napatech

Reconfigurable Computing

2017 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 2018

Chairman

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Editors
Napatech A/S
Tobaksvejen 23A
2860 Søborg

DEAR READER

2017 was a year of transition for Napatech as we accelerated investments in our people, technology and products to expand our solutions into cloud and software-defined networks that will fuel our growth for many years to come.

2017 was a year full of new opportunities, changes and challenges for our industry, the customers we serve, and Napatech. Major trends in cloud networking, 5G mobile networks, and the Internet of Things (IoT) have created once-in-a-generation opportunities. The year brought great visibility into our current and prospective customers' visions for their future within these trends, that validated the corporate strategy underpinning our own growth aspirations. As a result, we continued with the major initiatives that define the success of our strategy. Some of these efforts required changes within Napatech, that are similar in many ways to those happening at our customers. While making this journey together, Napatech encountered quarter-to-quarter revenue fluctuations and a full-year revenue below our target. In spite of these shortcomings, we are motivated by the certainty of our leading position as the preferred supplier of FPGA-based reconfigurable computing solutions, and the major market momentum leading more and more customers to require our solutions.

Napatech pioneered the use of FPGA-based technologies to improve the performance of leading IT network, security and communications applications. Our business is based on a solid foundation of customers in tier-one equipment manufacturers, network service providers and data centers in the cloud, enterprise and government networks. These early adopters of FPGA-based solutions have used Napatech's reconfigurable computing platform for a wide range of networking, cyber security, 5G mobile, analytics, big data, service quality management and other applications.

FPGA technologies have become pervasive, available for use in an increasing number of locations, ranging from standard servers on premise, to FPGA-as-a-service hosted in the cloud. As a result, the demand for FPGA-based software solutions will increase considerably. Napatech has years of experience in designing FPGA-based software and hardware solutions, making it uniquely capable of meeting the needs of the rapidly expanding market for FPGAs in networking and communications applications. As a result, 2017 saw the beginning of several initiatives to support these new opportunities.

We expanded our Board of Directors, adding industry recognized experts with proven success in cloud, data center, server and software businesses. We strengthened our executive management team, adding new chief sales and marketing officers in the United States, in the regions where they have decades of experience winning business with our target customers.

We have deeply aligned our product and technology plans by partnering with leading suppliers of FPGA technologies and tools, ensuring we benefit their sales and marketing success within our shared customer targets.

We have strengthened our worldwide sales force by organizing around unique customer segments, with focus on equipment manufacturers and end-users, both who benefit from reconfigurable computing. As a result of these intimate relationships, we have been able to gain deeper insight into how our products best benefit our customers and their applications, allowing us to identify new applications and customer types to increase our addressable market. We have increased our global sales force and technical support in the North American regions that represent the highest concentrations of customer growth. We have expanded our worldwide channel sales organization to further leverage external resources to extend our reach to the emerging set of end-user customers who require our solutions.

Our R&D investments have helped us transition our products from hardware-centric to software-centric, making it easier for our customers to deploy our solution in more places, and in more networks. We've expanded our product portfolio to include more software offerings and professional services, enabling our products to deployed in any open and standard server platform.

Combined, these items undertaken in 2017 allowed us to begin to make the transition with our customers from a hardware-centric to a software-centric world of software-defined networking.

In summary, 2017 was a year of transition for Napatech and our customers. Despite some results that were below our expectations, we are confident that the forecast for Napatech is looking exceedingly bright. Although we may still see order volatility in the short term, we strongly expect revenue growth to resume in 2018. With the continued dedication and ingenuity of our teams and collaborators, I am confident that we are on the right path forward.

Best regards,

Henrik Brill Jensen
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 reconfigurable computing platforms help companies to reimagine their business.

Napatech's focus has always been to help our customers make outstanding solutions. We have been doing that by developing software and hardware that improve the performance of leading IT applications in cybersecurity, mobile and other networking and communications designs. For nearly 15 years these solutions have been based on FPGA technologies and used by leading designers of networking equipment for their most challenging problems.

THE INDUSTRY IS TRANSFORMING

The world began to change with the emergence of hyper-scale cloud network operators. These new types of networks were of such immense size, and changing so rapidly, the traditional way of building networks had to change. In the new world of software-defined networking, these operators required a way to deliver hardware performance, with the speed of software innovation, at a previously unachievable cost point. This is where FPGAs found their next home. Today, from the Microsoft Azure Network to the Amazon FPGA-as-a-service offering, FPGAs are the preferred technology to improve the performance of the most complex workloads in standard server platforms. While originally invented to solve problems by hyperscale data center network operators, the same solutions were quickly embraced by service providers for 5G mobile networks and IoT infrastructure. Recently, these same technologies have been deployed for similar benefits in enterprise and government networks, even at lesser scale.

NETWORKS ARE TRANSFORMING

In the past, networks were based on proprietary, vertically integrated, physical devices, such as gateways, firewalls, load balancers. switches and routers. In order to support the massive scale of servers in cloud networks, access points in 5G mobile networks and billions of connected devices in IoT networks, a new architecture was required, with hyperscale needs met:

- **Hyperscale performance:** Link speeds across the network must transition from 1 and 10 Gigabit Ethernet to 25, 40, 50 and 100 Gigabit Ethernet.
- **Hyperscale innovation:** The network hardware must deliver those network speeds but with the support for rapidly evolving features and functions at the speed of software innovation, without compromise of either.
- **Hyperscale economics:** The software applications must be easily deployable on low-cost, standard, server platforms, removing the need for expense to purchase and manage proprietary hardware platforms.
- **Hyperscale security:** The new networks powered by software with millions or trillions of connected devices, must support a new security posture, far advanced from legacy models.
- **Hyperscale orchestration:** With a massive increase in the number of physical and virtual endpoints within a network, a highly automated method to deploy, configure, manage and debug the network is required.

At Napatech, we've helped the leading cloud, mobile and IoT network operators meet these challenges with our Reconfigurable Computing Platform. We've also harnessed the power of underlying technologies originally invented for the cloud and are now making it available for a wider set of IT applications, for network operators of every size.

RECONFIGURABLE COMPUTING DEFINED

The Napatech Reconfigurable Computing Platform begins with a standard computing platform – a server. It is enhanced with FPGA technology from leading suppliers like Xilinx and Intel, and powered by software from Napatech.

OUR VISION

At Napatech we aim to be, and be perceived, as the global leader in reconfigurable computing platforms that help companies to reimagine their business, by bringing hyper-scale computing benefits to information technology (IT) organizations of every size.

OUR MISSION

We enhance open and standard servers, to boost innovation and release valuable compute resources, that improve services and increase revenue.

OUR SOLUTION

Our Reconfigurable Computing Platform flexibly offloads, accelerates and secures standard servers based on a broad set of FPGA software for leading IT applications supported on a wide array of hardware.

PRESENT IN
3
CONTINENTS

CUSTOMERS
150+
INTERNATIONALLY

INDUSTRY EXPERIENCE
15
YEARS

OUR PRODUCTS

The Napatech product line strategy is anchored on four key tenets:

- **Application-Driven:** Our SmartNIC software and hardware are always defined with the leading IT applications in mind. Our products are built with a deep understanding of the applications and services that our customers rely on to make their business a success.
- **Software-Focused:** For success, customers choose Napatech because our SmartNIC software significantly improves the performance, scalability and capabilities of applications ranging from cyber security, 5G mobile networking, big data, analytics, recording and quality assurance. Our SmartNIC software is optimized around the unique attributes of this individual applications where we provide the most benefit.
- **Hardware-Independent:** Our SmartNIC software can power FPGA-acceleration when embedded within a CPU, integrated on a network interface card, or provided as a co-processor to a server's CPU. Our software can operate on hardware solutions from Napatech, and a wide ecosystem of hardware partners.
- **Everywhere it needs to be:** Our software is designed to operate on hardware regardless of where it is deployed, from the customer premise, to the cloud, and other hybrid configurations.

OUR PEOPLE

The solutions Napatech provides are made possible by a highly skilled team that is a part of an organization that has built unique skills, and patented methods, for sophisticated software and hardware development of FPGAs in networking, security and other communications designs. We are committed to serving our customers through the development of innovative market leading solutions in open and standard products as well as customer-centric integrations and co-development.

THE BUSINESS STRATEGY

Napatech has built the largest and leading portfolio of FPGA-based SmartNIC software for networking, cyber security, mobile and other communications needs. We aim to continually expand our portfolio with enhancements and new products that stay ahead of the needs of current and emerging applications in networks from the cloud to the enterprise and every network in-between.
To do this we have partnered with the two leading FPGA manufactures, the top application software manufactures globally, and leveraged our existing relationships with the most innovative end-user operators across a wide range of business and network types.

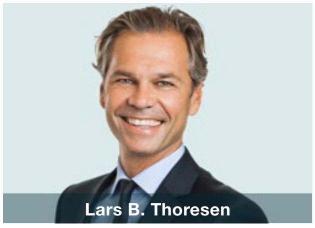
Our products are sold direct and through value added resellers (VARs) to network, security and server original equipment manufacturers, independent software vendors (ISVs) and end-users in enterprise, government, service provider and cloud networks.

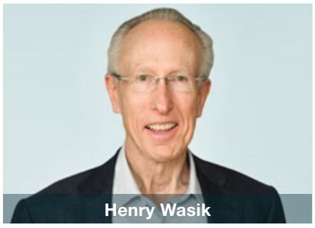
THE OPPORTUNITY

Leading industry analysts forecast that more than 10M network interface cards will be sold per year, in an ever increasing number of servers that are the standard computing platforms for applications and services. A large proportion of these will be network interface cards that are programmable or can offload applications representing a $1.5 billion opportunity. This is the total addressable market for Napatech reconfigurable computing platforms.

BOARD AND MANAGEMENT PRESENTATION

BOARD OF DIRECTORS





MANAGEMENT TEAM

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

Henrik Brill Jensen, CEO. **Niels Hobolt**, CFO. **Peter Ekner**, CTO. **Jarrod J.S. Siket**, CMO. **Ken Way**, CSO.
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 DEFENCE

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

	2017	2016	2015	2014	2013
KEY FIGURES (DKK'000)					
Revenue	206,046	234,737	216,677	182,335	182,047
Gross profit	139,435	163,608	154,701	133,627	130,501
EBITDA	13,885	43,459	34,232	18,010	29,354
EBIT	(23,870)	6,001	5,465	(5,889)	7,998
Net finance income / (expense)	(5,956)	(60)	5,534	5,186	580
Profit / (loss) before tax	(29,826)	5,941	10,999	(703)	1,796
Profit / (loss) for the year	(24,431)	3,723	7,713	(981)	(509)
Investments in intangible assets	48,402	45,792	42,915	38,371	26,446
Investments in tangible assets	4,864	3,178	4,125	7,244	4,649
Net working capital	51,976	55,444	27,663	20,333	8,776
Total assets	266,176	261,399	247,552	224,829	232,648
Equity	183,167	204,409	197,002	189,619	190,364
Net cash flows from operating activities	15,081	15,040	33,226	10,665	23,538
Cash at the end of year	39,967	46,951	75,921	88,230	122,223
Free cash flow	(38,214)	(34,018)	(14,272)	(35,047)	(7,987)
Average number of employees	114	107	108	106	95
FINANCIAL REPORTING RATIOS (%)					
Gross profit margin	67.7%	69.7%	71.4%	73.3%	71.7%
EBITDA margin	6.7%	18.5%	15.8%	9.9%	16.1%
Current ratio	181.8%	339.0%	360.3%	462.9%	461.9%
Return on equity	-12.6%	1.9%	4.0%	-0.5%	-0.4%
SHARE-RELATED RATIOS (DKK)					
Basic EPS*	(1.03)	0.16	0.33	(0.04)	(0.03)
Diluted EPS*	(1.00)	0.15	0.33	(0.04)	(0.03)
Free cash flow per share*	(1.57)	(1.41)	(0.61)	(1.51)	(0.51)
Operating cash flow per share*	0.62	0.62	1.43	0.46	1.50

* 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.

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 developent costs, selling and distribution costs, administrative expenses, depreciation and amortisation and finance costs.
EBITDA margin	$\frac{\text{EBITDA}}{\text{Revenue}} \times 100$	The ratio represents the Groups operating profitability.
Current ratio	$\frac{\text{Current assets}}{\text{Current liabilites}} \times 100$	The ratio represents the percentage of the Groups 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 Groups 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 Groups 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 Groups ability to generate cash flow from operating and investing activities per the average number of diluted shares.

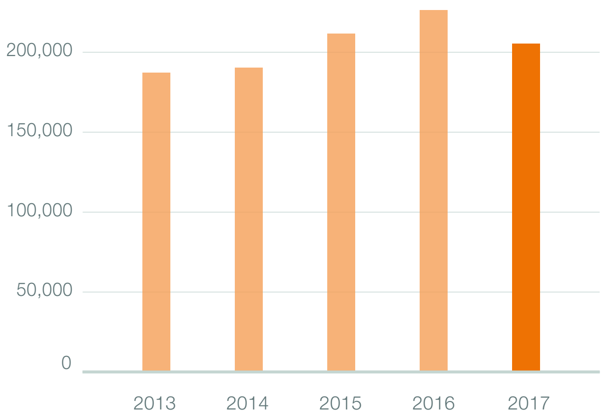
Net working capital represents the value of inventories, trade receivables of other current operating assets less trade payables and other current operating liabilities. Cash and cash equivalents and income tax receivable or payable are not part of the net working capital.

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 amortisation.

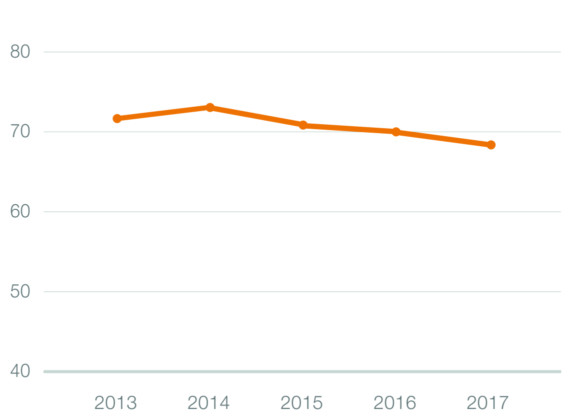
Free cash flow is net cash flow from operating activities added or deducted investing activities.

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

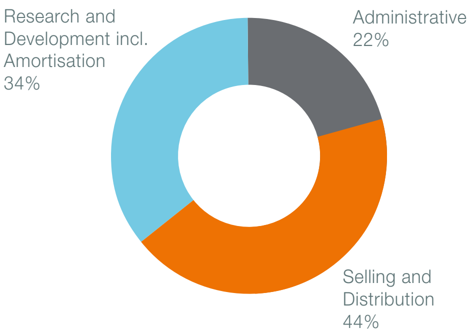
REVENUE in DKK'000



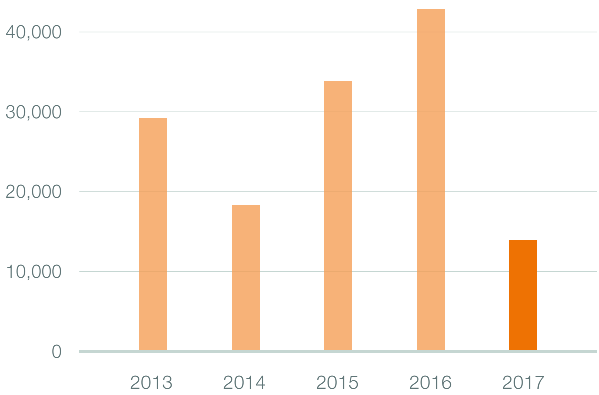
GROSS MARGIN IN %



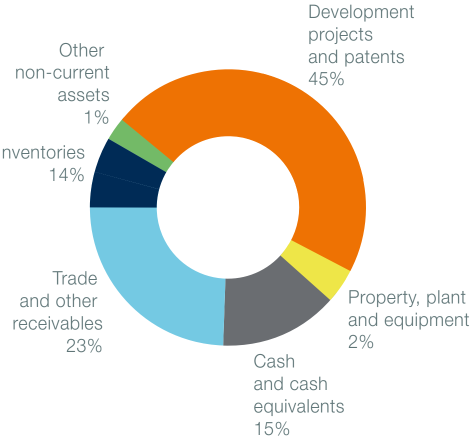
COST



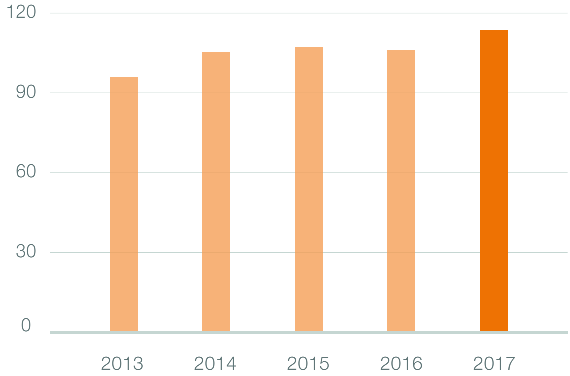
EBITDA IN DKK'000



ASSETS



AVERAGE NUMBER OF EMPLOYEES



BOARD OF DIRECTORS' REPORT 2017

Napatech is poised to benefit greatly by major external market trends that take Napatech's Reconfigurable Computing Platform from specialized segments to mass market use cases.

SUMMARY

We aspire to be and be perceived as the global leader in reconfigurable computing solutions. Our strategy focuses 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.

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. which 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 three offices in the United States, one in Japan and one in Taiwan.

GROUP ENTITIES

The United States subsidiary has offices in Andover, MA, Los Altos, CA, and Columbia, MD. The subsidiary in Japan has an office in Tokyo.

FINANCIAL DEVELOPMENT (2016 FIGURES IN BRACKETS)

Net revenues in 2017 came in at DKK 206.0 million (DKK 234.7 million) representing a revenue decline of 12%. The decline is due to several factors including a loss of a large project in Q3, and delays in other projects in Q4, as well as a decline in our main currency USD compared to DKK during the year.

The group experienced delays in a number of projects towards the end of 2017, as well as softness in the North American market. APAC had a limited decline for the year. The EMEA market did show significant decline for the year, but 2016 was also exceptionally strong. Overall the weakening of the USD was also an important factor for the decline. The EBITDA for 2017 was DKK 13.9 million (DKK 43.5 million), and the loss before tax for the year was DKK 29.8 million (profit of DKK 5.9 million).

The group's equity at the end of the year was DKK 183.2 million (DKK 204.4 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 48.4 million was capitalized in 2017 (DKK 45.8 million). The increase is due to both added internal resources and external costs in connection with the new hardware platforms, as well as our Pandion products, and the development of our virtualization solutions.

The financial items were negative DKK 6.0 million primarily due to the decline in USD, which affects our USD denominated assets, as compared to last year where the financial items were close to zero, with a negative DKK 60 thousand.

The group had a negative cash flow of DKK 7.0 million (negative DKK 28.9 million), The cashflow was negatively affected by the loss for the period and the high investment level, this was partly offset by increased borrowings during the year.

Napatech issued a revised outlook on 13th of December, and the report results were in line with that.

Target	Realised 2017	Guidance Dec'17
Revenue Growth	(12%)	Slightly negative
EBITDA margin	7%	Lower than 20%

FINANCIAL DEVELOPMENT IN THE PARENT COMPANY

Net revenues for the parent company in 2017 came in at DKK 170.9 million (DKK 198.0 million) representing a revenue decrease of 14%. The EBITDA in the parent company for 2017 was DKK 11.7 million (DKK 43.6 million), and the loss before tax was negative DKK 31.8 million (profit of DKK 6.4 million).

DEVELOPMENT ACTIVITIES AND KNOWLEDGE

The company has historically had high focus on development of new products and solutions within our SmartNIC products, both for existing markets and new markets. This work continued with high intensity throughout 2017. Additionally, the company used significant resources on developing our new revenue streams - the Pandion product line for network recording, and the solutions for Virtualized network functions.

The network recording solutions are a fast engine for real-time capture, indexing and search of network data. Napatech underlines its technology leadership by providing new and innovative products and functionality for our entire portfolio of 1, 10, 25, 40, 50 and 100 gigabit products. During 2017, we started the journey of disaggregating our products, and increasing our focus on becoming more software centric, making it 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.

DIVIDEND

The company has until now not distributed any dividends and 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 on 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 e-mail service to receive company announcements as well as other news via e-mail.

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. The guidelines are based on the Norwegian Code of Practice for Corporate Governance, last revised on October 30th, 2014. The Code of Practice use the "follow or explain principle". The company follows all the 14 recommendations.

NET REVENUES

206.0

DKK MILLION

GROSS PROFIT

139.4

DKK MILLION

EBITDA

13.9

DKK MILLION

LEADING
200G
TECHNOLOGY

INDUSTRY AWARDS
20+
WORLDWIDE

GUARANTEED
100%
DATA DELIVERY

The Board of Directors have 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 operates 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 the 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.

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. None of the Board members are employees of the company and 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 14 board meetings in 2017, whereby 4 of the meetings 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 receive monthly financial reports from the finance department, including key financial and operational performance indicators. The company approves and presents quarterly reports to the market in accordance with IAS 34. Financial reports are prepared and issued by the finance department, and the financial responsibility for quality assurance of the financial reports lies with the CFO. The group has, under careful consideration of its limited size, set up procedures to secure the best possible segregation of duties.

CORPORATE SOCIAL RESPONSIBILITY

The group has not adopted any more specific policies regarding corporate social responsibilities including policies for human rights, climate and environmental impact.

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 EICC'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 established a Conflict Mineral policy with the objective to only use 3TG that originate from conflict-free sources, all components are screened towards the Responsible Minerals Initiative smelter database, the actual screening is outsourced to Greensoft. We are very proud that we succeed in having our flagship products for 1-gigabit and 10-gigabit becoming 100% conflict free by the end of 2017.

OUR PRODUCTS

Our products are assembled by contract manufacturers that share our ambitions for social responsibility. We investigate each component regularly, and we declare that 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 114 fulltime employees, as of December 30th 2017, include 16 women (14%), 15 in 2016. 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 groups policy to increase the presence of women in the management team. In recruiting processes, the company aims for at least one of the last three candidates be a female, however, it is always the best candidate for a specific position that will be chosen. The Board of Directors consists of only men. The Board of Directors have a long-term goal to have at least 20% women 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 to an additional 4 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 put in to improving work-life balance. It is, however, always the candidate which 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 11 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 parent company and the US based subsidiary's consumption of electricity and through the usage of the group's petrol driven cars. The group has 6 different locations which is a fairly high number of locations compared to the size of the company with an average number of employees of 114 in 2017. 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 make measurements covering at least 85% of the employees in 2018.

LEGAL MATTERS

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

EVENTS AFTER YEAR-END

There are no material events from after the year-end and until this date.

OUTLOOK

Napatech´s strategy is to be and be perceived as the 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 growth to resume in 2018, but underlines that the short-term visibility is limited and will continue to be affected by quarter-to-quarter order volatility.

2017 saw the beginning of several initiatives to support our longer term growth ambitions, both within organizational enhancements, stronger partnerships with leading technology vendors and expansion of Napatech's product portfolio to include more software offerings and professional services, enabling Napatech products to be deployed in any open and standard server platform. These initiatives demonstrate the ongoing transition with our customers from a hardware-centric to a software-centric world of software defined networking. As a result of the changes that the markets, customers and Napatech are going through, the long-term outlook is exceedingly 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, as an established leader in FPGA technology, Napatech believes that it will see renewed and increased growth at the other side of the current transition.

2018 guidance for the company is the following:

- Sales growth in USD 0 to 10%
- Gross margin around 68%
- EBITDA margin around 15%

The progress from our recent design-wins and new design wins across our products combined with the initiatives we have taken during the second part of 2017 will drive this growth.

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
114
FULLTIME

WORLDWIDE
13
NATIONALITIES

LOCATIONS
6
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 23,877,672 shares outstanding of a nominal value of DKK 0.25. The company owned 2,700 treasury shares at year end. The company had 405 shareholders and 53% 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 registred 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 2017 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 2018 is:

Date	Activity	Venue
April 10, 2018	CMD	Oslo
April 25, 2018	Annual assembly	Copenhagen
May 8, 2018	Q1 2018 report	Oslo
Aug. 14, 2018	Q2 2018 report	Oslo
Nov. 6, 2018	Q3 2018 report	Oslo

NAPATECH SHARE PRICE DEVELOPMENT 2017 IN NOK

NAPATECH HAD BY 1ST MARCH 2018 THE FOLLOWING TOP 20 SHAREHOLDERS

Investor	Number of shares	% of total	Country
VERDANE CAPITAL VIII	5,172,844	21.66%	Denmark
ARCTIC FUNDS PLC	2,270,021	9.51%	Irland
STOREBRAND VEKST VER	1,507,802	6.58%	Norway
VERDIPAPIRFONDET DNB	1,388,024	5.81%	Norway
SILVERCOIN INDUSTRIE	1,304,873	5.46%	Norway
DNB NOR MARKETS, AKS	1,218,000	5.10%	Norway
THE BANK OF NEW YORK	980,000	4.10%	Great Britain
DANSKE BANK A/S	913,927	3.83%	Denmark
SÆTER HAAKON MORTEN	686,539	2.88%	Norway
HOLTA INVEST AS	655,272	2.74%	Norway
VINTERSTUA AS	648,521	2.72%	Norway
UBS SWITZERLAND AG	624,042	2.61%	Switzerland
DANSKE BANK A/S	568,211	2.38%	Denmark
TIGERSTADEN AS	507,408	2.13%	Norway
MARSTAL AS	420,000	1.76%	Norway
NORDEA BANK AB	302,033	1.26%	Denmark
HOBOLT NIELS	294,272	1.23%	Denmark
NORDNET BANK AB	272,862	1.14%	Sweden
EKNER PETER DAHL	247,200	1.04%	Denmark
SIX-SEVEN AS	200,850	0.84%	Norway
Total owned by top 20	20,182,701	84.53%	
Total owned by 384 other	3,694,971	15.47%	
Total number of shares	**23,877,672**	**100.00%**	

WHY NAPATECH?

RECONFIGURABLE COMPUTING

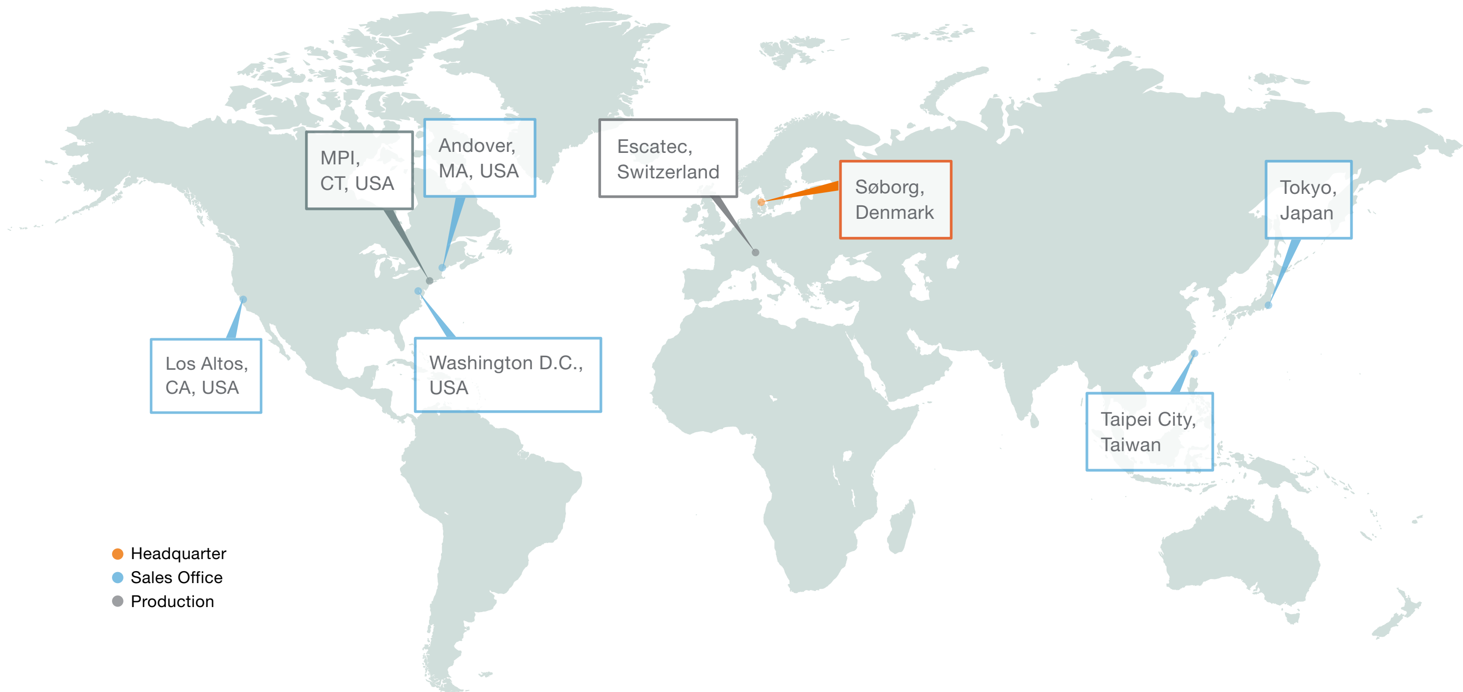
The shift towards cloud networking, 5G and IoT is disrupting the way applications and services are created and deployed. With this disruption, the gap between growing data processing needs and available capacity is widening.

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 belive it is extremely important to be attentive and responsive to our customers. To accomplish that we are located in different offices around the world. In the map below, our presence and the locations of our outsourced production facilities are shown.



FINANCIAL STATEMENTS

CURRENT ASSETS
137.4
DKK MILLION

NET OPERATING CASH FLOW
15.1
DKK MILLION

EQUITY
183.2
DKK MILLION

CONSOLIDATED INCOME STATEMENT

for the year ended 31 December 2017

Note	In DKK '000	2017	2016
4	Revenue	206,046	234,737
	Cost of goods sold	(66,611)	(71,129)
	Gross profit	**139,435**	**163,608**
5, 6	Research and development costs	(17,907)	(15,164)
5	Selling and distribution expenses	(71,420)	(74,677)
5, 7, 8	Administrative expenses	(36,223)	(30,308)
	Operating profit before depreciation, amortisation and impairment (EBITDA)	**13,885**	**43,459**
9	Depreciation, amortisation and impairment	(37,755)	(37,458)
	Operating result (EBIT)	**(23,870)**	**6,001**
10	Finance income	-	303
11	Finance costs	(5,956)	(363)
	Result before tax	**(29,826)**	**5,941**
12	Income tax	5,395	(2,218)
	Result for the year	**(24,431)**	**3,723**
13	**Earnings per share:**		
	Basic, DKK	(1.03)	0.16
	Diluted, DKK	(1.00)	0.15

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

for the year ended 31 December 2017

Note	In DKK ’000	2017	2016
	Result for the year	**(24,431)**	**3,723**
	Other comprehensive income to be reclassified to profit and loss in subsequent periods:		
	Exchange differences on translation of foreign operations	(519)	429
	Value adjustments on hedging instruments:		
	- Net gain / (loss) on cash cash flow hedges	10,265	743
	- Net (gain) / loss on cash cash flow hedges reclassified to revenue	(5,314)	(886)
	- Net (gain) / loss on cash cash flow hedges reclassified to finance costs	(3,637)	(163)
	- Income tax effect	(289)	53
	Net other income / (loss) to be reclassified to profit or loss in subsequent periods	**506**	**176**
	Total comprehensive income for the year, net of tax	**(23,925)**	**3,899**

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

at 31 December 2017

Note	In DKK '000	2017	2016
	ASSETS		
	Development projects, completed	68,416	75,689
	Development projects, in progress	46,342	22,488
	Patents	5,412	6,379
	Other intangible assets	50	489
14	**Intangible assets**	**120,220**	**105,045**
	Plant and equipment	5,166	5,186
	Leasehold improvements	1,079	1,173
15	**Tangible assets**	**6,245**	**6,359**
21	Leasehold deposits	2,283	2,312
	Other non-current assets	**2,283**	**2,312**
	Non-current assets	**128,748**	**113,716**
17	Inventories	36,124	18,675
18, 21	Trade receivables	51,938	75,119
18, 21	Other receivables	3,899	4,844
19	Income tax receivable	5,500	2,094
21	Cash and cash equivalents	39,967	46,951
	Current assets	**137,428**	**147,683**
	Total assets	**266,176**	**261,399**

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

at 31 December 2017

Note	In DKK '000	2017	2016
	EQUITY AND LIABILITIES		
20	Issued capital	5,969	5,916
20	Share premium	219,729	216,429
	Foreign currency translation reserve	(9)	510
20	Other capital reserves	6,361	6,586
	Retained earnings	(48,883)	(25,032)
	Equity	**183,167**	**204,409**
16	Deferred tax liability	7,425	8,427
21, 25	Interest-bearing loans and borrowings	-	5,000
	Non-current liabilities	**7,425**	**13,427**
21, 25	Interest-bearing loans and borrowings	35,109	-
21	Trade payables	26,130	25,978
	Other payables	13,855	15,902
22	Derivative financial instruments	-	1,314
23	Provisions	490	369
	Current liabilities	**75,584**	**43,563**
	Total liabilities	**83,009**	**56,990**
	Total equity and liabilities	**266,176**	**261,399**

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

for the year ended 31 December 2017

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 2016	**5,822**	**210,675**	**81**	**9,981**	**(772)**	**(28,785)**	**197,002**
	Result for the year	-	-	-	-	-	3,723	3,723
	Exchange differences on translation of foreign operations	-	-	429	-	-	-	429
	Net gain on cash cash flow hedges	-	-	-	-	743	-	743
	Net gain on cash cash flow hedges reclassified to revenue	-	-	-	-	(886)	-	(886)
	Net gain on cash cash flow hedges reclassified to finance costs	-	-	-	-	(163)	-	(163)
	Income tax effect	-	-	-	-	53	-	53
	Total comprehensive income	**-**	**-**	**429**	**-**	**(253)**	**3,723**	**3,899**
	Issue of shares	94	2,939	-	-	-	-	3,033
	Reversal, exercised and lapsed share options	-	2,815	-	(2,845)	-	30	-
7	Share-based payments	-	-	-	475	-	-	475
	Total transactions with shareholders	**94**	**5,754**	**-**	**(2,370)**	**-**	**30**	**3,508**
	At 31 December 2016	**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 cash flow hedges	-	-	-	-	10,265	-	10,265
	Net gain on cash cash flow hedges reclassified to revenue	-	-	-	-	(5,314)	-	(5,314)
	Net gain on cash 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
	Reversal, exercised and lapsed share options	-	1,648	-	(2,228)	-	580	-
7	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**

CONSOLIDATED STATEMENT OF CASH FLOWS

for the year ended 31 December 2017

Note	In DKK '000	2017	2016
	Operating activities		
	Result before tax	(29,826)	5,941
	Adjustments to reconcile profit before tax to net cash flows:		
	Finance income	-	(303)
	Finance costs	5,956	363
	Depreciation, amortisation and impairment	37,755	37,458
	Gain/loss on the sale of non-current assets	428	-
	Share-based payment expense	978	475
	Working capital adjustments:		
	Change in inventories	(17,449)	(4,334)
	Change in trade and other receivables	16,283	(29,319)
	Change in trade and other payables and provisions	(1,419)	2,735
	Cash flows from operating activities	**12,706**	**13,016**
	Cash flow hedges in financial items	2,506	163
	Interest received	-	4
	Interest paid	(861)	(363)
	Income tax received, net	730	2,220
	Net cash flows from operating activities	**15,081**	**15,040**
	Investing activities		
	Purchase of tangible assets	(4,864)	(3,178)
	Investments in intangible assets	(48,402)	(45,792)
	Investments in leasehold deposits	(29)	(88)
	Net cash from investing activities	**(53,295)**	**(49,058)**
	Free cash flow	**(38,214)**	**(34,018)**
	Financing activities		
	Issue of shares	1,705	3,033
	Proceeds from borrowings	30,109	-
	Repayment in borrowings	-	(637)
	Net cash flows from financing activities	**31,814**	**2,396**
	Net change in cash and cash equivalents	**(6,400)**	**(31,622)**
	Net foreign exchange difference	(584)	2,652
	Cash and cash equivalents at 1 January	46,951	75,921
	Cash and cash equivalents at 31 December	**39,967**	**46,951**

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 authorised for issue in accordance with the resolution of the management on 3 April 2018.

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES

General
The financial statements have been prepared in accordance 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
During the financial year, the Group implemented all new IFRS standards, amendments to existing standards and annual improvements that have been approved by the EU for annual periods beginning on 1 January 2017. The standards, amendments and annual improvements to existing standards which are deemed relevant to the Group are enumerated below:

With the exception of the new standards, amendments to standards and basis for conclusions enumerated below, the accounting policies are consistent with those of last year.

The following standards, amendments to existing standards and interpretations have been implemented but have no effect on the company's Annual Report:

- Amendments to IAS 7 Disclosure Initiative
- Amendments to IAS 12 Recognition of Deferred Tax Assets for Unrealised losses
- Annual Improvements to IFRSs 2014-16 Cycle

As none of the standards and interpretations impacted recognition and measurement in 2017, they neither impacted profit or loss for the year nor diluted earnings per share.

New and amended standards and interpretations that have not yet become operative
The IASB has issued a number new standards, amendments to existing standards which will become operative for financial statements covering periods beginning on or after 1 January 2018. New and amended standards are expected to be implemented by their effective dates.

The Following standards, amendments to existing standards and interpretations are expected to affect Napatech A/S' future annual reports:

- IFRS 9 Financial instruments and amendments to IFRS 9, IFRS 7 and IAS 39
- IFRS 15 Revenue from Contracts with Customers
- IFRS 16 Leases

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)

Either a full retrospective application or a modified retrospective application is required for annual periods beginning on or after 1 January 2018. The Group plans to adopt the new standard on 1 January 2018 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 2018 and that comparative figures will not be restated.

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 recognised in the income statement.

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

- Sales transactions must be recognised 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 recognise and measure the individual components.
- New and more detailed guidance on the recognition of revenue over time.

Napatech A/S has performed an analysis of the potential impact of the new standard on the Group. Based on analyses of the Group’s current product mix and types of contracts, it is Napatech A/S’ assessment that the new standard will not affect the recognition and measurement of the Group’s sales types which primarily consist of goods for resale and finished goods and there are no complex discount agreements, variable considerations or other elements that could result in significant reversals of revenue already recognized. Overall, based on the analyses performed, it is assessed that the implementation of IFRS 15 will have no significant effect on the Group’s financial statements, as revenue recognition under IFRS 15 is already in line with the Group’s current revenue recognition policies.

IFRS 9: Financial instruments was issued in July 2014 and is effective for annual periods beginning on 1 January 2018. Napatech has performed an assessment of IFRS 9, based on which Napatech expects no significant impact on recognition and measurement for the Group and Parent company. The assessment for the Group is based on the fact that the Group on a historical basis has experienced very low losses on Trade receivables due to the fact that the Trade receivables is towards large companies with high solvency ratio. The assessment for the Parent company is based on the fact that the Parent Company has not historically realised any significant losses on intra group receivables and the fact that the Group companies in all material aspects are able to settle the receivable as they fall due. The new standard also introduces expanded disclosure requirements and changes in presentation, which will be shown in the year of adoption. The Group will apply the new rules retrospectively from 1 January 2018.

IFRS 16 Leases sets out the principles for the recognition, measurement presentation and disclosure of leases and requires lessees to account for all leases, with a few exceptions, under a single on-balance sheet model similar to the accounting for finance leases under IAS 17.
At the commencement date of a lease, a lessee will recognise a liability to make lease payments (i.e., the lease liability) and an asset representing the right to use the underlying asset during the lease term (i.e., the right-of-use asset). Lessees will be required to separately recognise the interest expense on the lease liability and the depreciation expense on the right-of-use asset.
Lessor accounting under IFRS 16 is substantially unchanged from today’s accounting under IAS 17.

The Group has operating leases with minimum lease payments of approx. DKK 7,984 thousand, corresponding to 3.0% of the Group’s assets. Based on analyses of the Group’s operating lease

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

contracts, it is Napatech A/S' assessment that the new standard will have some effect on the Group's balance and cash flow statement, but only immaterial effect on the consolidated income statement. The standard becomes effective for annual periods starting on or after 1 January 2019. The Group does not intend to adopt the standard before the effective date.

In addition, the IASB has issued a number of new standards, amendments to existing standards and interpretations which are not relevant to the company and which are therefore not expected to affect its future annual reports.

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, unrealised 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 recognised 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 recognised 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 recognised 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 are translated at the exchange rates at the reporting date. Any foreign exchange differences arising on the translation are recognised 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 recognised in the income statement.

Revenue
Revenue from the sale of goods is recognised in the income statement when the significant risks and rewards of ownership of the goods have passed to the buyer, usually on delivery of the

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

goods. Revenue is recognised to the extent that it is probable that future economic benefits will flow to the group and the revenue can be reliably measured.

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

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 realised interest income and expenses, unrealised gains and losses on financial assets and liabilities in foreign currencies and realised gains and losses on fair value adjustments of derivative financial instruments.

For all financial instruments measured at amortised cost, interest income and expenses are recognised using the effective interest rate method. Financial income and expenses also comprise realised and unrealised 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 recognised 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 programme 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.

Costs relating to equity-settled share-based payments are recognised in the income statement under administrative expenses and in equity over the vesting period. The total expense recognised for equity-settled share-based payments at the reporting date reflects the share of

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 recognised had the terms not been changed, provided that the employee's or management's right had vested. In addition, an expense is recognised 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 recognised 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 recognised in the income statement under financial income/expenses.

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

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

Intangible assets with finite useful lives are amortised 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. Amortisation and impairment losses are recognised 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 recognised in the income statement.

Development projects
Research costs are recognised in the income statement as incurred. Development costs incurred for individual projects are recognised 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.

Subsequent to initial recognition of the development costs as an intangible asset, the development project is recognised at cost less any accumulated amortisation and impairment losses.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Amortisation 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 recognised as intangible assets at the time of acquisition. Patents are amortised 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 recognised 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 amortised cost.

Lease payments concerning operating leases are recognised 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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

carrying amount is reduced to the recoverable amount. The impairment loss is recognised in the income statement.

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 amortised cost less impairment losses. Where receivables are found to be impaired, their carrying amount is reduced to the estimated net realisable value.

Impairment losses are recognised in the income statement under administrative expenses.

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 recognised 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 recognised in the income statement in the same item as the gain/loss from the sale. The reserve is part of the distributable reserves.

Financial liabilities
Amounts owed to banks etc. are recognised 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 amortised cost using the effective interest method. Accordingly, the difference between the proceeds and the nominal value is recognised in financial expenses over the term of the loan.

Non-financial liabilities are measured at net realisable value.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Provisions
Provisions include warranty commitments and are recognised 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.

Income tax and deferred tax
Current tax liabilities and current tax receivable are recognised 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 recognised 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 recognised 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.

Unrecognised deferred tax assets are reviewed at each reporting date and are recognised 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 realised 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 recognised in correlation to the underlying transaction either in other comprehensive income or directly in equity.

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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Statement of cash flows
The statement 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, 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 68,416 thousand at 31 December 2017 (31 December 2016: DKK 75,689 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 recognised 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 recognised in the consolidated financial statements:

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 agreeements concluded with employees and management. The managements 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 recognised 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 2017 and 2016, respectively:

Year ended 31 December 2017:

DKK'000	EMEA	NAM	APAC	Consolidated
Revenue				
Total revenue	158,123	157,086	10,899	326,108
Inter-segment	(120,062)	-	-	(120,062)
Revenue, external customers	**38,061**	**157,086**	**10,899**	**206,046**
Cost of goods sold	(9,310)	(54,976)	(2,325)	(66,611)
Segment gross profit	**28,751**	**102,110**	**8,574**	**139,435**

Year ended 31 December 2016:

DKK'000	EMEA	NAM	APAC	Consolidated
Revenue				
Total revenue	192,148	175,156	11,039	378,343
Inter-segment	(143,606)	-	-	(143,606)
Revenue, external customers	**48,542**	**175,156**	**11,039**	**234,737**
Cost of goods sold	(12,244)	(56,073)	(2,812)	(71,129)
Segment gross profit	**36,298**	**119,083**	**8,227**	**163,608**

Explanation of abreviatons:
EMEA = Europe, Middle East and Africa
NAM = North America
APAC = Asia and Pacific

Inter-segment revenues are eliminated upon consolidation and are reflected in the "Inter-segment" row.

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 46,681 thousand (2016: DKK 29,757 thousand) corresponding to 23% (2016: 13%) of the Group revenue. Revenue from this customer is arising from the sales in the NAM segment.

Revenue from second significant customer amounted to DKK 21,731 thousand (2016: DKK 11,257 thousand) corresponding to 11% (2016: 5%) of the Group revenue. Revenue from this customer is arising from the sales in the NAM segment.

Revenue from third significant customer amounted to DKK 17,186 thousand (2016: DKK 99 thousand) corresponding to 8% (2016: 0%) of the Group revenue. Revenue from this customer also arises from sales in the NAM segment.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5 EMPLOYEE BENEFITS EXPENSE

DKK'000	2017	2016
Employee benefits expense is reported as follows:		
Wages and salaries	104,435	99,004
Defined contribution schemes	4,452	4,162
Share-based payment expense (Note 7)	978	476
Social security costs	3,221	2,826
Allocated to development projects	(41,326)	(34,095)
Total employee benefits expense	**71,760**	**72,373**

DKK'000	2017	2016
Employee benefits expense is recognised in the consolidated income statement as follows:		
Research and development costs	9,136	9,966
Selling and distribution expenses	49,614	47,767
Administrative expenses	13,010	14,639
Total employee benefits expense	**71,760**	**72,372**
Average number of employees	**114**	**107**

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

	2017		2016	
DKK'000	Manage-ment	Board of Directors	Manage-ment	Board of Directors
Short-term staff benefits	12,704	1,294	8,270	792
Defined contribution schemes	522	-	566	-
Share-based payment expense	313	-	230	-
Total compensation of key management personnel	**13,539**	**1,294**	**9,066**	**792**

Of the total compensation to the Management the CEO received DKK 2.3 million (2016: DKK 2.3 million).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6 RESEARCH AND DEVELOPMENT COSTS

Research and development costs including annual amortisation charge on completed development projects recognised in the consolidated income statement are DKK 49,216 thousand (2016: DKK 44,211 thousand). All research and development costs are incurred by the parent company.

NOTE 7 SHARE-BASED PAYMENTS

Employees and members of the management in both the parent company and the US-based subsidiary are eligable 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 still 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 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 recognised 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 recognised in the income statement with the counter item in the other reserves under the equity, and it is recognised 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 programmes. Therefore, the remaining vesting period of the share options has been accelerated.

The general terms for share options are summarised 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 issed 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 summarised as follows:

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 7 SHARE-BASED PAYMENTS (CONTINUED)

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 issed 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.

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 spli 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 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). The share options' life time is 5 years, where the share options holders are subject to a lock-up periode 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.

Based on the same decision made on General Assembly in April 2016 to issue 400,000 share options, the Board of Directors issued 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). The share options' life time is 5 years, where the share options holders are subject to a lock-up periode 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.

Based on the same decision made on General Assembly in April 2016 to issue 400,000 share options, the Board of Directors issued 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 periode 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 programme are summarised as follows:

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 7 SHARE-BASED PAYMENTS (CONTINUED)

	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	-	-
Excercised/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**

	2016					
	Executive Management		Other Employees		Total	
Share options	Number	Avg. ex. price	Number	Avg. ex. price	Number	Avg. ex. price
At 1 January 2016	1,032,848	8.60	620,780	8.80	1,653,628	8.67
Granted during the year	46,000	9.04	191,000	18.04	237,000	9.80
Transfer	(178,000)	8.00	178,000	8.00	-	-
Excercised/expired during the year	(186,300)	8.00	(289,344)	8.00	(475,644)	8.00
At 31 December 2016	**714,548**	**8.41**	**700,436**	**10.71**	**1,414,984**	**8.82**
Exercisable at 31 December 2016	**542,588**	**8.32**	**389,433**	**8.40**	**932,021**	**8.35**

In 2017, 212,216 share options were exercised and nil lapsed (2016: 386,568 exercised and 89,076 lapsed).
The following shows the exercise price of the outstanding share options and warrants:

	2017	2016
Number of share options at 31 December:		
Exercise price DKK 8.00	584,100	812,648
Exercise price DKK 10.75	381,668	365,336
Exercise price DKK 12.53	92,000	92,000
Exercise price DKK 18.04	140,000	145,000
Exercise price DKK 19.41	150,000	-
Exercise price DKK 14.90	110,000	-
Total number of outstanding share options	**1,457,768**	**1,414,984**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 7 SHARE-BASED PAYMENTS (CONTINUED)

The weighted average of the remaining contractual period of the outstanding share options from the 2014 share options programme at 31 December 2017 is 1 years and 6 months (at 31 December 2016: 2 years and 6 months). The weighted average of the remaining contractual period of the outstanding share options from the 2016 share options programme at 31 December 2017 is 4 years and 3 months (at 31 December 2016: 5 years and 3 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 and 2017 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

	May **2017**	November **2017**
Volatility	50.50%	47.30% - 48.40%
Risk-free interest rate	0.80% - 1.10%	0.70% - 1.00%
Exercise price (DKK)	19.41	14.90
Exercise period (years)	3.00 - 5.00	3.00 - 5.00
Number of options	150,000	105,000

The volatility is calculated based on a peer group of 7 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 2017, the Group has recognised DKK 978 thousand of share-based payment expense in the income statement (2016: DKK 475 thousand). DKK 313 thousand was recognised in relation to the Executive Management (2016: DKK 230 thousand) and DKK 665 thousand in relation to others (2016: DKK 245).

NOTE 8 AUDITORS' FEES

DKK'000	**2017**	**2016**
Ernst & Young:		
Statutory audit fee	266	266
Tax advisory fee	30	49
Fees for other services	107	125
Total auditors' fees	**403**	**440**

Fee in relation to non-audit services from Ernst & Young P/S, DKK 137 thousand consists of advices on new share based payment programmes and various accounting and tax assistance.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 9 DEPRECIATION, AMORTISATION AND IMPAIRMENT

DKK'000	2017	2016
Depreciation, amortisation and impairment are reported as follows:		
Depreciation of plant and equipment	3,927	4,740
Depreciation of leasehold improvements	601	578
Total depreciation of tangible assets	**4,528**	**5,318**
Amortisation of patents	561	611
Impairment of patents	918	1,769
Amortisation of completed development projects	31,309	29,047
Amortisation of other intangible assets	439	713
Total amortisation and impairment of intangible assets	**33,227**	**32,140**
Total depreciation, amortisation and impairtment	**37,755**	**37,458**

NOTE 10 FINANCE INCOME

DKK'000	2017	2016
Interest receivable from banks	-	4
Foreign exchange gains	-	299
Total finance income	**-**	**303**

NOTE 11 FINANCE COSTS

DKK'000	2017	2016
Interest payable to banks	466	332
Foreign exchange losses	5,095	-
Finance charges payable under finance leases	-	19
Other finance costs	395	12
Total finance costs	**5,956**	**363**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 12 INCOME TAX

DKK'000	2017	2016
Current tax recognised in the consolidated income statement:		
Current income tax	1,533	1,043
Current income tax carry back refund	(5,500)	(2,123)
Change in deferred tax	(1,291)	3,298
Adjustment prior years taxes	(137)	-
Total income tax	**(5,395)**	**2,218**

A reconciliation between tax expense and profit before tax multiplied by the applicable income tax rate for the Group for 2017 and 2016 is as follows:

DKK'000	2017	2016
Profit before tax	(29,826)	5,941
At the applicable Danish income tax rate for the Group, 22.0% (2016: 22.0%)	(6,562)	1,307
Tax effect of:		
Carry back refunded at 22.0% (2016: 23.5%)	-	113
Tax-deductable expenses	-	(37)
Non-deductible expenses	269	172
Effect of higher tax rates in the US and Japan	1,058	661
Adjustment prior years taxes	(137)	-
Other	(23)	2
At the effective income tax rate of 18% (2016: 37%)	**(5,395)**	**2,218**

NOTE 13 EARNINGS PER SHARE

DKK'000	2017	2016
Net profit attributable to equity holders of the parent company for basic earnings and the effect of dilution	**(24,431)**	**3,723**

	2017	2016
	Thousands	Thousands
Weighted average number of shares for basic earnings per share	23,809	23,520
Effect of dilution:		
Share options	505	594
Weighted average number of shares adjusted for the effect of dilution	**24,314**	**24,114**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 14 INTANGIBLE ASSETS

	Development projects, completed		Development projects, in progress		Patents		Other intangible assets		Total	
DKK'000	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016
Cost at 1 January	205,129	170,480	22,488	12,439	9,279	8,185	2,139	2,139	239,035	193,243
Additions in the year	-	-	47,890	44,698	512	1,094	-	-	48,402	45,792
Transfers in the year	24,036	34,649	(24,036)	(34,649)	-	-	-	-	-	-
Cost at 31 December	**229,165**	**205,129**	**46,342**	**22,488**	**9,791**	**9,279**	**2,139**	**2,139**	**287,437**	**239,035**
Accumulated and impairment amortisation at 1 January	129,440	100,393	-	-	2,900	520	1,650	937	133,990	101,850
Amortisation for the year	31,309	29,047	-	-	561	611	439	713	32,309	30,371
Impairment for the year	-	-	-	-	918	1,769	-	-	918	1,769
Accumulated amortisation and impairment at 31 December	**160,749**	**129,440**	**-**	**-**	**4,379**	**2,900**	**2,089**	**1,650**	**167,217**	**133,990**
Carrying amount at 31 December	**68,416**	**75,689**	**46,342**	**22,488**	**5,412**	**6,379**	**50**	**489**	**120,220**	**105,045**

Within the completed development projects there are two material development projects with carrying amount of DKK 7,835 thousand and DKK 7,344 thousand at 31 December 2017 respectively (31 December 2016: 9,836 and DKK 11,017 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 new 1 x 100G accelerator. The remaining amortisation periods of these two projects are 3 years and 11 months and 2 years respectively.

Within the in progress development projects there are two material development projects with carrying amount of DKK 15,789 thousand and DKK 13,617 thousand. The aim of the first project is to develop next generation of our network recording platform and the aim of the second project is to develop our new product aimed at the virtualization market primarily focused towards telecom and cloud providers. The projects are not yet completed and therefore have not been amortised.

At 31 December 2017, the Group tested the intangible assets for impairment. In relation to this, the Group identified patents on markets that are not expected to be utilised. Therefore, the Group recognised DKK 918 thousand as an impairment in respect of patents. There were no indications of impairment in respect of the Group's development projects and other intangible assets in the reporting period.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 15 TANGIBLE ASSETS

	Plant and equipment		Leasehold improvements		Total	
DKK'000	2017	2016	2017	2016	2017	2016
Cost at 1 January	34,622	32,224	4,630	3,970	39,252	36,194
Additions	4,342	2,488	522	690	4,864	3,178
Disposals in the period	(5,403)	(135)	-	(47)	(5,403)	(182)
Currency adjustment	(161)	45	(47)	17	(208)	62
Cost at 31 December	**33,400**	**34,622**	**5,105**	**4,630**	**38,505**	**39,252**
Accumulated depreciation at 1 January	29,436	24,789	3,457	2,921	32,893	27,710
Depreciation for the year	3,927	4,740	601	578	4,528	5,318
Disposals in the period	(4,975)	(135)	-	(47)	(4,975)	(182)
Currency adjustment	(154)	42	(32)	5	(186)	47
Accumulated depreciation at 31 December	**28,234**	**29,436**	**4,026**	**3,457**	**32,260**	**32,893**
Carrying amount at 31 December	**5,166**	**5,186**	**1,079**	**1,173**	**6,245**	**6,359**

At 31 December 2017, the Group tested the tangible assets for impairment.
There were no indications of impairment of the Group's tangible assets in the reporting period.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 16 DEFERRED TAX

	Consolidated statement of financial position		Consolidated income statement	
DKK'000	2017	2016	2017	2016
Tax losses carry-forwards	(16,007)	(11,361)	(4,646)	-
Intangible assets	25,365	21,830	3,535	3,053
Tangible assets	(1,726)	(1,863)	137	124
Provision for bad debts	(207)	(179)	(28)	68
Deferred tax liability / (asset) and expense / (income)	**7,425**	**8,427**	**(1,002)**	**3,245**

DKK'000	2017	2016
Reconciliation of deferred tax liability / (asset) is as follows:		
Opening balance at 1 January	8,427	5,182
Recognised in consolidated income statement	(1,291)	3,298
Recognised in consolidated statement of comprehensive income	289	(53)
Closing balance at 31 December	**7,425**	**8,427**

NOTE 17 INVENTORIES

DKK'000	2017	2016
Consumables and components	6,466	1,259
Finished goods and goods for resale	29,658	17,416
Total inventories	**36,124**	**18,675**
Carrying value of inventories recognised at fair value	-	-

The cost of goods sold for the year is DKK 66,611 thousand (2016: DKK 71,129 thousand).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 18 TRADE AND OTHER RECEIVABLES

DKK'000	2017	2016
Receivables recognised in the consolidated statement of financial position:		
Trade receivables	51,938	75,119
Other receivables	3,899	4,844
Total current receivables	**55,837**	**79,963**

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

DKK'000	2017	2016
At 1 January	2,103	1,815
Reversed in the year	(607)	(480)
Written off in the year	(560)	-
Change in the year	424	768
At 31 December	**1,360**	**2,103**

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

DKK'000	2017	2016
Not past due	45,451	70,541
Past due for less than 30 days	2,592	1,373
Past due between 30 and 60 days	722	962
Past due between 60 and 90 days	525	152
Past due after 90 days	2,648	2,091
Total maximum credit risk	**51,938**	**75,119**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 19 INCOME TAX RECEIVABLE

DKK'000	2017	2016
At 1 January	2,094	2,451
Income tax carry back refund	5,500	2,094
Income tax carry back refund received during the year	(2,094)	(2,451)
At 31 December	**5,500**	**2,094**

NOTE 20 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. The same principal has been applied on comparative figures from 2015 to enable comparison and consistency with previous periods.

	2017	2016
Authorised shares	Thousands	Thousands
Ordniary shares of DKK 0.25 each at 1 january	23,664	23,288
Increase in ordinary shares DKK 0.25 each	213	376
Ordiniary shares of DKK 0.25 each at 31 December	**23,877**	**23,664**

	2017	2017
Ordinary shares and fully paid	Thousands	DKK'000
At 1 January 2017	23,664	5,916
Exercise of share options for cash during the year	213	53
At 31 December 2017	**23,877**	**5,969**

DKK'000	2017	2016
Share premium		
At 1 January	216,429	210,675
Exercise of share options for cash in excess of cost of ordinary shares during the year	1,652	2,939
Reversals regarding exercised share options	1,648	2,815
At 31 December	**219,729**	**216,429**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 20 ISSUED CAPITAL AND RESERVES (CONTINUED)

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 other capital reserves are as follows:

DKK'000	2017	2016
At 1 January	7,611	9,981
Share-based payment expense (Note 7)	978	475
Reversals regarding exercised and lapsed share options	(2,228)	(2,845)
At 31 December	**6,361**	**7,611**

NOTE 21 FINANCIAL ASSETS AND FINANCIAL LIABILITIES

DKK'000	2017	2016
Financial assets measured at amortised cost:		
Leasehold deposits	2,283	2,312
Trade receivables	51,938	75,119
Other receivables	3,899	4,844
Cash and cash equivalents	39,967	46,951
Total financial assets	**98,087**	**129,226**
Financial liabilities measured at amortised cost:		
Finance lease liability	-	-
Interest-bearing loans and borrowings	35,109	5,000
Trade payables	26,130	25,978
Derivatives designed as hedging instruments:		
Foreign exchange forward contracts	-	1,314
Total financial liabilities	**61,239**	**32,292**

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 22 DERIVATIVE FINANCIAL INSTRUMENTS

At 31 December 2017, 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:

2017

No outstanding contracts at 31 December 2017

2016	Latest maturity date	Average exchange rate DKK/USD	Fair value	Unrealised gain/(loss)
			DKK'000	DKK'000
Forward exchange contracts to hedge expected future sales and costs USD 3,942 thousand	17/01-2017	671.49	(1,314)	(1,314)

In the year ended 31 December 2017 the Group realised gain from the expiry of forward contracts held during the totalled DKK 8,951 thousand (2016: gain DKK 1,048 thousand).

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 revorded 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 techiques 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 23 PROVISIONS

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

DKK'000	2017	2016
At 1 January	369	315
Utilised during the year	(369)	(315)
Additions in the year	490	369
At 31 December	**490**	**369**

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

NOTE 24 LIABILITIES FROM FINANCING ACTIVITIES

		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 25 COMMITMENTS AND CONTINGENCIES

Collaterals
The Group has issued a floating charge in the amount of DKK 30 million (2016: DKK 10 million) secured on receivables, inventories and tangible assets with carrying amount of DKK 44,875 thousand (2016: DKK 36,734 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:

		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**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 25 COMMITMENTS AND CONTINGENCIES (CONTINUED)

	2016		
DKK'000	Cars	Office facilities	Total
Falling due within one year	71	7,464	7,535
Falling due between one and five years	-	7,195	7,195
Total	**71**	**14,659**	**14,730**

The Group recorded DKK 252 thousand and DKK 8,044 thousand (2016: DKK 106 thousand and DKK 5,644 thousand) as operating lease expenses for cars and office facilities.

NOTE 26 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. Verdane Capital VIII owns 21.7%% (2016: 21.9%). 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 2016 or 2017.

Transactions with key management personnel
Remunerations, salaries and share-based payments to the Board of Directors and the Executive Management are reflected in Note 5. There were no other transactions with the Executive Management in 2016 and 2017. 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 2016 and 2017.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 27 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Group's principal financial liabilities comprise loans and borrowings, finance lease liabilities, 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 summarised 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.

In 2017, the Group had 3 customers (2016: 2 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 need for an impairment is analysed each quarter on an individual basis for major customers. Additionally, a number of minor receivables are grouped into homogenous groups and assessed for impairment collectively. The calculation is based on actual incurred historical data.
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 the geographical segments in which the Group operates is similar and do not differ significantly.

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 2017 and 2016 is the carrying amounts as illustrated in Note 21.

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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 27 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (CONTINUED)

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.

The Group has access to unused credit facilities in the amount of DKK 16,243 thousand (2016: DKK 17,637 thousand) in a case of a need for cash to finance its activities.

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.

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

	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
Derivative financial instruments	-	-	-	-
Total financial liabilities	**26,130**	**35,109**	**-**	**61,239**

	2016			
DKK'000	Jan - Mar	Apr - Dec	Over 1 year	Total
Interest-bearing loans and borrowings	-	-	5,000	5,000
Trade payables	25,978	-	-	25,978
Derivative financial instruments	1,314	-	-	1,314
Total financial liabilities	**27,292**	**-**	**5,000**	**32,292**

Interest rate risk

Interest rate risk is the risk that the fair value or future cash flow of a financial instrument will fluctuacte 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 35,109 thousand (2016 DKK 5,000 thousand). This loan yield an interest rate of 3.49%. 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 27 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (CONTINUED)

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

Cash flow hedges
Foreign exchange forward contracts measured at fair value through other comprehensive income are designated as hedging instruments to hedge cash flow exposure in USD based on the part of the future budgeted sales in USD that is 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.

	Effect on profit before tax		Effect on equiy	
DKK'000	2017	2016	2017	2016
Change in DKK by +/- 2%	+/- 823	+/- 1,483	+/- 823	+/- 1,483

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%. The Group's gearing ratios for 2016 and 2017 are negligable.

NOTE 28 EVENTS AFTER THE REPORTING PERIOD

There have been no significant events after 31 December 2017 that might affect the consolidated financial statements.

PARENT COMPANY INCOME STATEMENT

for the year ended 31 December 2017

Note	In DKK ’000	2017	2016
	Revenue	170,885	197,977
	Cost of goods sold	(66,611)	(70,574)
	Gross profit	**104,274**	**127,403**
2, 3	Research and development costs	(17,907)	(15,164)
2	Selling and distribution expenses	(40,802)	(38,977)
2, 4, 5	Administrative expenses	(33,824)	(29,615)
	Operating profit before depreciation, amortisation and impairment (EBITDA)	**11,741**	**43,647**
6	Depreciation, amortisation and impairment	(37,590)	(37,218)
	Operating result (EBIT)	**(25,849)**	**6,429**
7	Finance income	-	303
8	Finance costs	(5,956)	(363)
	Result before tax	**(31,805)**	**6,369**
9	Income tax	6,928	(1,175)
	Result for the year	**(24,877)**	**5,194**

PARENT COMPANY STATEMENT OF COMPREHENSIVE INCOME

for the year ended 31 December 2017

Note	In DKK '000	2017	2016
	Result for the year	(24,877)	5,194
	Other comprehensive income to be reclassified to profit and loss in subsequent periods:		
	Value adjustments on hedging instruments:		
	- Net gain / (loss) on cash cash flow hedges	10,265	743
	- Net (gain) / loss on cash cash flow hedges reclassified to revenue	(5,314)	(886)
	- Net (gain) / loss on cash cash flow hedges reclassified to finance costs	(3,637)	(163)
	- Income tax effect	(289)	53
	Net other comprehensive loss to be reclassified to profit or loss in subsequent periods	1,025	(253)
	Total comprehensive income for the year, net of tax	**(23,852)**	**4,941**

PARENT COMPANY STATEMENT OF FINANCIAL POSITION

at 31 December 2017

Note	In DKK '000	2017	2016
	ASSETS		
	Development projects, completed	68,416	75,689
	Development projects, in progress	46,342	22,488
	Patents	5,412	6,379
	Other intangible assets	50	489
10	**Intangible assets**	**120,220**	**105,045**
	Plant and equipment	5,160	5,085
	Leasehold improvements	998	1,000
11	**Tangible assets**	**6,158**	**6,085**
12	Investments in subsidiaries	2,380	2,197
18	Leasehold deposits	2,072	2,072
	Other non-current assets	**4,452**	**4,269**
	Non-current assets	**130,830**	**115,399**
14	Inventories	36,130	18,675
15, 18	Trade receivables	8,758	12,034
15, 18	Receivables from group entities	51,573	79,210
15, 18	Other receivables	3,492	4,187
16	Income tax receivable	5,500	2,094
18	Cash and cash equivalents	26,763	23,823
	Current assets	**132,216**	**140,023**
	Total assets	**263,046**	**255,422**

PARENT COMPANY STATEMENT OF FINANCIAL POSITION

at 31 December 2017

Note	In DKK '000	2017	2016
	EQUITY AND LIABILITIES		
17	Issued capital	5,969	5,916
17	Share premium	219,729	216,429
17	Other capital reserves	67,914	39,830
	Retained earnings	(112,180)	(59,574)
	Equity	**181,432**	**202,601**
13	Deferred tax liability	7,425	8,427
18	Interest-bearing loans and borrowings	-	5,000
	Non-current liabilities	**7,425**	**13,427**
18	Interest-bearing loans and borrowings	35,109	-
18	Trade payables	26,130	25,978
18	Payables to group entities	190	86
	Other payables	12,270	11,647
19	Derivative financial instruments	-	1,314
20	Provisions	490	369
	Current liabilities	**74,189**	**39,394**
	Total liabilities	**81,614**	**52,821**
	Total equity and liabilities	**263,046**	**255,422**

PARENT COMPANY STATEMENT OF CHANGES IN EQUITY

for the year ended 31 December 2017

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 2016	**5,822**	**210,675**	**9,981**	**(772)**	**-**	**(31,554)**	**194,152**
	Result for the year	-	-	-	-	33,244	(28,050)	5,194
	Net gain on cash cash flow hedges	-	-	-	743	-	-	743
	Net gain on cash cash flow hedges reclassified to revenue	-	-	-	(886)	-	-	(886)
	Net gain on cash cash flow hedges reclassified to finance costs	-	-	-	(163)	-	-	(163)
	Income tax effect	-	-	-	53	-	-	53
	Total comprehensive income	**-**	**-**	**-**	**(253)**	**33,244**	**(28,050)**	**4,941**
	Issue of shares	94	2,939	-	-	-	-	3,033
	Reversal, exercised and lapsed share options	-	2,815	(2,845)	-	-	30	-
5	Share-based payments	-	-	475	-	-	-	475
	Total transactions with shareholders	**94**	**5,754**	**(2,370)**	**-**	**-**	**30**	**3,508**
	At 31 December 2016	**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 cash flow hedges	-	-	-	10,265	-	-	10,265
	Net gain on cash cash flow hedges reclassified to revenue	-	-	-	(5,314)	-	-	(5,314)
	Net gain on cash 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**

PARENT COMPANY STATEMENT OF CASH FLOWS

for the year ended 31 December 2017

Note	In DKK '000	2017	2016
	Operating activities		
	Result before tax	(31,805)	6,369
	Adjustments to reconcile profit before tax to net cash flows:		
	Finance income	-	(303)
	Finance costs	5,956	363
	Depreciation, amortisation and impairment	37,590	37,218
	Impairments and reversal of impairments in subsidiaries	-	(2,146)
	Gain/loss on the sale of non-current assets	428	-
	Share-based payment expense	795	475
	Working capital adjustments:		
	Change in inventories	(17,455)	(4,782)
	Change in trade and other receivables and intercompany receivables	23,765	(21,085)
	Change in trade and other payables, intercompany payables and provisions	1,355	2,461
	Cash flows from operating activities	**20,629**	**18,570**
	Cash flow hedges in financial items	2,506	163
	Interest received	-	4
	Interest paid	(861)	(363)
	Income tax received, net	2,231	2,479
	Net cash flows from operating activities	**24,505**	**20,853**
	Investing activities		
	Purchase of tangible assets	(4,864)	(2,959)
	Investments in intangible assets	(48,402)	(45,792)
	Investments in subsidiaries	-	-
	Investments in leasehold deposits	-	(60)
	Net cash from investing activities	**(53,266)**	**(48,811)**
	Free cash flow	**(28,761)**	**(27,958)**
	Financing activities		
	Issue of shares	1,705	3,033
	Proceeds from borrowings	30,109	-
	Repayment in borrowings	-	(637)
	Net cash flows from financing activities	**31,814**	**2,396**
	Net change in cash and cash equivalents	**3,053**	**(25,562)**
	Net foreign exchange difference	(113)	136
	Cash and cash equivalents at 1 January	23,823	49,249
	Cash and cash equivalents at 31 December	**26,763**	**23,823**

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 recognised as income in the parent company's income statement in the year in which the 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 recognised 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 recognised development costs. The reserve cannot be used to distribute dividends or cover losses. The reserve will be reduced or dissolved if the recognised development costs are no longer part of the Company's operations by a transfer directly to the distributable reserves under equity.

NOTES TO THE PARENT COMPANY FINANCIAL STATEMENTS

NOTE 2 EMPLOYEE BENEFITS EXPENSE

DKK'000	2017	2016
Employee benefits expense is reported as follows:		
Wages and salaries	82,323	76,546
Defined contribution schemes	4,452	4,162
Share-based payment expense (Note 5)	798	476
Social security costs	680	719
Allocated to development projects	(41,326)	(34,095)
Total employee benefits expense	**46,927**	**47,808**

DKK'000	2017	2016
Employee benefits expense is recognised in the parent company income statement as follows:		
Research and development costs	9,136	9,966
Selling and distribution expenses	24,962	23,202
Administrative expenses	12,830	14,640
Total employee benefits expense	**46,928**	**47,808**
Average number of employees	**94**	**85**

Compensation of key management personnel is set out in Note 5 to the consolidated financial statements of the Group.

NOTE 3 RESEARCH AND DEVELOPMENT COSTS

Research and development costs including annual amortisation charge on completed development projects recognised in the consolidated income statement are DKK 49,216 thousand (2016: DKK 44,211 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 8 to the consolidated financial statements.

NOTE 5 SHARE-BASED PAYMENT EXPENSE

The share options decribed in Note 7 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 recognised as the cost of the investment in the subsidiary. Out of the Group's total share-based payment expense of DKK 978 thousand (2016: DKK 475 thousand), DKK 183 thousand (2016: DKK 0) has been recognised as an additional cost of the investment in the subsidiary.

NOTES TO THE PARENT COMPANY FINANCIAL STATEMENTS

NOTE 6 DEPRECIATION, AMORTISATION AND IMPAIRMENT

DKK'000	2017	2016
Depreciation, amortisation and impairment are reported as follows:		
Depreciation plant and property	3,839	4,571
Depreciation of leasehold improvements	524	506
Total depreciation of tangible assets	**4,363**	**5,077**
Amortisation of patents	561	611
Impairment of patents	918	1,769
Amortisation of completed development projects	31,309	29,047
Amortisation of other intangible assets	439	714
Total amortisation and impairment of intangible assets	**33,227**	**32,141**
Total depreciation, amortisation and impairment	**37,590**	**37,218**

NOTE 7 FINANCE INCOME

DKK'000	2017	2016
Interest receivable from banks	-	4
Foreign exchange gains	-	299
Total finance income	**-**	**303**

NOTE 8 FINANCE COSTS

DKK'000	2017	2016
Interest payable to banks	466	332
Foreign exchange losses	5,095	-
Finance charges payable under finance leases	-	19
Other finance costs	395	12
Total finance costs	**5,956**	**363**

NOTES TO THE PARENT COMPANY FINANCIAL STATEMENTS

NOTE 9 INCOME TAX

DKK'000	2017	2016
Current tax recognised in the parent company income statement:		
Current income tax carry back refund	(5,500)	(2,123)
Change in deferred tax	(1,291)	3,298
Adjustment prior years taxes	(137)	-
Total income tax	**(6,928)**	**1,175**

A reconciliation between tax expense and profit before tax multiplied by the applicable income tax rate for the parent company for 2017 and 2016 is as follows:

DKK'000	2017	2016
Profit before tax	(31,805)	6,369
At the applicable Danish income tax rate for the parent company, 22% (2016: 22%)	(6,997)	1,401
Tax effect of:		
Carry back refunded at 22% (2016: 23,5%)	-	113
Tax deductable expenses	-	(511)
Non-deductible expenses	229	172
Adjustment prior years taxes	(137)	-
Other	(23)	-
At the effective income tax rate of 22% (2016: 18%)	**(6,928)**	**1,175**

NOTE 10 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 11 TANGIBLE ASSETS

	Plant and equipment		Leasehold improvements		Total	
DKK'000	2017	2016	2017	2016	2017	2016
Cost at 1 January	33,273	30,800	4,220	3,734	37,493	34,534
Additions	4,342	2,473	522	486	4,864	2,959
Disposals in the period	(5,403)	-	-	-	(5,403)	-
Cost at 31 December	**32,212**	**33,273**	**4,742**	**4,220**	**36,954**	**37,493**
Accumulated depreciation at 1 January	28,188	23,617	3,220	2,714	31,408	26,331
Depreciation for the year	3,839	4,571	524	506	4,363	5,077
Disposals in the period	(4,975)	-	-	-	(4,975)	-
Accumulated depreciation at 31 December	**27,052**	**28,188**	**3,744**	**3,220**	**30,796**	**31,408**
Carrying amount at 31 December	**5,160**	**5,085**	**998**	**1,000**	**6,158**	**6,085**

There were no indications of impairment of the parent company's tangible assets in the reporting period.

NOTES TO THE PARENT COMPANY FINANCIAL STATEMENTS

NOTE 12 INVESTMENTS IN SUBSIDIARIES

DKK'000	2017	2016
Cost at 1 January	6,947	6,947
Additions	-	-
Value of share-based payment to employees in subsidiaries	183	-
Cost at 31 December	**7,130**	**6,947**
Accumulated impairment at 1 January	4,750	6,896
Impairment for the year	-	-
Reversal of impairment losses	-	(2,146)
Accumulated impairment at 31 December	**4,750**	**4,750**
Carrying amount at 31 December	**2,380**	**2,197**

The parent company's investments in subsidiaries at 31 December 2017 and 2016 consist of the following:

		Ownership in %		Proportion of voting rights in %		
Name	**Country**	**2017**	**2016**	**2017**	**2016**	**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	Sale and distribution of the Group's products

In 2016 the reversal of impairment losses relates to the investment in Napatech Inc., USA. Due to the positive market conditions in the USA the subsidiary has incurred profits, whereby the value of net assets in the consolidated financial statements are above the cost of investment net assets in the consolidated financial statements are above the cost of investment.

NOTES TO THE PARENT COMPANY FINANCIAL STATEMENTS

NOTE 13 DEFERRED TAX

	Statement of financial position		Income statement	
DKK'000	2017	2016	2017	2016
Tax losses carry-forwards	(16,007)	(11,361)	(4,646)	-
Intangible assets	25,365	21,830	3,535	3,053
Tangible assets	(1,726)	(1,863)	137	124
Provision for bad debts	(207)	(179)	(28)	68
Deferred tax liability and expense	**7,425**	**8,427**	**(1,002)**	**3,245**

DKK'000	2017	2016
Reconciliation of deferred tax liability / (asset) is as follows:		
Opening balance at 1 January	8,427	5,182
Recognised in parent company income statement	(1,291)	3,298
Recognised in parent company statement of other comprehensive income	289	(53)
Closing balance at 31 December	**7,425**	**8,427**

NOTE 14 INVENTORIES

DKK'000	2017	2016
Consumables and components	6,467	1,259
Finished goods and goods for resale	29,663	17,416
Total inventories	**36,130**	**18,675**
Carrying value of inventories recognised at fair value	**-**	**-**

The cost of goods sold for the year is DKK 66,611 thousand (2016: DKK 70,574 thousand).

NOTES TO THE PARENT COMPANY FINANCIAL STATEMENTS

NOTE 15 TRADE AND OTHER RECEIVABLES

DKK'000	2017	2016
Receivables recognised in the parent company statement of financial position:		
Trade receivables	8,758	12,034
Receivables from group entities	51,573	79,210
Other receivables	3,492	4,187
Total current receivables	**63,823**	**95,431**

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

DKK'000	2017	2016
At 1 January	812	1,125
Reversed in the year	-	(487)
Written off in the year	(83)	-
Change in the year	212	174
At 31 December	**941**	**812**

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

DKK'000	2017	2016
Not past due	5,396	8,717
Past due for less than 30 days	1,218	1,310
Past due between 30 and 60 days	218	697
Past due between 60 and 90 days	376	124
Past due after 90 days	1,550	1,186
Total maximum credit risk	**8,758**	**12,034**

NOTE 16 INCOME TAX RECEIVABLE

Income tax receivable relates to income tax carry back refund based on the prevoius years tax losses as a result of investements in development projects. The movement in the income tax receivable is disclosed in Note 19 to the consolidated financial statements.

NOTE 17 ISSUED CAPITAL AND RESERVES

Information in relation to issued capital and reserves is disclosed in Note 20 to the consolidated financial statements.

NOTES TO THE PARENT COMPANY FINANCIAL STATEMENTS

NOTE 18 FINANCIAL ASSETS AND FINANCIAL LIABILITIES

DKK'000	2017	2016
Financial assets measured at amortised cost:		
Leasehold deposits	2,072	2,072
Trade receivables	8,758	12,034
Receivables from group entities	51,573	79,210
Other receivables	3,492	4,187
Cash and cash equivalents	26,763	23,823
Total financial assets	**92,658**	**121,326**
Financial liabilities measured at amortised cost:		
Interest-bearing loans and borrowings	35,109	5,000
Trade payables	26,130	25,978
Payables to group entities	190	86
Derivatives designed as hedging instruments:		
Foreign exchange forward contracts	-	1,314
Total financial liabilities	**61,429**	**32,378**

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

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 22 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 23 to the consolidated financial statements.

NOTE 21 LIABILITIES FROM FINANCING ACTIVITIES

The parent company's liabilities from financing activities are the same as the Group's. Additional information is set out in Note 24 of the consolidated financial statements.

NOTES TO THE PARENT COMPANY FINANCIAL STATEMENTS

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 (2016: DKK 10 million) secured on receivables, inventories and tangible assets with carrying amount of DKK 44,875 thousand (2016: DKK 36,794 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:

		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**

		2016	
DKK'000	Cars	Office facilities	Total
Falling due within one year	71	5,164	5,235
Falling due between one and five years	-	2,582	2,582
Total	**71**	**7,746**	**7,817**

NOTES TO THE PARENT COMPANY FINANCIAL STATEMENTS

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 26 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 12 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	2017	2016	2017	2016
Income statement:				
Sales to subsidiaries	120,062	138,513	-	-
Purchases from subsidiaries	-	-	3,088	3,230
Statement of financial position:				
Receivables from subsidiaries	51,573	79,210	-	-
Payables to subsidiaries	-	-	190	86

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 27 to the consolidated financial statements.

NOTE 25 EVENTS AFTER THE REPORTING PERIOD

There have been no significant events after 31 December 2017 that might affect the parent company financial statements.

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 2017.

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 2017 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 2017.

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 2018

Executive Management

Henrik Brill-Jensen, Chief Executive 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 2017, 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 2017 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 2017 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 four years up to and including the financial year 2017.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the consolidated financial statements and the parent financial statements for the financial year 2017. These matters were addressed in the context of our audit of the consolidated financial statements and parent financial statement 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 consolidated financial statements and the parent company 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 consolidated financial statements, and parent company financial statements.

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

Capitalized development costs amount to DKK 114.8 million net at 31 December 2017 in the accompanying consolidated financial statements and account for 43% of the Group’s assets and 63% of the Group’s equity, and accordingly, we have identified recognition and valuation of capitalized development costs as a key audit matter.

Recognition of development costs as an intangible asset under IAS 38 requires significant judgement and measurement related to the initial costs. Subsequent measurement and impairment testing are subject to judgement and estimates based on Management’s assumptions, including assumption of future cash flows, expected technological development and discount rates.

Additional details on capitalized development costs are provided in note 14 to the consolidated Financial Statements.

Our audit procedures included an assessment of the eligibility of the development costs for capitalization as intangible asset under IAS 38 and an evaluation of the assumptions and methodologies used by Management to test the impairment of these intangible assets. As part of our audit procedures we have assessed design of the controls implemented by Management in respect of capitalization of development costs and performed substantive test of details on a sample basis testing to underlying evidence, including hour registration. Further, we have tested the key assumptions and methodologies used by management in the impairment test to budget and forecasts approved by the Board of Directors.

We further evaluated the disclosures provided by management in the financial statements compared to applicable accounting standards.

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 2018

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

RECONFIGURABLE COMPUTING

DN-1153 Rev. 1

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