intangible assets are not depreciated or amortized once classified as held for sale.

INTANGIBLE ASSETS

Intangible assets acquired for a consideration are recognized at acquisition cost taking into account incidentals and cost reductions and amortized on a straight-line basis over their estimated useful lives.

Franchises, rights and licenses relate to purchased computer software. Amortization is allocated to the respective function.

Research costs are expensed as incurred. An intangible asset arising from development expenditures on an individual project is recognized only when the Group can demonstrate the technical feasibility of completing the intangible asset so that it will be available for internal use or sale and its intention to complete the intangible asset and its ability to use or sell it. In addition, the Group must substantiate the creation of a future economic benefit by the asset, the availability of resources to complete the asset and the ability to measure reliably the expenses allocable to the intangible asset during its development. Following initial recognition of the development expenditure as an asset, the cost model is applied requiring the asset to be carried at cost less any accumulated amortization and accumulated impairment losses. Amortization of the asset begins when the asset is available for use. It is amortized over the period of expected future benefit. Amortization of capitalized development costs are recognized under cost of goods sold. The residual value, useful lives and methods of amortization are reviewed, and adjusted if appropriate, at each fiscal year end. During the period of development, the asset is tested for impairment on an annual basis. Capitalized development costs comprise all costs and overheads directly attributable to the development process.

Amortization is primarily based on the following useful lives:

USEFUL LIVES OF INTANGIBLE ASSETS

YEARS	
Other intangible assets	3 – 10
Capitalized development costs	5 – 10

TABLE 025

IMPAIRMENT OF NON-FINANCIAL ASSETS

The Group assesses at each reporting date whether there is an indication that a non-financial asset may be impaired. If there are such indications or an annual review of the value of an asset is required, the Group estimates the recoverable amount of the relevant asset. An asset's recoverable amount is the higher of an asset's or cash-generating unit's (CGU) fair value less costs to sell and its value in use. The recoverable amount is determined for each individual asset. Where the carrying amount of an asset or CGU exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. In assessing the value in use and fair value less cost of disposal, the estimated future cash flows are discounted to their present value.

For assets excluding goodwill, an assessment is made at each reporting date as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. If such indication exists, the Group estimates the asset's or CGU's recoverable amount. A previously recognized impairment expense is only reversed if a change in the assumptions on the basis of which the recoverable amount was determined has occurred since the last reported impairment expense. The increase in value is limited to the extent that the carrying amount of an asset must neither exceed its recoverable amount nor the carrying amount which would have resulted after taking into account scheduled amortization if no impairment expense had been recognized for the asset in prior years.

The following criteria are also applied in assessing impairment of specific assets:

GOODWILL

Goodwill is tested for impairment once a year and when circumstances indicate that the carrying value may be impaired. Impairment is determined for goodwill by assessing the recoverable amount of each CGU to which the goodwill relates. In the Kontron Group, CGUs correspond to the operating segments. Where the recoverable amount of the cash-generating unit is less than their carrying amount an impairment loss is recognized. Impairment losses relating to goodwill cannot be reversed in future periods.

INTANGIBLE ASSETS

Intangible assets with indefinite useful lives and development projects that are still being developed are tested for impairment at least once annually as of December 31 either individually or at the cash generating unit level, as appropriate and when circumstances indicate that the carrying value may be impaired. Impairment tests are also conducted when circumstances indicate that the carrying value may be impaired.

Impairment losses on property, plant and equipment are recognized in other operating expenses. Impairment losses on internally generated intangible assets are recognized in the cost of goods sold. Impairment losses on goodwill are recorded in a separate line in earnings before financial result and income taxes.

TAXES

Current tax assets and liabilities

Current income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the end of the reporting period. Management periodically evaluates tax matters with respect to situations in which applicable tax regulations are subject to interpretation and establishes tax provisions where appropriate.

Deferred taxes

Deferred taxes are accounted for using the liability method in accordance with IAS 12. According to this method, deferred taxes have to be recorded for all temporary differences between the carrying amounts in the tax accounts and the consolidated statement of financial position (temporary concept). Deferred taxes on loss carryforwards are also to be recognized.

Deferred taxes are calculated based on the tax rates enacted or substantively enacted by the reporting date that apply or are expected to apply in the countries concerned at the time of realization.

Deferred tax assets comprise future tax relief from temporary differences between the carrying amounts in the consolidated statement of financial position and in the tax accounts. Furthermore, deferred tax assets are also recognized for unused tax losses as well as tax privileges that can be realized in the future. The determining factor in assessing the recoverability of deferred tax assets is the probability estimate of the reversal of measurement differences and the usability of loss carryforwards or tax privileges that have led to the recognition of deferred tax assets. This depends on whether there will be taxable profit in the periods in which unused tax losses can be utilized.

Deferred tax assets may be netted against deferred tax liabilities if they are levied by the same taxation authority and offsetting is permitted.

Deferred taxes are generally considered non-current.

TRADE PAYABLES

Trade payables are non-interest bearing and are carried at nominal value.

LEASES

In accordance with IAS 17, property, plant and equipment acquired under leases is capitalized if the criteria for a finance lease have been fulfilled, i.e., if the risks and rewards incidental to ownership have been transferred to the lessee. The lease is capitalized at the commencement of the lease at fair value of the leased property or, if lower, the present value of the minimum lease payments at the time the contract is entered into and depreciated on a straight-line basis over the economic useful life or the term of the lease, whichever is shorter. Payment obligations arising from future lease payments are recognized at the present value of the lease payments as a liability.

If the economic ownership in the lease agreements lies with the lessor (operating lease), the leased asset is accounted for by the lessor. Lease expenses incurred are expensed in full.

The determination of whether an arrangement is, or contains, a lease is based on the substance of the arrangement at inception date and requires an assessment of whether the fulfillment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

A sale-and-leaseback transaction comprises the sale of an asset that is already owned by a future lessee to a lessor and the subsequent continued use of the asset by the lessee under a lease agreement. There are two economically-related agreements, the purchase agreement and the lease agreement. Both are presented in a single transaction by the lessee, which is accounted for as an operating lease or a finance lease depending on the structure of the leaseback agreement.

OTHER PROVISIONS

Provisions are recognized if there is an obligation to a third party from a past event which will probably lead to an outflow of resources embodying economic benefits and the amount of the obligation can be reliably estimated.

Provisions for warranty-related costs are recognized when the product is sold or service provided. Initial recognition is based on historical experience. The initial estimate of warranty-related costs is reviewed annually.

Restructuring provisions are recognized only when the Group has a constructive obligation, which is when a detailed formal plan about the business or part of the business concerned, the location and number of employees affected, a detailed estimate of the associated costs and appropriate timeline, and the employees affected have been notified of the plan’s main features.

A provision for compensation payments is recognized if the Group can no longer withdraw its offer for compensation or the Group has recognized the associated restructuring cost, whichever occurs first.

In accordance with IAS 37, the amount recognized as other provisions is the best estimate of the expenditure required to settle the present obligation without considering recourse claims. Provisions with a residual term of more than one year must be stated at their prospective settlement value discounted to the reporting date. Releases of provisions are posted to those line items in profit or loss to which the provision was originally charged.

OBLIGATIONS FROM PENSION PLANS

In the case of defined benefit plans, Kontron determines benefit obligations using the actuarial present value of the benefits earned. The calculated present value of the defined benefit obligation also takes into consideration future salary increases and pension increases as the obligation reflects the pension entitlement that could be earned by the regular age of retirement.

Remeasurements, including actuarial gains and losses, changes resulting from the application of an asset ceiling and the return on any plan assets (without net interest), are recognized in other comprehensive income and retained earnings under equity after tax in the year in which they arise. These amounts are not subsequently reclassified to the statement of income.

Past service cost is recorded immediately in profit or loss. Net interest results from applying the discount rate on the total (asset or liability) from the defined benefit plan. The Group recognizes service cost based on its function in the cost of goods sold, general and administrative cost or selling and marketing cost in the statement of income. Net interest is included in the financial result.

FINANCIAL LIABILITIES AND EQUITY

Financial liabilities and equity instruments are classified based on the economic substance of the respective underlying contracts. An equity instrument is defined as any contract that is based on the residual amount of a group asset after deducting all liabilities. Equity instruments are included at income received less issue costs incurred.

TREASURY SHARES

If the Group reacquires own equity instruments (treasury shares), these are recognized at acquisition cost and deducted from equity. No gain or loss is recognized in the statement of income on the purchase, sale, issue or cancellation of treasury shares. Any difference between the carrying amount and the consideration is recognized in additional paid-in capital.

OBLIGATIONS FROM SHARE-BASED PAYMENTS

The Kontron Group grants cash-settled share-based payments to certain employees. The cost of cash-settled transactions is measured initially at fair value at the grant date using a binomial model. This fair value is expensed over the period until the vesting date with recognition of a corresponding liability. The liability is remeasured to fair value at each reporting date up to and including the settlement date. Changes in fair value are recognized immediately in the employee benefits expense.

Significant accounting estimates and assumptions

Judgments

In the process of applying the Group's accounting policies, management has made the following judgments, which have a significant effect on the amounts recognized in the consolidated financial statements:

Classification of expenses as restructuring cost (see note (4))

The Kontron Group recorded restructuring cost in a separate item in the statement of income. Expenses are recognized as restructuring cost if they relate to expenses incurred in connection with the realignment of the Kontron Group that shall be completed by end of 2017. These relate in particular to expenses for personnel measures.

Estimates

The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the amounts recorded for assets, liabilities and contingent liabilities as of the reporting date as well as the amount recognized for income and expenses in the reporting period. Actual amounts may diverge from these estimates. Estimates are required in particular in order to:

- assess the need for and amount of amortization or impairment losses of intangible assets including capitalized goodwill (see note (15) for details on estimates and assumptions)
- recognize and measure provisions
- determine the need for write-downs of inventories
- determine the recoverability of deferred tax assets
- determine valuation allowances on receivables (see note (11))

Recognition and measurement of provisions

The company recognized provisions totaling € 17,811k in the fiscal year for restructuring initiated in the second half of the year. The provision mainly relates to expenses for personnel measures and was estimated based on the planned and communicated reduction in personnel, taking into account expected payments due to the termination of employment relationships. Actual costs may differ from the estimate as of the reporting date due to ongoing negotiations.

Due to the decrease in revenues in the 2016 fiscal year, the company recognized provisions of € 3,593k for potential losses from procurement transactions entered into before the reporting date. The provision is based on requirements planning for the coming fiscal year. The actual burden is largely dependent on future performance.

The company recognized provisions in the upper single-digit million range for individual contractual risks from sales transactions and warranties. The estimates are based on estimated costs of rectification and compensation claims. The provisions are based on judgment. The actual burdens are dependent on future developments and on a future agreement being reached with the contracting parties.

Determine the need for write-downs of inventories

Write-downs of inventories are measured based on the inventory range and the net realizable value (estimated proceeds less estimated costs of completion and estimated costs necessary to make the sale). Future consumption, actual proceeds and costs to complete may diverge from the expected amounts. The parameters for write-downs of inventories based on the inventory range were adjusted in 2016. This was due to an improvement in the management of material requirements achieved with the SAP system introduced in 2016 as well as changes in the product portfolio. The adjustment resulted in an impairment of € 4.1 million in the fiscal year 2016. The change also has an impact on the amount of the impairments in subsequent periods.

Determining the recoverability of deferred tax assets

Deferred tax assets are recognized to the extent that their recovery is likely, i.e., taxable profits are expected in future periods. Due to the company's history of losses and based on its planning for the coming fiscal years, the company assumes that it will not be possible to utilize loss carryforwards recognized at significant group entities. Actual taxable profits in future periods may diverge from the estimates prepared as of the reporting date. The carrying amount of deferred tax assets totals € 6,566k as of the reporting date (prior year: € 15,772k). Further information can be found in note (7).

NOTES TO THE CONSOLIDATED STATEMENT OF INCOME

1. Revenues

Revenues break down as follows:

IN €K	2016	2015
Revenues from the sale of goods	369,496	453,990
Revenues from construction contracts	0	616
Revenues from services	15,629	13,045
	385,125	**467,651**

TABLE 026

A breakdown by business units and regions is shown in segment reporting in note (35).

2. Personnel expenses

IN €K	2016	2015
Wages and salaries	84,059	81,684
Social security expenses	16,685	17,077
Severance payments	15,218	3,734
	115,962	**102,495**

TABLE 027

Personnel expenses increased by 13.1 % to € 115,962k mainly due to severance payments in connection with the restructuring program initiated in the second half of 2016. Social security expenses include pension expenses of € 11k (prior year: € 76k). Information concerning pension provisions can be found in note (20).

As a long-term incentive, the company grants performance options plans, which are explained in note (32).

Contributions to the statutory pension insurance scheme total € 2,426k (prior year: € 2,393k).

AVERAGE HEADCOUNT BY FUNCTION

	2016	2015
Production	318	331
Research & Development (R&D)	402	399
Sales & Marketing	357	362
Administration & IT	178	182
ANNUAL AVERAGE	**1,255**	**1,274**

TABLE 028

AVERAGE HEADCOUNT BY REGION

	2016	2015
EMEA	669	686
North America	380	405
APAC	206	183
ANNUAL AVERAGE	**1,255**	**1,274**

TABLE 029

3. Operating expenses

IN €K	2016	2015
Personnel expenses	71,121	69,912
Legal, consulting and audit fees	10,618	6,390
Outsourcing	10,191	8,130
Depreciation and amortization	8,484	6,582
Rent, building and fixtures maintenance	6,795	6,540
Travel expenses	3,820	3,628
Office material and internal material requirements	2,903	2,902
Allowances recognized for trade receivables	2,657	–858
Advertising	2,369	3,023
Telephone and communication	1,291	1,264
Insurance and bank charges	1,254	1,328
Vehicle fleet	1,158	1,331
Repairs and maintenance	529	1,561
Sundry	111	–143
	123,301	111,590

TABLE 030

The costs listed above comprise expenses for sales and marketing, research and development as well as general administration.

Development costs included in current operating expenses that do not meet the IFRS recognition criteria are treated as expenses for the current fiscal year. These expenses amount to € 29,861k in the 2016 fiscal year (prior year: € 29,999k).

Depreciation and amortization recognized in current operating expenses pertain to write-downs of non-current assets, with the exception of amortization of capitalized development project costs. Amortization of capitalized development projects of € 23,658k (thereof impairment losses: € 13,416k) is disclosed in full under the cost of goods sold (prior year: € 15,229k – thereof impairment losses: € 2,318k).

4. Restructuring cost

Of the restructuring cost recorded for the 2016 fiscal year, € 17,985k relates to the restructuring program initiated in the second half of 2016 and mainly consists of personnel-related measures as well as consulting costs. The further implementation of measures from the “New Kontron” program to cut costs and enhance efficiency (CRP) gave rise to costs of € 983k in 2013. Reversals of provisions of € 1,755k, which were recognized in connection with the “New Kontron” program, had the opposite effect.

OVERVIEW OF RESTRUCTURING COST

IN €K	2016	2015
Expenses for personnel restructuring	16,221	5,401
Expenses for reorganization / restructuring, IT	2,747	3,104
Measurement effects in sales / customers	0	650
Income from the reversal of the provision no longer needed	– 1,755	– 850
	17,213	8,305

TABLE 031

5. Other operating income and expenses

IN €K	2016	2015
Exchange rate gains	15,920	22,987
Income from the reversal of provisions	1,941	54
Income from the disposal of assets	688	90
Private motor vehicle use	444	0
Income from the reversal of specific bad debt allowances	323	0
Indemnification payments and reimbursements	61	1,236
Subsidies	0	152
Income from the deconsolidation of subsidiaries	0	1,993
Sundry income	439	190
OTHER OPERATING INCOME	19,816	26,702
Exchange rate losses	14,956	22,181
Losses on the disposal of assets	578	0
Loss from the deconsolidation of subsidiaries	274	0
Other taxes	99	105
Sundry expenses	210	155
OTHER OPERATING EXPENSES	16,117	22,441

TABLE 032

Other operating income and expenses mainly contain realized and unrealized exchange rate gains and losses on receivables and liabilities denominated in foreign currencies.

6. Financial result

IN €K	2016	2015
Interest income	23	38
Other finance income	0	107
FINANCE INCOME	23	145
Interest and similar expenses	1,029	1,062
Credit facility transaction costs	744	505
Credit facility guarantees and standby fees	290	321
Expenses from derivative financial instruments	0	106
Other finance expenses	152	243
FINANCE EXPENSE	2,215	2,237
FINANCIAL RESULT	– 2,192	– 2,092

TABLE 033

7. Income taxes

Income tax expense breaks down as follows:

IN €K	2016	2015
Current income tax	– 1,906	– 8,123
Relating to origination and reversal of temporary differences	– 1,834	1,326
TAXES REPORTED IN THE CONSOLIDATED STATEMENT OF INCOME	– 3,740	– 6,797

TABLE 034

Income tax expense comprises corporate income tax and trade tax for German entities as well as comparable taxes levied at foreign entities. Other taxes are included under other operating expenses.

Kontron AG applies an income tax rate of 32.3 % in Germany (prior year: 31.1 %).

The tax rates outside of Germany range between 15 % and 45 %.

The other comprehensive income of the Group includes income taxes of € 17k on actuarial gains and losses from pension plans (prior year: € 38k).

The following table presents the reconciliation of the expected income tax expense that would theoretically result from applying the current income tax rate in Germany of 32.3 % (prior year: 31.1 %) to the current tax expense reporting by the Group.

RECONCILIATION OF INCOME TAX EXPENSE

IN €K	2016	2015
Income / loss before tax	– 143,869	4,097
Group income tax rate	32.28 %	31.10 %
Estimated tax effect	46,441	– 1,272
Effect of other tax rates from foreign operations	967	– 184
Effect of impairment loss on goodwill	– 19,671	
Share of taxes for differences, losses and tax credits for which no deferred taxes were recognized	– 10,022	– 5,453
Income / government grants exempted from tax	354	62
Non-deductible expenses	– 2,209	– 849
Tax expense / refunds for prior years	– 4,124	– 3,350
Adjustments of deferred tax from prior years	– 13,920	3,527
Other	– 1,556	722
INCOME TAXES REPORTED	**– 3,740**	– 6,797
Income tax rate	2.60 %	166.00 %

TABLE 035

In the 2016 fiscal year, income tax expense reported totals € 3,740k (prior year: € 6,797k). Government grants exempted from tax stem from tax credits for research and development for the entity Kontron Modular Computers S.A.S.

The total amount of deferred tax assets and liabilities as of December 31, 2016 and December 31, 2015 relates to the following items:

DEFERRED TAX ASSETS / LIABILITIES

	Deferred tax assets		Deferred tax liabilities	
IN €K	**2016**	2015	**2016**	2015
Property, plant and equipment	1	26	130	527
Other intangible assets	342	325	6,577	13,107
Inventories	1,094	2,719	33	230
Receivables / other receivables	510	600	535	593
Provisions and accruals	9,947	3,231	952	1,300
Liabilities / other liabilities	938	75	19	1,127
Loss carryforwards	286	15,560	0	0
Tax credits for research and development	1,654	2,994	0	0
Other	40	210	0	313
GROSS AMOUNT	**14,812**	25,740	**8,246**	17,197
Offsetting	8,246	9,968	8,246	9,968
DISCLOSURE	**6,566**	15,772	**0**	7,229
NET DEFERRED TAX LIABILITIES			**– 6,566**	– 8,543

TABLE 036

TAX INCOME / EXPENSE

IN €K	**2016**	2015
AS OF JANUARY 01	**8,543**	7,291
Tax income / expense during the reporting period recognized in profit or loss	– 1,834	1,326
Tax income / expense during the reporting period recognized in other comprehensive income	– 17	– 38
Exchange rate differences / tax income / expense not recognized in tax expense	– 126	– 36
AS OF DECEMBER 31	**6,566**	8,543

TABLE 037

It is possible to deduct certain research and development expenses from taxes in Canada. The capitalized tax credits for research and development reduce future tax payments at Kontron Canada Inc. The tax credits may be carried forward for 20 years.

Deferred tax assets may be netted against deferred tax liabilities if they are levied by the same taxation authority and offsetting is permitted. Deferred tax assets netted against deferred tax liabilities amount to € 8,246k in the 2016 fiscal year. Deferred tax assets of € 6,566k are recognized in the consolidated statement of financial position.

Unused tax losses break down as follows:

UNUSED TAX LOSSES

IN €K	2016	2015
Can be carried forward 1 year	0	0
Can be carried forward 10 years	12,611	6,442
Can be carried forward more than 10 years	37,400	23,745
Can be carried forward indefinitely	82,821	94,507
	132,832	124,694
Recognition of unused tax losses	– 1,021	– 45,851
UNUSED TAX LOSSES	131,811	78,843

TABLE 038

Unused tax losses originate from Kontron AG and the subsidiaries, Kontron Europe GmbH, Kontron Modular Computers AG, Kontron America Inc., Kontron Modular Computers S.A.S., Kontron Technology A / S and Kontron Asia Pacific Design Sdn. Bhd.

No deferred tax assets were recognized on the unused tax losses of Kontron AG of € 53,821k as there is no prospect of taxable income against which they could be used in the future based on the current business planning.

On account of the sale of production at Kontron Asia Pacific Design Sdn Bhd the entity lost its pioneer status in 2012 and the associated tax exemption. At the same time, the loss of the pioneer status means that unused loss carryforwards of € 25,969k can be used in the future. Due to the company's history of losses, it was not however possible to account for the loss carryforwards in the 2016 fiscal year.

Based on the current business planning, no deferred tax assets were recognized on the unused tax losses of Kontron America Inc. of € 38,856k.

Based on the current business planning, deferred tax assets were only recognized on unused tax losses of € 1,021k of the total unused tax losses of Kontron Modular Computers S.A.S. (€ 8,030k).

Kontron Modular Computers AG is purely a holding company, which will not generate sufficient profit to utilize unused tax losses of € 3,125k in the future.

Kontron Technology A/S's unused tax losses of € 3,032k will most likely be forfeited on account of the planned restructuring of the entity.

As of December 31, 2016, no deferred tax liabilities were recognized on the accumulated profits of subsidiaries of € 69,323k (December 31, 2015: € 77,917k) as it is intended to reinvest these profits for an indefinite period.

In the course of the planned merger of Kontron AG with S&T Deutschland Holding AG, the unused tax losses of the German companies will be forfeited.

8. Non-current assets held for sale

A property no longer used by the Group and with a carrying amount of € 3,357k as of December 31, 2015 was sold as planned in the fiscal year.

NOTES TO THE CONSOLIDATED STATEMENT OF FINANCIAL POSITION

9. Cash and cash equivalents

Cash and cash equivalents totaling € 43,787k (prior year: € 27,823k) consist of cash on hand, checks and bank balances that are available within three months of deposit and earn interest at the respective short-term deposit rates.

Cash and cash equivalents include credit balances blocked in favor of third parties of € 3,259k. In addition, there are foreign exchange and corporate law restrictions. An amount of € 16,505k from the cash and cash equivalents presented therefore cannot be included in the Group's cash management system. As such, this amount is not directly available to Kontron AG.

10. Inventories

Inventories break down as follows:

INVENTORIES

IN €K	2016	2015
Raw materials, consumables and supplies	24,102	34,972
Work in process	12,387	12,876
Finished goods and merchandise	23,609	33,333
Prepayments	401	2,152
	60,499	83,333

TABLE 039

Inventories are measured at the lower of cost and net realizable value. Net realizable value is the estimated sales price less all estimated costs to complete and selling and marketing costs.

Write-downs of inventories recognized as an expense amounted to € 24,356k (prior year: € 6,989k), of which € 1,099k relates to scrapping. This amount is recognized under cost of goods sold.

Inventories are determined using end-of-year or perpetual inventory-taking.

As of the reporting date, there were neither receivables (prior year: € 0k) nor obligations from construction contracts (prior year: € 8k). In the 2015 fiscal year, revenues of € 616k and costs of € 564k were reported in connection with construction contracts.

11. Trade receivables

Receivables and other assets are accounted for at nominal value or at amortized cost. All recognizable risks are covered by appropriate allowances. The general credit risk is accounted for by allowances based on past experience, an aging analysis as well as the value of the assets according to prudent business judgment.

The line item “Trade receivables” comprises the following items:

TRADE RECEIVABLES

IN €K	2016	2015
Trade receivables	98,051	154,068
Impairments	– 30,631	– 31,384
	67,420	122,684

TABLE 040

As of December 31, 2016, trade receivables with a face value of € 34,087k were impaired (prior year: € 32,415k).

Movements in the bad debt allowance were as follows:

BAD DEBT ALLOWANCES

IN €K	2016	2015
Impairments as of January 01	– 31,384	– 35,030
Charge for the year	– 3,359	– 1,677
Utilized	2,994	1,714
Reversed	919	819
Exchange rate effects	199	2,790
IMPAIRMENTS AS OF DECEMBER 31	**– 30,631**	– 31,384

TABLE 041

The amount brought forward from the prior year primarily contains impairment losses at the level of Kontron Asia Pacific Design Sdn. Bhd., which were recognized in 2010 in connection with a case of suspected fraud. Additions totaling € 3,359k in 2016 (prior year: € 1,677k) consist of additions to specific bad debt allowances of € 2,085k (prior year: € 765k) and portfolio-based bad debt allowances of € 1,274k (prior year: € 912k).

The aging analysis of trade receivables is as follows:

AGING ANALYSIS OF RECEIVABLES

			thereof: not impaired but past due by					
IN €K	Face value	thereof: neither past due nor impaired	less than 30 days	between 31 and 60 days	between 61 and 150 days	between 151 and 240 days	between 241 and 330 days	more than 330 days
12/31/2016	98,051	52,414	9,130	1,046	249	40	785	300
12/31/2015	154,068	100,338	15,959	3,093	879	382	347	655

TABLE 042

With respect to the trade receivables that were neither impaired nor past due, there was no indication as of the reporting date that the debtors would fail to meet their payment obligations. This also applies to past due trade receivables that are not impaired.

12. Other receivables and assets

Other receivables and assets are composed of the following items:

OTHER CURRENT RECEIVABLES AND ASSETS

IN €K	2016	2015
VAT receivables	3,042	3,052
Security deposits for contract manufacturers	2,560	0
Prepaid expenses	2,447	2,167
Receivables from escalation clauses	1,684	1,684
Short-term securities	890	1,384
Other prepayments	712	0
Other tax receivables	639	618
Security deposits	307	168
Creditors with debit balances	261	420
Receivables from supplier bonuses	159	452
Receivables from derivative financial instruments	58	258
Receivables from personnel	34	107
Sundry	448	225
	13,241	10,535

TABLE 043

OTHER NON-CURRENT RECEIVABLES AND ASSETS

IN €K	2016	2015
Security deposits	393	383
Prepaid expenses	0	781
Receivables from the disposal of an entity	0	230
Sundry	44	13
	437	1,407

TABLE 044

In the prior year, security deposits for contract manufacturers of € 1,802k were recognized in inventories. Due to the nature of this item, the presentation was changed in the current fiscal year.

As of December 31, 2015, non-current prepaid expenses included the residual carrying amount of the transaction costs from the credit facility of € 781k repaid in the 2016 fiscal year.

13. Deferred tax assets

Explanations regarding deferred taxes can be found in note (7) of these notes.

14. Property, plant and equipment

Impairment losses are calculated in accordance with IAS 36 Impairment of Assets.

15. Intangible assets, goodwill

Internally generated intangible assets

Research and development costs totaled € 43,192k in the 2016 fiscal year (prior year: € 41,963k), of which € 13,331k (prior year: € 11,964k) meets the IAS 38 recognition criteria.

The Kontron Group received government grants of € 163k in the fiscal year (prior year: € 18k), which reduced the cost of capitalized development projects, as well as additional subsidies of € 673k (prior year: € 848k), which reduced research and development costs.

Due to the adjusted revenue forecasts, impairment losses of € 13,416k were recorded on internally generated intangible assets (capitalized development costs) in the reporting year (prior year: € 2,318k). These expenses are recorded under amortization of capitalized development projects in the statement of income. Of this amount, € 10,737k is attributable to the Industrial business unit, € 1,176k to the Communication business unit and € 1,503k to the Avionics / Transportation / Defense business unit. The recoverable amount of internally generated intangible assets is determined based on a value-in-use calculation using cash flow projections. The cash flow projections are based on updated assessments of the market and customer situation by the respective project managers, whose respective planning periods cover a period of approximately eight years, growth is determined for each product according to the available market analyses. The discount rates used in the cash flow projections range between 13.1 % and 14.7 % (prior year: between 9.1 % and 9.6 %).

Other intangible assets

Other intangible assets mainly comprise the ERP software which was implemented in full in the fiscal year.

Due to changes in the ERP environment, existing modules and licenses will not be used as planned in the future and an impairment loss was recorded. The impairment loss totaling € 1,221k was recorded in general and administrative costs in the statement of income.

Amortization of intangible assets is contained in the following individual line items of the statement of income:

AMORTIZATION OF INTANGIBLE ASSETS

IN €K	2016	2015
Cost of goods sold	10,242	12,930
Research and development cost	516	600
General and administrative cost	3,050	2,753
Selling and marketing cost	1,215	1,317
	15,023	17,600

TABLE 045

Goodwill

Goodwill stems from business acquisitions. The table below shows goodwill broken down by business unit as of December 31, 2016:

GOODWILL BY BUSINESS UNIT

IN €K	Industrial	Communication	Avionics/ Transportation/ Defense	Total
12/31/2016	33,102	0	0	33,102
12/31/2015	33,248	10,295	50,911	94,454

TABLE 046

Impairment of goodwill:

In July 2016, the Management Board reduced its guidance for the 2016 fiscal year due to the adjusted revenues and earnings prospects and communicated its expectation that its targets for revenues, gross margin and EBIT margin before restructuring cost and non-recurring costs (EBIT adjusted for restructuring cost and non-recurring costs) will not be met by a large margin in the fiscal year. Against this backdrop, the company carried out an impairment test as of June 30, 2016. In order to determine the need for impairment, the recoverable amounts of the cash-generating units were prepared based on a value-in-use calculation using cash flow projections. This test revealed a need to record impairment losses on goodwill allocated to the cash-generating units Communication of € 10.2 million and Avionics / Transportation / Defense of € 50.7 million; these amounts pertain to the full amount of goodwill allocated to the cash-generating units. The impairment loss is recorded in a separate line in the consolidated statement of income. In the Kontron Group, the cash-generating units correspond to the respective segments for the purpose of segment reporting. As of June 30, 2016, the recoverable amount was € 23.0 million for the cash-generating unit Communication and € 27.2 million for the cash-generating unit Avionics / Transportation / Defense. In determining the recoverable amount, a pre-tax discount rate of 11.33 % (as of December 31, 2015: 10.52 %) was applied to the cash-generating unit Communication and 9.30 % (as of December 31, 2015: 10.81 %) to the cash-generating unit Avionics / Transportation / Defense.

ANNUAL GOODWILL IMPAIRMENT TEST

Kontron performs its annual impairment test of goodwill as of December 31 of each year. In order to determine the need for impairment, the recoverable amounts of the cash-generating units are determined based on a value-in-use or a fair value less cost of disposal calculation using cash flow projections (level 3 of the fair value hierarchy).

The value-in-use concept takes into account the as-is situation of the Group as of the measurement date. Fair value less costs of disposal corresponds to the price that would be received in an orderly transaction between market participants for the disposal of a cash-generating unit less the associated costs of disposal. As of December 31, the test was performed using a value-in-use calculation.

At Kontron, the cash-generating units correspond to the company's business units. Due to the abovementioned impairment losses recorded on the cash-generating units Communication as well as Avionics / Transportation / Defense, goodwill was allocated only to the cash-generating unit Industrial on December 31, 2016. At this cash-generating unit, there was no need to recognize impairment losses pursuant to IAS 36 due to the fact that its recoverable amount exceeded its carrying amount.

The cash flow projections are based on financial budgets approved by the Supervisory Board covering a four-year period (2017 to 2020). Cash flows after the four-year period are extrapolated using a growth rate of 1 % (prior year: 1 %) based on the final year that has been planned in detail (2020). For the cash-generating unit, cash flows have been forecast based on operating results, results of the fiscal year and the best possible estimate of future developments, using, among other things, management's assumptions concerning future development and market conditions. The cash flow forecasts also take into account cost savings and other benefits arising from the restructuring program which the company initiated in the second half of 2016. Future measures to improve or increase the earning power of the cash-generating unit are not included in the value in use.

The recoverable amount is primarily derived from the terminal value (present value of the perpetual annuity), which responds particularly sensitively to changes in the long-term growth rate and discount rate.

The pre-tax discount rate applied to the cash flow projections for the Industrial business unit is 16.5 % (prior year: 11.12 %).

KEY ASSUMPTIONS USED IN RECOVERABLE AMOUNT CALCULATIONS

There are valuation uncertainties regarding the following assumptions that form the basis of the calculation of the recoverable amount of the cash-generating units:

- Growth in revenues during the forecast period
- EBIT margins
- Discount rates
- Growth rates used to extrapolate cash flows beyond the detailed planning period

Growth in revenues – For the period from 2017 to 2019, revenues were planned using detailed planning at individual customer level by business unit, division, region and product lines. This planning was prepared by the business unit and subsequently approved. Historical values from the past years are included to check the plausibility of revenues. Revenues for 2020 are extrapolated based on the 2019 planning.

EBIT margins – The costs for 2017 have been planned for all functions by account groups. In this context, prior-year costs were used as a basis for the planning. EBIT margins are based on average values achieved in prior fiscal years as well as expectations of price, cost and changes in the product range and improvements to efficiency in the planning period. The resulting EBIT margins are typically within the range of margins seen in the peer group.

Discount rates – Discount rates represent the current market assessment of the risks specific to each cash generating unit. The discount rate calculation is based on the specific circumstances of Kontron AG and its operating segments and is derived from its weighted average cost of capital (WACC) for the industry. The average cost of capital takes into account both debt and equity. The cost of equity is derived from the expected return on investment based on the parameters of the defined peer group, while the borrowing costs are determined based on the anticipated debt servicing. This interest rate was raised by 1.5 percentage points to reflect the market assessment of increased rates of return due to the current restructuring situation and the resulting risks. These are not included in the parameters underlying the peer group or in future cash flows.

Growth rate assumptions – The long-term growth rate may be significantly impacted by the speed of technological change, customer retention and the possibility of new competitors. Based on current knowledge, Kontron does not expect forecast cash flows to be negatively impacted. However, this could lead to a different potential growth rate. The growth rate of 1 % was used to extrapolate the cash flow projections after the four-year planning period. It includes external macroeconomic factors and industry-specific trends.

SENSITIVITY OF THE ASSUMPTIONS MADE

The implications of the key assumptions for the recoverable amount are summarized below:

IMPAIRMENT LOSS FROM PRINCIPAL ASSUMPTIONS 2016

	Industrial
Amount by which the recoverable amount exceeds the carrying amount (in €k)	40,422
Growth in revenues (detailed planning period) (in %)	– 13.1 % – 14.5 %
Necessary change in growth in revenues, so that the recoverable amount equals the carrying amount (in percentage points)	– 13.01
EBIT margins (in %)	1.1 % – 10.1 %
Necessary change in EBIT margins, so that the recoverable amount equals the carrying amount (in percentage points)	– 3.42
Discount rate (in %, after taxes)	12.10 %
Necessary change in the discount rate, so that the recoverable amount equals the carrying amount (in percentage points)	5.32
Long-term growth rate (in %)	1 %
Necessary change in the long-term growth rate, so that the recoverable amount equals the carrying amount (in percentage points)	– 16.72

TABLE 047

16. Trade payables

Trade payables break down as follows:

IN €K	2016	2015
Trade payables	57,413	67,836
Customer prepayments	2,215	3,092
	59,628	70,928

TABLE 048

Trade payables have the following remaining terms:

REMAINING TERMS OF PAYABLES

IN €K	Due in less than one year	Due in one to five years	Due in more than five years	Total
12/31/2016	57,142	0	271	57,413
12/31/2015	67,734	102	0	67,836

TABLE 049

17. Other liabilities

Other liabilities break down as follows:

OTHER CURRENT LIABILITIES

IN €K	2016	2015
Personnel obligations	11,954	12,475
Accrual for services to be rendered	9,250	0
Outstanding invoices	4,503	3,389
Payments received to be paid to factoring bank	1,938	0
Other taxes	1,503	2,450
Return obligation from the sale of materials	1,494	331
Cost of preparing the financial statements	1,364	1,037
Legal and consulting costs	677	37
Debtors with credit balances	295	403
Liabilities from derivative financial instruments	171	475
Liabilities from purchase commitments	157	858
Rental obligations	102	192
Liabilities from social security	78	75
Interest payable	3	182
Sundry	628	492
	34,117	22,396

TABLE 050

OTHER NON-CURRENT LIABILITIES

IN €K	2016	2015
Accrual for services to be rendered	12,713	0
Rental obligations	297	1,122
Personnel obligations	0	435
Deferred income	688	397
	13,698	1,954

TABLE 051

Accrued expenses recognized under current and non-current liabilities for services to be rendered relate to future purchase commitments in connection with the strategic partnership with Ennoconn initiated in January 2016. See note (27.).

18. Deferred tax liabilities

Explanations regarding deferred tax liabilities can be found in note (7) of these notes.

19. Financial liabilities

All interest-bearing liabilities of the Kontron Group as of the respective reporting date are shown under financial liabilities. They break down as follows:

2016 FINANCIAL LIABILITIES

IN €K	Due in less than one year	Due in one to five years	Due in more than five years	2016 total
NON-CURRENT				
Non-current liabilities (bank loans)	0	0	0	0
Obligations from financial leases	0	0	0	0
NON-CURRENT FINANCIAL LIABILITIES	0	0	0	0
CURRENT				
Liabilities to banks	613	0	0	613
Obligations from financial leases	0	0	0	0
CURRENT FINANCIAL LIABILITIES	613	0	0	613
	613	0	0	613

TABLE 052

2015 FINANCIAL LIABILITIES

IN €K	Due in less than one year	Due in one to five years	Due in more than five years	2015 total
NON-CURRENT				
Non-current liabilities (bank loans)	0	56,513	0	56,513
Obligations from financial leases	0	27	0	27
NON-CURRENT FINANCIAL LIABILITIES	0	56,540	0	56,540
CURRENT				
Liabilities to banks	702	0	0	702
Obligations from financial leases	31	0	0	31
CURRENT FINANCIAL LIABILITIES	733	0	0	733
	733	56,540	0	57,273

TABLE 053

Non-current liabilities to banks were subject to an interest rate of 2.21 % as of December 31, 2015.

Due to the Group's changed liquidity needs, the credit facility entered into with a banking syndicate in 2012 (prior year: € 116,270k) was gradually reduced during the 2016 fiscal year and ultimately repaid in full on December 21, 2016. In this connection, deferred transaction costs of € 226k were released through profit or loss.

In order to finance working capital, bilateral lines of credit were concluded with foreign subsidiaries without an assumption of liability by Kontron AG. The volume of these cash credits amounts to € 2,069k (prior year: € 2,020k), of which € 613k was utilized (prior year: € 702k).

In addition, there is a bilateral guarantee facility for a subsidiary of € 198k (prior year: € 198k), which was utilized in full. This line of credit was also concluded without an assumption of liability by Kontron AG.

The bank guarantees previously issued under the line of credit will be continued by the issuing banks in return for cash collateral of equivalent value. The total amount of all guarantees issued thereunder is € 2,480k.

In December 2016, a subsidiary concluded a factoring program with a volume of up to € 30.0 million. Under this program, those receivables of the company that meet a specific requirements profile are sold to the purchaser of the receivables without recourse. The outstanding volume of receivables are subject to variable interest plus a defined margin.

20. Provisions

IAS 37 defines provisions as liabilities of uncertain timing or amount, although a distinction must be made between provisions and accruals.

Accruals are included in the items "Other current liabilities" or "Other non-current liabilities" and are discussed in more detail in note (17).

Provisions developed as follows:

CURRENT PROVISIONS 2016

IN €K	Carried forward 01/01/2016	Exchange rate effects	Change in basis of consolidation	Reclassification	Additions	Utilization	Reversal	As of 12/31/2016
Warranties	2,732	32	0	– 204	1,526	431	132	3,522
Litigation	339	– 2	– 56	0	2,876	0	281	2,876
Potential losses	299	0	0	0	3,750	30	0	4,019
Restructuring	3,679	138	0	0	17,811	994	1,143	19,490
Sundry	1,111	0	– 7	0	194	1	517	779
	8,159	168	– 63	– 204	26,157	1,457	2,073	30,686

TABLE 054

NON-CURRENT PROVISIONS 2016

IN €K	Carried forward 01/01/2016	Exchange rate effects	Change in basis of consolidation	Reclassification	Additions	Utilization	Reversal	As of 12/31/2016
Warranties	942	15	0	204	181	213	122	1,009
Restructuring	53	– 2	0	0	0	0	52	0
Sundry	49	– 5	0	0	5,700	4	0	5,740
	1,045	8	0	204	5,881	216	174	6,749

TABLE 055

CURRENT PROVISIONS 2015

IN €K	Carried forward 01/01/2015	Exchange rate effects	Change in basis of consolidation	Additions	Utilization	Reversal	As of 12/31/2015
Warranties	2,947	100	0	251	406	160	2,732
Litigation	214	0	0	143	0	17	340
Potential losses	576	0	0	293	188	382	299
Restructuring	5,871	– 6	0	1,891	3,418	659	3,679
Sundry	1,260	– 4	– 79	20	22	66	1,109
	10,868	**90**	**– 79**	**2,598**	**4,034**	**1,284**	**8,159**

TABLE 056

NON-CURRENT PROVISIONS 2015

IN €K	Carried forward 01/01/2015	Exchange rate effects	Change in basis of consolidation	Additions	Utilization	Reversal	As of 12/31/2015
Warranties	884	45	0	427	353	61	942
Restructuring	736	– 1	0	55	521	214	55
Sundry	42	2	0	4	0	0	48
	1,662	**46**	**0**	**486**	**874**	**275**	**1,045**

TABLE 057

Warranties

A provision is created for warranty obligations from the products sold during the last two years. The measurement of the provision is based on past experience of repairs and returns. Assumptions used to calculate the provision for warranties were based on current sales levels and current information about returns based on the two-year warranty period for all products sold.

This item also includes provisions for individual warranty claims.

Litigation

In the reporting period, there were various legal disputes pending in the Kontron Group. Provisions for litigation chiefly comprise provisions in connection with personnel as well as potential claims for damages.

Potential losses

Due to the decrease in revenues in the 2016 fiscal year, the Company added an amount of € 3,593k to provisions for potential losses from procurement transactions entered into before the reporting date.

Restructuring

The addition to the provision for restructuring consists of expenses from the restructuring program initiated in the second half of 2016. A significant portion of this relates to personnel measures which were communicated to the employees concerned in November 2016. The restructuring is expected to be completed by the end 2017.

Sundry provisions

The addition to other provisions primarily relates to provisions for individual contract risks from sales transactions.

Costs in connection with non-current provisions are expected to be incurred in the period from 2018 to 2020.

Pensions and other post-employment benefits

REGULATORY FRAMEWORK AND DESCRIPTION OF BENEFITS

In Germany, the regulatory framework for the company pension plan is stipulated by the BetrAVG ["Gesetz zur Verbesserung der betrieblichen Altersversorge": German Company Pensions Act], which prescribes the minimum legal requirements for company pension plans. In addition, labor legislation regulations and court rulings must be observed. At Kontron, the post-employment benefit system consists of a pension that is paid as:

- old-age pension upon or after reaching the fixed retirement age of 65
- early old-age pension in the event of drawing benefits from the statutory pension insurance scheme or as
- disability benefits upon retirement and subsequent occupational disability.

The pension amount is not affected by salary increases. Nine (prior year: ten) employees were participating in the plan as of the reporting date.

As a result of the legal regulations and collectively bargained agreements in France, the company is required to make one-off payments to its employees upon retirement. The payments are collectively bargained and are based on employees' years of service and final salary prior to retirement. An employee that leaves the company prior to retirement does not receive payment, regardless of whether they leave the company of their own volition or not. As of the reporting date, 103 employees were participating in the plan (prior year: 102 employees).

CURRENT RISKS

In Germany, the company pension plan is closed for new entrants. The pensionable salaries of entitled employees are fixed. Risks are essentially limited to the development of interest rates and longevity.

In France, risks are also essentially limited to the development of interest rates and longevity. An additional financial risk is the risk of employee turnover (due to the fact that employees do not draw benefits from the plan if they leave the company before reaching retirement age). The plan is not covered by plan assets, as is customary for small entities.

PROVISIONS FOR PENSION OBLIGATIONS AND OTHER BENEFITS

The provision for pension obligations amounted to € 1,835k as of December 31, 2016 (prior year: € 1,850k). Of the change in the pension obligation during the year, € 70k was recorded under general and administrative cost and € 33k under interest expenses in the financial result in the statement of income. The effect in other comprehensive income amounts to € 60k.

21. Disclosures on litigation

Provisions have been recognized for litigation pending against Kontron (as plaintiff).

The claim for damages (litigation as plaintiff) against various plaintiffs that has been ongoing in Malaysia since the 2010 fiscal year could not be resolved in the reporting period. With the action,damages of € 29,348k have been claimed. Kontron has not recognized receivables for the claim for damages. Nine hearings were held in the reporting period to hear witnesses. Kontron expects a ruling by the court of first instance in the 2017 fiscal year.

22. Equity and stock options

Kontron had 55,683,024 no-par bearer shares outstanding as of December 31, 2016. Each share represents € 1 of the issued capital. Different share categories do not exist.

The additional paid-in capital includes share premiums and expenses from share option schemes (see note (32)).

Retained earnings contain profits generated in the past by the entities included in the consolidated financial statements that have not been distributed, actuarial gains / losses from pensions and other post-employment benefits. In addition, since January 01, 2010, the difference between the consideration and the carrying value of the interest acquired when purchasing non-controlling interests has been recognized in retained earnings.

23. Contingent capital

Contingent capital 2003 I can be used to contingently increase the company's share capital by up to € 1,105k by issuing up to 1,104,850 new shares for conversion or subscription rights. The contingent capital increase will only be conducted to the extent that bearers of options issued under the 2003 stock option program make use of this option right. With the resolution of the Annual General Meeting of Shareholders of June 09, 2010 the term of the issued and not yet exercised stock options was extended until December 31, 2013. No stock options were outstanding as of December 31, 2016.

The company's share capital is contingently increased by contingent capital 2007 by up to € 1,500k by issuing up to 1,500,000 no-par value shares (contingent capital 2007). The contingent capital increase will only be conducted to the extent that bearers of options issued under the 2007 stock option program make use of this option right. There were no stock options outstanding as of December 31, 2016.

The company's share capital is contingently increased by contingent capital 2015 by up to € 22,200k by issuing up to 22,200,200 no-par value shares (contingent capital 2015). The contingent capital increase will only be conducted to the extent that the bearers of convertible and / or warrant bonds issued based on the authorization granted by the Annual General Meeting of Shareholders on June 11, 2015 for issue by the company until June 10, 2020 make use of this conversion / option right. As in the prior year, this did not result in any convertible or warrant bonds as of December 31, 2016.

24. Authorized capital

By resolution passed at the Annual General Meeting of Shareholders of Kontron AG on June 11, 2015, authorized capital 2015 was approved.

The authorized capital 2015 authorizes the issue, once or several times, of up to 27,841,512 new no-par value bearer shares in exchange for cash contributions or contributions in kind subject to the approval of the Supervisory Board by June 10, 2020 (authorized capital 2015). In principle, shareholders are granted the right to subscribe to the new shares. The shareholders' statutory subscription right can also be granted to the shareholders in such a way that the new shares may also be acquired by one or more banks subject to the proviso that they offer them to the shareholders for subscription.

The Management Board is authorized to exclude, subject to the approval of the Supervisory Board, the shareholders' statutory subscription rights

to avoid subscription rights to fractional amounts.

- (when required to prevent the dilution of capital) to provide subscription rights for new shares to the creditors of the bonds (including profit participation rights and participating bonds) with convertible or warrant bonds or a conversion right granted by Kontron AG or one of its group entities as it would have been granted to them after the exercise of their conversion rights or options or after fulfilling their conversion obligations.

- if the new shares are issued in exchange for contributions in kind for the purpose of business combinations, acquiring companies or equity investments in companies or parts of companies, receivables due from the company or for the issue of other assets.

- if the new shares are issued at a price per new share that does not fall significantly below the quoted price, and the shares issued without subscription rights pursuant to Sec. 186 Sentence 4 AktG, do not represent more than 10 % of the share capital, either on the date on which this authorization takes effect or on the date on which it is exercised. This limit of 10 % is included in treasury shares during the term of this authorization in application of Sec. 186 (3) Sentence 4 AktG. Moreover, this limit is to include those shares that were to be issued or are issued in order to serve bonds (including profit participation rights and participating bonds) with convertible or warrant bonds or a conversion right, if the bonds or profit participating rights have been issued during the term of this authorization in exclusion of shareholders' subscription rights in application of Sec. 186 (3) Sentence 4 AktG.

The total shares issued precluding subscription rights in accordance with this authorization in return for a cash or non-cash contribution cannot exceed 20% of the share capital existing either as of the date on which the authorization takes effect or as of the date on which the authorization is exercised, whichever is lower. This limit of 20% is included in treasury shares during the term of this authorization. Moreover, this limit is to include those shares that were or are to be issued to serve bonds (including profit participation rights and participating bonds) with attached rights / duties of conversion and / or put or call options, provided the bonds have been issued during the term of this authorization in exclusion of shareholders' subscription rights.

The Management Board is also authorized, subject to the approval of the Supervisory Board, to decide on the content of the respective share rights and the conditions of share issue as well as on the further details concerning performance of the capital increase.

25. Treasury shares

At the Annual General Meeting of Shareholders on June 11, 2015, the Management Board was authorized to redeem treasury shares with an imputed value of up to 10% of share capital. The authorization is valid until June 10, 2020.

In the reporting year, the company did not redeem any treasury shares or transfer any treasury shares to employees on account of share options.

As of December 31, 2016, Kontron holds 111,976 treasury shares (prior year: 111,976); this corresponds to a nominal amount of € 112k of share capital (prior year: € 112k). The imputed share of capital comes to 0.20% (prior year: 0.20%).

26. Other equity components

Other components of equity changed from € – 12,728k to € – 12,526k, mainly on account of exchange rate fluctuations as well as transactions with equity holders (see note (27)).

27. Non-controlling interests

The share in equity attributable to non-controlling interests of € 14,529k (prior year: € – 128k) mainly comprises the subsidiary Kontron Canada Inc., Boisbriand, Canada. As of December 31, 2015, this item included the non-controlling interests of Railway Infrastructure and Integration Services Sp. z o.o., Warsaw, Poland, which was deconsolidated in the 2016 fiscal year.

Kontron AG transferred a share of 49 % in the subsidiary Kontron Canada Inc., Boisbriand, Canada, to Ennoconn Investment Holdings Co., Ltd. as of April 01, 2016 for a total purchase price of $ 57.3 million or € 50.3 million. The transfer took place as part of the closing of the agreement on the strategic partnership between Kontron AG and Ennoconn Corporation dated January 22, 2016. Purchase obligations of Kontron Canada Inc. and other group entities in favor of the Ennoconn Group are a key element of this strategic partnership. These obligations have a term until 2019. Against this backdrop, the company valued the purchase price components and divided the total purchase price into two components:

An amount of € 26.2 million relates to the acquisition of the non-controlling interest in Kontron Canada Inc., Boisbriand, Canada, and was therefore recognized directly in equity as a transaction with equity holders. Overall, an amount of € 11.2 million was reported as non-controlling interests and an amount of € 14.0 million was recognized in retained earnings. Other equity components of € – 1.0 million were reclassified to non-controlling interests. The payment of € 26.2 million is recognized in the consolidated statement of cash flows as net cash used in financing activities.

An amount of € 24.1 million relates to the future purchase of Ennoconn products and was recorded as other current and non-current liabilities. These liabilities will be released over the term of the purchase obligations through profit or loss as the purchase commitments are fulfilled. In this connection, an amount of € 2.2 million was recognized through profit and loss in the 2016 fiscal year. The payment of € 24.1 million is recognized in the consolidated statement of cash flows as net cash used in operating activities.

Financial information of Kontron Canada Inc., Boisbriand, Canada, as a subsidiary that has material non-controlling interests is provided below:

PROFIT ALLOCATED TO NON-CONTROLLING INTERESTS / ACCUMULATED SHARES

IN €K	2016
Accumulated balances of material non-controlling interest:	14,529
Profit allocated to material non-controlling interest:	3,189

TABLE 058

The summarized financial information of this subsidiary is provided below. This information is based on amounts before intercompany eliminations.

SUMMARIZED FINANCIAL INFORMATION

IN €K	12/31/2016
Current assets	42,755
Non-current assets	8,792
Current liabilities	17,398
Non-current liabilities	510
	04/01/2016 – 12/31/2016
Revenues	62,939
Net income / loss for the period	6,507

TABLE 059

28. Nature and purpose of reserves

ADDITIONAL PAID-IN CAPITAL

In addition to share premiums and costs of capital increases, additional paid-in capital also includes additions from share-based payments in prior-year periods.

FOREIGN CURRENCY TRANSLATION RESERVE

The foreign currency translation reserve is used to record exchange differences arising from the translation of the financial statements of foreign subsidiaries. It is also used to record the effect of hedging net investments in foreign operations.

29. Commitments and contingencies

As of December 31, 2016, the Kontron Group had no commitments or contingencies.

30. Other financial obligations

Besides liabilities and provisions, the Group has other financial obligations, in particular from rental and lease agreements for buildings, vehicles, technical equipment and machinery as well as software.

Total other financial obligations break down as follows:

OTHER FINANCIAL OBLIGATIONS 2016

IN €K	Due in less than one year	Due in one to five years	Due in more than five years	2016 total
Obligations from operating leases				
of which leases of buildings	5,625	17,992	6,040	29,657
of which vehicle leases	770	709	0	1,479
of which software licenses	884	81	0	965
of which leases for technical equipment and machines	88	248	51	387
of which other leases	74	65	10	149
	7,441	19,095	6,101	32,637

TABLE 060

OTHER FINANCIAL OBLIGATIONS 2015

IN €K	Due in less than one year	Due in one to five years	Due in more than five years	2015 total
Obligations from operating leases				
of which leases of buildings	5,596	19,564	10,261	35,421
of which vehicle leases	931	1,080	0	2,011
of which software licenses	782	439	0	1,221
of which leases for technical equipment and machines	137	314	0	451
of which other leases	156	190	0	346
	7,602	21,586	10,261	39,449

TABLE 061

The obligations from rental agreements for buildings comprise future rental expenses for the properties at the Augsburg location. This rental agreement expires in 2024.

The average term of the leases for vehicles, technical equipment and software licenses lies between three and seven years. These lease agreements do not contain renewal or bargain-purchase options. The lease agreements did not impose any restrictions on the lessee.

The following lease payments were recognized as an expense in the reporting period:

LEASE PAYMENTS

IN €K	2016	2015
Minimum lease payments from operating leases	6,711	7,556

TABLE 062

31. Notes to the consolidated statement of cash flows

The consolidated statement of cash flows presents the source and utilization of cash flows in the 2015 and 2016 fiscal years. In accordance with IAS 7 *Statements of Cash Flows* a distinction is made in the statement of cash flows between cash flows from operating activities and cash flows from investing and financing activities.

The cash and cash equivalents presented in the statement of cash flows contain cash and cash equivalents shown in the statement of financial position, i.e., cash in hand, checks and bank balances which can be disposed of within three months of the time of contribution.

Cash flows from investing activities and financing activities are derived from the actual cash payments, while cash flows from operating activities are calculated indirectly from net income for the year. When performing the indirect calculation, changes in items of the statement of financial position considered in connection with operating activities are adjusted to eliminate exchange rate effects and changes in the consolidated group. For this reason, it is not possible to reconcile the changes in the relevant items of the statement of financial position with the corresponding figures evident from the published consolidated statement of financial position.

Investing activities comprise additions to property, plant and equipment and financial assets, as well as additions to capitalized development costs.

OTHER DISCLOSURES IN THE NOTES

32. Share-based payments

Under the performance option plan (POP), performance options were granted to members of the Management Board and employees of Kontron AG and its subsidiaries in the 2013, 2014, 2015 and 2016 fiscal years. Performance options were granted in the form of basis performance options and premium performance options, which vary in the issue price. These performance options grant their holders a right to a cash settlement equal to the difference between the average share price over a period of 20 trade days after the respective exercise date and the exercise price. There is no entitlement to Kontron AG shares.

The following conditions were defined for the performance options granted in the 2013 to 2016 fiscal years:

- The exercise price for the basis performance options corresponds to the unweighted average price of the Kontron share in the month of December prior to the grant date.
- The exercise price of the premium performance options corresponds to 150 % of the exercise price of the basis performance options.
- Taking into account blackout periods as well as any agreed-upon performance targets, the options can be exercised in a period of six months after a vesting period of one year and an additional waiting period of three years.
- Blackout periods are required by the Kontron "Insider Trading Policy" regulations. The exercise period is extended by the duration of the respective blackout period, although the constructive exercise period may not exceed six months.
- The payment of each option is capped at 400 % of the basis strike price.

For the performance options granted in the 2013 fiscal year, the following performance targets have also been defined with respect to revenues and EBIT:

- 70 % of the options granted are vested if the defined revenues target of € 547.0 million is reached for the 2013 fiscal year. If revenues are below € 383.0 million in the 2013 fiscal year, 80 % of the entitlement to the options granted is forfeited entirely.
- An additional 30 % of the options granted are vested when the defined EBIT target (EBIT adjusted for special items, e.g., restructuring cost) of € 10 million is reached for the 2013 fiscal year. If EBIT is below € 3 million, 30 % of the entitlement to the options granted is forfeited entirely.
- The way the performance targets are designed allows options to be vested in an interval of 0 % to a maximum of 125 % of the options originally granted.

Applying the resolution of the Supervisory Board dated July 24, 2014, additional conditions were excluded for the performance options granted in the 2014 to 2016 fiscal years relating to individual goal attainment.

PERFORMANCE OPTIONS PLANS

	2016 performance options plan		2015 performance options plan		2014 performance options plan		2013 performance options plan	
NO.	Basis performance options	Premium performance options	Basis performance options	Premium performance options	Basis performance options	Premium performance options	Basis performance options	Premium performance options
Grant date	01/04/2016	01/04/2016	01/02/2015	01/02/2015	01/02/2014	01/02/2014	01/02/2013	01/02/2013
Outstanding performance options as of 01/01/2016	0	0	1,000,000	100,000	850,000	100,000	610,000	150,000
Performance options granted in the 2016 fiscal year	740,000	100,000	0	0	0	0	0	0
Performance options forfeited in the 2016 fiscal year	720,000	100,000	785,000	100,000	750,000	100,000	610,000	150,000
Outstanding performance o ptions as of 12/31/2016	20,000	0	215,000	0	100,000	0	0	0

TABLE 063

The performance options are classified and measured as cash-settled share-based payments. Fair value of the liability to be recognized from the performance option plan was measured using a binomial option pricing model.

Measurement as of December 31, 2016 was based on the following model inputs:

MODEL INPUTS PERFORMANCE OPTIONS

	2016 performance options plan		2015 performance options plan		2014 performance options plan	
	Basis performance options	Premium performance options	Basis performance options	Premium performance options	Basis performance options	Premium performance options
Share price on the measurement date	€ 2.85	€ 2.85	€ 2.85	€ 2.85	€ 2.85	€ 2.85
Exercise price of the performance options	€ 2.90	€ 4.34	€ 4.95	€ 7.42	€ 5.37	€ 8.06
Remaining term of the performance options	4.33 years	4.33 years	3.33 years	3.33 years	2.33 years	2.33 years
Expected dividend	0.00 %	0.00 %	0.00 %	0.00 %	0.00 %	0.00 %
Risk-free interest rate for the term	0.00 %	0.00 %	0.00 %	0.00 %	0.00 %	0.00 %
Expected volatility for the term	40 %	40 %	47 %	47 %	50 %	50 %
Expected beneficiary turnover for the term	5 %	5 %	5 %	5 %	5 %	5 %
Fair value of performance option	€ 0.90	€ 0.55	€ 0.49	€ 0.25	€ 0.33	€ 0.14

TABLE 064

Estimates reflect the future expected volatility based on the historical volatility extrapolated over an annual period. The expected volatility reflects the assumption that the historical volatility over a period similar to the life of the options is indicative of future trends, which may also not necessarily be the actual outcome.

The company recognized income of € 351k for the performance option plan in the 2016 fiscal year and a liability of € 84k. The expenses are allocated to the respective function.

33. Earnings per share

Basic earnings per share is determined pursuant to IAS 33 Earnings per Share by dividing the profit attributable to equity holders of Kontron AG by the weighted average number of shares outstanding during the fiscal year.

EARNINGS PER SHARE

IN €K	2016	2015
Net income / loss attributable to equity holders	– 150,803	– 2,527
SHARES K		
Weighted average number of outstanding shares	55,571	55,571

TABLE 065

As no dilutive effects exist, the basic earnings per share is identical to diluted earnings per share.

34. Financial instruments and risk management

34.1. FINANCIAL INSTRUMENTS

Set out below is a comparison of the carrying amounts and fair value of the Group's financial instruments that are carried in the consolidated financial statements.

FINANCIAL INSTRUMENTS

	Category	Carrying amount		Fair value	
IN €K	IAS 39*	2016	2015	2016	2015
Financial assets					
Cash and cash equivalents	LaR	43,787	27,823	43,787	27,823
Trade receivables	LaR	67,420	122,684	67,420	122,684
Other financial assets	LaR	6,585	5,418	6,585	5,418
TOTAL LOANS AND RECEIVABLES		117,792	155,925	117,792	155,925
Available-for-sale financial assets	AfS	0	146	0	146
Derivative financial instruments	HfT	58	258	58	258
Held-to-maturity investments	HtM		0		0
TOTAL FINANCIAL ASSETS		117,850	156,329	117,850	156,329
Financial liabilities					
Interest-bearing loans	FLAC	613	57,215	613	57,215
Trade payables	FLAC	57,413	67,836	57,413	67,836
Derivative financial instruments	HfT	171	475	171	475
Other financial liabilities	FLAC	31,611	10,138	31,611	10,138
TOTAL FINANCIAL LIABILITIES		89,808	135,664	89,808	135,664

* LaR: *Loans and receivables*
AfS: *Available-for-sale*
HtM: *Held-to-maturity*
HfT: *Held-for-trading*
FLAC: *Financial liabilities at amortized cost*

TABLE 066

The levels of the fair value hierarchy are defined as follows:

Level 1: Market prices quoted on active markets for identical assets or liabilities

Level 2: Other information than quoted market prices that can be directly (e. g., prices) or indirectly (e. g., derived from prices) observed

Level 3: Information relating to assets and liabilities that is not based on observable market data

The derivative financial instruments held by the Group consist of forward exchange contracts, foreign exchange swaps, currency options (plain vanilla options) and interest swaps and qualify for classification in level 2. The fair value of forward exchange contracts and foreign exchange swaps is calculated at the forward rates as of the reporting date and the results are then presented at the discounted present value. The market values of the currency options are calculated on the basis of customary option pricing models ("Black-Scholes"). With regard to the market values of the interest swaps, Kontron draws on the interest curves for the reporting date with the results shown at net present value.

NET GAINS / LOSSES FROM FINANCIAL INSTRUMENTS

	From interest	From subsequent measurement			From disposals	Net income / loss	
IN €K		Currency translation	Marked-to-market	Impairment		2016	2015
Loans and receivables	4	353	0	– 2,406	0	– 2,049	– 1,808
Held-to-maturity investments	0	0	0	0	0	0	2
Derivative financial instruments	0	0	– 166	0	0	– 166	– 642
Financial liabilities	– 981	221	0	0	0	– 760	– 1,742
	– 977	574	– 166	– 2,406	0	– 2,975	– 4,190

TABLE 067

The interest and gains / losses arising from the fair value measurement of these options are reported in the financial result. The other components of the net gains / losses as well as the results from the measurement of forward exchange contracts, currency swaps and currency options are reported in the operating result (EBIT).

34.2. HEDGING POLICY AND RISK MANAGEMENT

The Group's principal financial liabilities, other than derivatives, comprise bank loans and overdraft facilities, financial guarantees, trade payables and operating leases. The main purpose of these financial liabilities is to finance the Group's operations. The Group has various financial assets such as trade receivables, cash and short-term deposits that derive directly from its operations.

The Group also holds derivative financial instruments for the purpose of hedging foreign currency or interest rate risks resulting from the Group's operations and sources of financing.

No trading in derivatives was undertaken in the fiscal years 2016 and 2015 and this policy will remain in place in the future.

The Group's main risks comprise market risks (consisting of foreign currency, interest rate and pricing risks), liquidity risks and credit risks.

The Group's management agrees on policies for managing each of these risks which are summarized below.

FOREIGN CURRENCY RISK

Foreign currency risk is the risk that the fair value or future cash flows of an exposure will fluctuate because of changes in foreign exchange rates.

The Group's exposure to the risk of changes in foreign exchange rates relates primarily to the Group's operating activities (when the revenues and / or expenses of an operating unit are denominated in a different currency to that unit's functional currency) as well as changes in the fair value of items denominated in foreign currencies as a result of changes in the relevant exchange rates.

Due to its international orientation, the Kontron Group is exposed to a foreign currency risk (transaction risk) in relation to various foreign currencies. Consequently, the Group's foreign currency hedging strategy focuses on the general hedging of amounts denominated in foreign currencies at the time an obligation denominated in a foreign currency arises by netting cash inflows and outflows in foreign currencies. As a global company, Kontron generates revenues and procures materials in US dollars and euros. The resulting currency effects offset each other over time to some extent. The remaining fractions are hedged by means of short-term forwards and options. To optimize its hedging strategy, the risk arising from the difference between income and expenses in foreign currencies in connection with planned transactions (which are highly likely to arise based on the Group's planning) is eliminated or mitigated using various hedging instruments. A team of several members from the finance department of Kontron AG meets at six to eight week intervals to analyze any existing or future foreign exchange risks and create the appropriate hedging measures. Foreign currency risks arising for Kontron AG in connection with the issuing of group financing to subsidiaries in their local currencies and / or liabilities to subsidiaries in connection with the Group's cash management activities are also hedged using forward exchange contracts.

Receivables and liabilities in the same currency are netted before any remaining fractional amounts are hedged.

Foreign currency hedging transactions are only entered into with banks with good credit ratings by the central treasury department. If the foreign exchange contracts can be clearly allocated to subsidiaries, spot transactions are generally made between Kontron AG and the respective subsidiary which are settled via internal clearing accounts. Foreign exchange swaps in which the central treasury department either purchases a foreign currency at the spot rate in return for euros with an agreement to sell it back at a later date at a particular exchange rate (or vice versa) are also concluded for the purpose of liquidity management and in order to optimize the Group's financial result.

The foreign exchange contracts concluded in the 2016 fiscal year are not classified as hedges to secure cash flows, fair value or a net investment, and are measured at fair value through profit or loss. The period for which the foreign exchange contracts are concluded corresponds to the period in which a foreign currency risk exists for the underlying transactions, generally between one and twelve months. The foreign exchange contract balances vary with the level of expected foreign currency sales and purchases and the associated peaks and fluctuations in foreign exchange forward rates.

The fair value of the forward exchange contracts carried on the reporting date, which had a face value of € 24,195k (prior year: € 50,361k), came to € – 117k (prior year: € 12k). The share of open foreign exchange contracts with a positive market value came to € 54k (prior year: € 165k). The fair value of the currency options carried on the reporting date, which had a face value of € 10,000k (prior year: € 15,892k), came to € 5k (prior year: € – 123k). As the Kontron Group only concludes foreign exchange contracts with banks with good credit ratings, and concludes them with multiple banks in order to diversify the risk, the resulting credit risk from the foreign exchange contracts can be classified as exceptionally low.

The Group's main transaction risks stem from changes in the USD / EUR exchange rate. In addition, there are transaction risks between the US dollar and the Canadian dollar and also between the euro and Chinese renmimbi, although the volumes involved are lower.

The following table demonstrates the sensitivity of the Group's net income / loss before tax (due to changes in the fair value of monetary assets and liabilities) and equity to a potential change in the exchange rate between the US dollar and the respective functional currency of ± 10 %. All other variables remain constant. The Group's exposure to exchange rate changes for other currencies is lower, which is why it has not presented a more extensive sensitivity analysis.

SENSITIVITY TO CHANGES IN EXCHANGE RATES

	Change in USD rate	Effect on income / loss before tax and equity in €k
2016	+ 10 %	1,289
	– 10 %	– 1,054
2015	+ 10 %	184
	– 10 %	– 224

TABLE 068

The following table demonstrates the sensitivity of the Group's income / loss to marking the forward exchange contracts in place as of December 31, 2016 to market. The impact on earnings is presented based on a hypothetical change in the value of the euro with respect to the foreign currency of 5 % and 10 % respectively.

SENSITIVITY OF FORWARD EXCHANGE CONTRACTS

Change in the euro	Effect on income / loss before tax in €k	
	2016	2015
+ 5 %	– 16.7	– 142
+ 10 %	– 31.8	– 271
– 5 %	18.4	157
– 10 %	38.9	331

TABLE 069

The following table demonstrates the sensitivity of the Group's income / loss to marking the foreign currency options contracts in place as of December 31, 2016 to market.

As there were currency options in the USD/CAD currency pair as of the reporting date December 31, 2015, the following table demonstrates the sensitivity of the currency options to a change in the US dollar.

SENSITIVITY OF CURRENCY OPTIONS

Change in the USD	Effect on income / loss before tax in €k	
	2016	2015
+ 5 %	– 5	– 243
+ 10 %	– 5	– 209
– 5 %	+ 103	– 121
– 10 %	+ 528	546

TABLE 070

INTEREST RATE RISKS

The Group's financial liabilities were repaid almost in full in the 2016 fiscal year. As only variable-rate financial liabilities of € 0.6 million were recognized as of the reporting date, the resulting interest rate risk is very low.

Due to a significant cash inflow at the beginning of 2016 and the related reduction in variable-rate financial liabilities, the interest rate swaps concluded in the 2015 fiscal year were released at their market values.

Variable-rate interest is also charged on the receivables sold under the factoring program. On account of the current monetary policies of the European Central Bank and the development on the money and capital markets, the interest rate risk for liabilities denominated in euro can be classified as low. Liabilities denominated in US dollars, which result from the sale of receivables denominated in US dollars, also pose an interest rate risk. This interest rate risk is analyzed regularly by the global treasury department, with appropriate interest instruments being used as needed to limit interest rate risk.

LIQUIDITY RISK

A cash flow projection based on a fixed planning horizon ensures the solvency and financial flexibility of the Kontron Group. In addition to the "indirect" method based on the statement of financial position, this also takes the form of a rolling three-month forecast using the "direct" method.

To secure liquidity, a factoring program with a maximum volume of € 30,000k was initiated after the repayment of the credit facility.

In addition, Kontron has a financing commitment (letter of comfort) from S+T AG, Linz, Austria of € 20,000k if required. Kontron called for this support by letter dated February 17, 2017, as without this financing the liquidity of Kontron AG and thus of the Kontron Group is not secured as of the second quarter of 2017.

The group entities are supplied with cash and cash equivalents as necessary by means of their inclusion in the Group's central cash management system. The corporate treasury department extends lines of credit to the subsidiaries in the form of intercompany loans. There are also some smaller, bilateral lines of credit available within the Group that can be utilized individually following consultation with the central treasury department. Please refer to note (19) "Financial liabilities" for further details.

As of December 31, 2016 the financial liabilities of the Group had the following terms to maturity. based on contractual, undiscounted payments.

MATURITY OF LIABILITIES AS OF 12/31/2016

IN €K	On demand	Less than 3 months	3 – 12 months	one to five years	More than 5 years	Total
Interest-bearing loans	0	613	0	0	0	613
Trade payables	21,169	33,840	2,133	0	271	57,413
Other financial liabilities	3,097	6,668	3,354	0	0	13,119
Interest	0	0	0	0	0	0
	24,266	41,122	5,487	0	271	71,145

TABLE 071

MATURITY OF LIABILITIES AS OF 12/31/2015

IN €K	On demand	Less than 3 months	3 – 12 months	one to five years	More than 5 years	Total
Interest-bearing loans	702	0	0	56,513	0	57,215
Trade payables	19,778	47,956	0	102	0	67,836
Other financial liabilities	2,402	5,184	1,933	171	911	10,600
Interest	0	289	0	0	0	289
	22,882	53,429	1,933	56,786	911	135,941

TABLE 072

CREDIT RISK

Credit risk is the risk that a counterparty will not meet its obligations under a financial instrument or customer contract, leading to a financial loss. The Group is exposed to credit risk from its operating activities (primarily in connection with defaults on trade receivables).

Customer credit risk is managed by each business unit subject to the Group's established policy, procedures and control relating to credit risk management. The individual counterparty credit limits are set accordingly. Outstanding receivables from customers are monitored on a regular basis. Depending on the nature and volume of the business in question, credit information is obtained or historical data regarding the business relationship to date (including payment patterns) is used to minimize the credit risk and avoid defaults on payment.

Kontron has a diversified customer base consisting of several thousand customers. The ten biggest customers make up about 37 % of the Group's total revenues, and the largest accounts for 10 % of total revenues. In most cases, the Group's relationships with its customers go back several years.

The need for valuation allowances is analyzed for each major customer on every reporting date, and a general valuation allowance is recognized for all other receivables from customers based on the maturity profile of the receivables.

Regardless of the collateral provided, the carrying amount of the financial assets indicates the maximum credit risk in the event that business partners do not meet their contractual payment obligations. The corresponding comments can be found in notes (11) and (12).

CAPITAL MANAGEMENT

The primary objective of the Group's capital management is to ensure that Kontron maintains a strong credit rating and equity ratio in order to support its business operations. A higher equity ratio generally means better creditworthiness and financial stability on the part of the company, and a reduced dependency of the company on external lenders. All of the individual equity components qualify as equity for the purposes of capital management.

EQUITY RATIO

IN €K	2016	2015
Equity	137,031	258,924
Total equity	291,126	441,907
EQUITY RATIO	47.1 %	58.6 %

TABLE 073

The Group manages its capital structure and makes adjustments in response to changes in economic conditions. To maintain or adjust the capital structure, the Group may adjust the dividend payment to shareholders or issue new shares.

No changes were made to the objectives, policies and processes as of December 31, 2016 and December 31, 2015.

35. Segment information

In accordance with IFRS 8 Operating Segments, external segment reporting reflects group-wide business management and internal financial reporting. The operational management of the Kontron Group is performed based on the three global business units Industrial, Communication and Avionics / Transportation / Defense in which the business activities were combined based on similarity of products and services as well as the application range for customers.

Transfer prices between operating segments are determined at arm's length.

SEGMENT INFORMATION 2016

IN €K	Industrial	Communication	Avionics / Transportation / Defense	Other	Consolidated financial statements
Revenues	198,369	90,116	96,640	0	385,125
Operating result (EBIT)	– 25,477	– 2,900	– 57,438	– 55,862	– 141,677
Trade receivables	62,698	12,103	23,250	0	98,051

TABLE 074

SEGMENT INFORMATION 2015

IN €K	Industrial	Communication	Avionics / Transportation / Defense	Other	Consolidated financial statements
Revenues	234,672	105,829	127,150	0	467,651
Operating result (EBIT)	16,336	10,058	17,698	– 37,903	6,189
Trade receivables	106,367	20,747	26,954	0	154,068

TABLE 075

Other includes intercompany items such as income or expenses that are eliminated and not directly allocable to the segments. This particularly includes restructuring cost of € 17,213k. The remaining amount is mainly attributable to costs for support functions, such as HR, IT and treasury.

Trade receivables are presented prior to the recognition of allowances.

SEGMENT INFORMATION ABOUT GEOGRAPHICAL AREAS:

SEGMENT INFORMATION ABOUT GEOGRAPHICAL AREAS 2016

IN €K	Germany	Rest of world
REVENUES EXTERNAL CUSTOMERS	64,023	321,102
thereof USA		92,104
thereof China		73,235
NON-CURRENT ASSETS	41,929	25,378
thereof Canada		8,761
thereof USA		7,891

TABLE 076

SEGMENT INFORMATION ABOUT GEOGRAPHICAL AREAS 2015

IN €K	Germany	Rest of world
REVENUES EXTERNAL CUSTOMERS	77,560	390,091
thereof USA		126,673
thereof China		73,407
NON-CURRENT ASSETS	51,847	52,565
thereof USA		36,368
thereof France		6,759

TABLE 077

Revenues are distributed to segments based on the registered offices of the customers. Non-current assets do not contain financial instruments or deferred tax assets.

36. Related party disclosures (IAS 24)

Related parties in the meaning of IAS 24 are persons or entities that can be influenced by the reporting entity or that can influence the entity. Related party transactions mainly relate to goods and services. The transactions are carried out at arm's length conditions and are based on contractual agreements.

Business dealings with related entities

In 2016, related party transactions were with S&T AG, Linz, Austria, and its subsidiaries as well as transactions with Ennoconn Investment Holdings Co., Ltd., Taipei, Taiwan, and its affiliates.

Related party transactions in the fiscal year 2016 were as follows:

BUSINESS DEALINGS WITH RELATED ENTITIES

IN €K	Goods and services received	Goods and services provided	Receivables	Liabilities
Transactions with parent company	103	178	1,870	13
Transactions with related entities	27,793	3,220	873	14,134

TABLE 078

The Group has been given a financing commitment in the form of a letter of comfort from S&T AG, Linz, Austria, with a volume of € 20.0 million and a term until 2018.

As of December 31, 2015, there were no outstanding balances due to related parties.

Business dealings with people in key positions

The remuneration paid to the Management Board and Supervisory Board is described in detail in the remuneration report, which is part of the management report.

The remuneration paid to people in key positions at the company, which must be disclosed in accordance with IAS 24, comprises the remuneration paid to the Management Board and Supervisory Board. The total remuneration paid to the Management Board amounted to € 2,203k in the 2016 fiscal year (prior year: € 1,723k). This includes short-term payments amounting to € 1,653k (prior year: € 1,603k), stock-based remuneration of € 0k (prior year: € 120k) and termination benefits amounting to € 550k (prior year: € 0k).

The amounts paid to the members of the Supervisory Board are short-term and totaled € 385k for the fiscal year (prior year: € 439k). Provisions for share-based payment were reversed in the fiscal year in the amount of € 250k.

The disclosures on the compensation of the Management Board and Supervisory Board are explained in the remuneration report in more detail.

37. Fees of the auditor

Expenses recognized for audit fees of Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft totaled € 1,479k in the reporting year and break down into audit services of € 996k (thereof for previous year: € 159k), other assurance services of € 7k, tax advisory services of € 404k and other services of € 72k.

38. Disclosures on the Supervisory Board and the Management Board

The information on the remuneration of the Management Board and the Supervisory Board is provided on pages 20 ff.

As of December 31, 2016, no active members of the Management Board and Supervisory Board held shares in Kontron AG.

Appointments in other oversight boards held by members of the Management Board and the Supervisory Board are shown in the following table:

APPOINTMENTS IN OTHER OVERSIGHT BOARDS HELD BY MEMBERS OF THE MANAGEMENT BOARD AND THE SUPERVISORY BOARD

Management Board	
HANNES NIEDERHAUSER	
Chairman of the Management Board	since December 14, 2016
Member of the Management Board	since December 06, 2016
Member in oversight boards:	
Chairman of the management board of S&T AG	
STEFAN FRANKE	
Management Board Member Corporate Finance	since February 01, 2017
DR. THOMAS RIEGLER	
Management Board Member Corporate Finance	since July 25, 2016
Member in oversight boards:	until January 31, 2017
Chairman of the Advisory Board of Sustainable Growth Associates, Munich, Germany	
STEN DAUGAARD	
Chairman of the Management Board	From July 25, 2016 to
Member in oversight boards:	December 14, 2016
Thomas Cook GmbH, Oberursel, Germany	
ROLF SCHWIRZ	
Chairman of the Management Board	until July 25, 2016
ANDREAS PLIKAT	
Board Member Corporate Development and Technology	until July 25, 2016
MICHAEL BOY	
Management Board Member Corporate Finance	until June 30, 2016
Member in oversight boards:	
Advisory Council of Hengstenberg GmbH & Co. KG, Esslingen am Neckar, Germany	
Provincial Advisory Council of Commerzbank Süd / Südwest, Munich, Germany	

Supervisory board	
RICHARD NEUWIRTH (MMAG.) Chairman of the Supervisory Board CFO of S&T AG, Linz, Austria	since December 02, 2016
MICHAEL JESKE Chief Operations Officer (COO) S&T AG, Linz, Austria	since December 02, 2016
MICHAEL ROIDER (DIPL. ING) Head of development of Roding Embedded GmbH, Roding, Germany	since December 02, 2016
DR. VALERIE BARTH Lawyer Member in oversight boards: Diebold Nixdorf AG, Paderborn, Germany Diebold Nixdorf International GmbH, Paderborn, Germany Orlando Nordics AB, Stockholm, Sweden	since November 03, 2016
DR. DIETER DÜSEDAU Physicist Wincor Nixdorf International, Paderborn, Germany Diebold Nixdorf AG, Paderborn, Germany Diebold Nixdorf Incorporated, Canton, Ohio, USA	
RAINER ERLAT Chairman of the Supervisory Board Partner of redpartners GmbH, Berlin, Germany	until November 30, 2016
STEN DAUGAARD Freelance business consultant Member in oversight boards: Thomas Cook AG, Oberursel, Germany	until July 25, 2016
HARALD JOACHIM JOOS Senior Advisor at Warburg Pincus Deutschland GmbH Member in oversight boards: Berliner Volksbank e. G., Berlin, Germany Deutsche Bank Düsseldorf, Germany Fraunhofer-Gesellschaft Berlin, Germany Hertha BSC GmbH, Berlin, Germany Ultima GmbH, Luxembourg, Luxembourg	until November 30, 2016
MARTIN BERTINCHAMP Managing partner of MB Prochairman Member in oversight boards: Rothenberger AG, Kelkheim, Germany Huber Packaging GmbH, Öhringen, Germany Nordwest Handel Aktiengesellschaft, Hagen, Germany	until November 30, 2016 until December 05, 2016
DR. HARALD SCHRIMPF Chairman of the Board of Directors of PSI Aktiengesellschaft für Produkte und Systeme der Informationstechnologie, Berlin, Germany Intershop Communications AG, Jena, Germany	 until November 30, 2016

TABLE 079

39. Approval of the consolidated financial statements

The Management Board of Kontron AG authorized the consolidated financial statements for presentation to the Supervisory Board on April 05, 2017.

40. Affiliates and consolidated companies of the Kontron Group as of December 31, 2016

	Share in capital (%)	Local currency (LC)	Equity* (LC in k)	Net income / loss for the year (LC in k)
KONTRON EUROPE GMBH, AUGSBURG	100	EUR	115,245	1,373
Indirectly via Kontron Europe GmbH				
Kontron ECT design s.r.o., Pilsen, Czech Republic	100	CZK	5,216	1,421
Kontron UK Ltd., Chichester, UK	100	GBP	2,803	307
Kontron Modular Computers S.A.S., Toulon, France	100	EUR	7,345	– 7,797
Kontron Technology A/S, Hørsholm, Denmark	100	DKK	6,458	740
Kontron Modular Computers AG, Cham, Switzerland	100	CHF	3,103	1
KONTRON MANAGEMENT GMBH, AUGSBURG	100	EUR	27	– 23
KONTRON AMERICA INC., SAN DIEGO, USA	100	USD	33,931	– 22,430
KONTRON CANADA INC., BOISBRIAND, CANADA	51	USD	35,459	7,566
KONTRON ASIA PACIFIC DESIGN SDN. BHD., PENANG, MALAYSIA	100	MYR	– 79,140	– 683
KONTRON (BEIJING) TECHNOLOGY CO. LTD., BEIJING, CHINA	100	CNY	66,825	– 16,925
Indirectly via Kontron (Beijing) Technology Co. Ltd.				
Kontron Hongkong Technology Co. Ltd., Hong Kong, China	100	CNY	1,238	615
KONTRON TECHNOLOGY INDIA PVT. LTD., MUMBAI, INDIA	100	INR	8,161	12,478

* Information as of December 31, 2016

TABLE 080

Disclosures on equity and net income / loss have been derived from the financial statements of subsidiaries that were prepared for consolidation purposes (HB II figures).

In the 2016 fiscal year, as in the prior year, the subsidiaries Kontron Europe GmbH and Kontron Management GmbH made use of the exemption clause according to Sec. 264 (3) HGB.

CLOSING RATES DECEMBER 31, 2016

Closing rate	12/31/2016	Closing rate	12/31/2016
CHF	1.07	INR	71.59
CNY	7.32	MYR	4.73
CZK	27.02	PLN	4.41
DKK	7.43	USD	1.05
GBP	0.86		

TABLE 081

41. Subsequent events

On February 15, 2017, the Management Board of Kontron AG signed a letter of intent with the Management Board of S&T Deutschland Holding AG, a wholly-owned subsidiary of the listed S&T AG, on the planned merger between Kontron AG and the non-listed S&T Deutschland Holding AG. A merger agreement is to be concluded between Kontron AG and S&T Deutschland Holding AG for this purpose. To take effect, this agreement is subject to the approval of the shareholder meetings of both Kontron AG and S&T Deutschland Holding AG.

42. Declaration of compliance with the German Corporate Governance Code

The Management Board and the Supervisory Board of Kontron AG issued a declaration of compliance with the German Corporate Governance Code pursuant to Sec. 161 AktG ["Aktiengesetz": German Stock Corporations Act] on January 30, 2017. The declaration was made permanently available to the shareholders on the homepage.

Augsburg, April 05, 2017

Kontron AG
The Management Board

Hannes Niederhauser **Stefan Franke**

INDEPENDENT AUDITORS' REPORT

We have audited the consolidated financial statements prepared by Kontron AG, Augsburg, comprising the consolidated statement of financial position, the consolidated statement of income, the consolidated statement of comprehensive income, the consolidated statement of cash flows, the consolidated statement of changes in equity, and the notes to the consolidated financial statements, together with the group management report for the fiscal year from January 01, 2016 to December 31, 2016. The preparation of the consolidated financial statements and the group management report in accordance with IFRSs as adopted by the EU and the additional requirements of German commercial law pursuant to Sec. 315a (1) HGB ["Handelsgesetzbuch": German Commercial Code] is the responsibility of the company's management. Our responsibility is to express an opinion on the consolidated financial statements and on the group management report based on our audit.

We conducted our audit of the consolidated financial statements in accordance with Sec. 317 HGB and German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer [Institute of Public Auditors in Germany] (IDW). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the consolidated financial statements in accordance with the applicable financial reporting framework and in the group management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Group and expectations as to possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the consolidated financial statements and the group management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the annual financial statements of those entities included in consolidation, the determination of entities to be included in consolidation, the accounting and consolidation principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements and the group management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.

In our opinion, based on the findings of our audit, the consolidated financial statements comply with IFRSs as adopted by the EU, the additional requirements of German commercial law pursuant to Sec. 315a (1) HGB and give a true and fair view of the net assets, financial position and results of operations of the Group in accordance with these requirements. The group management report is consistent with the consolidated financial statements, complies with the legal requirements, and as a whole provides a suitable view of the Group's position and suitably presents the opportunities and risks of future development.

Without qualifying this opinion, we make reference to the comments in the section on risks and opportunities in the management report. There it is stated that, due to the tight liquidity situation, the ability of the parent company, and therefore the group as a whole, to continue as a going concern is at risk. The ability of the company to continue as a going concern depends on the funds pledged to it by S&T AG in a letter of comfort being provided.

Munich, April 05,2017

Ernst & Young GmbH
Wirtschaftsprüfungsgesellschaft

Gallowsky
Wirtschaftsprüfer [German Public Auditor]

Dr. Eisele
Wirtschaftsprüfer [German Public Auditor]

RESPONSIBILITY STATEMENT

"To the best of our knowledge, and in accordance with the applicable reporting principles, the consolidated financial statements give a true and fair view of the net assets, financial position and results of operations of the Group, and the group management report includes a fair review of the development and performance of the business and the position of the Group, together with a description of the principal opportunities and risks associated with the expected development of the Group."

Augsburg, April 05, 2017

Kontron AG
The Management Board

Hannes Niederhauser

Stefan Franke

FURTHER INFORMATION

GRAPHS AND TABLES

THE KONTRON GROUP IN A MULTI-YEAR OVERVIEW

		2011	2012 [1]	2013 [1]	2014 [1]	2015	2016
RESULTS OF OPERATIONS							
Revenues	€ million	589.6	466.9	445.3	456.8	467.7	385.1
EBITDA [2]	€ million	55.7	7.5	– 0.5	19.2	29.9	– 47.6
EBIT [3]	€ million	34.1	– 24.7	– 29.0	– 5.1	6.2	– 141.7
EBT [4]	€ million	32.6	– 26.5	– 30.6	– 6.9	4.1	– 143.9
Net income / loss for the period	€ million	22.9	– 26.1	– 24.0	– 6.4	– 2.7	– 147.6
Earnings per share	€	0.39	– 0.46	– 0.43	– 0.11	– 0.05	– 2.71
PROFITABILITY							
EBIT margin [5]	%	5.8	– 5.3	– 6.5	– 1.1	1.3	– 36.8
EBT margin [5]	%	5.5	– 5.7	– 6.9	– 1.5	0.9	– 37.4
Return on equity [6]	%	6.9	– 9.1	– 9.7	– 2.5	– 1.0	– 107.7
Return on investment (ROI) [7]	%	6.2	– 5.8	– 6.9	– 1.6	0.9	– 49.4
STATEMENT OF FINANCIAL POSITION							
Total assets	€ million	523.5	460.4	444.6	421.8	441.9	291.1
Equity	€ million	333.6	286.7	246.9	252.7	258.9	137.0
Financial debt	€ million	37.3	14.5	35.4	36.1	57.3	0.6
Equity ratio [8]	%	63.7	62.3	55.5	59.9	58.6	47.1
CASH FLOW [9]							
Cash flow from operating activities	€ million	31.6	46.2	2.0	1.7	14.2	60.5
Cash flow from investing activities	€ million	– 29.3	– 18.9	– 20.0	– 15.4	– 23.9	– 14.3
Cash flow from financing activities	€ million	– 22.4	– 38.0	23.0	– 2.9	20.9	– 30.4
EMPLOYEES							
Number of employees		3,057	1,574	1,479	1,342	1,286	1,215
Revenues per employee	€k	192.9	296.6	301.1	340.4	363.6	317.0

1 Continuing operations
2 EBITDA is defined as EBIT before depreciation and amortization
3 EBIT is defined as earnings before financial income and taxes
4 EBT is defined as earnings before taxes
5 Margins refer to revenues
6 Return on equity = Income / loss from continuing operations / Equity
7 Return on Investment (ROI) = EBT / Total assets
8 Equity ratio = Equity / Total assets
9 No breakdown of continuing and discontinued operations is made in the statement of cash flows

TABLE 082

FINANCIAL CALENDAR

April 06, 2017	Publication of the 2016 Annual Report
May 05, 2017	Publication of Q1 / 2017 Quarterly Statement
May 30, 2017	Annual General Meeting of Shareholders
August 04, 2017	Publication of Q2 / 2017 Half-yearly Financial Report
November 10, 2017	Publication of Q3 / 2017 Quarterly Statement

TABLE 083

Our annual report and our quarterly reports can be found on our website *www.kontron.com/investor* from publication date. Any eventual date changes are also announced on our website in good time.

This annual report was published on April 06, 2017. It is available in German and in English. The German version is authoritative.

The management report contains statements relating to the future that are based on current assumptions and estimates of the Management Board concerning future development. Although we are of the opinion that the assumptions and estimates are realistic and correct, they are subject to certain risks and uncertainties that may cause actual future results to diverge materially from the assumptions and estimates. Factors that may result in a discrepancy include changes in the overall economic, business, financial and competitive situation, exchange and interest rate fluctuations as well as changes to the business strategy. We cannot guarantee that the future development and actual future results will coincide with the assumptions and estimates expressed in this annual report. Assumptions and estimates presented in this report will not be updated.

This annual report was produced in a climate-neutral process. CO_2 pollution generated in connection with the production was offset in full through support for a climate protection project run by natureOffice.

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