



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

TRANSLATION – AUDITOR'S REPORT

HENSOLDT Holding GmbH
Taufkirchen, District of Munich, Germany

KPMG AG Wirtschaftsprüfungsgesellschaft

The English language text below is a translation provided for information purposes only. The original German text shall prevail in the event of any discrepancies between the English translation and the German original. We do not accept any liability for the use of, or reliance on, the English translation or for any errors or misunderstandings that may arise from the translation.



IFRS consolidated financial statements of

HENSOLDT Holding GmbH

as of December 31, 2018

HENSOLDT - Consolidated income statement

KEUR	Note	2018	2017
Revenue	10	1,110,117	917,093
Cost of sales	10	-900,422	-831,496
Impairment losses on trade receivables and contract assets		-5,898	197
Gross profit		203,797	85,794
Selling and distribution expenses		-76,848	-49,000
General administrative expenses		-68,849	-80,372
Research and development costs	11	-32,178	-29,767
Other operating income	12	32,724	23,390
Other operating expenses	12	-36,243	-19,104
Share of profit from investments accounted for using the equity method	8	-643	0
Earnings before interest and tax		21,760	-69,059
Interest income	13	14,855	12,369
Interest expense	13	-96,425	-55,528
Other finance income/costs	13	-5,275	-10,212
Finance income/costs		-86,845	-53,371
Earnings before income taxes		-65,085	-122,430
Income taxes	14	5,205	22,010
Consolidated profit/loss		-59,880	-100,420
thereof attributable to the owners of the Parent Company		-60,565	-101,374
thereof attributable to non-controlling interests		685	954

The following disclosures in the notes are an integral part of these consolidated financial statements.

HENSOLDT - Consolidated statement of comprehensive income

KEUR	Note	2018	2017
Consolidated profit/loss		-59,880	-100,420
Other comprehensive income/loss			
Items that will not be reclassified to profit or loss			
Measurement of defined benefit plans	28	24,343	-23,442
Tax on items that will not be reclassified to profit or loss		-6,975	6,646
Subtotal		17,368	-16,796
Items that will be reclassified to profit or loss			
Difference from currency translation of financial statements of foreign entities		-6,805	-4,626
Cash flow hedge – unrealized gains/losses	33.4	-6,034	-4,491
Cash flow hedge – reclassified to profit or loss	33.4	1,302	2,663
Tax effect on unrealized gains/losses	33.4	1,648	1,257
Subtotal		-9,889	-5,197
Other comprehensive income/loss, net of tax		7,479	-21,993
Total comprehensive income/loss in the financial year		-52,401	-122,413
thereof attributable to the owners of the Parent Company		-51,633	-122,552
thereof attributable to non-controlling interests		-768	139

The following disclosures in the notes are an integral part of these consolidated financial statements.

HENSOLDT - Consolidated statement of financial position

ASSETS

KEUR	Note	Dec. 31, 2018	Dec. 31, 2017
Non-current assets		1,129,633	1,170,065
Goodwill	15	593,860	584,050
Intangible assets	15	398,781	452,970
Property, plant and equipment	16	89,180	91,402
Investments accounted for using the equity method	8	1,570	63
Other investments and other non-current financial assets	17	11,347	5,143
Non-current other financial assets	23	735	18,904
Other non-current assets	24	9,125	3,145
Deferred tax assets	14	25,035	14,388
Current assets		1,082,689	944,189
Other non-current financial assets, due at short-notice	17	5,269	41,314
Inventories	18	407,002	386,656
Contract assets	10	80,688	0
Trade receivables	19	338,072	345,026
Current other financial assets	23	1,460	11,310
Current assets	24	21,422	16,464
Income tax receivables	14	1,226	5,445
Cash and cash equivalents	32	227,550	137,974
Total assets		2,212,322	2,114,254

EQUITY AND LIABILITIES

KEUR		Dec. 31, 2018	Dec. 31, 2017
Share capital		25	25
Capital reserve		46,275	46,275
Other reserves		-12,246	-21,178
Retained earnings		-220,655	-130,702
Treasury shares		-10,563	0
Equity held by shareholders of HENSOLDT Holding		-197,164	-105,580
Non-controlling interests		10,870	13,162
Equity, total	30	-186,294	-92,418
Non-current liabilities		1,609,935	1,476,072
Shareholder loans	32	349,567	437,474
Non-current provisions	21	310,272	294,069
Non-current financial liabilities	32	880,364	677,084
Non-current contract liabilities	10	24,767	0
Other non-current financial liabilities	23	4,561	983
Other non-current liabilities	24	3,399	21,118
Deferred tax liabilities	14	37,005	45,344
Current liabilities		788,681	730,600
Current provisions	21	210,900	310,201
Current financial liabilities	32	3,367	15,024
Current contract liabilities	10	332,800	0
Trade payables	20	167,073	146,562
Other current financial liabilities	23	13,299	18,049
Other current liabilities	24	56,294	240,754
Tax liabilities	14	4,948	10
Total equity and liabilities		2,212,322	2,114,254

The following disclosures in the notes are an integral part of these consolidated financial statements.

HENSOLDT - Consolidated statement of cash flows

KEUR	Note	Jan. 1.- Dec. 31, 2018	Jan. 1.- Dec. 31, 2017
Profit/loss for the period (including minority interests)		-59,880	-100,420
Depreciation and amortization	15/16	124,414	91,686
Allowances on inventories, trade receivables and contract assets		6,984	3,390
Profit/loss from disposals of non-current assets		143	-57
Share of profit in entities recognized according to the equity method		643	0
Financial expenses (net)		81,570	43,159
Other non-cash expenses/income		4,853	1,072
Change in			
Provisions		31,501	48,645
Inventories		15,447	137,850
Contract balances		-112,406	-
Trade receivables		-14,533	-94,981
Trade payables		913	34,491
Other assets and liabilities		25,068	-56,876
Interest paid		-35,171	-27,075
Income tax expense		-5,205	-22,010
Payments or refunds of income taxes		1,336	-4,657
Change in tax receivables/payables, tax provisions including deferred taxes		0	-5,036
Cash flows from operating activities		65,677	49,182
Acquisition of intangible assets and property, plant and equipment	15/16	-60,084	-39,277
Proceeds from sale of intangible assets and property, plant and equipment	15/16	426	902
Acquisition of associates, other investments and other non-current investments	8/17	-8,324	-281
Disposal of associates, other investments and other non-current investments	17	24,182	0
Acquisition or subsidiaries net of cash acquired		-17,329	-1,012,440
Other		240	701
Cash flows from investing activities		-60,889	-1,050,396
Assumption of financial liabilities	32.3	222,900	1,116,827
Repayment of financial liabilities	32.3	-123,995	0
Changes in capital and changes in non-controlling interests	32.3	0	22,314
Purchase of treasury shares	30.2	-10,563	0
Dividend payments to non-controlling interests		-304	0
Other		149	0
Cash flows from financing activities		88,187	1,139,141
Effects of movements in exchange rates on cash and cash equivalents		-3,399	0
Net changes in cash and cash equivalents		89,576	137,927
Cash and cash equivalents			
Cash and cash equivalents on January 1	32.1	137,974	46
Cash and cash equivalents on December 31	32.1	227,550	137,974

The following disclosures in the notes are an integral part of these consolidated financial statements.

HENSOLDT - Notes to the consolidated financial statements

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I. Basis of presentation

1. The Company

These IFRS consolidated financial statements comprise the financial position, financial performance and cash flows of HENSOLDT Holding GmbH (the 'Company' or 'HENSOLDT Holding') and its subsidiaries (the 'Group' or 'HENSOLDT Group') with its registered office in Taufkirchen, Germany (registered office: Willy-Messerschmitt-Str. 3, 82024 Taufkirchen, Germany, under file no. HRB 232418, Munich District Court).

The financial year is the calendar year.

Management released the IFRS consolidated financial statements for circulation to the Supervisory Board on March 8, 2019.

HENSOLDT Holding GmbH is a multinational company in the defense and security industry and is based in Germany. The main product areas are radars and optoelectronic systems, spectrum dominance and airborne solutions.

The consolidated financial statements of HENSOLDT Holding GmbH are included in the financial statements of Square Lux TopCo S.à r.l.; Luxembourg. Square Lux TopCo S.à r.l., Luxembourg prepares the consolidated financial statements for the smallest and largest group of companies. This company's registered office is located at Rue de Rollingergrund 59, 2440 Luxembourg, and listed at the Registre de Commerce et des Sociétés under number B204231.

2. Significant accounting policies

2.1. Basis of preparation

In accordance with Section 290 of the German Commercial Code [HGB], HENSOLDT Holding GmbH, as ultimate German parent company, prepares consolidated financial statements pursuant to Section 315e (3) HGB according to EU IFRS.

The Company's consolidated financial statements as of December 31, 2018, have been prepared voluntarily in accordance with the International Financial Reporting Standards (IFRS) of the International Accounting Standards Board (IASB), as these are to be applied in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards in the European Union. The additional requirements of Section 315e (1) of the German Commercial Code [HGB] were taken into account.

These consolidated financial statements of the Company are the first financial statements in which IFRS 15 Revenue from Contracts with Customers and IFRS 9 Financial Instruments are applied. For the transition to the new standards, use was made of the option to present the comparative period according to the previous standards and thus no adjustments were made to the comparative information.

In addition, the period of operating activities in the prior year covered only 10 months owing to the assumption of business activities.

The current reporting period is thus comparable with the corresponding prior-year period only to a limited extent. Changes in important accounting policies are described in Section 4.

These consolidated financial statements are presented in euro (EUR), which is the Group's functional currency. Unless otherwise indicated, all financial figures presented in euro are rounded to the nearest thousand.

These financial statements were prepared based on the assumption of the Group's continuation as a going concern. In the Group's second year of operating activities a consolidated loss of EUR 60 million was generated as a result of expenses in connection with acquisitions, from separation costs and other non-recurring effects as well as the subsequent expenses arising from the purchase price allocation. This resulted in negative consolidated equity of EUR 186 million.

The Group's liquidity is ensured at all times due to cash flows from operating activities of EUR 66 million, cash and cash equivalents as of December 31, 2018, of EUR 228 million and via an existing revolving credit facility of EUR 200 million.

Unless otherwise stated, the consolidated financial statements have been prepared on a historical cost basis. The principal accounting policies are set out below:

2.2. Consolidation policies

Business combinations

The Group accounts for business combinations using the acquisition method, provided the Group has gained control. The consideration transferred for the acquisition and the identifiable net assets acquired are generally recognized at fair value. Any goodwill arising is tested for impairment annually. Any gain on a bargain purchase is recognized directly in the consolidated income statement. Transaction costs are expensed as incurred unless they are related to the issue of debt or equity securities.

Any contingent consideration obligation is measured at fair value as of the acquisition date. If the contingent consideration is classified as equity, it is not remeasured and a payment is recognized in equity. Otherwise, other contingent considerations are measured at fair value on the reporting date and subsequent changes in the fair value of the contingent considerations are recognized in the consolidated statement of comprehensive income.

Subsidiaries

Subsidiaries are companies controlled by the Group. The Group controls a company when it is exposed to or has rights to variable returns from its involvement with the company and has the ability to affect those returns through its power over the company. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

Non-controlling interests

Non-controlling interests are valued at the date of acquisition at the relevant share in the acquired company's identifiable net assets.

Changes in the Group's interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions.

If the Company is obligated to buy back shares of external shareholders due to written put options, the potential purchase price liability according to contractual provisions is recognized at fair value as of the reporting date in other non-current liabilities. Changes in the market value are recognized in the income statement.

Shares in investments accounted for using the equity method

Interests of the Group accounted for using the equity method include interests in associates and joint ventures.

Associates are companies in which the Group has a significant influence, but not control or joint control in respect to financial and business policies. A joint venture is an arrangement, over which the Group exercises joint control and in which it has rights to the net assets of the arrangement rather than rights to its assets and obligations for its liabilities.

Investments in associates and joint ventures are recognized as equity-accounted investees. They are initially recognized at cost, which also includes transaction costs. After initial recognition, the consolidated financial statements contain the Group's share in the total comprehensive income of the equity-accounted investee until the date at which significant influence or joint management ends.

Consolidation of intercompany transactions

Internal group balances and business transactions and all unrealized revenue and expenses from internal group business transactions are eliminated during preparation of the consolidated financial statements. Unrealized gains on transactions with equity-accounted investees are derecognized against the investment in the amount of the Group's share in the investment. Unrealized losses are eliminated in the same way as unrealized gains, but only if there are no indications of impairment.

2.3. Revenue recognition

Revenue recognition – approach from January 1, 2018

HENSOLDT recognizes revenue if the control over the distinct goods and services has transferred to the customer, i.e. when the customer has the capacity to determine the use of the transferred goods or services and to primarily obtain the remaining benefits therefrom. The precondition in this respect is that a contract with enforceable rights and obligations is in place and, inter alia, recovery of the consideration – taking account of the credit rating of the customer – is probable.

Revenue is equal to the transaction price to which HENSOLDT is expected to be entitled. Variable considerations (such as price escalations, contractual penalties, price audit) are included in the transaction price if it is highly probable that a significant reduction in revenue will not occur or when the uncertainty associated with the variable consideration no longer exists. The amount of the variable consideration is determined either according to the expected value method or using the most likely amount, depending on which method better predicts the variable consideration. If the length of time between the transfer of the goods or services and the payment date exceeds 12 months and a significant benefit from financing arises for the customer or HENSOLDT, the consideration under IFRS 15 would need to be adjusted by the time value of money. As there are significant other reasons leading to a divergence between the point in time of performance and payment, the financing component is not given from the perspective of management of HENSOLDT.

If a contract comprises several distinct goods or services, the transaction price is allocated to the performance obligation based on the relative stand-alone selling price. If stand-alone selling prices are not directly observable, HENSOLDT estimates these in an appropriate amount. HENSOLDT generally prices all performance obligations in each case with their stand-alone selling price, adjusted for increases in costs or improvements in efficiency where applicable; this price is calculated on the basis of expected costs plus a margin typical for this type of good or service. This means that a reallocation of transaction prices (deviating from the prices recorded in the contract) is generally not necessary. If there are specific indications in the individual case that the prices stipulated in the contract for the separate performance obligations do not correspond to their respective stand-alone selling price, further evaluation is necessary. The best evidence of a stand-alone selling price is the observable price at which HENSOLDT sells the particular good or service separately and under similar conditions to similar customers. If stand-alone selling prices are not directly observable, HENSOLDT estimates these at the level of the separate performance obligation (and not at the level of the contract).

If no observable prices exist, particularly as the goods and services offered by HENSOLDT are highly complex and individual, the adjusted market assessment approach is also not possible. In these cases, HENSOLDT estimates the stand-alone selling price of each separate performance obligation based on the expected costs plus margin approach.

Revenue is recognized for each performance obligation either at a point in time or over time.

For each performance obligation to be satisfied over time pursuant to IFRS 15, HENSOLDT recognizes revenue over time by determining the progress towards complete satisfaction of that performance. HENSOLDT applies one single method (percentage of completion) to determine the progress for each performance obligation to be satisfied over time, with the selected method being consistently applied to similar performance obligations and similar circumstances.

HENSOLDT provides performance obligations over time where one of the following criteria is met:

(a) Routine or recurring services, particularly maintenance contracts or training services

In the case of routine or recurring services, progress is generally measured according to an output-based method (e.g. number of goods or services already rendered as a proportion of total goods or services to be rendered)

(b) Performance obligations for which the customer clearly controls the asset already during performance

(c) Performance obligations for which HENSOLDT in the course of performance creates or improves an asset without alternative benefit for HENSOLDT and at each point in time during performance HENSOLDT has an enforceable right to payment of performance already rendered including an appropriate profit margin.

In cases of criteria (b) and (c), progress is measured using an input-based method (e.g. costs already incurred to satisfy the performance obligation as a proportion of the total expected costs (percentage of completion method)).

For the percentage of completion method (PoC), the estimate of total costs is of particular significance; in addition, the estimates regarding the extent of performance can include costs required for the fulfilment of contractual obligations. These main estimates include the estimated total costs, the estimated total revenue, contract risks and other significant parameters. According to the percentage of completion method, changes in estimates can increase or reduce revenue.

An expected loss on a contract is recognized immediately in profit or loss.

Costs for obtaining and fulfilling a contract: Costs capitalized for obtaining and fulfilling a contract are amortized in line with the transfer of control over the promised goods and services which relate to these capitalized costs. If there is a significant change in respect of HENSOLDT's expected period of transfer of control over the promised goods and services to which the capitalized costs refer, HENSOLDT is required to correspondingly adjust the amortization period and to recognize this as a change to the accounting-related estimates pursuant to IAS 8.

In addition, HENSOLDT is required to recognize impairment losses on capitalized costs for obtaining and fulfilling a contract if their residual carrying amount as of the reporting date exceeds the expected consideration that HENSOLDT expects to receive in exchange for the transfer of the goods and services concerned less the remaining costs which relate directly to the performance of these goods and services.

Revenue from the provision of services: Revenue is recognized on a linear basis over time or – if performance is not linear – then corresponding to the provision of the services. Invoices are issued pursuant to the contractual terms; in this regard the payment terms typically provide for payment between 30 and 60 days after invoicing.

Revenue from the sale of goods: Revenue is recognized at the point in time at which the power of control transfers to the purchaser, generally upon delivery of the goods. Invoices are issued at that time; in this regard the payment terms typically provide for payment between 30 and 60 days after invoicing.

Contract assets, contract liabilities and trade receivables

If one of the contract parties has met its contractual obligations – depending on whether HENSOLDT has performed its contractual obligations or the customer has paid the agreed consideration – a contract asset, contract liabilities or a receivable is recognized.

If HENSOLDT satisfies its contractual obligations by transferring goods and services to a customer but before the customer pays a consideration or is required to pay pursuant to the contractual terms, HENSOLDT recognizes a contract asset in the amount of the satisfied performance less all amounts recognized as receivable.

If the customer pays a consideration or HENSOLDT has an unconditional entitlement to a specific consideration (i.e. a receivable) prior to the transfer of a good or a service to the customer, HENSOLDT recognizes a contract liability when the payment is made or due (depending on which point in time occurs first).

The distinction between contract asset and receivable includes diverse information on the risks of the company: both items include the default risk on the part of the customer, nevertheless only the contract asset also includes the risk of future performance. Receivables are shown when the entitlement to recovery of consideration is no longer subject to any condition.

HENSOLDT measures contract assets and receivables using the effective interest method at amortized cost less impairment losses. Impairment losses on contract assets and receivables include significant judgments and estimates of management based on the credit rating of individual customers, which are in turn based on the assessment of external rating agencies, on country-specific default risks, the current economic development and analysis of past bad debts.

Revenue recognition – approach until December 31, 2017

Sale of goods and services

Revenue is realized in the amount in which it is likely that the economic benefits from the Group's operating activities will be accrued by the HENSOLDT Group, the revenue can be reliably determined and the recognition criteria for each type of revenue generating activity are fulfilled (sale of goods and services as well as construction contracts). Revenue is measured at the fair value of the consideration received or to be received.

Revenue is recognized when significant risks and rewards of ownership have been transferred to the customer, recovery of the consideration is probable, the associated costs and possible returns can be estimated reliably, there is no continuing control over the goods, and the amount of revenue can be measured reliably. Revenue is recognized less returns, price deductions and volume discounts.

CONSTRUCTION CONTRACTS

Until December 31, 2017, the Group recognized long-term construction contracts pursuant to IAS 11 for some customers of HENSOLDT Group on the basis of customer-specific contracts.

Contract revenue includes the initial amount agreed in the contract plus all payments for variations in contract work, claims and incentives, to the extent that it is probable that they will result in revenue and can be measured reliably.

If the outcome of a construction contract can be reliably estimated, contract revenue is recognized in profit or loss in line with the stage of completion. The stage of completion is

assessed by reference to surveys of work performed. If the outcome of a construction contract cannot be reliably estimated, contract revenue is recognized only in the amount of the contract costs incurred that are likely to be recoverable.

Contract costs are recognized as incurred unless they form an asset associated with the future order fulfillment. An expected loss from a contract is recognized immediately in profit or loss.

Receivables from long-term construction contracts (POC receivables) represent the gross amounts that can be demanded from customers for the service performed up until the reporting date. These are measured at the amount of costs incurred plus recognized profits less partial payments received and any recognized losses.

Receivables from long-term construction contracts are presented in the statement of financial position as a part of trade and other receivables for all contracts in which the costs incurred plus recognized profits exceed partial payments received and recognized losses. If the partial payments received and recognized losses exceed the costs incurred plus recognized profits, the difference is presented as other provision.

2.4. Intangible assets and goodwill

Intangible assets

The intangible assets with limited useful lives are generally amortized on a straight-line basis over their respective expected useful lives (3 to 10 years) to their estimated residual values. Brands with indefinite useful lives are not amortized but tested for impairment annually.

Goodwill

Goodwill arising from business combinations is measured at cost less accumulated impairment losses. Goodwill is tested for impairment annually or if objective evidence of impairment exists.

Research and development

Research costs are recognized in the consolidated income statement as incurred.

Development expenditure is capitalized only if development costs can be reliably estimated, the product or process is technically and commercially feasible, future benefit is probable and the Group intends and has sufficient resources to be able to complete development and use or sell the asset.

Research and development activities generally begin with a concept phase. In the concept phase the Group generally assumes that the criteria for recognition under IAS 38 are satisfied if the Preliminary Design Review (PDR: for established technologies) or Critical Design Review (CDR) was successfully completed.

Other development expenditure is recognized in the consolidated income statement as soon as it is incurred. Capitalized development expenditure is measured at cost less accumulated amortization and accumulated impairment losses. An impairment test is carried out on an annual basis. Capitalized development expenditure is generally amortized over the estimated

useful life of the internally generated intangible asset. Amortization of the capitalized development expenditure is recognized under cost of sales.

2.5. Inventories

Inventories are measured at the lower of cost (generally the average cost) and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of selling.

Manufacturing costs include all costs directly attributable to the manufacturing process, such as material costs, wage and production-related overheads (based on normal operating capacity and normal use of materials, labor and other production costs) including write-downs. If any inventory risks exist, e.g. due to reduced usability after longer storage periods or lower replacement costs, suitable write-downs are recognized. Write-downs on inventories are recognized when it is probable that projected contract costs will exceed total contract revenue.

2.6. Employee benefits

Short-term employee benefits

Obligations under short-term employee benefits are recognized as expenses as soon as the employees perform the work involved. A liability must be recognized for the amount to be paid if the Group currently has a legal or constructive obligation to pay this amount on the basis of work done by an employee and the obligation can be reliably estimated.

Defined contribution plans

Obligations for contributions to defined contribution plans are recognized as expenses as soon as the associated work is performed. Prepaid contributions are recognized as an asset to the extent that there is an entitlement to a refund or a reduction in future payments.

Defined benefit plans

The Group's net obligation for defined benefit plans is calculated separately for each plan by estimating the future benefits for which the employees have accrued entitlement in the current and in earlier periods. This amount is discounted and the fair value of plan assets is then deducted from this.

The defined benefit obligations are calculated annually by a recognized actuary using the projected unit credit method. If the calculation results in a potential asset for the Group, the recognized asset is limited to the present value of economic benefits available in the form of any future refunds from the plan or reductions in future contributions to the plan.

Remeasurements of the net defined benefit liability are recognized directly in other comprehensive income. Remeasurements of the net defined benefit liability comprise actuarial gains and losses and the return on plan assets (excluding interest). The Group determines the net interest expense (income) on the net defined benefit liability (plan asset) for the reporting period by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual reporting period. This discount rate is applied to the

net defined benefit liability (asset) on that date. Any changes to the net defined benefit liability (asset) due to payment of contributions or benefits during the reporting period are taken into account. Net interest and other expenses relating to defined benefit plans are recognized in the consolidated income statement.

If a plan amendment or curtailment occurs, any past service cost resulting from a plan amendment or gain or loss on curtailment is recognized directly in the consolidated income statement.

Other long-term employee benefits

The Group's net obligations for other long-term employee benefits are the future payments due to employees in exchange for services provided during employment in the current and in earlier periods. These payments are discounted to present value. Remeasurements are recognized in the consolidated income statement in the period in which they occur.

2.7. Other provisions

Provision for onerous contracts

The Group recognized provisions for onerous (loss-making) contracts if it is probable that total contract costs will exceed the total contract revenue. The provision is measured at the lower amount of expected costs for terminating the contract and the expected net costs from performing the contract. Before a provision for onerous contracts is recognized the associated inventories are written down.

Onerous sales contracts are identified by monitoring the progress of the contract and the underlying project and by updating the estimate of contract costs, which involves significant and complex assumptions, assessments and estimates in connection with obtaining a certain performance standard and estimates relating to other costs (see note 3 'Key estimates and assessments', note 10 'Revenue, cost of sales, gross margins, contract assets and contract liabilities' and note 21 'Provisions').

Warranties

A provision for warranties is recognized when the underlying products or services are sold. The provision is based on the individual assessment of future costs to be incurred taking account of cases of goodwill.

2.8. Hedge accounting

The HENSOLDT Group carries out some transactions in foreign currency. The income and cost risks resulting from currency fluctuation are limited by purchases and sales in corresponding foreign currencies as well as forward exchange transactions. Hedging contracts are concluded for foreign exchange risks of individual customer or supplier contracts. The Company concludes these forward exchange contracts with banks.

For foreign currency transactions the Group applies cash flow hedge accounting to its derivatives contracts if the corresponding criteria are met. Hedge accounting ensures that derivative gains or losses are recorded through profit or loss (primarily as a part of revenue)

in the same period in which the hedged items or transactions are recognized through profit or loss. By contrast, changes in the value of derivative contracts are recognized in total comprehensive income if the hedged items or transactions have not yet been recognized through profit or loss.

Derivative contracts that do not qualify for hedge accounting are accounted for at fair value through profit or loss and all associated gains and losses are recognized in finance income/costs.

The Group's hedging strategy and hedge accounting policies are described in more detail in note 33 'Information on financial instruments'.

2.9. Financial instruments

Recognition and initial measurement

The Group recognizes trade receivables from the date that they arise. All other financial assets and liabilities are recognized for the first time on the trade date when the entity becomes a party according to the contractual provisions of the instrument.

A financial asset (except for a trade receivable without financing component) or a financial liability is measured at fair value on initial recognition. For an item which is not measured at fair value with changes through profit or loss (FVTPL), transaction costs are included which can be directly allocated to its acquisition or issuance. Trade receivables without a significant financing component are measured at their transaction price on initial recognition.

Classification and subsequent measurement

Financial assets – approach from January 1, 2018

For initial recognition, a financial asset is classified and measured as follows:

IFRS 9 includes a new classification and measurement approach for financial assets, which reflects the business model (in which the assets are held) and the characteristics of their cash flows. From January 1, 2018, the Group classifies its financial assets into the following measurement categories:

- (i) "measured at amortized cost" (AC)
- (ii) "at fair value with changes through profit or loss" (FVTPL) and
- (iii) "at fair value through other comprehensive income" (FVTOCI).

Financial assets are not reclassified after initial recognition unless the Group changes its business model to manage financial assets. In this case all affected financial assets are reclassified on the first day of the reporting period following the change in the business model.

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

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

A debt instrument is designated at FVTOCI if both of the following conditions are met and it was not designated at FVTPL:

- the financial asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

At initial recognition of an equity instrument that is not held for trading, the Group can irrevocably elect to present subsequent value changes of the investment in other comprehensive income. This decision is made on a case-by-case basis for each investment. All financial assets that are not measured at amortized cost or at FVTOCI are measured at FVTPL. This includes all derivative financial assets (see note 33). For initial recognition the Group can irrevocably elect to designate at FVTPL financial assets which otherwise meet the conditions for measurements at amortized cost or at FVTOCI, if this otherwise results in measurement and recognition inconsistencies (accounting mismatch) that arise being eliminated or significantly reduced.

Financial assets – subsequent measures and gains and losses: approach from January 1, 2018

Financial assets at FVTPL: These assets are subsequently measured at fair value. Net gains and losses, inclusive of any interest and dividend income, are recognized in profit or loss. For derivatives designated as hedging instruments in an effective hedge, see note 33.

Financial assets at amortized cost: These assets are measured at amortized cost using the effective interest method. Amortized cost is diminished by impairment losses. Interest income, foreign exchange gains and losses as well as impairment losses are recognized in profit or loss. A gain or loss arising from derecognition is recognized in profit or loss.

Debt instruments at FVTOCI: These assets are subsequently measured at fair value. Interest income, which is calculated using the effective interest method, foreign exchange gains and losses as well as impairment losses are recognized in profit or loss. Other net gains or losses are recognized in other comprehensive income. For derecognition, the accumulated other comprehensive income is reclassified to profit or loss.

Equity instruments at FVTOCI: These assets are subsequently measured at fair value. Dividends are recognized as income in profit or loss unless the dividends clearly represent cover of a part of costs of the investment. Other net gains or losses are recognized in other comprehensive income and are never reclassified to profit or loss.

Financial assets – approach until December 31, 2017

Non-derivative financial assets – classification until December 31, 2017

Until December 31, 2017, the Group classified non-derivative financial assets in the following categories:

- Financial assets at fair value through profit or loss
- Loans and receivables
- Available-for-sale financial assets.

The Group did not hold held-to-maturity investments.

Non-derivative financial liabilities – classification until December 31, 2017

The Group did not classify non-derivative financial liabilities as financial liabilities measured at amortized cost.

Non-derivative financial assets – measurement until December 31, 2017

A **financial asset is measured at fair value through profit or loss** if it is classified as held for trading or is designated as such on initial recognition. Attributable transaction costs are recognized in profit or loss as incurred. Changes in financial assets measured at fair value through profit or loss, which also include all interest and dividend income, are recognized in profit or loss.

Loans and receivables are initially recognized at fair value plus any directly attributable transactions costs. Subsequent to initial recognition, they are measured at amortized cost using the effective interest method.

Available-for-sale financial assets are measured initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, the available-for-sale

financial assets are measured at fair value and any changes in value are recognized in OCI and shown in the revaluation reserve in equity. If an asset is derecognized, any accumulated related amounts disclosed as a component of other comprehensive income are reclassified to profit or loss.

Non-derivative financial liabilities – classification, subsequent measurement and gains and losses

IFRS 9 largely retains the existing requirements of IAS 39 for the classification of financial liabilities.

Financial liabilities are classified and measured at amortized cost or at fair value through profit or loss (FVTPL). A financial liability is classified at FVTPL if it is classified as held for trading, is a derivative or is designated as such on initial recognition.

Financial liabilities measured at FVTPL are measured at fair value and net gains or losses, including interest expenses, are recognized in profit or loss.

Other financial liabilities are measured using the effective interest method for subsequent measurement at amortized cost. Interest expenses and foreign currency translation differences are recognized in profit or loss. Gains or losses arising from derecognition are also recognized in profit or loss.

See note 33.4 for financial liabilities, which were designated as hedging instruments.

Derecognition

Financial assets

The Group derecognizes a financial asset when the contractual rights to receive the cash flows of an asset expire or it transfers the rights to receive the cash flows in a transaction in which substantially all the risks and rewards of ownership of the financial asset are also transferred.

Assets are also derecognized when the Group does not retain substantially all the risks and rewards of ownership or control of the transferred asset.

Financial liabilities are derecognized when the contractual obligations are discharged, canceled or expire. The Group also derecognizes a financial liability if its contractual terms are changed and the cash flows of the adjusted liability differ significantly. In this case a new financial liability based on the adjusted terms is recognized at fair value.

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

Netting

Financial assets and liabilities are offset and the net amount is presented in the statement of financial position when the Group has a current, legally enforceable right to offset the amounts and intends either to settle them on a net basis, or to realize the asset and settle the related liability simultaneously.

Derivative financial instruments and hedge accounting

Derivative financial instruments and hedge accounting – approach from January 1, 2018

The Group holds derivative financial instruments to hedge its foreign currency and interest rate risk exposures. Embedded derivatives are separated from the host contract under certain circumstances and accounted for separately.

Derivatives are measured at fair value on initial recognition; attributable transaction costs are recognized in profit or loss when incurred. For the purposes of subsequent measurement, derivatives are measured at fair value. Any resulting changes are generally recognized in profit or loss.

Hedge accounting: Upon initial application of IFRS 9 the Group has the option of continuing to apply the accounting policies of IAS 39 for hedging transactions. The Group decided to continue to apply the existing requirements of IAS 39 for hedges for the time being.

To hedge cash flow fluctuations from highly probable forecast transactions due to changes in exchange rates and interest rates, the Group designates certain derivatives as hedging instruments.

At the inception of the designated hedge, the Group documents the risk management objectives and strategies that it is pursuing in respect of hedging. The Group also documents the financial relationship between the hedged item and the hedging instrument and whether there is an expectation that the changes in cash flows of the hedged item and the hedging instrument will offset each other.

Cash flow hedge

If a derivative is designated a cash flow hedging instrument, the effective portion of changes in the fair value is recognized in other comprehensive income and the cumulative change transferred to the hedging reserve. The effective portion of changes in fair value recognized in other comprehensive income is limited to the cumulative change of fair value of the hedged item (calculated on the basis of present value) from the inception of the hedge. An ineffective portion of changes in fair value of the derivative is recognized directly in profit or loss.

If a hedged forecast transaction later results in the recognition of a non-financial item, such as inventories, the accumulated amount from the hedging reserve and the costs of hedging reserve is included directly in the cost of the non-financial item when this is recognized.

For all other hedged forecast transactions, the accumulated amount, which was transferred to the hedging reserve and the costs of hedging reserve, is reclassified to profit or loss in the period or periods in which the hedged forecast future cash flows affect profit or loss.

If the hedge no longer meets the criteria for hedge accounting, or the hedging instrument is sold, expires, is terminated or exercised, then hedge accounting is discontinued prospectively.

If hedge accounting to hedge cash flows is terminated, the amount which was transferred to the hedging reserve remains within equity until

- for a hedging transaction which results in the recognition of a non-financial item: this amount is included in the cost of the non-financial items on initial recognition, or
- for other cash flow hedges: this amount is reclassified to profit or loss in the period or periods in which the hedged forecast future cash flows affect profit or loss.

If the hedged future cash flows are no longer forecast, the amounts that were transferred to the hedging reserve and the costs of hedging reserve are directly reclassified to profit or loss.

Derivative financial instruments and hedge accounting – approach before January 1, 2018

The approach used for comparative information for 2017 is similar to the approach applied for 2018. For all cash flow hedges, including those resulting in the recognition of a non-financial item, the amounts which were cumulatively transferred to the cash flow hedging reserve were reclassified in profit or loss in the period or periods in which the hedged forecast future cash flows affected profit or loss.

2.10. Taxes on income

Income tax expense comprises both actual income tax to be paid and deferred taxes.

Actual income tax receivables and liabilities are measured at the amount at which a refund from or a payment to the relevant tax authorities is expected. The amount is calculated on the basis of the tax rates and tax laws applicable as of the reporting date or will be applicable in the near future.

Applying the liability method of IAS 12 (Income taxes), **deferred taxes** are calculated on the basis of temporary differences between the tax and commercial valuation approaches including differences from consolidation, loss and interest carryforwards as well as tax credits. The calculation uses the tax rates that are expected to apply to the period when the asset is realized or the liability is settled. The amount is calculated on the basis of the tax rates and tax laws applicable as of the reporting date or will be applicable in the near future.

Deferred tax liabilities are recognized for all taxable temporary differences, with the exception of:

- the initial recognition of goodwill; or
- an asset or liability from a transaction which is not a business combination and at the date of the transaction affects neither the income (loss) for the period nor taxable profit (taxable loss), and
- all taxable temporary differences associated with investments in subsidiaries, associates, interests in joint ventures, where the Group is able to control the timing of the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer likely that sufficient taxable earnings will be available against which the deferred tax asset could be offset at least in part. Deferred tax assets that are not

recognized are reviewed at each reporting date and recognized to the extent to which it has become likely that future taxable earnings will permit the realization of the deferred tax asset.

Deferred taxes relating to items recognized directly in equity are also posted directly in equity. Deferred taxes are recognized either in other comprehensive income or directly in equity, depending on the underlying business transaction involved.

Deferred tax assets and liabilities are netted if there is a legally enforceable right to offset current tax assets against current tax liabilities, and the deferred taxes relate to the same taxable entity and the same taxation authority.

2.11. Transactions in foreign currency

In the separate financial statements of the subsidiaries, transactions denominated in foreign currency are translated at the exchange rate applicable on the date the transaction is recorded. Gains and losses from settling such transactions and from the translation of monetary assets and liabilities with the exchange rate prevailing on the reporting date are recognized in profit or loss.

The financial statements of foreign subsidiaries are translated into euro on the basis of the functional currency method in accordance with IAS 21, The Effects of Changes in Foreign Exchange Rates. The functional currency is the respective local currency of the entity. Assets and liabilities as well as contingent liabilities and other financial obligations are translated at the exchange rate prevailing on the reporting date (closing rate). The items in the income statement and consequently the net income for the year recognized in the income statement are translated at the average monthly exchange rate of the accounting period. The equity in place at the date of initial consolidation is translated at historical exchange rates for the foreign entities included in the consolidated financial statements. Any resulting differences are recorded as a reserve in equity with no effect on profit or loss.

2.12. Statement of cash flows

Under the indirect determination of cash flow, the changes in items in the statement of financial position related to operating activities are adjusted by currency translation effects and by changes in the scope of consolidation. For this reason, they cannot be directly reconciled with the relevant changes on the basis of the published consolidated statement of financial position.

2.13. Impairment

(a) Non-derivative financial assets – approach from January 1, 2018

The Group recognizes allowances for expected credit losses (ECL) for:

- financial assets at amortized cost
- contract assets.

Allowances on trade receivables and contract assets are always measured in the amount of the lifetime expected credit loss.

To assess whether the credit risk of a financial asset since initial recognition has significantly increased and for the assessment of expected credit losses the Group considers reasonable and supportable information which is relevant and available without undue cost or effort. This covers both quantitative and qualitative information and analysis, which is based on past experience of the Group and in-depth assessments, inclusive of forward-looking information.

Lifetime expected credit losses are expected credit losses which result from all possible default events over the expected lifetime of a financial instrument.

12-month credit losses are the share of expected losses resulting from default events which are possible within 12 months of the reporting date (or a shorter period if the expected term of the instrument is less than 12 months). The maximum period over which the ECL is to be estimated is the maximum contractual period over which the Group is exposed to credit risk.

Measurement of expected credit losses

In this regard, the estimated expected losses on trade receivables were calculated on the basis of actual credit losses in recent years. Credit risks were segmented according to common credit risk attributes. These are the risk assessments on the basis of rating grades of the Standard & Poor's rating agency as well as the geographic location.

Financial assets with a deterioration in credit risk

At each reporting date, the Group assesses whether the credit risk of the financial assets measured at amortized cost has deteriorated. The credit risk of a financial asset has deteriorated if one or more events occurs which has adverse effects on the expected future cash flows of the financial asset:

Indicators of a financial asset having a deterioration in credit risk include the following observable data:

- significant financial difficulty of the issuer or the borrower,
- a breach of contract, such as a default or past-due situation of more than 90 days
- restructuring of a loan or credit by the Group which would not otherwise have been considered
- if it is probable that the borrower will become insolvent or enter into other bankruptcy proceedings, or
- the disappearance of an active market for a security because of financial difficulties.

Presentation of impairment for expected credit losses in the statement of financial position

Impairment losses on financial assets measured at amortized cost are deducted from the gross carrying amount of the assets.

Impairment

The gross carrying amount of a financial asset is impaired when according to an appropriate assessment the Group does not assume that the financial asset can be partly or wholly realized.

(b) Non-derivative financial assets – approach before January 1, 2018

A financial asset that is not measured at fair value through profit or loss, including the interest in an equity-accounted investee, was tested on every reporting date to determine whether there is objective indication of impairment.

Objective indications that financial assets are impaired included:

- default or payment delay by a debtor;
- restructuring of an amount payable to the Group at terms which the Group would not otherwise consider;
- indications that a debtor or issuer will enter bankruptcy;
- adverse changes in the payment status of borrowers or issuers;
- the disappearance of an active market for a security due to financial difficulties or observable data indicating that there is a measurable decrease in estimated future cash flows from a group of financial assets.

Financial assets at amortized cost

The Group considered indications of impairment of these financial assets at both the individual asset and the collective level. All individually significant assets were tested for specific impairment. Those that did not prove to be specifically impaired were then tested collectively for any impairment that has occurred but has not yet been identified. Assets that were not individually significant were tested collectively for impairment by grouping assets with similar risk characteristics.

To test for collective impairment, the Group used historical information on the timing of payments and the amount of losses incurred, adjusted in accordance with the management's judgment as to whether the current economic conditions and lending conditions are such that actual losses are likely to be greater or smaller than the losses expected on the basis of historical trends.

An impairment loss was calculated as the difference between the asset's carrying amount and the present value of estimated future cash flows and discounted using the asset's original effective interest rate. Losses are expenses and recognized in an allowance account. Amounts are fully written off if the Group does not have any realistic prospects of recovering the asset. If an event that occurred after the recognition of impairment reduces the amount of the impairment, the impairment loss would have been reversed through profit or loss.

Available-for-sale financial assets

Impairment losses on available-for-sale financial assets were recognized by reclassifying the losses accumulated in equity from the fair value reserve to profit or loss. The amount of the cumulative loss that was reclassified from equity to profit or loss was the difference between the cost (net of any principal repayment and amortization) and current fair value, less any impairment loss on that financial asset previously recognized in profit or loss. If, in a subsequent period, the fair value of an impaired debt instrument classified as available for sale increased and the increase could be objectively related to an event occurring after the impairment loss was recognized in profit or loss, the impairment loss was reversed, with the amount of the reversal being recognized in profit or loss. Impairment losses recognized in profit or loss for an investment in an equity instrument classified as available for sale were not reversed through profit or loss.

(c) Non-financial assets

The carrying amounts of the non-financial assets of the Group – with the exception of inventories and deferred tax assets – are reviewed at the end of each reporting period to determine if there are indications of impairment. If this is the case, the recoverable amount of the asset is estimated. Goodwill and intangible assets with indefinite useful lives are tested for impairment once a year.

To determine if an impairment has occurred, assets are combined into the smallest group of assets that generate cash inflows from continuing use and are largely independent from the cash inflows of other assets or cash generating units (CGUs). Goodwill acquired from a business combination is allocated to the CGUs or groups of CGUs which are expected to benefit from the synergies of the combination.

The recoverable amount of an asset or CGU is the higher of its value in use and its fair value less costs to sell. To assess the value in use, the estimated future cash flows are discounted to their present value using a discount rate that reflects the present market assessment of the time value of money and the specific risks relating to an asset or a CGU.

An impairment loss is recognized if the carrying amount of an asset or CGU exceeds its recoverable amount.

Impairment losses are recognized as expenses immediately. Impairment losses recognized on CGUs are allocated first to any goodwill allocated to the CGU, and then to the carrying amounts of the other assets of the CGU (group of CGUs) on a pro rata basis.

An impairment loss on goodwill cannot be reversed. Impairment losses on other assets can only be reversed to the extent that the carrying amount of the asset does not exceed the carrying amount that, less depreciation or amortization, would have been determined if no impairment had been recognized.

For further details, please refer to '3.4 Impairment testing'.

2.14. Assessment at fair value

A number of the Group's accounting policies and disclosures require the measurement of fair values for both financial and non-financial assets and liabilities.

The fair value is the price at which an asset would be sold or a liability transferred under current market conditions on the measurement date in an orderly transaction on the primary market or, if such a market is not available, the most advantageous market to which the Group has access at this point in time. The fair value of a liability reflects the non-performance risk.

The Group uses the following hierarchy to determine and present fair value of the financial instruments for each valuation method:

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

Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly

Level 3: Methods by which input parameters that substantially impact the fair value determination are not based on observable market data

If an asset or liability measured at fair value has a bid or ask price then the Group measures assets or long positions at the bid price and liabilities and short positions at the ask price.

The best indication of the fair value at initial recognition of a financial instruments is generally the transaction price, i.e. the fair value of the consideration paid or received. If the Group determines that at initial recognition the fair value is different to the transaction price and the fair value can neither (a) be substantiated using a quoted price on an active market for an identical asset or liability nor (b) is based on a measurement technique in which all unobservable inputs can be considered immaterial, then this financial instrument is to be measured at fair value on initial recognition. This amount is adjusted to define the difference between the fair value and transaction price. For the purposes of subsequent measurement, this difference is recognized in profit or loss appropriately over the term of the instrument, however no later than upon full measurement using observable market data or upon derecognition of the transaction.

The significant, non-observable input factors and the measurement adjustments are regularly reviewed. If information from third parties, such as price quotations from brokers or price information services, is used to determine the fair values, the evidence obtained from third parties is examined to determine whether such measurements fulfil the requirements of IFRS, including the classification in the fair value hierarchy.

The Group uses the following methods to determine the fair value:

Equity instruments: the fair value of unlisted equity instruments cannot be reliably determined as the area of reasonable approximation of the fair value is decisive and the probabilities of the various estimates within the area cannot be appropriately assessed. With due consideration of materiality, these instruments are measured at cost and their carrying amounts are used in the place of fair value.

Assets from customer financing and other loans: the carrying amounts shown in the financial statements are used as rough estimates of the fair value.

Trade and other receivables, contract assets and other receivables: the carrying amounts shown in the financial statements are used as reasonable approximation of the fair value due to the relatively short period between the receivable arising and it falling due.

Cash and cash equivalents: comprise cash on hand, cash at bank and checks. The carrying amounts shown in the financial statements are used as reasonable approximation of the fair value due to the relatively short period between the instrument arising and its term or maturity.

Derivatives: the fair values of derivative instruments are based on quoted market prices where available but in most cases are determined using accepted measurement methods such as option pricing models and discounted cash flow models. Measurement is based on observable market data such as exchange rates, rates for forward exchange transactions, interest rates and yield curves.

The fair values of derivatives are measured on the basis of input parameters from Level 2.

Forward rate price determination for forward exchange transactions: the fair value is determined by using the quoted forward rate as of the reporting date and net present value calculations based on yield curves with high credit ratings in the relevant currencies.

Price determination for interest rate futures: the fair value is calculated as the present value of estimated future cash flows. Estimates of future cash flows from variable interest payments are based on quoted rates for interest rate futures, future prices and interbank interest rates. The estimated cash flows are discounted using a yield curve that was constructed from similar sources and reflects the relevant comparable interbank interest rate used by market participants for pricing the interest rate futures. The fair value estimate is adjusted for the credit risk which reflects the credit risk of the Group and the contracting party. This is calculated using credit spreads derived from credit default swap and bond prices.

Financial liabilities: the fair values recognized for financial liabilities, which are not bond or debt securities, are determined on the basis of input parameters from Level 2 in which planned or expected cash flows are discounted with corresponding market interest rates.

Trade payables, contract liabilities as well as current other financial liabilities: the carrying amounts of trade payables, contract liabilities and other current financial liabilities are seen as reasonable approximations of the fair value due to the relatively short period between the instrument arising and its maturity.

3. Key estimates and assessments

The preparation of consolidated financial statements requires the use of assumptions and estimates. In preparing the consolidated financial statements, management uses its best judgment based on its experience and the prevailing circumstances at that time. The estimates and assumptions are based on available information and conditions at the end of the accounting period and are regularly reviewed. The following key estimates and assessments have a significant influence on the amounts reported in the consolidated financial statements:

3.1. Revenue recognition for construction contracts (rendering of performance obligations over time)

Revenue from the rendering of performance obligations over time is recognized using the percentage of completion method (PoC method). Under this method, exact estimates of contract results at the stage of completion and on the extent of progress to completion are very important. To determine the progress of the contract the key estimates include total contract costs, the remaining costs until completion, the overall contract revenue, the contract risks and other claims.

Management regularly reviews all estimates used for these contracts and adjusts them as required (for more information please refer to note 10 'Revenue, cost of sales, gross margin, contract assets and contract liabilities' as well as note 19 'Trade receivables').

3.2. Capitalization of development cost

When capitalizing development costs the Company makes estimates regarding the development costs as well as estimates as to whether the product or the process is technically and commercially viable.

3.3. Assets acquired and liabilities assumed as well as goodwill

Measurement of the fair value of assets acquired and liabilities assumed in the course of company acquisitions, which form the basis of the measurement of goodwill, requires significant estimates. Land, buildings and machinery are usually measured independently while marketable securities are measured at market prices. If intangible assets are identified, based on the type of intangible asset and the complexity of determining its fair value, the Group consults either an independent external valuation expert or develops the fair value internally using suitable valuation techniques that are based in general on the forecast of total expected future net cash flows.

These measurements are closely related to management's assumptions regarding the future development of related assets and the discount rate to be applied.

3.4. Impairment testing

After initial recognition, goodwill is measured at cost less cumulative impairment losses. For the purpose of impairment testing, goodwill acquired in a business combination is, starting from the acquisition date, allocated to the Group's cash-generating units that are expected to benefit from the combination. This applies irrespective of whether other assets or liabilities of the entity acquired are assigned to these cash-generating units.

An impairment is recognized when the carrying amount of an asset or cash generating unit exceeds its recoverable amount. The recoverable amount of an asset or a cash-generating unit is the higher of fair value less costs to sell and value in use. The calculation of fair value less costs to sell is based on available data from binding sales transactions between independent business partners for similar assets or observable market prices less costs directly attributable to the sale of the asset. To calculate the value in use the discounted cash flow method is generally applied. Cash flows are generally derived from the financial plan for the next three years, which does not include restructuring measures to which the Group has not yet committed and material future investments that are not yet approved.

At the end of each reporting period the Group assesses whether there is an indication of impairment of a non-financial asset or CGU to which the asset belongs. In addition, intangible assets with indefinite useful lives, intangible assets not yet available for use as well as goodwill are tested for impairment in the fourth quarter of each financial year, regardless of whether there are any indications of impairment. For impairment testing, goodwill is allocated to a CGU or group of CGUs to thus reflect the manner in which goodwill is monitored for internal management purposes.

The discounted cash flow method is used to determine the recoverable amount of a CGU or group of CGUs to which goodwill is assigned. The discounted cash flow method is particularly sensitive to the selected discounting rates and management's estimates of future cash flows. The discount rates are based in each case on the weighted average cost of

capital (WACC) for the group of cash generating units. The discount rates are calculated based on a risk-free interest rate and a market risk premium. In addition, the discount rates reflect the current market estimate of the specific risks for each group of cash generating units, in which specific peer group information on beta factors, leverage and borrowings costs are taken into account. Therefore, even minor changes to these elements can impact the resulting measurement and thus significantly impact the amount of a potential impairment.

These estimates are influenced by a number of assumptions including the assumptions on CGU, availability and breakdown of future defense budgets and institutional budgets as well as exchange rate fluctuations or effects resulting from the volatility of the capital markets. Cash flow projections take into account past experience and represent management's best estimate of future developments.

The HENSOLDT Group has two corporate sectors, Optronics and Sensors, which are each considered a CGU. Both corporate sectors are managed as independent subgroups under the subgroup parent HENSOLDT Optronics GmbH and HENSOLDT Sensors GmbH. HENSOLDT France S.A.S, acquired in 2018, and PentaTec Elektronische Systeme Gesellschaft mit beschränkter Haftung were allocated to the CGU Sensors.

3.5. Provisions

The measurement of provisions, e.g. for contract losses, guarantees, restructuring measures and legal proceedings, is based on best available estimates. Onerous contracts are determined by monitoring the progress of projects and updating estimates of contract costs, which also requires significant judgment in relation to reaching certain performance standards and estimates of guarantees and follow-up costs. The extent of the assumptions, assessments and estimates in these monitoring processes depends on the size and type of the Group's contracts and the associated projects.

3.6. Employee benefits

The Group recognizes pension and other retirement benefits in accordance with actuarial valuations. These valuations are based on statistical and other factors for anticipating future events. The assumptions can deviate significantly from actual developments due to changing market and economic conditions and thus lead to a significant change in employee benefits obligations and the related future costs (see note 28 'Pension benefits').

In addition to uncertainties arising from the estimate of exercising the payout option, the Group is exposed to other actuarial uncertainties relating to defined benefits obligations, including the following:

Market risk

The market values of plan assets are subject to fluctuations which can impact the net defined benefit obligation.

Interest rate risk

The value of the defined benefit obligation is significantly affected by the discount rate used. Lower interest rates, particularly market conditions linked to the euro, result in a relatively high net defined benefit obligation. If the decline in return on corporate bonds continues, the

defined benefit obligation will continue to increase in future reporting periods and can be only partially offset by the positive development in market values of these corporate bonds which are included in plan assets. In general, the defined benefit obligation is sensitive to movements in interest rates which leads to volatile results of the valuation.

Inflation risk

Defined benefit obligations can be sensitive to movements in the inflation rate, whereby a higher inflation rate could lead to an increase in the obligation. As some pension plans are directly tied to salary, pay increases can lead to an increase in pension obligations.

Longevity risk

Pension obligations are sensitive to the life expectancy of their beneficiaries. Increased life expectancy leads to an increase in the valuation of the pension obligation.

The weighted average assumptions for the most important pension plans used to calculate the actuarial value of the pension plans as of December 31, are as follows:

Assumptions in %	Pension plans in Germany	
	31.12.2018	31.12.2017
Discount rate	2.00%	1.70%
Wage increase rate (until age 36)	3.75%	3.75%
Wage increase rate (from age 36)	2.75%	2.75%
Inflation rate	1.50%	1.50%

For Germany the Group derives the discount rate used to determine defined benefits obligations from the yields for high quality corporate bonds. The discount rate for the estimated term of the respective pension plan is then extrapolated along the yield curve.

The pay increase rates are based on long-term expectations of the respective employer that are derived from the inflation rate assumed and are adjusted using recruiting and productivity scales. Payments for pension growth rates are derived from the respective inflation rate for the plan.

The inflation rate for plans corresponds to the expected increase in the cost of living.

Moreover, an assumption is made as to what extent the employees choose a one-off payment, installment payment or pension when the benefit falls due.

The calculation of pension obligations is based on the current 2018 G biometric reference tables provided by Heubeck, which replaced the previous 2005 G mortality tables. The new reference tables take into account in particular the decline in mortality and thus the increase in life expectancy which results in an increase in the cost of the company pension. The changes resulting from the application of the new 2018 G reference tables are included in the actuarial gain or losses from changes in the demographic assumptions. As of December 31, 2018, an actuarial loss from changes in these demographic assumptions of KEUR 1,106 is recognized.

3.7. Contingent legal liabilities

Group companies can be parties to legal disputes in a variety of ways as described in note 21 'Provisions'. The outcome of these issues can have a material impact on the Group's financial position, operating profit and cash flows. Management regularly analyzes current information on these issues and recognizes provisions in the amount of likely cash outflows, including estimated legal costs. In deciding on the need for provisions, management takes into account the degree of probability of an unfavorable outcome and the possibility of reliably estimating the amount of damage. Filing an action or formally exercising damage claims against Group companies or the announcement of such an action or exercising of damage claims does not automatically mean that a provision is appropriate.

3.8. Income taxes

In terms of income taxes, material estimates and assessments arise in respect of deferred tax assets. The assessment of impairment of deferred tax assets depends on the management's estimate of the utilization of the deferred tax assets. This is dependent on taxable profits in the periods when the tax measurement differences are reversed and the tax loss carryforwards can be utilized.

On the basis of individual company planning and taking into account tax adjustment effects, the Company assumes that the advantages of deferred tax assets can be realized in the next four to five years on the basis of sufficient, future taxable income. The main influencing factor for the occurrence of loss carryforwards were one-off transformation-related effects. In addition, the business plan is positively impacted by general business development and the establishment of a tax pooling arrangement for income tax in Germany.

4. Change in accounting policies and disclosure

4.1. Changes in accounting policies

The HENSOLDT Group applied IFRS 15 and IFRS 9 for the first time as of January 1, 2018. Amendments from other standards have no material effect on the consolidated financial statements of the HENSOLDT Group.

Effects on the financial statements

Changes in the accounting policies and adjustments in the amounts recognized in the financial statements resulted from the initial application of IFRS 15 from January 1, 2018. In accordance with the transition provisions in IFRS 15, comparative data for the consolidated financial statements were not retroactively adjusted. The following table summarizes the effects of the adoption of IFRS 9 and IFRS 15 on the consolidated financial statements as of January 1, 2018.

KEUR	Explanatory notes	Dec. 31, 2017 as reported	Adjustments to IFRS 9	Reclassification IFRS 15	Adjustments to IFRS 15	Jan. 1, 2018 adjusted
Assets						
Other non-current assets	(a, b)	3,145	0	0	15,319	18,464
Deferred tax assets	(a, b, d)	14,388	334	0	16,018	30,740
Inventories	(a, b)	386,656	0	0	26,634	413,290
Contract assets	(a, b, c)	0	0	17,589	35,778	53,367
Trade receivables	(c, d)	345,026	-1,180	-17,589	0	326,257
Other		1,365,039	0	0	0	1,365,039
Total assets		2,114,254	-846	0	93,749	2,207,157
Equity						
Retained earnings	(a, b, d, e)	-130,702	9,873	0	-40,583	-161,412
Other		38,284	0	0	0	38,284
Equity, total		-92,418	9,873	0	-40,583	-123,128
Liabilities						
Non-current financial liabilities	(e)	677,084	-14,950	0	0	662,134
Contract liabilities (non-current)	(c)	0	0	18,436	0	18,436
Other non-current liabilities	(c)	21,118	0	-18,436	0	2,682
Deferred tax liabilities	(e)	45,344	4,231	0	0	49,575
Current provisions	(a, b)	310,201	0	-13,546	-79,593	217,062
Contract liabilities (current)	(a, b, c)	0	0	205,668	213,925	419,593
Trade payables	(a, b)	146,562	0	13,546	0	160,108
Other current liabilities	(c)	240,754	0	-205,668	0	35,086
Other		765,609	0	0	0	765,609
Total liabilities		2,206,672	-10,719	0	134,332	2,330,285
Total equity and liabilities		2,114,254	-846	0	93,749	2,207,157

4.2. IFRS 15 Revenue from Contracts with Customers

IFRS 15 establishes a comprehensive framework for determining whether, to what extent and when to recognize revenue. It replaces existing guidelines for the recognition of revenue, including IAS 18 Revenue, IAS 11 Construction Contracts and IFRIC 13 Customer Loyalty Programmes. In accordance with IFRS 15, revenue is recognized when a customer obtains control over a promised good or service. At contract inception, whether control is transferred

at a point in time or – particularly for specific customers – over time is determined for each identified performance obligation.

Reconciliation as of January 1, 2018

For transition to IFRS 15, the Group applied the modified retrospective method (without practical expedients), whereby the cumulative adjustment amounts are recognized under adjustments to retained earnings in the opening statement of financial position as of January 1, 2018.

Comparative information for 2017 was not adjusted. It was presented as before pursuant to IAS 18, IAS 11 and the corresponding interpretations thereof. Furthermore, the disclosure requirements pursuant to IFRS 15 have generally not been applied to the comparative information.

Due to the adjustments of IFRS 15, the Group's retained earnings were adjusted as of January 1, 2018, as follows:

KEUR	Explanatory notes	Jan. 1, 2018
Transition of milestone method to recognition of revenue at a point in	(a)	-34,391
Transition of milestone method to recognition of revenue over time	(b)	-22,210
Subtotal		-56,601
Increase in deferred tax assets		16,018
earnings		-40,583

Effects of the initial application on financial year 2018

The following tables summarize the effects of the initial application on the consolidated statement of financial position as of December 31, 2018 and on the consolidated statement of comprehensive income for 2018 for each of the items affected had IFRS 15 not been applied. No material effects occurred on the statement of cash flows as of December 31, 2018.

Impact on the consolidated statement of financial position

KEUR	Explanatory notes	Dec. 31, 2018, as reported	Reclassi- fication IFRS 15	Adjustments to IFRS 15	Dec. 31, 2018, without adjustment
Assets					
Other non-current assets	(b)	9,125		-4,208	4,917
Deferred tax assets	(a, b)	25,035		-8,541	16,494
Inventories	(a)	407,002		18,191	425,193
Contract assets	(a)	80,688	-44,367	-36,321	0
Trade receivables		338,072	44,367		382,439
Other		1,352,400			1,352,400
Total assets		2,212,322	0	-30,879	2,181,443
Equity, total					
Retained earnings	(a, b)	-220,655		21,638	-199,017
Other		34,361			34,361
Equity, total		-186,294	0	21,638	-164,656
Liabilities					
Contract liabilities (non-current)		24,767	-24,767		0
Current provisions	(a)	210,900	13,546	79,593	304,039
Contract liabilities (current)	(a)	332,800	-200,690	-132,110	0
Trade payables	(a)	167,073	-13,546		153,527
Other		1,663,076	225,457		1,888,533
Total liabilities		2,398,616	0	-52,517	2,346,099
Total equity and liabilities		2,212,322	0	-30,879	2,181,443

Impact on the consolidated statement of comprehensive income

KEUR		2018	Adjustments to IFRS 15	Dec. 31, 2018, without adjustment
Revenue	(a)	1,110,117	-82,358	1,027,759
Cost of sales	(a, b)	-900,422	55,936	-844,486
Selling and distribution expenses		-76,848	0	-76,848
Finance income/costs		-86,845	0	-86,845
Income tax expense	(a, b)	5,205	7,477	12,682
Other		-111,086	0	-111,086
Consolidated profit/loss		-59,879	-18,945	-78,824
thereof attributable to the owners of the Parent Company		-60,565	-18,945	-79,510
Adjustment effects of IFRS 15 as of Jan. 1, 2018			40,583	
Adjustment of retained earnings			21,638	

Explanatory notes

IFRS 15 mainly requires that the various performance obligations assumed under a contract are identified and recognized separately on the basis of their relative retail prices. For all contracts, including long-term construction contracts for the most part previously recognized according to IAS 11 'Construction Contracts' and IAS 18 'Revenue' by HENSOLDT Group using the milestone method, revenue according to IFRS 15 can only be recognized when the control of the good or service is transferred under certain conditions to the customer.

Compared to the previous accounting treatment, the following changes largely resulted at HENSOLDT Group from the initial application of IFRS 15:

(a) Change in reporting method – transition from the milestone method to recognition of revenue at a point in time

If the criteria of IFRS 15.35 were not met, the HENSOLDT Group converted the contracts and the performance obligations contained therein from the previous milestone method to the method of recognizing revenue at a point in time. As a performance obligation generally comprises several milestones, a part of the revenue (milestone met, performance obligation not satisfied) needed to be canceled. As a consequence, revenue tended to be recognized later for these contracts under IFRS 15 than under IAS 18. The effects of this change on other items in the consolidated financial statements produce, depending on the contractual situation, a decrease in other provisions or an increase in inventories. In addition, the differences are presented initially in the new item 'contract liabilities'.

(b) Change in reporting method – transition from the milestone method to cost-to-cost method (recognition of revenue over time)

For contracts for which the HENSOLDT Group has no alternative use due to the highly customer-specific adjustment of products, recognition of revenue over time (cost-to-cost method) is to be applied according to IFRS 15.35. As a consequence, revenue under IFRS 15, depending on the progress of performance at the date of transition in the respective contract, was recognized earlier or later than the previous milestone method. The effects of

this change on other items in the consolidated financial statements, depending on the contractual situation, produce a decline in inventories or in other provisions, while – depending on the contract balance – contractual assets or liabilities were to be recognized for the first time.

(c) Reclassifications

Owing to the adjustment in IFRS 15, the POC receivables and advance payments recognized as of December 31, 2017, were reclassified to the items contract assets and contract liabilities in the statement of financial position.

4.3. IFRS 9 Financial Instruments

IFRS 9, issued in July 2014, replaces the existing rules in IAS 39 Financial instruments: Recognition and Measurement. IFRS 9 includes revised rules on classification and measurement of financial instruments, including a new model of expected losses for the calculation of impairments of financial assets and new rules on hedge accounting treatment. The standard also carries forward the guidelines for the recognition and derecognition of financial instruments from IAS 39.

Changes in the accounting policies and adjustments in the amounts recognized in the financial statements resulted from the initial application of IFRS 9 on January 1, 2018. The new accounting policies are presented under 2.10 Financial instruments.

Reconciliation as of January 1, 2018

Changes in accounting policies due to the application of IFRS 9 are always applied retroactively, except for the following exemption: comparative information for preceding periods with regard to changes in classification and measurement (including impairment) was not adjusted. Differences between the carrying amounts of financial assets and financial liabilities due to the application of IFRS 9 were always recognized in retained earnings as of January 1, 2018.

Due to the adjustments of IFRS 9, the Group's retained earnings were adjusted as of January 1, 2018, as follows:

KEUR	Explanatory notes	Jan. 1, 2018
Increase in allowances for trade receivables and assets	(d)	-1,180
Increase in deferred tax assets in view of impairment requirements	(d)	334
Adjustment through profit or loss within the scope of the effective interest method	(e)	14,950
Increase in deferred tax liabilities	(e)	-4,231
Adjustment of retained earnings		9,873

Classification and measurement of financial assets and financial liabilities

IFRS 9 contains three key classification categories for financial assets: (i) measured at amortized cost, (ii) at fair value with changes in value through profit or loss (FVTPL) and (iii) measured at fair value with changes in value through other comprehensive income (FVOCI). The standard eliminates the existing IAS 39 categories of "held to maturity", "loans and

receivables" and "available for sale". Under IFRS 9, derivatives embedded in agreements, for which the basis is a financial asset within the scope of the standard, are not recognized separately. Instead, the hybrid financial instrument will be assessed overall with regard to classification.

IFRS 9 largely retains the existing requirements of IAS 39 for the classification of financial liabilities.

At the date of initial application of IFRS 9 (January 1, 2018), the Group's management assessed which business models apply for the financial assets held by the Group, and classified the financial instruments into respectively appropriate IFRS 9 categories. The most important effects from this reclassification are as follows:

KEUR Jan. 1, 2018	Explanatory notes	Category pursuant to IAS 39	Category pursuant to IFRS 9	Original carrying amount according to IAS 39	Carrying amount according to IFRS 9
Assets					
Other investments and other non-current financial assets		FVTOCI	FVTOCI	5,143	5,143
Trade receivables ¹	(c,d)	LaR	AC	345,026	326,257
Other financial assets					
■ Derivative instruments for cash flow hedges		no category	no category	8,904	8,904
■ Other derivative instruments		FVTPL	FVTPL	20,281	20,281
■ Non-derivative instruments		FVTPL	FVTPL	1,028	1,028
Total financial assets				380,382	361,613
Liabilities					
Financing liabilities					
				437,474	437,474
■ Liabilities to shareholders		FLAC	FLAC		
■ Liabilities to banks	(e)	FLAC	FLAC	692,109	677,159
Trade payables		FLAC	FLAC	146,562	146,562
Other financial liabilities					
■ Derivative instruments for cash flow hedges		no category	no category	170	170
■ Other derivative instruments		FVTPL	FVTPL	5,081	5,081
■ Liability from put option		no category	no category	972	972
■ Other		FLAC	FLAC	12,809	12,809
Total financial liabilities				1,295,177	1,280,227

LaR: Loans and Receivables

AC: Amortized cost

FLAC: Financial liabilities measured at amortized cost

FVTPL: Fair value through profit or loss

FVtOCI: Fair value through other comprehensive income

¹⁾ Figure according to IFRS 9 inclusive of reclassification pursuant to IFRS 15

Explanatory notes

(d) Impairment loss on trade receivables

IFRS 9 replaces the incurred loss model of IAS 39 with a prospective model of expected credit losses (ECL). The new impairment model is to be applied to financial assets measured at amortized cost, contract assets and debt instruments measured at FVOCI, however not to equity investments held as financial assets. Under IFRS 9 credit losses are recorded at an earlier stage than under IAS 39.

The HENSOLDT Group applies a simplified approach pursuant to IFRS 9 to measure expected credit losses; accordingly, lifetime expected losses are used for all trade receivables. This requires considerable judgment regarding the issue of the extent to which expected credit losses are influenced by changes in economic factors. This estimate is determined on the basis of weighted probabilities.

The Group has identified additional impairment expenses of KEUR 1,180 (before deferred taxation) arising from the application of the impairment requirements of IFRS 9 as of January 1, 2018.

Details on the calculation of impairment are presented under 33.1 Financial risk management (credit risk).

(e) Adjustment of effective interest through profit or loss

Specific amendments of contractual terms and the resulting adjustments of the present value of a financial liability are generally to be recognized according to IFRS 9 at the point in time of the change through profit or loss. The adjustment of effective interest through OCI, as in prior years, is no longer permitted.

The application of the adjustment of the loan recognized under financial liabilities through profit or loss according to the effective interest method as of January 1, 2018, in comparison to the IAS 39 adjustments through OCI would have led to an approx. EUR 14.9 million lower expense in finance income/costs in financial year 2017. Having regard to deferred taxation of EUR 4.2 million, this resulted in an increase in retained earnings as of January 1, 2018, of approx. EUR 10.7 million.

Hedge accounting

Upon initial application of IFRS 9 the Group has the option of continuing to apply the accounting policies of IAS 39 for hedging transactions instead of applying the requirements of IFRS 9. The Group decided to continue to apply the existing requirements of IAS 39 until further notice.

For explanatory notes on how the Group's hedge accounting is carried out according to IAS 39, please refer to note 2.9.

5. New, revised and amended IFRS standards and interpretations issued but not yet adopted

A range of new or revised standards, changes and improvements to standards and interpretations are not yet applicable to the financial year ending December 31, 2018, and were not applied when preparing these consolidated financial statements.

Standard and changes	Date of effectiveness from IASB for the annual reporting period beginning on or after	EU Endorsement status
Amendments to IAS 19 Employee Benefits	January 1, 2019	Not yet confirmed
Amendments to IAS 28 Investments in Associates	January 1, 2019	Confirmed
Amendment to IFRS 9 Financial Instruments	January 1, 2019	Confirmed
IFRS 16 Leases	January 1, 2019	Confirmed
IFRIC 23 Uncertainty over Income Tax Treatments	January 1, 2019	Confirmed
Annual improvements 2015-2017	January 1, 2019	Not yet confirmed
IFRS 17 – Insurance Contracts	January 1, 2021	Not yet confirmed
Amendments to References to the Conceptual Framework in IFRS Standards	January 1, 2020	Not yet confirmed
Amendments to IFRS 3 Business Combinations	January 1, 2020	Not yet confirmed
Amendments to IAS 1 and IAS 8: Definition of Material	January 1, 2020	Not yet confirmed

Further, other standards and interpretations have been adopted which are not expected to have a material effect on the consolidated financial statements. With the exception of the following standard amendment which is explained in detail, HENSOLDT Group does not expect a material effect on its consolidated financial statements from the amendments of other standards.

IFRS 16 Leases

The core idea of the standard IFRS 16 Leases issued in January 2016 is that the lessee records all leases and related contractual rights and obligations in the statement of financial position. For all lease arrangements, the lessee recognizes a lease liability for the obligation to pay future lease payments. At the same time, the lessee recognizes a right of use to the underlying asset that generally corresponds to the present value of future lease payments plus directly attributable costs. IFRS 16 abolishes the current classification of leases on the part of the lessee into operating and finance leases.

IFRS 16 is to be applied to annual reporting periods beginning on or after January 1, 2019. The HENSOLDT Group will retrospectively apply the standard for the financial year beginning on January 1, 2019. The cumulative effect of the application of IFRS 16 will thus be stated as adjustment to the opening balance as of January 1, 2019, with no restatement of comparative information. HENSOLDT intends to largely make use of the exemptions in place according to IFRS 16.

It is currently expected that the conversion effect will largely affect the properties leased by the HENSOLDT Group. With the application of IFRS 16, straight-line expenses for operating leases are replaced by amortization/deprecations for right-of-use assets and interest expenses for lease liabilities. This results in a deterioration of cash flows from financing activities and an improvement of cash flows from operating activities. Based on the information currently available, the HENSOLDT Group estimates that it will report additional right-of-use assets of EUR 152 million as well as lease liabilities in the equivalent amount as of January 1, 2019.

By contrast, the rules of the new standard for the lessor are similar to the requirements of IAS 17. Leases are still classified either as finance or operating leases. Leases, for which all the risks and rewards of ownership are transferred, are classified as finance leases and all other lease agreements are classified as operating leases. For classification under IFRS 16 the criteria of IAS 17 were adopted.

II. Group structure

6. Consolidated group

The consolidated financial statements include the financial statements of HENSOLDT Holding GmbH and the financial statements of all direct and indirect significant subsidiaries controlled by HENSOLDT Holding GmbH. The group entities prepare their financial statements for the same reporting date as the Group's consolidated financial statements. 24 (PY: 21) entities were fully consolidated. One entity was included in the Group using the equity method. 10 companies were not consolidated. The shareholdings as of December 31, 2018, are listed in the following table.

Company	Registered office	Equity interest	Consolidation method
HENSOLDT Holding GmbH	Taufkirchen / Germany	100.00%	PC
EuroAvionics Holding GmbH ²	Pforzheim / Germany	100.00%	FC
EuroAvionics GmbH ^{2,5}	Pforzheim / Germany	100.00%	FC
EuroAvionics UK Ltd. ²	Slinfold, West Sussex / United Kingdom	100.00%	FC
EuroAvionics Schweiz AG ²	Sissach / Switzerland	100.00%	FC
EuroAvionics US HoldCo. Inc. ²	Sarasota (Florida) / USA	100.00%	FC
EuroAvionics USA LLC ²	Sarasota (Florida) / USA	100.00%	FC
GEW Integrated Systems (Pty) Ltd. ^{1,4}	Brummeria (Pretoria) / South Africa	75.00%	FC
GEW Technologies (Pty) Ltd. ^{1,4}	Brummeria (Pretoria) / South Africa	75.00%	FC
HENSOLDT Holding Germany GmbH	Taufkirchen / Germany	100.00%	FC
HENSOLDT Optronics (Pty) Ltd. ¹	Irene (Centurion) / South Africa	70.00%	FC
HENSOLDT Optronics GmbH ¹	Oberkochen / Germany	100.00%	FC
HENSOLDT Sensors GmbH ¹	Taufkirchen / Germany	100.00%	FC
KH Holdco Limited ³	Enfield / United Kingdom	100.00%	FC
KH Finance No.2 ³	Enfield / United Kingdom	100.00%	FC
KH Finance Ltd. ³	Enfield / United Kingdom	100.00%	FC
Kelvin Hughes Ltd. ³	Enfield / United Kingdom	100.00%	FC
Kelvin Hughes BV ³	Rotterdam / The Netherlands	100.00%	FC
A/S Kelvin Hughes ³	Ballerup / Denmark	100.00%	FC
Kelvin Hughes LLC ³	Alexandria (Virginia) / USA	100.00%	FC
Kelvin Hughes PTE Ltd. ³	Singapore / Singapore	100.00%	FC
HENSOLDT Holding France S.A.S.	Paris / France	100.00%	FC
HENSOLDT France S.A.S.	Paris / France	100.00%	FC
Kite Holding France S.A.S.	Paris / France	100.00%	FC
Hensoldt Cyber GmbH	Taufkirchen / Germany	51.00%	EQ
Atlas Optronics LLC ¹	Abu Dhabi / United Arab Emirates	49.00%	NC
Deutsche Elektronik Gesellschaft für Algerien (DEGFA) GmbH ¹	Ulm / Germany	66.66%	NC
EURO-ART Advanced Radar Technology GmbH ¹	Munich / Germany	25.00%	NC
EURO-ART International EWIV ¹	Munich / Germany	50.00%	NC
EUROMIDS S.A.S. ¹	Paris / France	25.00%	NC
LnZ Optronics Co., Ltd. ¹	Seoul / South Korea	50.00%	NC
Optronbras Segurança e Defesa Eletrônica e Optica Ltda	Belo Horizonte / Brazil	99.00%	NC
Société Commune Algérienne de Fabrication de Systèmes Electroniques (SCAFSE) SPA ¹	Sidi Bel Abbès / Algeria	48.99%	NC
HENSOLDT Inc. ¹	Wilmington (Delaware) / USA	100.00%	NC
HENSOLDT Private Ltd. ¹	Bangalore / India	100.00%	NC

PC = Parent Company

FC = Fully consolidated

¹ Orlando Group

² EuroAvionics Group

EQ = Accounted for using the equity method

NC = Not consolidated due to minor importance

³ Kelvin Hughes Group

⁴ 93.28% taking into account treasury shares

Pursuant to Section 264 (3) HGB, EuroAvionics GmbH, Pforzheim, is released from its obligation to issue annual financial statements pursuant to German commercial law and a management report pursuant to the regulations applicable to corporations, to have these audited and to disclose them.

7. Acquisitions

7.1. Acquisition of HENSOLDT France SAS

With effect from April 26, 2018, HENSOLDT Holding Germany GmbH by way of HENSOLDT Holding France SAS (previously Square Holding France SAS) acquired 100% of the shares in HENSOLDT France S.A.S. (previously Airbus DS Electronics and Border Security SAS) from Airbus Defence and Space SAS.

The former business segment of Airbus Group comprises IFF systems and datalink solutions for guide missiles and airborne mission systems.

This acquisition ensures HENSOLDT a presence in France and fosters the expansion of its product portfolio.

The consideration paid amounted to EUR 15 million. Acquisition-related costs amounted to EUR 0.3 million.

The carrying amounts or fair values of the identifiable assets at the date of acquisition were as follows:

EUR million	Book value	Fair value
Assets		
Intangible assets	0.2	9.4
Property, plant and equipment	0.6	0.6
Deferred tax assets	2.4	2.4
Inventories	11.0	13.5
Receivables and other assets	8.3	8.3
Total assets	22.5	34.2
Deferred taxes	0.0	-3.5
Liabilities	-23.9	-23.9
Total identifiable net assets	-1.4	6.8
Goodwill		8.2
Consideration transferred		15.0

The purchase price allocation resulted in other intangible assets of EUR 9 million and deferred tax liabilities of EUR 3 million. The other intangible assets consist of technology of EUR 7 million and order volumes of EUR 2 million.

The residual amount is goodwill in the amount of EUR 8 million. This mainly represents the expected future prospects from the market position of the acquired group.

On the date of transfer of control the acquired companies had no cash and cash equivalents and had gross amounts from trade receivables of EUR 6 million, of which KEUR 68 was estimated as probably irrecoverable.

Taking account of amortization from the purchase price allocation, HENSOLDT France has contributed a loss of EUR 3 million to total comprehensive income and EUR 15 million to Group revenue since the acquisition date (April 26, 2018).

If HENSOLDT France had been included in the scope of consolidation already as of January 1, 2018, management estimates that this would have resulted in an increase in

Group revenue for financial year 2018 of EUR 6 million and negative total comprehensive income taking account of amortization from the purchase price allocation in the amount of EUR 2 million.

7.2. Acquisition of PentaTec Elektronische Systeme GmbH

With effect from January 1, 2018, and retroactive effect from December 15, 2017, HENSOLDT Holding Germany GmbH acquired 100% of the shares in PentaTec Elektronische Systeme Gesellschaft mit beschränkter Haftung, Grasbrunn. The company complements the HENSOLDT product portfolio.

The carrying amounts or fair values of the identifiable assets at the date of acquisition were as follows:

EUR million	Book value	Fair value
Assets	0.2	0.2
Liabilities	-0.3	-0.3
Total identifiable net assets	-0.1	-0.1
Goodwill		1.6
Consideration transferred		1.5

The residual amount is goodwill in the amount of EUR 1.6 million. This mainly represents the expected future prospects from the market position of the acquired company.

On the date of transfer of control the acquiree had cash and cash equivalents of KEUR 95 and gross amounts from trade receivables of KEUR 18.

Acquisition-related costs of EUR 0.2 million were recognized as an expense under other expenses.

The Company was merged into the already fully consolidated HENSOLDT Sensors GmbH with retroactive effect from January 1, 2018.

7.3. Determination of fair values

The valuation methods used to determine the fair value of the significant assets acquired were as follows:

Acquired assets	Market approach and cost approach
Property, plant and equipment	The measurement model takes into account market prices for similar items, if available, and depreciated replacement cost, if applicable. Depreciated replacement costs reflect adjustments for physical deterioration as well as functional reconditioning and economic obsolescence.
Intangible assets	The relief from royalty method and multi-period excess earnings method: the relief from royalty method takes into account the discounted estimated royalty payments that are expected to be saved by patents and trademarks being kept in the Company's ownership. The multi-period excess earnings method takes into account the present value of the expected net cash flows generated by customer relationships, with the exception of all cash flows relating to the underlying assets.
Inventories	Market approach: the fair value is determined on the basis of the estimated sales price in the ordinary course of business less estimated production and selling costs as well as an appropriate profit margin based on the time and effort expended on producing and selling inventories.

If new information on the facts and circumstances that existed as of the acquisition date and that would have resulted in corrections of the above amounts or additional provisions become known within one year of the acquisition date, the accounting for the acquisition is adjusted.

8. Investments accounted for using the equity method

HENSOLDT Cyber GmbH, Taufkirchen, District of Munich, is a 51% joint venture founded in 2017 by HENSOLDT Holding Germany GmbH and Secure Elements GmbH, Munich. The equity of the company amounts to KEUR 25. On the part of HENSOLDT Holding Germany GmbH payments of KEUR 50 at end-2017 and an additional KEUR 2,150 in 2018 were made into the capital reserve. The valuation of the investment of KEUR 2,212 was reduced in 2018 by the pro-rated loss of KEUR 643.

The Company's purpose is the development, production, integration and sale of solutions in the areas hardware, software and services.

9. Transactions with related parties

In accordance with IAS 24, individuals or entities that control or are controlled by HENSOLDT Group must be disclosed unless they have already been included as consolidated entities in the consolidated financial statements. In addition, there is an obligation to disclose transactions with associates and persons who have significant influence over the operating and financial policies of the HENSOLDT Group. Significant influence here can mean a shareholding in HENSOLDT Holding of 20% or more, a position in management or on the Supervisory Board of HENSOLDT Holding or a key management position.

Related parties of HENSOLDT Holding GmbH are:

members of the **management** of HENSOLDT Holding GmbH:

- Thomas Müller, CEO
- Axel Albert Hans Salzmann, CFO
- Peter Fieser, CHRO

as well as other members of the **management team**:

- Peter Schlote, COO
- Sabine K. Hipp, Head of Sales & Marketing
- Celia Pelaz, Head of Spectrum Dominance & Airborne Solutions
- Uwe Virkus, Head of Electronic Warfare/Situational Awareness (until December 31, 2018)
- Erwin Paulus, Head of Radar / IFF / Data links
- Andreas Hülle, Head of Optronics
- Solms U. Wittig, General Counsel
- Thomas Stocker, Head of Engineering & CTO (from January 1, 2018)

as well as the **members of the Supervisory Board**:

- Johannes P. Huth, Chairman of the Supervisory Board
- Christian Ollig
- Philipp Freise (until March 22, 2018)
- Martin Mix (from March 22, 2018)
- Ingrid Jägering
- Prof. Dr. Burkhard Schwenker
- Prof. Wolfgang Ischinger
- Armin Maier-Junker, Chairman of the Works Council and the General Works Council of HENSOLDT Sensors GmbH, Deputy Chairman of the Supervisory Board
- Winfried Fetzer, Chairman of the Works Council, Chairman of the General Works Council of HENSOLDT Optronics GmbH
- Thomas Hoepfner, Chairman of the Works Council / Deputy Chairman of the General Works Council of HENSOLDT Sensors GmbH
- Peter Härtle, Chairman of the Company Spokesperson Committee of senior management
- Jürgen Bühl, Trade Union Secretary of the IGM Management Board
- Helene Sommer, Second Authorized Representative of IGM Friedrichshafen (until December 10, 2018)
- Julia Wahl, Union Secretary of IG Metall (from January 31, 2019)

The Company is under the majority control of the investment company KKR Square Aggregator L.P., Canada, and its subsidiaries, which is advised by the private equity company Kohlberg Kravis Roberts & Co. L.P. (KKR).

The company is under the majority control of Square Lux MidCo 1 & Co S.C.A., Luxembourg, which is controlled by the private equity company Kohlberg Kravis Roberts & Co. L.P. (KKR). This means HENSOLDT Holding GmbH's related parties include Square Lux MidCo 1 & Co S.C.A., Luxembourg, as indirect shareholder, Square Lux Holding II. S.à r.l, Luxembourg, as majority shareholder, and its affiliate company Square Lux Finco S.à r.l, Luxembourg. In addition, the companies engaged by KKR, i.e. KKR Capstone LLP, USA, KKR Capital Markets Ltd., London, UK, and KKR & Co. LP, USA, are treated as related parties.

Airbus Defence and Space GmbH (ADS GmbH) was non-controlling shareholder until June 30, 2018. ADS GmbH and the subsidiaries of Airbus SE were related parties until June 30, 2018.

HENSOLDT Pension Trust e.V. (including its subsidiaries) as pension fund of HENSOLDT Sensors GmbH is an additional related party.

Related party transactions:

KEUR	Jan.1 - Dec. 31, 2018	Jan.1 - Dec. 31, 2017
Revenue and other income		
Non-consolidated companies	0	117
Associates	37,763	31,720
Joint ventures	60,961	0
Other related parties (Airbus)	75,248	212,762
<i>(thereof ADS GmbH)</i>	33,499	98,252
Other related parties (miscellaneous)	0	1,448
Expenses		
Non-consolidated companies	1,106	0
Associates	1,083	777
Joint ventures	307	0
Other related parties (Airbus)	7,400	62,931
<i>(thereof ADS GmbH)</i>	4,520	39,285
Other related parties (miscellaneous)	34,830	4,143

KEUR	Dec. 31, 2018	Dec. 31, 2018
Receivables		
Non-consolidated companies	167	587
Associates	25,922	10,200
Joint ventures	52,079	0
Other related parties (Airbus)	0	125,846
<i>(thereof ADS GmbH)</i>	0	83,548
Other related parties (miscellaneous)	0	391
Liabilities		
Non-consolidated companies	902	0
Associates	1,030	1,502
Joint ventures	14,236	0
Other related parties (Airbus)	0	275,328
<i>(thereof ADS GmbH shareholder loan)</i>	0	109,810
<i>(thereof ADS GmbH)</i>	0	44,466
Other related parties (miscellaneous)	353,577	327,876
<i>(thereof Square Lux Finco S.à r.l. shareholder loans)</i>	349,567	327,664

Receivables from non-consolidated companies relate to trade receivables.

The companies engaged by KKR, i.e. KKR Capstone LLP, USA, KKR Capital Markets Ltd., London, UK, and KKR & Co. LP, USA, rendered services of KEUR 175 (PY: KEUR 13,195) in 2018.

As majority shareholder Square Lux Holding II. S.à r.l., Luxembourg, has a controlling influence on the Company. For the transfer of the shareholder loan described under 32.2 'Financial liabilities', interest expenses of KEUR 21,923 were recognized in favor of the shareholder in the financial year (PY: KEUR 18,572).

Further information regarding the **financing of pension plans** of the Group which are considered related parties are presented under note 28 'Pension benefits'.

Information on the compensation and benefits granted to members of the **management team** and the **Supervisory Board** are shown in note 29 'Remuneration'.

III. Group performance

Operating activities of the HENSOLDT Group only began in the prior year on February 28, 2017, with the acquisition of the 'Orlando' investments. In addition, considerable adjustment effects due to the modified retrospective application of IFRS 15 Revenue from Contracts with Customers are recorded in the financial year. This means comparability with prior year's figures is possible only to a limited extent.

10. Revenue, cost of sales, gross margin, contract assets and contract liabilities

Revenue

HENSOLDT generates revenue from contracts with customers for the development and production of products, the provision of installation, training and service performance and other services.

Revenue in the Sensors segment comprises Radar / Identification-Friend-or-Foe (IFF) / Datalink, Spectrum Dominance & Airborne Solutions and Customer Support. Revenue in the Optronics segment is mainly generated with optical and optronic products and systems for army, navy and air force and other public sector clients, such as aerospace agencies, and also police forces and border control.

KEUR	Sensors	Optronics	2018	Sensors	Optronics	2017
Revenue from contracts with customers						
Revenue from supplies	478,693	229,758	708,451	346,274	162,084	508,358
Revenue from services	382,478	19,235	401,713	358,414	51,426	409,840
	861,171	248,993	1,110,164	704,688	213,510	918,198
Other income						
Other revenue	677	-10	667	0	0	0
Exchange rate changes	-604	-110	-714	-2,371	1,266	-1,105
	73	-120	-47	-2,371	1,266	-1,105
Total	861,244	248,873	1,110,117	702,317	214,776	917,093
Point in time of revenue recognition				Sensors	Optronics	2018
Revenue recognition at a point in time				611,806	234,316	846,122
Revenue recognition over time				247,088	14,472	261,560
Other income				2,350	85	2,435
Total				861,244	248,873	1,110,117

Contract assets and contract liabilities

KEUR	Contract assets	Contract liabilities
Dec. 31, 2017	0	0
Adjustment to IFRS 15 as of Jan. 1, 2018	53,366	438,029
Jan. 1, 2018	53,366	438,029
Income recognized in the reporting period, which was included in the balance of contract liabilities at the beginning of the period	0	-266,580
Increases due to cash received, except for amounts which were recognized as revenue during the reporting period	0	173,770
Reclassifications from contract assets, which were recognized at the beginning of the period, to receivables	-11,919	0
Increases due to changes in the determination of stage of completion	32,776	0
Changes in the estimate of the transaction price or contract modification	0	288
Changes due to business combinations	6,443	11,256
Other	22	804
Dec. 31, 2018	80,688	357,567
thereof current	80,688	332,800
thereof non-current	0	24,767
Dec. 31, 2018	80,688	357,567

Revenue from performance obligations, which had been (partially) fulfilled in prior periods, in the amount of KEUR 1,158 was recognized in the reporting period.

Transaction price for remaining performance obligations

As of December 31, 2018, the total amount of the transaction price for the remaining performance obligations amounted to EUR 2,261 million. Management expects that 42% of this transaction price will be recognized as revenue in the next reporting period and an additional 30% in financial year 2020. The remaining 29% will be recognized in financial year 2021 and following years.

Capitalized costs which arise in the course of obtaining or fulfilling the contract (see 24 Other assets)

KEUR	
Dec. 31, 2017	0
Adjustment to IFRS 15 as of Jan. 1, 2018	15,319
Jan. 1, 2018	15,319
Additions	20,062
Amortization	-31,173
Dec. 31, 2018	4,208

HENSOLDT makes use of the practical expedient of IFRS 15.94 and waives capitalizing the costs arising in the course of obtaining the contract, which fulfil the recognition criteria of IFRS 15 but would nevertheless be written-off within one year.

Cost of sales and gross margin

Cost of sales includes amortization from adjustments to the fair values of assets as part of the purchase price allocations of KEUR 93,070 (PY: KEUR 126,201).

Impairment losses on trade receivables of KEUR 5,898 (PY: income from the reversal of KEUR 197) are shown separately from this reporting year.

Inventories recognized as an expense in the reporting period amounted to KEUR 246,085 (PY: KEUR 352,957), in each case excluding amortization from the purchase price allocation).

11. Research and development expenses

Research and development expenses amounted to KEUR 32,178 (PY: KEUR 29,767). For the capitalization of development costs, please refer to Section 15 'Intangible assets'.

12. Other operating income and expenses

Other operating income

KEUR	2018	2017
Recharged services	30,794	19,193
Other	1,930	4,197
Other operating income	32,724	23,390

Other operating income relates mainly to recharged building services including the modernization project of building 88 in Taufkirchen, IT services and supply of temporary employees.

Other operating expenses

KEUR	2018	2017
Recharged costs	32,772	17,709
Other	3,471	1,395
Other operating expenses	36,243	19,104

13. Finance income/costs

KEUR	2018	2017
Interest income from plan assets	1,309	2,281
Other interest income	12,595	10,089
Other	951	0
Interest income	14,855	12,369
Interest expense for shareholder loans and other financial liabilities		
Loan (Term Loan)	-54,129	-20,262
Revolving Credit Facility	-2,207	-657
Shareholder loan (Airbus Defense and Space GmbH)	-3,638	-6,123
Shareholder loan (Square Lux Finco S.à r.l.)	-21,923	-18,572
Interest expense from swap	-6,741	-4,167
Interest expenses on provisions for employee benefits	-6,829	-4,852
Other	-958	-896
Interest expense	-96,425	-55,528
Bank fees	-1,524	-7,436
Foreign currency translation monetary items	-3,064	744
Other	-687	-3,520
Other finance income/costs	-5,275	-10,212

14. Income tax

Income taxes are broken down as follows:

KEUR	2018	2017
Current tax expense (expenses - / income +)	-7,997	-2,339
<i>(of which income tax attributable to the prior year)</i>	<i>-1,125</i>	<i>253</i>
Deferred taxes (expense - / income +)	13,202	24,349
<i>(thereof changes in temporary differences)</i>	<i>8,166</i>	<i>18,380</i>
Recognized tax (expense - / income +)	5,205	22,010
Deferred tax expense recognized directly in equity (PY: tax income)	-5,326	7,903

At German companies, a corporation tax rate of 15% was used for the calculation of deferred taxes. In addition, a solidarity surcharge of 5.5% on corporation tax and a trade tax rate of 12.48% were taken into account. This resulted in an overall tax rate of 28.30% for German companies. At international group companies, the respective country-specific tax rates were used for the calculation of current and deferred taxes.

The following table presents the reconciliation of expected tax expense and reported tax expense. Expected tax expense is determined by multiplying consolidated profit before tax from continuing operations by the total tax rate of 28.30% applicable in 2018:

KEUR	2018	2017
Earnings before income tax (profit + / loss -)	-65,085	-122,430
<i>Income tax rate</i>	<i>28.30%</i>	<i>28.30%</i>
Expected income taxes on this (expense - / income +)	18,419	34,648
Effects deriving from differences to the expected tax rate	-365	-261
Change in the tax rate and tax laws	-524	50
Taxes for prior years	2,681	436
Non-deductible interest expenses	-1,957	-1,503
Other non-deductible expenses and taxes as well as effects from change f	3,567	-385
Tax-exempt income	0	1,539
Changes in the realization of deferred tax assets	-15,917	-12,213
Other	-699	-301
Income tax as per income statement (expense - / income +)	5,205	22,010
<i>Effective tax rate in %</i>	<i>8.00%</i>	<i>17.98%</i>

Deferred tax assets and liabilities are recognized in accordance with IAS 12 Income Taxes if future tax effects are to be expected that are due to temporary differences between the carrying amounts of existing assets and liabilities and their tax bases, on the one hand, or due to loss carryforwards on the other. Deferred tax assets and liabilities from valuation differences in items of the statement of financial position break down as follows:

KEUR	Dec. 31, 2018	Dec. 31, 2017
Deferred tax assets		
Assets		
Intangible assets	796	6
Property, plant and equipment	306	176
Financial assets	5,757	6,527
Inventories and contract assets	54,243	28,996
Receivables and other assets	7,727	1,312
Liabilities		
Provisions	66,053	53,394
Liabilities	26,777	4,604
Loss carryforwards	39,983	35,234
Tax credits	2,548	2,260
Other	2,939	248
Deferred tax assets (gross)	207,129	132,757
Netting	-182,094	-118,369
Deferred tax assets (net)	25,035	14,388

KEUR	Dec. 31, 2018	Dec. 31, 2017
Deferred tax liabilities		
Assets		
Intangible assets	88,568	94,588
Property, plant and equipment	1,640	1,726
Financial assets	0	2,489
Inventories and contract assets	67,572	41,168
Receivables and other assets	4,480	8,968
Liabilities		
Provisions	36,467	8,482
Liabilities	20,247	6,231
Other	125	61
Deferred tax liabilities (gross)	219,099	163,713
Netting	-182,094	-118,369
Deferred tax liabilities (net)	37,005	45,344
Excess of deferred tax liabilities	11,970	30,956

The change in the amount of deferred taxation includes an increase in deferred tax assets in the amount of KEUR 12,121 due to adjustments resulting from IFRS 9 and IFRS 15.

The assessment of impairment of deferred tax assets depends on the management's estimate of the utilization of the deferred tax assets. This is dependent on taxable profits in the periods when the tax measurement differences are reversed and the tax loss carryforwards can be utilized.

As of December 31, 2018, there were no deferred tax liabilities for taxes on profits not transferred from subsidiaries. The Group assumes that for the time being the profits of its subsidiaries not yet distributed will not be distributed in the foreseeable future. Temporary differences in connection with investments in subsidiaries for which no deferred tax liabilities have been recognized totaled KEUR 539 (PY: KEUR 1,321). As of December 31, 2018, there were the following loss and interest carryforwards (gross):

KEUR	Dec. 31, 2018	Dec. 31, 2017
Corporation tax loss carryforwards	147,430	131,477
Trade tax loss carryforwards	146,863	129,693
Interest carry forwards	109,142	48,570
Tax credits	2,548	2,260

As of December 31, 2018, the Company reported loss carryforwards that are subject to restrictions on loss offsetting. For this reason, no deferred tax assets were recognized for the following matters as their use through future positive taxable earnings is not likely (gross amounts):

KEUR	Dec. 31, 2018	Dec. 31, 2017
Corporation tax loss carryforwards	8,459	8,058
Trade tax loss carryforwards	8,058	8,058
Interest carry forwards	109,142	48,570

The tax loss carryforwards for which no deferred tax assets were recognized are not subject to any limitations on use.

IV. Operating assets and liabilities

15. Intangible assets

Intangible assets comprise (i) goodwill (see note 6 'Scope of consolidation'), (ii) capitalized development costs (see note 2 'Significant accounting policies'), and (iii) other intangible assets, mainly acquired intangible assets.

Intangible assets (excluding goodwill) comprise the following as of December 31, 2018 and as of December 31, 2017:

KEUR	Licenses, patents and other rights	Other intangible assets	Capitalized development costs	Customer relationship, technology, order backlog, brand	Construction in progress	Total
COST						
As of Jan. 1, 2017	0	0	0	0	0	0
Purchase by company acquisition	3,780	0	4,931	496,582	189	505,482
Additions	1,101	0	19,942	0	2,163	23,206
Disposals	-1,395	0	0	0	0	-1,395
Reclassifications	281	0	0	0	-25	257
Currency translation	-2	0	17	0	0	15
As of Dec. 31, 2017	3,766	0	24,890	496,582	2,327	527,565
Purchase by company acquisition	0	169	0	9,168	0	9,337
Additions	1,663	113	36,575	0	879	39,230
Reclassifications	98	0	0	0	-71	27
Currency translation	1	0	-546	0	0	-545
As of Dec. 31, 2018	5,528	282	60,919	505,750	3,135	575,614
ACCUMULATED AMORTIZATION, DEPRECIATION AND WRITE-DOWNS						
As of Jan. 1, 2017	0	0	0	0	0	0
Additions	-1,338	0	-4,660	-69,416	0	-75,414
Disposals	814	0	0	0	0	814
Currency translation	0	0	5	0	0	5
As of Dec. 31, 2017	-524	0	-4,655	-69,416	0	-74,596
Additions	-2,103	-134	-10,170	-89,886	0	-102,292
Currency translation	0	0	55	0	0	55
As of Dec. 31, 2018	-2,627	-134	-14,770	-159,302	0	-176,833
CARRYING AMOUNT						
As of Dec. 31, 2017	3,242	0	20,235	427,165	2,327	452,970
As of Dec. 31, 2018	2,901	148	46,149	346,448	3,135	398,781

Development costs

The Group capitalized development costs in financial year 2018 of KEUR 36,575 (PY: KEUR 19,942) as internally generated intangible assets, primarily for development of various radar and sensor technologies (ASR, TRS-4D, Passive Radar, AMPS).

The impairment test resulted in a need to recognize impairment losses in the amount of KEUR 3,357 (PY: KEUR 0) for one project.

Goodwill

Goodwill developed as follows:

COST	EUR million
As of Jan. 1, 2017	0
Additions Orlando	471
Additions EuroAvionics	84
Additions Kelvin Hughes	29
As of Dec. 31, 2017	584
Additions PentaTec GmbH	2
Additions HENSOLDT France SAS	8
As of Dec. 31, 2018	594
ACCUMULATED AMORTIZATION, DEPRECIATION AND WRITE-DOWNS	EUR million
As of Jan. 1, 2017	0
As of Dec. 31, 2017	0
As of Dec. 31, 2018	0
CARRYING AMOUNT	EUR million
As of Dec. 31, 2017	584
As of Dec. 31, 2018	594

As of December 31, goodwill was allocated to CGUs or a group of CGUs, which are summarized here:

EUR million	Sensors	Optronics	Total
Goodwill as of Jan 1, 2017	0	0	0
Additions Orlando	388	83	471
Additions EuroAvionics	84	0	84
Additions Kelvin Hughes	29	0	29
As of Dec. 31, 2017	501	83	584
Additions PentaTec GmbH	2	0	2
Additions HENSOLDT France SAS	8	0	8
As of Dec. 31, 2018	511	83	594

General assumptions applied in the planning process

The basis for determining the recoverable amount is the value in use of the GCU. In general, the cash flow forecasts applied in the Group's impairment testing are based on the operational business plan. The operational planning used for impairment testing includes a detailed planning horizon of three years and is extrapolated for two more years. This is based on the following assumptions:

Assumptions in %	Dec. 31, 2018		Dec. 31, 2017	
	Sensors	Optronics	Sensors	Optronics
Discount rate (post-tax)	6.02%	6.02%	5.89%	5.89%
Sustainable growth rate	1.00%	1.00%	1.00%	1.00%
Projected sustainable EBIT margin	12.20%	12.20%	12.50%	11.50%

Based on the market position, management assumes further revenue growth of between 10% and 14%, and possible above this in the best case scenario. An increase in EBIT for 2019 is expected due to efficiency and cost saving measures.

Besides the macroeconomic developments described above, the forecast is based on the Group's multi-year business plan. The business plan from Q3/Q4 2018 includes in particular a projected US dollar rate of USD 1.28/EUR 1.00 (based on forecasts from Bloomberg/Thomson Reuters) and an inflation rate and an increase in personnel expenses of an average 2%.

Cash flows beyond a period of five years are extrapolated using a growth rate of 1%.

16. Property, plant and equipment

Property, plant and equipment are measured at cost less accumulated depreciation and impairment losses. Property, plant and equipment are depreciated on a straight-line basis. The following useful lives have been assumed:

Buildings	between 5 and 50 years
Technical equipment and machinery	between 4 and 10 years
Other equipment, operating and office equipment	between 3 and 13 years

Property, plant, and equipment as of December 31, consisted of the following:

KEUR COST	Land, improvements and buildings, including buildings on third-party land	Technical equipment and machinery	Other equipment, operating and office equipment	Construction in progress	Total
As of Jan. 1, 2017	0	0	0	0	0
Acquisition through business combinations	5,722	57,333	18,356	10,655	92,065
Additions	376	5,791	3,271	6,633	16,071
Disposals	0	-1,277	-359	0	-1,636
Reclassifications	0	101	0	-357	-257
Currency translation	-163	-454	-97	-9	-724
As of Dec. 31, 2017	5,935	61,492	21,171	16,921	105,519
Acquisition through business combinations	0	351	272	0	623
Additions	224	6,878	5,652	8,101	20,855
Disposals	-132	-4,274	-2,031	0	-6,437
Reclassifications	2,929	5,438	1,228	-9,622	-27
Currency translation	-211	-866	-183	-17	-1,277
As of Dec. 31, 2018	8,745	69,019	26,109	15,383	119,256
ACCUMULATED AMORTIZATION, DEPRECIATION AND WRITE-DOWNS					
As of Jan. 1, 2017	0	0	0	0	0
Additions	-144	-11,296	-4,024	0	-15,463
Disposals	0	1,273	99	0	1,372
Reclassifications	0	0	0	0	0
Currency translation	0	-22	-5	0	-26
As of Dec. 31, 2017	-143	-10,045	-3,929	0	-14,117
Additions	-450	-14,626	-7,046	0	-22,122
Disposals	98	3,847	1,923	0	5,868
Reclassifications	0	0	0	0	0
Currency translation	4	235	56	0	295
As of Dec. 31, 2018	-491	-20,589	-8,996	0	-30,076
CARRYING AMOUNT					
As of Dec. 31, 2017	5,792	51,448	17,242	16,921	91,402
As of Dec. 31, 2018	8,254	48,430	17,113	15,383	89,180

17. Other investments and other non-current financial assets

KEUR	Dec. 31, 2018	Dec. 31, 2017
Other investments	11,128	4,956
Other non-current financial assets	219	187
Other investments and other non-current financial assets	11,347	5,143
Other non-current financial assets, due at short-notice	5,269	41,314
Total	16,616	46,457

Other investments relate mainly to the investment in Deutsche Elektronik Gesellschaft für Algerien mbH of KEUR 9,284 (PY: KEUR 3,110).

Interests in other non-current financial assets due at short notice mainly include loans to ADS GmbH.

18. Inventories

KEUR	Gross amount	Impairment	Dec. 31, 2018 Net carrying amount	Dec. 31, 2017 Net carrying amount
Raw materials and supplies	181,357	-41,448	139,909	135,686
Work in process	268,577	-29,111	239,466	230,187
Finished goods and parts for resale	41,067	-13,440	27,627	20,783
Total	491,001	-83,999	407,002	386,656

The amounts relating to impairments recognized in profit or loss in the financial year equal KEUR 1,121 (PY: KEUR 3,586). No significant reversal of impairment losses were recognized as reduction in the cost of materials in the financial year.

19. Trade receivables

Trade receivables

KEUR	Dec. 31, 2018	Dec. 31, 2017
Receivables from the sale of goods and services	347,957	347,767
Allowance for doubtful receivables	-9,885	-2,741
Total	338,072	345,026

The allowance for doubtful accounts in relation to trade receivables developed as follows over the course of the year:

KEUR	2018	2017
As of Dec. 31	2,741	0
Adjustments from the initial application of IFRS 9	1,180	0
As of Jan. 1	3,921	0
Acquisition through business combinations	68	2,941
Addition	5,975	832
Utilized	-2	-4
Reversal	-77	-1,028
As of Dec. 31	9,885	2,741

The credit and market risks as well as impairment losses are presented in Section 33. 'Information on financial instruments'.

Contract assets and liabilities are presented in Section 10. Revenue, cost of sales, gross margin, contract assets and contract liabilities.

20. Trade payables

As in the prior year, all trade payables as of December 31, 2018, fall due within one year.

21. Provisions

The measurement of provisions, e.g. for contract losses, warranties and court proceedings, is based on best available estimates.

KEUR	Dec. 31, 2018	Dec. 31, 2017
Pension provisions (note 28)	266,093	258,956
Other provisions	255,079	345,314
Total	521,172	604,271
thereof non-current portion	310,272	294,069
thereof current portion	210,900	310,201

Other provisions developed as follows over the course of the year:

KEUR	Warranties	Personnel- related provisions (note 27)	Contract losses	Outstandin g costs	Other risks and costs	Total
Jan. 1, 2018	53,766	49,540	4,665	211,277	26,066	345,314
IFRS 15 adjustment	1,068	0	0	-105,229	11,022	-93,139
Utilized	-11,096	-27,754	-913	-98,474	-8,937	-147,174
Reversal	-6,364	-5,339	-4,187	-3,693	-16,912	-36,495
Additions	52,692	30,346	2,935	28,113	69,084	183,169
Effect of movements in exchange rates	-396	-77	0	-1,466	-115	-2,054
Unwinding of discount	-226	0	0	0	-22	-248
Assumption through business combinations	14	326	3,442	0	4	3,786
Reclassifications	0	2,129	-4,665	0	4,455	1,919
Dec. 31, 2018	89,458	49,171	1,277	30,528	84,645	255,079

Other provisions developed as follows in the prior year:

KEUR	Warranties	Personnel-related provisions (note 27)	Contract losses	Outstanding costs	Other risks and costs	Total
Jan. 1, 2017	0	0	0	0	5	5
Utilized	-7,913	-24,354	0	-96,379	-2,465	-131,111
Reversal	-1,757	-4,514	-1,291	-29,075	-7,352	-43,988
Additions	22,678	25,102	3,045	137,417	8,417	196,659
Effect of movements in exchange rates	-277	-41	0	-466	-109	-893
Unwinding of discount	-18	-2	0	0	0	-20
Assumption through business combinations	41,131	51,731	3,127	199,781	27,569	323,339
Reclassifications	-78	1,617	-216	0	0	1,323
Dec. 31, .2017	53,766	49,540	4,665	211,277	26,066	345,314

Provisions for outstanding costs relate mainly to deferrals for supplies not yet invoiced and outstanding own services under long-term construction contracts.

The provisions for other risks and costs relate to contract-related provisions for subsequent work for performance obligations already fulfilled.

Breakdown of other provisions by term:

KEUR	Dec. 31, 2018			Dec. 31, 2017		Total
	current	non-current	Total	current	non-current	
Warranties	55,631	33,827	89,458	33,413	20,353	53,766
Personnel-related provisions	31,127	18,043	49,170	28,467	21,073	49,540
Contract losses	1,277	0	1,277	2,157	2,508	4,665
Outstanding costs	30,530	0	30,530	211,277	0	211,277
Other risks and costs	66,544	18,100	84,644	13,433	12,633	26,066
Total	185,109	69,970	255,079	288,746	56,567	345,314

For the non-current provisions of the Company, it is generally assumed that they will lead to cash outflows in the next 2 to 5 years.

Legal disputes and damage claims

Legal disputes and damage claims include various proceedings, official investigations and proceedings as well as damage claims that are pending or will be initiated or claimed against the Group in the future. These proceedings are subject to much uncertainty and the result of individual issues cannot be reliably predicted. The Group believes that it has recognized adequate provisions to cover current or potential litigation risks. It is quite possible that the final ruling in some cases could lead to expenses beyond those accounted for in the recognized provisions. These cases can drag on for a long time and an amount cannot be reliably estimated. The term 'quite possible' used here means that the chance of a future transaction or future occurrence of an event is more than unlikely, however less than likely.

Within the scope of its ordinary business operations, the HENSOLDT Group is involved in different court and arbitration proceedings from time to time. The HENSOLDT Group is not currently aware of any official, judicial or arbitration proceedings (including pending and threatened proceedings) during the previous twelve months or longer that could significantly impact or significantly impacted on the Group's assets, liabilities, financial position and financial performance. As of the reporting date provisions for legal disputes and damage claims of a negligible amount were recognized under other provision for other risks and costs.

22. Contingent assets and contingent liabilities

Due to the type of its transactions, the HENSOLDT Group is exposed to the risk of contingent liabilities. The following tables shows the undiscounted maximum amounts for which HENSOLDT Group is liable as of the reporting date due to the type of guarantees (including sureties):

KEUR	Dec. 31, 2018	Dec. 31, 2017
Loan guarantees / sureties	28,373	36,955
Contractual guarantees / sureties	269,470	146,855
Other guarantees and sureties	35,912	32,399
Total	333,755	216,209

The item loan guarantees/sureties shows to what extent the HENSOLDT Group is liable for financial obligations of third parties. For loan guarantees/sureties the Company guarantees in general that if the principal debtor does not pay the debt then the Company will fulfill its financial obligations. The maximum liability coverage corresponds to utilization of the outstanding liability of the credit or – in the event of credit facilities that can be utilized in variable amounts – the maximum amount that can be claimed. The table includes the maximum liability coverage. The terms of these guarantees/sureties extend up to 2 years.

In addition, HENSOLDT Group guarantees the fulfillment of its own contractual obligations, mainly due to advance payments and performance guarantees/sureties. If the HENSOLDT Group does not meet its contractual obligations, the HENSOLDT Group or one of its subsidiaries can claim up to an agreed maximum amount. Generally the terms of these contingent liabilities run to 8 years or in some cases there are indefinite guarantees/sureties.

The other guarantees and sureties relate to bid bonds, performance guarantees, customs guarantees and rental guarantees.

23. Other financial assets and other financial liabilities

23.1. Other financial assets

KEUR	Dec. 31, 2018	Dec. 31, 2017
Positive fair values of derivative financial instruments ⁽¹⁾	723	18,892
Miscellaneous other non-current financial assets	12	12
Total other non-current financial assets	735	18,904
Positive fair values of derivative financial instruments ⁽¹⁾	1,017	10,294
Receivables from employees	312	509
Miscellaneous other current financial assets	131	507
Total other current financial assets	1,460	11,310
Total	2,195	30,214

(1) See note 33 'Information on financial instruments'

23.2. Other financial liabilities

KEUR	Dec. 31, 2018	Dec. 31, 2017
Liabilities for derivative financial instruments ⁽¹⁾	3,355	0
Liability from put options	1,206	972
Miscellaneous other non-current financial liabilities	0	11
Total other non-current financial liabilities	4,561	983
Liabilities for derivative financial instruments ⁽¹⁾	13,299	5,251
Liabilities to related parties	0	12,380
Other	0	419
Total other current financial liabilities	13,299	18,050
Total	17,860	19,033

(1) See note 33 'Information on financial instruments'

Other current financial liabilities as of December 31, 2017, of KEUR 12,380 relate to a liability to ADS GmbH.

24. Other assets and liabilities

24.1. Other assets

KEUR	Dec. 31, 2018	Dec. 31, 2017
Capitalized costs to fulfil contracts	4,208	-
Other	4,917	3,145
Total other non-current assets	9,125	3,145
Advance payments	8,112	4,191
Retentions	2,954	3,673
Creditors with debit balances	966	1,687
VAT	7,159	5,223
Miscellaneous other current assets	2,231	1,690
Total other current assets	21,422	16,464
Total	30,547	19,610

24.2. Other liabilities

KEUR	Dec. 31, 2018	Dec. 31, 2017
Advances received ⁽¹⁾	0	18,436
Other	3,399	2,682
Total other non-current liabilities	3,399	21,118
Advances received ⁽¹⁾	0	203,703
Tax liabilities (not incl. income tax)	25,234	10,494
Liabilities to employees	18,529	20,948
Other	12,531	5,609
Total other current liabilities	56,294	240,754
Total	59,693	261,872

⁽¹⁾ From 2018 advances received are recognized under contract liabilities due to IFRS 15

V. Expenses and employee benefits

25. Headcount

	2018	2017
Production, research and development, service	3,423	3,152
Sales and distribution	108	89
Administration and general services	475	435
Apprentices, trainees, etc.	365	373
Total¹	4,371	4,049

⁽¹⁾ Average figures (end quarter)

Due to start of the Group's operating activities on March 1, 2017, the average was calculated over a period of 10 months in the prior year.

26. Personnel expenses

KEUR	2018	2017
Wages, salaries	347,083	258,613
Social security contributions	47,847	39,572
Net periodic employee benefit expenses	22,163	16,181
Total	417,093	314,367

The prior-year figures comprise the period of operating activities from March 1 to December 31, 2017.

27. Personnel-related provisions

Several German group entities offer models for life-time working accounts, which represent defined benefit plans due to a pledged interest on contributions or nominal contributions and are to be classified as post-employment benefits in accordance with IAS 19. The obligations of KEUR 14,473 (PY: KEUR 13,765) are fully offset against corresponding assets. The regular contributions of employees to their life-time working accounts lead to a corresponding personnel expense in the reporting period which is recognized in personnel expenses.

Personnel-related provisions developed as follows:

KEUR	Long service awards/ bonuses	Partial retirement	Other personnel expenses	Total
Jan. 1, 2018	44,547	3,457	1,536	49,540
Utilized	-24,932	-2,557	-265	-27,754
Reversal	-4,610	-729	0	-5,339
Additions	30,271	75	0	30,346
Effect of movements in exchange rates	-77	0	0	-77
Assumption through business combinations	326	0	0	326
Reclassifications	0	2,129	0	2,129
Dec. 31, 2018	45,525	2,375	1,271	49,171

KEUR	Long service awards/ bonuses	Partial retirement	Other personnel expenses	Total
Jan. 1, 2017	0	0	0	0
Utilized	-19,804	-4,550	0	-24,354
Reversal	-3,764	0	-750	-4,513
Additions	23,223	1,879	0	25,102
rates	-41	0	0	-41
Assumption through business combinations	45,089	4,354	2,288	51,731
Unwinding of discount	0	0	-2	-2
Reclassifications	-157	1,774	0	1,617
Dec. 31, 2017	44,547	3,457	1,536	49,540

28. Pension benefits

KEUR	Dec. 31, 2018	Dec. 31, 2017
Provisions for employee benefits (see note 28.1)	164,281	172,203
Provisions for deferred compensation (see note 28.2)	101,812	86,753
Total	266,093	258,956

28.1. Provisions for pension plans

Provision for pension plans

Provisions for German pension obligations (defined benefit obligations or 'DBO') are recognized on the basis of defined benefit plans for old-age, invalidity and survivor's pension benefits. The benefits are based on the employee's length of service and remuneration.

Most domestic employees are under the 'P3 Plan', which allows a choice between immediate payment of the credit saved, payment in installments or an annuity.

To finance domestic pension obligations, the Group introduced several contractual trust arrangements or 'CTA'. The structure of the contractual trust arrangement is based on mutual trust agreements. Assets transferred to the contractual trust arrangement are considered plan assets under IAS 19.

In terms of the significant accounting policies and significant estimates and assessments, e.g. actuarial assumptions, please refer to the note 2.6 'Employee benefits' and note 3.6 'Employee benefits'.

Changes in the defined benefit obligation and plan assets

KEUR	DBO		Plan assets		Total	
	2018	2017	2018	2017	2018	2017
As of Jan. 1	320,018	0	147,815	0	172,203	0
Assumption due to business combinations	1,151	279,754	0	143,209	1,151	136,545
Expenses for pension benefit entitlements	16,468	11,322	0	0	16,468	11,322
Interest expense/income	5,185	3,898	1,125	2,124	4,060	1,774
Payments	-1,977	-615	0	0	-1,977	-615
Actuarial gains/losses deriving from						
■ Changes in demographic assumptions	-908	16,801	0	0	-908	16,801
■ Changes in financial assumptions	-16,061	-3,193	0	0	-16,061	-3,193
■ Adjustments based on experience	7,444	13,788	0	0	7,444	13,788
■ Plan assets	0	0	16,483	2,482	-16,483	-2,482
Other changes in consolidation, transfers	-1,039	-568	578	0	-1,617	-568
Benefits paid	0	-1,169	0	0	0	-1,169
As of Dec. 31	330,282	320,018	166,001	147,815	164,281	172,203

As of December 31, the defined benefit obligation or the assets amounted to:

KEUR	Pension plans Germany	
	2018	2017
Defined benefit obligation	330,282	320,018
Plan assets	-166,001	-147,815
Total	164,281	172,203

The weighted average duration of the defined benefit obligation for pensions and deferred compensation is 15 years.

The breakdown of the defined benefit obligation for pension and deferred compensation between active, former and retired members for the most important plans is as follows:

	2018	2017
Assets	82%	90%
Eligible employees	6%	4%
Pensioner	12%	6%
	100%	100%

The expected employer's contribution to defined benefit plans for the 2019 financial year amounts to KEUR 15,410.

The following table shows how the present value of defined benefit obligations of pension plans and deferred compensation would be impacted by changes to actuarial assumptions as of December 31, 2018:

KEUR	Change in actuarial assumptions	Effect on defined benefit obligations			
		as of December 31, 2018		as of December 31, 2017	
		Increase	Decline	Increase	Decline
Present value of obligation					
Discount rate	by 0.5 percentage points	-29,939	33,879	-29,162	33,122
Wage increase rate	by 0.25 percentage point	1,025	-997	1,235	-1,201
Pension increase rate	by 0.25 percentage point	4,580	-4,355	4,097	-3,890
Life expectancy	by 1 year	5,781	-5,892	5,131	-5,199
Exercising of pension option	by 10 percentage points	19,824	-19,824	21,338	-21,338

Sensitivities are calculated using the same method (present value of the defined benefit obligation calculated using the projected unit credit method) as used for the calculation of post-employment benefits. The sensitivity analysis is based on a change of one assumption maintaining all other assumptions unchanged. This is very unlikely to occur in practice. Changes to more than one assumption can correlate which can have differing effects on the DBO as described above. If the assumptions change to various degrees, the effects on the defined benefit obligation are not necessarily linear.

Asset-liability matching strategy

The HENSOLDT Group identified the deterioration in the financing status due to the unfavorable development of plan assets and/or the defined benefits obligations as a result of changing parameters as a main risk.

For this reason, the HENSOLDT Group implements a risk management plan that is aligned with the defined benefits obligations.

The fair value of the plan assets for pensions and deferred compensation can be allocated to the following classes:

KEUR	Quoted prices		Unquoted prices		Total	
	2018	2017	2018	2017	2018	2017
Other investments	0	0	133,338	113,826	133,338	113,826
Pooled investment instruments	46,681	47,941	0	0	46,681	47,941
Total	46,681	47,941	133,338	113,826	180,019	161,766

Other investments relate to limited partnership interests in HENSOLDT Real Estate GmbH & Co. KG.

The employer's contribution to state and private pension funds in Germany is considered a defined contribution obligation. The contributions in 2018 amounted to KEUR 21,216 (PY: KEUR 18,046).

28.2. Provisions for deferred compensation

This amount represents obligations that arise when employees convert a part of their remuneration or bonus to an equivalent entitlement for deferred compensation, which is treated as a defined benefit plan upon termination of employment. The development of DBO and plan assets is as follows:

KEUR	DBO		Plan assets		Total	
	2018	2017	2018	2017	2018	2017
As of Jan. 1	100,705	0	13,952	0	86,753	0
Assumption due to business combinations	0	89,816	0	10,911	0	78,905
Expenses for pension benefit entitlements	5,218	4,189	0	0	5,218	4,189
Interest expense/income	1,644	954	184	157	1,460	797
Payments	-571	-204	384	0	-955	-204
Actuarial gains/losses deriving from						
■ Changes in demographic assumptions	-108	0	0	0	-108	0
■ Changes in financial assumptions	-3,710	-68	0	0	-3,710	-68
■ Adjustments based on experience	4,953	-1,648	0	0	4,953	-1,648
■ Plan assets	0	0	-530	-244	530	244
Other changes in consolidation, transfers	7,699	-28	0	0	7,699	-28
Benefits paid	0	-76	0	0	0	-76
Contributions	0	7,770	28	3,128	-28	4,642
As of Dec. 31	115,830	100,705	14,018	13,952	101,812	86,753

As of December 31, reported as:

KEUR	Deferred compensation	
	2018	2017
Defined benefit obligation	115,830	100,705
Plan assets	-14,018	-13,952
As of Dec. 31	101,812	86,753

29. Compensation

Employees in key positions in the Group include members of the management team including the management of HENSOLDT Holding GmbH and members of the Supervisory Board.

29.1. Compensation – Management team

KEUR	2018	2017
Salaries and other short-term benefits (including bonuses)	5,590	4,263
Termination benefits	352	0
Total	5,942	4,263

The amounts shown in the table were reported as an expense in the reporting period:

Remuneration of members of management is not disclosed pursuant to the protective clause of Section 314 (3) in conjunction with Section 286 (4) HGB.

29.2. Compensation – Supervisory Board

The currently applicable compensation policy for the Supervisory Board was adopted by the Annual General Meeting on May 24, 2017.

Each member of the Supervisory Board receives an annual base salary of EUR 40,000, each member of a standing committee receives additional annual compensation of EUR 10,000, irrespective of the number of committees.

If a Supervisory Board member is not employed for the full financial year, they receive a proportionate share of the compensation.

Remuneration of Supervisory Board members amounted to KEUR 540 for the financial year (PY: KEUR 400).

29.3. Management participation

Key management personnel and other senior staff and governing body members of the HENSOLDT Group (collectively referred to as 'participants') can indirectly invest (in each case a 'management participation') in HENSOLDT Holding GmbH by indirectly acquiring ordinary shares and in some cases also interest-bearing convertible preferred equity certificates (CPECs) that have been issued by Square Lux Midco 1 & Co S.C.A. As of the reporting date, key management personnel held approx. 7.48% of the ordinary shares in Square Lux Midco 1 & Co S.C.A. Other senior staff of the HENSOLDT Group indirectly hold approx. 4.34% of the ordinary shares of Square Lux Midco 1 & Co S.C.A. and overall approx. 0.67% of the CPECs issued by Square Lux Midco 1 & Co S.C.A.

Management's participation via ordinary shares corresponds to a notional share of 11.82% in the share capital of HENSOLDT Holding GmbH (based on the share capital of HENSOLDT Holding GmbH which is held by itself but not in the form of treasury shares from HENSOLDT Holding GmbH). Of this, 7.48% is attributable to key management personnel.

The acquisition of the management participation took place in 2017 and 2018 at various dates, in each case from the participants' own funds.

Management participations serve to involve participants in the Company's development and thus the opportunities and risks of the HENSOLDT Group. In this sense the participants as investors bear that risk underlying their management participation including the risk of full loss of the value of their management participation.

The realization of the value of the management participation occurs via a direct or indirect sale of the investment in the HENSOLDT Group, in the course of an initial public offering of the HENSOLDT Group or other sale of the HENSOLDT Group (each an 'exit case'), whereby the participants themselves cannot determine the time and conditions (including the price) of such an exit case. Subject to certain market protection agreements as part of an initial public offering, the participants can nevertheless generally participate in such a sale in line with their shareholding and in this respect have the tag-along selling rights and are subject to drag-along selling obligations generally at the same conditions (including the price for ordinary shares or CPECs) as Square Lux TopCo S.à r.l., i.e. the majority owner of Square Lux Midco 1 & Co S.C.A..

In addition, the management participation is subject to a purchase right on the part of Square Lux TopCo S.à r.l. that can be exercised in the event of certain conditions, in particular in the event of the participant leaving their active employment at the HENSOLDT Group ('purchase option'). The calculation of the purchase price upon exercising the purchase option is determined by the reason for exercising the acquisition option (e.g. reaching the age limit, termination by the participant or termination without notice). Depending on the reason for exercising the purchase option, the purchase price corresponds to the cost of the management participation or the current market value of the management participation, which is calculated on the basis of a contractually agreed valuation method. Depending on the reason for exercising the purchase option the market value of the management participation for managers in key positions and individual other senior staff is not paid for the entire management participation but rather only a share determined on the basis of the length of time the respective management participation is held. This share increases each quarter over a period of four years. For the remaining share of the management participation, the purchase price is determined based on the cost of the related share. The management participations of several parties who are no longer employed by the HENSOLDT Group were bought back by Square Lux TopCo S.à r.l. in 2018. The purchase price paid by Square Lux TopCo S.à r.l. for the purposes of buying back these management participations exceeded the fair value of the respective management participation.

HENSOLDT Holding GmbH and its subsidiaries themselves are not a contracting party to the agreement on the management participation and are not at any time obligated – whether in an exit case or upon resignation of a participant – to make payment to the participant.

In the course of purchasing management participations the purchase price to be paid by the participants corresponded to at least the fair value of the management participation. As the participants pay at least the fair value of the participation at the time of purchase or receive from Square Lux TopCo S.à r.l. no more than the fair value of the management participation associated with the buyback of a management participation, there is no monetary advantage granted at the time the parties become or withdraw from being participants. For this reason,

at no point is an expense recognized in the consolidated financial statements (whether in an exit case or upon resignation of the manager).

VI. Capital structure and financial instruments

30. Total equity and liabilities

30.1. Equity attributable to owners of the parent company

HENSOLDT Holding GmbH's share capital is fully paid and amounted to KEUR 25 as of December 31, 2018. The share capital consists of 25,000 shares at EUR 1.00 each.

The capital reserve is unchanged at KEUR 46,275 as of December 31, 2018.

Other reserves include cumulative other comprehensive income.

Retained earnings contain earnings of the companies included in the consolidated financial statements including earnings in the financial year, provided these have not been distributed.

The Group's retained earnings were adjusted as of January 1, 2018, due to the adjustments to IFRS 15 (see Section 4 'Change in accounting policies and disclosure').

30.2. Treasury shares

With effect from June 30, 2018, 6,275 treasury shares were acquired for KEUR 10,563. The treasury shares are deducted in an amount equal to costs in a one-off sum from total equity and liabilities.

30.3. Non-controlling interests

The non-controlling interests reflect the share of other shareholders in the net asset value of consolidated subsidiaries.

KEUR	HENSOLDT Optronics (Pty) Ltd.	GEW Technologies (Pty) Ltd.	Total	Intragroup eliminations/ adjustments	Dec. 31, 2018
Percentage of non-controlling interests	30%	6.72%			
Non-current assets	12,197	5,920	18,117		
Current assets	44,444	55,223	99,667		
Non-current liabilities	-1,152	-1,368	-2,520		
Current liabilities	-23,797	-27,775	-51,572		
Net assets	31,692	32,000	63,692		
Net assets of non-controlling interests	9,508	2,150	11,658	-788	10,870
Revenue	33,483	52,595	86,078		
Profit	986	5,785	6,771		
Other comprehensive income/loss	-5,568	-2,717	-8,285		
Total comprehensive income/loss	-4,582	3,068	-1,514		
Profit attributable to non-controlling interests	296	389	685		685
Other comprehensive income/loss attributable to non-controlling interests	-1,670	-183	-1,853	400	-1,453
Cash flows from operating activities	-6,466	7,940	1,474		
Cash flows from investing activities	-2,926	-898	-3,824		
Cash flows from financing activities	3,150	-3,500	-350		
Net increase (decrease) in cash and cash equivalents	-6,242	3,542	-2,700		

KEUR	HENSOLDT Optronics (Pty) Ltd.	GEW Technologies (Pty) Ltd.	Total	Intragroup eliminations/ adjustments	Dec. 31, 2017
Percentage of non-controlling interests	30%	6.72%			
Non-current assets	11,963	5,066	17,029		
Current assets	38,034	63,768	101,801		
Non-current liabilities	-1,539	-2,314	-3,853		
Current liabilities	-14,383	-31,295	-45,678		
Net assets	34,074	35,225	69,300		
Net assets of non-controlling interests	10,222	2,367	12,589	572	13,162
Revenue	28,640	72,856	101,496		
Profit	4,106	8,073	12,179		
Other comprehensive income/loss	-2,093	3,828	1,734		
Total comprehensive income/loss	2,013	11,900	13,913		
Profit attributable to non-controlling interests	1,232	542	1,774	-822	953
Other comprehensive income/loss attributable to non-controlling interests	-628	257	-371	-445	-815
Cash flows from operating activities	6,172	33,174	39,346		
Cash flows from investing activities	2,094	-1,833	261		
Cash flows from financing activities	-420	-5,975	-6,395		
Net increase (decrease) in cash and cash equivalents	7,846	25,366	33,212		

Under company law, the non-controlling shareholder of GEW Technologies (Pty) Ltd. has a 25% interest under company law in GEW Technologies (Pty) Ltd. and its subsidiary GEW Integrated Systems (Pty). The non-controlling shareholder was issued with 500 shares, of which 392 shares are treated as treasury shares until full payment of the purchase price. This results in a financial stake of non-controlling interests of 6.72%. In connection with the shares considered treasury shares, there is a put option in favor of the non-controlling shareholder which is recognized at market value under other non-current financial liabilities.

31. Capital management

The capital structure of the HENSOLDT Group is made up of equity capital attributable to the shareholders of the parent company and of debt capital. A capital structure that optimizes capital costs of equity and debt is being targeted.

The Group is not subject to any capital requirements imposed by the Articles of Association.

The non-current syndicated loan agreement (Term Loan) is tied to compliance with a financial covenant that refers to the ratio of net liabilities to earnings before interest, taxes, depreciation and amortization (EBITDA). In the year under review the financing conditions were met at all times.

The availability and conditions of the loan are tied to this financial covenant. In the event of breach, the financing partners are authorized to terminate the syndicated loan. There are no indications that the covenant cannot be fully complied with at all times (see note 33 'Information on financial instruments').

The term loan was increased by a nominal EUR 225 million to a total of EUR 920 million during the financial year, in order to take account of additional operating and strategic company growth.

In order to hedge against changes in exchange rates and interest rates, the Group routinely concludes derivative hedging contracts for variable interest-bearing liabilities and payables in foreign currency.

In the Group's second year of operating activities a consolidated loss of EUR 60 million was generated as a result of expenses in connection with transactions, the expenses from the purchase price allocation, separation costs and other non-recurring effects.

32. Net debt

KEUR	Dec. 31, 2018	Dec. 31, 2017
Cash and cash equivalents	227,550	137,974
Shareholder loans	-349,567	-437,474
Long-term liabilities due to banks	-880,364	-677,084
Current financial liabilities	-3,367	-15,024
Total	-1,005,748	-991,608

32.1. Cash and cash equivalents

Cash and cash equivalents consist of the following items:

KEUR	Dec. 31, 2018	Dec. 31, 2017
Cash at bank and liquid funds	227,550	137,974
Total cash and cash equivalents	227,550	137,974

32.2. Financing liabilities

Financial liabilities to shareholders and banks consist of current and non-current loans.

The conditions and repayment schedules of the loans as of December 31, 2018, are as follows:

Loans	Capital amount KEUR	Issue date	Coupon or interest rate	Interest	Effective interest rate	Due date
Loan (Term Loan)	920,000	2017-02-28/ 2017-04-18/ 2017-07-26/ 2018-02-28/ 2018-12-06	3m EURIBOR + 3.25%	Floating rate	3.99%	2024-02-28
Shareholder loan (Square Lux Finco S.à r.l.)	349,567	2017-02-27/ 2017-02-28	6.716%	Fixed rate		2027-02-27

The conditions and repayment schedules of the loans as of December 31, 2017, are as follows:

Loans	Capital amount KEUR	Issue date	Coupon or interest rate	Interest	Effective interest rate	Due date
Loan (Term Loan)	695,000	2017-02-28/ 2017-04-18/ 2017-07-26	3m EURIBOR + 3.75%	Floating rate	3.65%	2024-02-28
Revolving Credit Facility	15,000	28.02.2017	3m EURIBOR + 3.75%	Floating rate		2023-02-27
Shareholder loan (Airbus Defence and Space GmbH)	107,419	28.02.2017	6.716%	Fixed rate		2027-02-28
Shareholder loan (Square Lux Finco S.à r.l.)	320,530	27.02.2017	6.716%	Fixed rate		2027-02-27

The conditions of the loan agreement, which is in place to finance the Group, were adjusted in favor of HENSOLDT in the reporting year. The volume of lending commitments currently amounts to EUR 920 million with a contractual term to February 2024. In addition, there is a credit facility of EUR 200 million which was available in full as of December 31, 2018.

The loan agreement is secured by pledging shares in the subsidiaries HENSOLDT Sensors GmbH, HENSOLDT Optronics GmbH and Square Holding France S.A.S., KH Holdco Ltd, KH Finance No.2, KH Finance Ltd. and Kelvin Hughes Ltd.

For the variable interest-bearing loan ('Term Loan'), interest rate caps and interest rate swaps were concluded in order to hedge the risk resulting from the variable interest charge on the loan. The variable interest charge on the loan is capped at half of the loan for the period until March 2019 and for the period from March 2019 to March 2022 is fully replaced with a fixed interest rate. The loan includes an embedded derivative in the form of a

repayment right that and zero-floor clause that must be presented separately. In determining the effective interest rate, the transaction costs are allocated to the host contract.

The total amounts of financial liabilities due in the next five years and thereafter, as of December 31, 2018, amount to:

KEUR	Up to 1 year	Between 1 and 5 years	More than 5 years	Total
Liabilities to banks	3,367	0	880,364	883,731
Shareholder loans	0	0	349,567	349,567
Dec. 31. 2018	3,367	0	1,229,931	1,233,298

The total amounts of financial liabilities due in the next five years and thereafter, as of December 31, 2017, amount to:

KEUR	Up to 1 year	Between 1 and 5 years	More than 5 years	Total
Liabilities to banks	15,024	0	677,084	692,109
Shareholder loans	0	0	437,474	437,474
Dec. 31, 2017	15,024	0	1,114,558	1,129,582

The shareholder loan of a nominal amount of EUR 110 million (including incurred interest) from the former non-controlling shareholder Airbus Defence and Space GmbH (until June 30, 2018) was assumed as part of a call option being exercised on company shares of the former non-controlling shareholder in HENSOLDT Holding GmbH by the main shareholder Square Lux Holding II S.à r.l.

In this regard a proportionate share of the shareholder loan provided by Square Lux Finco S.à r.l. was repaid.

32.3. The reconciliation of changes in financial liabilities to cash flows from financing activities

The following shows the cash flows from financing activities in a reconciliation from the opening balances to closing balances for the liabilities and equity components attributable to financing activities including the accompanying financial assets and liabilities from the hedging transactions of these financing activities.

KEUR	of financial position as of Dec. 31, 2018	Cash flow (net cash changes)	Other non-cash changes				Changes in fair value	of financial position as of Dec. 31, 2018
			IFRS 9 adjustment	Accrued interest	Capitalize d interest	Change to consolidat ed group		
Non-current borrowing								
Shareholder loans	437,474	-109,830	0	20	21,903	0	0	349,567
Bank loans (net)	677,084	222,900	-14,950	-4,670	0	0	0	880,364
Current borrowing	15,024	-14,165	0	0	0	2,588	-80	3,367
Change in financial liabilities due to financing activities	1,129,582	98,905	-14,950	-4,650	21,903	2,588	-80	1,233,298
Change in equity due to financing activities								
Treasury shares	0	-10,563	0	0	0	0	0	-10,563
Capital reserve	46,275	0	0	0	0	0	0	46,275
Change in equity due to financing activities	46,275	-10,563	0	0	0	0	0	35,712
Change in assets (-) and liabilities (+) to hedge non-current borrowing								
Interest rate swap assets	-2	0	0	0	0	0	2	0
Interest rate swap liabilities	4,078	0	0	0	0	0	6,740	10,818
Embedded derivative (-) (asset (+) liability)	-18,892	0	0	0	0	0	22,175	3,283
Change in assets (-) and liabilities (+) to hedge non-current borrowing	-14,816	0	0	0	0	0	28,917	14,101

KEUR	of financial position as of Jan. 1, 2017	Cash flow (net cash changes)	Other non-cash changes				Changes in fair value	of financial position as of Dec. 31, 2017
			Separation of embedded derivative	Accrued interest	Capitalize d interest	Non-cash contributio ns		
Non-current borrowing								
shareholder loans	0	436,713	0	0	24,694	-23,934	0	437,474
bank loans (net)	0	665,113	10,303	1,668	0	0	0	677,084
Current borrowing	0	15,000	0	24	0	0	0	15,024
Change in financial liabilities due to financing activities	0	1,116,826	10,303	1,692	24,694	-23,934	0	1,129,582
Change in equity due to financing activities								
Capital reserve	27	22,314	0	0	0	23,934	0	46,275
Change in equity due to financing activities	27	22,314	0	0	0	23,934	0	46,275
Change in assets (-) and liabilities (+) to hedge non-current borrowing								
Interest rate swap assets	0	0	0	0	0	0	-2	-2
Interest rate swap liabilities	0	0	0	0	0	0	4,078	4,078
Embedded derivative (asset)	0	0	-10,303	0	0	0	-8,589	-18,892
Change in assets (-) and liabilities (+) to hedge non-current borrowing	0	0	-10,303	0	0	0	-4,512	-14,815

For non-current borrowing, transaction costs of KEUR 29,887 were deducted in the prior year.

33. Information on financial instruments

33.1. Financial risk management

On the basis of its activities, the Group is exposed to a range of financial risks; (i) market risks, in particular foreign exchange risk and interest rate risk, (ii) liquidity risk and (iii) credit risk.

Overall, the Group's financial risk management system concentrates on minimizing unforeseeable market risks and their potential negative effects on the Group's operating and financial performance.

The Group's financial risk management is generally carried out by Corporate Finance in the Group in compliance with the guidelines approved by the Chief Financial Officer.

Further information on risks relating to financial instruments can be found in the risk report of the group management report additionally prepared for the IFRS consolidated financial statements.

The Group uses financial derivatives exclusively to mitigate risks (hedging) and applies hedge accounting for part of its hedging portfolio.

Market risk

Foreign exchange risk

The Group is exposed to foreign exchange risks due to its operations in various countries around the globe that do not use euro.

For orders received that are invoiced in foreign currency, the Group concludes forward exchange transactions in order to rule out or minimize foreign exchange risks (hedging). Forward exchange contracts are exclusively concluded with prime international banks. The necessary measures and rules related to the hedging of orders not invoiced in euro are agreed in the Group-wide treasury policy.

The Group's main hedging instrument are forward exchange transactions.

To hedge its foreign currency transactions in South Africa, the Group uses the cash flow hedge model that requires (i) recognition of the effective portion of the change in fair value of the hedging derivative in equity (under other reserves) and (ii) recognition of the effect of the hedge in profit or loss if the hedged cash flows affect profit or loss.

In the financial year a gain on foreign currency translation of KEUR 2,011 (PY: KEUR 5,726) was recognized in profit or loss.

Sensitivity of foreign exchange risk

The sensitivity analysis approximately quantifies the risk that can occur based on set assumptions if certain parameters are changed to a defined extent. Currency risks pertain in particular to the US dollar (USD), South African rand (ZAR), pound sterling (GBP) and Canadian dollar (CAD).

The following disclosures describe the Group's view of the sensitivity of an increase or decrease in the USD, ZAR, etc., against the EUR. The change is the value used in internal currency risk reporting and represents the Group's estimate of the impact of a potential change in the exchange rate. Currency exposures within the meaning of IFRS 7 result from financial instruments that are denominated in a currency other than the functional currency and are of a monetary nature. Translation differences from the translation of financial statements of foreign group entities into the Group's currency remain unrecognized. The sensitivity analysis includes the HENSOLDT Group's main financial instruments outstanding on the reporting date.

The effects on the consolidated profit and other comprehensive income are as follows:

If the EUR had appreciated/depreciated by 10% against the USD, ZAR, GBP and CAD as of December 31, 2018/2017, the consolidated profit and other comprehensive income would have changed in the manner shown below:

		Dec. 31, 2018		Dec. 31, 2017	
		Consolidated profit/loss	Other comprehensive income/loss	Consolidated profit/loss	Other comprehensive income/loss
KEUR					
EUR/GBP	+/- 10%	+/- 2,481	0	-/+ 954	0
EUR/ZAR	+/- 10%	+/- 3,452	0	+/- 1,923	0
EUR/USD	+/- 10%	+/- 1,540	+/- 1,349	+/- 2,458	+/- 1,451
EUR/CAD	+/- 10%	+/- 379	0	+/- 1,083	0

The changes compared to the reported consolidated profit result mainly from the market valuation of forward exchange transactions with new exchange rates, which are used to hedge planned items and which are not included in any hedging relationship under IAS 39. These changes in the fair value of derivatives are offset against the hedged order backlog. The changes in other comprehensive income result from the market valuation of forward exchange transactions for cash flow hedge accounting.

Interest rate risk

The Group is exposed to interest risks due to its borrowing at fixed and floating rates. Interest rate risks are a result in particular of variable portions of interest, which depend on current market interest rates; these have an impact on cash flow from financing activities. The cash flow risk is mainly due to the change in market interest rates. An increase in the market interest rate means increasingly negative cash flows from financing activities, and vice versa.

Interest rate caps and interest rate swaps were concluded for the variable interest-bearing syndicated loan. The loan also includes an embedded derivative in the form of a repayment right and zero-floor clause that must be presented separately.

The changes in fair values of interest rate derivatives and embedded derivatives are recorded in the consolidated income statement.

Sensitivity of interest rate risk

A change of +/- 50 basis points in interest rates as of the reporting date would have decreased/increased equity and profit or loss by KEUR 3,938 (PY: KEUR 2,424). This analysis assumes that all other variables, in particular exchange rates, remain constant.

Liquidity risk

The Group's business policy is to maintain sufficient cash and cash equivalents at all times in order to be able to meet current and future obligations when due. The Group manages its liquidity by retaining a sufficient amount of liquid assets and having additional cash inflows from unused credit facilities (EUR 200 million) on hand.

Adverse developments on capital markets could increase the Group's borrowing costs and limit its financial flexibility. Management monitors the Group's cash reserves as well as expected cash flows from operating activities.

The contract terms of the Group's financial liabilities, based on undiscounted cash flows and including interest payments, where applicable, are as follows:

KEUR	Carrying amount	Contractual cash flows	< 1 year	1 year to 2 years	2 years to 3 years	3 years to 4 years
Non-derivative financial liabilities	1,401,577	1,858,783	195,834	27,330	27,405	27,405
Derivative financial liabilities	16,654	16,654	2,480	74	0	10,818
As of Dec. 31, 2018	1,418,231	1,875,437	198,314	27,404	27,405	38,223

KEUR	Carrying amount	Contractual cash flows	< 1 year	1 year to 2 years	2 years to 3 years	3 years to 4 years
Non-derivative financial liabilities	1,289,926	1,817,323	198,898	22,947	20,653	21,569
Derivative financial liabilities	5,251	5,251	454	336	233	0
As of Dec. 31, 2017	1,295,177	1,822,574	199,352	23,283	20,886	21,569

KEUR	4 years to 5 years	> 5 years
Non-derivative financial liabilities	20,597	1,532,658
Derivative financial liabilities	4,228	0
As of Dec. 31, 2017	24,825	1,532,658

The non-derivative financial liabilities included in the above table include financial liabilities and trade payables as presented in the tables to note 33.2 'Carrying amounts and fair values of financial instruments'.

Besides the commercial opportunities from additional margins and cost savings realized, the HENSOLDT Group's main risks relate primarily to compliance with the financial covenants agreed with banks in the context of corporate financing, which were renegotiated in the HENSOLDT Group's favor in the reporting year.

The previous quarterly test of the agreed financial covenants was canceled. A test is now only carried out on an indication basis when the working capital line of credit exceeds an agreed threshold or in the event of taking up additional external funding.

The HENSOLDT Group's aim is compliance with the financial covenant at all times and to ensure via monthly simulations of budgets that the financial covenants will be complied with in future quarters.

For short-term liquidity management, group-wide rolling liquidity planning, updated weekly, is used and this constitutes the operative instrument for short-term liquidity management of the HENSOLDT Group.

The agreed financial covenants are only then tested if one of the reasons specified is in place. Where the covenants must be tested and the financial performance indicators are non-compliant, the respective lender is entitled to terminate the loan. This could result in a going concern risk for the HENSOLDT Group if no alternative funding were to be available at the time when the liabilities to banks fall due.

The probability of occurrence of the risk of non-compliance with financial covenants is considered low. Liquidity is ensured at all times via a medium-term revolving credit facility.

Credit risk

The Group is exposed to a credit risk from non-fulfillment of financial instruments, either by customers or counterparties to the financial instruments. However, the Group prepared guidelines in order to avoid the concentration of credit risks and to ensure that the credit risk remains limited.

Where activities of the central treasury department are affected, the credit risk resulting from financial instruments is managed at group level.

The Group monitors the development of individual financial instruments and the impact of market developments on their performance and take appropriate measures in the event of foreseeable unfavorable developments on the basis of predefined procedures and escalation levels.

Products and services are sold to customers following a proper internal credit check.

The amount of the financial assets recognized, including contract assets, represents the maximum credit exposure.

Assessment of the expected credit losses for customers as of January 1, 2018 and December 31, 2018

Allowances on trade receivables and contract assets are always measured in the amount of the lifetime expected credit loss. Lifetime expected credit losses are expected credit losses which result from all possible default events over the expected lifetime of a financial instrument.

In this regard, the estimated expected credit losses on trade receivables were calculated on the basis of actual credit losses in recent years. Credit risks were segmented according to common credit risk attributes. These are the risk assessments on the basis of rating grades of the Standard & Poor's rating agency taking account of the geographic location.

The following table includes information on the credit risk and the expected credit losses for trade receivables as well as contract assets as of December 31, 2018.

	Rating at Standard & Poor's	Loss rate (weighted average)	Gross carrying amount	Loss allowance	Impaired creditworthiness
KEUR					
Rating 1-6: low risk	BBB- to AAA	1.72%	151,460	-2,603	No
Rating 7-9: moderate risk	BB- to BB+	2.14%	263,204	-5,629	No
Rating 10: below average	B- to CCC-	11.82%	13,981	-1,653	No
Classification 11: doubtful	C to CC	-	0	0	Yes
Classification 12: loss	D	-	0	0	Yes
			428,645	-9,885	

	Dec. 31, 2018
Contract assets	80,688
Trade receivables	338,072
	418,760

Based on the historical payment history and analysis of customer credit risk, including the credit ratings of customers where available, management is of the opinion that past due amounts not impaired are still collectible.

At year-end there were no indications that impairments are necessary for financial assets recognized at fair value that go beyond the amounts already recognized (see Section 19 'Trade receivables').

Comparative information under IAS 39

The analysis of the recoverability as well as the age structure of trade receivables that are not overdue nor impaired, as of December 31, 2017, is as follows:

KEUR	Dec. 31, 2017
Receivables, neither past due nor impaired	250,109
Receivables not impaired and ≤ 1 month past due	36,394
Receivables not impaired and >1 and ≤ 2 months past due	8,565
Receivables not impaired and >2 and ≤ 3 months past due	6,332
Receivables not impaired and >3 and ≤ 6 months past due	9,144
Receivables not impaired and >6 months past due	34,481
Specifically impaired receivables	2,630
	347,656
from: specific impairment allowances	-2,630
Total	345,026

33.2. Carrying amounts and fair values of financial instruments

The Group's financial assets mainly consist of cash and cash equivalents, short and medium-term deposits and trade receivables. The financial liabilities include trade payables, payables to financial institutions, and shareholder loans. All purchases and sales of financial assets are recorded on the settlement date in line with market convention.

Within the Group, only derivatives that do not serve hedging purposes are classified as 'measured at fair value with changes in value through profit or loss'.

The Group groups its financial instruments into classes on the basis of accounting categories. The following table includes the carrying amounts and fair values of financial instruments according to class and valuation category as of December 31:

KEUR Dec. 31, 2018	Category pursuant to IFRS 9	Carrying amount	Fair value	Level
Assets				
Other investments and other non-current financial	FVTOCI	11,347	11,347	2
Trade receivables	AC	338,072	338,072	2
Other financial assets				
■ Other derivative instruments	FVTPL	1,739	1,739	2
■ Non-derivative instruments	FVTPL	454	454	2
Total financial assets		351,612	351,612	

Liabilities				
Financing liabilities				
■ Liabilities to shareholders	FLAC	349,567	356,489	2
■ Liabilities to banks	FLAC	883,731	902,312	2
Trade payables	FLAC	167,073	167,073	2
Other financial liabilities				
■ Derivative instruments for cash flow hedges	FVTOCI	1,024	1,024	2
■ Other derivative instruments	FVTPL	15,630	15,630	2
■ Liability from put option	no category	1,206	1,206	2
■ Other	FLAC	0	0	2
Total financial liabilities		1,418,231	1,443,734	

KEUR Dec. 31, 2017	Category pursuant to IAS 39	Carrying amount	Fair value	Level
Assets				
Other investments and other non-current financial assets	FVTOCI	5,143	5,143	2
Trade receivables	LaR	345,026	345,026	2
Other financial assets				
■ Derivative instruments for cash flow hedges	FVTOCI	8,904	8,904	2
■ Other derivative instruments	FVTPL	20,281	20,281	2
■ Non-derivative instruments	FVTPL	1,028	1,028	2
Total financial assets		380,383	380,383	

Liabilities				
Financing liabilities				
■ Liabilities to shareholders	FLAC	437,474	449,237	2
■ Liabilities to banks	FLAC	692,109	714,139	2
■ Finance lease liabilities	FLAC			
Trade payables	FLAC	146,562	146,562	2
Other financial liabilities				
■ Derivative instruments for cash flow hedges	FVTOCI	170	170	2
■ Other derivative instruments	FVTPL	5,081	5,081	2
■ Liability from put option	no category	972	972	2
■ Other	FLAC	12,809	12,809	2
Total financial liabilities		1,295,177	1,328,970	

There are put options in favor of the non-controlling shareholder of GEW Technologies (Pty) Ltd. (see Section 30.3 Non-controlling interests).

33.3. Nominal value of derivative financial instruments

The following listed contract volumes or the nominal value of derivative financial instruments do not necessarily show the amount exchanged by the parties and are therefore not a measure of the risk the Group is exposed to due to the derivative financial instruments.

The nominal value of derivative interest and foreign currency financial instruments are broken down according to the year of expected maturity as follows:

KEUR	less than 1 year		Remaining term nominal amounts more than 1 year		Total	
	2018	2017	2018	2017	2018	2017
Interest rate futures						
■ Swaps	0	0	920,000	695,000	920,000	695,000
■ Caps	460,000	0	2,650	351,250	462,650	351,250
■ Component of embedded derivative	0	0	920,000	695,000	920,000	695,000
Forward exchange transactions	97,206	126,479	38,540	28,624	135,746	155,104

33.4. Derivative financial instruments and disclosures on hedge accounting

Derivative instruments in the presentation of the Group's financial position consist of (i) instruments recorded as hedging operating group activities against foreign exchange risks or hedging the interest result, and (ii) embedded interest rate derivatives that result from the separation of the interest rate portion and the call options of certain loan agreements and (iii) put options for buying back the shares of external shareholders.

The development of hedging instruments for foreign exchange risks recorded in other comprehensive income as of December 31, 2018/2017, is as follows:

KEUR	Equity attributable to owners of the Parent Company	Non-controlling interests	Total
As of Jan. 1, 2017	0	0	0
Unrealized valuation gains (+) and losses (-)	-4,190	-302	-4,491
Reclassification to consolidated income/loss	2,484	179	2,663
Deferred taxes on unrealized valuation gains	1,173	85	1,258
Change	-533	-38	-571
As of Dec. 31, 2017	-533	-38	-571
Unrealized valuation gains (+) and losses (-)	-5,668	-367	-6,035
Reclassification to consolidated income/loss	1,225	77	1,302
Deferred taxes on unrealized valuation gains	1,537	111	1,648
Change	-2,906	-179	-3,085
As of Dec. 31, 2018	-3,439	-217	-3,656

In connection with trade with international customers and suppliers, forward exchange transactions were concluded to manage the currency risk.

In the financial year, an amount of KEUR 1,908 (PY: KEUR 5,914) from cash flow hedges due was reclassified from equity primarily to revenue. There were no material inefficiencies from hedging relationships.

The fair values corresponding to the carrying amounts of various types of financial instruments were as follows as of December 31, 2018/2017:

KEUR	Assets		Liabilities	
	Dec. 31, 2018	Dec. 31, 2017	Dec. 31, 2018	Dec. 31, 2017
Foreign exchange contracts				
■ Cash flow hedges	0	8,904	1,025	170
■ not designated in a hedging relationship	1,740	1,388	1,528	1,003
Interest rate swaps				
■ Component of embedded derivative	0	18,892	3,282	0
■ not designated in a hedging relationship	0	2	10,819	4,078
Liability from put option	0	0	1,206	972
Total	1,740	29,186	17,860	6,223

33.5. Net gains or net losses

The following net gains or net losses were recognized in profit or loss in 2018 and 2017.

KEUR	2018	2017
Financial assets or liabilities at fair value through profit or loss	633	0
Financial assets at amortized cost	511	2,965
Financial liabilities at amortized cost	-17	-473
Net gains or net losses	1,127	2,492

Interest income from financial assets and financial liabilities measured at fair value through profit or loss are included in the net gains or net losses.

33.6. Impairment losses

The following impairment losses on financial assets were recognized in profit or loss in 2018 and 2017:

(in KEUR)	Category	2018	2017
Impairment losses for:			
Other investments and other financial assets	FVTOCI	0	765
Trade receivables and contract assets	AC	5,975	832
Other loans	AC	0	200
Impairment losses (gross) on other financial assets and contract assets		5,975	1,797
Reversals of impairment losses	AC	-77	-1,028
Impairment losses (net) on other financial assets and contract assets		5,898	769

VII. Additional comments

34. Auditor's fee and services

The HENSOLDT Group, its subsidiaries and other companies included in the consolidated financial statements recognized the following expenses for the fees and services of KPMG AG for financial year 2018 and 2017:

KEUR	Parent Company		Subsidiaries		Total	
	2018	2017	2018	2017	2018	2017
Audit services	472	192	597	519	1,069	711
Other assurance services	0	0	0	0	0	0
Tax advisory services	75	0	365	317	440	317
Other services	3	0	253	360	256	360
Total	550	192	1,214	1,197	1,765	1,389

35. Events after the reporting date

No significant events have occurred subsequent to the reporting date.

36. Operating leases

The Group leases a range of offices and production areas as well as laboratories (including also combined leases of land and buildings) under operating leases. The leases typically run for a non-cancellable minimum term of lease of more than ten years, with an option to renew the lease after that date. The leases were largely assumed from the Airbus Group and partially adjusted in this regard. The rent paid to the lessor is adjusted at regular intervals and the HENSOLDT Group does not participate in the residual value of land and buildings. For certain operating leases the Group requires the approval of the lessor to sublet.

Leased real estate is partially sublet by the HENSOLDT Group. Both the lease and sublease run until 2029. Income from subleases of KEUR 1,587 is expected.

In addition to leases for office and production areas and laboratories, the HENSOLDT Group mainly leases vehicles, office equipment as well as technical machinery.

As of December 31, the future minimum lease payments from leases are:

KEUR	Dec. 31, 2018	Dec. 31, 2017
less than one year	24,006	20,419
between one and five years	70,698	34,626
more than five years	111,732	4,961
Total	206,436	60,006

Of this, future minimum lease payments from leases concern related parties in the amount of KEUR 155,140.

The amounts recognized in the financial year in the consolidated income statement are set out in the following table:

KEUR	Dec. 31, 2018	Dec. 31, 2017
Leasing expense	25,018	22,405
Expense for contingent lease payments	0	21
Income from subleases	-42	-16
Total	24,976	22,410

37. Future payment obligations

Purchase commitments amounted to KEUR 302,543 as of December 31, 2018 (PY: KEUR 246,389).

HENSOLDT Holding GmbH

Taufkirchen, District of Munich

Group management report

for the year ended December 31, 2018

I. Business and general environment

1. Company profile

HENSOLDT Holding GmbH (hereinafter referred to as 'Group', 'HENSOLDT', or 'HENSOLDT Group') is a global high-tech pioneer in the area of defense and security electronics. The Company is a market leader in civilian and military sensor solutions. In addition, HENSOLDT develops new products for data management, robotics and cyber security by crosslinking existing expertise with software solutions.

HENSOLDT Group was formed in 2016 largely from former divisions of Airbus Defence and Space GmbH, Taufkirchen, for sensor technologies in the areas of defense, security and aerospace. The German holding structure was formed in February 2016 as a result of the contribution of HENSOLDT Holding Germany GmbH to HENSOLDT Holding GmbH. In March 2016, Airbus Defence and Space GmbH signed a share purchase agreement with the investment company Kohlberg Kravis Roberts & Co. L.P. (KKR) for 100% of the shares in HENSOLDT Sensors GmbH (formerly Airbus DS Electronics and Border Security GmbH) and in HENSOLDT Optronics GmbH (formerly Airbus DS Optronics GmbH) including their respective subsidiaries. With legal and economic effect as of the end of February 2017, HENSOLDT Holding GmbH via its subsidiary HENSOLDT Holding Germany GmbH first assumed 100% of the shares in HENSOLDT Sensors GmbH and HENSOLDT Optronics GmbH. Airbus Defence and Space GmbH then had an indirect 25.1% share in HENSOLDT Holding GmbH for a limited period of time in order to ensure a smooth transition. With the completion of separation actions, these shares were acquired by HENSOLDT Holding GmbH from Airbus Defence and Space GmbH in June 2018, resulting in HENSOLDT being able to act as an autonomous business in this respect.

HENSOLDT is under the control of the investment company KKR Square Aggregator L.P., Canada, which is advised by KKR, as well as its subsidiaries. The Federal Republic of Germany holds a minimal investment under company law in HENSOLDT Holding GmbH.

HENSOLDT's headquarters are in Taufkirchen, near to Munich, one of the most important innovation centers in the defense industry in Germany. In addition, business activities are operated in Ulm and Oberkochen in particular. Other locations in Germany include Wetzlar, Immenstaad, Pforzheim (EuroAvionics Group) and Kiel. Of the 4,400 staff employed by HENSOLDT, approx. 3,400 are employed in Germany. With 26 engineering and operating locations worldwide, especially in South Africa, where approx. 600 staff of the subsidiaries HENSOLDT Optronics Pty and GEW Technologies Pty operate at sites in Pretoria, and in Enfield near London (Kelvin Hughes Group), where approx. 170 staff work – HENSOLDT can strategically serve its growing customer base.

With effect from April 26, 2018, still within the share purchase agreement with the investment company KKR, HENSOLDT France SAS, with registered office in Plaisir/France (until April 26, 2018: 'Airbus DS Electronics & Border Security SAS') was acquired from Airbus Defence and Space SAS.

With effect from January 1, 2018, with retroactive effect from December 15, 2017, respectively, HENSOLDT Holding Germany GmbH acquired the shares in PentaTec Elektronische Systeme Gesellschaft mit beschränkter Haftung, Grasbrunn, (hereinafter 'PentaTec'). The Company merged into the fully consolidated HENSOLDT Sensors GmbH with retroactive effect from January 1, 2018.

In terms of operations, HENSOLDT has two corporate divisions, Optronics and Sensors, which represent cash generating units (CGU) under IFRS. HENSOLDT France SAS, acquired in 2018, was allocated to the Sensors CGU.

The HENSOLDT Group is organized along the following four business lines, in which business activities are combined and bundled into product categories:

- Radar / Identification, Friend or Foe ('IFF') / Datalink (Sensors corporate division)
- Spectrum Dominance & Airborne Solutions (Sensors corporate division)
- Optronics (Optronics corporate division)
- Customer Services (Sensors corporate division)

Activities of the business units

Radar / IFF / Datalink

Military and civilian radar systems have been a core competence of HENSOLDT for decades. The Group's radar portfolio concentrates on applications for monitoring, reconnaissance, flight security and air defense.

As innovative technology pioneer, HENSOLDT drives the development and application of high-end active electronically scanning radars (AESA) for air, naval and ground applications. HENSOLDT's passive radar enables the establishment of a highly comprehensive air picture without emissions of its own.

In the area of air traffic control and IFF, the Group provides the most powerful air traffic control radar ASR NG as well as the successful secondary radar MSSR and a range of transponders including highly sensitive encryption devices.

The HENSOLDT portfolio also includes a range of radio data link solutions. This range enables secure exchange of real-time data between moving airborne as well as maritime platforms and their control stations. Today HENSOLDT's radar systems for monitoring, reconnaissance, air defense and flight security are deployed worldwide, both for military and civilian applications. They are used in the Eurofighter, the F125 frigates of the German Navy and on US Navy ships. They are also in use to monitor airbases of the German armed forces as well as for military air fields in Switzerland, the United Kingdom, Australia and Canada.

Spectrum Dominance & Airborne Solutions

Under Spectrum Dominance, HENSOLDT develops systems and products which extract information from the electromagnetic spectrum and deny opposing forces use of the spectrum. The information superiority thus obtained serves to protect own forces and to defend against hostile activities. In addition, existing disciplines and capabilities of electronic warfare are combined with new solutions. For electronic warfare, HENSOLDT provides systems for recognizing and interpreting radar and radio signals as well as interference system (jammers), which, among others, serve to protect convoys or individual vehicles against improvised bombs.

Spectrum Dominance activities take into account that military superiority can no longer be attained with just physical presence – by tanks, aircraft, warships. In fact, information about the field of operations, own and enemy forces, plays a decisive role.

In the field of Airborne Solutions, HENSOLDT provides military and civilian solutions. In the military area, the business develops, among others, position detection systems, military mission computers and flight data recorders for helicopters and combat aircraft. Its flagship product is the Sferion pilot assistance system, which allows for safe flight operations in low visibility environments.

Furthermore, HENSOLDT offers certified civil avionic equipment for helicopters with interfaces to avionic and sensor systems of third party providers. The products include flight management systems as well as avionic computers and autopilot systems for drones in particular.

Optronics

Optical and optronic devices for military and civil security applications are part of the core business of HENSOLDT. The business produces optical and optronic devices for military and civil security applications. Optronic devices include daytime cameras, thermal imaging equipment, residual light intensifiers and laser range finders. The systems are applied across different platforms for air, land, sea and space missions and for infrastructure and border security.

The product portfolio also includes electronic self-protection systems for aircraft and helicopters against missile attacks.

HENSOLDT also produces visors, scope and optical systems for handguns all the way up to heavy weapon systems.

Customer Services

HENSOLDT Services is responsible for providing product support services to customers over the entire product life cycle and the product range. This includes both integrated logistics support, which ensures the maintainability and maintenance capabilities of products during the development and production stage, but also supports customers on site after delivery (in-service support).

2. Financial performance indicators

In addition to revenue and earnings before interest and tax (EBIT), a key financial performance and management and control indicator is the development of order intake. Non-financial performance indicators are not directly used to manage the Company (see Section 'V. Non-financial performance indicators'). Adjusted earnings before interest and tax (EBIT) is used as a key indicator of the economic performance of HENSOLDT.

Operating activities of the HENSOLDT Group began on February 28, 2017, with the acquisition of investments in HENSOLDT Sensors GmbH and HENSOLDT Optronics GmbH ('Orlando'). The EuroAvionics Group was acquired with effect from August 16, 2017 and the Kelvin Hughes Group was acquired with effect from September 28, 2017. As the financial year of the HENSOLDT Group covers the entire calendar year, it must be considered for the 2017 comparison year that the operating business of HENSOLDT Sensors GmbH and HENSOLDT Optronics GmbH for the months January and February in 2017 are not included in the consolidated statement of financial position or consolidated income statement. The same applies for the EuroAvionics Group and Kelvin Hughes Group, which were first included in the HENSOLDT Group from mid-August 2017 and end-September 2017. In view of the acquisition of HENSOLDT France SAS and the acquisition and merger of PentaTec in financial year 2018, comparability with the prior year is possible only to a limited extent.

To illustrate the non-recurring effects on the operating income/loss resulting from the acquisition of HENSOLDT Sensors GmbH, HENSOLDT Optronics GmbH, the EuroAvionics Group, the Kelvin Hughes Group, HENSOLDT France SAS and PentaTec, the separation activities from the Airbus Group and from other non-recurring costs, EBIT is presented as adjusted for these effects:

KEUR	2018	2017
Earnings before interest and and tax (EBIT)	21,760	-69,059
+ Effect on earnings from purchase price allocations	93,070	126,201
<i>of which intangible assets</i>	89,938	64,416
<i>of which property, plant and equipment</i>	669	580
<i>of which inventories</i>	2,463	56,205
+ Transaction costs	1,044	28,914
+ Separation costs	7,081	45,607
+ Other non-recurring effects	24,664	13,010
Adjusted EBIT	147,619	144,673

The effect on earnings from the purchase price allocations of KEUR 93,070 (PY: KEUR 126,201) relates to write-downs to the carrying amounts of intangible assets (KEUR 89,938; PY: KEUR 69,416) and property, plant and equipment (KEUR 669; PY: KEUR 580) that had been stepped up in the course of the purchase price allocation. Initially, KEUR 56,205 was added to acquired margins in inventories in the prior year. This effect was already largely realized in the course of the prior year due to regular inventory turnover. In financial year 2018, KEUR 2,463 was still attributable to this.

The transaction costs include expenses for the acquisition of HENSOLDT France SAS with retroactive effect from April 26, 2018 as part of the 'Orlando' carve-out as well as the expenses incurred for financial year 2018 arising from the Kelvin Hughes Group already acquired in the prior year.

The separation costs include the IT and site separation costs incurred in the course of the carve-out of 'Orlando' from the Airbus Group, which were recognized by the Group as an expense.

Other non-recurring costs include costs for the design of 'stand-alone' capabilities, the international representative offices and the global distribution structure as well as expenses incurred for the efficiency program 'HENSOLDT GO!'. The initiatives launched under 'HENSOLDT GO!' should significantly increase business volumes as well as profitability and liquidity. To this end, there are eleven 'workstreams' that work towards specifically designed goals. This item also includes expenses which were incurred as part of completed and ongoing acquisition and integration processes.

3. Key ratios

The key ratios in the 2017 comparison year result mainly from the activities of the HENSOLDT Group for the period March to December 2017 as operating activities began on February 28, 2017, with the acquisition of the 'Orlando' investments. The contributions of the EuroAvionics Group and Kelvin Hughes Group acquired in the second half of 2017 and HENSOLDT France SAS and PentaTec, acquired in 2018, are solely of minor importance. As a result, comparability of financial year 2018 with the prior year is possible only to a limited extent.

		2018	2017
Revenue	KEUR	1,110,117.00	917,093.00
Europe	KEUR	734,116.00	691,271.00
<i>of which Germany</i>	<i>KEUR</i>	<i>497,353.00</i>	<i>437,584.00</i>
Middle East	KEUR	137,763.00	86,877.00
APAC	KEUR	112,930.00	72,487.00
North America	KEUR	35,767.00	49,917.00
Other regions	KEUR	89,541.00	16,541.00
Radar/IFF/Datalink	KEUR	398,093.00	259,790.00
Spectrum Dominance & Airborne Solutions	KEUR	318,662.00	281,869.00
Optronics	KEUR	248,877.00	245,576.00
Customer Services	KEUR	144,485.00	129,858.00

		2018	2017
Order Intake	EUR million	1,160	1,042
Orders on hand	EUR million	2,261	2,052
Employees as of December 31	Number	4,456	4,219
Capital expenditure (incl. intangible assets)	KEUR	69,252	19,315
Research and development costs	KEUR	32,178	29,767
Cash flows from operating activities	KEUR	65,677	49,182
Earnings before interest and tax (EBIT)	KEUR	21,760	-69,059
Net loss for the year	KEUR	-59,880	-100,420
Adjusted EBIT	KEUR	147,619	144,673

II. Overview of business performance and assets, liabilities, financial position and financial performance

1. General economic conditions

The German Federal Government's projection for 2018 and 2019, issued in February 2019, expects real German GDP growth of 1.4% for 2018. Although growth would thereby be lower than in 2017 (2.2%), the German economy continues to be in a period of economic upswing. This is being especially driven by private and public spending as well as investments. Strong momentum is also expected for 2019 due to the implementation of the coalition agreements. Overall, the rate of growth of the German economy remains high, even if it is gradually normalizing.

Risks for the German outlook arise particularly from the external environment. This is influenced by growing risks, for instance the trade conflict between the two largest economies, the USA and China, and increasing uncertainty, such as the impending Brexit in 2019. While the G20 summit in Buenos Aires produced an initial rapprochement between the USA and China, the forecasts for short and medium-term development remain volatile. In addition, Prime Minister Theresa May and the EU have agreed a draft text for the withdrawal agreement, which has yet to achieve a majority in this form in the British House of Commons. Whether this leads to a hard Brexit without agreement or an amended withdrawal agreement between the United Kingdom and the EU is still not clear.

Consequently, the International Monetary Fund's World Economic Outlook of January 2019 assumes continued positive growth but at the same time weakening global expansion. In detail, the IMF expects global economic growth of 3.7% for 2018 – 0.2 percentage points less than 2017 – and growth of 3.5% for 2019.

Average economic growth of 2.4% is expected for mature economies for 2018 (2017: 2.3%), with the US expected to grow by an average 2.9% (2017: 2.2%) and the euro area by 2.0% (2017: 2.4%). Average growth in emerging economies and developing countries remains stable at 4.7% in 2018 (2017: 4.7%). While growth in China is expected to slow slightly to 6.6% (2017: 6.9%), growth in India is expected to increase to 7.3% (2017: 6.7%).

Positive general political conditions continue to be the key requirement to expand the defense business and boost it in a sustainable manner. Despite the overall favorable general economic conditions, the HENSOLDT Group faces major challenges.

Conflicts in the international trade environment could primarily foster risks, such as more difficult access to markets, custom conventions, slowdown in the consumer climate, declines in global, European and national growth forecasts and volatility in financial markets. These risks are set against opportunities resulting from an increase in defense budgets, particularly in Germany.

2. Business development

Operating business

Overall, HENSOLDT Group's operating business in the financial year 2018 was marked by continued profitable development. Increased revenue of KEUR 1,110,117 (PY: KEUR 917,093) resulted in earnings before interest and tax (EBIT) of KEUR 21,760 (PY: KEUR -69,059). EBIT rose considerably due to the improved gross profit, which showed a significant increase by KEUR 118,003 to KEUR 203,797 (PY: KEUR 85,794), but was also affected, as in the prior year, by non-recurring effects in financial year 2018, which resulted in expenses of KEUR 32,789 (PY: KEUR 87,531). This includes transaction costs (KEUR 1,044; PY: KEUR 28,914), expenses for the separation of IT and facilities (KEUR 7,081; KEUR 45,607) as well as other non-recurring effects such as restructuring measures and optimization projects (KEUR 24,664; PY: KEUR 13,010). In addition, cost of sales includes amortization from the purchase price allocations of KEUR 93,070 (PY: KEUR 126,201).

Incoming orders

The HENSOLDT Group reported order intake of EUR 1,160 million in the financial year (PY: EUR 1,042 million). Of this, approx. 42% (PY: 30%) is attributable to Radar / IFF / Datalink, in particular the TRML-4D and Eurofighter Captor programs and 22% (PY: 28%) to Spectrum Dominance & Airborne Solutions, in particular the Eurofighter DASS program. 12% of order intake is attributable to Customer Services (PY: 10%), with a majority of this made up by Eurofighter support. 24% is attributed to Optronics (PY: 28%), especially the Industrial Metrology Solutions and Leopard 2 Upgrade programs.

Orders on hand

Order volume at EUR 2,261 million rose by EUR 209 million over the prior year (EUR 2,052 million). On the one hand, this is due to the EUR 49.5 million increase in order intake relative to revenue. On the other hand, an increase of EUR 36.5 million is due to the change in the consolidated group in the wake of the acquisition of HENSOLDT France SAS as well as to adjustments of EUR 123 million due to the modified retrospective application of IFRS 15 Revenue from Contracts with Customers. At 41% (PY: 32%), the lion's share of order volume is attributable to Radar / IFF / Datalink, particularly the Naval & Ground Radars and the Eurofighter programs. In addition, 20% (PY: 25%) is attributable to Spectrum

Dominance & Airborne Solutions, 14% (PY: 14%) to Customer Services and 25% (PY: 27%) to Optronics.

Research and development (R&D)

Research and development (R&D) in the HENSOLDT Group involves both product-specific developments and general research and development activities that concentrate on basic research and product innovation. R&D expenses financed from own funds amounted to KEUR 32,178 in financial year 2018 (PY: KEUR 29,767). This corresponds to 2.90% of revenue (PY: 3.24%). This does not include capitalized development expenses in the financial year of KEUR 36,575 (PY: KEUR 19,942). This reflects a capitalization rate of 53.2% (PY: 40.1%) in terms of total research and development expenses of KEUR 68,753 (PY: KEUR 49,709).

Investments

Besides replacements, additions to property, plant and equipment relate mainly to investments to streamline workflows, IT licenses acquired as a result of the carve-out from the Airbus Group and necessary building measures as well as product-specific models for demonstration purposes. The Group also invested in intangible assets to a limited extent (KEUR 1,663; PY: KEUR 1,101), which relate mainly to software.

Personnel

The Group had 4,456 employees (PY: 4,219), including 365 trainees and interns (PY: 342) as of December 31, 2018.

3. Assets, liabilities, financial position and financial performance

Operating activities of the HENSOLDT Group only began in the prior year on February 28, 2017, with the acquisition of the 'Orlando' investments. In addition, considerable adjustment effects due to the modified retrospective application of IFRS 15 Revenue from Contracts with Customers are recorded in the financial year. This means comparability with prior year's figures is possible only to a limited extent.

Assets and liabilities

The HENSOLDT Group reported total assets of KEUR 2,212,322 as of December 31, 2018 (PY: KEUR 2,114,254).

Due to the acquisition of investments in the companies in the defense electronics segment (Orlando) of the Airbus Group (Airbus SE and its subsidiaries) as of February 28, 2017, the EuroAvionics Group as of August 16, 2017, the Kelvin Hughes Group as of September 28, 2017, and HENSOLDT France SAS as of April 26, 2018, goodwill of EUR 594 million was recognized (PY: EUR 584 million). Goodwill relates to the CGU 'Sensors' with EUR 511 million (PY: EUR 501 million) and 'Optronics' with EUR 83 million (PY: EUR 83 million).

Intangible assets totaling EUR 399 million (PY: EUR 453 million) include EUR 327 million (PY: EUR 408 million) from individual purchase price allocations in the course of acquisitions, which are attributable to technology, existing customer relationships and to the 'HENSOLDT' brand. In addition, as of December 31, 2018, the Group capitalized development costs of approx. EUR 46 million (PY: EUR 20 million) as internally generated intangible assets, primarily for the development of various radar and sensor technologies (ASR, TRS-4D, Passive Radar, AMPS).

Property, plant and equipment amounted to KEUR 89,180 as of December 31, 2018 (PY: KEUR 91,402). Technical equipment and machinery (KEUR 48,430; PY: KEUR 51,488) includes KEUR 2,922 (PY: KEUR 3,591) as a result of the continuation of individual purchase price allocations at financial year-end. Capital expenditure in the financial year amounted to KEUR 20,854 (PY: KEUR 16,071) and was slightly below the level of depreciation of KEUR 22,122 (PY: KEUR 15,463). This depreciation expense does not include the effects from the continuation of the purchase price allocation for technical equipment and machinery of KEUR 1,250 (PY: KEUR 580). Economic goods with a residual carrying amount of KEUR 569 (PY: KEUR 264) were divested from property, plant and equipment.

Financial assets of KEUR 18,809 (PY: KEUR 76,671) were recognized, of which KEUR 11,347 (PY: KEUR 5,143) is attributable to non-current assets (other investments and other non-current financial assets) and relate mainly to the investment in Deutsche Elektronik Gesellschaft für Algerien mbH of KEUR 9,284 (PY: KEUR 3,110). A further KEUR 735 (PY: KEUR 18,904) in non-current financial assets relates to derivative financial instruments measured at fair value. Current assets (other non-current financial assets, due in the short-term) of KEUR 5,269 were recognized (PY: KEUR 41,314). The decline is due to the repayment of the loan to Airbus Defence and Space GmbH. Other (current) financial assets of KEUR 1,460 (PY: KEUR 11,310) include positive fair values of derivative financial instruments (KEUR 1,017; PY: KEUR 10,294).

Inventories have a value of KEUR 407,002 as of December 31, 2018 (PY: KEUR 386,656). This item is comprised of typically high levels of inventories of work in process of KEUR 239,466 (PY: KEUR 230,187), raw materials and supplies of KEUR 139,909 (PY: KEUR 135,686) and finished goods and parts for resale of KEUR 27,627 (PY: KEUR 20,783). Based on the purchase price allocation in the wake of the completed acquisition of HENSOLDT France SAS, a margin of KEUR 2,463 was initially added to inventories. This effect was realized in the course of the financial year as a result of full inventory turnover.

Due to the introduction of the new financial reporting standard IFRS 15 Revenue from Contracts with Customers, contract assets of KEUR 80,688 were recognized for the first time as of December 31, 2018. This includes performance obligations already satisfied by HENSOLDT for which all required preconditions for invoicing have not yet been met.

Trade receivables amounted to KEUR 338,072 (PY: KEUR 345,026), of which KEUR 35,217 (PY: KEUR 34,481) is not due for six months or more.

Under financial reporting standard IAS 39 and IFRS 9, introduced for the first time in 2018, contract assets and receivables are measured at amortized cost less impairment losses. Impairment losses include significant judgments and estimates of management based on the credit rating of individual customers, on the basis of the assessment of external rating

agencies, on country-specific default risks, the current economic development and analysis of past bad debts. Appropriate provisioning was made by impairment losses on contract assets and receivables totaling KEUR 9,885 (PY: KEUR 2,741).

Other assets totaling KEUR 30,548 (PY: KEUR 19,610) include KEUR 4,208 due to costs to fulfil a contract capitalized for the first time in financial year 2018, and KEUR 4,916 due to other assets (PY: KEUR 3,145) as well as non-current assets of KEUR 21,423 (PY: KEUR 16,464) such as advance payments (KEUR 8,112; PY: KEUR 4,191), VAT receivables (KEUR 7,159; PY: KEUR 5,223) or retentions (KEUR 2,954; PY: KEUR 3,673).

Income tax receivables include tax receivables from corporation tax, solidarity surcharge and trade tax of KEUR 1,226 (PY: KEUR 5,445) due to higher tax prepayments for financial year 2018. After netting, deferred tax assets of KEUR 25,035 (PY: KEUR 14,388) were recognized as of December 31, 2018.

Cash and cash equivalents as of December 31, 2018, comprise cash at bank of KEUR 227,550 (PY: KEUR 137,974).

HENSOLDT Holding GmbH's share capital is fully paid and amounted to KEUR 25 as of December 31, 2018 (PY: KEUR 25). This consists of 25,000 shares at EUR 1.00 each. With effect from June 30, 2018, 6,275 treasury shares were acquired by HENSOLDT Holding GmbH from Airbus Defence and Space GmbH for KEUR 10,563. The treasury shares are deducted in an amount equal to costs in a one-off sum from total equity and liabilities.

The capital reserve results from the non-cash contributions of KEUR 22,341 paid in the course of acquisition of the defense electronics segment of the Airbus Group. On August 31, 2017, a further KEUR 23,934 was contributed to the capital reserve under a debt equity swap by way of the shareholders waiving a portion of their loan including interest accrued. The capital reserve thus amounts unchanged to KEUR 46,275 as of December 31, 2018.

Retained earnings contain the earnings of the companies included in the consolidated financial statements including earnings in the financial year, of KEUR -220,655 (PY: KEUR -130,702). The Group's retained earnings were adjusted as of January 1, 2018, due to the adjustments to IFRS 9 (KEUR +9,873) and IFRS 15 (KEUR -40,583).

Together with other reserves of KEUR -12,246 (PY: KEUR -21,178) and the amount of KEUR 10,870 (PY: KEUR 13,162) attributable to non-controlling interests, negative equity of KEUR -186,294 (PY: KEUR -92,418) was reported at financial year-end.

A consolidated loss of EUR 60 million was generated in financial year 2018 (PY: EUR 100 million) largely due to expenses in connection with transactions, subsequent expenses from purchase price allocations, separation costs and other non-recurring effects of EUR 125 million (PY: EUR 213 million).

Provisions include provisions for employee benefits and similar obligations of KEUR 266,093 (PY: KEUR 258,956), of which KEUR 164,281 (PY: KEUR 172,203) is attributable to provisions for pensions and KEUR 101,812 (PY: KEUR 86,753) to provisions for deferred compensation. Plan assets of KEUR 166,001 (PY: KEUR 147,815) are netted with the defined benefit obligation (gross KEUR 330,282; PY: KEUR 320,018) and plan assets of KEUR 14,018 (PY: KEUR 13,952) with liabilities for deferred compensation of gross KEUR 115,830 (PY: KEUR 100,705). Other provisions amount to KEUR 255,079 (PY: KEUR 345,314) and cover typical business risks, e.g. warranties, risks from loss of orders, outstanding costs, penalties for delays and contractual penalties, price audit risks and also

other personnel-related provisions. The decline in other provisions over the prior year is largely due to adjustments of KEUR 93,139 in the wake of the initial application of IFRS 15. The effect of this is nevertheless offset by the presentation of corresponding liabilities. Other personnel-related provisions totaling KEUR 49,170 (PY: KEUR 49,540) mainly include provisions for long-service benefits and bonuses of KEUR 45,524 (PY: KEUR 44,547) and for partial retirement benefits of KEUR 2,375 (PY: KEUR 3,457).

Interest-bearing shareholder loans totaling KEUR 349,567 (PY: KEUR 437,474) with a term of over 5 years as well as financial liabilities to banks from current and non-current loans of KEUR 883,732 (PY: KEUR 692,108) were reported as of December 31, 2018. Of this, KEUR 3,367 (PY: KEUR 15,024) is attributable to the current portion (term under one year) and KEUR 880,364 (PY: KEUR 677,084) to the non-current portion with a term of over 5 years. Other financial liabilities (current and non-current) totaling KEUR 17,860 (PY: KEUR 19,033) relate mainly to derivative financial instruments (KEUR 16,654; PY: KEUR 5,251). The prior year also included a liability to Airbus Defence and Space GmbH as former shareholder in the amount of KEUR 12,380.

Due to the introduction of the new financial reporting standard IFRS 15 Revenue from Contracts with Customers, contract liabilities of KEUR 357,567 were recognized for the first time as of December 31, 2018, of which KEUR 332,800 were current. On the one hand, this included KEUR 173,562 in performance obligations still to be satisfied by HENSOLDT, for which invoicing has already taken place, and on the other hand, payments received of KEUR 184,005. The performance obligations still to be satisfied mainly divide into performance obligations at a point in time (KEUR 61,444) and over time (KEUR 112,117). In the prior year, advances from customers of KEUR 222,139 were presented under other liabilities.

Trade payables amount to KEUR 167,073 (PY: KEUR 146,563). Other liabilities include liabilities to employees of KEUR 18,529 (PY: KEUR 20,948) and tax liabilities of KEUR 25,234 (PY: KEUR 10,494).

Financial position

Cash flows from operating activities amounted to EUR 65.7 million in the financial year (PY: EUR 49.2 million).

Cash flows from investing activities amounted to EUR -60.9 million (PY: EUR -1,050.4 million) and are the result of investment in fixed assets as well as the acquisitions of HENSOLDT France SAS and PentaTec, which were merged with retroactive effect from January 1, 2018 with HENSOLDT Sensors GmbH.

Cash flows from financing activities amounted to EUR 88.2 million (PY: EUR 1,139.1 million) and result mainly from financing via banks, shareholder loans and contributions from shareholders. Owing to the buyback of treasury shares and the associated repayment of shareholder loans, partially offset by the capitalization of interest accrued, this was reduced by EUR 87.9 million to EUR 349.6 million.

Cash and cash equivalents as of December 31, 2018, comprise solely liquid funds of EUR 227.6 million. Liabilities to banks amounted to EUR 883.8 million as of the reporting date, of this EUR 880.4 million is attributable to a long-term loan ('Term Loan') and

EUR 3.4 million to short-term borrowing. Initially, to finance the spin-off of the Orlando Group, the nominal volume of the lending commitment of the Term Loan was increased to a total of EUR 920 million during the financial year, in order to take account of the additional operating and strategic company growth. To ensure the working capital requirement over the medium term, the Company has variable credit facilities of EUR 200.0 million available under the loan agreement.

Positive business development in financial year 2018 gives the HENSOLDT Group again the opportunity to adjust its financing parameters to its benefit to take account of current market standards and to expand the Group's operating flexibility. HENSOLDT Group benefits from the fact that the contractually agreed financial covenant is only tested on an ad-hoc basis.

Financial performance

In financial year 2018, the Group generated revenue of KEUR 1,110,117 (PY: KEUR 917,093). The CGU 'Sensors' contributed KEUR 861,240 to revenue (PY: KEUR 702,317) and CGU 'Optronics' contributed KEUR 248,877 (PY: KEUR 214,776).

'Radar / IFF / Datalink' contributed 36% (PY: 28%), 'Spectrum Dominance & Airborne Solutions' 29% (PY: 31%) and 'Optronics' 22% (PY: 27%). 'Customer Services' accounted for 13% of revenue (PY: 14%). The acquisition of HENSOLDT France SAS contributed to reinforcing Radar / IFF / Datalinks.

Gross profit amounted to KEUR 203,797 (PY: KEUR 85,794). This includes cost of goods sold in the amount of KEUR -906,321 (PY: KEUR 831,299), which also comprises the impairment loss from receivables and performance as well as contract assets. This is composed mainly of the material and personnel costs of projects. This also includes separation costs of KEUR -7,081 (PY: KEUR -45,607) for the finalization of the IT and site separation expenses necessary for the purposes of the 'Orlando' carve-out from the Airbus Group as well as other non-recurring effects of KEUR -93,070 (PY: KEUR -126,201), which had a negative impact on earnings. Non-recurring effects relate to amortization costs from the adjustments to fair values in the context of purchase price allocations.

Earnings before interest and tax (EBIT) of the financial year amounts to KEUR 21,760 (PY: KEUR -69,059). The selling and distribution expenses contained in this of KEUR -76,848 (PY: KEUR -49,001) mainly include the cost center costs of sales and marketing and expenses for sales support. In line with the increase in sales activities, in the financial year clearly higher operating selling and distribution expenses were incurred than in the prior year. General administrative costs of KEUR -68,850 (PY: KEUR -80,372) include personnel-related costs of the administration and other non-recurring effects, which include KEUR -24,664 (PY: KEUR -13,010) in costs for the design of 'stand-alone' capabilities, the international representative offices and the global distribution structure as well as restructuring expenses incurred for the efficiency program 'HENSOLDT GO!'. Transaction costs of KEUR -1,044 clearly declined relative to the prior year (KEUR -28,914).

The return on sales calculated relative to adjusted EBIT of KEUR 147,619 (PY: KEUR 144,673) amounted to 13.30% (PY: 15.78%). The slight decline over the prior year is due in particular to the higher operating selling and distribution expenses in the financial year. In addition, in contrast to the financial year under review, in 2017 the first two months, which customary for the industry are low margin months, were not included; this had a

positive influence on return on sales in the prior year. Operating activities of the HENSOLDT Group only began in the prior year on February 28, 2017, with the acquisition of the 'Orlando' investments.

Finance income/costs amounted to KEUR -86,845 (PY: KEUR -53,371). Negative finance income/costs mainly result from the interest expense for shareholder loans in the amount of KEUR -25,561 (PY: KEUR -24,695) and for other existing bank loans and those taken up in the financial year of KEUR -56,336 (PY: KEUR -20,919). The increase in interest expense is, on the one hand, due to the nominal increase in the Term Loan to EUR 920 million, and, on the other, to the measurement through profit or loss of the derivatives embedded therein in accordance with IFRS 9. Equally, amounts arising from unwinding the discount on pension and similar obligations of KEUR -6,829 (PY: KEUR -4,852) are included in interest expense. Interest income in the financial year amounts to KEUR 14,854 (PY: KEUR 12,369). The adjustment of the fair values of derivative financial instruments resulted in income of KEUR 10,325 (PY: KEUR 8,590); interest income of KEUR 1,309 (PY: KEUR 2,281) was generated from the measurement of plan assets.

For orders received that are invoiced in foreign currency, the Group concludes forward exchange transactions in order to rule out or minimize foreign exchange risks (hedging). In addition, the Group applies the cash flow hedge model in South Africa to hedge its foreign currency transactions. In financial year 2018, a gain on foreign currency translation of KEUR 2,011 (PY: KEUR 5,726) was recognized.

A tax income of KEUR 5,205 in the financial year (PY: KEUR 22,010) was recognized under income taxes. This includes a current tax expense of KEUR 7,997 (PY: KEUR 2,339) and an opposing effect from deferred tax income of KEUR 13,202 (PY: KEUR 24,349). The deferred tax effects are declining but continue to be determined by transaction-related non-recurring effects, such as amortization from increased inventories.

A consolidated loss after taxes of KEUR -59,880 (PY: KEUR -100,420) was generated in the financial year, of which KEUR -60,565 (PY: KEUR -101,374) relates to the owner of the parent company and KEUR 685 (PY: KEUR 954) to non-controlling interests. As in the prior year, negative earnings is due mainly to the amortization of the purchase price allocation.

Management assessed the business performance and the position as positive overall. Despite the at times difficult environment, ambitious targets for both revenue and order intake were almost met. On account of the rigorous implementation of measures to improve efficiency, adjusted earnings before interest and tax (EBIT) met our expectations in full.

III. Forecast

1. Development of overall economic conditions

The International Monetary Fund (IMF) expects the global economy to grow by 3.7% in 2018 and 3.5% in 2019 (Source: World Economic Outlook (WEO), January 2019).

For the euro area, the IMF expects average growth of 2.0% and thus sees a slight softening of growth compared to the prior forecast. In addition to the positive development of a high level of domestic demand and planned investments in general and digital infrastructure, continued apparent uncertainties in global trade disputes and expected sanctions and export

bans due to political developments have a curbing effect. Pending Brexit is also dampening favorable development.

Following growth in 2018, a slight slowdown is expected for 2019, which is being driven by unsustainable policy measures, according to the IMF. Alongside risks on goods and services markets, these uncertainties could compel the central banks of the advanced economies to abandon expansive monetary policies. Reforms, the avoidance of protectionist measures and creation of financial buffers are thus necessary in order to prepare to a possible tightening in financial conditions.

The Russia-Ukraine crisis, which appears to have been stepped up by incidents in the Kerch strait and conflicts in the Middle East, especially in Syria, and the Yemen conflict and the handling of the refugee crisis all continue to influence national security and defense and the macroeconomic environment.

An increasing great power competition is also evident between the USA, China and Russia. In view of these developments, the European heads of state and government highlighted the necessity to make the EU a more powerful security player at the 55th Munich Security Conference. Transatlantic disagreements were evident at the conference and the US Vice President again demanded that the NATO partners comply with their obligations in respect of collective defense.

The Yemen conflict, the security situation in Turkey and affairs connected with the journalist Jamal Khashoggi had a direct impact on the business in 2018. These security issues resulted in a decline in the approvals for armaments in Turkey and Saudi Arabia issued by the German Federal Government and, in the case of Saudi Arabia, also a freeze on exports that have already been approved.

2 Developments in the defense and security sector

The global security situation remains tense and this is also reflected in increasing defense spending worldwide. The developments in Germany, Europe and NATO are particularly relevant for HENSOLDT. NATO members continue to work to achieving the goals formulated at the NATO Summit in Wales in 2014. The most important aspect is the declaration of intent to move towards defense spending of 2% of GDP.

An increase in the German defense budget to EUR 42.9 billion is planned for 2019 in the government bill for the 2019 budget and the finance plan to 2022. Based on the EUR 38.5 billion in 2018, this would represent growth of 11.4% to 1.31% of GDP. The budget 'Single plan 14', which includes Germany's defense spending, will increase to EUR 43.9 billion by 2022. Defense Minister Ursula von der Leyen has announced the intent of achieving defense spending equivalent to 1.5% of GDP by 2025. The corresponding proposal of CDU leaders was confirmed by delegates at the party congress on December 8, 2018. Based on the current positive overall economic development, experts estimate that this would correspond to approx. EUR 60 billion in 2025.

At the time of preparing the management report there was no information available regarding the share of arms expenditure in 2019. Hitherto this included items for the combat aircraft Eurofighter, the transport aircraft Airbus A400M, the support helicopter Tiger, the helicopter NH90 and the Frigate 125. In addition to the matters specified, in the near future items for the

multi-purpose battleship MKS 180, the corvette K130 and the tactical air defense system TLVS are expected. The HENSOLDT Group is involved in all systems via supply contracts.

France will considerably increase its defense spending between 2019 and 2025. This was already decided by the government cabinet in February 2018. The French defense budget for 2018 amounts to EUR 34.2 billion, which is EUR 1.8 billion more than in the prior year. The French defense budget is expected to increase each year by EUR 1.7 billion to 2022. In 2022, defense spending is expected to be EUR 44 billion – 36% above the 2017 level. The defense budget is scheduled to rise by EUR 3 billion each year between 2022 and 2025 in order to achieve the NATO 2% target by 2025. In addition, the governments in Germany and France agreed in 2017 on intensive cooperation for defense projects and signed memoranda of understanding on joint ventures for reconnaissance aircraft, transport aircraft and for a new combat aircraft system.

On January 22, 2019, German Chancellor Angela Merkel and French President Emmanuel Macron signed the Treaty of Aachen, which serves to supplement the existing Élysée Treaty. According to the text of the Treaty both countries intend to develop a joint strategic culture in respect of military deployment. In addition, both countries aim to drive the consolidation of the European defense industry and to reach an agreement on contentious armament exports. To this end, a new Franco-German defense and security council is to be established which will meet regularly and steer collaboration. In addition, there is the first political understanding on common procedures for armament exports in the context of Franco-German joint projects or supplies.

The UK will show defense spending of GBP 37.8 billion in 2018/19. As a result, the UK is expected to comply with the NATO target of 2% for the eighth year in succession. Current publicly issued figures expect an increase in defense spending until 2019/2020 of GBP 38.8 billion. This implies an increase of 10% compared with 2016/2017.

Especially strong increases in defense spending have been observed in the Eastern European countries, which is attributable to greater uncertainty since the beginning of the conflict in Eastern Ukraine. Almost all countries in Eastern and Southeast Europe as well as the Baltic states therefore aim to comply with the target set in Wales and to ensure the protection of NATO's eastern border and the airspace over the Baltics. Here the trend towards defense budget cutbacks as a result of the global banking and financial crises has been reversed already since the annexation of the Crimean peninsula by Russia.

In addition, further growth in the APAC region and BRIC countries is again expected. However, Russia and China make up a significant share of these markets and are not accessible or difficult to access for HENSOLDT Group's products.

The export environment for defense and security goods, in particular in non-European customer countries, is currently subject to a restrictive export approval policy under the German War Weapons Control Act and the Foreign Trade and Payments Act.

3. Outlook

In the operational planning for the HENSOLDT Group, management assumes further revenue growth for 2019 between 10% and 14%. In addition, on the basis of the current development in the security and defense industry, management expects increasing order

intake in the same range for 2019, and possibly above this in the best-case scenario. Efficiency measures already introduced as well as the continued implementation of cost saving programs under the improvement program 'HENSOLDT GO!' mean a significant increase in earnings before interest and tax (operating earnings, EBIT) is expected for 2019. Management expects increases here of between 4% and 11%.

The forecasts depends strongly on the conditions referred to in the opportunities and risks report and, besides the macroeconomic developments described above, is based on the multi-year business plan of the Group. This forecasts a US dollar exchange rate of USD 1.28/EUR 1.00 (based on the forecasts of Bloomberg/Thomson Reuters) and an inflation rate and increase in personnel expenses on average of 2%.

On June 23, 2016, a majority of 51.89% voters in the United Kingdom voted for the United Kingdom to leave the European Union ('Brexit'). The exit process began on March 29, 2017. According to the current status of talks between the United Kingdom and the EU, exit is planned for March 29, 2019.

The HENSOLDT Group plans for approx. 5% of total revenue volume to be attributable to end customers and business customers from the UK for 2019 to 2021. The Group also expects order intake in a similar volume. Business from the United Kingdom with the European Union in the planning period is estimated to account for approx. 2% - 3% of the total volume of the HENSOLDT Group. Therefore, the Group currently expects Brexit to have only a marginal effect on current and future business in the planning period at this juncture. Nevertheless, additional charges due to customs duties and VAT as well as extensive administrative challenges from both the VAT and income tax perspective should not be disregarded.

The current geopolitical conditions, especially the Yemen conflict, the security situation in Turkey and the affair surrounding the journalist Jamal Khashoggi resulted in a decline in the approvals issued by the German Federal Government for armaments and to a partial export freeze by the German Federal Government in the case of Saudi Arabia. Consequently, HENSOLDT Group has subjected projects expected in the period of operational planning which should have resulted in supplies to these countries to very conservative consideration.

IV. Opportunities and risks

The HENSOLDT Group is subject to diverse risks and uncertainties that could affect financial earnings and forecast growth targets of the business. The following risks are presented in decreasing order of significance.

These risks and uncertainties relate particularly to economic development or changes in the regulatory environment in the economies that are important for the business, the development of highly competitive markets, the availability of sufficient operating resources in the supply chains as well as the availability of sufficient liquidity in the financial markets, or financial support from governments, changes to tax law, product liability, product warranties and intellectual property rights.

In the first six months of 2018, the German Federal Government approved the export of armaments in the amount of approx. EUR 2.57 billion, thus approx. EUR 1 billion less than in

the prior-year period. The German Federal Government thus continues to set a more restrictive armament export policy. The negative impact for HENSOLDT is however assessed to be low as Germany is one of the core markets for HENSOLDT, HENSOLDT's civilian products can be sold without restriction worldwide and the participation in major European projects promises new business. At the same time, there is the first political understanding on common procedures for armament exports in the context of Franco-German joint projects or supplies.

With the development of new products, systems and customer-specific solutions in the Radar, Electronic Warfare Technologies and Optronics areas, HENSOLDT Group is laying the basis for future business successes. In the early phase of projects spanning many years, which are typical for the security and defense industry, there are uncertainties concerning the achievement of technical implementation by the agreed delivery dates and respecting relevant budgets. However, management sees no risk for the business from these uncertainties, as appropriate risk provisioning has been made for these.

In the delivery and operating phase, provided the predicted learning curve effect can be achieved, economic success potential and further opportunities can be realized in the expansion of the service business. One challenge is the continuation and successful implementation of the ongoing efficiency enhancement program. Additional opportunities and risks result from the integration of newly acquired or formed group companies. This could possibly result in synergies, for instance through the centralization of functions.

The conclusions derived following the portfolio review of the Airbus Defence and Space division to spin off the 'Security and Defense Electronics' businesses and to sell the shares, led to a realignment of central departments in the HENSOLDT Group as an autonomous business unit and the implementation of new processes in these functions, among other things.

Following transfer of the shares in HENSOLDT to the investment company KKR & Co. L.P., the main aim of the business is to generate additional business volume. To this end, the initiative 'HENSOLDT GO!' was initiated. This focuses on five long-term, strategic policies: 'Provide innovative products and solutions', 'Expand the range of target markets', 'Increase customer proximity', 'Establish a stronger corporate culture' and 'Increase operating efficiency'. This first phase initially involves implementing promising improvement measures. These include strengthening the distribution network, expanding the global partner network, increasing operating efficiency and optimization, a market-oriented expansion of the product portfolio and review of efficiency in the support functions such as HR, finance and communication.

The exit process for Brexit began on March 29, 2017. According to the current talks between the United Kingdom and the EU, exit is planned for March 29, 2019. It remains unclear how Brexit will look and what consequences it will specifically have for HENSOLDT. A hard Brexit without an exit agreement with the EU would result to an increased burden for HENSOLDT from customs duties and VAT. In addition, there would be extensive administrative challenges from both the VAT and income tax perspective. Preparatory measures based on a risk evaluation have already been taken at HENSOLDT – to the extent that it is possible – to be braced for all eventualities.

Overall, management classifies the opportunities and risk profile of HENSOLDT Group to be evenly balanced, which is maintained by proactive opportunity and risk management

1. Risk management

Enterprise risk management and internal control system

Due to its global activities, the HENSOLDT Group is naturally exposed to a range of risks that are inextricably linked to its business activities.

One of the main objectives of management is to ensure an effective risk management and internal control environment. The HENSOLDT Group has a group-wide enterprise risk management (ERM) system for integrating the risk management and internal control systems (ICS). This is established within HENSOLDT Holding Germany GmbH for the Group.

The requirements of the ERM system are set out in the Group policy 'Enterprise Risk Management (ERM) Policy' (BMS-ERM-001-EN). The ICS system is documented in the Group policy BMS-ICS-001-EN.

Regardless of the design and implementation of the ERM system, all risk management and internal control systems are subject to inherent limitations such as vulnerability to system workarounds or conscious negative interference with the internal control system by individual company employees.

The ERM system covers all major types of risks and opportunities, whether operational, functional, location-specific or business process-related risks or opportunities. Risks and opportunities are assessed by the probability of occurrence and the amount of potential damage as well as the impact on business performance is measured.

A formal mechanism for the annual self-assessment of the ERM system is included in the business process and is carried out by identified responsible persons in their areas of responsibility. Regular monitoring allows for identified risks and opportunities to be remeasured if necessary and for the tracking of risk-reducing or opportunity-enhancing activities and control measures. The results of ongoing monitoring are regularly reported in ERM reports. In addition, selected risk management and internal controls systems in the business units are subject to an independent audit by the internal audit team.

Compliance

The HENSOLDT Group is subject in all countries in which it operates or sells its products to a range of compliance requirements. In view of the industry and the markets in which HENSOLDT operates, HENSOLDT has determined as significant areas of risk: corruption, data protection, export controls, economic sanctions and competition law. These issues are dealt with centrally by the compliance department. In addition, all areas of HENSOLDT are responsible for compliance with applicable laws and regulations in the course of their work.

HENSOLDT issued standards to the business and all employees for the most important ethical questions and compliance issues in its policy 'Standards of Business Conduct'. All employees receive regular training on this. To further minimize risk, HENSOLDT introduced processes for dealing with third parties (including sales representatives), gifts and invitations

as well as memberships and donations. Other measures include processes for regulating export controls and international sanctions as well as an anti-boycott directive that should prevent behavior that could lead to illegal violations of boycotting measures.

In connection with the current compliance policy, HENSOLDT employees are obliged to promptly report all compliance violations to their supervisors, their contacts in the HENSOLDT compliance team, the head of the compliance department or any other employee of the HENSOLDT compliance team. In addition, employees have the option of anonymously reporting violations to the 'OpenLine' (anonymous telephone and email hotline).

2. Corporate finance

Functional activities in the area of corporate finance are conducted by the Corporate Finance & Investor Relations department of HENSOLDT Sensors GmbH.

The business is exposed to a range of financial risks; in particular foreign exchange risk and interest rate risk, liquidity risk and credit risk.

Overall, HENSOLDT's financial risk management system concentrates on minimizing unforeseeable market risks and their potential negative effects on the operating and financial performance of the business.

HENSOLDT engages with financial derivatives solely to mitigate risk (hedging).

The corporate finance department's risk-related activities include in particular:

Financial management

The Corporate Finance & Investor Relations department is centrally responsible for the financial management of the HENSOLDT Group and in this function sets out framework conditions in the form of finance guidelines. These primarily include ensuring external group financing at all times, coordinating financing needs within group entities and monitoring corresponding internal and external compliance requirements, such as compliance with covenants of loan agreements.

In the course of its financial management, the HENSOLDT Group is exposed to interest rate risks and currency risks as a result of exchange rate fluctuations. Both the interest rate risks and currency risks are mitigated by way of corresponding interest rate hedges and foreign currency hedges. The aim of interest rate and currency management is to limit the impact of exchange rate fluctuations on the financial performance and assets and liabilities of HENSOLDT Group.

Liquidity management

To ensure the liquidity of the HENSOLDT Group, the business has the option of utilizing a revolving credit facility ('RCF'). In order to plan the required utilization of this, there is a comprehensive process in place for planning future liquidity requirements.

Guarantee management

For certain projects, in particular in the event of advance payments before delivery, HENSOLDT Group entities require guarantees that are issued as collateral instrument for customers. The business has its own guarantee lines with various banks and insurers. The guarantees for the respective companies are issued centrally by the Corporate Finance & Investor Relations department.

Currency management

The HENSOLDT Group carries out some transactions in foreign currency. The income and cost risks resulting from currency development are limited by purchases and sales in corresponding foreign currencies as well as forward exchange transactions. Hedging contracts are concluded for aggregated foreign exchange risks of various customer or supplier contracts. Corresponding forward foreign exchange contracts are concluded with banks for the respective group entities.

Insurance management

The Corporate Finance & Investor Relations department is responsible for the insurance management of the Group. In addition, AON was engaged as external insurance broker to place company insurance policies with insurers.

V. Non-financial performance indicators

Occupational safety, health and environmental protection

The health of employees, occupational safety and environmental protection are all integral components of the non-financial performance indicators of the HENSOLDT Group. To this end, the Company established site management committees at all sites; these meet once a month to discuss these issues at the various locations and adopt and implement improvement measures.

The occupational, health and environmental protection management system integrated in all locations is certified in accordance with the standard ISO 14001 (EuroAvionics Holding GmbH, Kelvin Hughes Ltd., HENSOLDT Optronics GmbH, HENSOLDT Sensors GmbH) and OHSAS 18001 (HENSOLDT Sensors GmbH). The Ulm and Oberkochen locations are also certified in accordance ISO 50001 energy management.

HENSOLDT Sensors and HENSOLDT Optronics successfully secured recertification of the management systems in 2018.

Surveys on 'psychological stress and employee health' were carried out at the Taufkirchen and Oberkochen locations. At the HENSOLDT Sensors GmbH locations, annual safety training is offered for cyclists and motorcyclists. There are also training and workshops for safety inspectors in collaboration with the employers' liability insurance association. The newsletter (issue of the month) addresses issues regarding energy, environmental protection and occupational safety and employees are made aware of these issues. A lively exchange on this subject area is conducted between HENSOLDT Sensors GmbH and HENSOLDT Optronics GmbH. A joint HSE (Health Safety Environment) internet presence of both companies is a prelude to closer cooperation from 2019.

VI. Corporate governance statement

Regarding female representation on the Supervisory Board of HENSOLDT Holding GmbH, a target of 16.67% was defined for the period until December 31, 2021. Regarding female representation among the managing directors of HENSOLDT Holding GmbH, a target of 20% was defined for the period until December 31, 2021.

Taufkirchen, March 8, 2019

HENSOLDT Holding GmbH

Management

Thomas Müller

Axel Salzmann

Peter Fieser

Independent Auditor's Report

To HENSOLDT Holding GmbH, Taufkirchen, District of Munich

Opinions

We have audited the consolidated financial statements of HENSOLDT Holding GmbH, Taufkirchen, District of Munich, and its subsidiaries (the Group), which comprise the consolidated statement of financial position as of December 31, 2018, the consolidated income statement, the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the financial year from January 1 to December 31, 2018, and notes to the consolidated financial statements, including a summary of significant accounting policies. In addition, we have audited the group management report of HENSOLDT Holding GmbH for the financial year from January 1 to December 31, 2018. In accordance with German legal requirements, we have not audited the content of the corporate governance statement pursuant to Section 289f (4) HGB (information on female representation), which is included in Section VI of the management report.

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

- the accompanying consolidated financial statements comply, in all material respects, with the IFRSs as adopted by the EU, and the additional requirements of German commercial law pursuant to Section 315e (1) HGB [Handelsgesetzbuch: German Commercial Code] and, in compliance with these requirements, give a true and fair view of the assets, liabilities, and financial position of the Group as of December 31, 2018, and of its financial performance for the financial year from January 1 to December 31, 2018, and
- the accompanying group management report as a whole provides an appropriate view of the Group's position. In all material respects, this group management report is consistent with the consolidated financial statements, complies with German legal requirements and appropriately presents the opportunities and risks of future development. Our opinion on the management report does not cover the content of the corporate governance statement mentioned above.

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

Basis for the Opinions

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

Other Information

Management is responsible for the other information. The other information comprises:

- the corporate governance statement pursuant to Section 289f (4) HGB (information on female representation) and
- the remaining parts of the annual report, with the exception of the audited consolidated financial statements and group management report and our auditor’s report.

Our opinions on the consolidated financial statements and on the group management report do not cover the other information, and consequently we do not express an opinion or any other form of assurance conclusion thereon.

In connection with our audit, our responsibility is to read the other information and, in so doing, to consider whether the other information

- is materially inconsistent with the consolidated financial statements, with the group management report or our knowledge obtained in the audit, or
- otherwise appears to be materially misstated.

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

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

In preparing the consolidated financial statements, management is responsible for assessing the Group's ability to continue as a going concern. They also have the responsibility for disclosing, as applicable, matters related to going concern. In addition, they are responsible for financial reporting based on the going concern basis of accounting, provided no actual or legal circumstances conflict therewith.

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

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

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

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

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

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

- Identify and assess the risks of material misstatement of the consolidated financial statements and of the group management report, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinions. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as

fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls.

- Obtain an understanding of internal control relevant to the audit of the consolidated financial statements and of arrangements and measures (systems) relevant to the audit of the group management report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of these systems.
- Evaluate the appropriateness of accounting policies used by management and the reasonableness of estimates made by management and related disclosures.
- Conclude on the appropriateness of management’s use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group’s ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in the auditor’s report to the related disclosures in the consolidated financial statements and in the group management report or, if such disclosures are inadequate, to modify our respective opinions. Our conclusions are based on the audit evidence obtained up to the date of our auditor’s report. However, future events or conditions may cause the Group to cease to be able to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements present the underlying transactions and events in a manner that the consolidated financial statements give a true and fair view of the assets, liabilities, financial position and financial performance of the Group in compliance with IFRSs as adopted by the EU and the additional requirements of German commercial law pursuant to Section 315e (1) HGB.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express opinions on the consolidated financial statements and on the group management report. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our opinions.
- Evaluate the consistency of the group management report with the consolidated financial statements, its conformity with [German] law, and the view of the Group’s position it provides.
- Perform audit procedures on the prospective information presented by management in the group management report. On the basis of sufficient appropriate audit evidence we evaluate, in particular, the significant assumptions used by management as a basis for the prospective information, and evaluate the proper derivation of the prospective information from these assumptions. We do not express a separate opinion on the prospective information and on the assumptions used as a basis. There is a substantial unavoidable risk that future events will differ materially from the prospective information.

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

Munich, March 8, 2019

KPMG AG
Wirtschaftsprüfungsgesellschaft
[Original German version signed by:]

Leistner
Wirtschaftsprüfer
[German Public Auditor]

Peschel
Wirtschaftsprüfer
[German Public Auditor]