Q2 | 2016

KONTRON GROUP | QUARTERLY REPORT

POSSIBILITIES START HERE

KONTRON IN FIGURES

		Q2/2016	Q2/2015	01–06/2016	01–06/2015
RESULTS OF OPERATIONS AND PROFITABILITY					
Revenues	€ million	90.9	108.5	180.5	207.0
EBITDA [1]	€ million	–7.2	0.6	–8.5	1.4
EBITDA margin [2]	%	–7.9	0.6	–4.7	0.7
EBIT [3]	€ million	–79.9	–4.4	–86.0	–8.7
EBIT [4] (adjusted)	€ million	–10.0	–1.8	–14.9	–4.0
EBIT margin [2] (adjusted)	%	–11.0	–1.7	–8.3	–1.9
EBT	€ million	–80.6	–5.0	–87.2	–9.8
Net income / loss for the period	€ million	–81.1	–6.4	–87.6	–10.4
Earnings per share (basic / diluted)	€	–1.46	–0.11	–1.58	–0.19
CASH FLOW		Q2/2016	Q2/2015	01–06/2016	01–06/2015
Cash flow from operating activities	€ million	–8.8	–9.3	–1.9	4.3
STATEMENT OF FINANCIAL POSITION				06/30/2016	12/31/2015
Total assets	€ million			318.9	441.9
Equity	€ million			219.3	258.9
Equity ratio	%			68.8	58.6
Financial debt	€ million			4.5	57.3
EMPLOYEES				06/30/2016	06/30/2015
Employees				1,258	1,280

[1] EBITDA is defined as EBIT before depreciation and amortization.
[2] Margins refer to revenues.
[3] EBIT is defined as earnings before interest, other finance costs and tax.
[4] EBIT is adjusted for cost of restructuring and reorganizing the company, non-recurring costs and impairment losses on goodwill and other non-current assets.

KONTRON – A PROFILE OF THE COMPANY

Kontron is a leading global provider of Embedded Computer Technology (ECT) with a product portfolio that covers the entire range of standard modern products for circuit boards and modules right through to specific system solutions for customers. In addition to offering its customers embedded technologies, Kontron also offers services tailored to its product portfolio. Our engineers have a wealth of experience in developments and solutions expertise and our sales staff has excellent knowledge of the market, customers and products – this makes Kontron an internationally respected partner.

ECT is used in technical applications to realize monitoring, management and controlling functions as well as special forms of data processing or data transmission. The requirements placed on ECT are as numerous as the fields of application. Kontron's products not only have to possess the mandatory certifications, but also meet the detailed specifications of the customer and remain available without any technical change over the entire life cycle of the application. Qualities such as reliability, security and longevity are what make our high-quality products so successful in the market. The development of solutions that, on the one hand, occupy ever less space and, on the other, are increasingly networked, opens up a growing field of technological applications for ECT. The relevant market segments for Kontron display a particular need for ECT products, promising growth rates and great prospects for the future. In addition, the latest trends and market needs for the Internet of Things (IoT) and machine to machine communication (M2M) will have a positive impact on the ECT business in future.

GLOBAL ORGANIZATION AND BUSINESS UNITS

The global organization divides our business into three business units:

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

GLOBAL PRESENCE

Together with its subsidiaries and sales offices, Kontron AG maintains a global presence. The company has its headquarters in Augsburg and has subsidiaries in 13 countries, including Germany, France, the US, Canada, China, India and Malaysia. These subsidiaries and the international sales offices ensure that the company is in close proximity to its customers and regional markets. As of June 30, 2016, the Kontron Group employed 1,258 staff worldwide.

For further information please visit
www.kontron.de

INTERIM MANAGEMENT REPORT

RESULTS OF OPERATIONS

Consolidated revenues continued to decline in the second quarter of 2016, falling from € 108.5 million in the comparative period of the prior year by € 17.6 million to € 90.9 million. At € – 10.0 million (Q2/2015: € – 1.8 million), EBIT adjusted for restructuring cost, non-recurring costs and impairment losses, like revenues, fell considerably short of expectations. The first half of 2016 reflected this development: revenues came to € 180.5 million in the first six months of the year, compared to € 207.0 million in the first half of 2015. Adjusted EBIT deteriorated from € – 4.0 million in the first six months of 2015 to € – 14.9 million in the first half of 2016.

The decline in revenues was seen in all business units. Revenues in the Avionics / Transportation / Defense unit came to € 22.7 million in the second quarter, following € 28.9 million in the comparative period of the prior year. This represents a 21.4 % decrease. As a result of this development, Avionics / Transportation / Defense only accounted for 25.0 % of consolidated revenues in the second quarter (Q2/2015: 26.6 %). The Communications business unit closed the quarter with revenues of € 22.3 million, also below the level of the comparable quarter of the prior year (Q2/2015: € 26.2 million), thereby accounting for 24.5 % (Q2/2015: 24.1 %) of total revenues. The development of the Industrial business unit was also negative, where revenues fell by 14.0 % to € 45.9 million (Q2/2015: € 53.4 million). Accounting for 50.5 % of revenues (Q2/2015: 51.1 %), this business unit continues to be the largest business unit of the Kontron Group.

Cost of goods sold came to € 74.0 million in the second quarter of 2016, following € 81.4 million in the comparative period of the prior year. While productions costs remained virtually unchanged at € 6.6 million, amortization of capitalized development projects rose from € 3.0 million to € 3.8 million due to impairment losses. The cost of materials also increased as a percentage of revenues on account of necessary value adjustments. Excluding these value adjustments, which, among other things, stemmed from the revised revenues forecast, the cost of materials decreased in proportion to revenues.

As a result, the gross profit came to € 16.9 million, below the level of the prior-year quarter (Q2/2015: € 27.0 million). Gross margin decreased significantly, sliding by more than six percentage points to 18.6 %.

Operating cost rose by 32.0 % or € 9.0 million to € 37.1 million in the second quarter of 2016 (Q2/2015: € 28.1 million). The increase is chiefly attributable to the non-recurring costs, which were incurred in connection with the strategic partnership with Ennoconn, as well as impairment losses on tangible assets.

The reversal of the provisions no longer needed as well as the anticipated decrease in current expenses gave rise to restructuring cost of € – 0.9 million compared to € 2.7 million in the comparative quarter of the prior year.

In view of the adjusted revenues and earnings prospects, an impairment test was performed as of June 30, 2016. This test revealed a need to record impairment losses on goodwill of € 60.9 million.

Other operating income less other operating expenses rose by € 1.0 million on the comparative quarter of the prior year to € 0.2 million (Q2/2015: € – 0.8 million).

On aggregate, earnings before interest and taxes (EBIT) deteriorated from € – 4.4 million to € – 79.9 million. At € – 0.6 million, the financial result remained unchanged on the comparative quarter of the prior year (Q2/2015: € – 0.6 million). The expense from income taxes, which still included provisions for potential risks related to tax audits in the second quarter of 2015, stood at € – 0.6 million in the second quarter of 2016 (Q2/2015: € – 1.3 million)

This gives rise to a net loss of € 81.1 million for the second quarter of 2016 (Q2/2015: net loss of € 6.4 million). Earnings per share came to € – 1.46, after € – 0.11 in the comparative quarter of the prior year. The net loss for the first six months of the year came to € 87.6 million compared to € 10.4 million in the first six months of 2015, while earnings per share were € – 1.58 (first six months of 2015: € – 0.19).

ORDER INTAKE AND ORDER BACKLOG

The order intake in the second quarter of 2016 came to € 104.6 million and was therefore € 4.5 million up on the comparative quarter of the prior year (Q2/2015: € 100.1 million). This increase is primarily attributable to the Avionics / Transportation / Defense business unit, which saw a € 7.6 million rise on the comparative quarter of the prior year (Q2/2016: € 35.9 million; Q2/2015: € 28.3 million). The Communication business unit remained at a similar level with an order intake of € 20.8 million (Q2/2015: € 20.3 million). The Industrial business unit reported a € 3.6 million decrease in order intake to € 47.9 million.

The order backlog of € 270.2 million as of June 30, 2016, is significantly below the prior-year figure of € 322.5 million.

FINANCIAL POSITION

The change in the financial position is primarily shaped by the strategic partnership with Ennoconn. The income of € 50.3 million generated from the sale of the 49 % stake in Kontron Canada Inc. in the first quarter of 2016 was utilized to repay liabilities to banks in the second quarter of 2016.

The cash outflow from operating activities came to € 8.8 million in the second quarter of 2016, compared to a cash outflow of € 9.3 million in the second quarter of 2015. The net loss for the quarter as well as the cash outflow resulting from higher trade receivables was counterbalanced by cash inflows from reduced inventories.

The cash flow from investing activities increased by € 4.2 million to € – 4.8 million on the comparable prior-year period chiefly due to investments in the global SAP system in the second quarter of 2015.

As of June 30, 2016, the Group carried cash and cash equivalents of € 13.9 million, € 13.9 million lower than the figure as of December 31, 2015. In sum, net debt of € 29.4 million as of December 31, 2015 was counterbalanced by a surplus of cash and cash equivalents of € 9.4 million as of June 30, 2016.

The gearing ratio (debt / equity) of the Group stood at 45.4 % as of June 30, 2016, 25.3 percentage points below the 70.7 % reported on December 31, 2015.

Kontron AG has complied with all covenants in connection with the credit facility to date. The Management Board assumes that the company will continue to do so in the future as well.

NET ASSETS

Total assets came to € 318.9 million as of June 30, 2016. This represents a decrease of € 123.0 million or 27.8 % compared to year-end 2015. This development is mainly attributable to the impairment losses recorded on goodwill and other tangible assets as of June 30 as well as the significant decline in trade receivables and trade payables.

Current assets decreased by 21.2 % or € 53.0 million compared to December 31, 2015. In this context, cash and cash equivalents decreased € 13.9 million to € 13.9 million and inventories were down € 7.3 million to € 76.0 million as a result of impairment losses of € 3.5 million. At € 89.4 million, trade receivables were € 33.2 million below the level as of December 31, 2015, which was unusually high on account of strong revenues at year-end 2015. Other current receivables and assets of € 12.5 million were € 2.0 million above the level seen at the end of the prior year, primarily due to higher prepayments received.

At € 121.5 million, non-current assets were down 36.5 % or € 69.9 million compared to year-end 2015 mainly due to the impairment losses recorded on goodwill (€ 60.1 million) and on property, plant and equipment (€ 6.0 million). The balance of deferred tax assets and deferred tax liabilities increased slightly by € 0.3 million to € 8.9 million. Deferred tax liabilities are reported under non-current liabilities.

As of the reporting date, current liabilities were € 25.6 million or 22.4 % below the figure reported on December 31, 2015. This development is mainly attributable to the € 21.0 million lower trade payables as of the end of the quarter (June 30, 2016: € 49.9 million), primarily on account of the significant fall in the cost of materials used in comparison to the end of the prior year. Current liabilities to banks rose by € 3.8 million to € 4.5 million due to the utilization of short-term credit lines in order to finance current assets. By contrast, the provision for income taxes was reduced by € 4.9 million to € 4.8 million. As of year-end 2015, this provision had been particularly high on account of the provisions for current taxes and risks related to tax audits. Other current liabilities were also down € 1.9 million to € 20.5 million.

The € 57.7 million or 84.1 % decrease in non-current liabilities to € 10.9 million can be almost exclusively attributed to the repayment of bank loans of € 56.5 million.

At the end of the second quarter of 2016, equity came to € 219.3 million (December 31, 2015: € 258.9 million); the equity ratio stands at 68.8 % (December 31, 2015: 58.6 %). This change mainly stems from the net loss incurred in the first half of the year.

NON-FINANCIAL PERFORMANCE INDICATORS

As of June 30, 2016, Kontron had 1,258 employees (June 30, 2015: 1,280 employees). The lower headcount compared to the prior year is primarily due to a more conservative hiring policy based on the optimization measures underway. Nevertheless, replacements were sought after in a targeted manner to strengthen and maintain our research and development expertise where necessary. Employee churn on the whole was at the customary level.

SUBSEQUENT EVENTS

Kontron AG announced the introduction of a comprehensive package of measures in an ad hoc announcement on July 15, 2016. These measures are both aimed at counteracting the developments on the revenues side as well as making corresponding adjustments on the cost side.

Other than the above, no events of significance for a presentation of a true and fair view of the net assets, financial position and results of operations of the Kontron Group occurred between July 01, 2016 and July 22, 2016, the date on which this interim report was released, that would require reporting and forwarding to the Supervisory Board.

OPPORTUNITY AND RISK REPORT

Due to its business activities, its international positioning and the broad product portfolio, Kontron has many opportunities available to it, but is also exposed to numerous risks. Constant monitoring of the market and analyses of the competition as well as proactive management of potential budget deviations are a sine qua non of managing risk. In addition to the opportunities and risks disclosed in the 2015 annual report, there is a risk that the changes in the sales processes – resulting from the reorganization of the sales department – are not yet fully harmonized and implemented. This may result in delayed revenue and, in the worst case, to foregone business opportunities. With a consistent follow-up and monitoring of the implementation of the new sales organization it will be ensured that inefficiencies will be eliminated without delay. Other than the abovementioned, there have been no significant changes to the risks and opportunities in the first six months of 2016.

FORECAST

In view of the unsatisfactory first half of the fiscal year, the Management Board expects the second half of the year to develop similar to the first half. However, these improvements will not be enough to achieve our original forecast for the 2016 fiscal year. On July 15, 2016, the Management Board therefore reduced its guidance for the 2016 fiscal year. The original forecast had been for revenues between € 460 million and € 480 million, a gross margin of over 25 % and a positive EBIT-margin before restructuring cost and non-recurring costs (EBIT adjusted for restructuring cost and non-recurring costs) of between 3 % and 5 %. The Management Board assumes that both the gross margin as well as the adjusted EBIT-margin will be on a likewise level in the second half of the year as in the first half. This results in a significant shortfall of the annual targets. Net debt is also not expected to match the original forecast.

RESPONSIBILITY STATEMENT

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

Augsburg, July 22, 2016

Kontron AG
The Management Board

CONSOLIDATED STATEMENT OF INCOME (IFRS)

IN €K	Q2/2016	Q2/2015	01–06/2016	01–06/2015
REVENUES	**90,904**	108,454	**180,453**	206,986
Cost of materials	–63,631	–72,280	–119,664	–134,930
Other production cost	–6,592	–6,494	–13,157	–13,691
Amortization of capitalized development projects	–3,777	–3,034	–6,423	–6,143
Order-related development cost	0	401	0	–68
Cost of goods sold	**–74,000**	–81,406	**–139,244**	–154,832
GROSS PROFIT	**16,905**	27,048	**41,209**	52,154
Selling and marketing cost	–13,730	–12,278	–26,598	–24,550
General and administrative cost	–15,182	–8,071	–23,755	–16,822
Research and development cost	–8,154	–7,753	–15,414	–15,395
SUBTOTAL OPERATING COSTS	**–37,067**	–28,101	**–65,767**	–56,766
Restructuring cost	921	–2,628	–213	–4,727
Impairment losses on goodwill	–60,939	0	–60,939	0
Other operating income	4,115	5,768	10,614	19,286
Other operating expenses	–3,872	–6,528	–10,899	–18,646
OPERATING INCOME BEFORE FINANCIAL RESULT AND INCOME TAXES	**–79,938**	–4,440	**–85,996**	–8,699
Finance income	5	59	10	102
Finance expense	–653	–640	–1,181	–1,157
Income taxes	–548	–1,334	-442	–689
NET INCOME / LOSS FOR THE PERIOD	**–81,134**	–6,356	**–87,609**	–10,443
Thereof attributable to non-controlling interests	–106	–40	–108	–161
Thereof attributable to equity holders of Kontron AG	–81,028	–6,316	–87,501	–10,282
Earnings per share (basic/diluted) in €	–1.46	–0.11	–1.58	–0.19

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (IFRS)

IN €K	Q2/2016	Q2/2015	01–06/2016	01–06/2015
NET INCOME / LOSS FOR THE PERIOD	–81,134	–6,356	–87,609	–10,443
OTHER COMPREHENSIVE INCOME				
Other comprehensive income to be reclassified to profit or loss in subsequent periods:				
Exchange differences on translation of foreign operations	2,003	–3,743	–2,299	9,919
Reclassification for discontinued operations	–93		–93	
	1,909	–3,743	–2,393	9,919
Other comprehensive income not to be reclassified to the statement of income in subsequent periods:				
	0	0	0	0
OTHER COMPREHENSIVE INCOME AFTER TAXES	1,909	–3,743	–2,393	9,919
TOTAL COMPREHENSIVE INCOME	–79,225	–10,098	–90,002	–524
Thereof attributable to non-controlling interests	293	–125	291	–321
Thereof attributable to equity holders of Kontron AG	–79,518	–9,974	–90,293	–203

CONSOLIDATED STATEMENT OF CASH FLOWS (IFRS)

IN €K	Q2/2016	Q2/2015	01 – 06/2016	01 – 06/2015
NET INCOME / LOSS FOR THE PERIOD	– 81,134	– 6,356	– 87,609	– 10,443
Depreciation and amortization of fixed assets	11,831	5,056	16,509	10,101
Impairment losses on goodwill	60,939	0	60,939	0
Net gain / loss in connection with investing activities	2	61	4	59
Change in deferred taxes	132	– 306	– 478	– 2,651
Interest income	– 4	– 59	– 9	– 249
Interest expense	821	349	1,149	627
Other non-cash items	2,408	1,011	– 61	1,583
Change in assets / liabilities:				
Trade receivables	– 9,669	– 1,777	34,878	29,646
Inventories	8,064	232	3,743	– 9,180
Other receivables	– 1,331	4,547	– 2,044	2,990
Liabilities and provisions	267	– 11,553	– 23,440	– 16,987
Interest paid	– 676	– 233	– 1,188	– 566
Interest received	8	7	8	22
Income taxes paid	– 604	– 305	– 4,501	– 1,103
Income taxes refunded	112	46	171	420
NET CASH USED IN / PROVIDED BY OPERATING ACTIVITIES	– 8,834	– 9,280	– 1,929	4,269
Purchases of property, plant and equipment	– 627	– 2,003	-1,147	– 2,937
Purchases of intangible assets	– 3,766	– 7,106	– 7,534	– 15,222
Proceeds from the disposal of property, plant and equipment	38	86	38	1,734
Proceeds from the sale of subsidiaries, net of cash	– 440	0	– 440	0
NET CASH USED IN / PROVIDED BY INVESTING ACTIVITIES	– 4,795	– 9,023	– 9,083	– 16,425
Changes in short-term borrowings	3,792	1,137	3,792	1,129
Changes in long-term borrowings	– 43,717	11,561	– 56,513	7,351
Transactions with non-controlling interests	0	0	50,329	0
NET CASH USED IN / PROVIDED BY FINANCING ACTIVITIES	– 39,925	12,698	– 2,392	8,480
Effect of exchange rate changes on cash	271	– 459	– 520	884
NET CHANGE IN CASH AND CASH EQUIVALENTS	– 53,283	– 6,064	– 13,924	– 2,792
Cash and cash equivalents at the beginning of the period	67,182	18,909	27,823	15,637
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	13,899	12,845	13,899	12,845

CONSOLIDATED STATEMENT OF FINANCIAL POSITION (IFRS) ASSETS

IN €K	06/30/2016	12/31/2015
ASSETS		
Cash and cash equivalents	13,899	27,823
Inventories	76,045	83,333
Thereof prepayments	505	2,152
Trade receivables	89,449	122,684
Tax receivables	2,178	2,751
Other current receivables and assets	12,537	10,535
Assets held for sale	3,357	3,357
TOTAL CURRENT ASSETS	**197,464**	**250,482**
Financial assets	652	640
Property, plant and equipment	5,067	11,758
Intangible assets	66,130	67,395
Goodwill	33,102	94,454
Other non-current receivables and assets	1,360	1,407
Deferred taxes	15,168	15,772
TOTAL NON-CURRENT ASSETS	**121,478**	**191,425**
ASSETS	**318,942**	**441,907**

CONSOLIDATED STATEMENT OF FINANCIAL POSITION (IFRS) LIABILITIES AND EQUITY

IN €K	06/30/2016	12/31/2015
LIABILITIES AND EQUITY		
Trade payables	49,949	70,928
Liabilities to banks	4,492	702
Current portion of finance lease obligation	0	31
Current provisions	6,265	8,159
Deferred income	2,774	2,421
Obligations from construction contracts	0	8
Taxes payable	4,782	9,720
Other current liabilities	20,492	22,396
TOTAL CURRENT LIABILITIES	**88,754**	**114,366**
Long-term borrowings	0	56,513
Non-current provisions	1,021	1,045
Pension provisions	1,905	1,850
Non-current portion of finance lease liability	0	27
Other non-current liabilities	1,673	1,954
Deferred taxes	6,278	7,229
TOTAL NON-CURRENT LIABILITIES	**10,877**	**68,617**
Issued capital	55,683	55,683
Additional paid-in capital	200,048	200,048
Retained earnings	– 31,477	17,862
Other equity components	– 14,527	– 12,728
Treasury shares	– 1,813	– 1,813
Equity attributable to equity holders of the parent	**207,914**	**259,052**
Non-controlling interests	11,398	– 128
TOTAL EQUITY	**219,312**	**258,924**
TOTAL LIABILITIES AND EQUITY	**318,942**	**441,907**

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (IFRS)

IN €K	Issued capital	Additional paid-in capital	Retained earnings	Foreign currency translation reserve	Treasury shares		Non-controlling interests	Total equity
	Equity attributable to equity holders of the parent							
JANUARY 01, 2015	55,683	200,048	20,554	–21,492	–1,813	252,980	–282	252,698
Net income / loss for the period			–10,282			–10,282	–161	–10,443
Other comprehensive income				10,079		10,079	–160	9,919
TOTAL COMPREHENSIVE INCOME	0	0	–10,282	10,079	0	–203	–321	–524
Dividend distribution						0	–82	–82
JUNE 30, 2015	55,683	200,048	10,272	–11,413	–1,813	252,777	–685	252,092
JANUARY 01, 2016	55,683	200,048	17,862	–12,728	–1,813	259,052	–128	258,924
Net income / loss for the period			–87,501			–87,501	–108	–87,609
Other comprehensive income				–2,792		–2,792	399	–2,393
TOTAL COMPREHENSIVE INCOME	0	0	–87,501	–2,792	0	–90,293	291	–90,002
Sale of non-controlling interests			38,162	993		39,155	11,169	50,324
Other changes						0	66	66
JUNE 30, 2016	55,683	200,048	–31,477	–14,527	–1,813	207,913	11,398	219,312

SELECTED NOTES TO THE FINANCIAL STATEMENTS

1. GENERAL INFORMATION

The financial statements were prepared in euro and in accordance with the IFRSs as adopted by the EU. The accounting policies remained unchanged compared to the consolidated financial statements for the 2015 fiscal year. Standards and interpretations that are issued, but not yet effective, up to the date of publication of the interim financial statements are presented on page 137 et seq. of the 2015 Annual Report of the Kontron Group. The application of these standards and interpretations – with the exception of IFRS 9 and IFRS 15 – is not expected to have any effects on the net assets, financial position and results of operations of the Group. The impact of IFRS 9 (accounting for and measurement of financial instruments) and IFRS 15 (revenue recognition) on the net assets, financial position and results of operations of the Kontron Group is currently being analyzed.

This interim report has not been audited or subjected to external review.

All figures are in thousands of euro (€k), unless otherwise stated. Due to rounding differences, figures in tables and cross-references may differ slightly from the actual figures.

2. CHANGES IN BASIS OF CONSOLIDATION

On May 04, 2016, Kontron Europe GmbH sold all of its shares in its subsidiary Railway Infrastructure and Integration Services Sp. z o.o. in Poland.

Kontron AG transferred a share of 49 % in the subsidiary Kontron Canada Inc., Boisbriand, Canada, to Ennoconn Investment Holdings Co., Ltd. as of April 01, 2016 for a purchase price of US$ 57.3 million. The transfer took place as part of the closing of the agreement on the strategic partnership between Kontron AG and Ennoconn Corporation dated January 22, 2016.

3. INTANGIBLE ASSETS, GOODWILL

The treatment of intangible assets and goodwill is described in detail on page 177 et seq. in the 2015 Annual Report.

Internally generated intangible assets

On account of adjusted cash flow projections, impairment losses of € 1.2 million were recorded on internally generated intangible assets (capitalized development costs) in the reporting period. Of this amount, € 0.5 million is attributable to the Industrial business unit, € 0.4 million to the Communication business unit and € 0.3 million to the Avionics / Transportation / Defense business unit.

Goodwill

In view of the adjusted revenues and earnings prospects, an impairment test was performed as of June 30, 2016. In order to determine the need for impairment, the recoverable amounts of the cash-generating units was determined based on a fair value less cost of disposal calculation using cash flow projections (level 3 of the fair value hierarchy).

The cash flow projections are based on the revised budget covering a three-year period (2017 to 2019). Cash flows after the three-year period are extrapolated using a growth rate of 1 % based on the final year that was planned separately (2019). For cash-generating units, cash flows have been forecast based on operating results and reliability of recent projections, current operating results of the fiscal year and the best possible estimate of future developments, using, among other things, management's assumptions concerning market development and market assumptions. Moreover, restructuring measures are only included in the fair value less cost of disposal calculation to the extent which a potential buyer would typically implement similar measures.

The pre-tax discount rate applied to the cash flow projections is presented in the following table:

DISCOUNT RATES FOR THE CASH-GENERATING UNITS (BUSINESS UNITS)

%	06/30/2016	12/31/2015
Industrial	9.48	11.12
Communication	11.33	10.52
Avionics / Transportation / Defense	9.30	10.81

This test revealed a need to record impairment losses on goodwill allocated to the cash-generating units Communication of € 10.2 million and Avionics / Transportation / Defense of € 50.7 million; these amounts pertain to the full amount of goodwill allocated to the cash-generating units. In addition, an impairment loss of € 6.0 million was recorded on property, plant and equipment. Of this amount, € 3.8 million relates to Communication and € 2.2 million to Avionics / Transportation / Defense.

For the Industrial cash-generating unit, the recoverable amount significantly exceeds the carrying amount. The implications of the key assumptions for the recoverable amount of the Industrial cash-generating unit are presented in the table below:

IMPAIRMENT LOSS FROM PRINCIPAL ASSUMPTIONS

%	Industrial
Amount by which the recoverable amount exceeds the carrying amount (in € million)	36.3
Growth in revenues (detailed planning period)	4.5 % – 6.8 %
Necessary change in growth in revenues, so that the recoverable amount equals the carrying amount (in % points)	– 6.5
EBIT margins (%)	4.8 % – 7.3 %
Necessary change in EBIT margins, so that the recoverable amount equals the carrying amount (in percentage points)	– 1.5
Discount rate (%, after taxes)	7.40 %
Necessary change in the discount rate, so that the recoverable amount equals the carrying amount (in percentage points)	+ 1.7
Long-term growth rate (%)	1 %
Necessary change in the long-term growth rate, so that the recoverable amount equals the carrying amount (in percentage points)	– 22.8

4. EQUITY

Issued capital (share capital) of Kontron AG stood at € 55,683k as of June 30, 2016, unchanged on the prior year, and is divided into 55,683,024 shares with a par value of € 1 each.

5. MANAGEMENT BOARD AND SUPERVISORY BOARD SHARES AND SHARE OPTIONS

SHARES OF MEMBERS OF THE MANAGEMENT BOARD AND SUPERVISORY BOARD

SHARES	Shares	Stock options
SUPERVISORY BOARD		
Rainer Erlat	0	0
Sten Daugaard	0	0
Martin Bertinchamp	30,500	0
Harald Joachim Joos	0	0
Dr. Harald Schrimpf	2,500	0
Dr. Dieter Düsedau	0	0
MANAGEMENT BOARD		
Rolf Schwirz	50,000	0
Andreas Plikat	25,000	0

6. INFORMATION ON FINANCIAL INSTRUMENTS

The carrying amount of all financial assets and financial liabilities as of June 30, 2016 corresponds with their fair value. The derivative financial instruments held by the Group consist of forward exchange contracts, foreign exchange swaps and currency options (plain vanilla options) and qualify for classification in level 2 in the fair value hierarchy. The fair value of forward exchange contracts and foreign exchange swaps is calculated at the forward rates as of the reporting date and the results are then presented at the discounted present value. The fair value of currency call options is measured using common option-pricing models ("Black-Scholes").

The nominal value of the outstanding currency hedging transactions totals € 24.3 million as of the reporting date (December 31, 2015: € 66.3 million).

The interest rate swaps concluded in the prior year to hedge financial liabilities subject to variable interest rates were released through profit and loss in the financial result on account of the elimination / significant reduction of financial liabilities, as internal guidelines require that derivatives are only concluded for hedging purposes.

7. SEGMENT REPORTING

In accordance with IFRS 8 (Operating Segments), Kontron's segment reporting reflects group-wide business management and internal financial reporting.

SEGMENT INFORMATION 01–06/2016

In €k	Industrial	Communication	Avionics/ Transportation/ Defense	Other	Consolidated financial statements
REVENUES	94,557	41,040	44,856	0	180,453
OPERATING RESULT (EBIT)	–247	–9,730	–55,224	–20,795	–85,996
TRADE RECEIVABLES	87,949	15,955	18,896	0	122,800

SEGMENT INFORMATION 01–06/2015

In €k	Industrial	Communication	Avionics/ Transportation/ Defense	Other	Consolidated financial statements
REVENUES	100,339	48,138	58,509	0	206,986
OPERATING RESULT (EBIT)	2,563	1,518	6,851	–19,631	–8,699
TRADE RECEIVABLES	90,764	10,406	22,441	0	123,611

Other includes intercompany items such as income or expenses that are eliminated and not directly allocable to the segments. Specifically, this includes restructuring cost as well as costs for support functions such as human resources, IT and finance.

Trade receivables are presented prior to the recognition of allowances.

8. ANNUAL GENERAL MEETING OF SHAREHOLDERS

On June 09, 2016, Kontron AG's Annual General Meeting of Shareholders approved with a large majority the proposals of the Supervisory Board and Management Board on the exoneration of the Supervisory Board and Management Board as well as the motions by management. In addition, two profit and loss transfer agreements were approved between Kontron AG and its two wholly-owned subsidiaries, Kontron Europe GmbH and Kontron Management GmbH. A total of around 55 % of share capital was represented at the Annual General Meeting of Shareholders at Augsburg's WWK Arena.

9. CORPORATE GOVERNANCE: CHANGES ON THE SUPERVISORY BOARD

Dr. Dieter Düsedau was appointed onto the Supervisory Board of Kontron AG at the Annual General Meeting of Shareholders on June 09, 2016.

10. SUBSEQUENT EVENTS

There were no significant events after the reporting date.

FINANCIAL CALENDAR

October 27, 2016	Publication of the Q3/2016 Quarterly Statement

Our annual report and our quarterly reports and statements can be found at *www.kontron.com/investor* from publication date. We will announce any date changes in good time on our website.

This quarterly report was published on July 26, 2016. It is available in German and in English. The German version is authoritative.

Kontron AG prepared its quarterly report in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Due to rounding differences, figures in tables and cross-references may differ slightly from the actual figures.

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

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