

GROUP
MANAGEMENT
REPORT

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1. Fundamentals of the Group

1.1 Business model of the Group

euromicron

Specialist for digital infrastructures

Profile

The euromicron Group unites medium-sized high-tech companies that operate in particular in the target markets of “Digital Buildings”, “Smart Industry” and “Critical Infrastructures”. As German specialists for digital infrastructures, the companies in the euromicron Group enable their customers to network business and production processes and so successfully move to a digital future.

From design and implementation, operation, to intelligent services – euromicron provides its customers with tailor-made solutions for technologies, system integration and smart services and creates the IT, network and security infrastructures required for them. As a result, euromicron enables existing infrastructures to be migrated gradually to the digital age. Thanks to this expertise, the euromicron Group helps its customers increase their own company’s agility and efficiency, as well as develop new business models that lay the foundation for commercial success down the road.

The Group’s structure and locations

euromicron AG, Frankfurt/Main, is a strategic management holding that performs group-wide tasks. They include not only strategic controlling, but also assumption of cross-cutting functions such as financing, Group controlling and accounting, taxes, legal affairs, human resources, purchasing, IT, corporate marketing, investor relations and innovation management.

The central controlling functions are pooled at euromicron AG.

Alongside euromicron AG as the ultimate parent company, the euromicron Group’s operating business is conducted by the following 16 group companies:

Companies in the euromicron Group



Extensive restructuring and reorganization measures, including through mergers, had already been undertaken within the euromicron Group in the course of fiscal year 2015. Since then, national system house business for the target market of “Digital Buildings” has been pooled at euromicron Deutschland GmbH. The reorganization of euromicron Deutschland GmbH initiated in 2015 was continued in 2016. telent GmbH, which is also organized nationally, is the second large system house in the euromicron Group and offers its services in the target market of “Critical Infrastructures”.

Further systematic additions and optimizations were made to the portfolio of associated companies in fiscal year 2016, in particular relating to the segments “Smart Buildings” and “Critical Infrastructures”.

For example, a decision was taken in the “Smart Building” segment in fiscal year 2016 to part with the “Telecommunications” division of euromicron Deutschland GmbH since it is not of strategic importance for the Group. The telecommunications market is contracting and is highly competitive; sales in the overall market of telecommunications infrastructure have been declining significantly for years. There is strong consolidation among manufacturers and installation companies alike. The “Telecommunications” division can only withstand this competitive pressure to a limited extent and only extensive investments would enable it to achieve the necessary scaling to be profitable in the medium term. After the previously regionally organized business had been pooled in a national unit, an M&A project was launched in 2016. After completion of the sales negotiations, the agreement to sell this division was signed on March 15, 2017. The division is expected to be transferred to the purchaser at the end of April 2017, after the suspensive conditions specified in the agreement have been fulfilled.

In the “Critical Infrastructures” segment, the company SIM Asia PTE. LTD., Singapore, was founded as a wholly-owned subsidiary of Secure Information Management GmbH (SIM GmbH) in February 2016 and, as a sales company that is near to customers, will help tap the Asian market further for the products and services of SIM GmbH. A decision was also taken in 2016 to discontinue the “Optical Tracking Systems” product line of SIM GmbH, since it was a product portfolio that was at the end of its technical lifecycle. SIM GmbH stepped up its development activities in 2016 in order to achieve greater market penetration with higher-margin products developed in-house.

In addition, Netzikon GmbH was founded as a subsidiary of telent GmbH in August 2016. Netzikon GmbH establishes and operates customized sensor wireless networks based on the technology standard LoRa™ in Germany. The networks are designed to connect a very large number of sensors and actuators with a large range, coupled with low power consumption. This network infrastructure means that smart city solutions, machine-to-machine networking and new digital applications – such as in agriculture and environmental protection – can be implemented efficiently. As a result, customers benefit from the potential of the Internet of Things.

16

associated companies are responsible for operating business.

In order to round out its competences, telent GmbH also took over 75.0% of the shares in Koramis GmbH, a service provider specializing in IT-security, in January 2017. As a result, telent's value chain is being expanded to include cybersecurity for critical infrastructures and industrial infrastructures. Please also refer to the comments in the section "Significant events after the balance sheet date".

A decision was also taken toward the end of 2016 to discontinue the "Fiber-optic Infrastructure" division of RSR GmbH & Co. KG. The "Fiber-optic Infrastructure" division is not strategic and is characterized by low margins and high project risks. The division will complete its remaining orders on hand in the course of the first half of 2017 and then be closed.

Winding up of the companies in the "Non-strategic Business Segments" went as planned in fiscal year 2016. The business operations of euromicron NBG Fiber Optics GmbH and euromicron benelux S.A. had already been discontinued effective December 31, 2015, and the remainder was wound up in 2016, while liquidation of Avalan GmbH was continued in 2016. Liquidation of WCS Fiber Optic B. V., Amersfoort/the Netherlands, was completed on October 24, 2016, and the company was removed from the Dutch commercial register ("Kamer van Koophandel").

To reflect its strategic alignment toward the future market of the Internet of Things, the Group geared its internal and external reporting structure toward operating business on a market-oriented basis. The euromicron Group's segments in accordance with its internal reporting structure are as follows:



With its three segments, euromicron has a market-oriented setup.

All the activities of the euromicron Group in the target markets of "Digital Buildings" and "Smart Industry" are pooled in the "Smart Buildings" segment. The "Critical Infrastructures" segment comprises the euromicron Group's activities in the target market of the same name. The "Distribution" segment groups consulting and supply of vendor-independent products relating to active and passive network components in the fiber-optic and copper arena.

The regional focus of the euromicron Group's business operations remains on German-speaking countries. euromicron's companies in Germany are represented at a total of 32 locations distributed throughout the country. That enables ideal proximity to and intensive care and support for euromicron's customers.

Sales by region

in € million



The companies in the euromicron Group are represented in other European countries with locations in Italy, Austria, France, Poland and Switzerland. Group companies are also based in some non-European countries in the shape of project offices so as to cater for country-specific market requirements there. Examples are China and Pakistan, as well as (since 2016) the office of SIM Asia PTE. LTD. in Singapore.

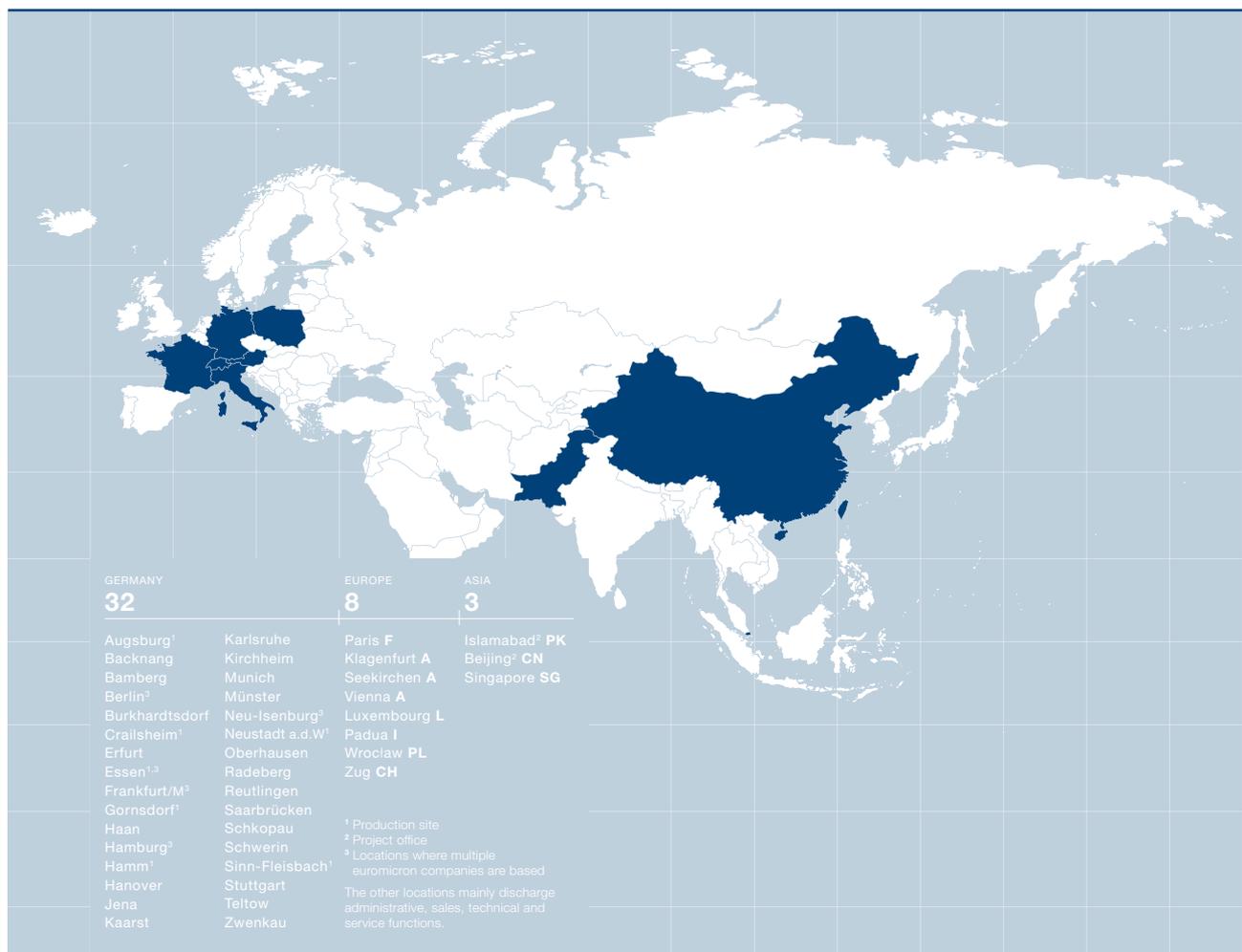
32 locations

in Germany enable proximity to customers.

Our activities in emerging markets with their great demand, such as the United Arab Emirates, Turkey, Brazil or the former CIS countries, are growing in importance. We tap these markets through project and export business and intensified sales activities, with these operations usually being controlled from Germany. As part of its internationalization strategy, the euromicron Group permanently examines its opportunities for tapping interesting foreign markets by acquiring niche companies as a springboard for additional business activities.

The chart below shows the regional footprint of the euromicron Group's companies:

euromicron's main locations



Target markets

The possibilities for digitization are innumerable and enable holistic technical solutions in all areas of life and business. The underlying trend of networking holds out the promise of gains in quality, convenience and resource efficiency. The euromicron Group pools the know-how of different small and medium-sized enterprises for the target market of the “Internet of Things”, specifically the target markets of “Digital Buildings”, “Smart Industry” and “Critical Infrastructures”. In each of these target markets, euromicron offers its customers individualized solutions for technologies, system integration and complementary smart services. There is significant future market potential for the euromicron Group with its more than 15 years of know-how in IT, network and security infrastructures in view of the growing digitization and networking of infrastructures.

Digital Buildings/Smart Industry

Smart buildings are an integral part of the Internet of Things. A digital building describes the automation and central operation of the technical equipment of functional buildings, such as office buildings, airports or shopping malls. Crucial factors are ensuring the safety of the building – such as with intelligent access control or dynamic escape route planning – and optimizing energy efficiency in running the building so as to slash operating costs. Other core issues are high availability, convenience and sustainability. In the target market of “Digital Buildings”, euromicron delivers cross-industry, all-round solutions in the fields of innovative building, network and security technology, as well as tailored services. Services relating to building or process automation, access control, video surveillance, fire prevention or support services as part of efficient energy and building management are planned, implemented and operated as part of that. One application example of that is the intelligent, energy-efficient lighting systems from MICROSENS (“Smart Lighting”), which can be integrated as part of a solution-oriented group strategy by the system house euromicron Deutschland GmbH.

After telecommunications and security technology, lighting is also following the trend toward IP-capable devices powered by PoE. Here too, digitization is the key innovation. LED lights are increasingly replacing conventional lighting with fluorescent tubes and ballasts, both in new installations and as part of extensive renovations. Combined with powerful sensors and intelligent controllers, power savings of up to 80% are possible. Results like that can only be achieved thanks to smart building and network technology: Micro apps programmed on MICROSENS switches organize energy-saving building equipment. Sensors and actuators record the actual states in the building and applications derive “actions” for the devices. Because when the lights go on only where they are needed or the air-conditioning adjusts itself to the number of people in a room that is not only convenient, but also energy-efficient.

The benefits of the digital building for our customers are in particular security, convenience and greater cost-effectiveness of their functional buildings and properties. Existing buildings can also be digitized subsequently with euromicron technologies, since digitization of the infrastructure can subsequently be carried out gradually, i.e. room by room or story by story.

This area also includes equipping data centers with innovative connector systems that have been developed by our technology companies and can also be installed by euromicron Deutschland GmbH.



You can find out more about our expertise in the field of “Digital Buildings” at: <http://www.euromicron.de/en/areas-of-expertise/digital-buildings>

The focus in the target market of “Smart Industry” is on digitizing and networking development, production and service processes in the SME sector. The “Smart Industry” market is developing at a rapid pace. According to a study by PwC, German industry intends to invest €40 billion per year in applications and network components by 2020. Companies thereby hope to increase efficiency and cut costs, as well as achieve qualitative advantages, such as great flexibility and the possibility of catering for customers’ individual wishes. The euromicron Group develops holistic approaches and the related processes for and with its customers and implements them in a forward-looking way that protects investments.

Apart from intelligent data management, a highly available, fault-tolerant network infrastructure is a crucial success factor here. In networking and automating digital business processes, the euromicron Group mainly sets store by comprehensive risk analysis. It offers an IT-security solution that is compatible with “Smart Industry” so that production can be networked with IT securely and with a high level of performance.

At ELABO GmbH in Crailsheim, Swabia, euromicron is showcasing concrete application scenarios for Smart Industry solutions in a “Smart Factory”. The model factory is specially tailored to working conditions in production at SMEs and shows how typical subprocesses in industrial production – research and development, production and quality assurance, repair and maintenance – can be networked with each other in a practical way on the basis of central data management software. All production-related information is available in real time at every workplace. Measurement and testing equipment is automatically parameterized. Also integrated are access control, video surveillance and light controlling, as well as intelligent material chutes and equipment storage facilities directly at the assembly line. Special IT-security solutions from euromicron Deutschland GmbH protect processes and production data against external intrusion and round out the overall concept, meaning the technology companies and system integrators of the euromicron Group present a holistic solution to their customers here.

Critical Infrastructures

Critical infrastructures are vital business infrastructures whose failure is highly problematic for the general public. That may be the digital mobile radio system at an airport or the communications network of Deutsche Bahn or a power utility, for example. Apart from that, professional video, audio and special solutions for sensitive security restricted areas round out the euromicron Group’s product portfolio in this target market. telent GmbH is the nationally oriented system integrator within the euromicron Group here, boasting a broad customer base in the segments telecommunications, energy and transportation, as well as highly specialized process know-how in this market.

Digitization in the energy industry is a challenge, yet gives operators and distributors opportunities to reposition themselves. Fault-tolerant, highly available IT and network infrastructures are crucial to that. telent GmbH thus plans, supplies and implements future-proof communications solutions for creating intelligent energy information networks (EINs) and telecontrol applications. If required, telent GmbH also delivers the related service and designs customized solution concepts for a highly available energy information network. Intelligent technologies are demanded for smart grids that are intended to optimize power generation, capacity utilization, storage, network management and consumption. Smart energy concepts can be launched faster thanks to innovative IoT infrastructures. The prime concern in that is the security of the systems and their digital infrastructures.

€ **40** billion

The amount German industry intends to invest in “Smart Industry” by 2020.



You can find out more about our expertise in the field of Smart Industry at:
<https://www.euromicron.de/en/areas-of-expertise/smart-industry>



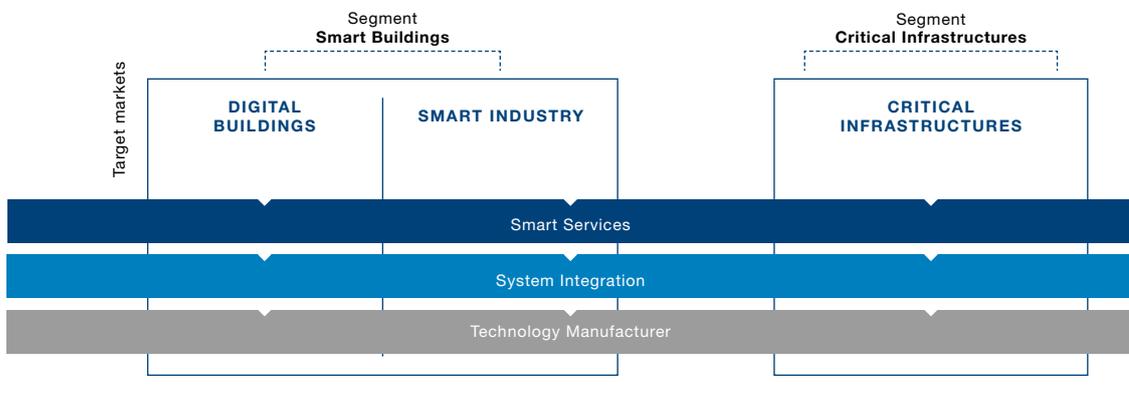
You can find out more about our expertise in the field of "Critical Infrastructures" at: <http://www.euomicron.de/en/areas-of-expertise/critical-infrastructures>

Decentralized energy supply systems need new communications solutions. The Internet of Things (IoT) and efficient digital infrastructures pave the way for that. A reliable infrastructure for transferring data, even over large distances, is necessary to enable components and measurement equipment to communicate in smart grids. Depending on bandwidth requirements, different standards and mobile technologies are used to transmit data, such as the new wireless standard Long Range Wide Area (LoRa®), digital mobile radio and IP-based wireless applications.

Products and solutions

In its target markets, the euomicron Group unites technological and system integration expertise to create holistic, innovative solutions. These are systematically made ready for the market as part of a cross-company, structured innovation process.

Business model of the euomicron Group



The Group's technology suppliers develop and produce active and passive optical network components, high-quality fiber-optic cabling systems, public address systems, testing and inspection equipment, networked workplace systems and highly professional safety and security technology for special applications. Reliable delivery, professional training in how to use our products and comprehensive services round out the portfolio.

As a system integrator, euomicron takes care of handling the entire project – from consulting, planning, selecting the system technology and implementation to service, maintenance and operation. As part of that, euomicron combines all technologies and applications in the field of information and communications technology (ICT) with digital sensor systems and software applications so as to be able to offer its customers tailored solutions in the Internet of Things area. In doing so, it combines the most innovative internal and external technologies to suit customers' requirements in order to create best-in-class solutions. As a result of the ever-changing and in some cases very specific customer requirements, strategic partnerships with leading external technology suppliers are also key success criteria for supplying best-in-class solutions. Thanks to their many established partnerships with vendors from the fields of network, transmission and security technology, the companies in the euomicron Group are always able to deliver the ideal solution for the customer's specific needs. At the same time, they have the necessary certification to ensure top quality when it comes to planning, installing and maintaining the products used. Customer proximity by means of on-site service is crucial in the consulting-intensive solution business and euomicron achieves that with its comprehensive network of branch offices. Services are provided directly on-site or through the central Service and Network Operation Center (NOC).

1.2 Objectives and strategies

After it took office in April 2015, the Executive Board of euromicron AG adopted a strategic realignment based on the company's existing bread-and-butter business, with the focus on the growth market of the Internet of Things (IoT). The overriding objective is to position the company with a solution-oriented differentiation strategy in the IoT market in order to leverage the market's growth potential.

Increasing networking and digitization of all conceivable information are impacting how existing and potential customers work and live to a greater and greater extent. The terrific pace of technological developments, such as in the Internet of Things, Smart Industry, smart services or big data analytics, pose new challenges for companies. In the past, customers mainly demanded individual communications and IT infrastructures or individual solutions for building technology, but now want complex, holistic solutions as a result of increasing digitization of processes.

Planning, implementing and operating digital infrastructures is the focus of euromicron's business activity. euromicron is positioning itself in a market segment that is at the start of its growth phase. The objective is a profitable growth model in a dynamic market of the future. To supplement that, we envisage targeted, strategic M&A activities in order to expand the portfolio with complementary solutions and technologies and so continuously increase our own competitiveness in the IoT market.

In order to achieve this strategy, necessary reorganization measures were implemented in 2015 and mainly accomplished at the operating companies by the end of fiscal year 2016. These measures, especially those relating to restructuring of euromicron Deutschland GmbH, took more time than was anticipated at the end of the previous year. As a result, implementation of the euromicron Group's strategy, which is laid down in a three-phase model, has been pushed back one year.

Now that the euromicron Group's reorganization has been largely completed in 2016, euromicron's transformation into a solution provider that generates a significant share of its sales from the IoT market is the core component of the strategy for fiscal years 2017 and 2018.

The goal in this phase of transformation is to leverage stable bread-and-butter business to systematically develop solutions that unite technology expertise and system integration expertise lastingly at the company. euromicron's extensive customer base, broad solution portfolio and enormous innovativeness in the areas of technology and system integration are the foundation for that. By intermeshing collaboration between the technology and system integration companies and pooling know-how, euromicron will be able in future to offer a broad range of smart services for all strategic target markets in the IoT market. In this way, the Group differentiates itself clearly and lastingly from the competition. This phase is accompanied by a tactical M&A strategy. The first element in that was acquisition of the majority stake in Koramis GmbH, a service provider specializing in IT-security, in January 2017. As a result, euromicron's value chain was expanded to include cybersecurity for critical infrastructures (KRITIS) and industrial infrastructures.



You can find out more about our expertise in the field of "Smart Services" at:
<http://www.euromicron.de/en/areas-of-expertise/smart-services>

From 2019 onward, euromicron aims to grow further through rigorous continuation of the IoT strategy. The medium-term goal up to 2019 is profitable sales growth that, complemented by tactical M&A measures, will result in sales of around €400 million by 2019. The share of smart services as part of system integration sales is to increase to more than 10%.

1.3 Control system

Corporate controlling

euromicron AG with its two Executive Board members and implemented cross-cutting functions sees itself as a strategic management holding.

The future target markets of the euromicron Group were defined and the Group was geared toward market needs as part of the strategic alignment from fiscal year 2015 on. In this connection, the Group's structures and organizational units were re-molded. The focus is on close collaboration between our Group companies so as to leverage synergies. As a result of that, we offer our customers tailored solutions using the full value chain of our Group's portfolio.

Corporate controlling is geared toward liquidity and profitable growth. Securing competitiveness is based on innovativeness, a focus on solutions and proximity to our customers. The core aspect for us is not only to secure our bread-and-butter business, but also to tap future markets in the growth market of the Internet of Things by means of a structured, Group-wide innovation process. The key success factor as part of that is our excellent employees.

Internal key control indicators

Our main financial control factors comprise key indicators for our business development, profitability, capital efficiency and liquidity controlling. At present, the operating EBITDA, the operating EBITDA margin, sales and the working capital ratio are the main key indicators used to control the Group.

Operating EBITDA and operating EBITDA margin

The factor for measuring operating results of the business units and Group and so the key earnings ratio for segment reporting is "earnings before interest, taxes, depreciation and amortization". The main focus of the analysis is on return on earnings. To permit better comparison over time, we therefore look at EBITDA adjusted for reorganization costs ("operating EBITDA").

Focus on liquidity and profitable growth.

Sales

Profitable organic sales growth is a key element of our strategy to increase the company's value. The development of sales is used as the factor for measuring that.

Working capital ratio

In addition, the working capital ratio (working capital deployed relative to sales) is used to control the Group so that the Group's tied-up capital and liquidity development can be systematically monitored and continuously optimized. Working capital is defined as the total of inventories, trade accounts receivable and the gross amount due from customers for contract work minus trade accounts payable, the gross amount due to customers for contract work and prepayments.

All the euromicron Group's activities are controlled and monitored on a segment-oriented basis. Important key figures that are monitored regularly are shown in the table below:

Key figures and control factors	2016	2015
	€ m.	€ m.
Sales	325.3	344.9
Operating earnings before interest, taxes, depreciation and amortization (operating EBITDA)*	13.2	13.8
Operating EBITDA margin*	4.0%	4.0%
Reorganization costs (with an impact on EBITDA)	-5.8	-6.9
Earnings before interest, taxes, depreciation and amortization (EBITDA)	7.4	6.9
EBITDA margin	2.3%	2.0%
Working Capital	38.5	61.4
Working Capital Ratio	11.8%	17.8%

*) Adjusted for special effects of the reorganization

The development in these key figures is explained in sections 2.2. "Course of business" and 2.3. "Net assets, financial position and results of operations".

1.4 Research and development

Objectives

Research and development are the foundation of our technological leadership and play a major part in helping us stand out from the competition. Our main goal is to develop products and solutions that enable our customers to make their work processes more efficient and effective. In addition, our innovations should have unique technical selling points, safeguard our position in profitable niche markets and let us tap new markets of the future.

Significant projects and results

The focus of development activities at euromicron's subsidiary MICROSENS GmbH & Co. KG in the past year was on further development of its own software and hardware components for smart office solutions and on development of new products for future-proof networking in buildings.

At the "elektrotechnik" trade fair in February 2017, for example, MICROSENS GmbH & Co. KG showed how, following telephony and video technology, acoustic systems like traditional loudspeakers can be integrated in the data network easily and reliably thanks to the new Smart Audio Controller. Acoustic systems are used in a wide range of ways in modern buildings: Whether background music in department stores or announcements and acoustic alerts to specifically address or warn people in buildings – there is hardly any large building that does not have loudspeaker systems. IP-based solutions offer the advantage that announcements can be confined to specific rooms or areas. In the event of an alarm, predefined announcements tailored to the area and incident in question are automatically triggered.

With the Medical Switch it newly developed in 2016, MICROSENS GmbH & Co. KG is setting new standards of performance, reliability and security for data networks in hospitals, clinics and practices. Specially designed to meet requirements in the medical arena, the switch ensures patients' safety and protects them against fault currents from the mains. To meet the particularly high requirements for network security in the medical arena, the Medical Switch offers extensive security features so that confidential data also remains confidential. The Medical Switch surpasses the strict statutory requirements for electromagnetic compatibility for patients. The surface made of rugged plastic permits efficient cleaning and disinfection and optionally comes with an antibacterial coating.

The decentralized Smart Office concept brings network intelligence to the application's direct vicinity and so creates an exceptional level of performance and security. Based completely on IP, the concept uses standard IT cabling infrastructure that exists in every office building and so offers an open, standards-compliant solution. The sensors, actuators and management system communicate via secure, encrypted IP network protocols. The MICROSENS Smart Office concept can be scaled and expanded as desired. Existing rooms can be integrated gradually and depending on needs. That enables gentle migration to state-of-the-art building management and so offers a far higher degree of convenience, security and efficiency compared to conventional building technology. Thanks to the Smart Lighting solution, the LED lights are supplied with power by means of Power over Ethernet Plus (PoE+). Sensors placed near to the lights record ambient parameters (e.g. brightness, incident daylight and the presence of persons in the room). The smart apps use this data and settings to adjust the lighting to suit the users' needs. The brightness and color of the light can also be controlled from the smartphone or tablet. The use of state-of-the-art lighting technology and smart controlling of it can result in large savings in electricity charges.

MICROSENS

The Smart Office concept enables gentle migration to state-of-the-art building management.

In 2016, EUROMICRON Werkzeuge GmbH expanded its product family for connection solutions in harsh environments. They include environments where a fiber-optic connection is exposed to crude oil, mud, extreme temperatures or strong vibrations. In addition to the familiar 2- and 4-channel variants of the EUROLENS family, the 8-channel variant was made ready for series production and successfully launched on the market. There are also further developments, such as a stainless steel version for even more extreme situations, such as on rough seas. In the field of fiber-optic cabling for data centers and infrastructure, the URM family was successfully standardized. The URM system has now assumed a firm place in the IEC 61754 series of standards for defining optical connectors. In addition to the presented product developments, various technology and innovation projects were launched, such as RFID connection and new coating methods.

One focus of development at ELABO GmbH in 2016 was on enhancing the modular workplace system "CIS – Connected Industry System". Thanks to the modular concept, customers can assemble an overall system to suit their needs from a raft of individual modules. The functionality of the workplace system can also be expanded subsequently. Market launch of the system commenced at the end of 2016.

The development activities of LWL-Sachsenkabel GmbH in 2016 focused on the development of new distribution components (patch cables) and a large number of further developments of technical connectors, as well as improvements in handling as part of assembly and installation of the URM connector as a component for data center applications. In addition, it continued ongoing development activities for a new service portal in which registered customers will in future be able to choose Sachsenkabel products from predefined products, as well as put together and order customized products using a configurator. A customized service section will round out the portal's range of services.

R&D ratios

The continued investments in innovative and competitive new products and solutions are also reflected in the carrying amounts of capitalized development costs and self-developed software, which were €9.2 million at December 31, 2016 (previous year: €9.5 million); amortization of capitalized development costs and self-developed software was €2.8 million (previous year: €3.8 million). The newly capitalized costs in fiscal year 2016 totaled €2.5 million (previous year: €2.6 million).

ELABO

CIS – the further-developed Connected Industry System was launched in 2016.

€ **9.2** million

in capitalized development costs and self-developed software.

2. Economic report

2.1 General economic and industry-specific conditions

General economic conditions

According to the spring economic report of the Kiel Institute for the World Economy (IfW), the global economy firmed up in the course of 2016, despite greater political uncertainties, and picked up pace again at the beginning of this year. In the advanced economies, the elections in the U.S. not only aroused worries due to the nascent risk of protectionism, but also hopes for powerful economic boosts from the United States. According to the IfW, the situation in emerging countries has stabilized and a gradual pickup is expected, albeit without any major economic momentum. Globally, no strong upturn is anticipated in view of the diverse structural impediments that still exist. The risks of a reorientation in economic policy in the United States are assessed as considerable, although there are not any concrete specifics in this regard so far. All in all, global gross domestic product (GDP) in 2016 grew by 3.1%. The IfW's economists assume that GDP will grow by 3.5% in the current year. Economic growth will likely rise to 3.6% in 2018.

3.5%

The rate at which the IfW expects global GDP to increase by in 2017.

Trends in the Euro area

According to the Kiel Institute for the World Economy, the economic recovery in the Euro area remains moderate, but stable, although there are first signs of an additional upswing. The European economy grew by 1.7% in 2016. The economists predict GDP to grow moderately by 1.8% in 2017 and by 1.7% the year after. In the Euro area excluding Germany, the pace of expansion will probably be slightly weaker, especially since it is exposed to a number of political risks in 2017. These imponderabilities include the upcoming negotiations with the United Kingdom on its leaving the EU, important elections in four of the five major member states, and the fact that the economic and trade policy of the new U.S. administration is difficult to predict. Buoyancy in the Euro area comes from the decline in unemployment, the upward-pointing early indicators, and boosts to economic activity from low interest rates and the low external value of the Euro.

The economic situation in the Federal Republic of Germany

The regional focus of the euromicron Group companies' business operations is on German-speaking countries. According to the Federal Statistical Office, the economic situation in Germany in 2016 was again characterized by solid and steady growth. All in all, the average increase in gross domestic product (GDP) for 2016 as a whole was 1.8% (after price and working-day adjustments). The IfW anticipates that gross domestic product will grow by 1.7% in 2017 and 2.0% the year after. The driving forces will be consumption, which is losing momentum, as well as exports and investments. It is expected, for example, that construction investment – ignoring weather-related fluctuations – will also expand vigorously due to favorable financing conditions. Inflation will probably rise to 1.8% this year. The German economy will thus continue to expand in an unsettled international environment.

1.7%

growth in German GDP is forecast by the IfW for 2017.

German ICT market grows in line with the economy as a whole

The German Association for Information Technology, Telecommunications and New Media (BITKOM) states that the German ICT market grew by 1.7% to €160.5 billion in the whole of 2016, compared with revenue of €157.6 billion the year before. The industry's growth driver remains information technology, whose revenue was able to grow by 3.6% to €84 billion. According to the association, business of software vendors in particular grew at an above-average rate: by 6.2% to €21.6 billion.

Investment in digital technologies is a must if the digital transformation is to succeed. Revenue from IT services, which are an especially strong reflection of orders relating to digitization of companies, recorded a rise of 2.7% to €38.2 billion. Around 57.0% of enterprises that use or plan to use Smart Industry have budgeted funds for that this year, according to a survey by BITKOM. However, enterprises are still tending to be cautious when it comes to investment. Business with infrastructure systems performed positively again in 2016, growing by 2.1% to €6.6 billion.

Information technology was the strongest driver in the international ICT market as well and posted rising revenue, especially for software. According to the annual report of EITO (European Information Technology Observatory), global revenue from IT and communications products and services grew by 2.1% to €3.1 trillion in 2016.

Outlook for 2017

BITKOM expects the overall ICT market to grow by 1.2% to €162.4 billion in 2017. Apart from slightly weaker growth in the overall economy, anticipated weaker business with IT hardware, such as desktop PCs and notebooks, as well as a sharper decline in revenue from fixed-line and mobile services due to price competition and regulatory effects will result in the slightly lower growth rate. EITO assumes that the global ICT market will grow by 2.5% in the coming year.

1.2%

growth is expected by BITKOM for the ICT industry.

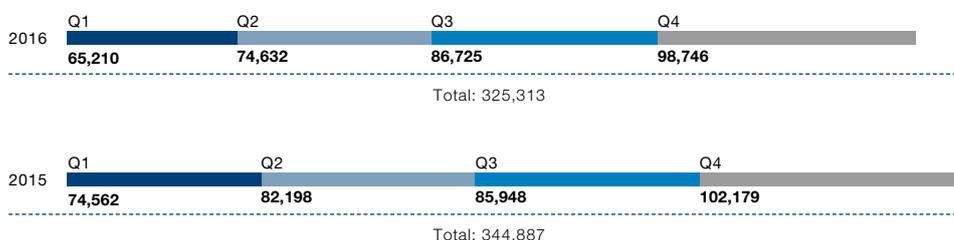
2.2 Course of business

General statement on the performance of the euromicron Group in fiscal year 2016

The euromicron Group closed fiscal year 2016 with sales of €325.3 million (previous year: €344.9 million). Consequently, sales in fiscal year 2016 were slightly down by 1.4% on the forecast range of €330 million to €350 million that was adjusted in the 2016 half-yearly financial report (original forecast in the 2015 Annual Report: €350 million to €370 million). €10.6 million of the €19.6 million decline in sales is due to the fact that there was no longer any revenue from the non-strategic business segments, whose business operations were discontinued at the end of 2015. The remainder of the decline (€9.0 million) is attributable to the "Smart Buildings" segment (€2.2 million) and the "Critical Infrastructures" segment (€7.4 million). However, sales in the "Distribution" segment were €0.6 up compared to the previous year. We refer to the presentation of the segments' development for an explanation of their sales.

Sales by quarter

In € thousand



The traditionally cyclical nature of business at the euromicron Group, which generates most of its sales and income in the fourth quarter, was especially strong in fiscal year 2016. 30.4% of annual sales were achieved in the fourth quarter in 2016 (previous year: 29.6%). There was a particularly strong peak in sales in December 2016: Whereas sales of €38.5 million (or 11.2% of the annual figure) were generated in December 2015, sales in December 2016 were €44.2 million or 13.6% of the annual total. Overall, the very strong fourth quarter was partly able to compensate for the restrained sales performance during the rest of the year, but not fully.

The euromicron Group's total operating performance (sales plus inventory changes) was €324.5 million, €21.3 million down on the previous year (€345.8 million). The effect of the €21.3 million reduction in total operating performance on gross profit was € -3.2 million. The volume-related effect from the lower total operating performance (€ -9.7 million) was partly offset by the sharp improvement in the material usage ratio. The latter fell in fiscal year 2016 by 2.0 percentage points to 52.7%, resulting in a positive effect on gross profit of €6.5 million. On the one hand, the improvement in the adjusted material usage ratio is attributable to discontinuation of the non-strategic business segments, which had an above-average material usage ratio. On the other, there was a more favorable margin mix compared with the previous year in parts of product and solution business.

Operating EBITDA (EBITDA before reorganization costs) was only slightly down by €0.6 million compared to the previous year, despite the lower gross profit. As in the previous year, the operating EBITDA margin (relative to sales) was 4.0%. It was therefore at the upper end of the target range of 2.0% to 4.0% forecast in the 2016 half-yearly financial report (original forecast in the 2015 Annual Report: 4.5% to 5.5%).

The fact that operating EBITDA was only €0.6 lower despite a fall of €3.2 million in gross profit is attributable to an amount of €1.4 million to a rise in other operating income. This results to a total of €1.4 million from recognition of a receivable from reimbursement of legal costs. There was also income of €1.1 million from claims from rights of recourse against former shareholders of ATECS AG due to payment of tax arrears for a period before the company was acquired by euromicron AG. However, this other operating income is offset by tax and interest expenses to the same amount. On the other hand, there was in particular no longer any income resulting from reversal of a conditional purchase price obligation (€1.0 million) that had been carried in the other operating income in the year before.

€ **13.2** million

our operating EBITDA.

In addition, the balance of personnel costs and other operating expenses fell by €1.3 million compared to the previous year. That was slightly offset by a fall of €0.1 million in own work capitalized.

Reorganization costs with an impact on EBITDA totaled €5.8 million and reduced the EBITDA margin by 1.7%. Consequently, they were above the range of €3.0 million to €4.0 million that was forecast in the 2016 half-yearly financial report (original forecast in the 2015 Annual Report: €2.0 million to €3.0 million). €1.0 million of the extra costs was due to non-cash effects from write-downs in connection with sale of the “Telecommunications” division of euromicron Deutschland GmbH, €0.5 million was due to effects from discontinuation of the “Optical Tracking Systems” product line of Secure Information Management GmbH, and €0.1 million was due to closure of the non-strategic “Fiber-optic Infrastructure” division of RSR GmbH & Co. KG. All these measures were not initiated until the fourth quarter and were therefore not reflected in the adjusted forecast. In addition, the reorganization costs of euromicron AG were above the forecast figure, in particular as a result of higher costs for legal advice, financial advice and other consulting services related to the reorganization. There were also slightly higher follow-up costs from the closure of the non-strategic divisions. However, a positive aspect was that the reorganization costs in the area of IT integration and centralization of the properties were below the forecast costs.

The unplanned amortization and depreciation effects from reorganization measures totaled €1.0 million. €0.5 of that was in connection with sale of the “Telecommunications” division of euromicron Deutschland GmbH and €0.5 million was due to the discontinuation of the “Optical Tracking Systems” product line of Secure Information Management GmbH.

The euromicron Group’s working capital ratio (working capital relative to sales) was reduced by 6.0 percentage points to 11.8% in 2016 and so was well below the forecast maximum figure of 15.0%. The working capital ratio before factoring was also reduced by 1.2 percentage points from 23.7% to 22.5%. This shows that the measures with which the Group intensified in 2016 to optimize working capital and so reduce its tied-up capital had a significant impact in fiscal year 2016.

The working capital ratio fell by 6.0 percentage points to

11.8%

In summary: Fiscal year 2016 was negatively affected by a weak first half with sales and income below the levels of the previous year. That also led to the adjusted forecast published in the half-yearly financial report on August 9, 2016. However, there was a positive operating trend in the second half of the year, in particular in the fourth quarter. The operating EBITDA margins of the Group’s two largest segments were improved significantly in the fourth quarter compared with the figures at September 30, 2016: In the “Smart Buildings” segment, there was an improvement in the operating EBITDA margin from –0.2% to 3.1%, while that at the “Critical Infrastructures” segment improved from 3.3% to 6.3%. The “Smart Buildings” segment was impacted in particular by stabilization of euromicron Deutschland GmbH, which recorded a significant increase in sales and was hit to a far lesser extent by unproductive work required to complete old projects than in the first half of the year. All in all, that meant euromicron Deutschland GmbH closed the fourth quarter of 2016 with a positive operating EBITDA. Both segments also benefited from the fact that the situation as regards order postponements eased at the technology companies and there was also a sharp increase in sales here.

The described effects also had a positive impact on other operating income. Overall, the sales forecast adjusted for the year as a whole was not quite achieved and the adjusted forecast for the operating EBITDA margin came in at the upper end of the range.

After continuation of the reorganization measures in 2016, as part of which the Group shed further loss-making divisions and product lines, it is expected that this positive trend will continue in fiscal year 2017, in particular in view of the high order books.

Development of the segments

The key figures for the individual segments of the euromicron Group changed as follows in fiscal year 2016:

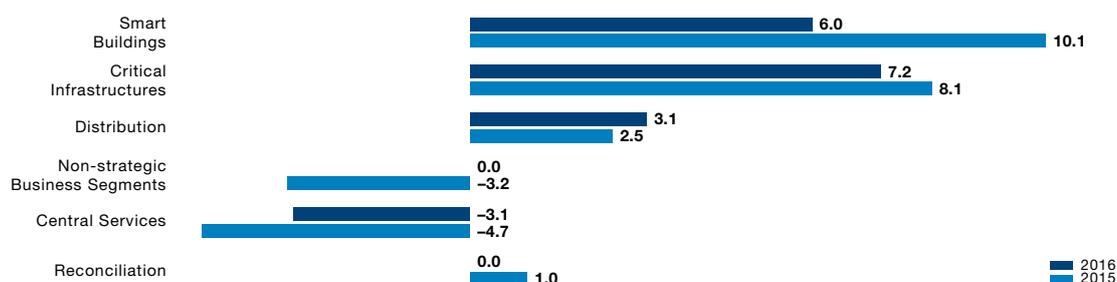
Sales

In € million



Operating EBITDA

In € million

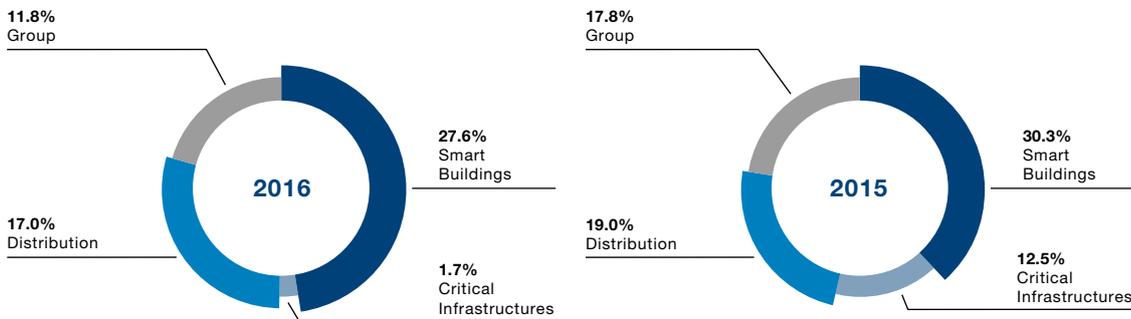


Reconciliation of the reported EBITDA with operating EBITDA/presentation of the reorganization costs

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	2016			2015		
	Reported EBITDA	Reorganiza-tion costs	Operating EBITDA	Reported EBITDA	Reorganiza-tion costs	Operating EBITDA
	€ m.	€ m.	€ m.	€ m.	€ m.	€ m.
Smart Buildings	4.2	-1.8	6.0	7.5	-2.6	10.1
Critical Infrastructures	6.6	-0.6	7.2	7.9	-0.2	8.1
Distribution	3.1	0.0	3.1	2.5	0.0	2.5
Non-strategic Business Segments	-0.5	-0.5	0.0	-5.0	-1.8	-3.2
Central Services	-6.0	-2.9	-3.1	-7.0	-2.3	-4.7
Reconciliation	0.0	0.0	0.0	1.0	0.0	1.0
Total EBITDA	7.4	-5.8	13.2	6.9	-6.9	13.8

Working capital ratio



Smart Buildings

Sales in the “Smart Buildings” segment were €193.7 million and so €4.2 million or 2.1% below the previous year’s figure of €197.9 million. This was due to the fact that the previous year’s figure for this segment included sales from a large order to equip data centers with special connectors – sales that are subject to annual fluctuations. In addition, sales from the supply of components were down year on year due to the postponement of international large projects. However, sales in this segment’s system house business were slightly up on the level of the previous year.

The forecast for the “Smart Buildings” segment envisaged sales growth in the high single-digit percentage range. In addition to the previously explained causes for the year-on-year deviation in sales, the forecast growth in sales at euromicron Deutschland GmbH did not materialize in fiscal year 2016. Whereas the forecast still contained sales from large projects with general contractors and, taking into account the planned performance of the company’s other divisions, anticipated a sharp increase in sales, a decision was taken in the first quarter of 2016 to withdraw from this business segment and to mainly acquire projects as part of direct customer business in the future. The readjustment of sales activities to compensate for the resultant drop in orders only took effect with a time delay. Although new orders at euromicron Deutschland GmbH were increased significantly as of the second half of 2016 by means of additional sales measures, the large sales volume from the lost large projects meant that for the year as a whole there was all in all a slight decline in sales of 1.2%, which is the main reason for the deviation from the sales forecast in this segment.

Operating EBITDA decreased by €4.1 million from €10.1 million to €6.0 million, meaning the operating EBITDA margin fell from 5.1% in the previous year to 3.1%. This negative deviation is due in particular to earnings at euromicron Deutschland GmbH, which were reduced by higher unproductive work required to complete old projects. Operational handling of the main old projects was completed by the end of fiscal year 2016, with the result that no notable effects on earnings are to be expected in the year after. There were also negative effects on margins from the loss of a large order, which does not recur annually, to equip data centers with special connectors.

The forecast envisaged an operating EBITDA margin at around the level of fiscal year 2015 (5.1%). The previously described causes for the year-on-year decline in the EBITDA margin are the main causes of the deviation from the forecast.

In the “Smart Buildings” segment, there were reorganization costs with an impact on EBITDA totaling €1.8 million, or €0.8 million lower than in the previous year (€2.6 million). The forecast envisaged reorganization costs with an impact on EBITDA within a range of between €1.0 million and €1.2 million. The deviation from the forecast was caused in particular by unplanned write-downs due to the sale of the “Telecommunications” division of euromicron Deutschland GmbH.

2.7 percentage points:

The improvement in the working capital ratio for the “Smart Buildings” segment.

The working capital ratio improved by 2.7 percentage points from 30.3% to 27.6%. This was due in particular to the reduction in up-front financing of project business and the fact that old projects in which a lot of capital was tied up were able to be billed. The forecast target of reducing the working capital ratio by up to 4.0 percentage points was therefore almost achieved.

In view of market trends, the fact that new products are ready for the market, as well as due to the fact that unproductive work for old projects will be eliminated and there will be positive effects from the realignment of euromicron Deutschland GmbH, we anticipate sales at this segment to grow in the medium single-digit percentage range in 2017. The operating EBITDA margin in 2017 is expected to be slightly above the level of fiscal year 2015 again. Completion of the reorganization measures is expected to reduce this segment’s EBITDA in 2017 by around €0.5 million to €0.7 million in 2017. As a result of further old projects being billed and the continuation of the measures to optimize working capital, we expect a further sharp improvement in the working capital ratio of up to 4.0 percentage points for the year after.

Critical Infrastructures

The “Critical Infrastructures” segment posted sales of €114.0 million, €7.4 million or 6.1% lower than in the previous year (€121.4 million). €1.7 million of this decline is due to discontinuation of the “Fiber-optic Infrastructure” division. The remaining decrease is mainly attributable to unrealized sales due to the fact that export approvals have not yet been issued as part of product business. In addition, there were changes in the sales mix at various companies in this segment, with the result that sales with higher volumes, but lower margins were substituted by sales with lower volumes, but higher margins in 2016. Overall, however, there were no negative effects on the segment’s earnings as a result of this sales effect.

The forecast envisaged an increase in sales in the medium single-digit percentage range for this segment. Apart from the above-described reasons for the year-on-year fall in sales, there was also the additional factor that the forecast included a slight growth in sales at the “Fiber-optic Infrastructure” division, which was discontinued in 2016, with the result that these sales were not able to be achieved. In addition, the forecast envisaged slight growth in certain sales as part of product business; however, these sales declined in 2016, for example due to the fact that export approvals were not issued.

The segment's operating EBITDA fell by €0.9 million to €7.2 million (previous year: €8.1 million). As a result, the operating EBITDA margin was 6.3% following 6.7% the year before. €0.5 million of the decline in earnings is attributable to effects from discontinuation of the "Fiber-optic Infrastructure" division. The lack of sales due to the fact that export approvals were not issued resulted in a negative impact on earnings of €1.9 million. On the other hand, there was a positive earnings trend, in particular in system house business, as a result of which earnings improved year on year by €0.4 million. There was also the positive effect of income of €1.1 million from claims from rights of recourse against former shareholders of ATECS AG due to payment of tax arrears from the period before the company was acquired by euromicron AG.

The forecast envisaged an operating EBITDA margin at around the level of fiscal year 2015 (6.7%). The previously described causes for the year-on-year decline in the EBITDA margin are the main causes of the deviation from the forecast.

The reorganization costs with an impact on EBITDA in this segment were €0.6 million, €0.4 million up on the previous year's figure. The forecast for 2016 did not envisage any reorganization costs for this segment. The deviation from the forecast is due to the decisions taken in the fourth quarter of 2016 to discontinue the "Fiber-optic Infrastructure" division and the "Optical Tracking Systems" product line, which resulted in reorganization costs of €0.1 million and €0.5 million respectively.

This segment's working capital ratio improved significantly from 12.5% to 1.7%, which was attributable to the lower up-front financing as part of project business and, in particular, the increase in the volume of factoring. Consequently, the forecast target of a working capital ratio below 11.0% was far surpassed. Sales are to be increased by a figure in the high single-digit percentage range next year. This is due in particular to rising sales in product business, which are also to be increased by the market launch of products developed in-house. The anticipated operating EBITDA margin for 2017 is around the level of 2016. The forecast reorganization costs for final closure of the "Fiber-optic Infrastructure" division in 2017 are expected to be in the order of €0.1 million to €0.2 million. The goal is to keep the working capital ratio in this segment at below 5.0%.

1.7%

working capital ratio after 12.5% in the previous year – a significant improvement in the "Critical Infrastructures" segment.

Distribution

The segment's sales were €22.6 million, almost at the level of the previous year (€22.5 million) and so were in line with the forecast, which envisaged sales at this segment matching the figure for the previous year.

The operating EBITDA margin was 13.9% and so well up on the previous year's 11.3%. The operating EBITDA was thus €3.1 million, €0.6 million above the previous year's figure. That is due to the sharp improvement in the gross profit margin for the sold product mix.

The forecast anticipated a slight decline in this segment's EBITDA margin, since investments in the sales organization were planned in 2016. However, a large part of these investments will not be made until 2017, which is the reason for the positive deviation from the forecast EBITDA margin.

As in the previous year, reorganization costs were not incurred in this segment and were also not forecast.

The working capital ratio is 17.0% and so 2.0 percentage points better than forecast for 2016 (19.0%).

Sales at this segment are expected to grow in the medium single-digit percentage range in 2017. The operating EBITDA margin of around 9.0% forecast for 2017 is below that of 2016, since the investments in the "Distribution" segment's sales organization originally planned for 2016 are to be made in 2017. For the subsequent year, we expect a working capital ratio at the level of 2016.

Overall, the euromicron Group generated an operating EBITDA of €16.3 million (previous year: €20.7 million) from the operating reportable segments. The operating EBITDA margin was 4.9% compared with 6.1% the previous year.

Non-strategic Business Segments

In fiscal year 2015 a decision was taken to discontinue the business operations of Avalan GmbH, euromicron NBG Fiber Optics GmbH, euromicron benelux S.A. and WCS Fiber Optic B.V., since the loss-making core business of these companies was no longer consistent with the euromicron Group's new strategic orientation. WCS Fiber Optic B.V. was liquidated in the course of fiscal year 2016. The remaining companies are still included in the "Non-strategic Business Segments".

Due to the discontinuation of business operations, there were no longer any sales in 2016 (previous year: €10.9 million), as well as no negative operating EBITDA (previous year: € -3.2 million), as envisaged by the forecast.

The reorganization costs incurred in 2016 (follow-up costs from the closures) totaled €0.5 million (previous year: €1.8 million) and so are slightly up on the forecast figure by an amount €0.2 million.

Further follow-up costs from the closures until the planned final liquidation of these companies totaling €0.1 million to €0.2 million are anticipated in 2017.

Central Services

The "Central Services" area mainly includes euromicron AG, the strategic management holding company responsible for central controlling functions for the euromicron Group.

The negative operating EBITDA fell significantly by €1.6 million from € -4.7 million to € -3.1 million and so was €2.5 million better than forecast (€ -5.6 million). The positive deviation compared to the previous year and the forecast is attributable to income from recognition of a receivable from reimbursement of legal costs to an amount of €1.4 million. In addition, there were in particular savings in personnel cost and other operating expenses compared to the forecast.

Strategic decision: The business operations of Avalan GmbH, euromicron NBG Fiber Optics GmbH, euromicron benelux S.A. and WCS Fiber Optic B.V. were discontinued.

The reorganization costs were €2.9 million, €0.6 higher than in the previous year. They were €1.6 higher than the forecast (upper end of the forecast range: €1.3 million). This is due in particular to higher costs for legal advice, financial advice and other consulting services related to the reorganization.

Negative operating EBITDA of around € –5.3 million is anticipated for the subsequent year. The rise is due to lower planned other operating income (loss of income from recognition of the receivable from reimbursement of legal costs) as well as higher personnel costs in connected with the planned expansion of euromicron AG into a strategic management holding.

In addition, reorganization costs totaling €1.7 million to €1.9 million are expected in the “Central Services” area in fiscal year 2017.

2.3 Net assets, financial position and results of operations

Net assets

The table below presents the asset and equity structure of the euromicron Group:

Asset and equity structure

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	Dec. 31, 2016		Dec. 31, 2015	
	€ m.	%	€ m.	%
Noncurrent assets	141.2	57.7	142.0	52.4
Current assets	96.5	39.5	118.1	43.6
Cash and cash equivalents	6.9	2.8	10.7	4.0
Total assets	244.6	100.0	270.8	100.0
Equity	82.4	33.7	97.0	35.8
Noncurrent liabilities	48.2	19.7	31.0	11.5
of which financial liabilities	39.3	16.1	22.2	8.2
Current liabilities	114.0	46.6	142.8	52.7
of which financial liabilities	40.3	16.5	69.7	25.7
Total equity and liabilities	244.6	100.0	270.8	100.0

The euromicron Group's total assets at December 31, 2016, decreased by 9.7% to €244.6 million compared with €270.8 million in the previous year.

The fall in noncurrent assets of €0.8 million (€141.2 million; previous year: €142.0 million) is mainly due to a decline in other intangible assets by €1.1 million from €17.5 million to €16.4 million due to write-offs. On the other hand, there was an increase of €0.3 million in property, plant and equipment due to investments.

Capital spending in fiscal year 2016 totaled €8.9 million (previous year: €8.3 million). This figure includes additions from the acquisition of a division (asset deal) of around €0.1 million (previous year: €0.2 million).

The remaining investments of €8.8 million (previous year: €8.1 million) include €2.3 million (previous year: €2.4 million) on capitalized development costs, €1.3 million (previous year: €0.9 million) on other intangible assets and €5.2 million (previous year: €4.8 million) on property, plant and equipment.

The ratio of equity and long-term debt to noncurrent assets is 92.4% (previous year: 90.1%).

Current assets fell by €21.6 million to €96.5 million. That is mainly attributable to a €15.1 million drop in trade accounts receivables. This is mainly due – to an amount of €14.4 million – to the higher volume of receivables sold as part of the factoring program. The gross amount due from customers for contract work and inventories also fell by €6.8 million and €2.4 million respectively. On the other hand, there was in particular an increase in other financial assets by €2.6 million, of which €1.4 million was attributable to recognition of a receivable from reimbursement of legal costs in the fiscal year and €1.0 million to higher receivables due from the factoring company from factoring monies not yet paid out.

Working capital (trade accounts receivable, gross amount due from customers for contract work and inventories minus trade accounts payable and prepayments) was €38.5 million at the balance sheet date, an increase of €22.9 million or around 37.3% over the previous year (€61.4 million). €14.4 million of the decline is attributable to the increase in the volume of factoring and €8.5 million to the reduction in working capital as part of operational business. The latter is the result of adjustment of working capital to the lower volume of sales and of positive effects from the Group-wide program to cut working capital, whose aims included reducing up-front financing in project business and stock tie-up in manufacturing business. The Group's working capital ratio (working capital relative to sales) was thus reduced by 6.0 percentage points to 11.8% in 2016. As a result, the target forecast in the previous year – to achieve a working capital ratio of below 15.0% by the end of fiscal year 2016 – was far surpassed.

37.3%

A sharp year-on-year reduction in working capital.

Cash and cash equivalents were €6.9 million, a decline of €3.8 million compared with the figure at December 31 of the previous year (€10.7 million). We refer in this regard to the comments on the Group's financial situation.

Equity at December 31, 2016 was €82.4 million and therefore below the level of the previous year (€97.0 million). The equity ratio is 33.7% (previous year: 35.8%) and is accordingly still at a high level. The decline in equity by €14.6 million is mainly due to an amount of €12.5 million to the consolidated net loss in fiscal year 2016. In addition, lower revaluation effects from pensions, which had to be recognized directly in equity, reduced equity by €1.9 million. Other effects also reduced equity by an amount of €0.2 million.

33.7%

equity ratio – still at a high level.

Other noncurrent financial liabilities were zero (previous year: €0.5 million) due to the reclassification of a purchase price obligation from preemptive rights as other current financial liabilities.

The liabilities to banks are divided into long-term liabilities (€38.5 million; previous year: €20.5 million) and short-term liabilities (€38.0 million; previous year: €44.3 million). The rise in liabilities to banks is due to refinancing as a result of the financing agreement that was concluded in fiscal year 2016 and which runs until March 31, 2018.

Although consolidated sales in December 2016 rose by €5.7 million compared to the figure for December of the previous year and so was accompanied by higher procurement of materials, trade accounts payable fell by €3.1 million from €47.6 million to €44.5 million. This is due in particular to faster settlement of trade accounts payable, one goal of which is to take greater advantage of cash discounts.

The reduction in other current financial liabilities of €23.0 million from €24.8 million to €1.8 million consists to an amount of €21.8 million of lower liabilities from customer monies to be passed on as part of factoring, which is due in particular to a change in practice (customer payments are returned to the factoring company). We refer in this regard to the notes on the Group's financial situation.

The Group's net debt (interest-bearing financial liabilities minus securities and cash) at December 31, 2016, was €71.0 million (previous year: €55.8 million). We likewise refer in this regard to the comments on the Group's financial situation.

Financial position

The Group is largely financed centrally through euromicron AG. This is done through a central cash pooling system to which in general all Group companies are linked. Internal financial equalization as part of a cash management system of the individual companies reduces the volume of outside funding at the Group. Centralization of financing makes a contribution to optimizing the costs of capital and the opportunities for obtaining and investing capital. Apart from financing through euromicron AG, individual Group companies have a number of smaller credit lines, which are however insignificant in terms of volume.

At December 31, 2016, unutilized granted credit lines of €37.5 million were available to the Group (previous year: €48.2 million).

The Group's cash funds changed in fiscal year 2016 as follows:

Statement of cash flows of the euromicron Group		006
for the period from January 1 to December 31, 2016 (IFRS)	2016	2015
	€ thou.	€ thou.
Net cash used in/provided by operating activities*	-7,140	4,512
Net cash used in investing activities*	-7,770	-9,078
Net cash provided by/used in financing activities*	11,032	-334
Net change in cash funds	-3,878	-4,900
Cash funds at start of period	10,722	15,622
Cash funds at end of period	6,844	10,722

*) The previous year's figure has been adjusted.

The reported cash used in operating activities in fiscal year 2016 was € -7.1 million, whereas in the previous year there was net cash provided by operating activities totaling €4.5 million. However, the reported cash flow figures from operating activities are substantially impacted by effects resulting from the Group's factoring program.

In order to obtain comparable cash flow figures that permit a statement to be made on the development of cash flows from operating activities, the figure was therefore adjusted to take into account the factoring effects. This involves the following:

- Elimination of the effect from the change in the volume of factoring used between the balance sheet date and the respective balance sheet date of the previous period. This resulted in a positive cash flow effect to be eliminated of €14.4 million at December 31, 2016 (previous year: €1.6 million), due to the higher volume of factoring compared with at December 31, 2015.

- Where Group companies received monies from customers resulting from receivables sold as part of factoring shortly before the balance sheet date and the Group companies were not able to transfer these monies to the factoring company, this results in a liability from customer monies to be passed on, which is carried under “Other financial liabilities”. The effect on liquidity from the change in these liabilities between the respective balance sheet date and the balance sheet date of the previous period is eliminated for the purposes of analyzing the cash flow from operating activities. This negative cash flow effect to be eliminated was € –21.8 million in 2016 (previous year: negative effect of € –1.6 million). The sharp decline in liabilities from customers’ monies to be passed on in fiscal year 2016 is attributable to a change in practice made in the first quarter of 2016 (customer payments are now returned directly to the factoring company). Accordingly, such a liability can only arise in exceptional cases. Before this change, customer payments from sold receivables were held in trust in local accounts and passed on to the factoring company at regular times.
- The full amount of the receivable offered for sale is initially not paid out by the factoring company, but a blocked amount is withheld. Some of the sold receivables were also still being examined and so had not been paid out by the factoring company. The resultant receivable due from the factoring company is carried under “Other financial assets”; here too, the change in the balance sheet item has to be eliminated for the purposes of analyzing the cash flow from operating activities. This negative cash flow effect to be eliminated was € –1.0 million in 2016 (previous year: positive cash flow effect to be eliminated of €0.1 million).

All in all, reconciliation of these three factors results in cash flows from operating activities after adjustment for factoring effects as summarized in the table below:

Adjusted cash flow

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	Cash flow from operating activities acc. to statement of cash flows	Effects from factoring and customers' monies to be passed on includ- ed in the above	Adjusted cash flow
	€ m.	€ m.	€ m.
2015*	4.5	–0.1	4.4
2016	–7.1	8.4	1.3

*) The previous year's figure has been adjusted.

The described factoring effects, in particular as a result in the change in practice relating to the return of customer monies, meant there was a negative cash flow effect of € –8.4 million in fiscal year 2016, which resulted correspondingly in a greater need for external financing and so an increase in the euromicron Group's net debt.

After adjustment for factoring effects, there is net cash provided by operating activities totaling €1.3 million in fiscal year 2016 compared with €4.4 million in the previous year. As a result, the cash flow from operating activities after adjustment for the effects of factoring fell by €3.1 million in fiscal year 2016.

This is due in particular to cash effects from the sharp decrease in trade accounts payable. Whereas the reduction in trade accounts payable resulted in a negative cash flow effect of € –3.1 million in 2016, the cash flow of the previous year was impacted positively to an amount of €3.3 million by the reduction in trade accounts payable. In total, this effect explains a cash flow change of € –6.4 million. In addition, the balance of paid and received income taxes and interest resulted in the net cash used in operating activities increasing by € –3.0 year on year. On the other hand, there were positive cash flow effects from the intensified measures to optimize working capital in 2016 in the area of inventories, gross amounts due from and to customers for contract work, trade accounts payable (before factoring) and payments on account. The change in these items resulted in 2016 in positive effects on the cash flow from operating activities of €5.0 million, €6.3 million higher than in the previous year (negative effect on the cash flow from operating activities of € –1.3 million). It should also be noted in this regard that the Group's sales in December 2016 were €44.2 million, €5.7 million higher than the comparative figure for December 2015 (€38.5 million), which resulted in higher working capital at the end of the year. Excluding this effect, working capital (before factoring) at December 31, 2016, would have fallen far more sharply, which would have had corresponding positive effects the cash flow from operating activities.

Net cash used in investing activities was € –7.8 million in fiscal year 2016, €1.3 million below the figure for the previous year (€ –9.1 million). This change is mainly due to lower purchase price payments in connection with the company acquisitions, which were € –0.6 million in 2016 (previous year: € –2.7 million). Of this, € –0.5 million related to payments in connection with the exercise of options to purchase company shares and € –0.1 million to purchase price payments as part of an asset deal. Net cash used in purchasing intangible assets (€ –3.5 million; previous year: € –3.3 million) and property, plant and equipment (€ –3.8 million; previous year: € –3.2 million) in fiscal year 2016 was € –0.8 million above the level of the previous year.

The net cash provided by financing activities in fiscal year 2016 was €11.0 million (previous year: net cash used in financing activities of € –0.3 million). The net cash inflow in fiscal year 2016 was due to the raising of new loans, which exceeded the net cash used to repay loans by €11.7 million (previous year: net cash provided of €1.7 million). On the other hand, there were cash repayments of liabilities from finance leases totaling € –0.5 million (previous year: € –0.7 million) and distributions to non-controlling shareholders and from profit shares of minority interests totaling € –0.2 million (previous year: € –1.3 million).

Cash and cash equivalents of the euromicron Group at December 31, 2016, were thus €6.9 million (previous year: €10.7 million).

Results of operations

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Income statement of the euromicron Group for the period January 1 to December 31, 2016 (IFRS)	2016		2015		2015	
	before reor- ganization costs	Reorganiza- tion costs	2016 operational*	before reor- ganization costs	Reorganiza- tion costs	2015 operational*
	€ thou.	€ thou.	€ thou.	€ thou.	€ thou.	€ thou.
Sales	325,313	2	325,311	344,887	0	344,887
Inventory changes	–864	0	–864	883	0	883
Own work capitalized	2,808	0	2,808	2,942	0	2,942
Other operating income	4,499	42	4,457	3,073	0	3,073
Cost of materials	–171,506	–629	–170,877	–189,883	–909	–188,974
Personnel costs	–109,057	–787	–108,270	–107,875	–3,193	–104,682
Other operating expenses	–43,809	–4,390	–39,419	–47,104	–2,733	–44,371
Earnings before interest, taxes, depreciation and amortization (EBITDA)	7,384	–5,762	13,146	6,923	–6,835	13,758
Amortization and depreciation	–9,649	–979	–8,670	–10,238	–1,003	–9,235
Impairment of goodwill	0	0	0	–5,333	–5,333	0
Earnings before interest and taxes (EBIT)	–2,265	–6,741	4,476	–8,648	–13,171	4,523
Interest income	152	0	152	66	0	66
Interest expenses	–5,439	–591	–4,848	–3,791	0	–3,791
Other financial expenses	–73	0	–73	–332	0	–332
Income before income taxes	–7,625	–7,332	–293	–12,705	–13,171	466
Income taxes	–4,845	0	–4,845	–424	0	–424
Consolidated net income/loss for the year	–12,470	–7,332	–5,138	–13,129	–13,171	42
Thereof for euromicron AG shareholders	–12,656	–7,332	–5,324	–13,253	–13,171	–82
Thereof for non-controlling interests	186	0	186	124	0	124
(Un)diluted earnings per share in €	–1.76	–1.02	–0.74	–1.85	–1.84	–0.01

*) Adjusted for special effects of the reorganization

Consolidated earnings for 2016 are mainly reduced by reorganization costs incurred as part of the strategic realignment. They are distributed over the individual companies of the euromicron Group as follows:

Reorganization costs	009	
	2016	2015
	€ thou.	€ thou.
Reorganization costs (with an impact on EBITDA)		
euromicron AG	-2,937	-2,280
euromicron Deutschland GmbH	-1,774	-2,574
Secure Information Management GmbH	-385	0
Avalan GmbH (in liquidation)	-342	-859
RSR Datacom GmbH & Co. KG	-125	0
ATECS AG	-95	0
euromicron NBG Fiber Optics GmbH	-89	-905
euromicron benelux S.A.	-12	0
WCS Fiber Optic B.V. (liquidation completed in 2016)	-2	0
euromicron austria GmbH	0	-217
Total reorganization costs with an impact on EBITDA	-5,762	-6,835
Reorganization costs (amortization and depreciation)		
euromicron Deutschland GmbH	-490	-36
Secure Information Management GmbH	-489	0
euromicron AG	0	-570
euromicron NBG Fiber Optics GmbH	0	-333
Avalan GmbH (in liquidation)	0	-64
Impairment of goodwill	0	-5,333
Total reorganization costs with an impact on EBIT	-6,741	-13,171
Reorganization costs (net financial result)		
euromicron AG	-591	0
Total reorganization costs	-7,332	-13,171

€ **7.3** million

The costs of the Group-wide reorganization measures in 2016

The reorganization costs of euromicron AG (totaling €3,528 thousand) are mainly due to costs for legal advice, costs for financial advice, other consulting costs, costs of concluding the financing agreement and costs for personnel measures.

Reorganization costs at euromicron Deutschland GmbH totaled €2,264 thousand, of which the lion's share (€1.493 thousand) was due to write-downs as a result of fair value measurement of the assets held for sale at the "Telecommunication" division. The remainder of €771 thousand is mainly due to costs for personnel measures and IT integration.

The reorganization costs for Secure Information Management GmbH (totaling €874 thousand) are mainly attributable to write-downs of demo stock and inventories and costs for personnel measures and dissolution of contracts in connection with discontinuation of the "Optical Tracking Systems" product line.

The reorganization costs for ATECS AG (€95 thousand) include costs for dissolution of contracts due to discontinuation of the “Optical Tracking Systems” product line.

The reorganization costs for RSR Datacom GmbH & Co. KG (€125 thousand) mainly comprise write-downs of inventories due to discontinuation of the “Fiber-optic Infrastructure” division.

The reorganization costs of Avalan (in liquidation), euromicron NBG Fiber Optics GmbH, euromicron benelux S.A. and WCS Fiber Optics B. V. (totaling €445 thousand) result from follow-up costs from the closure of these companies, whose business operations were discontinued at the end of 2015.

The following explains the year-on-year changes in the results of operations of the euromicron Group after adjustment for the effects of the reorganization.

The euromicron Group generated sales of €325.3 million in fiscal year 2016 and so €19.6 million or 5.7% below the previous year’s figure of €344.9. €10.6 million of the €19.6 million decline in sales is due to the fact that there was no longer any revenue from the non-strategic business segments, whose business operations were discontinued at the end of fiscal year 2015. We refer to the presentation of the segments’ development for an explanation of the remaining €9.0 million decline in sales.

A breakdown by the various regions shows that most sales were generated within Germany, as in previous years. The sales generated in Germany in fiscal year 2016 were €274.3 million (previous year: €291.3 million) or a share of 84.3% (previous year: 84.5%). Foreign sales fell slightly in 2016 from €53.6 million to €51.0 million, with the result that international sales now contribute around 15.7% (previous year: 15.5%) to the euromicron Group’s total volume of sales.

€ **274.3** million
in sales in Germany.

The euromicron Group’s total operating performance (sales plus inventory changes) was €324.4 million, down €21.4 million or 6.2% on the previous year (€345.8 million).

Own work capitalized was €2.8 million, almost at the level of the previous year (€2.9 million). The euromicron Group continues to invest in developing new products to expand its market position and increase its innovativeness.

The €1.4 million increase in other operating income to €4.5 million results to an amount of €1.4 million from recognition of a receivable from reimbursement of legal costs. There was also income of €1.1 million from claims from rights of recourse against former shareholders of ATECS AG due to payment of tax arrears from the period before the company was acquired by euromicron AG. However, this other operating income is offset by tax and interest expenses to the same amount. On the other hand, there was in particular no longer any income resulting from reversal of a conditional purchase price obligation (€1.0 million) that had been carried in the other operating income in the year before

As in the previous year, the cost of materials is the largest expense item in the euromicron Group's income statement. The (adjusted) cost of materials in fiscal year 2016 was €170.9 million (previous year: €189.0 million); the (adjusted) material usage ratio relative to total operating performance thus improved significantly by 2.0 percentage points from 54.7% to 52.7%.

On the one hand, the improvement in the adjusted material usage ratio is attributable to discontinuation of the business operations of the non-strategic business segments, which had a high material usage ratio. On the other, there was a more favorable margin mix compared with the previous year in parts of product and solution business.

(Adjusted) personnel costs increased in fiscal year 2016 by €3.6 million from €104.7 million to €108.3 million, a rise of 3.4%. The average headcount (excluding trainees) in the year under review fell only slightly from 1,747 to 1,742. Apart from effects from pay adjustments, this is attributable in particular to an increase in staff with higher qualifications. Whereas there were job cuts in the non-strategic business segments, staff with higher qualifications were added, in particular in the "Smart Buildings" segment.

(Adjusted) amortization and depreciation totaled €8.7 million, a fall of €0.5 million compared with the previous year (€9.2 million). This is mainly due to lower amortization of hidden reserves disclosed as part of capital consolidation, which declined to €1.0 million (previous year: €1.4 million).

(Adjusted) other operating expenses in the fiscal year were €39.4 million, €5.0 million below the comparative figure for the previous year of €44.4 million. The largest items in the other operating expenses were still vehicle and travel expenses (€12.4 million; previous year: €13.6 million), rent/room costs (€5.8 million; previous year: €6.6 million) and legal and consulting costs (€2.9 million; previous year: €4.4 million), which all declined followed adjustment for reorganization costs.

Operating earnings before interest, taxes, depreciation and amortization (operating EBITDA) totaled €13.2 million (previous year: €13.8 million). As in the previous year, the operating EBITDA margin is 4%. The operating EBIT was €4.5 million and so likewise at the level of the previous year.

The (adjusted) net financial result was € -4.8 million, € -0.7 million down on the previous year (€ -4.1 million). This is attributable in particular to the higher utilization of external credit lines as an average for the year.

1,742

employees (excluding trainees) worked at euromicron as an average in 2016.

The tax ratio in the year under review was –63.5% after –3.3% in the previous year. The tax expense was €4.8 million (previous year: €0.4 million). The increase in the tax expense is due to various special effects: One effect totaling €3.5 million is the result of tax risks from the securities lending transactions in the years 2010 to 2012. An amount of €2.1 million has been recognized for possible payment of tax arrears. There was also a non-cash charge from the reduction in deferred tax assets of €1.4 million from the additionally expected utilization of corporation income tax loss carryforwards. In addition, there were tax expenses not relating to the period from completion of the tax audit at ATECS AG for the time before it was acquired by euromicron AG (€1.1 million), although these are offset by corresponding other operating income from recognition of claims from rights of recourse against former shareholders. There was also a non-cash effect of €2.0 million resulting from the derecognition of deferred tax assets on loss carryforwards of euromicron Deutschland GmbH which were incurred before the tax group with euromicron AG was established in 2016 that can no longer be used during the term of the tax group under German tax law. We refer in this regard to the tax reconciliation in section 20 of the notes on the consolidated income statement.

The (adjusted) consolidated net loss for shareholders of euromicron AG was € –5.3 million (previous year: net loss of € –0.1 million). (Adjusted) undiluted earnings per share were € –0.74 versus € –0.01 in the previous year.

Without adjustment for the effects of the reorganization, the consolidated net loss for shareholders of euromicron AG for fiscal year 2016 is € –12.7 million (previous year: net loss of € –13.3 million) and the undiluted earnings per share are € –1.76 (previous year: € –1.85).

New orders and order books

New orders at the euromicron Group in fiscal year 2016 were €346.0 million (previous year: €326.8 million), an increase of €19.2 million or 5.9%. It should be noted in this regard that the previous year's figure still includes new orders of €4.8 million from the divisions that have since been discontinued. In relation to continuing core business operations, new orders in the fiscal year thus even increased by €24.0 million or 7.5%.

€ **24.0** million

The year-on-year increase in new orders in continuing core business operations.

Order books at December 31, 2016, were €123.3 million (previous year: €103.4 million). That is an increase of €19.9 million or 19.2% – a very good foundation for fiscal year 2017.

2.4 Non-financial performance indicators

As a German specialist for the Internet of Things, not only key economic ratios are important for us, but also the sustainability of our activities. That is also reflected in our performance indicators. Competent and motivated employees, sparing use of the natural resources available to us, increasing and preserving our brand value, our customers' satisfaction and social responsibility are preconditions for our Group's sustainability. We endeavor to increase and improve them at all times.

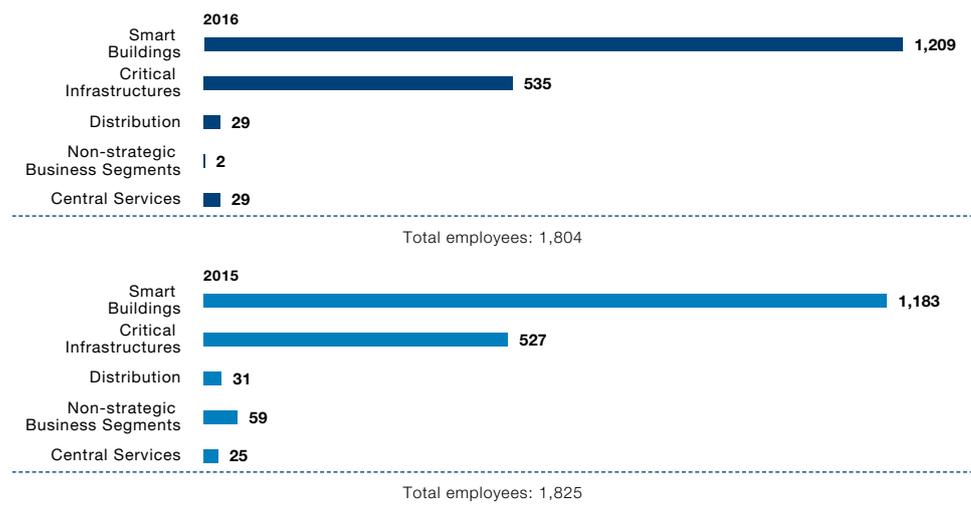
Employee development and loyalty

The euromicron Group's success is founded on the skills and commitment of its employees. Our focus as part of that is on close cooperation with the HR departments at our locations and strategic further development and implementation of the Group-wide HR strategy. Organizational and personnel development and employer branding are also important focal areas.

As part of the HR strategy, our HR tools such as performance and career reviews, agreements on objectives and development plans are to be constantly developed further and communication between the team and managers optimized actively.

The euromicron Group aims to employ a sufficient number of qualified and committed employees at all times and to offer them attractive working conditions and prospects. The average headcount in fiscal year 2016 fell slightly from 1,825 to 1,804 or by 1.1 percentage points. The average number of employees (excluding trainees) was 1,742 or around the level of the previous year (1,747).

Employees by segment



The reduction in staff in the “Non-strategic Business Segments” (fall of 57 employees) was partly offset by the addition of employees in the segments “Smart Buildings” (increase of 26 employees) and “Critical Infrastructures” (increase of 8 employees). In the year under review, we were able to recruit further specialized, highly qualified personnel in these segments.

Personnel costs in fiscal year 2016 were €109.1 million compared with €107.9 million in the previous year. After adjustment for reorganization costs, personnel costs were €108.3 million (previous year: €104.7 million). As a result, personnel costs adjusted for reorganization costs increased by €3.6 million or 3.4%, which is attributable to the effects of pay adjustments and the hiring of staff with higher qualifications.

Enhancing the loyalty of our employees to the company remains of major importance for us, since they and their expertise and dedication are the main guarantee of our Group's sustainable success in the coming years. Especially in times of a shortage of skilled workers and demographic change, it is vital for us to ensure their long-term loyalty.

euromicron employee survey 2016

In order to hear what our employees require and expect and derive sound measures from that, we launched the first Group-wide euromicron employee survey in 2016. The aim was not to compare the actual situation and what things should be like, but to find out:

- How employees rate their current workplace conditions
- What factors have a positive impact on our corporate culture and
- How we can further strengthen interaction between our employees and their managers.

Its contents were created on the basis of the results from the sample analysis from the "Employee Loyalty" project conducted in 2014. The focal areas derived at the time were used to structure the employee survey, which was held by means of an online tool in September 2016. The objective of the survey was to find out what the euromicron Group's employees currently regard as important in order to feel a good affinity for their company and what measures in the past two years have achieved positive effects. Among other things, employees' views on workplace conditions, the company's attractiveness as an employer and employee loyalty were examined.

Completion of the survey was followed in October 2016 by a multi-perspective analysis of the results, as well as creation of company-specific reports and the Group-wide report. The results of the employee survey confirm the correctness of the measures taken in previous periods, but also reveal subject areas that must given greater focus in the future. They include the areas of "healthy workplace", "forward-looking range of further training to maintain employability skills", "work-life balance" and "continuous, goal-oriented information meetings and use of a modern media mix."

Employee development

Vocational training is changing as a result of digital media, yet – as far as our training topics are concerned – our employees should rub minds, try things out in practice, and provide and accept feedback. We believe that to be vital. Further training is interfacing more and more closely with organizational and corporate development. Moreover, training and management have the same requirements, namely efficiency, sustainability and ensuring that what is learned is applied in practice. So that we meet those requirements, we understand personnel development to be a system of coordinated measures that challenge and encourage our employees so that they gain extensive qualifications to achieve their personal goals.

Trainee ratio

As always, training of new employees is of particular importance to euromicron. The euromicron Group's trainee ratio was 3.4% in the year under review, lower than the previous year's figure of 4.2%. The goal for fiscal year 2017 is to increase the trainee ratio again.

Under the new program "For our future! For our trainees!", trainees at the euromicron Group are given support when they start their job, while collaboration and dialog with each other is strengthened. The new trainee program contains modules such as "Business etiquette and a visit to the Smart Factory" and "Job rotation". The program is rounded out by an annual meeting of all trainers in the euromicron Group so that they can share notes.

New offerings for trainees:
Job rotation, business etiquette
and a visit to the Smart Factory

Optimization of HR processes at euromicron Deutschland GmbH

Rollout of integrated HR software at euromicron Deutschland GmbH enabled HR processes to be optimized and made more efficient. Six modules were set up at euromicron Deutschland GmbH: from Employee Management as the basis, Applicant Management, Absence, Seminar Management, Performance Management to HR Cost Management. The use of an HR software solution means employees can be involved in numerous related processes ("employee self service"). As a result, they can maintain their personal data on their own or initiate approval processes. It also means that information, such as the applicant pool in recruiting, the agreement on objectives in performance management or key indicators for controlling are available centrally at all times. In addition, overviews and query options in the newly introduced integrated HR software deliver great benefits for executives.

Our objective is to stage initiatives and programs in future as well and also develop new training measures in response to requirements in the IoT market. We want our employees to keep on contributing their strengths competently to the company and so help make euromicron a success through their motivation and personal successes.

Staff loyalty thanks to professional
and personal further development

Responsible use of natural resources

Although none of the Group's companies is subject to special environmental protection guidelines, euromicron nevertheless aims to live up to its responsibility for society as a whole and so attaches great importance to complying with environmental protection regulations. Consequently, the Group helps ensure the responsible use of resources voluntarily. As part of that, audits are conducted to identify potentials for increasing efficiency in and reducing power consumption at the Group and appropriate measures are initiated to cut the company's ecological footprint further. The production operations of euromicron's technology companies are also geared to energy-saving processes. These include, for example, computer-aided control of the standby switches or the continuous review and rollout of electric motors with higher efficiency classes.

As part of the DIN EN 16247 energy audit in connection with the requirements of the German Energy Services Act, we had our company audited by external, independent energy consultants in fiscal year 2015. Measures derived from that were implemented in fiscal year 2016. For example, a 2,500 m² production hall was completely converted to LEDs, resulting in significant power savings compared to the previous fluorescent lamps. In addition, the lighting at production halls, parking lots and passageways and in office buildings was refurbished and halogen spotlights replaced with new, efficient LED lighting.

In procuring new vehicles for its fleet, whether by leasing or other means of expanding it, the companies in the euromicron Group consciously attach importance to economical vehicles with low CO₂ emissions. In the case of existing vehicles, we ensure that they are passed on internally. In order to enhance preventive healthcare among employees, the cars used in the fleet also have ergonomic seats as minimum equipment. euromicron is also examining the possibility of converting the fleet to electric vehicles or ones with alternative drives.

As part of moving to new locations, we also ensured that the new buildings meet the latest environmental protection guidelines. The existing and new offices and workplaces have been equipped with energy-efficient equipment whose individual components are predominantly recyclable. All in all, euromicron makes a major contribution to achieving green IT by using hardware that has low power consumption.

Consequently, euromicron's corporate philosophy, which is geared toward sustainability, is not only manifested in its commercial operations, but also in sparing use of natural resources.

Established brands and growing visibility

Under the umbrella brand “euromicron”, the Group and its technology companies have corporate brands that in some cases have been established in their specific market segment for more than 40 years. These brands include LWL-Sachsenkabel or MICROSENS, for example. Both have a high reputation and so a brand value in their segment due to the fact that they have operated so long and successfully in the market. Preserving and increasing the value of our brands will continue to be a key element of our corporate strategy in future: Continuous investments in product innovations, modern manufacturing methods, patent applications and appropriate sales and marketing activities help entrench our brands lastingly in their special segments.

euromicron enters into strategic partnerships with leading technology vendors.

Strategic partnerships with leading technology suppliers are also key success criteria for supplying best-in-class solutions and increasing awareness of our company. euromicron was awarded the title of Gold Certified Partner by Cisco Systems for the first time in 2016 and so crowned the more than 20-year partnership between the two companies by obtaining this highest accolade for partners. To achieve this certification, euromicron had to fulfill strict standards defined by Cisco in the areas of network expertise, service, support and customer satisfaction. As a Cisco Gold Certified Partner, euromicron meets all the conditions for achieving the very highest expertise in a wide range of technologies. Cisco Gold certification gives euromicron access to training and support by Cisco, as well as extensive sales, technology and lifecycle services.

We still keep on striving to enhance the visibility and image of our umbrella brand. Following our extensive reorganization, positioning of the euromicron brand is especially important so that in particular the realignment can be presented understandably and in detail on the capital market. We aim to increase the value of the euromicron brand on the capital market, as well as ensure transparent, clear reporting as the basis of a trusted relationship with our investors. As part of that, we conduct active investor and public relations work. In the year under review, we presented our company in a raft of investor conferences and roadshows, as well as in programs and articles in various media. We demonstrated the innovativeness and high performance of the euromicron Group at internationally well-known trade shows, such as InnoTrans, the international trade show for transport technology, and security essen, the world’s leading trade show for security and fire prevention. The focus of our appearance at InnoTrans was holistic approaches for smart transport infrastructures. At security essen, several euromicron companies presented their individual protection concepts and smart services for people, buildings, data and objects.

In 2016, we also accomplished an extensive relaunch of our website www.euromicron.de. Apart from technical enhancements (such as search engine optimization, introduction of a flexible means of presenting websites for mobile use, and an improvement in user friendliness), we highlighted our positioning as a medium-sized high-tech group in the IoT market with our new online presence. New content, application examples and customer statements from the areas “Digital Buildings”, “Smart Factory” and “Critical Infrastructures” offer visitors extensive information and prove the practical nature of the presented solutions.

Customers and quality

Apart from our employees and our visibility as a brand, another aspect of great importance to us is to ensure the products and services we offer give our customers maximum satisfaction. By streamlining our structure and reorganizing the segments, we are able to network our customers' business and production processes and successfully accompany them on the way to the digital future. That demands the very highest standards as regards the quality of our processes, our products and services and our employees.

Our product quality is certified.

We gauge our customers' satisfaction at our large system houses by means of standardized customer satisfaction surveys and analyses. We thus use customer feedback to actively achieve potentials for improvement and optimization.

To meet the very highest demands made of the quality of our products and services, some of euromicron's companies are certified in accordance with ISO 9001. In the production arena, we also hold certification, for example for making and assembling certain products, as well as approvals to supply specific products and solutions.

We measure customer satisfaction and incorporate the results into our improvement process.

3. Forecast, Opportunity and Risk Report

3.1 Explanation of deviations from the previous year's forecast

The previous year's forecast envisaged a sales target of €350 million to €370 million and an operating EBITDA margin between 4.5% and 5.5% for fiscal year 2016. It was also anticipated that reorganization costs would reduce EBITDA in fiscal year 2016 by around €2.0 million to €3.0 million.

The forecast for fiscal year 2016 was adjusted with publication of the half-yearly financial report for 2016 on August 9, 2016. The corrected forecast envisaged sales of €330 million to €350 million for fiscal year 2016. An operating EBITDA margin in the range between 2.0% and 4.0% was forecast. The expected reduction in EBITDA by reorganization costs was put at €3.0 million to €4.0 million.

The forecast was adjusted in particular in view of the sales and earnings performance of euromicron Deutschland GmbH in the first half of 2016. The realignment of sales that was initiated in order to avoid risky large projects resulted in declines in sales and so a lack of contribution margins in the first half of the year; as a result of that, the Group's sales and earnings were impacted more strongly than assumed at the time the original forecast was made. Apart from that, higher unproductive work required to complete old projects also put a greater burden on the company's earnings than anticipated.

The operating EBITDA margin is at the upper end of the forecast target range.

Sales in fiscal year 2016 were €325.3 million and so slightly down by 1.4% on the adjusted forecast range of €330 million to €350 million. The operating EBITDA margin was 4.0% and so at the upper end of the target of 2.0% to 4.0% in the adjusted forecast. Reorganization costs reduced EBITDA by €5.8 million in fiscal year 2016 and so more strongly than expected in the adjusted forecast. There were also unplanned amortization and depreciation effects from divestment decisions (€1.0 million) made in the fourth quarter of 2016.

For the purpose of explaining the deviation between the actual and forecast figures for fiscal year 2016, reference is made to the original forecast for fiscal year 2016, irrespective of the adjusted forecast dated August 9, 2016. As part of that, the actual figures for sales and operating EBITDA/operating EBITDA margin are compared with the lower thresholds of the original forecast. The actual figure for the reorganization costs with an impact on EBITDA is compared with the upper threshold of the original forecast.

Deviation from forecast sales

010

	€ m.
Sales forecast for fiscal year 2016 (lower end of the forecast range)	350.0
Actual sales for fiscal year 2016	325.3
Deviation from the forecast	-24.7

The deviation from the forecast sales totaling € -24.7 million is due mainly to the fact that sales at the "Smart Buildings" segment were lower than planned. As described in the presentation of the segments' development, this deviation in sales is mainly attributable to the deviation from the planned figures at euromicron Deutschland GmbH and is due in particular to the decision not to generate sales from large projects with general contractors that were included in planning. As a result, this company was not able to grow its sales as planned in 2016. In addition, sales at the "Critical Infrastructures" segment were below the forecast level. The main causes of that are, as described in the presentation of the segments' development, the effects from loss of sales in product business, such as due to export approvals that were not issued, sales effects from discontinuation of the "Fiber-optic Infrastructure" division, and a product and project mix that deviated from the planning and resulted in lower sales, although that did not have any impact on the segment's earnings.

Deviation from forecast EBITDA

011

	€ m.
Sales forecast for fiscal year 2016 (lower end of the forecast range)	350.0
Forecast operating EBITDA margin for fiscal year 2016 (lower end of the forecast range)	4.5%
Forecast operating EBITDA for fiscal year 2016 (lower end of the forecast range)	15.8
Actual operating EBITDA margin for fiscal year 2016	4.0%
Actual operating EBITDA for fiscal year 2016	13.2
Deviation from the forecast	-2.6

The deviation from the forecast for operating EBITDA was € -2.6 million. That is mainly due to the lack of gross profit as a result of sales below the level forecast. Given a deviation in forecast sales of € -24.7 million and a material usage ratio adjusted for reorganization effects (relative to sales) of 52.5%, this sales effect resulted in the gross profit being € -11.7 million lower than forecast.

On the other hand, there was the positive effect of other operating income of €2.8 million that was not included in the forecast. In particular, €1.4 million of that figure comes from recognition of a receivable from reimbursement of legal costs and €1.1 million from claims from rights of recourse against former shareholders of ATECS AG due to payment of tax arrears from the period before the company was acquired by euromicron AG.

The remaining effect of €6.3 million is attributable in particular to the fact that personnel and material costs were able to be adjusted to the lower sales volume, resulting in cost savings compared to the forecast.

Deviation from forecast reorganization costs with an impact on EBITDA

012

	€ m.
Forecast reorganization costs with an impact on EBITDA for 2016 (upper end of the forecast range)	-3.0
Actual reorganization costs with an impact on EBITDA for fiscal year 2016	-5.8
Deviation from the forecast	-2.8

The reorganization costs with an impact on EBITDA in fiscal year 2016 were € –5.8 million, € -2.8 million higher than envisaged in the forecast. € –1.0 million of the deviation from the forecast was due to write-downs in connection with sale of the “Telecommunications” division of euromicron Deutschland GmbH, € –0.5 million was due to effects from discontinuation of the “Optical Tracking Systems” product line of Secure Information Management GmbH, and € –0.1 million was due to closure of the non-strategic “Fiber-optic Infrastructure” division of RSR GmbH & Co. KG. These measures were not initiated until the fourth quarter and so were not reflected in the adjusted forecast. In addition, the reorganization costs of euromicron AG were € –1.6 million above the forecast figure, in particular as a result of higher costs for legal advice, financial advice and other consulting services related to the reorganization. In addition, the follow-up costs from the closure of the non-strategic divisions were € –0.2 higher than planned. However, there was also the positive aspect that other reorganization costs were a total of €0.4 million below the planned costs.

We refer to the section “Development of the segments” in 2.2 “Course of business” as regards segment-specific reporting on the forecasts.

3.2 Risk report and salient features of the risk management system

Risk strategy and general risk management

euromicron AG and its subsidiaries have an established risk management system based on statutory stipulations. The system was expanded to include opportunities and new risks and the risk assessment methodology was revised in 2016. There were also Group-wide training courses on the changes to the risk management system. The risk management system identifies and documents the main risks and opportunities in accordance with their risk categories and assesses them as regards the probability of their occurring and the level of financial damage. The Executive Board of euromicron AG is notified directly if defined thresholds are exceeded. The risk management system is applied in standardized form at all associated companies and is an integral part of their extensive continuous planning, controlling and reporting processes. This ensures that the Executive Board is informed promptly of all major risks and can respond suitably. The risk management system also covers the consolidated accounting processes. Group-wide policies are in place to ensure compliance with consistent standards in the risk management system and consolidated accounting.

The risks that may have a significant influence on the net assets, financial position and results of the euromicron Group are classified in the following categories in accordance with the risk management system:

Risk management system



Markets and competition

In principle, the euromicron Group is dependent on positive economic trends in the Euro zone; as in the previous year, the German market accounts for around 84.0% of the Group's sales and so is crucial to its success. Germany is also the place of activity of most of euromicron's subsidiaries, which benefit from investments in communications, security and data networks. Consequently, the development of the German market is of great significance for the overall Group's earnings. Given the positive economic forecasts for 2017, the likelihood of potential economic risks occurring in the German market is assessed as being low. According to current assessments, the merely slow recovery in the economies of the Mediterranean region will not have any direct impact on the company. There are currently only few business relationships outside the European economies, which is why distortions there should not have any material effects on euromicron.

Apart from economic risks, euromicron is subject to the fundamental risks relating to competition and the related pressure on prices. euromicron tackles these challenges by means of diversification and by nurturing intensive contacts with customers so as to be able to offer top-quality products and services at competitive prices. Certain subsidiaries have a low degree of dependence on individual large accounts. This risk at the Group level is relativized, since – as in the previous year – only one customer accounts for more than 10% of total sales. The risk of default by large customers is assessed as being low due to their very good creditworthiness. The risk of nonpayment is additionally reduced by factoring of some receivables from customers.

Products, technologies and R&D

Technology/R&D risks exist to the extent that leaps in technology might mean the loss of technological leadership. However, that applies to the Group only to a limited extent: euromicron's system houses and distributors can keep up with technological innovations without any problems because they have access to their own products and a diversified product portfolio from a wide range of different vendors (philosophy of vendor independence) for delivering customer solutions.

euromicron's customers demand that the production companies deliver top-quality, tailored solutions. To meet this requirement, euromicron's development departments not only respond to technological trends, but also occupy a pioneering role in research and development. To achieve that, the development units at the production companies have been expanded in the past years and the quality and quantity of support for them enhanced by enlisting the services of external development partners. Due to the continued investments in innovative new products and solutions, which is also reflected in the large proportion of capitalized development costs, only low risks to the Group's future earnings performance are seen in this area.

Projects

In general, project business harbors risks that can never be ruled out completely, but are controllable and calculable. They include up-front financing for projects, ensuring adequate availability of subcontractors and own staff, long-term contractual commitments, and general warranty obligations. It is also necessary to ensure that the technical specifications for the acquired projects can be handled and the projects can be completed in time and in the agreed quality. These risks are influenced by many factors, such as cooperation with suppliers and partners, employee fluctuation and qualifications, or changes to the law or general political conditions. The affected companies are aware of these risks and counter them.

The system houses are mainly affected by up-front financing. They provide up-front financing themselves for some of the projects. If a customer does not meet its payment obligations, the result may be financial losses, depending on the size of the project. To minimize this risk, there are clear stipulations that down-payments and partial invoices should be agreed when the project is accepted so that up-front financing and so potential risks of default are minimized.

Further risks are the completion of large projects acquired by euromicron Deutschland GmbH in previous periods. Operational handling of these old projects, which resulted in considerable unproductive work and so in operating losses in fiscal year 2016, was largely completed by the end of fiscal year 2016. As a result, the Group's risk exposure has been reduced significantly. There are residual risks in obtaining the amounts billed for some of these projects. In some cases, final negotiations are being conducted with the customers; in individual cases, it is also possible that claims will have to be enforced through legal action, which means receipt of payment may be delayed. This risk was reflected in measuring the value of these projects.

In order to minimize the risks from project business moving ahead, a decision was taken in 2016 not to accept any large projects from general contractors in future, if they have a high risk profile and low margin. Instead, the focus was placed on direct customer business. euromicron Deutschland GmbH developed a standardized process that was rolled out comprehensively in all regions in 2016 and has now been implemented at all branch offices. It covers all aspects from the process for approval, processes in implementation management, to standardization of project controlling. Project staff are given continuous further training and education. Personnel capacities in project controlling were increased further in 2016. Moreover, project controlling was integrated more strongly in Group reporting and accompanied centrally. Thanks to the measures that have already been implemented and those additionally planned in 2017, the impact of risks from project business in subsequent years is regarded as manageable, with the result that project losses exceeding the customary operational extent are not expected.

Finances/liquidity

The Group's focus on Germany and the Euro zone minimizes risks relating to the exchange rate between the US dollar and Euro. Goods paid for in US dollars are purchased on the basis of short-term, foreign currency-based sales lists, which means that the currency risk can be controlled. Other currencies have as good as no relevance to the euromicron Group.

A further significant financial risk at the euromicron Group is the earnings strength of its companies. Since the Group companies are part of the centrally managed cash pool of euromicron AG, it is necessary to ensure that no financing risk derive from this financing of the Group companies via the cash pool. This is achieved by permanent and standardized finance management and reporting that constantly monitors and assesses the Group companies' activities and assigns measures to them, which is why the likelihood of this risk occurring is assessed as being low.

In fiscal year 2016, the euromicron Group had sufficient funds to finance its operational business. In addition, the Group's reorganization measures were continued and largely completed. Winding up of what remains of the loss-making business areas that are not strategically relevant and were closed in 2015 is proceeding as planned. In addition, further divisions were identified in 2016 and the Group commenced measures to discontinue or sell them in 2016. The reorganization measures in 2016 again focused on euromicron Deutschland GmbH, the largest system house in the euromicron Group. The reorganization measures at euromicron Deutschland GmbH in 2016 comprised in particular continued reduction and restructuring of the workforce to reflect the requirements of the individual regions, measures to reduce working capital and optimize receivables management, and creation of standardized controlling and IT structures. The goal of these measures is in particular to optimize structures and processes so as to lastingly boost the earnings and financial strength of euromicron Deutschland GmbH and so of the euromicron Group.

So as to secure liquidity in future, euromicron AG needed to refinance the loans that expired in fiscal year 2016. To enable that, a financing agreement running until March 31, 2018, was concluded with financing partners. The agreement specifies that the company must fulfill specific key ratios (covenants), which must be tested quarterly. There were no indicators at the balance sheet date that these financial covenants cannot be fulfilled in the future. In fiscal year 2017, follow-up financing after March 31, 2018, will be a key focus of the Executive Board's activities. Together with our main financing partners, we are currently working on a structure that is tailored to the strategic realignment and related requirements of the euromicron Group. As things stand at present, the Executive Board of euromicron AG – also based on assessments by external experts who are supporting the company in this financing process – expects that the follow-up financing will be completed in the second half of fiscal year 2017 and so the Group will secure the funding it needs.

Tax risks are also subsumed under the category “finances/liquidity”. One aspect that should be mentioned in this connection are tax risks from the securities lending transactions euromicron AG conducted in the years 2010 to 2012. As part of that, shares in various companies were borrowed by euromicron AG from a bank directly before the dividend record date and returned to the lender at the same price shortly after the dividend record date. euromicron AG received the net dividends (less withheld capital gains tax and solidarity surcharge) and paid the lender compensation to the amount of the gross dividends. 95% of the distributed dividends were exempt from corporation income tax at euromicron AG, while the compensation payments were able to be claimed immediately as a deductible operating expense. euromicron AG offset the amounts of tax withheld as part of the dividend payments against the corporation income tax it owed. However, that requires euromicron AG to be the economic owner from the tax perspective of the shares loaned by the lender on the respective dividend record date. Pursuant to the change in jurisdiction by the German Federal Fiscal Court and the subsequent letter from the Federal Ministry of Finance on the question of ascribing economic ownership in securities lending transactions, this aspect was addressed in the current tax audit for the years 2010 to 2012.

There is the risk that the dividends, which were treated as being exempt from corporation income tax to an amount of 95%, will have to be fully counted as taxable operating income, since the change in the legal viewpoint means euromicron AG is no longer regarded as the economic owner of the shares from the tax perspective. This risk was reflected fully in the balance sheet in the 2016 financial statements by recognition of the possible payment of tax arrears (€2.1 million) and related interest payment (€0.3 million). In addition there was a charge from the reduction in deferred tax assets of €1.4 million from the additionally expected utilization of corporation income tax loss carryforwards.

There is also the risk that amounts of tax withheld as part of dividend payments (capital gains tax and solidarity surcharge) might no longer be able to be offset by euromicron AG due to the change in jurisdiction on the issue of securities lending transactions. That would result in a payment of tax arrears of around €5.8 million and an interest payment (as per December 31, 2016) of around €1.1 million. Due to the many doubts about the lawfulness of this change in terms of procedural law and content, an appeal has been lodged and suspension of execution applied for. The fiscal authorities have already granted the suspension of execution. In addition, this issue means that euromicron AG has claims from rights of recourse to the same amount. These claims have been underpinned by a legal opinion from a specialist external attorney. Consequently, no outflow of liquidity from this risk is expected in total.

Procurement and production

As a producer, service provider and operator of IoT and Smart Industry solutions, there are procurement risks as regards the supply of raw materials and in the supply of complete technical components.

We counter these risks with organizational and contractual measures, as well as measures relating to purchasing strategy.

Our procurement management delivers the basis for qualified consulting in all portfolio groups. By pooling this expertise, we ensure that our customers and own companies benefit from the very best procurement channels and optimum terms and conditions. That enables us to leverage synergies to the full, yet also minimize risks at the euromicron group and internal process costs.

The market success of our products goes hand in hand with the previously described technology leadership. Constant orientation toward customers' technological needs reduces the risk of producing solutions that ignore market requirements, so this risk is assessed as being low.

Service and sales

In addition, the ethos of service is a key aspect in our business model. Leading technologies, customer proximity and total commitment to service help secure sales. Proximity to customers also means that tendencies and trends are identified and the solution portfolio expanded in good time. Training and innovative service concepts underpin the product, training and sales strategy.

IT

A large part of our field of business is in digital technologies. In particular in times of growing cybercrime, risks to IT-security must be addressed to a greater and greater extent. It is vital for data, networks and systems to be protected and reliable. We counter the higher risk by means of constant monitoring, the use of protective systems, and regular training and further education. Apart from planned manipulative interference in networks, it is also necessary to take into account technical faults, which we counter by systematic protection, backup and modern data structures. The risk is regarded as low all in all.

Corporate

The loss of qualified personnel is a key risk at a technology group with a medium-sized character like euromicron, in particular in project business, which is highly reliant on the existing staff. That is why the Group offers its employees regular, systematic further qualifications to reflect needs. That enables employees to assume more responsibility in their departments and demanding, varied tasks in their function. euromicron believes that professional and personal further development is a means of enhancing employee loyalty and key to a successful HR policy. In addition, the employee loyalty program formulated by the Executive Board and HR was implemented throughout the Group in fiscal year 2016. Due to our existing and planned measures to ensure employees' loyalty and development, we believe the risk of losing highly qualified staff to be limited.

Summary of the risk situation

The main risks were presented in accordance with the categories from the risk management system, with most attention paid to financing and project risks. However, the residual risk is calculable given the countermeasures that have been initiated, guidelines and constant controls.

There are no legal risks from pending legal proceedings above and beyond current business.

In summary: In the assessment of the Executive Board, the currently known risks will probably have no significant impact on the net assets, financial position and results of operations of euromicron.

3.3 Opportunity report

Due to its strategic focus on the growth market of the "Internet of Things", euromicron has a virtually unlimited market with prospects of large growth. euromicron's target markets are the business areas "Digital Buildings", "Smart Industry" and "Critical Infrastructures" (see also section 1.2 "Objectives and strategies"), which are already core markets of euromicron. Underpinned by its extensive experience and forward-looking technologies in the field of IT, network and security infrastructures, the euromicron Group's solutions dovetail seamlessly into the innovative concepts for the Internet of Things.

Apart from the strategic alignment, systematic leveraging of synergies between technology companies and system integrators represents the greatest potential for improving the euromicron Group's results in the medium term. Whereas these synergies have been exploited mainly at the project level to date, euromicron used business development resources in the centrally controlled innovation process in a pinpointed manner in fiscal year 2016, such as in the areas of IT security, smart services for IoT and service management. Central Business Development functions at euromicron help gear the solution portfolio to the target markets across all the companies and systematically create synergies between the associated companies.

One result of the proactive cooperation was that the euromicron companies ELABO GmbH, MICROSENS GmbH & Co. KG and euromicron Deutschland GmbH jointly opened a “Smart Industry” showroom in July 2016. Visitors to the showroom in Crailsheim can gain an overview of the Group’s entire Smart Factory portfolio – from customized workplace configurations to fully networked production, including robotics.

Apart from these market-related opportunities, one of our main goals is still to increase efficiency, especially in project business. The measures described in the risk report mean there are great opportunities to increase profitability in project business and so help improve results further.

Further opportunities for euromicron lie in rigorously continuing and expanding the measures to reduce working capital and so the Group’s tied-up capital. The Group aims to follow up the successes it achieved in 2016 – reflected in a lower working capital ratio – by reducing the working capital ratio again in fiscal year 2017. This will also have a positive impact on the euromicron Group’s liquidity situation.

Following the realignment of our strategy and the reorganization measures derived from that, a major focus in 2017 will be on professionalizing and optimizing our sales activities. We will therefore continue to expand key account management at our Group for important customers and target industries.

One strategic objective is still to increase the share of services in our solution portfolio in order to help customers in the digital transformation of their business processes, strengthen their loyalty to euromicron and so increase our profitability lastingly. To enable that, we further standardized and professionalized our service structures and processes at the Group. Under the euromicron product group “Smart Services”, we formulated and developed new innovative service concepts for the IoT market that enable operation of digital infrastructures. For example, euromicron’s subsidiary telent GmbH has recently launched EvalorIQ, its own scalable IoT platform. The software solution enables information and data supplied by the connected devices and interfaces to be analyzed and visualized and translated into practical approaches or business models. Customers can use the IoT platform to manage and present complex smart city and smart industry applications efficiently.

3.4 Forecast for fiscal year 2017

Since the reorganization measures in 2016, especially those relating to realignment of euromicron Deutschland GmbH, took more time than was anticipated at the end of the previous year, implementation of the euromicron Group's strategy, which is laid down in a three-phase model, has been pushed back one year.

On the basis of sales of €325.3 million in 2016 and the pro-rata loss of sales from the disposal in 2017 of the "Telecommunications" division of euromicron Deutschland GmbH and from discontinuation of the "Fiber-optic Infrastructure" division of RSR GmbH & Co. KG, sales expectations for 2017 – allowing for the presented opportunities and risks – are in a range between €330 million and €350 million.

We assume an operating EBITDA margin of between 4.0% and 5.0% for 2017.

Completion of the reorganization measures and costs in connection with restructuring of the Group's financing will probably reduce the reported consolidated EBITDA in 2017 by around €2 million to €3 million.

After the reduction in the working capital ratio (defined as working capital relative to sales) by 6.0 percentage points to 11.8% in 2016, it is to be further decreased to approximately 10.0% in 2017 by the further intensification of working capital management up to the end of 2017.

We expect a further significant improvement in our profitability in the coming years as a result of the Group's transformation. We assume that the operating EBITDA margin will increase continuously by one percentage point per annum in the subsequent years until the target range of 8.0% to 11.0% is reached.

This forecast is based on the assumption of a positive economic development in the Federal Republic of Germany and in the general conditions in the IT/ICT industry in 2017, as presented in section 2.1 "General economic and industry-specific conditions". Nevertheless, the actual results may deviate significantly from the expectations and forecasts if one of the above, or other, uncertainties arise or the assumptions on which the statements were based should prove to be inaccurate.

4. Internal control and risk management system in relation to the consolidated accounting process

Legal background and definition of an internal accounting control and risk management system (ICS/RMS)

Stock corporations as defined by Section 264d of the German Commercial Code (HGB) are obliged pursuant to Section 315 (2) No. 5 of that Code to present the salient features of the ICS/RMS in relation to the consolidated accounting process in the group management report. The ICS/RMS comprises all principles, procedures and measures to ensure effective, cost-efficient and proper consolidated accounting and compliance with the relevant financial reporting regulations. It is integrated in the risk management system of the overall Group, which is described in detail in section 3.2. "Risk report and salient features of the risk management system".

Fundamental regulatory and control activities to ensure proper and reliable consolidated accounting

The measures in the ICS at euromicron AG and the euromicron Group are geared to proper and reliable consolidated accounting and ensure that business transactions are recorded fully, promptly and in compliance with statutory provisions. They also ensure that stock-takes are carried out properly and assets and liabilities are carried, measured and reported accurately in the consolidated financial statements. The regulatory activities also ensure that reliable and transparent evidence relating to business transactions is available in the form of accounting documents.

In fiscal year 2016, the workforce at the corporate units of euromicron AG was increased, especially in Group Accounting and Group Controlling, Taxes, Internal Auditing and Compliance, resulting in a further improvement in the internal accounting control system. In addition, extensive guidelines were drawn up and implemented throughout the Group so that processes, the design of the ICS and specific accounting matters are documented and governed consistently throughout the Group. In addition, optimization of structures and processes in system house business was continued to harmonize and standardize implementation management and project controlling at the project companies. That also included implementation of a consistent cockpit for regional controlling at euromicron Deutschland GmbH. In addition, a further increase in personnel in project controlling is planned. The process started in 2016 to integrate project controlling more strongly in Group reporting will be expanded further. The necessary personnel requirements for that were created in 2016 when a permanent post at the level of euromicron AG was filled.

The organizational structure of Group Controlling was meshed more closely with the operating companies in order to further improve analysis of deviations between actual and planned figures and to enable swift and effective countermeasures to be taken in response to deviations from planning. Core elements are the direct assignment of staff from Group Controlling to the individual operating companies and stronger integration of them in process-related or accounting-specific matters at the subsidiaries. Reporting was standardized further, as a result of which preparation of the Group's monthly financial statements was professionalized further. In the year under review, integrated income statement, balance sheet and cash flow planning for the subsequent years was created and is the foundation for monthly analysis with regard to deriving monthly budget figures. A project to enable IT-aided preparation of the integrated Group planning as of fiscal year 2017 is currently being implemented.

Process-integrated and process-independent control measures form the main elements of the ICS at the euromicron Group. Apart from manual process controls – such as the “four eyes principle” –, automated IT process checks are also a key part of the process-integrated controls. This ensures that Financial Accounting is informed promptly of the status of all documents, which significantly reduces the risk of matters not being completely or correctly reported in accounting. The separation of functions and the four eyes principle are prescribed in work instructions or have been implemented in some cases in the systems used. Strict compliance with these measures also reduces the possibility of acts of criminal intent.

Regular training courses make sure that accounting department's employees are informed of changes to the law that may have an impact on preparation of the consolidated financial statements. This is all the more important given that extensively amended IFRS standards have to be implemented in subsequent periods. Group-wide projects as part of that have already been launched. Examples that might be mentioned here are the amendments to the standards on revenue recognition (IFRS 15) and lease accounting (IFRS 16). In addition, the legislative texts and related commentaries are available to an adequate extent.

Other control bodies, such as the Supervisory Board and independent auditor, are integrated in the Group's control environment with their process-independent auditing and monitoring activities. The suitability and effectiveness of the internal control system are also examined constantly by the work of the Internal Auditing department.

Specific accounting-related risks

A particular risk in relation to consolidated accounting is that the consolidated financial statements to be published contain errors that may have a significant influence on the Group's financial position, net assets and results of operations. This risk exists in reporting unusual or particularly complex business transactions or other business transactions that are not routine and so have a relatively high inherent risk. We refer you in this regard to the comments in section 3.2 "Risk report and salient features of the risk management system".

Other aspects

In preparation of the consolidated financial statements, the accounting department is also dependent in part on data and information from other organizational units of the euromicron Group. Of particular importance in examining the intrinsic value of goodwill and other assets is the budgeting prepared in agreement with the Controlling unit of euromicron AG and approved by its Executive Board and Supervisory Board. The Treasury unit provides the data required for presenting factoring and any derivate financial instruments in the balance sheet. The data, which is provided by other organizational units, is subjected to a plausibility check in the accounting department before being further processed as part of preparation of the consolidated financial statements.

At the euromicron Group, the segments are assessed among other things by their achievement of earnings- or cash flow-based targets. The course of business is assessed during the year with reference to various key indicators, such as liquidity, profitability and comparison with budgeting. In the course of a fiscal year, three calculations on expectations with forecasts for the end of the year are conducted. However, far more criteria than pure key indicators are required as a basis for investment and business decisions in fast-moving technology markets and these are obtained through permanent monitoring and reviews. The company's management also bases its decisions on analyses by the specialists and persons responsible who are involved in the process and have extensive market, product and sector know-how. A wide range of different evaluation criteria are used, tailored to the specific case. The companies are accompanied permanently by investment controlling by euromicron AG; deviations are identified and countermeasures initiated immediately.



Corporate Governance Report
2016 and corporate governance
declaration in accordance
with Section 289a HGB
(German Commercial Code)

5. Corporate governance declaration in accordance with Section 315 (5) HGB (German Commercial Code)

The corporate governance declaration in accordance with Section 315 (5) HGB (German Commercial Code) can be found in the 2016 Corporate Governance Report, which is available at all times on the homepage of euromicron AG at <http://www.euromicron.de/en/investor-relations/corporate-governance-code-16>.

6. Compensation Report

Salient features of the compensation system for the Executive Board

euromicron's future success depends on the company's ability to acquire, motivate and retain good personnel. The compensation system for euromicron AG's Executive Board is therefore oriented toward performance incentives for long-term corporate governance geared to sustainability. The Executive Board's compensation is also part of an end-to-end system for executives at the euromicron Group and is intended to reflect the size and strategic alignment of the company, its economic situation and future prospects and the personal performance of the board member in question. The compensation should be competitive nationally and internationally and so offer incentives for committed and successful work. Overall responsibility for defining the compensation principles for the Group lies with the Supervisory Board, which also regularly reviews them.

Compensation of the Executive Board

The total compensation of the Executive Board is based on Section 87 AktG (German Stock Corporation Law) and takes into account the Group's earnings targets. It is currently made up of performance-unrelated components (salary, other remuneration) and performance-related components (earnings-related bonus and a variable component with a long-term incentive effect ("LTI")). The performance-unrelated component account for around 60%, the performance-related component for around 30% and the component with a long-term incentive effect for around 10% of the total compensation.

euromicron AG's compensation strategy also envisages offering remuneration that is fair and transparent and takes the interests of shareholders into consideration. The following criteria apply to the individual components of the Executive Board's compensation:

The non-performance-related compensation is paid as a monthly salary, along with non-cash compensation. The Executive Board members each receive identical fixed compensation. The other remuneration relates to use of company cars, premiums for a group accident insurance policy and a direct company insurance policy, contributions to health and nursing care insurance, and reimbursement of business-related travel and entertainment expenses. The Executive Board members pay tax on the respective benefit in money's worth of these non-cash benefits.

The company maintains an insurance policy for board members of the euromicron Group, what is termed a directors' and officers' (D&O) policy. This insurance covers personal liability if claims for financial loss are made against Executive Board members as part of their work. In accordance with the applicable arrangement in the contracts of employment with Executive Board members, a deductible of 10.0% is provided for in accordance with statutory provisions (deductible within the meaning of Section 93 (2) AktG (German Stock Corporation Law) in conjunction with Section 23 (1) EGAktG (Introductory Act to the German Stock Corporation Law)).

The variable, performance-related components of the compensation for Executive Board members are geared to the company's sustainable development and consist of the following, mutually independent components:

First, there is an earnings-related bonus in the form of a variable cash payment which is calculated taking the Group's EBITDA and working capital into account (75%). In addition, the compensation of Executive Board members includes variable components that are measured on the basis of the achievement of individual qualitative targets (25%). They relate to ensuring that planned earnings are achieved and to optimization of the financing structure. An upper limit (cap) avoids entitlement to an excessively high bonus in the event of highly positive developments.

In addition, the system for compensation includes variable components with a multi-year basis of assessment (LTI). For the contribution made to increases in the company's value, the Executive Board members can receive a long-term compensation component geared to the individually agreed targets (optimization of the financing structure). Payment of it is due after the consolidated financial statements for the final year of the performance period have been approved; annual payments on account are set off against this.

In the event that an Executive Board member's activity is terminated without an important reason, all contracts provide for continued payment of the performance-unrelated and performance-related components for the remaining term of the contract of employment. A shortened performance period can be assumed to calculate the LTI component. The contracts with both members of the Executive Board end on March 31, 2020. The same applies in the event of premature termination of a board member's activity in the case of a change of control. In both cases, no further payments that necessitated a severance pay cap have been agreed.

For their work in fiscal year 2016, the individual members of the Executive Board received the following payments:

The total compensation for all members of the Executive Board was €739 thousand. The performance-unrelated, fixed basic compensation accounted for €559 thousand (including other non-cash compensation of €9 thousand) and the variable, performance-related compensation for €180 thousand.

The following amounts were paid to the individual members of the Executive Board:

- Bettina Meyer: €370 thousand (performance-unrelated compensation of €280 thousand, including €5 thousand in other remuneration, plus performance-related compensation of €90 thousand)
- Jürgen Hansjosten: €369 thousand (performance-unrelated compensation of €279 thousand, including €4 thousand in other remuneration, plus performance-related compensation of €90 thousand)

The following interest-free advances on the LTI component were granted in 2016:

- Bettina Meyer: €33 thousand
- Jürgen Hansjosten: €33 thousand

No loans were granted to the members of the Executive Board in the year under review. Apart from the stated compensation components, the members of the Executive Board did not receive any fringe benefits.

In fiscal year 2016, the members of the Executive Board did not receive any benefits from third parties that have been promised or granted in relation to their work as board members. Activities in or for subsidiaries are not remunerated separately.

Salient features of the compensation system for the Supervisory Board

The compensation of members of the Supervisory Board is governed by the Articles of Association of euromicron AG. Apart from being reimbursed for their outlays, the members of the Supervisory Board receive a fixed annual remuneration of €30 thousand. The Chairman/Chairwoman of the Supervisory Board receives double and his/her deputy one-and-a-half times the fixed remuneration. The overall compensation for the Supervisory Board for 2016 in accordance with the Articles of Association was thus €135 thousand, which is broken down as follows:

Members of the Supervisory Board up to the General Meeting on June 28, 2016:

- Dr. Franz-Stephan von Gronau: €35 thousand
- Josef Martin Ortoff: €26.25 thousand
- Dr. Andreas de Forestier: €17.5 thousand

The compensation for 2015 and the pro-rata compensation for 2016 for the Supervisory Board members who served until July 28, 2016, have not yet been paid out.

Members of the Supervisory Board elected at the General Meeting on June 28, 2016:

- Evelyne Freitag: €25 thousand
- Rolf Unterberger: €18.75 thousand
- Dr. Alexander Kirsch: €12.5 thousand

In its own interests, the company maintains a directors' and officers' (D&O) insurance policy that also covers the members of the Supervisory Board. Its deductible is 10.0%.

With one exception, the members of the Supervisory Board did not receive any further payments for services provided in the year under review. The auditing firm LKC Kemper Czarske v. Gronau Berz was commissioned to prepare expert opinions in connection with legal and accounting matters. A fee totaling €33 thousand was incurred for the services.

7. Disclosures in accordance with Section 315 (4) HGB (German Commercial Code)

- a.) The subscribed capital of euromicron AG on the balance sheet date comprises 7,176,398 no-par value registered shares.
- b.) The company's Executive Board is not aware of restrictions on voting rights or transfer of shares, even if they may be defined under agreements between shareholders.
- c.) There are no direct or indirect capital stakes exceeding 10.0% of the voting rights, where the disclosures do not have to be made in the notes on the consolidated financial statements.
- d.) There are no holders of shares with special rights that confer controlling powers.
- e.) The Executive Board is appointed and removed by the Supervisory Board in accordance with the Articles of Association in compliance with Section 84 AktG (German Stock Corporation Law). Amendments to the Articles of Association require the consent of the General Meeting.
- f.) Powers of the Executive Board to issue or buy back shares:

Authorized capital

The General Meeting on May 14, 2014, adopted a resolution to create new authorized capital totaling €9,173,770.00. Under it, the Executive Board is authorized to increase the capital stock of euromicron AG by May 13, 2019, by up to a total of €9,173,770.00 on one or more occasions with the approval of the Supervisory Board by issuing new registered shares in exchange for cash or non-cash contributions. In accordance with the Articles of Association, there is the possibility, under specific preconditions, to exclude the statutory shareholders' subscription right.

Treasury shares

At December 31, 2016, there is no authorization from the General Meeting for euromicron AG to acquire its own shares. As in the previous year, the company did not therefore hold any treasury shares at December 31, 2016.

euromicron AG had been authorized to acquire its own shares in the period from June 10, 2011, to June 9, 2016, under a resolution adopted by the General Meeting on June 9, 2011. That resolution authorized euromicron AG to acquire its own shares at a maximum proportional amount of the capital stock of €1,310,539.74 for these shares. The Executive Board did not make use of the authorization to acquire treasury shares up to June 9, 2016.

- g.) There are no significant agreements by the company as defined by Section 315 (4) Nos. 8 and 9 of the German Commercial Code (HGB).

Frankfurt/Main, March 22, 2017

Bettina Meyer	Jürgen Hansjosten
Spokeswoman of the	Member of the
Executive Board	Executive Board