napatech
Reconfigurable Computing

2018 ANNUAL REPORT

Napatech A/S
Tobaksvejen 23 A. 1.
DK-2860 Søborg

CVR. No. 10 10 91 24

Approved by the Annual General Meeting of shareholders on 25 April 2019

Chairman

CONTENTS

Editors
Napatech A/S
Tobaksvejen 23A
2860 Søborg

DEAR READER

Change brings opportunity

As quoted in many ways, but succinctly so by Nido Qubein, an American Lebanese-Jordanian businessman; change brings opportunity. As a backdrop to our 2018 Annual Report, this concept cannot be more appropriate. Napatech is not immune to the forces of change. As a global tech company operating within a rapidly shifting landscape, we must be open to change. We must try hard to predict it. And we must strive to react to it in a timely manner. Our first decade of growth was built on our ability to find the opportunity in change. We created a unique world-class expertise in packet capture solutions by leveraging the accelerating high-performance abilities of the FPGA to improve the way networks were monitored. However over the last three years, industry momentum shifted dramatically, and we found ourselves assessing our strategy and regaining stability in 2018.

The IT industry is changing from hardware centric to software only, from premise-based architectures to the cloud, from fast to ever faster networking and hyperscale, where the application is finding itself at the center of this technology revolution. It is in these changes that I see the growing opportunity for Napatech to create new revenues by inserting our solutions where our world class FPGA software expertise can be engaged to accelerate applications and virtualized network functions in rapidly growing next generation networks.

Major trends in cloud networking, 5G mobile networks, and the Internet of Things (IoT) have created new opportunities. Our current and prospective customers updated their visions for their future within these trends, informing us of their direction and validating our strategy for growth. We made significant changes within our product strategy to align with the direction of our target markets. While we encountered quarter-to-quarter revenue fluctuations and a full-year revenue below our target, we recommitted our focus on our core competencies, made important changes to the way we will operate our business, and we are motivated by our ability to successfully execute as the top supplier of reconfigurable computing solutions.

FPGA technologies are becoming pervasive, available for use in an increasing number of locations. As a result, the demand for FPGA-based software solutions will increase considerably. Napatech has years of experience in designing FPGA-based solutions, making us uniquely capable of meeting the needs of the rapidly expanding market. As a result, 2018 saw the beginning of several initiatives to support these new opportunities.

We strengthened our leadership team, initiated with my appointment as the new CEO, and the addition of new highly-qualified financial leadership. We have fortified our product strategy around a short-term plan to stabilize and grow revenues in 2019 from existing product lines based on packet capture solutions where the market is large and viable. We introduced our first software only solution, and accelerated our development in the areas cybersecurity and virtualization, focused on highly leverageable use cases where our technology can shine so that we can catch new waves of growth for 2020 and beyond.

We also sized our team to shorten our path to profit, to maximize the potential of our engineering development ability around our core competencies, while focusing our marketing and sales within the markets and with alliance partnerships that will place Napatech in the right places at the right time.

Our finish to 2018 was a good indication for the opportunity that lies ahead with a clearer picture of what we can do, how we can perform and how we will position Napatech for the coming year of stability and growth.

Will this change bring opportunity for Napatech? We are a global tech company with a unique expertise and determination to win. But we are also a company with a heart and soul; its heart based in Denmark, its soul based in Silicon Valley. This will to win gives me confidence that 2019 will be the beginning of a new era of growth for our unique company. And it is with this in mind that I am committed to make it happen.

Best regards,

Ray Smets
Chief Executive Officer

OUR ASPIRATION

LEADING VENDOR OF RECONFIGURABLE COMPUTING SOLUTIONS

napatech

ENABLING IT ORGANIZATIONS OF ALL SIZES TO REAP THE BENEFITS OF RECONFIGURABLE COMPUTING

THE NAPATECH STORY

Napatech FPGA solutions come of age

MARKETS ARE CHANGING AND SO IS NAPATECH

Enterprises, governments and service providers are all in the midst of a digital transformation journey that promises to yield significant benefits for all of us. Yet, not only is this journey disruptive, it is also turbulent. There are new challenges requiring new solutions, technologies and ways of working.

The competence, technology and solutions that Napatech has developed over the last 15 years have now become critical to the success of digital transformation initiatives. There is a growing realization that the combination of standard server platforms with FPGA technology, what we call Reconfigurable Computing, is essential to ensuring that critical networking and cybersecurity applications can continue to support the continuous growth in data and ensure that this data is available, reliable and protected.

AT THE CROSSROADS OF TWO MAJOR MARKET TRENDS

The reconfigurable computing opportunity sits at the crossroads of two major market trends; the ubiquitous deployment of standard server platforms for every conceivable application and the growing intelligence and complexity of the software applications on which we all rely. Both trends are the source of tremendous growth in their own right, but the growing disparity between the performance and capabilities that software applications require and the ability of standard servers to meet those requirements is leading to an emerging and large opportunity in providing reconfigurable computing solutions that can bridge this performance gap.

GROWING INTELLIGENCE AND COMPLEXITY OF SOFTWARE APPLICATIONS

The intelligence and complexity of software applications are growing. For example, cybersecurity is a major concern for all organizations, which is driving a tremendous amount of innovation in new types of security threat detection and prevention solutions and more sophisticated cybersecurity software applications. Machine learning and artificial intelligence are more widely used today for cybersecurity and for many more applications, and their usage is expected to grow over the coming years. Even on a more practical level, smartphones and tablet devices generate more data that needs to be processed. Virtual and augmented reality, as well as the expected deployment of billions of IoT devices, will exacerbate these challenges.

CLOUD SERVICE PROVIDER INNOVATION OPENS OPPORTUNITIES

Cloud service providers have led the way in exploiting the superior scalability and economics of standard servers as well as innovating new software-defined approaches for managing and operating datacenters at hyper-scale. The majority of hyper-scale cloud service providers have the capability and resources to develop these solutions internally, but have also shared many of their learnings, techniques and even designs through open-source communities. This is enabling other companies and industries to benefit from the innovations that cloud service providers have developed.

This opens opportunities for companies like Napatech to develop solutions inspired by cloud service provider innovation. These solutions can enable other end-users to reap the same benefits as cloud service providers.

ADDRESSING THE PERFORMANCE GAP WITH FPGAS

As software applications have become more sophisticated and the amount of data to be processed in datacenters has increased, the traditional model of “just adding more servers” has struggled to keep up with demands. The data processing power of standard servers is continuously improving, but not fast enough to meet demands. The expectation now is that the processing power of standard servers will no longer double every 18 months, as has been the norm in the past, but will double over the next 20 years, i.e. a 3% increase per year. As data processing requirements continue to grow at double-digit rates, the only answer is to add more servers, but there is a limit to how many can be added as more servers can exceed the available electrical power, space and cooling capabilities of a given datacenter.

To mitigate these issues, cloud service providers have investigated alternative data processing technologies that could be added to standard servers. The idea is to offload some of the data processing tasks from the standard server to other technologies that are more suited to these particular tasks. Many different technologies have been investigated, and continue to be investigated, but a clear trend is developing around the use of reconfigurable computing technology and in particular the use of FPGAs. Microsoft Azure has led the way and has actively promoted their use of FPGA SmartNICs throughout their datacenters with impressive performance improvements.

PRESENT ON
2
CONTINENTS

CUSTOMERS
150+
INTERNATIONALLY

INDUSTRY EXPERIENCE
16
YEARS

Other cloud service providers have also adopted FPGA technology including Amazon Web Services, Alibaba, Tencent and Baidu. It is this interest in using FPGA technology and reconfigurable computing that prompted Intel to make one of its largest acquisitions to date in December 2015, namely the purchase of Altera, one of the two major FPGA chip vendors, for $16.7 billion.
The reconfigurable computing opportunity is not just confined to hyper-scale datacenters. Hyper-scale datacenters are often at the forefront of technology development and a beacon for other technology companies and service providers to follow. For example, telecommunication service providers were inspired by cloud service providers' hyper-scale datacenter solutions and in particular, their use of standard servers, virtualization and automated, software-defined management and control. This led to the establishment of SDN and NFV, which are currently being implemented by the telecommunication industry and form the backbone for planned 5th Generation (5G) mobile infrastructure deployments in the coming years.

In the same manner, the adoption of FPGA technology by cloud service providers is driving interest in other technology industries in investigating the power and versatility of reconfigurable computing solutions based on FPGA technology. This drives a significant opportunity for Napatech as more and more standard servers are enhanced to become reconfigurable computing platforms in support of ever more sophisticated and demanding software applications.

FROM HARDWARE-CENTRIC TO SOFTWARE-CENTRIC

The adoption of software-defined approaches pioneered by cloud service providers has led to a major transition in the industry from hardware-centric to software-centric solutions.

Previously, hardware-centric solutions, where there was a tight integration between the hardware platform and the application software running on that platform, were necessary to assure performance and reliability. This is still the case, but the benefits of enabling software-defined automation, and the flexibility that this brings in addressing the ever-increasing sophistication of modern networks and the services they support, far outweigh the benefits that hardware-centric solutions currently provide.
The transition from hardware-centric to software-centric solutions has proven to be turbulent for the industry and has affected both Napatech customers and Napatech performance in 2018. In general, the transition to more software-centric solutions and software-defined approaches has not progressed as smoothly or as quickly as the industry expected.

This is partly because of the inability of standard compute platforms to keep up with demand. Now, hardware acceleration using solutions like FPGA-based SmartNICs is becoming widely accepted as the path forward, as the telecommunication industry realizes that standard compute platforms alone cannot deliver the required performance.

NAPATECH RECONFIGURABLE COMPUTING PLATFORM™

Napatech Reconfigurable Computing Platform is the framework for Napatech solutions and consists of the following:

- A broad portfolio of FPGA-based SmartNICs that can be installed in any standard server.

- FPGA configuration software that defines the tasks to be performed on the FPGA. This software can be used to configure Napatech FPGA-based SmartNICs, but also FPGAs on 3rd-party SmartNICs or other hardware.
- Integration software with application programming interfaces designed to support the application software to be accelerated.
- Professional services to support solution development, integration, deployment and maintenance.

APPLICATION DRIVEN

The reconfigurable computing solutions provided by Napatech are driven by the needs of software applications, which means that all capabilities, performance and capacity are designed with the needs of specific software applications in mind.

SOFTWARE-CENTRIC

The value of the reconfigurable computing solution lies in the FPGA configuration software and the tasks that the FPGA needs to perform. The FPGA itself is available from major vendors like Xilinx and Intel. However, these vendors do not provide the FPGA configuration software that defines how the data is processed on the FPGA. This is the expertise and value that Napatech provides.

HARDWARE INDEPENDENT

Napatech is, and will continue to be, a provider of FPGA-based SmartNICs. As the adoption of reconfigurable computing solutions grows, we expect FPGA-based SmartNICs to be available from a wider range of vendors, many of which will not provide the solution software to configure the FPGA. It is also possible that FPGA technology will be embedded in standard servers and not require SmartNICs. In both cases, it is important that Napatech FPGA configuration software and other supporting software is hardware-independent and capable of supporting these alternative options.

SOLUTION FOCUSED

Napatech provides a range of reconfigurable computing solutions addressing specific market needs, such as network performance and cybersecurity applications. Nevertheless, Napatech does provide services for custom development of reconfigurable computing solutions to address specific software application needs. In many cases, these custom developments lead to new market opportunities as the needs identified by the lead customer are often shared by their competitors or similar companies.

THE NAPATECH ADVANTAGE

FPGA configuration software forms the core of Napatech reconfigurable computing solutions and Napatech is unique in providing FPGA configuration software for networking and cybersecurity applications.

READY FOR THE FUTURE

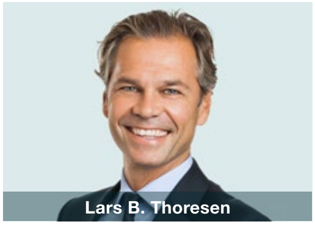
Napatech has taken the necessary steps over the last few years to prepare for the software-centric future. We have invested in the necessary technologies to position Napatech at the heart of future developments. We have established the necessary strategic relationships to exploit opportunities when they arise, and we have re-architected our solutions to support the software-centric transition. Now, Napatech FPGA configuration software can be deployed on third party hardware. A recent example is our partnership with Intel where Napatech Link™ Capture Software is now available for the Intel® Programmable Acceleration Card with Intel Arria® 10 GX FPGA.
The transition to a software-centric future is proving to be turbulent, but at Napatech, we have made the necessary changes and investments to succeed and have the experience, expertise and capabilities to become the leading provider of reconfigurable computing solutions.

Napatech has the ability to provide a complete reconfigurable computing solution that combines unmatched expertise in FPGA configuration software, FPGA-based SmartNICs and acceleration of software applications on standard server platforms. This leverages 15+ years of experience in delivering reconfigurable computing solutions that we believe is difficult for competitors to match.

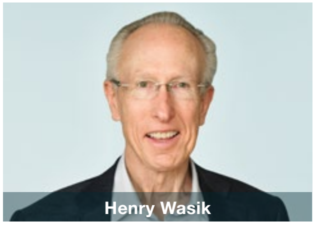
BOARD AND MANAGEMENT PRESENTATION

BOARD OF DIRECTORS


Lars Boilesen


Lars B. Thoresen


Howard Bubb


Henry Wasik


Bjørn Erik Reinseth

MANAGEMENT TEAM


Ray Smets


Henrik Brill Jensen


Heine Thorsgaard


Jarrod J.S. Siket


Flemming Andersen


Heidi Thisgaard

BOARD OF DIRECTORS

Lars Boilesen, Chairman. Directorships: Otello Corporation – CEO, Cobuilder AS – Chairman of the Board.
Lars B. Thoresen, Board member. Directorships: Lt Invest AS – CEO/Chairman of the board, Verdane Capital – Senior Advisor, Arundo Analytics – Board Member, Cxense – Chairman of the board, NextGenTel – Chairman of the Board, Carn Capital – Board Member.
Bjørn Erik Reinseth, Board member. Directorships: Foinco AS – CEO, Zentuvo Finland Oy – Chairman of the board, AllieroGruppen AS – Chairman of the board, Norstat AS – Chairman of the board.
Howard Bubb, Board member. No other directorships or executive functions.
Henry Wasik, Board member. No other directorships or executive functions.

MANAGEMENT TEAM

Ray Smets, CEO. **Heine Thorsgaard**, CFO. **Henrik Brill Jensen**, COO. **Jarrod J.S. Siket**, CMO. **Flemming Andersen**, CR DO.
Heidi Thisgaard, HR Manager.

KEY MARKETS

AS FPGAS BECOME PERVASIVE IN MORE NETWORK LOCATIONS, A BROADER SET OF USERS REQUIRE NAPATECH'S RECONFIGURABLE COMPUTING SOLUTIONS

SERVICE PROVIDERS

FORTUNE-5000 ENTERPRISES

CLOUD DATA CENTERS

INFRASTRUCTURE AND DEFENSE

New technology trends in software defined networking and virtualization enable Napatech to extend the benefits of hyperscale computing to IT organizations of every size.

GROUP KEY FIGURES AND RATIOS

	2018	2017	2016	2015	2014
KEY FIGURES (DKK'000)					
Revenue	106,153	206,046	234,737	216,677	182,335
Gross profit	49,093	139,435	163,608	154,701	133,627
EBITDA	(74,972)	13,885	43,459	34,232	18,010
EBIT	(182,530)	(23,870)	6,001	5,465	(5,889)
Net finance income / (expense)	(9,576)	(5,956)	(60)	5,534	5,186
Profit / (loss) before tax	(192,106)	(29,826)	5,941	10,999	(703)
Profit / (loss) for the year	(179,298)	(24,431)	3,723	7,713	(981)
Investments in intangible assets	35,411	48,402	45,792	42,915	38,371
Investments in tangible assets	461	4,864	3,178	4,125	7,244
Net working capital	28,241	51,486	55,075	27,348	20,024
Total assets	127,133	266,176	261,399	247,552	224,829
Equity	34,719	183,167	204,409	197,002	189,619
Net cash flows from operating activities	(47,899)	15,081	15,040	33,226	10,665
Cash at the end of year	17,159	39,967	46,951	75,921	88,230
Free cash flow	(81,542)	(38,214)	(34,018)	(14,272)	(35,047)
Average number of employees	107	114	107	108	106
FINANCIAL REPORTING RATIOS (%)					
Gross profit margin	46.2%	67.7%	69.7%	71.4%	73.3%
EBITDA margin	-70.6%	6.7%	18.5%	15.8%	9.9%
Current ratio	100.3%	181.8%	339.0%	360.3%	462.9%
Return on equity	-164.6%	-12.6%	1.9%	4.0%	-0.5%
SHARE-RELATED RATIOS (DKK)					
Basic EPS*	(6.55)	(1.03)	0.16	0.33	(0.04)
Diluted EPS*	(6.54)	(1.00)	0.15	0.33	(0.04)
Free cash flow per share*	(2,98)	(1.57)	(1.41)	(0.61)	(1.51)
Operating cash flow per share*	(1,75)	0.62	0.62	1.43	0.46

* In accordance with the decision made on the Annual General Meeting held on 20 April 2016, Napatech conducted a split of shares in the ratio of 1:4. The nominal value of each share has been reduced from DKK 1.00 to DKK 0.25, whereby each shareholder holding one share with the nominal value of DKK 1.00 received four new shares with the nominal value of DKK 0.25. This principle has been applied on comparative figures in order to enable comparison and consistency of share-related ratios with previous periods.

Comparatives for 2014 - 2017 are not restated following the implementation of IFRS 15 and IFRS 9 in 2018.

KEY FIGURE AND RATIO EXPLANATIONS AND DEFINITIONS

The financial highlights and ratios are defined and calculated in accordance with the online guidance from the Danish Finance Society regarding the calculation of financial highlights and ratios: ”Recommendations & Financial Ratios”.

Ratio	Calculation formula	Explanation
Gross profit margin	$\frac{\text{Gross profit}}{\text{Revenue}} \times 100$	The ratio represents the percentage of the revenue less cost of goods sold to cover research and development costs, selling and distribution costs, administrative expenses, depreciation and amortization and finance costs.
EBITDA margin	$\frac{\text{EBITDA}}{\text{Revenue}} \times 100$	The ratio represents the Group’s operating profitability.
Current ratio	$\frac{\text{Current assets}}{\text{Current liabilities}} \times 100$	The ratio represents the percentage of the Group’s resources to meet its liabilities over the next 12 months.
Return on equity	$\frac{\text{Profit for the year}}{\text{Average equity}} \times 100$	The ratio represents the Group’s ability to generate return to shareholders taking into account own capital base.
Operating cash flow per share	$\frac{\text{Cash flows from operating activities}}{\text{Average number of diluted shares}} \times 100$	The ratio represents the Group’s ability to generate cash flow from operating activities per the average number of diluted shares.
Free cash flow per share	$\frac{\text{Free cash flow}}{\text{Average number of diluted shares}} \times 100$	The ratio represents the Group’s ability to generate cash flow from operating and investing activities per the average number of diluted shares.

Net working capital represents the value of inventories, trade receivables of other current operating assets less trade payables and other current operating liabilities. Cash and cash equivalents and income tax receivable or payable are not part of the net working capital.

Cash flows from operating activities are profit or loss before tax added or deducted changes in the net working capital, added or deducted changes in provisions and added the yearly depreciation and amortization.

Free cash flow is net cash flow from operating activities added or deducted investing activities.

The Group’s basic and diluted earnings per share (EPS) is calculated in accordance with IAS 33 and specified in Note 13 to the consolidated financial statements.

APPLICATION DRIVEN

NAPATECH'S RECONFIGURABLE COMPUTING PLATFORM

Flexibly offloads, accelerates and secures standard servers based on a broad set of FPGA software for leading IT applications.

BOARD OF DIRECTORS' REPORT 2018

2018 was a challenging year, but with new management, a revised strategy and an improved internal cost structure, Napatech is poised for future growth.

SUMMARY

2018 was a challenging year for Napatech and our revenue was significantly impacted by the turbulence in the industry created by the ongoing transition from hardware-centric to software-centric solutions.

As a response to the changes in the industry, we implemented some significant adjustments within our product strategy in 2018 and fortified it around a short-term plan to stabilize and grow revenues in 2019 from existing product lines based on packet capture solutions.

During 2018 we also strengthened the management team in Napatech with the appointment of a new CEO and a new CFO. In addition, we took several actions to improve our internal cost structure and efficiency to shorten our path to profit. With these initiatives, we believe Napatech is well positioned to navigate the changes in the industry and is suitably poised for future growth.

Due to the above changes in market conditions and our responses, the income statement for 2018 has been negatively affected by three major one-off transactions: a) DKK 19.5 million in reversed revenue due to a commercial decision to accept return of goods for a channel partner, b) DKK 21.3 million in inventory write down partly related to decisions to end of life certain products, and c) DKK 65.7 million in impairment of intangible assets (se note 14). Because of the decline in the revenue in 2018 Napatech completed a private placement in July 2018 which secured net proceeds of DKK 31.5 million in additional funding for the operations.

The aspiration of Napatech is still to be and be perceived as a global leader in reconfigurable computing solutions focusing on delivering the solutions, technologies and expertise necessary to enable all organizations, that rely on IT for their business, to reap the benefits of reconfigurable computing.

Our strategy to support the increasing set of applications and services that benefit from reconfigurable computing includes four main pillars.

- **Dominate:** We will continue to be the preferred supplier and recognized leader of FPGA-based SmartNIC software for passive network and security applications.
- **Expand:** Expand our business with the Tier 1 OEMs, NSPs and CSPs by continuing to deeply partner on solutions that they rely on to grow their business.
- **Establish:** Establish our position in new, fast growth markets such as 5G Mobile and NFV with customers such as service providers and equipment providers.
- **Explore:** We will aggressively explore new ways to deliver our software benefits, decoupled from hardware in cloud and other environments.

THE MARKET

The market opportunity for Napatech is in providing a reconfigurable computing solution that will allow all IT organizations to reap the same benefits of reconfigurable computing that cloud service providers today enjoy, without the need to become experts in FPGA technology. Our strategy is to design, develop and deliver reconfigurable computing solutions that leverage our unique expertise and experience and are easy for our customers to implement and use. This will enable us to address a much larger part of the market.

Over the last decade, cloud service providers have led innovation in new networking, storage and compute paradigms as well as software automation of data center operations. This investment has been necessary to support the exponential growth these companies have experienced during this time and which no commercially available offerings could support. It has allowed them to reduce costs and dramatically increase the speed at which they can release new products, services and capabilities. Today, cloud service providers are constantly delivering new solutions to keep up with their customers' demands, often with several software releases per day, based on a data center infrastructure that is software programmable, flexible and agile.

Napatech has been a leading provider of FPGA-based hardware and software since 2003. The company is headquartered in Copenhagen, Denmark and has two offices in the United States.

GROUP ENTITIES

The United States subsidiary has offices in Portsmouth, NH, and Los Altos, CA.

FINANCIAL DEVELOPMENT (2017 FIGURES IN BRACKETS)

Net revenues in 2018 came in at DKK 106.2 million (DKK 206.0 million) representing a revenue decline of 48%. The decline was primarily due to uncertainty in the market about the impact of cloud and software only based solutions, but also a result of the commercial decision to accept returns from a channel partner. The uncertainty especially impacted the buying behavior of our North American customers and sales in the first three quarters of 2018 was significantly impacted by this uncertainty. Revenue in the EMEA & APAC increased by 6% in 2018 compared to 2017.

The EBITDA for 2018 was negative DKK 75.0 million (DKK 13.9 million), and the loss before tax for the year was DKK 192.1 million (profit of DKK 29.8 million).

Depreciation, amortization and impairment for 2018 was DKK 107.6 million (DKK 37.8 million). 2018 was impacted by the impairment of capitalized development projects of DKK 42.6 million due both to a revised assessment of timing of the expected acceleration of growth in the market for FPGA-based solutions, and to commercial obsoleteness of certain products due to changes in market demands. 2018 was also impacted by the impairment of assets in conjunction with the decision to divest the Pandion product line. The impairment of the Pandion asset is based on the market value determined by the sales agreement related to the divestiture. See note 14 for further comments.

The group's equity at the end of the year was DKK 34.7 million (DKK 183.2 million).

The group has in-house development resources, developing new products and new functionality (features). The group also engages external consultants for specific development projects. Development costs are capitalized in compliance with IFRS. DKK 35.4 million was capitalized in 2018 (DKK 48.4 million).

The group had a negative net change in cash DKK 22.7 million (negative DKK 6.4 million). The cash flow was negatively affected by the loss for the period and the investment level. This was partly offset by increased borrowings and issue of shares during the year.

Napatech issued a revised outlook on 14 August 2018:

Target	Realized 2018	Guidance
Sales	20.2 MUSD	18-23 MUSD
Gross margin	46%	around 68%

Reported sales is within the guided range. Realized sales, USD 20.2 million (DKK 127.6 million) is defined as net invoiced sale in USD before a commercial decision to take returns of DKK 19.5 million and other accounting adjustments. Gross margin is significantly below guidance due to the impact of extraordinary inventory write downs of DKK 21.3 million and costs of DKK 2.9 million related to the divestiture of the Pandion product line effected in the second half of 2018. Adjusted for these write downs the gross margin was 69%.

FINANCIAL DEVELOPMENT IN THE PARENT COMPANY

Net revenues for the parent company in 2018 came in at DKK 63.9 million (DKK 170.9 million) representing a revenue decrease of 63%. The EBITDA in the parent company for 2018 was negative DKK 77.2 million (DKK 11.7 million), and the loss before tax was negative DKK 193.9 million (negative DKK 31.8 million).

DEVELOPMENT ACTIVITIES AND KNOWLEDGE

Historically, the company has had a high focus on development of new SmartNIC-based products and solutions, both for new and existing markets. This work continued throughout 2018. Additionally, the company used significant resources on developing our new revenue streams within cybersecurity and Virtualized Network Functions. Industry standards around network function virtualization are still in the making and changes in 2018 include uncertainty related to common industry standards for NFV and thereby expectations of delay to the time of revenue and cash inflow, and expectations of increased costs to complete the product offerings. This resulted in impairments in 2018, but Napatech still believes in the long-term attractiveness in the market for our NFV solutions and will continue the development of solutions targeting this opportunity in the coming years.

Napatech underlines its technology leadership by providing new and innovative products and functionality for our entire portfolio of 1, 10, 25, 40, 50, 100 and 200 gigabit products. During 2018, we continued the journey of disaggregating our products, and increasing our focus on becoming more software centric, making our offerings more widely deployable by a broader set of customers in more networks.

Napatech spends a significant part of its development activity during the year targeting solutions for the growing mobile market and solutions within cybersecurity. The Napatech development team is organized in smaller cross-functional teams to secure optimal information sharing and agile product development. In addition, there is extensive use of IT tools that support the sharing of knowledge. All development activities are done in the parent company, in Denmark, which ensures a high degree of collaboration, focus and operational excellence.

NAPATECH FPGA SmartNICs

FROM 1G TO 200G.

Our products capture all network data at high speed with zero packet loss. With a portfolio that scales from 1 to 200G, we provide faster, more efficient data delivery and enable real-time insight into network traffic.

DIVIDEND

So far, the company has not distributed any dividends and it does not expect to do so in the near future.

CORPORATE GOVERNANCE

The company's Board of Directors recognizes the importance of good Corporate Governance. This is ensured through interaction between shareholders, the Board of Directors, and the administration. Napatech's goal is that all interested parties are confident that the group's activities are carried out in an acceptable way and that governing bodies have sufficient insight and influence to undertake their functions.

The communication between the company and shareholders primarily takes place at the annual general meeting, quarterly financial reporting and via company announcements.
The company shareholders are encouraged to subscribe to our investor relations email service to receive company announcements as well as other news via email.

Guidelines on Corporate Governance are approved annually by the Board of Directors in connection with the approval of the financial statements or when deemed necessary.
Napatech A/S is subject to Danish law but is listed on Nasdaq Oslo. Napatech has previously according to the Danish Financial Statements Act §107B followed the Norwegian code of practice for corporate governance. Effective from 2018 Napatech has chosen to follow and comply with Danish legislation meaning that Napatech now follows the Danish recommendations for good Corporate Governance. The Company follows all the Danish recommendations for good Corporate Governance except in a few areas where Napatech has chosen a different approach compared to the recommendations. The statutory report on Corporate Governance is available at www.napatech.com/stock-exchange/corporate-governance.

The Board of Directors has established three committees within the Board; the Remuneration Committee, the Audit Committee and the Risk Committee, of which all are sub-committees of the Board (the Board committees report to the Board of Directors) and operate according to the established internal procedures for each committee decided by the Board of Directors.

The Remuneration Committee is composed of three members of the Board of Directors and the CEO of the company. Chairman Lars Boilesen is the Chairman of the Remuneration Committee and Howard Bubb and Bjørn Erik Reinseth are members.

The Remuneration Committee handles the company's remuneration policy and programs, including bonus programs and share-based schemes, and presents recommendations to the Board of Directors for decision according to its meeting protocols and underlying material prepared. The committee annually evaluates the CEO's remuneration and presents recommendations to the Board of Directors for a decision. When the company's remuneration policy proposes a change, it is subject to approval in the annual general meeting.

LEADING
200G
TECHNOLOGY

INDUSTRY AWARDS
20+
WORLDWIDE

GUARANTEED
100%
DATA DELIVERY

The Audit Committee is composed of three members of the Board of Directors. Bjørn Erik Reinseth is the Chairman of the committee, and Lars Boilesen and Henry Wasik are members. This committee supports the Board of Directors in fulfilling its responsibilities, with respect to financial reporting, auditing matters, internal control, and risk matters. The Audit Committee has 2 meetings per year with the company auditors.

The Risk Committee is composed of three members. Lars Thoresen is the Chairman of the committee, with Howard Bubb and Henry Wasik as members. The Risk Committee oversees Napatech's risk profile and reviews Napatech's enterprise risk management processes and related actions implemented by the management.

The company's Board of Directors shall have a diverse composition and competence tailored to meet the company's needs. The Board of Directors' work complies with the company's internal instructions, guidelines and procedures for the Board members. The Board normally also carries out a self-assessment of its own activities and competence.

The Board of Directors held 16 board meetings in 2018, out of which 4 were for the approval of the quarterly report and presentations.

The guidelines, including the annual Corporate Governance status, can be found on the company's investor relations site, at www.napatech.com/investor.

RISKS

The group is, due to its normal course of business, exposed to a number of risk factors. The group operates in a technology market that could change the need for the solutions that Napatech provides. The customers are mainly large tier-one customers, with normal credit terms. The group is not significantly exposed towards credit risks, but as some customers are large, the outstanding amounts can potentially be substantial.

The group is exposed to operational risks due to the dependence on suppliers to deliver both components and the finished products necessary to recognize revenue. The group's growth partly depends on the delivery and adoption of new products and functionalities by the market.

As the group has all revenue in USD, as well as some assets in USD, there is a risk that fluctuations in USD exchange rate will affect our financial performance.

RISK MANAGEMENT AND INTERNAL CONTROL

Managing risk related to the group's financial performance is controlled by our CFO. The Board of Directors receives monthly financial reports from the finance department, including key financial and operational performance indicators. Up until the end of 2018, the company approved and presented quarterly reports to the market in accordance with IAS 34. Going forward, the company will present interim management statements for Q1, Q3 and Q4, and half year reports in accordance with IAS 34.

CORPORATE SOCIAL RESPONSIBILITY

Napatech is keen to comply with The Responsible Business Alliance (RBA), formerly the Electronic Industry Citizenship Coalition (EICC), Code of Conduct that establishes standards to ensure that working conditions in the electronics industry or industries in which electronics is a key component and its supply chains are safe, that workers are treated with respect and dignity, and that business operations are environmentally responsible and conducted ethically. Napatech RBA (EICC) conformance statement is available on request through the company website.

Companies in the group do not generate higher levels of direct pollution or emissions than those that are normal for a company in the industry. The working environment is considered to be good, and the general well-being in the work place is high.

At Napatech, we assign resources to ensure compliance with the constantly changing legislation. We make sure that working conditions are safe and that our employees are treated with fairness, respect, and dignity.

Any form of corruption, extortion, or embezzlement is strictly prohibited. No bribes or improper advantages are offered or accepted. Compliance to RBA's Code of Conduct is a matter of course. We have never received a single fine or penalty regarding corporate, employee, or environmental issues.

We are committed to conducting business operations in an environmentally responsible and ethical manner and have established a Conflict Mineral policy with the objective to only use tin, tantalum, tungsten, and gold (3TG) that originate from conflict-free sources. All components are screened towards the Responsible Minerals Initiative (RMI) smelter database, the actual screening is outsourced to GreenSoft Technology. By the end of 2017, we managed to make our products for 1 gigabit and 10 gigabit 100% conflict-free. We are proud to have maintained this position throughout 2018 and expanded it to include our products for 40 and 100 gigabit. Our commitment to achieve 100% conflict-free products is supported by our membership of RMI.

OUR PRODUCTS

Our products are assembled by contract manufacturers that share our ambitions for social responsibility. We investigate each component regularly, as declared in our conformance declaration with the EU RoHS directive and the REACH regulation.

Our products comply with EU directives and carry the CE-mark, as declared in our EU declaration of conformity. They carry the UL mark for recognized components, and they are manufactured under UL's inspection and follow-up service, ensuring that safety critical components are authenticated and handled according to UL's procedures.

OUR EMPLOYEES

Napatech's 87 fulltime employees, as of 31 December 2018, include 13 women, 16 in 2017. The group primarily employs engineers, and as women are underrepresented among engineers, it is considered a natural consequence that women are underrepresented in Napatech. There is one woman in management, holding the position as HR responsible. It is the group's policy to increase the presence of women in the management team. In recruiting processes, the company aim is for at least one out of three candidates to be female, however, the best candidate for a specific position will be chosen. The Board of Directors currently consists of only men. The long-term goal is to have at least 20% female representation on the Board. During the latest process for additions to the Board, there were no suitable female candidates, which is why the Board has extended the timescale for goal completion with an additional 3 years, until 2022. In general, Napatech wants to increase the presence of women throughout the organization. In order to attract more female applicants, efforts are focused on improving work-life balance. It is, however, always the candidate who is deemed best suited for a position that will be offered the position.

The group has a diversification strategy and has, in the Danish headquarters, employed 16 different nationalities. Salaries, positions and duties are determined on the basis of qualifications and experience.

OUR ENVIRONMENT

The group's main impact on the environment is through the consumption of electricity and the usage of the group's petrol driven cars. Almost all emissions are Scope 2 emissions, with the exception of the emissions from the company fleet. The only greenhouse gas emissions that Napatech has and accounts for is carbon dioxide.

Napatech has its own internal environmental policies, which oblige the group to take reasonable steps in order to reduce the environmental impact. Our goal is to complete measurements covering at least 85% of the employees in 2020.

Napatech's full Corporate Social Responsibility policy is available on www.napatech.com/about/csr as is our CSR report for 2018.

LEGAL MATTERS

There are currently no legal proceedings involving any company in the Napatech group.

EVENTS AFTER YEAR-END

On an Extraordinary General Meeting on March 15th, 2019 a private placement raising gross proceeds of NOK 50 million (DKK 38.4 million) and a separate offering tranche in favour of certain listed members of the company's board and management along with a subsequent offering of NOK 25 million (DKK 19.2 million), was approved. At the date of publishing of this report the subsequent offering has not yet been completed. The subscription period for the subsequent offering will commence as soon as practically possible following the approval of a prospectus by the relevant financial supervisory authority. This is expected to happen during first half of April 2019. As of the date of reporting the share capital of the company is DKK 16,600,388.25 divided into 66,401,553 shares, each with a nominal value of DKK 0.25.

OUTLOOK

Napatech´s strategy is to be and be perceived as a global leader in reconfigurable computing solutions. Our strategy is to focus on delivering the solutions, technologies and expertise necessary to enable all organizations that rely on IT for their business to reap the benefits of reconfigurable computing. Our goal is to become the number one vendor of reconfigurable computing solutions. The company expects the revenue to grow significantly in 2019 but underlines that the short-term visibility is limited and will continue to be affected by quarter-to-quarter order volatility.

2018 was a turbulent year for Napatech. The company's sales were significantly impacted in the first three quarters of the year by the ongoing transition in the market of many of our customers from a hardware-centric to a software-centric world of software defined networking. In Q4 of 2018 sales were more normalized and as a result of the changes the markets, customers and Napatech are going through, the long-term outlook is bright as Napatech products and services become applicable to not only our current, but also new market segments. In other words, Napatech will serve an increasing addressable market going forward. Thus Napatech believes that it will see renewed and increased growth at the other side of the current transition.

2019 guidance for the company is the following:

- Revenue in the range of DKK 150-180 million (USD 23-27,6 million)
- Gross margin around 68%
- Operating expenses in the range of DKK 115-125 million
- Investments in development projects in the range DKK 20-25 million
- Depreciation and amortization in the range of DKK 15-20 million

Operating expenses include costs on research and development, sales and distribution, as well as administrative expenses.

With performance in the middle of the guided ranges EBITDA would be negative DKK 7.8 million and EBIT would be negative DKK 30.3 million.

The company is exposed to risks that might affect our ability to reach our goals such as currency fluctuations, general market uncertainty, and material changes in our large OEMs' needs for Napatech's products.

EMPLOYEES
107
FULLTIME

WORLDWIDE
16
NATIONALITIES

LOCATIONS
3
WORLDWIDE

SHAREHOLDER INFORMATION

The group has a policy of continuously keeping shareholders, employees and other stakeholders updated on the group's operations.

At the end of the year, the Company had a total of 31,923,220 shares outstanding of a nominal value of DKK 0.25. The company owned 10,800 treasury shares at year end. The company had 404 shareholders and 61% of the shares were registered outside Norway. Total outstanding warrants at the end of the year were 1,457,768 warrants with an average exercise price of DKK 11.66. Napatech has one class of shares, and no restriction on the trading in the Company's shares.

The group has a policy of continuously keeping shareholders, employees and other stakeholders updated on the group's operations. This is achieved via open quarterly presentations, meetings with stakeholders and continuously updating the investor relations page on www.napatech.com.

Napatech is a Danish company registered in the Danish Central Business Register under 10109124. The ISIN number is DK0060520450, and the Company trades on Oslo Stock Exchange under the Ticker: NAPA.

During 2018 a number of releases have been announced on Oslo Stock market under the ticker: NAPA. For a complete overview, please see www.newsweb.no

The Company's financial calendar for the remainder of 2019 is:

Date	Activity in 2019
April 25	Annual assembly
May 8	Q1 2019 Interim Management Statement
August 27	Half-yearly Report
October 8	Capital Markets Day
November 5	Q3 2019 Interim Management Statement

NAPATECH SHARE PRICE DEVELOPMENT 2018 IN NOK

NAPATECH HAD BY 1ST MARCH 2019 THE FOLLOWING TOP 20 SHAREHOLDERS

Investor	Number of shares	% of total	Country
VERDANE CAPITAL VIII	6,902,444	21.62%	Denmark
SILVERCOIN INDUSTRIE	2,295,335	7.19%	Norway
STOREBRAND VEKST VERDIPAPIRFOND	1,840,804	5.77%	Norway
VERDIPAPIRFONDET DNB	1,753,312	5.49%	Norway
ARCTIC FUNDS PLC	1,750,072	5.48%	Irland
TIGERSTADEN AS	1,304,673	4.09%	Norway
DNB NOR MARKETS, AKSJEHAND	1,297,858	4.07%	Norway
THE BANK OF NEW YORK MELLON	964,896	3.02%	Great Britain
DANSKE BANK A/S	910,060	2.85%	Denmark
MARSTAL AS	720,000	2.26%	Norway
NORDNET BANK AB	674,838	2.11%	Sweden
HOLTA INVEST AS	555,205	1.74%	Norway
UBS SWITZERLAND AG	474,892	1.49%	Switzerland
INRO HOLDING AS	465,000	1.46%	Denmark
NORTH ENERGY ASA	340,000	1.07%	Norway
NORDEA BANK ABP	309,800	0.97%	Norway
MIDDELBORG INVEST AS	294,308	0.92%	Denmark
DANSKE BANK A/S	285,061	0.89%	Denmark
PRIVATE INVESTOR	278,927	0.87%	Denmark
SIX-SEVEN AS	272,210	0.85%	Norway
Total owned by top 20	23,689,695	74.20%	
Total owned by 614 other	8,233,525	25.80%	
Total number of shares	**31,923,220**	**100.00%**	

WHY NAPATECH?

RECONFIGURABLE COMPUTING

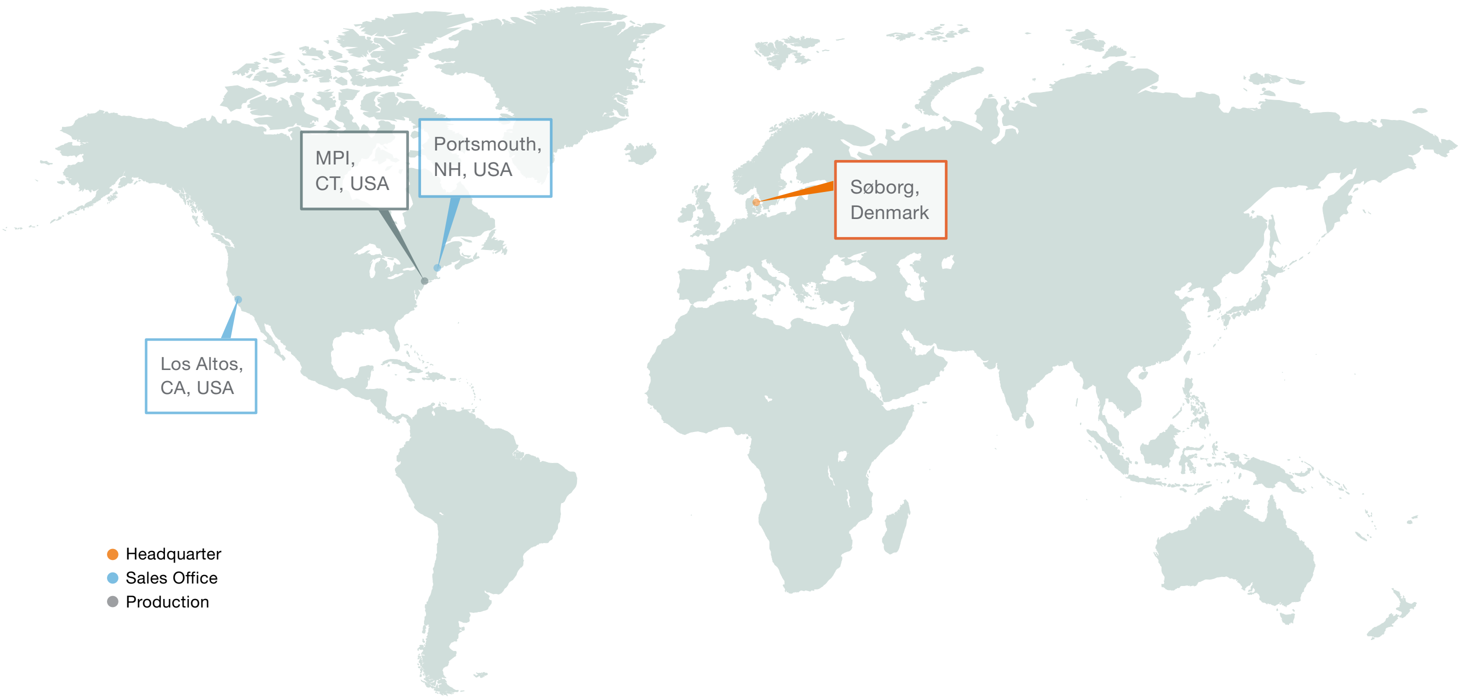
The shift towards cloud networking, 5G and IoT is disrupting the way applications and services are created and deployed. With this disruption, the gap between growing data processing needs and available capacity is widening.

Reconfigurable computing is an evolution driven by hyperscale cloud companies to address this gap by combining the flexibility of software with the high performance of hardware. By using vastly flexible high-speed computing fabrics like Field-Programmable Gate Arrays (FPGA) as a complementary processing alternative, compute intensive tasks can be offloaded, assuring maximum server performance and CPU utilization.

Napatech pioneered the use of reconfigurable FPGA-powered acceleration hardware and software for networking and security applications. Our Reconfigurable Computing Platform™ runs on our family of high-performance SmartNICs and helps IT organizations to support the growing number of demanding software applications required to do business today. By enhancing open and standard servers, we improve services, boost applications and bring hyperscale benefits to networks of every size.

GEOGRAPHICAL PRESENCE

We believe it is extremely important to be attentive and responsive to our customers. To accomplish that, we are represented in different offices around the world. See our presence on the map below.



FINANCIAL STATEMENTS

CONSOLIDATED INCOME STATEMENT

for the year ended 31 December 2018

Note	In DKK '000	2018	2017
4	Revenue	106,153	206,046
4	Cost of goods sold	(57,060)	(66,611)
	Gross profit	**49,093**	**139,435**
5	Other operating income	599	-
6, 7	Research and development costs	(18,460)	(17,907)
6	Selling and distribution expenses	(66,735)	(71,420)
6, 8, 9	Administrative expenses	(39,469)	(36,223)
	Operating profit before depreciation, amortization and impairment (EBITDA)	**(74,972)**	**13,885**
10	Depreciation, amortization and impairment	(107,558)	(37,755)
	Operating result (EBIT)	**(182,530)**	**(23,870)**
11	Finance costs	(9,576)	(5,956)
	Result before tax	**(192,106)**	**(29,826)**
12	Income tax	12,808	5,395
	Result for the year	**(179,298)**	**(24,431)**
13	**Earnings per share:**		
	Basic, DKK	(6.55)	(1.03)
	Diluted, DKK	(6.54)	(1.00)

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

for the year ended 31 December 2018

Note	In DKK ’000	2018	2017
	Result for the year	**(179,298)**	**(24,431)**
	Other comprehensive income to be reclassified to profit and loss in subsequent periods:		
	Exchange differences on translation of foreign operations	224	(519)
	Value adjustments on hedging instruments:		
	- Net gain / (loss) on cash flow hedges	(7,453)	10,265
	- Net (gain) / loss on cash flow hedges reclassified to revenue	-	(5,314)
	- Net (gain) / loss on cash flow hedges reclassified to finance costs	7,453	(3,637)
	- Income tax effect	-	(289)
	Net other income / (loss) to be reclassified to profit or loss in subsequent periods	**224**	**506**
	Total comprehensive income for the year, net of tax	**(179,074)**	**(23,925)**

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

at 31 December 2018

Note	In DKK '000	2018	2017
	ASSETS		
	Development projects, completed	29,773	68,416
	Development projects, in progress	8,194	46,342
	Patents	4,972	5,412
	Other intangible assets	-	50
14	**Intangible assets**	**42,939**	**120,220**
	Plant and equipment	1,932	5,166
	Leasehold improvements	605	1,079
15	**Tangible assets**	**2,537**	**6,245**
22	Leasehold deposits	2,407	2,283
	Other non-current assets	**2,407**	**2,283**
	Non-current assets	**47,883**	**128,748**
17	Inventories	16,971	36,124
18, 22	Trade receivables	25,305	51,938
19	Contract assets	514	-
18, 22	Other receivables	13,814	3,899
20	Income tax receivable	5,487	5,500
22	Cash and cash equivalents	17,159	39,967
	Current assets	**79,250**	**137,428**
	Total assets	**127,133**	**266,176**

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

at 31 December 2018

Note	In DKK '000	2018	2017
	EQUITY AND LIABILITIES		
21	Issued capital	7,981	5,969
21	Share premium	247,552	219,729
	Foreign currency translation reserve	215	(9)
21	Other capital reserves	4,971	6,361
	Retained earnings	(226,000)	(48,883)
	Equity	**34,719**	**183,167**
16	Deferred tax liability	-	7,425
22, 25	Other non-current financial liabilities	13,391	-
	Other non-current financial liabilities	**13,391**	**7,425**
22, 25	Interest-bearing loans and borrowings	44,701	35,109
22, 25	Other current financial liabilities	5,959	-
22	Trade payables	11,099	26,130
22	Other payables	13,720	13,855
24	Provisions	69	490
19	Contract liabilities	3,475	-
	Current liabilities	**79,023**	**75,584**
	Total liabilities	**92,414**	**83,009**
	Total equity and liabilities	**127,133**	**266,176**

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

for the year ended 31 December 2018

Note	In DKK '000	Share capital	Share premium	Foreign currency translation reserve	Share based payment reserve	Cash flow hedge reserve	Retained earnings	Total equity
	At 1 January 2017	**5,916**	**216,429**	**510**	**7,611**	**(1,025)**	**(25,032)**	**204,409**
	Result for the year	-	-	-	-	-	(24,431)	(24,431)
	Exchange differences on translation of foreign operations	-	-	(519)	-	-	-	(519)
	Net gain on cash flow hedges	-	-	-	-	10,265	-	10,265
	Net gain on cash flow hedges reclassified to revenue	-	-	-	-	(5,314)	-	(5,314)
	Net gain on cash flow hedges reclassified to finance costs	-	-	-	-	(3,637)	-	(3,637)
	Income tax effect	-	-	-	-	(289)	-	(289)
	Total comprehensive income	**-**	**-**	**(519)**	**-**	**1,025**	**(24,431)**	**(23,925)**
	Issue of shares	53	1,652	-	-	-	-	1,705
	Transaction costs	-	-	-	-	-	-	-
	Reversal, exercised and lapsed share options	-	1,648	-	(2,228)	-	580	-
8	Share-based payments	-	-	-	978	-	-	978
	Total transactions with shareholders	**53**	**3,300**	**-**	**(1,250)**	**-**	**580**	**2,683**
	At 31 December 2017	**5,969**	**219,729**	**(9)**	**6,361**	**-**	**(48,883)**	**183,167**
	Result for the year	-	-	-	-	-	(179,298)	(179,298)
	Exchange differences on translation of foreign operations	-	-	224	-	-	-	224
	Net gain on cash flow hedges	-	-	-	-	(7,453)	-	(7,453)
	Net gain on cash flow hedges reclassified to revenue	-	-	-	-	-	-	-
	Net gain on cash flow hedges reclassified to finance costs	-	-	-	-	7,453	-	7,453
	Income tax effect	-	-	-	-	-	-	-
	Total comprehensive income	**-**	**-**	**224**	**-**	**-**	**(179,298)**	**(179,074)**
	Issue of shares	2,012	29,493	-	-	-	-	31,505
	Transaction costs	-	(1,980)	-	-	-	-	(1,980)
	Reversal, exercised and lapsed share options	-	310	-	(2,491)	-	2,181	-
8	Share-based payments	-	-	-	1,101	-	-	1,101
	Total transactions with shareholders	**2,012**	**27,823**	**-**	**(1,390)**	**-**	**2,181**	**30,626**
	At 31 December 2018	**7,981**	**247,552**	**215**	**4,971**	**-**	**(226,000)**	**34,719**

CONSOLIDATED STATEMENT OF CASH FLOWS

for the year ended 31 December 2018

Note	In DKK '000	2018	2017
	Operating activities		
	Result before tax	(192,106)	(29,826)
	Adjustments to reconcile profit before tax to net cash flows:		
	Finance costs	9,576	5,956
	Depreciation, amortization and impairment	107,558	37,755
	Gain/loss on the sale of non-current assets	(599)	428
	Impairment of inventories	21,323	-
	Share-based payment expense	1,101	978
	Working capital adjustments:		
	Change in inventories	(2,170)	(17,449)
	Change in trade and other receivables and contract assets	22,849	16,283
	Change in trade and other payables, provisions and contract liabilities	(11,808)	(1,419)
	Cash flows from operating activities	**(44,276)**	**12,706**
	Cash flow hedges in financial items	(7,454)	2,506
	Interest paid	(1,552)	(861)
	Income tax received, net	5,383	730
	Net cash flows from operating activities	**(47,899)**	**15,081**
	Investing activities		
	Proceeds from sale of tangible assets	126	-
	Purchase of tangible assets	(461)	(4,864)
	Proceeds from sale of intangible assets	1,979	-
	Investments in intangible assets	(35,411)	(48,402)
	Investments in leasehold deposits	124	(29)
	Net cash from investing activities	**(33,643)**	**(53,295)**
	Free cash flow	**(81,542)**	**(38,214)**
	Financing activities		
	Capital increase	31,505	1,705
	Transaction costs on capital increase	(1,606)	-
	Proceeds from borrowings	28,942	30,109
	Net cash flows from financing activities	**58,841**	**31,814**
	Net change in cash and cash equivalents	**(22,701)**	**(6,400)**
	Net foreign exchange difference	(107)	(584)
	Cash and cash equivalents at 1 January	39,967	46,951
	Cash and cash equivalents at 31 December	**17,159**	**39,967**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 CORPORATE INFORMATION

The consolidated financial statements of Napatech A/S and its subsidiaries (collectively, the Group) for the year ended were authorized for issue in accordance with the resolution of the management on 3 April 2019.

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES

General
The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the EU and additional requirements in the Danish Financial Statement Act.

The consolidated financial statements are prepared on a historical cost basis, except for derivative financial instruments, which are measured at fair value.

The consolidated financial statements are presented in thousand Danish kroner (DKK’000).

Effect of implementation of new and revised standards
In its Annual Report for 2018, the Group has implemented all new IFRS standards, amendments to existing standards and IFRIC interpretations that have been adopted by the EU and are operative for financial statements covering periods beginning on or after 1 January 2018.

The following standards, amendments to existing standards and interpretations have been implemented in the Group’s Annual Report for 2018:

- IFRS 9 Financial instruments and amendments to IFRS 9, IFRS 7 and IAS 39
- IFRS 15 Revenue from Contracts with Customers
- Amendments to IFRS 2 - Classification and Measurement of Share-based Payment Transactions
- IFRIC 22 Foreign Currency Transactions and Advance Consideration
- Annual Improvements to IFRSs 2014-16 Cycle

None of the above mentioned standards, amendments to existing standards and interpretations have had any significant effect on recognition and measurement in the annual report for the Group and parent company:

IFRS 9 Financial instruments was issued in July 2014 and is effective for annual periods beginning 1 January 2018.

IFRS 9 requires the group to record expected credit losses on all its trade receivables, on a lifetime basis. The Group and Parent Company applied the simplified method upon adoption of IFRS 9 on 1 January 2018 and record lifetime expected losses on all trade receivables. Based on the Group’s portfolio of financial assets and liabilities and the historical low realized loss on trade receivables, the adoption of the new standard did not have any impact on the Group’s financial statements and therefore no effect on retained earnings at 1 January 2018.

The new standard has introduced expanded disclosure requirements and changes in presentation, which are adopted in the annual report 2018.

IFRS 15 “Revenue from Contracts with Customers”, which replaces the existing revenue standards (IAS 11 and IAS 18) and interpretations, creates a new model for revenue recognition and measurement of revenue from contracts with customers.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The new model is based on a five-step process which must be applied to all contracts with customers in order to identify when and how revenue is to be recognized in the income statement.

Compared to the current practice, the most significant changes in IFRS 15 are:

- Sales transactions must be recognized as revenue in the income statement when control (either at a single point in time or over time) of the goods or services is transferred to the customer (the current concept of “risk and rewards” is replaced by a concept of control).
- New and more detailed guidance on how to identify the components of a transaction in a contract and how to recognize and measure the individual components.
- New and more detailed guidance on the recognition of revenue over time.

The standard is effective for annual periods beginning 1 January 2018, and has been implemented using the modified retrospective method but has not had any cumulative impact recognized in retained earnings as of 1 January 2018.
The new standard have not had any effect on the recognition and measurement of the Group’s sales types, as the Group has assessed that the existing accounting policy for revenue recognition (sale of goods) in all material aspects are consistent with IFRS 15.

New and amended standards and interpretations that have not yet become operative
The IASB has issued a number of new standards, amendments to existing standards which will become operative for financial statements covering periods beginning on or after 1 January 2019:

- IFRS 16 Leases
- IFRS 3 Business combinations – amendments to IFRS 3
- IFRIC 23 Uncertainty over income tax treatments
- Annual Improvements to IFRSs 2015-2017 Cycle
- Amendments to IFRS 9 Prepayment Features with negative compensation
- Amendments to IFRS 28 Long-term interests in associates and joint ventures

New and amended standards are expected to be implemented by their effective dates. Of the above mentioned standards, amendments to existing standards and interpretations, only IFRS 16 is expected to affect Napatech A/S’ future annual reports.

IFRS 16 is effective for financial years commencing on or after 1 January 2019. The Group has not adopted the standard before the effective date.
IFRS 16 will result in almost all leases being recognized on the balance sheet, as the distinction between operating and finance leases is removed. Under the new standard, an asset (the right to use the leased item) and a financial liability to pay rentals are recognized. The standard will affect primarily the accounting for the Group´s operating leases. As of 31 December 2018, The Group has non-cancellable operating lease commitments of DKK 6,424 thousand (see note 26).

The Group plans to adopt the new standard of 1 January 2019 using the modified retrospective method, which means that the cumulative impact, if any, of the adoption will be recognized in retained earnings as of 1 January 2019 and that comparative figures will not be restated.

Napatech A/S has completed a detailed analysis of the potential impact of the new standard on the Group. Based on the analysis the group expects to recognize Right Of Use Assets and corresponding lease liability of DKK 18,662 thousand, equal to 15 % of the balance sheet. The expected impact on Equity as at 1. January 2019 is DKK 0 thousand and the expected impact on profit/loss for the year will not be material compared to the expected profit/loss for 2019.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Based on the analysis the parent company expects to recognize Right Of Use Assets and corresponding lease liability of DKK 10,724 thousand, equal to 11 % of the balance sheet. The expected impact on Equity as at 1. January 2019 is DKK 0 thousand and the expected impact on profit/loss for the year will not be material compared to the expected profit/loss for 2019.

The expected total lease payment (interest and installments) in 2019 for the Group, DKK 6.568 thousand, will according to IFRS16 be presented as finance activity.
The expected total lease payment (interest and installments) in 2019 for the parent company, DKK 4.825 thousand, will according to IFRS16 be presented as finance activity.

The consolidated financial statements
The consolidated financial statements comprise the parent company, Napatech A/S, and its subsidiaries. Subsidiaries are fully consolidated from the date of acquisition and/or incorporation, being the date on which the parent company obtains control, until the date when such control ceases. The financial statements of the subsidiary are prepared for the same reporting period as the parent company financial statements, using consistent accounting policies. The consolidated financial statements are prepared as a consolidation of the parent company's and the subsidiaries' financial statements, eliminating all intra-group balances, transactions, unrealized gains and losses and dividends.

Currency translation
Determination of functional currency and recognition of transactions denominated in foreign currencies
For each group entity, a functional currency is determined, and items recognized in the financial statements of the individual entities are measured using that functional currency. The functional currency is the currency used as primary currency for the activities of the reporting entity. Transactions denominated in currencies other than the functional currency are considered transactions denominated in foreign currencies.

On initial recognition, transactions denominated in foreign currencies are translated into the functional currency at the exchange rates at the transaction date. Foreign exchange differences arising between the exchange rates at the transaction date and at the date of payment are recognized in the income statement as financial income or financial expenses.

Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the exchange rates at the reporting date. Any exchange difference arising on the translation is recognized in the income statement as financial income or financial expenses.
Non-monetary assets and liabilities measured in terms of historical cost in a foreign currency are translated using the exchange rates at the date of the initial transaction.

Translation of group entities
On recognition in the consolidated financial statements of foreign entities with a functional currency different from the parent company's presentation currency (DKK), the income statement and the statement of cash flows are translated at the exchange rates at the transaction date, while the statement of financial position items is translated at the exchange rates at the reporting date. Any foreign exchange differences arising on the translation are recognized as other comprehensive income in a separate reserve. On full or partial disposal of a foreign entity, the share of the currency reserve relating to that particular foreign entity is recognized in the income statement.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Revenue
Revenue from contracts with customers is recognized in the income statement at the point in time when control of the goods is transferred to the customer, usually on delivery of the goods, and at an amount that reflects the consideration to which the group expects to be entitled in exchange for these goods.

Revenue is measured at the fair value of the consideration received, excluding rebates and VAT.

Other operating income
Other operating income comprises income of secondary nature in relation to the activities of the Company, including sale of scrap and gain on sale of fixed assets.

Cost of goods sold
Cost of goods sold is incurred to generate the period's revenue. Cost of goods sold comprises costs relating to purchases of products that are to be resold.

Research and development costs
Development costs include costs incurred to develop new products.

Selling and distribution expenses
Selling and distribution expenses include costs related to the distribution of goods sold, sales campaigns, wages to sales and distribution staff, cars, advertising and exhibitions.

Administrative expenses
Administrative expenses comprise expenses relating to management and administration of the Group, including expenses related to administrative staff, offices and office expenses.

Finance income and cost
Finance income and costs comprise realized interest income and expenses, unrealized gains and losses on financial assets and liabilities in foreign currencies and realized gains and losses on fair value adjustments of derivative financial instruments.

For all financial instruments measured at amortized cost, interest income and expenses are recognized using the effective interest rate method. Financial income and expenses also comprise realized and unrealized exchange gains and losses on foreign currency transactions.

Tax for the year
Tax for the year, which comprises the current tax charge for the year and changes in the deferred tax charge, including changes arising from changes in the tax rate, is recognized in the income statement as regards the portion that relates to the profit or loss for the year and in other comprehensive income as regards the portion that relates to entries in other comprehensive income. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted, by the reporting date, in the countries where the group operates and generates taxable income.

Management periodically evaluates positions taken in the tax returns with respect to situations in which applicable tax regulations are subjects to interpretation and establishes provisions where appropriate.

Share-based payments
The Group's employees and management receive consideration in the form of share-based payments. The share-based consideration is an equity-settled program under which employees and management deliver services in return for share options. The share options are measured at fair value at the time of granting. The fair value of share options is determined using the Black-Scholes option pricing model.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Costs relating to equity-settled share-based payments are recognized in the income statement under administrative expenses and in equity over the vesting period. The total expense recognized for equity-settled share-based payments at the reporting date reflects the share of the vesting period that has lapsed and management's best estimate of the number of equity instruments that will ultimately vest.

Where the terms for equity-settled programmes change, the minimum expense is the expense that would have been recognized had the terms not been changed, provided that the employee's or management's right had vested. In addition, an expense is recognized corresponding to the increase in the fair value of the share-based payment at the time at which the terms are changed.

Derivative financial instruments
The Group enters into forward exchange contracts to hedge the future value of its cash flows. Upon initiation of contracts, the Group classifies each contract that qualifies for hedge accounting as a hedge for a specific hedged financial transaction or firm commitment.

On initial recognition, all forward exchange contracts are measured at cost and subsequently re-measured at their fair value at the balance sheet date. The value adjustments on forward contracts designated as hedges are recognized directly in equity, given the hedge effectiveness. The value adjustments on those forward contracts that do not meet the requirements of IAS 39 for hedge accounting are recognized in the income statement under financial income/expenses.

Intangible assets
Intangible assets are initially recognized in the statement of financial position at cost. Subsequent to initial recognition, intangible assets are carried at cost less accumulated amortization and impairment losses.

Intangible assets comprise development projects, patents and other intangible assets with finite useful lives.

Intangible assets with finite useful lives are amortized over their economic lives and tested for impairment whenever there is an indication that an asset might be impaired. Useful lives are reassessed on an annual basis. Changes in expected useful lives are accounted for as changes in accounting estimates. Amortization and impairment losses are recognized in the income statement.

Gains and losses on disposal of intangible assets are determined by comparing the proceeds from disposal with the carrying amount of the asset and are recognized in the income statement.

Development projects
Research costs are recognized in the income statement as incurred. Development costs incurred for individual projects are recognized as an intangible asset when the Group can demonstrate the following:

- The technical feasibility of completing the development project so that it will be available for use or sale;
- The intention to complete the development project and the group's ability to use or sell it;
- The probability that the development project will generate future economic benefits;
- The availability of adequate technical, financial and other resources to complete the development project and to use or sell it; and
- The ability to measure the costs reliably.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Subsequent to initial recognition of the development costs as an intangible asset, the development project is recognized at cost less any accumulated amortization and impairment losses. Amortization of the intangible asset begins when the development of the asset has been completed and the asset is used as planned. Depreciation is provided on a straight-line basis over the expected useful lives of the assets. The expected useful life of development projects is 3 - 5 years.

Patents

Patents are recognized as intangible assets at the time of acquisition. Patents are amortized over their useful lives, starting at the time when the patent takes effect. Depreciation is provided on a straight-line basis over the expected useful lives of the assets. The useful life of patents is estimated at 10 years.

Tangible assets

Tangible assets include plant and equipment and leasehold improvements. Items of tangible assets are measured at cost less accumulated depreciation and impairment losses, the cost being the acquisition price and costs directly related to the acquisition until such time when the asset is ready for use.

Depreciation is provided on a straight-line basis over the expected useful lives of the assets, as follows:

Plant and equipment	3 years
Leasehold improvements	5 years

Gains and losses on disposal of tangible assets are determined by comparing the proceeds from disposal with the carrying amount of the asset and are recognized in the income statement.

Residual values and useful lives are reassessed on an annual basis. Changes in useful lives or residual values are accounted for as changes in accounting estimates.

Leases

Leases are divided into finance leases and operating leases. A finance lease is a lease that in all essential respects transfers the risk and benefits associated with owning the leased asset to the lessee. Other leases are designated as operating leases.

Assets held under finance leases are measured at the lower of the fair value of the assets and the net present value of future minimum lease payments. For purposes of calculating the net present value, the internal rate of return is used as discount factor or an approximate value thereof. Financial liabilities include the capitalised residual obligation on finance leases, measured at amortized cost.

Lease payments concerning operating leases are recognized on a straight-line basis over the term of the lease.

Impairment of non-financial assets

In-progress development projects are tested for impairment once a year. Other long-term assets with finite useful lives are reviewed for impairment at each reporting date. Where indications of impairment are identified for in-progress development projects or other long-term assets with finite useful lives, the Group estimates the recoverable amount of the asset. The recoverable amount is determined for the individual asset or a group of assets constituting an integrated cash-generating unit. The recoverable amount is the higher of the asset or the cash-generating unit's fair value less costs to sell and its value in use. Where the carrying amount of an asset or a cash-generating unit exceeds its recoverable amount, the asset is considered impaired and the carrying amount is reduced to the recoverable amount. The impairment loss is recognized in the income statement.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The value in use is calculated as the present value of expected future cash flows from the asset or the cash-generating unit of which the asset is a part. For purposes of determining the fair value less costs to sell, an appropriate valuation model is used.

Receivables
Receivables are measured at amortized cost less write-downs. Write-downs on receivables are based on the simplified expected credit loss model. Credit loss allowances on individual receivables are provided for when objective indications of credit losses occur such as customer bankruptcy and uncertainty about the customers' ability and/or willingness to pay, etc.

Write-downs on receivables are recognized in the income statement under administrative expenses.

Contract assets
Contract assets represents the Group's right to recover the goods expected to be returned by customers. The asset is measured at the former carrying amount of the inventory, less any expected costs to recover the goods, including any potential decreases in the value of the returned goods. The Group updates the measurement of the asset recorded for any revisions to its expected level of returns, as well as any additional decreases in the value of the returned products.

Inventories
Inventories are measured at the lower of cost and net realisable value. The cost is determined using the first-in/first-out (FIFO) method.

The cost of goods for resale, raw materials and consumables comprises the purchase price plus delivery costs. The Group uses sub-suppliers for the primary production of goods for resale.

The net realisable value of inventories is determined as the selling price less costs of completion and costs incurred to generate the revenue, taking into account marketability, obsolescence and developments in the expected selling price.

Equity
Share premium
Share premium is the value in excess of the nominal value of the shares that is contributed to the company upon formation or a capital increase. The share premium is part of the distributable reserves.

Share-based payment reserve
The value of share options granted is recognized in equity under share based payment reserve over the vesting period as the employees deliver the relevant services. The reserve reflects the total value of share options granted based on the share of the vesting period that has lapsed and the group's best estimate of the number of equity instruments that will ultimately vest. The reserve is part of the distributable reserves.

Foreign currency translation reserve
The foreign currency translation reserve comprises exchange differences arising upon translation of the financial statements of foreign operations from their functional currency to the parent company's presentation currency (DKK).

Upon full or partial realisation of the investment in the foreign operation, foreign exchange adjustments are recognized in the income statement in the same item as the gain/loss from the sale. The reserve is part of the distributable reserves.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Financial liabilities
Amounts owed to banks etc. are recognized at the date of borrowing at the amount of proceeds received net of transaction costs paid. In subsequent periods, the financial liabilities are measured at amortized cost using the effective interest method. Accordingly, the difference between the proceeds and the nominal value is recognized in financial expenses over the term of the loan.

Non-financial liabilities are measured at net realisable value.

Provisions
Provisions include warranty commitments and are recognized when the group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Provisions are discounted to net present value where this has a significant effect on the measurement of the liability.

Contract liabilities
A refund liability is the obligation to refund some or all of the consideration received (or receivable) from the customer and is measured at the amount the Group ultimately expects it will have to return to the customer.

Income tax and deferred tax
Current tax liabilities and current tax receivable are recognized in the statement of financial position as the estimated tax charge for the period, adjusted for tax on previous years' taxable income and tax paid on account.

Deferred tax is measured, using the "balance sheet liability" method, of all temporary differences at the reporting date between the tax base and the carrying amount of assets and liabilities.

Deferred tax is recognized for all taxable temporary differences, except for taxable temporary differences associated with investments in subsidiaries where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets are recognized for all deductible temporary differences and all unutilised tax loss carry forward to the extent that it is probable that taxable profit will be available against which the deductible temporary differences and the unutilised tax loss carry forward can be used.

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised.

Unrecognized deferred tax assets are reviewed at each reporting date and are recognized to the extent that it has become probable that future taxable profits will be available against which the deferred tax asset can be utilised.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the year when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantially enacted at the balance sheet date.

Deferred tax items are recognized in correlation to the underlying transaction either in other comprehensive income or directly in equity.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Deferred tax assets and deferred tax liabilities are offset if a legally enforceable right exists to set off current tax assets against current income tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

Statement of cash flows
The statement of cash flows shows the Group's cash flows for the year, broken down into operating, investing and financing activities, the period's changes in cash and cash equivalents and the Group's cash and cash equivalents at the beginning and the end of the period.

Cash flows from operating activities are presented using the indirect method and are stated as the profit or loss for the year before tax, adjusted for non-cash operating items, changes in working capital, paid and/or received interests and paid and/or received income taxes.

Cash flows from investing activities comprise payments related to purchases and/or proceeds of/from non-current assets.

Cash flows from financing activities comprise dividend distributed to shareholders, capital increases and/or reductions, repayments and/or proceeds of/from interest-bearing debt.

Cash and cash equivalents at end of reporting period include cash less bank overdrafts.

Segment information
The segment information is provided on geographical markets as the Group has only one business segment. The segmentation is based on the Group's internal financial reporting.
The segment information has been prepared in accordance with the Group's accounting policies.

Income/expenses in the segments comprise the items directly attributable to the individual segments as well as the items that may be allocated to the individual segments on a reliable basis. As a measure of segment profit or loss, the Group uses gross profit.

NOTE 3 SIGNIFICANT ACCOUNTING JUDGEMENTS, ESTIMATES AND ASSUMPTIONS

The preparation of the consolidated financial statements requires the managements to make judgements, estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities. Below are presented significant accounting judgements, estimates and assumptions.

Accounting estimates and uncertainty of estimates
The valuation of certain assets and liabilities requires the management to make estimates and assumptions related to future events. The estimates and assumptions are based on historical experience and other factors that, according to the management's assessment, are reasonable, but also inherently subject to uncertainty and unpredictability. The assumptions may be incomplete and inaccurate, and unexpected events and/or circumstances may arise.

Furthermore, the Group is subject to risks and uncertainties that may cause the actual results to differ from these estimates, both positively and negatively. The Group's specific risks are discussed in the relevant sections of the management's review and in the notes to the consolidated financial statements.

The major assumptions concerning future events and other sources of estimation of uncertainties at the reporting date, which involve significant risk of causing material adjustment to the carrying amounts of assets and liabilities within the next financial year, are presented below.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 3 SIGNIFICANT ACCOUNTING JUDGEMENTS, ESTIMATES AND ASSUMPTIONS (CONTINUED)

Development projects
There is an ongoing assessment whether the development costs meet the criteria for capitaliation as set out in the summary of accounting policies, Note 2, whether the development projects will generate future economic benefits.

Development projects in progress are annually tested for impairment. Completed development projects are reviewed for impairment indicators. If there is evidence of impairment, an impairment test is carried out for the project concerned. The impairment test is prepared on the basis of factors such as the future use of the project, the present value of expected future income, interest and risk. The carrying amount of completed development projects is DKK 29,773 thousand at 31 December 2018 (31 December 2017: DKK 68,416 thousand).

The accounting judgements, estimates and assumptions that the management makes for development projects are consistent with previous years.

Judgements in relation to significant accounting policies
In applying the Group's accounting policies, the management makes judgements that may have a material impact on the values recognized in the consolidated financial statements.

When defining the Group's significant accounting policies, the management made the following judgements that have a significant impact of the values recognized in the consolidated financial statements:

Right of return
The Group's customers do not have any contractual right of return, but during 2018 the general market recession has led to increased return requests from Napatech's channel partners.
In 2018, the Group has established a customary practice for acceptance of return requests, and adjusted the accounting principles for contracts with customers accordingly.

With the new customary practice for acceptance of returns, the Group recognizes a contract liability instead of revenue, for goods that are expected to be returned. The contract liability is estimated based on historical data and reasonable future expectations. A contract asset (and corresponding adjustment to cost of sales) is also recognized for the right to recover products from a customer.

Share-based payments
In February 2013, after the share options of the Group's employees and management had vested, but prior to the exercise date, the management made modifications to some of the share option agreements concluded with employees and management. The management treats the change of terms as modifications to the existing share option agreements. Accordingly, the fair value determined at the original grant date has been charged to the income statement over the original vesting period. In addition, an expense is recognized over the new vesting period, corresponding to the increase in the fair value of the share-based payments as a result of change of terms.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4 OPERATING SEGMENTS

The following tables present revenue and gross profit information about the Group's operating segments for the years ended 31 December 2018 and 2017, respectively:

Year ended 31 December 2018:

DKK'000	AMERICAS	ROW	OTHER ITEMS	Consoli-dated
Revenue				
Total revenue	54,081	52,072	-	106,153
Cost of goods sold	(22,036)	(13,701)	(21,323)	(57,060)
Segment gross profit	**32,044**	**38,372**	**(21,323)**	**49,093**

Year ended 31 December 2017:

DKK'000	AMERICAS	ROW	Consoli-dated
Revenue			
Total revenue	157,086	48,960	206,046
Cost of goods sold	(54,976)	(11,635)	(66,611)
Segment gross profit	**102,110**	**37,325**	**139,435**

Non-current assets DKK 47,883 thousand (2017: DKK 128,748 thousand) can be related with DKK 47,563 thousand (2017: DKK 128,450 thousand) to the ROW segment and DKK 320 thousand (2017: DKK 298 thousand) to the AMERICAS segment.

Explanation abbreviations
AMERICAS = North & South America ROW = Rest of the World OTHER ITEMS = Impairment of inventory

The Group's revenue relates to a single product category (SmartNIC products) why management has assessed that no further firm wide disclosures according to IFRS 15 are necessary

Adjustments and eliminations
Research and development costs, selling and distribution expenses, administrative expenses, finance income and costs are not allocated to individual segments as they are managed on a group basis.
Current taxes and deferred taxes are not allocated to individual segments as they are also managed on a group basis.

Transactions with major customers
Revenue from first significant customer amounted to DKK 20,388 thousand (2017: DKK 46,681 thousand) corresponding to 19% (2017: 23%) of the Group revenue. Revenue from this customer is arising from the sales in the AMERICAS segment. Revenue from second significant customer amounted to DKK 12,093 thousand (2017: DKK 0 thousand) corresponding to 11% (2017: 0%) of the Group revenue. Revenue from this customer is arising from the sales in the AMERICAS segment. Revenue from third significant customer amounted to DKK 11,917 thousand (2017: DKK 0 thousand) corresponding to 11% (2017: 0%) of the Group revenue. Revenue from this customer also arises from sales in the AMERICAS segment.

NOTE 5 OTHER OPERATING INCOME

Other operating income comprises sale of scrap and gain on sale of tangible and intangible assets. Other operating income amounted to DKK 599 thousand (2017: DKK 0 thousand).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6 EMPLOYEE BENEFITS EXPENSE

DKK'000	2018	2017
Employee benefits expense is reported as follows:		
Wages and salaries	102,817	104,435
Defined contribution schemes	4,644	4,452
Share-based payment expense (Note 8)	1,101	978
Social security costs	3,999	3,221
Allocated to capitalized development projects	(33,854)	(41,326)
Total employee benefits expense	**78,707**	**71,760**

DKK'000	2018	2017
Employee benefits expense is recognized in the consolidated income statement as follows:		
Research and development costs	14,733	9,136
Selling and distribution expenses	48,580	49,614
Administrative expenses	15,394	13,010
Total employee benefits expense	**78,707**	**71,760**
Average number of employees	**107**	**114**

Compensation of key management personnel of the Group is as follows:

	2018		2017	
DKK'000	Manage-ment	Board of Directors	Manage-ment	Board of Directors
Short-term staff benefits	13,557	1,219	12,704	1,294
Defined contribution schemes	844	-	522	-
Share-based payment expense	591	-	313	-
Total compensation of key management personnel	**14,992**	**1,219**	**13,539**	**1,294**

Of the total compensation to the Management the CEO and COO received DKK 4.3 million (2017: compensation to the CEO DKK 2.3 million).

NOTE 7 RESEARCH AND DEVELOPMENT COSTS

Research and development costs including annual amortization and impairment on completed development projects and development projects in progress recognized in the consolidated income statement are DKK 121,045 thousand (2017: DKK 49,216 thousand). All research and development costs are incurred by the parent company.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 8 SHARE-BASED PAYMENTS

Employees and members of the management in both the parent company and the US-based subsidiary are eligible for share option schemes. They are granted a certain number of share options in the parent company in return for the services they provide to the Group. Share options under these schemes are granted at fixed exercise prices. The right to share options can only be vested as long as the holder is an employee of the Group.

In February 2013, after the share options of the Group's employees and management had vested but prior to the exercise date, the management made modifications to some of the share-based payment agreements concluded with employees and management.

The management treats the change of terms as modifications to the existing share-based payment arrangements. Accordingly, the fair value determined at the original grant date has been charged to the income statement over the original vesting period. In addition, an expense is recognized over the new vesting period, corresponding to the increase in the fair value of the share-based payment as a result of the change of terms. All granted share options are equity-based.

The share based payment expense is measured at fair value at the grant date using Black-Scholes model. The expense is recognized in the income statement with the counter item in the other reserves under the equity, and it is recognized over: (a) the period during share option holder has met the vesting conditions; or (b) the period in which an exercising event is likely to occur if this period is shorter.

In December 2013 the initial public offering (IPO) on the Oslo Stock Exchange (OSE) resulted in an exercising event in relation to all share option programs. Therefore, the remaining vesting period of the share options has been accelerated.

The general terms for share options are summarized as follows:

Earliest exercise date	1 year from grant date
Latest exercise date	9 - 10 years from grant date

In May 2014 the Board of Directors decided to issue share options to key employees in the Group. A total of 101,000 share options have been issued for subscription of 101,000 shares of a nominal value of DKK 1 at an exercise price of NOK 48.70 (DKK 43.00 at 1 July 2014). The share options' life time is 5 years. The first 2 years from the date of issue is a lock-up period during which the share options may not be exercised. The exercise of these share options may take place in the 3rd, 4th and 5th year and they vest with 1/3 in each of these 3 years.

The general terms for the 2014 share options programme are summarized as follows:

Earliest exercise date	2 years from grant date
Latest exercise date	5 years from grant date

In February 2016 the Board of Directors decided to issue share options to key employees in the Group. A total of 23,000 share options have been issued for subscription of 23,000 shares of a nominal value of DKK 1 at an exercise price of NOK 63.50 (DKK 53.10 at 22 February 2016). The share options' life time is 5 years. The first 2 years from the date of issue is a lock-up period during which the share options may not be exercised. The exercise of these share options may take place in the 3rd, 4th and 5th year and they vest with 1/3 in each of these 3 years.

In accordance with the decision made on the Annual General Meeting held on 20 April 2016, Napatech conducted a split of shares in the ratio of 1:4. This means that the nominal value of each share has been reduced from DKK 1.00 to DKK 0.25, whereby each shareholder previously holding one share with the nominal value of DKK 1.00 received four new shares with the nominal value of DKK 0.25.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 8 SHARE-BASED PAYMENTS (CONTINUED)

The 1:4 share split has no direct impact on the value of share options and share option programs. When share options are exercised, the share capital will be increased by the same nominal amount at the same exercise price per share of DKK 1.00 nominal (multiples of four shares at nominally DKK 0.25). Consequently, the number and value of share options increases/decreases with the same ratio of 1:4. The principals of the 1:4 share split have been applied on comparative figures in order to enable comparison and consistency with previous periods.

Based on the decision made on General Assembly in April 2016 to issue 400,000 share options, the Board of Directors issued respectively 145,000 share options in August 2016 with the nominal value of DKK 0.25 at an exercise price of NOK 22.00 (DKK 18.04), 150,000 share options in May 2017 with the nominal value of DKK 0.25 at an exercise price of NOK 24.50 (DKK 19.41) and the remaining share options in November 2017 with the nominal value of DKK 0.25 at an exercise price of NOK 19.00 (DKK 14.90). The share options' life time is 5 years, where the share options holders are subject to a lock-up period in the first 2 years of the share options' life time. The share options vest with 1/3 in each of the remaining 3 years of the share options' life time.

The general terms for all issues based on the 2016 share options program are summarized as follows:

Earliest exercise date	2 years from grant date
Latest exercise date	5 years from grant date

Based on the decision made on General Assembly in April 2017 to issue 460,000 share options, the Board of Directors issued 460,000 share options in September 2018 with the nominal value of DKK 0.25 at an exercise price of NOK 5.00 (DKK 3.88). The share options' life time is 8 years, where the share options holders are subject to a lock-up period in the first 2 years of the share options' life time. The share options vest with 1/6 in each of the remaining 6 years of the share options' life time.

Based on the decision made on General Assembly in April 2018 to issue 480,000 share options, the Board of Directors issued 319,600 share options in September 2018 with the nominal value of DKK 0.25 at an exercise price of NOK 5.00 (DKK 3.88). The share options' life time is 8 years, where the share options holders are subject to a lock-up period in the first 2 years of the share options' life time. The share options vest with 1/6 in each of the remaining 6 years of the share options' life time.

Based on the same decision made on General Assembly in April 2018 to issue 480,000 share options, the Board of Directors issued 55,000 share options in December 2018 with the nominal value of DKK 0.25 at an exercise price of NOK 3.20 (DKK 2.45). The share options' life time is 8 years, where the share options holders are subject to a lock-up period in the first 2 years of the share options' life time. The share options vest with 1/6 in each of the remaining 6 years of the share options' life time.

The general terms for all issues based on the 2017 and 2018 share options program are summarized as follows:

Earliest exercise date	2 years from grant date
Latest exercise date	8 years from grant date

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 8 SHARE-BASED PAYMENTS (CONTINUED)

	2018					
	Executive Management		Other Employees		Total	
Share options	Number	Avg. ex. price	Number	Avg. ex. price	Number	Avg. ex. price
At 1 January 2018	793,200	11.77	664,568	11.54	1,457,768	11.66
Granted during the year	605,000	3.75	229,600	3.88	834,600	3.79
Transfer	(36,000)	10.75	36,000	10.75	-	-
Exercised/expired during the year	(288,100)	10.33	(129,600)	11.13	(417,700)	10.58
At 31 December 2018	**1,074,100**	**7.67**	**800,568**	**9.37**	**1,874,668**	**8.40**
Exercisable at 31 December 2018	**364,100**	**8.88**	**441,635**	**10.46**	**805,735**	**9.75**

	2017					
	Executive Management		Other Employees		Total	
Share options	Number	Avg. ex. price	Number	Avg. ex. price	Number	Avg. ex. price
At 1 January 2017	714,548	8.41	700,436	10.71	1,414,984	8.82
Granted during the year	255,000	17.55	-	-	255,000	17.55
Transfer	(41,000)	10.24	41,000	9.86	-	-
Exercised/expired during the year	(135,348)	8.00	(76,868)	8.04	(212,216)	8.01
At 31 December 2017	**793,200**	**11.77**	**664,568**	**11.54**	**1,457,768**	**11.66**
Exercisable at 31 December 2017	**470,536**	**8.73**	**365,901**	**8.95**	**836,437**	**8.83**

In 2018, 45,548 share options were exercised and 372,152 lapsed (2017: 212,216 exercised and nil lapsed).
The following shows the exercise price of the outstanding share options and warrants:

	2018	2017
Number of share options at 31 December:		
Exercise price DKK 8.00	404,400	584,100
Exercise price DKK 10.75	336,668	381,668
Exercise price DKK 12.53	92,000	92,000
Exercise price DKK 18.04	102,000	140,000
Exercise price DKK 19.41	150,000	150,000
Exercise price DKK 14.90	-	110,000
Exercise price DKK 3.88	734,600	-
Exercise price DKK 2.45	55,000	-
Total number of outstanding share options	**1.874.668**	**1.457.768**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 8 SHARE-BASED PAYMENTS (CONTINUED)

The weighted average of the remaining contractual period of the outstanding share options from the 2014 share options program at 31 December 2018 is 9 months (at 31 December 2017: 1 year and 6 months). The weighted average of the remaining contractual period of the outstanding share options from the 2016 share options program at 31 December 2018 is 3 years and 3 months (at 31 December 2017: 4 years and 3 months). The weighted average of the remaining contractual period of the outstanding share options from the 2017 share options program at 31 December 2018 is 7 years and 9 months. The weighted average of the remaining contractual period of the outstanding share options from the 2018 share options program at 31 December 2018 is 7 years and 9 months.

Assumptions for the calculation of the fair value of share options and warrants
The fair value of share options and warrants granted during 2013, 2014, 2016, 2017 and 2018 was estimated on the date of grant using the following assumptions:

	December **2013**	May **2014**	February **2016**	August **2016**
Volatility	47.92%	43.53% - 44.94%	49.00%	49.00%
Risk-free interest rate	1.65%	1.70% - 2.00%	0.50% - 0.60%	0.53% - 0.64%
Exercise price (DKK)	8.00	10.75	12.53	18.04
Exercise period (years)	2.27	3.00 - 5.00	3.00 - 5.00	3.00 - 5.00
Number of options	520,700	404,000	92,000	145,000
Grant date fair value for each option (DKK)	20.10	4.00	4.84	6.66

	May **2017**	November **2017**	September **2018**	December **2018**
Volatility	50.50%	47.30% - 48.40%	56.00%	67.71%
Risk-free interest rate	0.80% - 1.10%	0.70% - 1.00%	1.80%	1.76%
Exercise price (DKK)	19.41	14.90	3.88	2.45
Exercise period (years)	3.00 - 5.00	3.00 - 5.00	3.00 - 8.00	3.00 - 8.00
Number of options	150,000	105,000	779,600	55,000
Grant date fair value for each option (DKK)	3.88	5.54	2.04	1.50

The volatility is calculated based on a peer group of 5 similar companies listed on Nasdaq Stock Exchange in the USA. The fair value of the share options is determined using the Black-Scholes option pricing model. For 2018, the Group has recognized DKK 1,101 thousand of share-based payment expense in the income statement (2017: DKK 978 thousand). DKK 591 thousand was recognized in relation to the Executive Management (2017: DKK 313 thousand) and DKK 510 thousand in relation to others (2017: DKK 665).

NOTE 9 AUDITORS' FEES

DKK'000	**2018**	**2017**
Ernst & Young:		
Statutory audit fee	444	266
Assurance engagements	63	-
Tax advisory fee	21	30
Fees for other services	501	107
Total auditors' fees	**1,029**	**403**

Fee in relation to non-audit services from Ernst & Young P/S, DKK 585 thousand consists of advices on new share based payment programme, general accounting advice and related matters in connection with regulatory inspection.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 10 DEPRECIATION, AMORTIZATION AND IMPAIRMENT

DKK'000	2018	2017
Depreciation, amortization and impairment are reported as follows:		
Depreciation of plant and equipment	2,837	3,927
Impairment of plant and equipment	847	-
Depreciation of leasehold improvements	468	601
Total depreciation of tangible assets	**4,152**	**4,528**
Amortization of patents	654	561
Impairment of patents	117	918
Amortization of completed development projects	36,959	31,309
Impairment of completed development projects	35,441	-
Impairment of development projects in progress	30,185	-
Amortization of other intangible assets	50	439
Total amortization and impairment of intangible assets	**103,406**	**33,227**
Total depreciation, amortization and impairment	**107,558**	**37,755**

NOTE 11 FINANCE COSTS

DKK'000	2018	2017
Interest payable to banks	1,773	466
Foreign exchange losses including losses on hedging	7,770	5,095
Finance charges payable under finance leases	-	-
Other finance costs	33	395
Total finance costs	**9,576**	**5,956**
Finance costs at amortized costs	**1,773**	**466**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 12 INCOME TAX

DKK'000	2018	2017
Current tax recognized in the consolidated income statement:		
Current income tax	117	1,533
Current income tax carry back refund	(5,500)	(5,500)
Change in deferred tax	(7,425)	(1,291)
Adjustment prior years taxes	-	(137)
Total income tax	**(12,808)**	**(5,395)**

A reconciliation between tax expense and profit before tax multiplied by the applicable income tax rate for the Group for 2018 and 2017 is as follows:

DKK'000	2018	2017
Profit before tax	(192,106)	(29,826)
At the applicable Danish income tax rate for the Group, 22.0% (2017: 22.0%)	(42,263)	(6,562)
Tax effect of:		
Tax-deductible expenses	(116)	-
Non-deductible expenses	132	269
Effect of higher tax rates in the US and Japan	-	1,058
Accounting estimate for not recognized utilization of tax loss	29,698	-
Adjustment prior years taxes	-	(137)
Other	(259)	(23)
At the effective income tax rate of 7% (2017: 18%)	**(12,808)**	**(5,395)**

NOTE 13 EARNINGS PER SHARE

DKK'000	2018	2017
Net profit attributable to equity holders of the parent company for basic earnings and the effect of dilution	**(179,298)**	**(24,431)**

	2018	2017
	Thousands	Thousands
Weighted average number of shares for basic earnings per share	27,380	23,809
Effect of dilution:		
Share options	18	505
Weighted average number of shares adjusted for the effect of dilution	**27,398**	**24,314**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 14 INTANGIBLE ASSETS

	Development projects, completed		Development projects, in progress		Patents		Other intangible assets		Total	
DKK'000	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017
Cost at 1 January	229,165	205,129	46,342	22,488	9,791	9,279	2,139	2,139	287,437	239,035
Additions in the year	-	-	35,080	47,890	331	512	-	-	35,411	48,402
Transfers in the year	40,866	24,036	(40,866)	(24,036)	-	-	-	-	-	-
Disposals	(44,157)	-	(7,144)	-		-		-	(51,301)	-
Cost at 31 December	**225,874**	**229,165**	**33,412**	**46,342**	**10,122**	**9,791**	**2,139**	**2,139**	**271,547**	**287,437**
Accumulated impairment and amortization at 1 January	160,749	129,440	-	-	4,379	2,900	2,089	1,650	167,217	133,990
Amortization for the year	36,959	31,309	-	-	654	561	50	439	37,663	32,309
Impairment for the year	35,441	-	30,185	-	117	918	-	-	65,743	918
Disposals	(37,048)		(4,967)						(42,015)	-
Accumulated amortization and impairment at 31 December	**196,101**	**160,749**	**25,218**	**-**	**5,150**	**4,379**	**2,139**	**2,089**	**228,608**	**167,217**
Carrying amount at 31 December	**29,773**	**68,416**	**8,194**	**46,342**	**4,972**	**5,412**	**-**	**50**	**42,939**	**120,220**

Within the completed development projects there are two material development projects with carrying amount of DKK 5,835 thousand and DKK 5,462 thousand at 31 December 2018 respectively (31 December 2017: 7,835 and DKK 0 thousand respectively). The aim of the first project was to develop new 2 x 100G accelerator and the aim of the second project was to develop software enabling network security applications running on an Intel FPGA hardware platform . The remaining amortisation periods of these two projects are 2 years and 11 months and 2 years and 9 months respectively.

Within the in progress development projects there is one material development projects with carrying amount of DKK 4,046 thousand. The aim of the project is to develop software with flow matching capability for inline applications. The project is not yet completed and therefore have not been amortized.

The Group recognized DKK 65,743 thousand as an impairment in 2018 (2017: DKK 0) in respect of the Group's development projects and other intangible assets.
During 2018, the Group decided to divest the Pandion product line and prepared an impairment test based on fair value less costs, leading to an DKK 21,165 thousand impairment. The Pandion product line was divested in Q4 2018 at a sales price in same level as the impaired value.
At year end 2018 the Group performed its annual impairment test, based on value in use, for both Completed and In Progress Development Projects.
The Group considers the relationship between its market capitalization and its accounting value, among other factors, when reviewing for indicators of impairment.

Based on the annual impairment test, the Group recognized impairment of DKK 21,340 thousand on completed development projects and development projects in progress that, due to changes in market demands in 2018 have led to commercial obsoleteness. Two development projects is not expected to materialize in revenue generating

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 14 INTANGIBLE ASSETS (CONTINUED)

products, and therefore closed down before finalization, and on two development projects related to one-port long range SmartNIC's, the groups cash-flow expectations are significantly reduced, as most customers in 2018 have transitioned to the newer generation of two port products.

Based on the annual impairment test, the Group recognized impairment of DKK 21,699 thousand on development projects in progress, related to FPGA based solutions. The impairment related to FPGA based solutions are on overall caused by a revised assessment in 2018 of the timing of the expected acceleration of growth in the market for FPGA based solutions. Industry standards around network function virtualization (NFV) are still in the making and changes in 2018 includes uncertainty related to common industry standards for NFV and thereby expectations of delay to the time of revenue and cash inflow, and expectations of increased costs to complete the product offerings. Despite the impairment in 2018, Napatech still believes in the long-term attractiveness of the marked for our NFV solutions and will continue the development of solutions targeting this opportunity in the coming years.

In relation to the annual impairment test, the following key assumptions was applied:
The recoverable amount has been determined based on a value in use calculation using cash flow projections from financial budgets for 2019, and cash flow projections for a five-year period. The five-year cash flow projections are based on managements a five-year strategy plan and investments budget, that are approved by the board of directors. Due to uncertainty on projections the impairment test is therefore based on a finitive life span of 6 years, and do not include any terminal period beyond year 6.
Discount rates representing the current market assessment of the risks specific to the development project was applied to cash flow projections, but due to the fact that the impairment test is based on a finitive life span of 6 years and without any terminal period, the applied discount rate did only have marginal impact on the impairment test.

NOTE 15 TANGIBLE ASSETS

	Plant and equipment		Leasehold improvements		Total	
DKK'000	2018	2017	2018	2017	2018	2017
Cost at 1 January	33,400	34,622	5,105	4,630	38,505	39,252
Additions	461	4,342		522	461	4,864
Disposals in the period	(845)	(5,403)	(19)	-	(864)	(5,403)
Currency adjustment	39	(161)	11	(47)	50	(208)
Cost at 31 December	**33,055**	**33,400**	**5,097**	**5,105**	**38,152**	**38,505**
Accumulated depreciation at 1 January	28,234	29,436	4,026	3,457	32,260	32,893
Depreciation for the year	2,837	3,927	468	601	3,305	4,528
Disposals in the period	(826)	(4,975)	(19)	-	(845)	(4,975)
Impairment	847				847	-
Currency adjustment	31	(154)	17	(32)	48	(186)
Accumulated depreciation at 31 December	**31,123**	**28,234**	**4,492**	**4,026**	**35,615**	**32,260**
Carrying amount at 31 December	**1,932**	**5,166**	**605**	**1,079**	**2,537**	**6,245**

During 2018, the Group tested the tangible assets for impairment. In relation to this, the Group recognized DKK 847 thousand as an impairment in the reporting period. Impairments relate to assets around the Pandion product line that was divested in 2018.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 16 DEFERRED TAX

	Consolidated statement of financial position		Consolidated income statement	
DKK'000	2018	2017	2018	2017
Tax losses carry-forwards	(5,295)	(16,007)	10,712	(4,646)
Intangible assets	8,290	25,365	(17,075)	3,535
Tangible assets	(2,646)	(1,726)	(920)	137
Provision for bad debts	(97)	(207)	110	(28)
Contract assets and liabilities	(252)	-	(252)	-
Deferred tax liability / (asset) and expense / (income)	**-**	**7,425**	**(7,425)**	**(1,002)**

DKK'000	2018	2017
Reconciliation of deferred tax liability / (asset) is as follows:		
Opening balance at 1 January	7,425	8,427
Recognized in consolidated income statement	(7,425)	(1,291)
Recognized in consolidated statement of comprehensive income	-	289
Closing balance at 31 December	**-**	**7,425**

The Group has tax losses of DKK 159,060 thousand (2017: DKK 72.410 thousand) that are available indefinitely for offsetting against future taxable profit.
In 2018 the deferred tax assets have not been fully recognized in respect of these losses due to uncertainty in timing to offset future taxable profit.
If the Group were able to recognise all unrecognized deferred tax assets the profit would increase by DKK 29,698 thousand (2017: DKK 0 thousand).

NOTE 17 INVENTORIES

DKK'000	2018	2017
Consumables and components	3,830	6,466
Finished goods and goods for resale	13,141	29,658
Total inventories	**16,971**	**36,124**
Carrying value of inventories recognized at fair value	**-**	**-**

The cost of goods sold for the year is DKK 57,060 thousand (2017: DKK 66,611 thousand).
During 2018 DKK 21,323 thousand (2017; DKK 518 thousand) was recognized as an impairment expense partly related to decisions to end of life certain products for inventories, carried at net realisable value. This is recognized in cost of sales.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 18 TRADE AND OTHER RECEIVABLES

DKK'000	2018	2017
Receivables recognized in the consolidated statement of financial position:		
Trade receivables	25,305	51,938
Other receivables	13,814	3,899
Total current receivables	**39,119**	**55,837**

Movements in the provision for bad debts on trade receivables are as follows:

DKK'000	2018	2017
At 1 January	1,360	2,103
Reversed in the year	(279)	(607)
Written off in the year	(752)	(560)
Provision in the year	673	424
At 31 December	**1,002**	**1,360**

Ageing analysis of past due but not impaired trade receivables is as follows:

DKK'000	2018	2017
Not past due	22,158	45,451
Past due for less than 30 days	2,562	2,592
Past due between 30 and 60 days	335	722
Past due between 60 and 90 days	29	525
Past due after 90 days	221	2,648
Total maximum credit risk	**25,305**	**51,938**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 19 CONTRACT BALANCES

The Group's customers do not have any contractual rights of return. In 2018 the Group have established a customary practice for acceptance of return requests in special cases and adjusted the accounting principles for contracts with customers accordingly.

DKK'000	2018	2017
Contract assets	514	-
Contract liabilities	3,475	-

Contract assets represents the Group's right to recover the goods expected to be returned by customers. The asset is measured at the former carrying amount of the inventory, less any expected costs to recover the goods, including any potential decreases in the value of the returned goods. The Group updates the measurement of the asset recorded for any revisions to its expected level of returns, as well as any additional decreases in the value of the returned products.

Contract liabilities represents the obligation to refund some or all of the consideration received (or receivable) from the customer and is measured at the amount the Group ultimately expects it will accept to return to the customer. The Group updates its estimates of refund liabilities (and the corresponding change in the transaction price) at the end of each reporting period.

NOTE 20 INCOME TAX RECEIVABLE

DKK'000	2018	2017
At 1 January	5,500	2,094
Income tax carry back refund	5,487	5,500
Income tax carry back refund received during the year	(5,500)	(2,094)
At 31 December	**5,487**	**5,500**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 21 ISSUED CAPITAL AND RESERVES

In accordance with the decision made on the Annual General Meeting held on 20 April 2016, Napatech conducted a split of shares in the ratio of 1:4. The nominal value of each share has been reduced from DKK 1.00 to DKK 0.25, whereby each shareholder holding one share with the nominal value of DKK 1.00 received four new shares with the nominal value of DKK 0.25.

	2018	2017
Authorised shares	Thousands	Thousands
Ordinary shares of DKK 0.25 each at 1 January	23,877	23,664
Increase in ordinary shares DKK 0.25 each	8,046	213
Ordinary shares of DKK 0.25 each at 31 December	**31,923**	**23,877**

	2018	2018
Ordinary shares and fully paid	Thousands	DKK'000
At 1 January 2018	23,877	5,969
Exercise of share options for cash during the year	8,046	2,012
At 31 December 2017	**31,923**	**7,981**

DKK'000	2018	2017
Share premium		
At 1 January	219,729	216,429
Issue of shares for cash in excess of the cost of ordinary shares during the year	29,493	1,652
Transaction costs	(1,980)	-
Reversals regarding exercised share options	310	1,648
At 31 December	**247,552**	**219,729**

Share-based payment reserve
Share-based payment reserve is issued to recognise the value of equity-settled share-based payments provided to employees, including key management personnel, as part of their remuneration. Refer to Note 7 for further details on this plan.

Movements in share-based payment reserve are as follows:

DKK'000	2018	2017
At 1 January	6,361	7,611
Share-based payment expense (Note 8)	1,101	978
Reversals regarding exercised and lapsed share options	(2,491)	(2,228)
At 31 December	**4,971**	**6,361**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 22 FINANCIAL ASSETS AND FINANCIAL LIABILITIES

DKK'000	2018	2017
Financial assets measured at amortized cost:		
Leasehold deposits	2,407	2,283
Trade receivables	25,305	51,938
Other receivables	13,814	3,899
Cash and cash equivalents	17,159	39,967
Total financial assets	**58,685**	**98,087**
Financial liabilities measured at amortized cost:		
Other financial liabilities	19,350	-
Interest-bearing loans and borrowings	44,701	35,109
Trade payables	11,099	26,130
Total financial liabilities	**75,150**	**61,239**

Carrying amounts of financial assets and financial liabilities approximate their fair value.

NOTE 23 DERIVATIVE FINANCIAL INSTRUMENTS

During the financial year of 2018, the Group held forward exchange contracts to hedge part of the future budgeted sales covering a period of 12 months that is not naturally hedged by the costs denominated in USD.

The terms of the outstanding contracts at 31 December were as follows:

2018

No outstanding contracts at 31 December 2018

2017

No outstanding contracts at 31 December 2017

In the year ended 31 December 2018 the Group realized a loss from the expiry of forward contracts held during the totaled DKK 7.453 thousand (2017: gain DKK 8,951 thousand).

As the Group in 2018 has not assessed any effectiveness from an account point of view, all gain and loss was taken to the income statement as financial items.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 23 DERIVATIVE FINANCIAL INSTRUMENTS (CONTINUED)

Fair value hierarchy
The Group uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation techniques:

Level 1: Quoted (unadjusted) prices in active markets for identical assets or liabilities.

Level 2: Other techniques for which all inputs which have significant effect on the recorded fair value are observable, either directly or indirectly.

Level 3: Techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

Derivative financial instruments are classified as Level 2 instruments in accordance with the IFRS fair value hierarchy. The Group enters into derivative financial contracts with various counterparties composed of financial institutions. The derivative financial instruments are measured using valuation techniques with market observable inputs. The most frequently applied techniques for valuation of forward contracts and interest swap contracts are present value calculations based on foreign exchange spot rates and interest rate curves among others. Fair values are based on fair value reports from financial institutions.

NOTE 24 PROVISIONS

Provisions relate to guarantees associated with the sale of network adapters.
The movement in provisions is as follows:

DKK'000	2018	2017
At 1 January	490	369
Utilised during the year	(490)	(369)
Additions in the year	69	490
At 31 December	**69**	**490**

The provisions for guarantees are expected to be utilised within one year and are therefore classified as current liabilities.

NOTE 25 LIABILITIES FROM FINANCING ACTIVITIES

	2018		
DKK'000	At 1 Jan	Cash flows	At 31 Dec
Interest bearings loans and borrowings	35,109	9,592	44,701
Other financial liabilities	-	19,350	19,350
Total liabilities from financing activities	**35,109**	**28,942**	**64,051**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 25 LIABILITIES FROM FINANCING ACTIVITIES (CONTINUED)

	2017		
DKK'000	At 1 Jan	Cash flows	At 31 Dec
Interest bearings loans and borrowings	5,000	30,109	35,109
Other financial liabilities	-	-	-
Total liabilities from financing activities	**5,000**	**30,109**	**35,109**

NOTE 26 COMMITMENTS AND CONTINGENCIES

Collaterals
The Group has issued a floating charge in the amount of DKK 30 million (2017: DKK 30 million) secured on receivables, inventories and patents with carrying amount of DKK 29,371 thousand (2017: DKK 44,875 thousand) as collateral for bank debt.

Operating lease commitments
The Group's operating lease commitments relate to leasing of operating equipment, cars and office facilities. Future minimum payments under operating leases at 31 December are as follows:

	2018		
DKK'000	Cars	Office facilities	Total
Falling due within one year	439	3,541	3,980
Falling due between one and five years	671	1,773	2,444
Total	**1,110**	**5,314**	**6,424**

	2017		
DKK'000	Cars	Office facilities	Total
Falling due within one year	241	4,859	5,100
Falling due between one and five years	482	2,402	2,884
Total	**723**	**7,261**	**7,984**

The Group recorded DKK 329 thousand and DKK 8,824 thousand (2017: DKK 252 thousand and DKK 8,044 thousand) as operating lease expenses for cars and office facilities.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 27 RELATED PARTY DISCLOSURES

Terms and conditions of related party transactions
Sales to and purchases from related parties are made on terms equivalent to those that prevail in arm's length transactions. Outstanding balances at the year-end are unsecured and interest-free and settlement occurs in cash. This assessment is undertaken each financial year through by examining the financial position of the related party.

Controlling influence
The Group has no shareholders with controlling influence, as the shareholders include one large venture capital company with significant influence and many small private and corporate shareholders.

Entity with significant influence over the Group
Entity with significant influence over the Group include the venture capital company Verdane Capital VIII. As of 31 December 2018 Verdane Capital VIII owns 21.6% (2017: 21.7%). Related parties also include the shareholders' portfolio companies as they are subject to the same significant influence as the Group. The Group had no transacitons with neither the shareholders nor their portfolio companies in 2017 or 2018.

Transactions with key management personnel
Remunerations, salaries and share-based payments to the Board of Directors and the Executive Management are reflected in Note 6. In 2018 two board members received DKK a combined amount of 362 thousand as part of consultancy contracts. In 2017 a board member received DKK 266 thousand as part of a consultancy contract. There were no other transactions with the Board of Directors in 2017 and 2018.

NOTE 28 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Group's principal financial liabilities comprise loans and borrowings, trade and other payables and guarantees for sale of network adapters. The main purpose of these financial liabilities is to finance the Group's operations and to provide guarantees to support its operations. The Group has trade and other receivables, cash and long-term leasehold deposits that derive directly from its operations. The Group does not hold any available-for-sale investments.

The Group is exposed to credit risk, liquidity risk, interest rate risk and foreign currency risk. The Group's senior management provides assurance that financial risks are identified, measured and managed in accordance with the Group's policies and risk objectives. It is the Group's policy not to undertake any trading in derivatives for speculative purposes. The Board of Directors reviews and agrees policies for managing each of these risks, which are summarized below.

Credit risk
Credit risk is the risk that a counterparty will not meet its obligations under a customer contract, leading to financial loss. The Group is exposed to credit risk from its operating activities, receivables and deposits with banks.

Trade receivables
Customer credit risk is managed at group level. Credit quality of a customer is assessed based on a review of available financial information. The Group's customers have 30 - 90 days as a standard payment term and historically the Group has not had material impairment for bad debts.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 28 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (CONTINUED)

In 2018, the Group had 1 customers (2017: 3 customers) that each owed the Group more than 10% of all trade receivables. The credit risk associated with these customers has been assessed as low as they historically meet the Group standard payment terms of 30 - 90 days.

The Group has during 2018 implemented IFRS 9 which allows for an assessment of the need for impairment of financial assts measured at amortized cost including trade receivables, according to the simplified expected credit loss model. The model implies that the expected loss over the lifespand of the asset is recognized immediately in the income statement and is continuously monitored in accordance with the Group's risk management until realization. Impairment is calculated on the basis of expected loss percentages, which are calculated individually distributed per geographical location. Loss percentages are calculated on the basis of historical data based on expected losses over the total maturity of the receivable, adjusted for estimates of the effect of expected changes in relevant parameters, such as the economic development, political risks, etc. in the given market.

	2018			
DKK'000	Loss percentage	Receivable	Expected loss	Total
Not past due	0.9%	22,374	210	22,164
Past due for less than 30 days	2.3%	2,623	61	2,562
Past due between 30 and 60 days	4.7%	352	17	335
Past due between 60 and 90 days	9.7%	32	3	29
Past due after 90 days	76.7%	926	711	215
Total maximum credit risk			**1,002**	**25,305**

The maximum exposure to credit risk at the reporting date is the carrying value disclosed in Note 18. The Group does not hold collateral as security. The Group evaluates the concentration of risk with respect to trade receivables as low, as its customers are located in several jurisdictions and operate independently. The customer credit risk related to geographical segments in which the Group operates is similar and do not differ significantly.

Other receivables

Other receivables relates to the divestment of Pandion in 2018, and are due for repayment in Q4 2019. The credit risk was evaluated as low risk at initial recognition and have not increased significantly since then (IFRS 9, Stage 1 credit loss risk), and the calculated expected credit loss is marginal.

Cash deposits

Credit risk from balances with banks is managed by the senior management in accordance with the Group's policy. Investments of surplus funds are mainly made to finance development projects. Development projects are reviewed by the senior management on a quarterly basis. The Group's maximum exposure to credit risk for the components of the statement of financial position at 31 December 2018 and 2017 is the carrying amounts as illustrated in Note 21.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 28 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (CONTINUED)

Liquidity risk
Liquidity risk is the risk that the Group is unable to repay its financial liabilities as they fall due.

The Group monitors cash flows on a monthly basis and maximum one year in advance. The aim is to ensure sufficient cash from the operating acitivities to fund project development and the daily operations.

31 December 2018 the Group had access to unused credit facilities in the amount of DKK 3,079 thousand (2017: DKK 16,243 thousand) in a case of a need for cash to finance its activities.

Planning for 2019 the Group decided to raise more cash to ensure that the Group has sufficient cash available to cover the Group's obligations and planned investments as they fall due for a period of at least 12 months from 31 December 2018. On an Extraordinary General Meeting on 15 March 2019 proposals to raise a total of DKK 58.9 million was approved of which 39.7 has been completed by 31 March 2019.

The Groups interest-bearing loans and borrowings are not loans with fixed repayment terms but overdraft facilities renewed on a yearly basis. This has been the case for several years. In March 2019 the facility of DKK 25 million in Denmark was renewed until May 2020. The facility in the US of DKK 6.6 million is up for renewal in April 2019. It is the assessment of management that the overdraft facilities will be renewed, as management has no indications of otherwise. In connection with the renewal of the overdraft facility in Denmark, it is planned to switch some of the borrowings from overdraft facility to an accounts receivable financing-based facility. The implementation of the switch is under implementation at the date of reporting. This will however not affect the extent of the total overdraft facility.

It is assessed that the cash available and unused credit facilities is sufficient to cover the Group's obligations and planned investments as they fall due for a period of at least 12 months from 31 December 2018. The assessment is based on expected cash flow within the range of the guidance. Management has assessed the following cashflow based on guidance for 2019:

- Low range (revenue of DKK 150 and negative EBIT of DKK 39.2 million). Free cashflow assuming no changes in working capital is expected to be around negative DKK 34.1 million meaning that the Group will have DKK 33.4 million in cash and unused credit facilities available.

- High range (revenue of DKK 180 and negative EBIT of DKK 18.8 million). Free cashflow assuming no changes in working capital is expected to be around negative DKK 13.8 million meaning that the Group will have DKK 58.3 million in cash and unused credit facilities available

The Group's manufacturing policy is order production in order to ensure minimal amounts of cash being tied up in inventories. Furthermore, the suppliers' terms of payment are between 30 and 60 days, and the Group's customers standard terms of payment between 30 and 90 days.

In line with previous reporting periods, the Group's policy for liquidity management is to ensure timely payments from customers and to balance suppliers' credit terms with the terms of payment offered to the customers.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 28 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (CONTINUED)

The Group's cash outflows arising from the financial liabilities recognized in the consolidated statement of financial position are due as follows:

	2018			
DKK'000	Jan - Mar	Apr - Dec	Over 1 year	Total
Interest-bearing loans and borrowings	13,400	8,801	22,500	44,701
Other financial liabilities	63	5,896	13,391	19,350
Trade payables	11,099	-	-	11,099
Total financial liabilities	**24,562**	**14,697**	**35,891**	**75,150**

	2017			
DKK'000	Jan - Mar	Apr - Dec	Over 1 year	Total
Interest-bearing loans and borrowings	-	35,109	-	35,109
Trade payables	26,130	-	-	26,130
Total financial liabilities	**26,130**	**35,109**	**-**	**61,239**

Interest rate risk

Interest rate risk is the risk that the fair value or future cash flow of a financial instrument will fluctuate because of changes in market interest rates. The Group's exposure to the risk of changes in market interest rates relates mainly to the Group's interest-bearing loan in the amount of DKK 44,701 thousand (2017 DKK 35,109 thousand). This loan yields an interest rate of 3.98%. The Group's policy is to keep sufficient cash in place to mitigate adverse impacts caused by fluctuation in market interest rates. The Group's interest rate risk is immaterial.

Foreign currency risk

The parent company's functional currency is DKK. The Group's revenues and cost of goods sold are mainly denominated in USD. However, all the majority of all other transactions denominated in DKK and USD. The Group's main currency risk is thus associated with fluctuations in USD against DKK. The Group has negligible transactions in other currencies.

Cash flow hedges

Foreign exchange forward contracts measured at fair value through other comprehensive income are designated as hedging instruments in to hedge cash flow exposure in USD based on the part of the future budgeted sales in USD that are not naturally hedged by the costs denominated in USD. These forecast transactions are highly probable, and they comprise significant part the Group's net exposure in USD.

Sensitivity analysis of presentation currency

The following demonstrates the sensitivity to a reasonably likely change in the DKK exchange rate, with all other variables held constant. The effect on the Group's profit before tax and equity is due to changes in the fair value of monetary assets and liabilities.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 28 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (CONTINUED)

	Effect on profit before tax		Effect on equiy	
DKK'000	2018	2017	2018	2017
Change in USD by +/- 5%	+/- 754	+/- 2,057	+/- 588	+/- 1,605
Change in USD by +/- 10%	+/- 1,507	+/- 4,115	+/- 1,175	+/- 3,210

Capital management
Capital includes shares attributable to the equity holders of the parent company.

The primary objective of the Group's capital management is to ensure, in the short term, sufficient capital needed to fund the development of new products and new markets and thereby create healthy business platform to ensure return to the shareholders in the long term.

To maintain or adjust the capital structure, the Group may adjust the dividend payment to shareholders, return capital to shareholders or issue new shares. The Group has not distributed any dividends, and it does not expect to do so in the near future.

The Group monitors capital using a gearing ratio, which is net debt divided by total capital plus debt. The Group's policy is to keep the gearing ratio below 10%.

NOTE 29 EVENTS AFTER THE REPORTING PERIOD

On an Extraordinary General Meeting on March 15th, 2019 a private placement raising gross proceeds of NOK 50 million (DKK 38.4 million) and a separate offering tranche in favour of certain listed members of the company's board and management along with a subsequent offering of NOK 25 million (DKK 19.2 million), was approved. At the date of publishing of this report the subsequent offering has not yet been completed. The subscription period for the subsequent offering will commence as soon as practically possible following the approval of a prospectus by the relevant financial supervisory authority. This is expected to happen during first half of April 2019. As of the date of reporting the share capital of the company is DKK 16,600,388.25 divided into 66,401,553 shares, each with a nominal value of DKK 0.25.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 30 CONSOLIDATED INCOME STATEMENT BY NATURE

The Group presents it's consolidated income statement following a mixed approach.
A consolidated income statement by nature, in line with IAS 1 is presented below.

For the year ended 31 December 2018:

DKK'000	2018	2017
Revenue	106,153	206,046
Cost of goods sold	(57,060)	(66,611)
Gross profit	**49,093**	**139,435**
Other operating income	599	-
Staff expenses and renumeration	(112,561)	(113,086)
Transferred to capitalized development costs	33,854	41,326
Other external costs	(45,957)	(53,790)
Operating profit before depreciation, amortization and impairment (EBITDA)	**(74,972)**	**13,885**
Depreciation, amortization and impairment	(107,558)	(37,755)
Operating result (EBIT)	**(182,530)**	**(23,870)**
Finance costs	(9,576)	(5,956)
Result before tax	**(192,106)**	**(29,826)**
Income tax	12,808	5,395
Result for the year	**(179,298)**	**(24,431)**

PARENT COMPANY INCOME STATEMENT

for the year ended 31 December 2018

Note	In DKK '000	2018	2017
	Revenue	63,949	170,885
	Cost of goods sold	(57,060)	(66,611)
	Gross profit	**6,889**	**104,274**
	Other operating income	599	-
2, 3	Research and development costs	(18,460)	(17,907)
2	Selling and distribution expenses	(28,077)	(40,802)
2, 4, 5	Administrative expenses	(38,102)	(33,824)
	Operating profit before depreciation, amortization and impairment (EBITDA)	**(77,151)**	**11,741**
6	Depreciation, amortization and impairment	(107,451)	(37,590)
	Operating result (EBIT)	**(184,602)**	**(25,849)**
7	Finance costs	(9,321)	(5,956)
	Result before tax	**(193,923)**	**(31,805)**
8	Income tax	12,925	6,928
	Result for the year	**(180,998)**	**(24,877)**

PARENT COMPANY STATEMENT OF COMPREHENSIVE INCOME

for the year ended 31 December 2018

Note	In DKK '000	2018	2017
	Result for the year	(180,998)	(24,877)
	Other comprehensive income to be reclassified to profit and loss in subsequent periods:		
	Value adjustments on hedging instruments:		
	- Net gain / (loss) on cash flow hedges	(7,453)	10,265
	- Net (gain) / loss on cash flow hedges reclassified to revenue	-	(5,314)
	- Net (gain) / loss on cash flow hedges reclassified to finance costs	7,453	(3,637)
	- Income tax effect	-	(289)
	Net other comprehensive loss to be reclassified to profit or loss in subsequent periods	**-**	**1,025**
	Total comprehensive income for the year, net of tax	**(180,998)**	**(23,852)**

PARENT COMPANY STATEMENT OF FINANCIAL POSITION

at 31 December 2018

Note	In DKK '000	2018	2017
	ASSETS		
	Development projects, completed	29,773	68,416
	Development projects, in progress	8,194	46,342
	Patents	4,972	5,412
	Other intangible assets	-	50
9	**Intangible assets**	**42,939**	**120,220**
	Plant and equipment	1,834	5,160
	Leasehold improvements	592	998
10	**Tangible assets**	**2,426**	**6,158**
11	Investments in subsidiaries	2,907	2,380
18	Leasehold deposits	2,198	2,072
	Other non-current assets	**5,105**	**4,452**
	Non-current assets	**50,470**	**130,830**
13	Inventories	16,971	36,130
14, 18	Trade receivables	6,914	8,758
14, 18	Receivables from group entities	-	51,573
15	Contract assets	514	-
14, 18	Other receivables	13,381	3,492
16	Income tax receivable	5,500	5,500
18	Cash and cash equivalents	3,400	26,763
	Current assets	**46,680**	**132,216**
	Total assets	**97,150**	**263,046**

PARENT COMPANY STATEMENT OF FINANCIAL POSITION

at 31 December 2018

Note	In DKK '000	2018	2017
	EQUITY AND LIABILITIES		
17	Issued capital	7,981	5,969
17	Share premium	247,552	219,729
17	Other capital reserves	34,396	67,914
	Retained earnings	(258,869)	(112,180)
	Equity	**31,060**	**181,432**
12	Deferred tax liability	-	7,425
	Non-current liabilities	**-**	**7,425**
18, 21	Interest-bearing loans and borrowings	38,182	35,109
18	Trade payables	11,099	26,130
18	Payables to group entities	3,865	190
	Other payables	11,218	12,270
20	Provisions	69	490
15	Contract liabilities	1,657	-
	Current liabilities	**66,090**	**74,189**
	Total liabilities	**66,090**	**81,614**
	Total equity and liabilities	**97,150**	**263,046**

PARENT COMPANY STATEMENT OF CHANGES IN EQUITY

for the year ended 31 December 2018

Note	In DKK '000	Share capital	Share premium	Share based payment reserve	Cash flow hedge reserve	Reserve for development project costs	Retained earnings	Total equity
	At 1 January 2017	**5,916**	**216,429**	**7,611**	**(1,025)**	**33,244**	**(59,574)**	**202,601**
	Result for the year	-	-	-	-	28,309	(53,186)	(24,877)
	Net gain on cash flow hedges	-	-	-	10,265	-	-	10,265
	Net gain on cash flow hedges reclassified to revenue	-	-	-	(5,314)	-	-	(5,314)
	Net gain on cash flow hedges reclassified to finance costs	-	-	-	(3,637)	-	-	(3,637)
	Income tax effect	-	-	-	(289)	-	-	(289)
	Total comprehensive income	**-**	**-**	**-**	**1,025**	**28,309**	**(53,186)**	**(23,852)**
	Issue of shares	53	1,652	-	-	-	-	1,705
	Reversal, exercised and lapsed share options	-	1,648	(2,228)	-	-	580	-
5	Share-based payments	-	-	978	-	-	-	978
	Total transactions with shareholders	**53**	**3,300**	**(1,250)**	**-**	**-**	**580**	**2,683**
	At 31 December 2017	**5,969**	**219,729**	**6,361**	**-**	**61,553**	**(112,180)**	**181,432**
	Result for the year	-	-	-	-	(32,128)	(148,870)	(180,998)
	Net gain on cash flow hedges	-	-	-	(7,453)	-	-	(7,453)
	Net gain on cash flow hedges reclassified to finance costs	-	-	-	7,453	-	-	7,453
	Total comprehensive income	**-**	**-**	**-**	**-**	**(32,128)**	**(148,872)**	**(181,000)**
	Issue of shares	2,012	29,493	-	-	-	-	31,505
	Transaction costs	-	(1,980)	-	-	-	-	(1,980)
	Reversal, exercised and lapsed share options	-	310	(2,491)	-	-	2,181	-
5	Share-based payments	-	-	1,101	-	-	-	1,101
	Total transactions with shareholders	**2,012**	**27,823**	**(1,390)**	**-**	**-**	**2,181**	**30,626**
	At 31 December 2018	**7,981**	**247,552**	**4,971**	**-**	**29,425**	**(258,869)**	**31,060**

PARENT COMPANY STATEMENT OF CASH FLOWS

for the year ended 31 December 2018

Note	In DKK '000	2018	2017
	Operating activities		
	Result before tax	(193,923)	(31,805)
	Adjustments to reconcile profit before tax to net cash flows:		
	Finance costs	9,321	5,956
	Depreciation, amortization and impairment	107,451	37,590
	Gain/loss on the sale of non-current assets	(599)	428
	Impairment of inventories	21,323	-
	Share-based payment expense	573	795
	Working capital adjustments:		
	Change in inventories	(2,164)	(17,455)
	Change in trade and other receivables, contract assets and intercompany receivables	50,247	23,765
	Change in trade and other payables, contract liabilities, intercompany payables and provisions	(11,191)	1,355
	Cash flows from operating activities	**(18,962)**	**20,629**
	Cash flow hedges in financial items	(7,453)	2,506
	Interest paid	(1,551)	(861)
	Income tax received, net	5,500	2,231
	Net cash flows from operating activities	**(22,466)**	**24,505**
	Investing activities		
	Proceeds from sale of tangible assets	106	-
	Purchase of tangible assets	(335)	(4,864)
	Proceeds from sale of intangible assets	1,979	-
	Investments in intangible assets	(35,411)	(48,402)
	Investments in leasehold deposits	(126)	-
	Net cash from investing activities	**(33,787)**	**(53,266)**
	Free cash flow	**(56,253)**	**(28,761)**
	Financing activities		
	Capital increase	31,505	1,705
	Transaction costs on issue of shares	(1,606)	-
	Proceeds from borrowings	3,073	30,109
	Net cash flows from financing activities	**32,972**	**31,814**
	Net change in cash and cash equivalents	**(23,281)**	**3,053**
	Net foreign exchange difference	(82)	(113)
	Cash and cash equivalents at 1 January	26,763	23,823
	Cash and cash equivalents at 31 December	**3,400**	**26,763**

NOTES TO THE PARENT COMPANY FINANCIAL STATEMENTS

NOTE 1 SIGNIFICANT ACCOUNTING POLICIES

General

The financial statements for Napatech A/S (the parent company) have been prepared in accordance International Financial Reporting Standards (IFRS), as adopted by the EU, and additional requirements in the Danish Financial Statements Act.
The accounting policies for the Parent company are the same as for the Group as set out in Note 2 to the consolidated financial statements, except for the items listed below.

Dividends

Dividends from the investment in subsidiaries are recognized as income in the parent company's income statement in the year in which the dividend is declared.

Investments in subsidiaries

Investments in subsidiaries are measured at cost. If there is evidence of impairment, an impairment test is performed. If the cost exceeds the recoverable amount, a write-down is made to such lower value.

Share-based payments to employees in subsidiaries

The value of share options to the employees in the US-based subsidiary Napatech Inc. is recognized as an increase in the investment in subsidiaries as the employees' services rendered in exchange for the share options are received in subsidiaries.

Equity reserve for development project costs

The reserve for development project costs comprises recognized development costs. The reserve cannot be used to distribute dividends or cover losses. The reserve will be reduced or dissolved if the recognized development costs are no longer part of the Company's operations by a transfer directly to the distributable reserves under equity.

NOTE 2 EMPLOYEE BENEFITS EXPENSE

DKK'000	2018	2017
Employee benefits expense is reported as follows:		
Wages and salaries	75,690	82,323
Defined contribution schemes	4,275	4,452
Share-based payment expense (Note 5)	574	798
Social security costs	825	680
Allocated to development projects	(33,854)	(41,326)
Total employee benefits expense	**47,510**	**46,927**

DKK'000	2018	2017
Employee benefits expense is recognized in the parent company income statement as follows:		
Research and development costs	14,732	9,136
Selling and distribution expenses	17,910	24,962
Administrative expenses	14,868	12,829
Total employee benefits expense	**47,510**	**46,927**

NOTES TO THE PARENT COMPANY FINANCIAL STATEMENTS

NOTE 2 EMPLOYEE BENEFITS EXPENSE (CONTINUED)

	2018	2017
Average number of employees	**87**	**94**

Compensation of key management personnel is set out in Note 6 to the consolidated financial statements of the Group.

NOTE 3 RESEARCH AND DEVELOPMENT COSTS

Research and development costs including annual amortisation and impairment on completed development projects and development projects in progress recognized in the parent company's income statement are DKK 121,045 thousand (2017: DKK 49,216 thousand). All research and development costs are incurred by the parent company.

NOTE 4 AUDITORS' FEES

Auditors' fees for the parent company and the Group are the same. Details of the auditors' fees are disclosed in the Note 9 to the consolidated financial statements.

NOTE 5 SHARE-BASED PAYMENT EXPENSE

The share options described in Note 8 to the consolidated financial statements are issued by the parent company. The value of share options granted to employees in the wholly-owned US-based subsidiary is recognized as the cost of the investment in the subsidiary. Out of the Group's total share-based payment expense of DKK 1.101 thousand (2017: DKK 978 thousand), DKK 526 thousand (2017: DKK 183 thousand) has been recognized as an additional cost of the investment in the subsidiary.

NOTE 6 DEPRECIATION, AMORTIZATION AND IMPAIRMENT

DKK'000	2018	2017
Depreciation, amortization and impairment are reported as follows:		
Depreciation plant and property	2,792	3,839
Impairment of plant and equipment	847	-
Depreciation of leasehold improvements	406	524
Total depreciation of tangible assets	**4,045**	**4,363**
Amortization of patents	654	561
Impairment of patents	117	918
Amortization of completed development projects	36,959	31,309
Impairment of completed development projects	35,441	-
Impairment of development projects in progress	30,185	-
Amortization of other intangible assets	50	439
Total amortization and impairment of intangible assets	**103,406**	**33,227**
Total depreciation, amortization and impairment	**107,451**	**37,590**

NOTES TO THE PARENT COMPANY FINANCIAL STATEMENTS

NOTE 7 FINANCE COSTS

DKK'000	2018	2017
Interest payable to banks	1,531	466
Foreign exchange losses	7,770	5,095
Finance charges payable under finance leases	-	-
Other finance costs	20	395
Total finance costs	**9,321**	**5,956**
Finance costs at amortized costs	**1,531**	**466**

NOTE 8 INCOME TAX

DKK'000	2018	2017
Current tax recognized in the parent company income statement:		
Current income tax carry back refund	(5,500)	(5,500)
Change in deferred tax	(7,425)	(1,291)
Adjustment prior years taxes	-	(137)
Total income tax	**(12,925)**	**(6,928)**

A reconciliation between tax expense and profit before tax multiplied by the applicable income tax rate for the parent company for 2018 and 2017 is as follows:

DKK'000	2018	2017
Profit before tax	(193,923)	(31,805)
At the applicable Danish income tax rate for the parent company, 22% (2017: 22%)	(42,663)	(6,997)
Tax effect of:		
Tax deductible expenses	(116)	-
Non-deductible expenses	132	229
Accounting estimate for not recognized utilization of tax loss	29,698	-
Adjustment prior years taxes	-	(137)
Other	24	(23)
At the effective income tax rate of 7% (2017: 22%)	**(12,925)**	**(6,928)**

NOTE 9 INTANGIBLE ASSETS

Intangible assets comprise patents and development projects. An overview over these assets is disclosed in Note 14 to the consolidated financial statements.

NOTES TO THE PARENT COMPANY FINANCIAL STATEMENTS

NOTE 10 TANGIBLE ASSETS

	Plant and equipment		Leasehold improvements		Total	
DKK'000	2018	2017	2018	2017	2018	2017
Cost at 1 January	32,212	33,273	4,742	4,220	36,954	37,493
Additions	335	4,342		522	335	4,864
Disposals in the period	(441)	(5,403)	-	-	(441)	(5,403)
Cost at 31 December	**32,106**	**32,212**	**4,742**	**4,742**	**36,848**	**36,954**
Accumulated depreciation at 1 January	27,052	28,188	3,744	3,220	30,796	31,408
Depreciation for the year	2,792	3,839	406	524	3,198	4,363
Impairment for the year	847	-	-	-	847	-
Disposals in the period	(419)	(4,975)	-	-	(419)	(4,975)
Accumulated depreciation at 31 December	**30,272**	**27,052**	**4,150**	**3,744**	**34,422**	**30,796**
Carrying amount at 31 December	**1,834**	**5,160**	**592**	**998**	**2,426**	**6,158**

During 2018, the parent company tested the tangible assets for impairment. In relation to this, the parent company recognized DKK 847 thousand as an impairment in the reporting period. Impairments relate to assets around the Pandion product line that was divested in 2018.

NOTE 11 INVESTMENTS IN SUBSIDIARIES

DKK'000	2018	2017
Cost at 1 January	7,130	6,947
Additions	-	-
Value of share-based payment to employees in subsidiaries	527	183
Presentation currency adjustment	-	-
Cost at 31 December	**7,657**	**7,130**
Accumulated impairment at 1 January	4,750	4,750
Impairment for the year	-	-
Reversal of impairment losses	-	-
Accumulated impairment at 31 December	**4,750**	**4,750**
Carrying amount at 31 December	**2,907**	**2,380**

NOTES TO THE PARENT COMPANY FINANCIAL STATEMENTS

NOTE 11 INVESTMENTS IN SUBSIDIARIES (CONTINUED)

The parent company's investments in subsidiaries at 31 December 2018 and 2017 consist of the following:

		Ownership in %		Proportion of voting rights in %		
Name	Country	2018	2017	2018	2017	Business activity
Napatech Inc., USA	Andover, USA	100	100	100	100	Sale and distribution of the Group's products
Napatech Japan KK	Tokyo, Japan	100	100	100	100	Company in liquidation

DKK'000	Result for the year		Equity	
Name	2018	2017	2018	2017
Napatech Inc., USA	2,035	509	5,952	3,656
Napatech Japan KK	121	119	616	459

NOTES TO THE PARENT COMPANY FINANCIAL STATEMENTS

NOTE 12 DEFERRED TAX

	Statement of financial position		Income statement	
DKK'000	2018	2017	2018	2017
Tax losses carry-forwards	(5,295)	(16,007)	10,712	(4,646)
Intangible assets	8,290	25,365	(17,075)	3,535
Tangible assets	(2,646)	(1,726)	(920)	137
Provision for bad debts	(97)	(207)	110	(28)
Contract assets and liabilities	(252)	-	(252)	-
Deferred tax liability and expense	**-**	**7,425**	**(7,425)**	**(1,002)**

DKK'000	2018	2017
Reconciliation of deferred tax liability / (asset) is as follows:		
Opening balance at 1 January	7,425	8,427
Recognized in parent company income statement	(7,425)	(1,291)
Recognized in parent company statement of other comprehensive income	-	289
Closing balance at 31 December	**-**	**7,425**

The parent company has tax losses of DKK 159,060 thousand (2017: DKK 72.410 thousand) that are available indefinitely for offsetting against future taxable profit.
In 2018 the deferred tax assets have not been fully recognized in respect of these losses due to uncertainty in timing to offset future taxable profit.
If the parent company were able to recognise all unrecognized deferred tax assets the profit would increase by DKK 29,698 thousand (2017: DKK 0 thousand).

NOTE 13 INVENTORIES

DKK'000	2018	2017
Consumables and components	3,830	6,467
Finished goods and goods for resale	13,141	29,663
Total inventories	**16,971**	**36,130**
Carrying value of inventories recognized at fair value	**-**	**-**

The cost of goods sold for the year is DKK 57,060 thousand (2017: DKK 66,611 thousand).
During 2018 DKK 21,323 thousand (2017; DKK 518 thousand) was recognized as an impairment expense partly related to decisions to end of life certain products for inventories, carried at net realisable value. This is recognized in cost of sales.

NOTES TO THE PARENT COMPANY FINANCIAL STATEMENTS

NOTE 14 TRADE AND OTHER RECEIVABLES

DKK'000	2018	2017
Receivables recognized in the parent company statement of financial position:		
Trade receivables	6,914	8,758
Receivables from group entities	-	51,573
Other receivables	13,381	3,492
Total current receivables	**20,295**	**63,823**

Movements in the provision for bad debts on trade receivables are as follows:

DKK'000	2018	2017
At 1 January	941	812
Reversed in the year	(160)	-
Written off in the year	(723)	(83)
Change in the year	382	212
At 31 December	**440**	**941**

Ageing analysis of past due but not impaired trade receivables is as follows:

DKK'000	2018	2017
Not past due	4,044	5,396
Past due for less than 30 days	2,321	1,218
Past due between 30 and 60 days	335	218
Past due between 60 and 90 days	29	376
Past due after 90 days	185	1,550
Total maximum credit risk	**6,914**	**8,758**

NOTE 15 CONTRACT BALANCES

The Company's customers do not have any contractual rights of return. In 2018 the Company has established a customary practice for acceptance of return requests in special cases and adjusted the accounting principles for contracts with customers accordingly.

DKK'000	2018	2017
Contract assets	514	-
Contract liabilities	1,657	-

NOTES TO THE PARENT COMPANY FINANCIAL STATEMENTS

NOTE 15 CONTRACT BALANCES (CONTINUED)

Contract assets represents the Company's right to recover the goods expected to be returned by customers. The asset is measured at the former carrying amount of the inventory, less any expected costs to recover the goods, including any potential decreases in the value of the returned goods. The Company updates the measurement of the asset recorded for any revisions to its expected level of returns, as well as any additional decreases in the value of the returned products.

Contract liabilities represents the obligation to refund some or all of the consideration received (or receivable) from the customer and is measured at the amount the Company ultimately expects it will accept to return to the customer. The Company updates its estimates of refund liabilities (and the corresponding change in the transaction price) at the end of each reporting period.

NOTE 16 INCOME TAX RECEIVABLE

Income tax receivable relates to income tax carry back refund based on the previous year's tax losses as a result of investments in development projects. The movement in the income tax receivable is disclosed in Note 20 to the consolidated financial statements.

NOTE 17 ISSUED CAPITAL AND RESERVES

Information in relation to issued capital and reserves is disclosed in Note 21 to the consolidated financial statements.

NOTE 18 FINANCIAL ASSETS AND FINANCIAL LIABILITIES

DKK'000	2018	2017
Financial assets measured at amortized cost:		
Leasehold deposits	2,198	2,072
Trade receivables	6,914	8,758
Receivables from group entities	-	51,573
Other receivables	13,381	3,492
Cash and cash equivalents	3,400	26,763
Total financial assets	**25,893**	**92,658**
Financial liabilities measured at amortized cost:		
Interest-bearing loans and borrowings	38,182	35,109
Trade payables	11,099	26,130
Payables to group entities	3,865	190
Total financial liabilities	**53,146**	**61,429**

Carrying amounts of financial assets and financial liabilities approximate their fair value.

NOTES TO THE PARENT COMPANY FINANCIAL STATEMENTS

NOTE 19 DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments relate to forward exchange contracts in order to hedge the future budgeted sales in USD that is not naturally hedged by the costs denominated in USD covering a period of 12 months. The forward exchange contracts are held by the parent company and are disclosed in Note 23 to the consolidated financial statements.

NOTE 20 PROVISIONS

Provisions relate to guarantees associated with the sale of network adapters. These provisions are incurred by the parent company and are disclosed in Note 24 to the consolidated financial statements.

NOTE 21 LIABILITIES FROM FINANCING ACTIVITIES

	2018		
DKK'000	At 1 Jan	Cash flows	At 31 Dec
Interest bearings loans and borrowings	35,109	3,073	38,182
Total liabilities from financing activities	**35,109**	**3,073**	**38,182**

	2017		
DKK'000	At 1 Jan	Cash flows	At 31 Dec
Interest bearings loans and borrowings	5,000	30,109	35,109
Total liabilities from financing activities	**5,000**	**30,109**	**35,109**

NOTE 22 COMMITMENTS AND CONTINGENCIES

Collaterals
The parent company (as the whole Group) has issued a floating charge in the amount of DKK 30 million (2017: DKK 30 million) secured on receivables, inventories and patents with carrying amount of DKK 29,371 thousand (2017: DKK 44,875 thousand) as colleteral for bank debt.

Operating lease commitments
The parent company's operating lease commitments relate to leasing of operating equipment, cars and office facilities. Future minimum payments under operating leases at 31 December are as follows:

NOTES TO THE PARENT COMPANY FINANCIAL STATEMENTS

NOTE 22 COMMITMENTS AND CONTINGENCIES (CONTINUED)

	2018		
DKK'000	Cars	Office facilities	Total
Falling due within one year	440	2,830	3,270
Falling due between one and five years	671	-	671
Total	**1,111**	**2,830**	**3,941**

	2017		
DKK'000	Cars	Office facilities	Total
Falling due within one year	241	2,766	3,007
Falling due between one and five years	482	-	482
Total	**723**	**2,766**	**3,489**

The parent company recorded DKK 329 thousand and DKK 5,660 thousand (2017: DKK 252 thousand and DKK 5,292 thousand) as operating lease expenses for cars and office facilities.

NOTE 23 RELATED PARTY TRANSACTIONS

The parent company's related parties are the same as the Group's. Additional information is set out in Note 27 to the consolidated financial statements.
Related parties in which the parent company has a controlling influence include the company's subsidiaries as disclosed in Note 11 to the parent company financial statements.

The following provides the total amount of transactions that have been entered into with subsidiaries for the relevant financial year:

	Napatech Inc., USA		Napatech Japan KK, Japan	
DKK'000	2018	2017	2018	2017
Income statement:				
Sales to subsidiaries	9,824	120,062	-	-
Purchases from subsidiaries	-	-	2,647	3,088
Statement of financial position:				
Receivables from subsidiaries	-	51,573	-	-
Payables to subsidiaries	3,510	-	355	190

NOTES TO THE PARENT COMPANY FINANCIAL STATEMENTS

NOTE 24 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The parent company incurs external financial liabilities and settles its transactions in currencies other than the functional currency. The Groups' financial risks are therefore primarily related to the parent company. Relevant additional information is set out in Note 28 to the consolidated financial statements.

	2018			
DKK'000	Loss percentage	Receivable	Expected loss	Total
Not past due	0.9%	4,082	38	4,044
Past due for less than 30 days	2.3%	2,376	55	2,321
Past due between 30 and 60 days	4.7%	352	17	335
Past due between 60 and 90 days	9.7%	32	3	29
Past due after 90 days	63.8%	512	327	185
Total maximum credit risk			**440**	**6,914**

NOTE 25 EVENTS AFTER THE REPORTING PERIOD

On an Extraordinary General Meeting on March 15th, 2019 a private placement raising gross proceeds of NOK 50 million (DKK 38.4 million) and a separate offering tranche in favour of certain listed members of the company's board and management along with a subsequent offering of NOK 25 million (DKK 19.2 million), was approved. At the date of publishing of this report the subsequent offering has not yet been completed. The subscription period for the subsequent offering will commence as soon as practically possible following the approval of a prospectus by the relevant financial supervisory authority. This is expected to happen during first half of April 2019. As of the date of reporting the share capital of the company is DKK 16,600,388.25 divided into 66,401,553 shares, each with a nominal value of DKK 0.25.

NOTES TO THE PARENT COMPANY FINANCIAL STATEMENTS

NOTE 26 PARENT COMPANY INCOME STATEMENT BY NATURE

The Parent company presents it's income statement following a mixed approach.
An income statement by nature, in line with IAS 1 is presented below.

For the year ended 31 December 2018:

DKK'000

Revenue	63,949	170,885
Cost of goods sold	(57,060)	(66,611)
Gross profit	**6,889**	**104,274**
Other operating income	599	-
Staff expenses and renumeration	(81,364)	(88,253)
Transferred to capitalized development costs	33,854	41,326
Other external costs	(37,129)	(45,606)
Operating profit before depreciation, amortization and impairment (EBITDA)	**(77,151)**	**11,741**
Depreciation, amortization and impairment	(107,451)	(37,590)
Operating result (EBIT)	**(184,602)**	**(25,849)**
Finance costs	(9,321)	(5,956)
Result before tax	**(193,923)**	**(31,805)**
Income tax	12,925	6,928
Result for the year	**(180,998)**	**(24,877)**

STATEMENT BY THE BOARD OF DIRECTORS AND THE EXECUTIVE MANAGEMENT ON THE ANNUAL REPORT

The Board of Directors and the Executive Management have today discussed and approved the annual report of Napatech A/S for the financial year 1 January – 31 December 2018.

The annual report has been prepared in accordance with international Financial Reporting Standards as adopted by EU and additional requirements in the Danish Financial Statements Act.

It is our opinion that the consolidated financial statements and the Parent Company's financial statements give a true and fair view of the Group's and the Parent Company's financial position at 31 December 2018 and of the results of the Group's and the Parent Company's operations and cash flows for the financial year 1 January – 31 December 2018.

Further, in our opinion, the Management's Review includes a true and fair review of the development in the Group's and the Parent Company's operations and financial conditions, of the results for the year and of the financial position of the Group and the Parent Company, as well as a description of the more significant risks and uncertainty facing the Group and the Parent Company.

We recommend that the annual report be approved at the annual general meeting.

Søborg, 3 April 2019

Executive Management

Ray Smets, Chief Executive Officer

Henrik Brill-Jensen, Chief Operating Officer

Board of Directors

Lars Boilesen, Chairman

Bjørn Erik Reinseth

Henry Wasik

Howard Bubb

Lars B. Thoresen

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF NAPATECH A/S

Opinion

We have audited the consolidated financial statements and the parent company financial statements of Napatech A/S for the financial year 1 January – 31 December 2018, which comprise income statement, statement of comprehensive income, balance sheet, statement of changes in equity, cash flow statement and notes, including accounting policies, for the Group and the Parent Company. The consolidated financial statements and the parent company financial statements are prepared in accordance with International Financial Reporting Standards as adopted by the EU and additional requirements of the Danish Financial Statements Act.

In our opinion, the consolidated financial statements and the parent company financial statements give a true and fair view of the financial position of the Group and the Parent Company at 31 December 2018 and of the results of the Group's and the Parent Company's operations and cash flows for the financial year 1 January – 31 December 2018 in accordance with International Financial Reporting Standards as adopted by the EU and additional requirements of the Danish Financial Statements Act.

Our opinion is consistent with our long-form audit report to the Audit Committee and the Board of Directors.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs) and additional requirements applicable in Denmark. Our responsibilities under those standards and requirements are further described in the "Auditor's responsibilities for the audit of the consolidated financial statements and the parent company financial statements" (hereinafter collectively referred to as "the financial statements") section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) and additional requirements applicable in Denmark, and we have fulfilled our other ethical responsibilities in accordance with these rules and requirements.

To the best of our knowledge, we have not provided any prohibited non-audit services as described in article 5(1) of Regulation (EU) no. 537/2014.

Appointment of auditor

Subsequent to Napatech A/S being listed on the Oslo Stock Exchange, we were initially appointed as auditors of Napatech A/S on 29 April 2014. We have been re-appointed annually by resolution of the general meeting for a total consecutive period of five years up to and including the financial year 2018.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements for the financial year 2018. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matters is provided in that context.

We have fulfilled the responsibilities described in the "Auditors' responsibilities for the audit of the financial statements" section of our report, including in relation to the key audit matters below. Accordingly, our audit included the design and performance of procedures designed to respond to our assessment of the risks of material misstatement of the financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying financial statements.

Recognition and valuation of capitalized development costs
Development costs mainly comprise hardware and software development. The Group capitalizes eligible development costs upon meeting the criteria as described in IAS 38.

Recognition and valuation of capitalized development costs is significant to our audit due to the carrying values as well as the management judgement involved in the assessment of the carrying values, basis for capitalization of development costs and judgements involved in impairment testing of the capitalized development costs.

With challenging market conditions, divestment of the Pandion line and revised assessment of timing of the expected growth in the market for Field-Programmable Gate Array (FPGA) the Group's performance and prospects has been impacted. As a result, impairment charges of DKK 66 million have been recognized. Refer to note 14 in the consolidated financial statements and to note 9 in the financial statements for the parent company.

How our audit addressed the above key audit matters:

- Assessment of the eligibility of the development costs for capitalization as intangible asset under applicable accounting standards.
- Evaluation of the design of the controls implemented by Management in respect of capitalization of development costs and substantive test of details on a sample basis to underlying evidence, including hour registration.
- Consideration of the valuation methodology applied by Management as well as key assumptions and input based on our knowledge of the business and industry together with available supporting evidence such as available budgets and externally observable market data related to interest rates, etc.
- Assessment of the adequacy of the disclosures provided by management in the financial statements compared to applicable accounting standards.

Revenue recognition and product returns
Revenue from contracts with customers is recognized in the income statement at the point in time when control of the goods is transferred to the customer, usually on delivery of the goods, and at an amount that reflects the consideration to which the group expects to be entitled in exchange for these goods. Revenue is measured at the fair value of the consideration, excluding rebates and VAT.

Revenue recognition and measurement of variable consideration in relation to expected product returns was a key audit matter during our audit, due to the inherent risk related to the estimates and assumptions prepared by management in this relation.

How our audit addressed the above key audit matters:

- Consideration of the appropriateness of the Group's revenue recognition accounting policies, including those relating to incentives, returns and rebates and assessing compliance with applicable accounting standards
- Assessment of the key assumptions and methodologies used by management in the estimation of expected product returns, including historical evidence and changes in internal procedures that affect the expectations for future product returns.

- Test of selected sales transactions taking place at either side of the balance sheet date as well as credit notes issued after the year-end date to supporting documentation and assessing whether those transactions were recognized in the correct period and in accordance with the governing sales contracts and the Group's accounting policy.
- Inspection of the terms of significant sales contracts to determine the point of transfer of significant risk and rewards.

Statement on the Management's review
Management is responsible for the Management's review.

Our opinion on the financial statements does not cover the Management's review, and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the Management's review and, in doing so, consider whether the Management's review is materially inconsistent with the financial statements or our knowledge obtained during the audit, or otherwise appears to be materially misstated.

Moreover, it is our responsibility to consider whether the Management's review provides the information required under the Danish Financial Statements Act.

Based on the work we have performed, we conclude that the Management's review is in accordance with the financial statements and has been prepared in accordance with the requirements of the Danish Financial Statements Act. We did not identify any material misstatement of the Management's review.

Management's responsibilities for the financial statements
Management is responsible for the preparation of consolidated financial statements and parent company financial statements that give a true and fair view in accordance with International Financial Reporting Standards as adopted by the EU and additional requirements of the Danish Financial Statements Act and for such internal control as Management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, Management is responsible for assessing the Group's and the Parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting in preparing the financial statements unless Management either intends to liquidate the Group or the Parent Company or to cease operations, or has no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements
Our objectives are to obtain reasonable assurance as to whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs and additional requirements applicable in Denmark will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

As part of an audit conducted in accordance with ISAs and additional requirements applicable in Denmark, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's and the Parent Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by Management.
- Conclude on the appropriateness of Management's use of the going concern basis of accounting in preparing the financial statements and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's and the Parent Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group and the Parent Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and contents of the financial statements, including the note disclosures, and whether the financial statements represent the underlying transactions and events in a manner that gives a true and fair view.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

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

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements and the parent company financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Copenhagen, 3 April 2019

ERNST & YOUNG
Godkendt Revisionspartnerselskab
CVR no. 30 70 02 28

Jan C. Olsen State Authorised Public Accountant mne33717	Alex Nissov State Authorised Public Accountant mne33237

DN-1213 Rev. 1

RECONFIGURABLE COMPUTING

EUROPE, MIDDLE EAST AND AFRICA
Napatech A/S
Copenhagen, Denmark

Tel. +45 4596 1500
info@napatech.com
www.napatech.com

NORTH AMERICA
Napatech inc.
Portsmouth, New Hampshire
Los Altos, California

Tel. +1 888 318 8288
info@napatech.com
www.napatech.com

APAC
ntapacsales@napatech.com
www.napatech.com