



# 2015

ADVA Optical Networking SE, Meiningen

*Year  
of Light*

Financial Statements and Management Report - December 31, 2015

 **ADVA**<sup>TM</sup>  
Optical Networking

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# **ADVA OPTICAL NETWORKING SE, MEININGEN – MANAGEMENT REPORT FOR THE FINANCIAL YEAR 2015**

## **Forward-Looking Statements**

This management report of ADVA Optical Networking SE contains forward-looking statements using words such as “believes”, “anticipates” and “expects” to describe expected revenues and earnings, anticipated demand for optical networking solutions and liquidity from which internal estimates may be inferred. These forward-looking statements are based on the beliefs of the Management Board and respective assumptions made, and involve a number of unknown risks, uncertainties and other factors, many of which are beyond ADVA Optical Networking SE’s control. If one or more of these uncertainties or risks materializes, or if the underlying assumptions of the Management Board prove incorrect, actual results can differ materially from those described in or inferred from forward-looking statements and information. Unknown risks and uncertainties are discussed in the “risk report” section further below.

In the following, ADVA Optical Networking SE as a company is labeled “the Company” or “ADVA Optical Networking SE”, “ADVA Optical Networking” or “the Group” always refers to the ADVA Optical Networking Group.

## **Basis of Preparation**

This Management Report of ADVA Optical Networking SE was prepared in accordance with sections 289 and 289a of the German Commercial Code (Handelsgesetzbuch, HGB).

All information contained in this report relates to the status on December 31, 2015, or the financial year ending on that date, unless stated otherwise.

## **Strategy and Control Design**

ADVA Optical Networking SE is not controlled as a stand-alone entity. The following specifications describe the strategy and control design of the Group.

ADVA Optical Networking’s strategic goals are focused around growth & profitability, innovation, operational excellence and our employees. The strategic goals are reviewed by both the Management Board and the Supervisory Board on a yearly basis and amended where appropriate. Each of these goals is defined in detail and then broken down into specific departmental and individual targets. The strategic goals are traced to each individual employee, so that each employee can focus and be evaluated on his/her individual performance and contribution to ADVA Optical Networking’s overall performance.

ADVA Optical Networking measures the accomplishment of its strategic goals against revenues, pro forma operating income<sup>1</sup>, net liquidity<sup>2</sup> and as a non-financial criterion customer satisfaction as measured by the Net Promoter Score<sup>3</sup>. These metrics represent the Group’s key performance indicators. The Management Board sets target values for all four metrics for the coming year and measures actual values against the target values on a monthly basis for revenues and pro forma operating income, on a quarterly basis for net liquidity and on a yearly basis for the Net Promoter Score. In case of deviations from plan, corrective action can be taken quickly. This information is summarized and communicated to the Management Board in monthly, quarterly and yearly reports.

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<sup>1</sup> Pro forma operating income is calculated prior to non-cash charges related to the stock compensation programs and amortization and impairment of goodwill and acquisition-related intangible assets.

<sup>2</sup> Net liquidity is calculated by subtracting current and non-current financial liabilities as well as current and non-current finance lease obligations from cash and cash equivalents.

<sup>3</sup> The Net Promoter Score is obtained by asking customers a single question on a 0 to 10 rating scale: “How likely is it that you would recommend our company to a friend or colleague?” Based on their responses, customers are categorized into one of three groups: promoters (9-10 rating), passives (7-8 rating), and detractors (0-6 rating). The percentage of detractors is then subtracted from the percentage of promoters to obtain a Net Promoter Score.

## General Information

ADVA Optical Networking SE holds direct or indirect interests in 15 (prior year: 15) wholly-owned subsidiaries on December 31, 2015, as follows:

(in thousands)			Equity	Net income/loss (-)	Share in Equity	
					owned directly	owned indirectly
ADVA Optical Networking North America, Inc. Norcross/Atlanta (Georgia), USA	USD	*	54,235	7,320	100%	-
ADVA Optical Networking Ltd. York, United Kingdom	GBP	**	4,414	221	100%	-
Oscilloquartz SA Saint-Blaise, Switzerland	CHF	*	7,786	8,694	100%	-
ADVA Optical Networking sp. z o.o. Gdynia, Poland	PLN	**	10,244	-2,264	100%	-
ADVA Optical Networking Israel Ltd. Ra'anana/Tel Aviv, Israel	ILS	*	1,359	-7,912	100%	-
ADVA Optical Networking (Shenzhen) Ltd. Shenzhen, China	CNY	**	42,777	5,758	100%	-
Oscilloquartz Finland Oy Espoo, Finland	EUR	****	-31	17	100%	-
ADVA Optical Networking Trading (Shenzhen) Ltd. Shenzhen, China	USD	*	646	-33	-	100%
ADVA Optical Networking Singapore Pte. Ltd. Singapore	SGD	**	2,670	105	100%	-
ADVA Optical Networking Hongkong Ltd. Hongkong, China	HKD	**	1,540	728	-	100%
ADVA Optical Networking (India) Private Ltd. Gurgaon, India	INR	***	10,382	6,631	1%	99%
ADVA Optical Networking Serviços Brazil Ltda. São Paulo, Brazil	BRL	*	973	229	99%	1%
ADVA Optical Networking Corp. Tokyo, Japan	JPY	*	79,348	2,946	100%	-
ADVA Optical Networking AB Kista/Stockholm, Sweden	SEK	**	1,362	184	100%	-
ADVA Optical Networking AS i.L. Oslo, Norway	NOK	**	7,000	-1,228	100%	-

\* Prepared in accordance with the International Financial Reporting Standards (IFRS) for the period ended December 31, 2015.

\*\* Prepared in accordance with local commercial law for the period ended December 31, 2014.

\*\*\* Prepared in accordance with local commercial law for the period ended March 31, 2015.

\*\*\*\* Prepared in accordance with the International Financial Reporting Standards (IFRS) for the short financial year from July 23, 2015 to December 31, 2015.

On July 23, 2015, ADVA Optical Networking SE acquired 100% of the share capital of Time4 Systems Oy, Espoo, Finland, for a purchase price of EUR 550 thousand. On September 24, 2015, the company has been renamed to Oscilloquartz Finland Oy.

The company, located near Helsinki, employed five employees, focused on the development of ultra-compact synchronization solutions. The underlying technology will further strengthen the company's position in the market for synchronization and timing solutions.

On December 1, 2015, ADVA Optical Networking SE acquired materially all assets of a development division of FiSEC GmbH, Meiningen, Germany at a total purchase price of EUR 1,365 thousand.

The underlying technology will further strengthen the position of ADVA Optical Networking in the market for monitoring solutions for optical data transport technology. The seven employees were transferred to ADVA Optical Networking SE effective December 1, 2015.

At the end of 2013, the Management decided to close ADVA Optical Networking AS i.L., Oslo, Norway. At December 31, 2015, the liquidation of the entity was not completed.

## **Branch Offices and Organization**

The Company maintains its registered office in Meiningen, Germany. This is also the location of the main production and development facility of the Company (330 employees at year-end 2015). Branch offices are located in Berlin, focusing on software development for the Company's products (51 employees) and in Martinsried/Munich, where the Company maintains its headquarter with all central functions and the sales & marketing organization (120 employees). On December 31, 2015, further branch offices were located in Hanover (9 employees), Courtaboeuf/Paris, France (16 employees), Madrid, Spain (3 employees), Helsinki, Finland (1 employee), Grottaferrata/Rome, Italy (8 employees), Vienna, Austria (3 employees), Zurich, Switzerland (3 employees) and Centurion/Pretoria, South Africa (5 employees). ADVA Optical Networking is organized according to functional areas across all international locations.

## **Procurement**

For the production of its products, the Company relies on a limited number of suppliers of high-performance electronic and optical components. In order to procure the necessary quantities at the required high standard of quality, the Company works very closely with its suppliers. Procurement prices for components have steadily declined over the last few years. With increasing company size and strategic procurement activities, the Company drives long-term favorable purchase price levels as well. The Company aims to keep inventories as low as possible, however it also needs to ensure that order

lead times for customers are minimal. Flexible supply agreements are in place with vendors to drive short reaction times.

## **Research and Development**

ADVA Optical Networking SE's research and development activities are driven by the distinct emphasis on differentiating its highly innovative connectivity solutions, working with customers and partners to identify and meet their current and future needs. The resulting key technologies and products radically simplify complicated network structures, while reducing operating and capital expenses and supplementing existing solutions. During 2015, R&D activities focused mainly on the development of connectivity solutions, upgrade of Ethernet access solutions with features for performance monitoring of time distribution and virtualization of network solutions.

## **Products**

ADVA Optical Networking SE develops, manufactures and sells optical and Ethernet-based networking solutions for telecommunication carriers and enterprises to deliver data, storage, voice and video services. The Company's hardware and software portfolio is continuously expanded with new features and products. Telecommunication service providers, private companies, universities and government agencies worldwide use the Company's systems. ADVA Optical Networking SE sells its product portfolio both directly and through an international network of distribution partners.

Product manufacturing primarily takes place in the facility in Meiningen, Germany. The Company combines outsourcing, specifically the pre-assembly of individual components, with in-house production. Quality and seamless production are assured by close cooperation between all departments, from development to procurement to final assembly.

## General Economic and Market Conditions

### The Global Economy in 2015

Growth in the world economy weakened further in 2015. The International Monetary Fund (IMF) expects growth for 2015 to come in at 3.1%, according to its most recent forecast published in January 2016. In July 2015, global growth for the year was still predicted to be 3.3%. In 2014, the figure was 3.4%. The economy in Germany and the euro zone is expected to have grown 1.7% in 2015 with a forecast of 1.7% for the following year. In the US, on the other hand, the economy gained more momentum than previously anticipated and the gross domestic product (GDP) is forecast to have grown by 2.5%. For 2016, the experts revised their forecast slightly downwards, to 2.6%. The situation in the emerging markets remains difficult. According to the IMF forecast, China will only have grown at a rate of 6.9% in 2015. Its growth for 2016 is predicted to be 6.3%, the lowest in decades. Russia and Brazil are even threatened by prolonged recessions. One reason here is the erosion of the oil price. In 2016 the world economy is expected to grow again with 3.4% being back at the growth level of 2014. But even so, the IMF lowered its forecast for 2016 by 0.2 percentage points.

### Market Environment for ADVA Optical Networking

In this mixed macro-economic environment of 2015 the overall market for communications equipment, which is relevant for ADVA Optical Networking, grew at around 10%<sup>4</sup>. Industry analysts expect that the addressable market for ADVA Optical Networking will grow at a similar pace in 2016, varying by region.

The addressable market for ADVA Optical Networking consists of three areas: enterprise networks, carrier infrastructure and Ethernet access solutions for network operators. The volume of ADVA Optical Networking's total addressable market amounted to USD 11.3 billion<sup>4</sup> (EUR 10.2 billion<sup>5</sup>) in the year 2015. This amount splits into USD 10.6 billion (EUR 9.6 billion<sup>5</sup>) for optical networks and USD 0.7 billion (EUR 0.6 billion<sup>5</sup>) for Ethernet-based network access solutions.

Market growth is primarily driven by steadily increasing bandwidth demand. Communications service providers are striving to improve the performance of their triple play services (data, voice and video) for private customers and significantly expand and accelerate the roll-out of 4G mobile technology. Those two drivers were the main reasons for numerous infrastructure projects. Enterprise customers showed a strong demand for data storage and

security solutions and continued with their rapid adoption of cloud applications, all representing additional growth drivers for the global bandwidth demand. Based on these developments, the total addressable market for ADVA Optical Networking is forecast to grow between 2015 and 2018 at an annual compound growth rate of 9% to a total of USD 14.8 billion in 2018.

### Market Environment for Enterprise Networks

The market for private enterprise networks was approximately 18%<sup>4</sup> of ADVA Optical Networking's total addressable market. Based on a volume of USD 2.1 billion (EUR 1.9 billion<sup>5</sup>) in 2015, this market segment is forecast to grow with a compound annual growth rate of 13%<sup>4</sup>. The increasing demand for cloud applications and the rapid adoption of digital processes in all industries are key drivers for this market segment.

### Market Environment for Carrier Infrastructure

The largest addressable market segment for ADVA Optical Networking is carrier infrastructure. This segment amounted to 76% of the relevant market and it is expected to grow with a compound annual growth rate of 9% up to 2018<sup>4</sup>. The market volume for carrier infrastructure amounted to USD 8.5 billion<sup>4</sup> (EUR 7.7 billion<sup>5</sup>) in 2015. ADVA Optical Networking anticipates that growth in this market segment will be driven by the increasing demand for bandwidth from the carriers' residential and business customers.

### Market Environment for Carrier Ethernet Access

ADVA Optical Networking has a strong market position in this segment, which accounts for 6% of the total addressable market<sup>4</sup>. Based on a volume of USD 0.7 billion<sup>4</sup> (EUR 0.6 billion<sup>5</sup>) in 2015, the market segment for Carrier Ethernet access solutions is forecast to grow at a compound annual growth rate of 7% until 2018. Growth will continue to be driven by the ongoing conversion from legacy services to intelligent Ethernet-based services, as well as by the virtualization of network functions.

Addressable market and growth rates <sup>4</sup>	2015 USD billion	Share of total	CAGR* 2015-2018
Enterprise networks	2.1	18%	13%
Carrier infrastructure	8.5	76%	9%
Carrier Ethernet access	0.7	6%	7%
<b>Total addressable market</b>	<b>11.3</b>	<b>100%</b>	<b>9%</b>

\* CAGR = Compound annual growth rate

<sup>4</sup> Industry Analysis estimates for metro and long-haul WDM equipment ("Optical") and Ethernet access devices ("Ethernet"), which are relevant for ADVA Optical Networking. Sources: Infonetics Research, Optical Networking Hardware, Quarterly Market Share, Size, and Forecasts 2Q15, August 2015 and Infonetics Research, Ethernet Access Devices Biannual Market Share, Size and Forecasts, 2nd Edition,

September 2015. The split for WDM equipment in carrier infrastructure and enterprise networks is based on internal estimates of ADVA Optical Networking.

<sup>5</sup> Average annual conversion rate for 2015: EUR 0.89983 per USD



## **Business Development and Operational Performance**

In 2015, ADVA Optical Networking SE generated revenues of EUR 327.3 million, representing an increase of 60.1% compared to EUR 204.4 million in 2014. This increase mainly relates to improved carrier infrastructure as well as enterprise network business. Large Internet content providers accelerate their investment, reflecting the continued network traffic migration to the cloud. The megatrends cloud and mobility continue to fuel the global demand for more bandwidth and strengthen the overall demand for the ADVA Optical Networking's products.

The most important sales region in 2015 remained EMEA, followed by the Americas and Asia-Pacific. EMEA revenues rose significantly by 57.2% from EUR 139.0 million in 2014 to EUR 218.5 million in 2015, representing 66.7% of total revenues after 68.0% in 2014. This increase mainly relates to stronger enterprise networks business. However, revenue development in this region is still affected by a challenging market environment with strong consolidation tendencies and continuing price pressure. Also in the Americas, revenues increased significantly by 85.4% from EUR 43.9 million in 2014 to EUR 81.4 million in 2015. In this region, carrier Ethernet and carrier infrastructure business grew strongly as ADVA Optical Networking SE successfully continues deploying products in large accounts in 2015. The corresponding share of total annual revenues increased from 21.5% to 24.9%. In the Asia-Pacific region, revenues were up by 27.4% from EUR 21.5 million in 2014 to EUR 27.4 million in 2015. The Asia-Pacific region comprised 8.4% of total revenues in 2015 after 10.5% in 2014. Revenues in the Asia-Pacific region remain volatile due to the relatively small customer base. However, this region still continues to offer new opportunities and growth potential for the Company.

Cost of goods sold increased from EUR 149.6 million in 2014 to EUR 219.8 million in 2015, reducing the share in total revenue from 73.2% to 67.2% in 2015. The increase in cost of goods sold is primarily due to the rise in revenues and the increase in amortization charges for capitalized development projects to EUR 24.6 million in 2015 after EUR 19.9 million in 2014.

Gross profit increased from EUR 54.8 million or 26.8% of revenues in 2014 to EUR 107.4 million or 32.8% of revenues in 2015. The development of the Company's gross profit is impacted by variations in regional revenue distribution and in product and customer mix as well as by group intercompany recharges.

Selling and marketing expenses increased from EUR 24.6 million in 2014 to EUR 29.8 million in 2015. General and administrative expenses increased to EUR 17.0 million from EUR 14.4 million in 2014. After considering

capitalization of development expenses, which increased from EUR 25.5 million in 2014 to EUR 32.1 million in 2015, Research and development expenses totaled EUR 47.9 million or 14.6% from revenues in 2015 compared to EUR 28.8 million or 14.1% from revenues in the prior year. The other operating result (other operating income less other operating expenses) decreased from EUR 14.1 million in 2014 to EUR 1.8 million in 2015.

The result from ordinary activities totaled EUR 18.7 million in 2015, compared to EUR 0.6 million in the prior year.

The Company generated a net profit of EUR 17.6 million in 2015, compared to a net profit of EUR 4.4 million in 2014.

## **Summary: Business Development and Operational Performance**

Overall, the business development and operational performance in 2015 significantly improved when compared to 2014. This was predominantly a result of the favourable revenue development combined with a disproportional increase of cost of goods sold.

## Net Assets and Financial Position

The balance sheet total increased by EUR 42.8 million from EUR 206.8 million at year-end 2014 to EUR 249.6 million at year-end 2015. Current assets increased from EUR 108.9 million to EUR 140.6 million on December 31, 2015, representing 56.3% of total assets after 52.7% at the end of the previous year. Non-current assets increased from EUR 97.2 million to EUR 108.0 million at the end of 2015, representing 43.3% of total assets after 47.0% at the year-end 2014.

The increase in current assets was mainly driven by an increase in cash at banks and in hand by EUR 13.4 million to EUR 39.3 million, as well as by an increase in inventories with EUR 11.2 million to EUR 36.7 million. Furthermore the increase in trade accounts receivable and other assets with EUR 7.1 million to EUR 64.6 million drove the increase in current assets.

The increase in non-current assets is mainly related to an increase in intangible assets with EUR 13.8 million to EUR 67.1 million.

Mainly contributable to the net profit for the current year stockholders' equity was up from EUR 116.5 million at year-end 2014 to EUR 137.3 million at year-end 2015 and represented 55.0% of the balance sheet total after 56.3% at the end of 2014. Liabilities increased from EUR 68.4 million to EUR 86.7 million. Furthermore provisions increased from EUR 8.2 million in 2014 to EUR 12.0 million in 2015.

## Capital Expenditures

Total capital expenditures amounted to EUR 45.3 million in 2015 (prior year: EUR 37.9 million). Thereof, EUR 2.5 million (prior year: EUR 3.4 million) were attributable to property, plant and equipment, EUR 39.9 million (prior year: EUR 28.7 million) to intangible assets and EUR 3.0 million to financial assets (prior year: EUR 5.8 million).

Investments in property, plant and equipment mainly relate to measuring and test equipment.

Investments in intangible assets primarily relate to capitalized development projects, as well as the purchase of new technologies and intellectual property rights.

Investments in capitalized development projects are mainly driven by development activities for ADVA Optical Networking's enhanced FSP 3000 platform.

## Liquidity

The development of cash and cash equivalents is analyzed in the following table:

<b>Changes in cash at banks and in hand</b> (in millions of EUR)	<b>2015</b>	<b>2014</b>
Operating cash flow	46.9	11.4
Investing cash flow	-40.1	-36.7
Financing cash flow	6.4	-4.3
<b>Net change</b>		
<b>in cash at banks and in hand</b>	<b>13.3</b>	<b>-29.6</b>
Cash at banks and in hand at the beginning of the year	26.0	55.6
<b>Cash at banks and in hand</b> <b>at the end of the year</b>	<b>39.3</b>	<b>26.0</b>

The Company was able to meet all payment obligations at any point in time during 2015 and 2014.

Due to the increase in cash and cash equivalents in 2015, ADVA Optical Networking SE's net liquidity increased from EUR -9.0 million in 2014 to EUR -3.3 million in 2015. Cash and cash equivalents of EUR 39.3 million on December 31, 2015, and of EUR 26.0 million on December 31, 2014, were denominated mainly in EUR and USD.

## Financing

ADVA Optical Networking's financial management objective is to provide sufficient funds to ensure on-going operations and to support the Group's projected growth. Beyond the strong equity base appropriate for the business, ADVA Optical Networking finances its business by means of liabilities with maturities typically exceeding the life of the assets being financed. For any liability taken, ADVA Optical Networking is focused on minimizing related interest cost, as long as access to funds is not at risk. Excess funds are used either to redeem debt or are invested in short-term interest-bearing term deposits or money market funds.

Liabilities to banks increased from EUR 35.0 million at year-end 2014 to EUR 42.7 million at the end of 2015. This increase is mainly due to a new loan of EUR 15.0 million from HSBC. All liabilities to banks were exclusively denominated in EUR at the end of 2014 and 2015.



The following table provides an overview on interest terms and the maturity structure of each financial liability at year-end 2015:

(in millions of EUR)	Dec. 31, 2015	Interest terms	Maturity		
			≤ 12 months	12 - 36 months	> 36 months
IKB Deutsche Industriebank loans*	0.2**	Fixed rate, subsidized***	0.2	-	-
	0.4	Fixed rate, subsidized***	0.4	-	-
	15.6	Fixed rate, subsidized***	6.1	9.5	-
HSBC loan	15.0	Fixed rate, subsidized***	-	7.5	7.5
bonded loan Portigon AG*	11.5	Floating rate based on 3M EURIBOR	11.5	-	-
<b>Total financial liabilities</b>	<b>42.7</b>		<b>18.2</b>	<b>17.0</b>	<b>7.5</b>

\* Key covenants refer to the Group's year-end debt/equity ratio and to the quarter-end net liquidity.

\*\* The IKB Deutsche Industriebank loan is secured by a mortgage without certificate of EUR 5.6 million (prior year: EUR 5.6 million) on the production and development site in Meiningen, Germany.

\*\*\* Subsidized by the Kreditanstalt für Wiederaufbau, (KfW)

## Dividend Payments

In 2015 there were no dividend payments for 2014 (prior year: nil). ADVA Optical Networking SE does not plan to pay out a dividend for 2015.

## Summary: Net Assets and Financial Position

The net assets and financial position of ADVA Optical Networking SE continues to develop favorably in 2015, with cash and cash equivalents and net liquidity at record levels.

## Share Capital and Shareholder Structure

On December 31, 2015, ADVA Optical Networking SE had issued 49,374,484 no par value bearer shares (December 31, 2014: 48,096,431). No other class of shares had been issued during the reporting period.

At year-end 2015, Egora Holding GmbH held a total of 7,656,749 shares or 15.5% of all ADVA Optical Networking SE shares outstanding (at year-end 2014: 8,656,749 shares or 18.0% of all shares outstanding). 5,930,902 of

these shares or 12.0% of all shares outstanding (at year-end 2014: 6,330,902 shares or 13.2% of all shares outstanding) were held by Egora Ventures GmbH, a 100% subsidiary of Egora Holding GmbH, and the remaining 1,725,847 shares or 3.5% of all shares outstanding (at year-end 2014: 2,325,847 shares or 4.8% of all shares outstanding) were held directly by Egora Holding GmbH. Both Egora companies have their registered offices in Fraunhoferstrasse 22, 82152 Martinsried/Munich, Germany. No other shareholder has filed with the Company to have held more than 10% of the Company's shares outstanding on December 31, 2015. Further details on share capital and shareholder structure are disclosed in note (3.1.10) of the Group's financial statements.

## Restriction of Voting Rights and Share Transfers

At year-end 2015, the Management Board of ADVA Optical Networking SE had no knowledge of any restrictions related to voting rights or share transfers.

## Appointment and Dismissal of Management Board Members

The appointment and dismissal of members of the Management Board of ADVA Optical Networking SE follows the direction of the German Stock Corporation Act (Aktengesetz, AktG), the German SE Implementation Act (SE-Ausführungsgesetz, SEAG) as well as the provisions in section 6 of the Company's current articles of association, dated May 28, 2015. According to these articles, in principle the Supervisory Board appoints the members of the Management Board and does so for a maximum period of five years. However, it is the Company's practice to appoint the members of the Management Board for two years only. Repeated appointment is possible. The Management Board of ADVA Optical Networking SE regularly consists of two individuals. However, the Supervisory Board may appoint a higher number of individuals. If the Management Board consists of more than one individual, the Supervisory Board may appoint one member of the Management Board Chief Executive Officer or Speaker of the Management Board, and another member his or her deputy. The Supervisory Board may recall an already-effective appointment for important reasons. Apart from the appointment of Ulrich Dopfer as of January, 1 2015, there were no further appointments or dismissals of Management Board members in 2015.

ADVA Optical Networking SE's Management Board consisted of Brian Protiva (Chief Executive Officer), Christoph Glingener (Chief Technology Officer & Chief Operating Officer) and Ulrich Dopfer (Chief Financial Officer) throughout the year.

## **Changes to Articles of Association**

Changes to ADVA Optical Networking SE's articles of association follow section 179 of the German Stock Corporation Act (Aktiengesetz, AktG) in conjunction with section 133 AktG, as well as the provisions in section 4 paragraph 6 and section 13 paragraph 3 of the Company's current articles of association, dated May 28, 2015. Accordingly, in principle any changes to the articles of association need to be resolved by the Shareholders' Meeting. However, the Shareholders' Meeting has authorized the Supervisory Board to change the version of the articles of association in accordance with capital increases from authorized capital and conditional capital.

## **Issuance and Buy-Back of Shares**

The rights of the Management Board to issue new shares are regulated in section 4 paragraphs 4 to 5k of the articles of association of ADVA Optical Networking SE. According to ADVA Optical Networking SE's current articles of association, last amended on May 28, 2015, the Management Board may issue up to 24,048,215 shares from authorized capital, amounting to a total of EUR 24,048,215 against cash or contribution in-kind with possible exclusion of subscription rights. On December 31, 2015, the authorized capital amounted to EUR 24,048,215, i.e., that day the Management Board may have issued up to 24,048,215 shares or 48.7% of total shares outstanding. In addition, on December 31, 2015, a total of two tranches of conditional capital amounting to a total of EUR 4,809,178 or 9.74% of the share capital were recorded in the commercial register (Conditional Capitals 2003/2008 and 2011). The conditional capital has been used for granting stock option and similar rights to members of the Management Board, to employees of the Company and to management and employees of affiliated companies. The conditional capital increase is put into effect only if and when the holders of the option rights exercise these rights. 1,278,053 new shares were already created in 2015 as a result of the exercise of stock options, but will only be registered in the trade register after the balance sheet date. Thus, the number of shares that can be issued by the Management Board from the two tranches of conditional capital is reduced to 3,531,125 or 7.2% of total shares outstanding.

At year-end 2015, the Management Board was authorized to buy back, until May 19, 2020, up to a total of 10% of the existing share capital at the time of resolution by Annual General Meeting or – if this value is lower – at the time the authorization is exercised. This right was granted to the Management Board by a resolution of the Shareholders' Meeting on May 20, 2015. Shares bought back may be used exclusively as compensation for the acquisition of companies, parts of companies or investments in companies, for issuing stock to employees of the Company or affiliated companies, for serving share subscription rights from the Company's stock option plans, and for redeeming the shares.

## **Takeover Bid-Driven Change of Control Provisions**

At year-end 2015, a bonded loan with redemption value of nominally EUR 11.5 million (to be earlier repaid in January 2016), a loan with redemption value of nominally EUR 15.7 million (being repaid in 16 equal quarterly installments since September 2014) and a loan with redemption value of nominally EUR 15.0 million (being repaid in 16 equal quarterly installments from Q1 2017), respectively, are part of ADVA Optical Networking SE's financial liabilities. In the event of a potential takeover bid-driven change in control of ADVA Optical Networking SE, the creditors have the right to terminate these loans with immediate effect.

On December 31, 2015, for the event of a takeover bid-driven change in control there have been no recourse agreements in place with any of the members of the Management Board or with any of the Group's employees.

## **Declaration on Corporate Governance and Corporate Governance Report**

Compliance with the rules of proper corporate governance is of great importance to ADVA Optical Networking, it is the foundation for the Group's success. According to section 289a of the German Commercial Code (Handelsgesetzbuch, HGB), ADVA Optical Networking SE is obliged to publish a "declaration on corporate governance", and section 161 of the German Stock Corporation Act (Aktiengesetz, AktG) in connection with section 3.10 of the German Corporate Governance Code as amended on May 5, 2015 recommend that Management Board and Supervisory Board shall prepare a "corporate governance report". In order to facilitate public access to all respective data, ADVA Optical Networking integrates the "declaration on corporate governance" and the "corporate governance report" into one single publication on its website [www.advaoptical.com](http://www.advaoptical.com) (About Us / Investor Relations / Corporate Governance / Declaration on Corporate Governance and Corporate Governance Report).

## **Definition of Aims and Terms for the Rise of the Women Portion in Supervisory Boards, Management Organs and Both Leadership Levels Below the Management Organ**

In 2015, ADVA Optical Networking SE fulfils the legal regulation for a gender rate of 30% in the Supervisory Board with one female Supervisory Board member. All three Management Board members are male. On December 31, 2015 the women's portion in ADVA Optical Networking SE at the first management level amounts to 7% and at the second management level to 35%. On account of the low portion of female university graduates in relevant fields of study it is difficult for ADVA Optical Networking SE to achieve a desirable high women's portion in management. However, the Management Board and Supervisory Board took the decision that until June 30, 2017, the portion of female Supervisory Board members should stay stable at 33% and the portion in the Management Board as well as in the top two levels of management should be at least maintained at current status.

## **Remuneration of Management and Supervisory Boards**

The compensation of ADVA Optical Networking's Management Board members consists of fixed and variable components. In addition to a fixed salary, the members of the Management Board receive variable compensation in the form of bonus payments which are assessed based in part on short-term aspects and in part on long-term criteria focusing on the sustainable development of the Group. As additional long-term variable compensation, the Management Board members receive stock options within the scope of ADVA Optical Networking's stock option program. The maximum amount of compensation for the members of the Management Board is capped, both overall and for its variable compensation components (annual bonus, long term bonus, newly issued options).

In 2015, the combined fixed salary of the two members of the Management Board in office throughout the years 2014 and 2015 remained unchanged. The short-term variable compensation for both years was based on the Group's pro forma operating income<sup>1</sup> (40%), the Group's revenues (20%), the Group's net liquidity<sup>2</sup> (20%) as well as individual goals agreed with each

member of the Management Board at the beginning of the respective year (20%). The short-term variable compensation is determined annually as compensation for the current year at the discretion of the Supervisory Board. Furthermore, a new long-term variable compensation focusing on the sustainable development of the Group was agreed in 2015 after the previous long-term variable compensation became obsolete. The new long-term variable compensation will be paid to the members of the Management Board after three years, provided that minimum Group pro forma operating income margins, increasing year-by-year, are met for each of the three years. All members of the Management Board additionally receive a company car or a car allowance, as well as – in Germany – reimbursement of half of their social security contributions. Moreover, ADVA Optical Networking bears the costs of pecuniary damage liability insurance for the Management Board members, taking into account the statutory deductible amount. These benefits are partially taxable by the members of the Management Board as non-cash benefits. In addition, ADVA Optical Networking grants stock options to members of the Management Board. These option rights authorize the members of the Management Board to purchase a set number of shares in the Company once a fixed vesting period has elapsed.

Jaswir Singh left the Company at the end of 2014 by mutual agreement. From January 1, 2015, Ulrich Dopfer took over responsibility as Chief Financial Officer and Christoph Glingener took over responsibility as Chief Operating Officer. In addition to Jaswir Singh's remuneration for his services performed in 2014, he received an additional compensation amounting to EUR 490 thousand (USD 660 thousand).

Total Management Board compensation payable for 2015 and 2014 was EUR 3,732 thousand and EUR 1,943 thousand, respectively. During both years, there were no long-term service contracts in the sense of IAS 19 for any member of the Management Board. In 2015 and 2014, no loans were granted to the members of the Management Board. At December 31, 2015, ADVA Optical Networking reports a receivable of EUR 62 thousand from Brian Protiva relating to payroll tax on exercised stock options. The receivable has been offset from remuneration paid in January and February 2016.

**Value of Benefits Granted for the Year Under Review**

(in thousands of EUR)	Brian Protiva				Christoph Glingener				Ulrich Dopfer				Jaswir Singh			
	Chief Executive Officer				Chief Technology Officer & Chief Operating Officer				Chief Financial Officer				Chief Financial Officer & Chief Operating Officer			
									since January 1, 2015				until December 31, 2014			
<b>Benefits granted</b>	<b>2015</b>	<b>2014</b>	<b>2015 (Min)</b>	<b>2015 (Max)</b>	<b>2015</b>	<b>2014</b>	<b>2015 (Min)</b>	<b>2015 (Max)</b>	<b>2015</b>	<b>2014</b>	<b>2015 (Min)</b>	<b>2015 (Max)</b>	<b>2015</b>	<b>2014</b>	<b>2015 (Min)</b>	<b>2015 (Max)</b>
Fixed compensation	253	253	253	253	253	253	253	253	230	-	230	230	-	324	-	-
Fringe benefits	22	20	22	22	19	19	19	19	17	-	17	17	-	15	-	-
<b>Total</b>	<b>275</b>	<b>273</b>	<b>275</b>	<b>275</b>	<b>272</b>	<b>272</b>	<b>272</b>	<b>272</b>	<b>247</b>	<b>-</b>	<b>247</b>	<b>247</b>	<b>-</b>	<b>339</b>	<b>-</b>	<b>-</b>
Short-term variable compensation (1 year)	314	265	-	537	213	179	-	360	118	-	-	200	-	125	-	-
<i>Multi-year variable compensation:</i>																
Compensation	-	-	-	-	-	-	-	-	-	-	-	-	-	490	-	-
Long-term variable compensation (3 years)	268	-	-	268	180	-	-	180	111	-	-	111	-	-	-	-
Stock option plans (7 years)	426	632	-	3,700	316	466	-	3,600	351	-	-	3,060	-	-	-	-
<b>Total</b>	<b>1,283</b>	<b>1,170</b>	<b>275</b>	<b>4,780</b>	<b>981</b>	<b>917</b>	<b>272</b>	<b>4,412</b>	<b>827</b>	<b>-</b>	<b>247</b>	<b>3,618</b>	<b>-</b>	<b>954</b>	<b>-</b>	<b>-</b>

**Actual Contribution for the Year Under Review**

(in thousands of EUR)	Brian Protiva				Christoph Glingener				Ulrich Dopfer				Jaswir Singh			
	Chief Executive Officer				Chief Technology Officer & Chief Operating Officer				Chief Financial Officer				Chief Financial Officer & Chief Operating Officer			
									since January 1, 2015				until December 31, 2014			
<b>contribution</b>	<b>2015</b>	<b>2014</b>	<b>2015 (Min)</b>	<b>2015 (Max)</b>	<b>2015</b>	<b>2014</b>	<b>2015 (Min)</b>	<b>2015 (Max)</b>	<b>2015</b>	<b>2014</b>	<b>2015 (Min)</b>	<b>2015 (Max)</b>	<b>2015</b>	<b>2014</b>	<b>2015 (Min)</b>	<b>2015 (Max)</b>
Fixed compensation	253	253	253	253	253	253	253	253	230	-	230	230	-	324	-	-
Fringe benefits	22	20	22	22	19	19	19	19	17	-	17	17	-	15	-	-
<b>Total</b>	<b>275</b>	<b>273</b>	<b>275</b>	<b>275</b>	<b>272</b>	<b>272</b>	<b>272</b>	<b>272</b>	<b>247</b>	<b>-</b>	<b>247</b>	<b>247</b>	<b>-</b>	<b>339</b>	<b>-</b>	<b>-</b>
Short-term variable compensation (1 year)	314	265	314	314	213	179	213	213	118	-	118	118	-	125	-	-
<i>Multi-year variable compensation:</i>																
Compensation	-	-	-	-	-	-	-	-	-	-	-	-	-	490	-	-
Long-term variable compensation (3 years)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Stock option plans (7 years)	1,183	-	1,183	1,183	893	-	893	893	35	-	35	35	-	-	-	-
<b>Total</b>	<b>1,772</b>	<b>538</b>	<b>1,772</b>	<b>1,772</b>	<b>1,378</b>	<b>451</b>	<b>1,378</b>	<b>1,378</b>	<b>400</b>	<b>-</b>	<b>400</b>	<b>400</b>	<b>-</b>	<b>954</b>	<b>-</b>	<b>-</b>

The compensation of the members of ADVA Optical Networking's Supervisory Board, beyond the reimbursement of out-of pocket expenses, only consists of fixed compensation paid out quarterly.

The total compensation payable to the members of the Supervisory Board of ADVA Optical Networking for 2015 amounted to EUR 215 thousand, after EUR 224 thousand for 2014.

Furthermore, ADVA Optical Networking SE bears the cost of pecuniary damage liability insurance for all members of the Supervisory Board. During the financial year, no loans or advance payments were granted to members of the Supervisory Board.

Detailed information on the compensation structure of the individual members of the Management and Supervisory Boards can be found in notes 4.5 and 4.6 to the financial statements of ADVA Optical Networking SE.

## Compliance and Sustainability

### Corporate Ethics and Compliance

Integrity and ethical decision making are central requirements for the sustainable success of ADVA Optical Networking. The Group recognizes its responsibility to comply with national and international laws, regulations, internal policies and ethical standards – otherwise known as compliance. In order to ensure observance of all applicable laws and regulations, ADVA Optical Networking has actively adopted a code of conduct and a range of Group-wide policies which govern the Group's business operations and are mandatory for all employees to follow. Training on the code has been conducted in all major sites and all employees have acknowledged their compliance. The code is an extension of the Group's core values, and employees are encouraged to report suspected incidents of non-compliance and to seek support when they have questions or suggestions. An external ombudsman (this role is currently covered by Frank Fischer, tax lawyer and former member of ADVA Optical Networking's Supervisory Board) and an externally operated ethics and compliance helpline enable confidential and anonymous reporting. Enforcement of compliance with all applicable laws and regulations and deriving internal policies is coordinated by ADVA Optical Networking's Chief Compliance Officer who reports to the Chief Executive Officer and the Supervisory Board.

### Employees

Employee numbers and personnel expenses in this section relate to ADVA Optical Networking SE. All following specifications regarding employees, local community, suppliers and environmental responsibility relate to the Group. On December 31, 2015, ADVA Optical Networking SE had 549 employees, of whom 16 were apprentices (prior year: 538 employees, of whom 17

apprentices). This corresponds to an increase of 11 employee or 2.0% versus the end of the prior year. The breakdown of permanent employees by functional area is listed in the table below:

<b>Employees by functional area</b> (on December 31)	<b>2015</b>	<b>2014</b>	<b>Change</b>
Purchasing and production	171	161	+10
Sales, marketing and service	122	145	-23
Management and administration	90	82	+8
Research and development	150	133	+17
Apprentices	16	17	-1
<b>Total employees</b>	<b>549</b>	<b>538</b>	<b>+11</b>

Personnel expenses increased from EUR 42.6 million in 2014 to EUR 47.0 million in 2015, representing 14.4% of revenues in 2015 compared to 20.8% in 2014.

ADVA Optical Networking successfully attracts and retains highly qualified staff due to its competitive compensation programs and the rewarding work environment offered. The employee compensation packages comprise fixed and variable elements, and also include stock options and/or stock appreciation rights. These compensation packages enable employees to participate appropriately in the success of the Group and support employee retention, while at the same time rewarding individual efforts, teamwork, innovation and productivity. Furthermore, employees who perform exceptionally well or who make suggestions for significant improvements are recognized through the Group's Spot Award program. In addition, the Group is committed to offering all employees comprehensive on-the-job training, as well as specific continuing education opportunities in order to advance their personal and professional development.

The Group offers different types of continuing education programs through the ADVA Optical Networking University, based on employee development needs. These needs are identified, documented and reviewed semi-annually within an electronic performance appraisal and competency management system.

Within ADVA Optical Networking, all relevant local regulations for health and safety in the workplace are complied with and for the Group's sites in some countries are regularly monitored by independent engineering offices for safety in the workplace. ADVA Optical Networking provides a global work environment that is clean, bright and friendly. An efficient employee

representation without trade union ties is in place on a global basis, reflecting the international employee base and overall orientation of the Group.

ADVA Optical Networking is an equal opportunity employer and has an on-going commitment to the creation of a workplace free of discrimination and harassment. The Group recruits, hires, trains and promotes individuals on all job levels without regard to race, religion, ancestry, sexual orientation, marital status, national origin, age, gender and physical or mental disability. ADVA Optical Networking is committed to a fair and equitable workplace where everyone is a respected and valued member of the team. The Group's core values (teamwork, execution, accountability and motivation) and leadership principles (integrity/honesty, decisiveness and respect) guide employees and managers in all business activities.

At its main production and development facility in Meiningen, Germany, ADVA Optical Networking currently provides 17 apprenticeship positions, which lead to professions as electronic technicians for devices and systems and as office management assistant. In Meiningen, Germany, the Company is among the most recognized apprenticeship providers for industrial electronics professions in its region. In addition, ADVA Optical Networking offers an active university student trainee program in Germany that provides on-the-job work experience to students pursuing degrees.

The Group relies on a team of highly qualified and motivated employees of 40 different nationalities, with extensive experience in telecommunications and in various other industries. The interdisciplinary and intercultural exchange among employees on all levels advances the open and transparent culture of the Group and the creativity of its employees in the best possible way. In 2015, the Group conducted an employee survey with the support of an independent human resources consultancy. Based on the results of the 2015 survey, the Management Board derived an action plan to further improve employee satisfaction which has been implemented in 2016.

### Focusing on Sustainability

The various aspects of sustainability have always been important for ADVA Optical Networking and it has a successful track record in most of these areas. To further improve the related work, a dedicated Sustainability Group was established in the middle of 2015. This organizational step followed extensive sustainability-related work for dedicated key customers.

As a consequence, the Group issued its first Sustainability Report in 2015 and adopted a holistic model which covers all aspects of sustainability, as shown in the following diagram:



This model is now used for sustainability assessments by large operators like British Telecom. It is used for the same purpose, including self-assessments, by QuEST Forum, the body who also defines TL9000, telecommunication's version of the international quality standard ISO9001. It is a superset of a multitude of standards which, independently, cover the same areas. In particular, the self-assessments enable relatively simple identification of strong sustainability areas as well of areas which may require more attention.



The model is divided into three super-segments, called Operational, Organizational, and Commercial. The Operational super-segment refers to environmental and resource aspects that are related to production, and therefore mainly to ADVA Optical Networking's sites. The Organizational super-segment covers the corporate-related aspects of CSR (Corporate Social Responsibility) and sustainability-related organizational structure and capability, as well as stakeholder engagement and supply-chain management (the latter two again with regard to sustainability). Finally, the Commercial super-segments considers end-to-end delivery and logistics, eco design, and ultimately Circular-Economy lifecycle strategies.

### **Sustainability Performance**

As mentioned, ADVA Optical Networking is regularly assessed regarding the different aspects of sustainability by QuEST Forum and also a large customer, both using the same model as shown above. The latest result, as of November 2015, showed strong performance across all segments of the sustainability model. In particular, the Group's performance in the Commercial super-segment is strong, which includes all preparation, including various practical demonstrations, toward Circular-Economy business models.

For details regarding the Group's sustainability performance and indicators, we refer the reader to our Code of Conduct and to our dedicated Sustainability Report, which is compiled according to the GRI's G4 Guideline. These can be found on the Group's website [www.advaoptical.com](http://www.advaoptical.com) (About Us / Corporate Responsibility). The Sustainability Report is the latest addition to GRI reporting which started 2011.

### **Sustainability Awards**

As an indication of the sustainability-related progress that has been achieved since late 2014, the Group was granted two sustainability awards in 2015. First, in early 2015, ADVA Optical Networking received the Silver award in British Telecom's Better Future Supplier Forum, following the 2014 assessment and the win of BT's Game-Changing Challenge in late 2014.

Secondly, in September 2015, the Group also won the QuEST Forum's first annual Most-Improved Sustainability Award. This award followed a series of assessments which demonstrated a strong degree of improvement across the full area of sustainability.

More information can also be derived from the related press releases, which can be found on the Group's website [www.advaoptical.com](http://www.advaoptical.com) (Press Releases).

## Risk Report

ADVA Optical Networking's future development is subject to various risks, which in certain cases could endanger the Group's continued existence. The Management Board has implemented a comprehensive risk management and an internal control system that enables the Management Board to detect risks in a timely manner, to take corrective actions and benefit from identified opportunities. An integral aspect of the Group's strategy is its ability to anticipate developments in the marketplace and future customer needs. Special emphasis is given to product development, the quality of the Group's products and the validation, selection and oversight of key business partners. However, despite this comprehensive approach, due to the ever-changing market environment, limited ability to anticipate current geopolitical risks, as well as an ever increasing reliance on dispersed IT systems combined with potential efforts to compromise data confidentiality and intellectual property, no risk management system can fully eliminate all risks to the Group and its future well-being.

### Risk Management System

Since ADVA Optical Networking was founded in 1994, its business has become more diversified. The Group's global market is split into three focus areas (enterprise networks, carrier infrastructure, Carrier Ethernet access), all with drivers somewhat independent of each other. ADVA Optical Networking markets its products and solutions in part via a variety of distribution partners but has become less dependent on these partners over the years due to continued investment in a direct distribution model in core geographies. Beyond focusing on enhancing revenue predictability, a comprehensive risk management system has been established, enabling the Group to detect risks in a timely manner and to take appropriate preventive and corrective actions. The risk management system is subject to scheduled reviews by the Group's internal audit function. The Management Board recognizes that however good a risk management system may be, it cannot in all cases prevent the occurrence of events that may cause material damage to the Group.

ADVA Optical Networking is organized according to functional areas across all international locations. This is also reflected in the Management Board's split of responsibilities, in particular as related to risk management. The Management Board continuously analyzes the potential risks and implements the necessary measures to guard against them to the greatest extent possible. In recent years, ADVA Optical Networking has significantly improved its results-driven decision support and reporting system. The Group has established an appropriate risk management system across all departments with the purpose of quickly uncovering potential risks and taking corrective actions in a timely manner. These measures allow the Management Board to evaluate the present and future situation of the Group

at all times. A combination of regular and ad-hoc reports present a thorough picture of current and future business developments.

ADVA Optical Networking's strategic goals are the basis for this risk management system. These goals are growth and profitability, innovation, operational excellence and employees. The strategic goals are reviewed by both the Management Board and the Supervisory Board on a yearly basis and amended where appropriate. They also constitute the basis for the Group's three-year business plan, which is reviewed and updated annually. Each of these goals is defined in detail and then broken down into specific departmental and individual targets. The strategic goals are traced to each individual employee, so that each employee can focus and be evaluated on his/her individual performance and contribution to ADVA Optical Networking's overall performance.

Like any other Group company, ADVA Optical Networking SE is not controlled as a stand-alone entity. ADVA Optical Networking measures the accomplishment of its strategic goals against revenues, pro forma operating income<sup>1</sup>, net liquidity<sup>2</sup> and as a non-financial criterion customer satisfaction as measured by the Net Promoter Score<sup>3</sup>. These metrics represent the Group's key performance indicators. The Management Board sets target values for all four metrics for the year to come and measures actual values against the target values: revenues and pro forma operating income on a monthly basis, net liquidity on a quarterly basis and the Net Promoter Score on an annual basis. Corrective action is taken quickly should a deviation from the plan occur or be reasonably predicted to occur. This information is summarized and communicated to the Management Board in monthly, quarterly and yearly reports.

Moreover, budgets are reviewed on a monthly basis and adjustments are made if necessary. The Group's accounting, decision support and treasury departments provide globally consolidated reports on available cash funds and the development of margins and current assets (e.g. inventories and receivables) on a monthly and quarterly basis. These reports also include budgeted/forecasted and actual revenues and expenditures. Structure and content of these reports must be adapted continuously to meet information requirements. ADVA Optical Networking regularly monitors the credit worthiness of all customers and updates credit limits as needed. Material expenditures and investments must be approved in advance through an electronic purchase order system. In conjunction with continuously updated revenue and cash forecasts, a detailed monthly preview of anticipated Group developments within the next three to twelve months is regularly produced and communicated to the Management Board. Moreover, the Group's accounting, decision support and legal departments review potential legal and litigation risks on a quarterly basis in order to obtain a reliable estimate of the potential loss taking into account all relevant information and

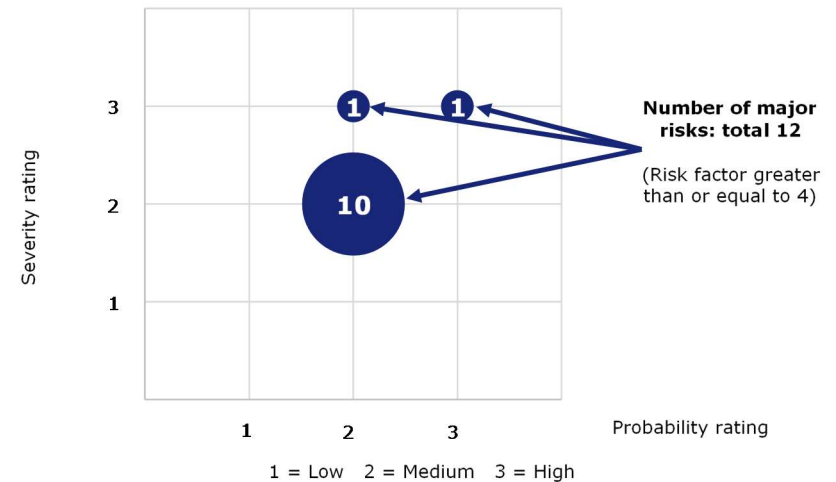
expectations. In addition, ADVA Optical Networking's Management Board regularly analyzes the financial position and profitability of the Group, as well as potential legal and litigation risks, discusses all significant business transactions with the Supervisory Board and obtains its approval if necessary.

In order to ensure observance of all applicable laws and regulations, ADVA Optical Networking has a code of conduct and a range of Group-wide policies in place which govern the Group's business operations and are mandatory for all employees to follow. The code is an extension of the Group's core values, and employees are actively encouraged to report suspected incidents of non-compliance and to seek support when having questions or suggestions. An external ombudsman (this role is currently covered by Frank Fischer, tax lawyer and former member of ADVA Optical Networking's Supervisory Board) and an externally operated ethics and compliance helpline enable confidential and anonymous reporting. Enforcement of compliance with all applicable laws and regulations and deriving internal policies is coordinated by ADVA Optical Networking's Chief Compliance Officer who reports to the Chief Executive Officer and the Supervisory Board.

The analytical tools and processes described above secure a constant and transparent reporting system across the Group. In regular monthly reports and multiple webinars per year, the Management Board informs the extended worldwide management team about the current business development, business outlook, Group and departmental goals.

In addition, ADVA Optical Networking systematically describes all major risks which may cause material harm to the Group or may even threaten its existence, as well as the internal controls, processes and tools that are used to mitigate these risks. A risk is classified as major if its severity and its probability of occurrence on a high-medium-low scale is each ranked "medium" at least. The list of major risks is subject to change, driven by input from within the organization and at least annual reviews by the Management Board. For each major risk identified, the Group assigns a dedicated risk owner who is responsible to report risk-related information periodically and to inform the Management Board immediately should the risk materialize. Compliance with this process is monitored by the Group's treasury department. Group treasury conducts at least quarterly risk reviews with each risk owner. Independent of specific risk ownership, all employees of ADVA Optical Networking are asked to escalate additional obvious risk items directly and informally to the Chief Financial Officer and the Group Treasurer.

At the end of 2015, ADVA Optical Networking ranked 12 risks as major risks (end of 2014: 12), which are discussed in detail below. The rating of those risks is based on probability and severity (p;s)



## **Competitive and Product Risks**

### *Technology Leadership Risk (2;2)*

The market for innovative connectivity solutions for cloud and mobile services is highly competitive and subject to rapid technological change. Competition in this market is characterized by various factors, such as price, functionality, service, scalability and the ability of systems to meet customers' immediate and future network requirements. Should ADVA Optical Networking be unable to adapt to changing market conditions, customer requirements or industry standards, the Group's development would be impacted negatively. Since most of the Group's competitors operate in a broader market and have considerably more resources available due to their greater size, ADVA Optical Networking must continue to leverage its competitive advantage in terms of functionality and efficiency of its solutions, as well as in terms of total cost for the customer. Preventive actions to achieve this include running advanced technology projects, running the navigator team to decide on strategic direction, industry and competitor analysis, keeping the Group's development roadmap up-to-date, testing product visions with customers, driving the evolution of intellectual property rights, monitoring and influencing standardization, minimizing dependency on legacy products, maximizing R&D efficiency and staying close to customers in order to identify differentiating technology opportunities.

### *Cost Leadership Risk (2;2)*

ADVA Optical Networking achieves cost leadership by its ability to scale economically and through the optimization of product design. The loss of cost leadership would drastically reduce the Group's success in winning new business and would have a negative effect on gross and operating margins. The significant pricing pressure for innovative connectivity solutions must be met strategically by improving processes, controls and technology as well as updating existing products, while maintaining adequate R&D budgets. Preventive actions to achieve this include running focused cost reduction programs on existing products by redesign of product parts or by improving the component price versus efficiency ratio. A dedicated team identifies competitive price and cost targets for new products, monitors product cost development throughout the development process, negotiates, tracks and forecasts product and related component costs. Additionally, the Group seeks to transfer manufacturing and distribution to the most efficient location around the world.

### *Product Quality Risk (2;2)*

The deterioration of the quality of ADVA Optical Networking's products could lead to delays in installation, return of products or cancellation of orders, and could result in additional costs for warranty and repair services. In addition, the Group could face penalties and lawsuits, contract terminations and liability claims, which ultimately could lead to lower market shares and harm to ADVA Optical Networking's overall reputation. Preventive actions to avoid

quality deterioration include continuously improving the Group's development processes, enhancing product testing, closely monitoring product return and customer complaint rates as well as analyzing respective root causes, optimizing complaint handling and supplier quality and measuring and analyzing customer satisfaction on a regular basis.

### *Major dependency on a few suppliers or a single-source supplier (2;2)*

A single source supplier is a risky environment. This may happen due to many reasons but the Group have a detailed action plan to mitigate this risk. Otherwise, the consequences can be huge – longer time to market, customer dissatisfaction, loss of customers and a negative impact on ADVA Optical Networking's reputation as high tech company.

## **Cyber Security Risks (2;2)**

Stolen credit card information, personal data as well as business data from major companies have become frequent business headlines these days. No matter how the Group secures and protects its data and system with the latest tools & technology, there is no guarantee that ADVA Optical Networking will be free from cyber security risk. To protect against reputational, financial and legal risks, ADVA Optical Networking purchased a Cyber Security Insurance policy to cover damages to a significant amount. The integrity and availability of the internal IT-systems is assured through the careful implementation of a so called "business continuity" solution.

## **Financial Risks**

### *Foreign Currency Risks (2;2)*

Due to a major portion of the Group's revenues and costs being generated in foreign currencies, ADVA Optical Networking's margin is particularly subject to fluctuations in the EUR/USD, EUR/GBP, GBP/USD, EUR/CHF and USD/CHF exchange rates. In 2015, on a net basis, the Group saw significant GBP inflows and USD outflows. To combat fluctuations, the USD and GBP net cash flows in part are hedged against EUR using forward exchange agreements, based on the Group's forecasted EUR/USD and EUR/GBP exposure for the current year and the next year, and taking into account ongoing fundamental analysis provided by a bank-independent foreign currency consultancy. ADVA Optical Networking targets to achieve a natural hedge scenario for the CHF cash flows but expansion in non-EUR regions of the world is likely to raise the Group's foreign exchange cash flow exposure as well. As part of a consolidation effort, ADVA Optical Networking reduced relationships to seven banks by the end of 2015 versus nine banks in 2014, for hedging purposes.

#### *Customer Payment Terms Risk (2;2)*

In ADVA Optical Networking's competitive market for innovative connectivity solutions, customers may ask to extend payment terms. The extension of the Group's weighted-average payment terms would have an adverse impact on working capital and cash levels. In order to mitigate this risk, there is a three-step process in place governing the escalation of payment terms extension requests. Also, at the end of 2015, the Group had frame contracts in place to sell receivables from one customer (at the end of 2014: from three customers) to financial institutions. At the end of 2015 ADVA Optical Networking SE had no contracts in place to sell receivables from customers (at the end of 2014: from two customers).

#### *Loss of Key Customers (2;3)*

The loss of key customers will have significant impact on ADVA Optical Networking's business especially key customer with a strategic value. This risk may originate to some extent from changes in customer demands and the Group's ability to meet those requirements reliably and in a timely manner. For key customers, the Group constantly ensure performance and customer satisfaction through a dedicated team of professionals.

#### *Intensifying price pressure resulting in lower margins (3;3)*

The extended economic downturn has created a tight spending environment. Today's customers are squeezing every purchase for maximum savings and therefore looking for lower pricing. Customers are conditioned to paying less and less for high tech products each year, especially when there are too many vendors vying for their business. Large customers will negotiate a scheduled price reduction into long term agreements. Parts of ADVA Optical Networking's product line are essentially commoditized, further eroding pricing power. The Group has many preventive action plans in place. To successfully defend higher prices, we communicate value, reliability, scalability, cost-effectiveness and performance to all of its customers.

### **Operational Risks**

#### *Poor inventory management resulting in either lack of material availability or obsolescence (2;2)*

Technological obsolescence, as well as short-term changes in customer demand and manufacturing processes may trigger significant inventory depreciation. Preventive measures to minimize inventory depreciation include an integrated sales and operations planning process and quarterly reviews of inventory depreciation at item levels involving the Finance and Operations departments. In 2015, inventory depreciation and cost related to scrapping of inventory amounted to EUR 1.3 million versus EUR 2.9 million in 2014.

#### *Warranty liability or epidemic failures (2;2)*

Mass field recalls due to epidemic failures can cause a significant strain on operational and financial functions. Therefore ADVA Optical Networking monitors field defects for alarming trends, watches for supplier defects and problems with their components and watches internal factory yields for unusual occurrences.

### **Legal Risks**

#### *Intellectual Property Risk (2;2)*

ADVA Optical Networking currently relies on a combination of copyright and trademark laws, contractual rights, patents and trade secrecy laws to protect its intellectual property. Unauthorized parties may attempt to copy or otherwise obtain and use the Group's products or technology. Monitoring unauthorized use of products and technology is difficult, and the Group cannot be certain that steps taken will prevent unauthorized use of products and technology. If competitors are able to use the Group's products and technology, ADVA Optical Networking's ability to compete effectively could be harmed. Counter measures may prove insufficient in the future and result in conflicts regarding the usage of property rights and technologies. In particular, the continued expansion of the Group's presence in China carries the risk that less stringent regulations for intellectual property rights could lead to an infringement on ADVA Optical Networking's patents and other intellectual property. Such infringement of intellectual property rights could take the form of the production of illegal copies of the Group's products and solutions, and could cause considerable damage to the Group. Third parties may also assert that ADVA Optical Networking has violated their own intellectual property rights and copyright laws, and may claim license fees, indemnities or discontinuation of production and marketing of the relevant products. Related disputes could result in considerable cost to ADVA Optical Networking in its efforts to protect intellectual property, while also diverting considerable management resources. This could result in a negative impact on the Group's business activities. In order to mitigate the intellectual property risk, the Group uses a systematic approach to document inventions and to decide which of these inventions are filed with the relevant authorities in order to obtain intellectual property rights.

### Major Risk Classification Changes During 2015

During 2015, there were several classification changes for risks considered as major from 2014. On the one hand, five risks that were considered major in 2014 are no longer classified in that category. The probability rating of these risks declined. On the other hand, five new risks have been added. The total number of major risks remains unchanged at twelve.

### Minor Risks

Beyond the 12 risks discussed above, there is a broad range of minor risks which can also have a negative impact on ADVA Optical Networking. These uncertainties include financial risks such as the inability to secure financing, impairment of intangible assets and changes in interest rate levels, time risks related to carrier investment cycles and to distribution partnerships, legal risks pertaining to potential claims under product and warranty liabilities, risk from unauthorized access to confidential data, customer concentration risk, general macro-economic risk and risks related to acquisitions. However, the Management Board of ADVA Optical Networking does not consider any of these or other uncertainties to be likely or to have a major impact on the Group.

### Opportunity Identification

The identification of opportunities results from applying the same analytical tools and processes as described in the "risk management system" section above. Group Management has regular discussions with key customers and industry thought leaders to identify new opportunities and technological trends. Throughout the Group agile processes have been introduced to maximize the Group's opportunity to take advantage on newly identified trends. Current opportunities have been identified as follows:

- The demand for cloud and mobile services continues to accelerate, leading to a permanent expansion of the target market for innovative transmission technology. Internet content providers build new and larger data centers of unprecedented scale to offer their digital content and services at a global level. Optical transmission technology is strategically important for coupling these data centers as well as for access to the cloud. Without additional bandwidth in the connectivity networks, Internet content providers' business models will not scale. ADVA Optical Networking introduced new product generations in 2015 that improve the competitiveness of its solution portfolio. The Group expects additional growth from this application space.
- Large companies worry about the security of their data and business processes, and build new data protection and storage solutions. These require transmission technology for connecting geographically dispersed locations. The security package ConnectGuard™ brings competitive

advantage and increased customer loyalty. ADVA Optical Networking expects solid growth in this segment with good profitability.

- Carrier infrastructure upgrades will proceed with different focal points in 2016. The introduction of 100Gbit/s technology in long-haul networks has been largely completed. The investment focus now shifts towards metro networks, where the large-scale use of 100G is just at the beginning. ADVA Optical Networking has good performance and a strong reputation in this area of infrastructure. The Group expects additional growth here.
- In recent years, growth in Europe had been lagging behind the North American lead market. As of 2015, there are intensified signs of revived investment behavior in Europe. ADVA Optical Networking is well positioned in this region, and the resulting backlog of European network operators should have a positive effect on the development of the business.
- The virtualization of network functions changes the market of fiber-based access solutions for the cloud. Both the connection of business customers as well as the connection of mobile base stations will rely on a combination of Carrier Ethernet and NFV as the basis of future networks. The NFV functions on the ADVA FSP 150, which were introduced in 2015, combined with the acquisition of Overture in January 2016, strengthen the visibility and the scope of ADVA Optical Networking in this future market. The company expects first commercial success with this technology by the second half of 2016.

There are additional market opportunities driven by LTE-Advanced rollouts and the build-out of mobile networks. The ongoing ramp of the Group's development activities for the delivery and assurance of highly accurate timing, accelerated through the acquisition of Time4 Systems, has further strengthened its technology positioning and product quality, reducing ADVA Optical Networking's competitive and product risks.

### Overall Opportunity and Risk Assessment

Based on careful inspection of the Group's opportunity and risk profile at the time of the preparation of the Group management report, the Management Board of ADVA Optical Networking believes that the Group's opportunities in the market for innovative connectivity solutions for cloud and mobile services clearly outweigh the risks identified. The Management Board has not identified any risks that pose a danger to ADVA Optical Networking's survival, and to the Management Board there are no risks evident that may endanger the future existence of the Group. ADVA Optical Networking's overall opportunity and risk balance net is at about the same level as it was at the time of the publication of the 2014 Group Management Report. The Group's global, diversified customer base helps offset continued volatility in the global markets. On the other hand, there is still a highly competitive environment



in most of the Group's markets and a level of uncertainty about the timing of capital investments by certain customer segments. The general macro-economic risk is viewed somewhat lower than it was in 2014.

### **Internal Controls Related to Financial Reporting**

The Management Board of ADVA Optical Networking is responsible for establishing and maintaining an adequate system of internal controls. It has implemented an internal control system that enables the Management Board to ensure completeness, accuracy and reliability of financial reporting at Group and legal entity level. When designing its internal control system, ADVA Optical Networking used the COSO framework<sup>6</sup> as a key reference and source of guidance. The internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting. No system of internal control over financial reporting, including one determined to be effective, may prevent or detect all misstatements.

#### *Control Environment*

The control environment is the foundation of the internal control system in every organization. ADVA Optical Networking fosters an environment of openness and integrity with a clear commitment to excellence, competence and the development of its employees. The Group's leadership principles of integrity/honesty, decisiveness and respect are based on this philosophy, and the culture is reflected in the overall tone set by the Management Board. ADVA Optical Networking has a clear organizational structure with well-defined authorities and responsibilities. The bodies charged with the governance and control of the Group (Management Board, Supervisory Board) actively participate in the running and steering of the business. The business is managed on a global basis and run via functional areas. Financial steering of the Group and financial stewardship for individual legal entities is handled by the Chief Financial Officer, under the Audit Committee's control.

#### *Risk Assessment*

As part of the internal controls related to financial reporting, the risk assessment follows the process described in the "risk management system" section.

#### *Control Activities*

At an individual entity level, ADVA Optical Networking's larger and more complex business units use an integrated enterprise resource planning solution, which also serves as general ledger system. Information technology controls have been implemented to restrict user access, ensure proper authorization of changes to the system and efficient handling of user help desk requests. Specific processes are defined and applied for the following

reporting cycles in those business units: cash reporting, revenue recognition, accounts payable, capitalization of development expenses and recognition of subsidies for research, inventory reporting, fixed assets, payroll and provisions. ADVA Optical Networking carries out monthly analytical reviews and quarterly balance sheet reviews based on a four-eye principle between the local accounting and the consolidation functions.

For the consolidated financial statements, those balance sheet and income statement positions requiring a significant degree of judgment and estimation when being valued are determined and analyzed with the involvement of management. This is the case for impairment testing reviews (annual or when a triggering event occurs), capitalization of development projects (when the industrialization stage is reached) and tax reporting and review, specifically deferred taxes (quarterly). ADVA Optical Networking additionally carries out monthly intercompany reconciliations as part of the consolidation process and analytical reviews of actual vs. expected results based on a four-eye principle between the financial planning and the consolidation functions.

All business units follow a set of global accounting policies and reporting guidelines. The financial statements preparation process is monitored globally via a calendar that is communicated to all involved parties on a monthly basis. Checklists are completed both in the individual business units and at the consolidation level to ensure completeness of all closing steps. Periodic reviews by Group management are conducted to detect errors and omissions.

#### *Information and Communication Tools*

The internal control system at ADVA Optical Networking is supported by tools to store and exchange information, enabling the Management Board to make informed business decisions about financial reports and disclosures. The following components ensure proper information and communication for financial reporting:

- Accounting systems for individual entities are matched to the degree of complexity of the business unit. For most entities, an integrated enterprise resource planning system which also serves as general ledger system is in place. All local accounts are mapped to the Group chart of accounts, which is used Group-wide.
- The Group consolidation is supported by a database tool which is linked to the enterprise resource planning and financial planning systems via interfaces. The global financial planning system is used extensively in

<sup>6</sup> Five major accounting organizations formed a group known as COSO (Committee of Sponsoring Organizations of the Treadway Commission), to provide guidance on evaluating internal control. They issued this guidance as the COSO Internal Control Framework.

analyzing actual vs. expected results and thus monitoring the results of the consolidation.

- There are global accounting policies for the more complex financial statement positions of the Group and a Group chart of accounts for all other financial guidance. Accounting policies are updated regularly and are implemented only after a thorough internal review and training.

#### *Internal Monitoring*

As part of the ongoing monitoring, the Chief Financial Officer is informed of all material misstatements and control breakdowns at Group and business unit level on a quarterly basis in the executive summary to the financial statements. The reporting of deficiencies follows the principles of open and transparent communication, and follow-up is ensured through regular calls where corrective actions are presented.

#### **Internal Financial Audit**

In order to monitor significant activities, to identify and minimize risks, to improve efficiency of financial processes and to support decision-making, ADVA Optical Networking maintains an internal audit function to review financial processes. Financial processes are globally harmonized in so far as a global process does not contravene local regulations. The internal audit review encompasses global financial processes as well as business-unit specific processes where necessary to satisfy local requirements.

Based on an annual risk assessment for key financial processes, the internal audit function proposes an audit program for the year which is discussed with and ratified by the Chief Financial Officer and the Audit Committee. The internal audit function performs appropriate internal audit procedures throughout the year, and presents the standardized internal audit reports to the Audit Committee.

Actions to adjust processes or enhance internal controls are initiated based on the recommendations included in the internal audit reports. The internal audit function regularly tracks actual implementation of these recommendations.

## **Events After the Balance Sheet Date**

On January 13, 2016, ADVA Optical Networking acquired 100% of the shares of Overture group, headquartered in Raleigh, North Carolina, USA. The acquisition expands ADVA Optical Networking's portfolio of Ethernet and cloud access solutions and increases its presence in North America including the local customer base. The Overture corporate group consists of two US companies and two subsidiaries in India and the UK. A large part of its revenue is generated in North America. The group currently employs 178 people worldwide. The purchase price totaled USD 40.0 million (EUR 36.9 million translated at the exchange rate of January 13, 2016: USD 1.0839 per EUR). USD 35.0 million (EUR 32.3 million) was payable in cash on the date of acquisition. In addition, a revenue-based earn-out component of USD 5.0 million was agreed. The purchase price has been financed through two bank loans totaling EUR 35.0 million. Both loans have a term of five years and a fixed interest rate of 1.4% per annum. The audited opening balance sheet on January 15, 2016, following IFRS and the results of the purchase price allocation, were not available at the time the preparation of the 2015 consolidated financial statement was finalized.

On February 1, 2016, ADVA Optical Networking submitted all required documents to court in order to appoint Prof. Dr.-Ing. Hans-Joachim Grallert to the Supervisory Board. Prof. Dr.-Ing. Hans-Joachim Grallert was lastly Head of the Department of Communications Engineering at the Technical University of Berlin. The appointment by the court was effective February 17, 2016.

## Outlook

Based on the macroeconomic framework described above, ADVA Optical Networking anticipates a compound annual growth rate of 9%<sup>4</sup> for the Group's addressable market between the years 2015 – 2018. The greatest growth potential is forecast for enterprise networks.

The global megatrends cloud and mobility still drive sustainable growth for the Group's addressable market. The demand for cloud and mobile services is driving demand for more bandwidth, and thus also the demand for more transmission technology.

Detailed further explanations for the forecast market environment up to 2018 as well as the resulting opportunities can be found in the section "General Economic and Market Conditions" and in the section "Business Overview".

In order to ensure sustainable corporate success, ADVA Optical Networking focuses on the following long-term strategic objectives:

- Grow global revenues profitably through continued strong direct sales and marketing efforts with a solid focus on key accounts, new customer wins, optimized distribution partnerships, service and software business.
- Expand the Group's proven innovation leadership and increase footprint by meeting strategic customers' demand for innovative connectivity solutions quickly and comprehensively.
- Maintain operational excellence by further focusing on industry-leading processes and best-in-class execution, which will result in product and service quality leadership, improved efficiency and increased overall customer satisfaction.
- Recruit, retain, motivate, educate and nurture the Group's employees to sustainably achieve high levels of performance, personal growth and job satisfaction, while keeping attrition rates low.

Looking back at 2015, ADVA Optical Networking made significant progress in meeting all of these strategic elements:

2015 revenues were up 30.3% compared to 2014. This exceeded the management board's expectations of moderately growing revenues as announced in the 2014 management report. The strong revenue growth was mainly driven by Internet content providers and the overall demand for more bandwidth from communication service providers. The Group's pro forma operating income<sup>1</sup> increased by EUR 20.5 million to EUR 30.0 million or 6.8% of revenues in 2015 after EUR 9.5 million or 2.8% of revenues in 2014. This

result also exceeded the management board's expectations of slightly increasing pro forma operating income, as announced in the 2014 management report. Operating income at EUR 26.8 million or 6.1% of revenues in 2015 improved as well, after EUR 8.4 million or 2.5% of revenues in 2014. The strong increase is closely tied to the strong revenue growth. Similarly the business development in ADVA Optical Networking SE exceeded the expectations of the Management board, in particular with regards to the increase of the gross profit.

As for innovation leadership, ADVA Optical Networking was able to expand its position in 2015. The Group has again brought new features and capabilities to the market and differentiated itself from its competitors with innovative technology. ADVA Optical Networking introduced in 2015 a new generation of transmission technology for data center interconnect. The ADVA FSP 3000 CloudConnect™ further enhances fiber utilization and scales to a capacity of more than 25Tbit/s per fiber. The ADVA FSP 3000 CloudConnect™ also dwarfs other solutions in terms of space and power efficiency. The platform delivers a highly compelling feature set for interconnecting hyper-scale data centers for Internet content providers. In the field of data security, ADVA Optical Networking extended its ConnectGuard™ solution to the FSP 150 platform, providing highest available levels of security. In addition, the ADVA FSP 150 has evolved to become a programmable, universal network demarcation device that can take over the functions of other networking appliances. Through the introduction of network function virtualization (NFV), more and more network functions are defined as software applications and developed in isolation from the supporting hardware. These software applications can be deployed centrally in a data center, or alternatively on a device with an integrated server functionality. In addition ADVA Optical Networking introduced a new generation of the ADVA FSP 150, which is fully aligned with this trend. The ADVA FSP 150 Pro Series supports both centralized and decentralized NFV concepts and significantly expands the addressable market for these Carrier Ethernet access devices. With its portfolio of innovative connectivity solutions, the Group is well positioned to serve all networking demands driven by cloud and mobile services and capitalize on these mega trends.

Furthermore, ADVA Optical Networking boosted operational excellence in 2015. In an environment of continued price pressure, the Group remained disciplined in controlling its operational costs, thereby enabling it to significantly grow revenues whilst maintaining a strong focus on profitability. With strict controls in place and tight working capital management, ADVA Optical Networking maintained a strong cash position throughout the year and reached a record high net liquidity<sup>2</sup> position of EUR 51.2 million at the end of 2015, up EUR 2.3 million from the EUR 48.9 million recorded at the end of 2014. This was in line with the 2014 projection that net liquidity will grow moderately.

As for customer satisfaction, ADVA Optical Networking uses the Net Promoter Score<sup>3</sup> metric to track progress. For 2015, the Group was able to further improve the record levels of 2014 by another point. This development exceeded the expectations of the management board announced in the 2014 management report, targeting to achieve in 2015 the same high level of the NPS-score as in the previous year. The further increase was due to a strong improvement in the sub-category technology and innovation.

On the employee side, ADVA Optical Networking selectively expanded its talent pool in 2015, mostly in its research & development organizations. The acquisition of Time4 Systems and the development team of FiSEC GmbH contributed to this expansion. Based on competitive compensation programs and a rewarding work environment with comprehensive education opportunities, the Group maintained the high motivation of its employees and moderate attrition rates in 2015.

ADVA Optical Networking aims to further improve profitability and achieve revenue growth above average market growth in 2016. The following factors, which have been discussed in the "Risk Report" under "Opportunity Identification", will play a major role:

- Internet content providers build new and larger data centers that need to be connected with optical transmission technology. The FSP 3000 CloudConnect™ has been specifically designed for this target group and ADVA Optical Networking expects additional growth from this application.
- Large companies build geographically dispersed data protection and storage solutions, requiring optical transmission technology. The security package ConnectGuard™ brings competitive advantage and increased customer loyalty. ADVA Optical Networking expects solid growth in this segment with good profitability.
- Carrier infrastructure upgrades will continue in 2016. The investment focus is shifting towards metro networks, where ADVA Optical Networking is particularly well positioned.
- As of 2015, there are intensified signs of revived investment behavior from European network operators. This should have a positive effect on the business development.
- The NFV functions on the ADVA FSP 150, which were introduced in 2015, combined with the acquisition of Overture in January 2016, strengthen the visibility and the scope of ADVA Optical Networking in the future market for cloud access solutions. The company expects first commercial success with this technology by the second half of 2016.

Despite the current political and global economic turmoil, the global megatrends cloud and mobility continue to fuel growth of the network equipment industry and support ADVA Optical Networking's strategy to be a reliable partner for open network solutions. The combination of application-optimized innovation, short development and delivery times, a broad and growing customer base and a well-balanced distribution model differentiates ADVA Optical Networking from its peers and leads to a profitable business model.

Based on these factors, and taking into account planning parameters such as personnel and currency exchange rates, the management board of ADVA Optical Networking expects the Group to grow faster than the average market and increase revenues in a moderate double digit percentage range. Under this assumption, the management board also expects its 2016 pro forma operating income<sup>1</sup> to further increase moderately. ADVA Optical Networking SE stand-alone is likely to develop correspondingly in 2016. Net liquidity<sup>2</sup> was reduced through the acquisition of Overture, completed in January 2016. The management board expects an increase from the new level in the lower double digit million Euro range by the end of the year. The Group will continue to selectively invest in product development, technology and revenue-generating opportunities. In addition, the management board of ADVA Optical Networking expects, due to the continued focus on innovation, quality and service, that customer satisfaction in 2016 will also be maintained at the record levels of the 2015 Net Promoter Score. Actual results may differ materially from expectations if risks materialize or the underlying assumptions prove unrealistic. The major risks facing ADVA Optical Networking are discussed in the "Risk Report" section.

Meiningen, February 23, 2016

Brian Protiva

Christoph Glingener

Ulrich Dopfer

## ADVA OPTICAL NETWORKING SE, MEININGEN – FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR FROM JANUARY 1 TO DECEMBER 31, 2015

### Balance Sheet on December 31, 2015

(on December 31, in thousands of EUR)	Note	2015	2015	2014
<b>Assets</b>				
<b>A. Fixed assets</b>	3.1.1			
<b>I. Intangible assets</b>				
1. Self-constructed industrial and similar rights and assets, and licenses in such rights and assets	3.1.2	61,457		51,464
2. Purchased industrial and similar rights and assets, and licenses in such rights and assets	3.1.3	5,350		1,858
3. Goodwill		27		-
4. Payments on account		265		-
		<b>67,099</b>		<b>53,322</b>
<b>II. Property, plant and equipment</b>				
1. Land, land rights and buildings, including buildings on third-party land		5,175		5,565
2. Plant and machinery		4,070		4,953
3. Other equipment, furniture and fixtures		656		534
4. Payments on account and assets under construction		137		29
		<b>10,038</b>		<b>11,081</b>
<b>III. Financial assets</b>				
1. Shares in affiliated companies	3.1.4	27,449		28,860
2. Loans to affiliated companies	3.1.5	2,225		2,701
3. Investments	3.1.6	1,198		1,198
		<b>30,872</b>		<b>32,759</b>
<b>B. Current Assets</b>				
<b>I. Inventories</b>				
1. Raw materials, consumables and supplies		9,742		7,224
2. Work in process		2,801		2,316
3. Finished goods and merchandise		23,961		15,718
4. Payments on account		184		184
		<b>36,688</b>		<b>25,442</b>
<b>II. Receivables and other assets</b>				
1. Trade accounts receivable	3.1.7	33,808		29,784
2. Receivables from affiliated companies	3.1.8	28,802		26,538
3. Other assets	3.1.9	1,970		1,181
		<b>64,580</b>		<b>57,503</b>
<b>III. Cash at banks and in hand</b>		<b>39,345</b>		<b>25,995</b>
<b>C. Prepaid expenses</b>		<b>940</b>		<b>696</b>
<b>Total assets</b>		<b>249,562</b>		<b>206,798</b>

(on December 31, in thousands of EUR)	Note	2015	2015	2014
<b>Equity and liabilities</b>				
<b>A. Equity</b>	3.1.10			
<b>I. Subscribed capital</b> (Conditional capital EUR 3,531 thousand (prior year: EUR 4,729 thousand))		49,374		48,096
<b>II. Capital reserve</b>		32,944		31,004
<b>III. Retained earnings</b>				
1. Other retained earnings		2,551		2,551
<b>IV. Accumulated profit</b>		52,392		34,824
			<b>137,261</b>	<b>116,475</b>
<b>B. Provisions</b>				
1. Provisions for pension and similar obligations	3.1.11	382		361
2. Tax provisions	3.1.12	1,177		680
3. Other provisions	3.1.13	10,457		7,174
			<b>12,016</b>	<b>8,215</b>
<b>C. Liabilities</b>	3.1.14			
1. Liabilities to banks		42,670		34,983
2. Advance payments received		2		-
3. Trade accounts payable		16,296		13,123
4. Liabilities to affiliated companies	3.1.8	18,373		14,225
5. Other liabilities		9,330		6,117
- thereof for taxes		1,629		725
- thereof for social security		335		287
			<b>86,671</b>	<b>68,448</b>
<b>E. Deferred income</b>			<b>7,036</b>	<b>7,596</b>
<b>F. Deferred tax liabilities</b>	3.1.15		<b>6,578</b>	<b>6,064</b>
<b>Total equity and liabilities</b>			<b>249,562</b>	<b>206,798</b>



## Income Statement for the Period From January 1 to December 31, 2015

(in thousands of EUR from January 1 to December 31)	Note	2015	2014
1. Revenues	3.2.1	<b>327,274</b>	204,409
2. Cost of goods sold	3.2.2	219,832	149,586
<b>3. Gross profit</b>		<b>107,442</b>	<b>54,823</b>
4. Selling and marketing expenses		29,819	24,561
5. General administrative expenses		17,014	14,376
6. Research and development expenses	3.1.2	47,937	28,820
7. Other operating income	3.2.4	9,858	18,631
- thereof currency translation		8,107	3,649
8. Other operating expenses	3.2.4	8,087	4,550
- thereof currency translation		7,848	4,287
<b>9. Operating Income (EBIT)</b>		<b>14,443</b>	<b>1,147</b>
10. Income from investments	3.2.5	6,458	439
- thereof from affiliated companies		6,458	439
11. Income from other securities and loans classified as financial assets		106	70
- thereof from affiliated companies		106	70
12. Other interest and similar income		10	50
13. Amortization of financial assets	3.2.6	1,573	-
14. Interest and similar expenses		726	1,123
- thereof interest expense for non-current provisions		66	12
- thereof from affiliated companies		84	30
		<b>4,275</b>	<b>-564</b>
<b>15. Result from ordinary activities</b>		<b>18,718</b>	<b>583</b>
16. Tax expense (benefit), net	3.2.7	1,146	-3,835
- thereof deferred taxes		515	-3,639
17. Other tax expense (benefit), net		4	16
		<b>1,150</b>	<b>-3,819</b>
<b>18. Net profit for the year</b>		<b>17,568</b>	<b>4,402</b>
19. Profit carried forward		34,824	30,422
<b>20. Accumulated profit</b>		<b>52,392</b>	<b>34,824</b>

## Notes to the Financial Statements 2015

### 1 Preparation of the Annual Financial Statements

The annual financial statements of ADVA Optical Networking SE (hereinafter referred to as "the Company") for the financial year ended 2015 were prepared in accordance with the regulations of the German Commercial Code (Handelsgesetzbuch, HGB) and the German Stock Corporation Law (Aktiengesetz, AktG). The classification of income and expenses in the income statement is based on their function within the Company. For the sake of clarity, when disclosure options exist, the appropriate disclosures are provided in the notes to the financial statements.

### 2 General Information on Corrections, Accounting Policies & Valuation and Currency Translation

#### 2.1 Information About the Company

The Company is a Societas Europaea located in Märzenquelle 1-3, 98617 Meiningen, Germany. ADVA Optical Networking SE is classed as a large company in accordance with the Germany Commercial Code (HGB) § 287. The business year is equal to the calendar year.

The financial statements for the year ended December 31, 2015 were authorized for issue in accordance with a resolution of the Management Board on February 23, 2016.

The company develops, manufactures and sells optical and Ethernet-based networking solutions to telecommunications carriers and enterprises to deliver data, storage, voice and video services.

Telecommunications service providers, private companies, universities and government agencies worldwide use the Group's systems. ADVA Optical Networking SE sells its product portfolio both directly and through an international network of distribution partners.

#### 2.2 Accounting Policies and Valuation

##### 2.2.1 Intangible and Tangible Assets

Intangible and tangible assets are recognized at acquisition or production costs, including incidental costs, less scheduled depreciation. Depreciation is based on a straight-line method pro rata temporis. Impairment charges are recognized in case of a permanent diminution in value.

Intangible assets with finite lives are amortized on a straight-line basis over the expected useful economic lives of the assets as follows:

• Goodwill	4,5 years
• Capitalized development projects	3 to 5 years
• Purchased technology	4 years
• Software and other intangible assets	3 to 6 years

Depreciation on property, plant and equipment is calculated over the estimated useful economic lives of the assets as follows:

• Buildings	20 to 25 years
• Technical equipment and machinery	3 to 4 years
• Factory and office equipment	3 to 10 years

Assets with historical costs up to EUR 410 are expensed in the year of purchase. Self-constructed tangible assets are capitalized at production costs including appropriate material and production overhead costs. General administrative expenses are not capitalized and are therefore not included in the production costs. Investment subsidies are deducted from the acquisition or production costs.

##### 2.2.2 Government Grants

Government grants are recognized where there is reasonable assurance that the grant will be received and all the attached conditions will be met. When the grant relates to an expense item, it is recognized as income over the period necessary to match the grant on a systematic basis to the costs that it is intended to compensate. Where the grant relates to an asset, it is recognized as a reduction of purchase costs and released as a reduction of amortization expense over the expected useful economic life of the related asset.

### **2.2.3 Research and Development Projects**

Development expenses for new products are capitalized as development projects if

- they can be unambiguously assigned to those products,
- the products under development are technically feasible and can be marketed,
- there is reasonable certainty that the development activity will result in future cash inflows.

Capitalized development projects include all costs that can be directly assigned to the development process, including borrowing costs.

After initial recognition of capitalized development projects as an asset, measurement is at historical cost, less accumulated amortization and impairment. The straight-line method of amortization is used from the start of production through the estimated selling periods for the products developed (generally between three and five years).

Finished as well as unfinished development projects are tested for impairment on the balance sheet date and at other defined dates in the product life cycle.

Research costs are expensed as incurred.

### **2.2.4 Financial Assets**

Shares in and loans to affiliated companies, investments and loans granted to investments are recognized at the cost of acquisition including transaction costs less impairment charges in case of a permanent diminution in value.

### **2.2.5 Inventories**

Inventories are recognized at the lower of acquisition or production cost, including incidental costs and allowances, and the market value or fair value. Production costs include material costs, direct manufacturing costs, depreciation on production-related assets and necessary manufacturing overhead costs. General administrative expenses and interest expenses are not included in production costs.

### **2.2.6 Accounts Receivable and Other Assets**

Accounts receivable and other assets are stated at nominal value, taking into consideration all identifiable risks.

### **2.2.7 Cash and Cash Equivalents**

Cash and cash equivalents are stated at nominal value.

### **2.2.8 Prepaid Expenses**

Prepaid expenses include payments recorded in the current reporting period that are related to a defined period after the balance sheet date.

### **2.2.9 Subscribed Capital**

Subscribed capital is recognized at nominal value.

### **2.2.10 Taxes**

#### *Current income tax*

Current income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted on the balance sheet date.

#### *Deferred tax*

Deferred tax is provided using the liability method on temporary differences on the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are recognized for all taxable temporary differences.

Deferred tax assets are recognized for all deductible temporary differences as well as for tax losses carried forward to the extent that it is probable that taxable profit will be available against which the deductible temporary differences respectively tax losses carried forward can be utilized.

The carrying amount of deferred tax assets is reviewed on each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow the deferred tax asset to be utilized.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted on the balance sheet date. Future changes in tax rates are recognized on the balance sheet date if their impact is materially certain as part of the tax legislation process.

Deferred tax assets and deferred tax liabilities are offset in the balance sheet.

### **2.2.11 Pensions and Similar Obligations**

Pensions and similar obligations are actuarially measured using the projected unit credit method. Future obligations are measured and discounted at the net present value based on proportionately acquired pension rights known at the reporting date. Specified parameters for the future development are considered and affect the measurement of future benefits. The company uses the published appropriate discount rate for the duration of 15 years from German Federal Bank at the end of each year.

### **2.2.12 Provisions**

Provisions are made for all identifiable risks to an adequate extent considering the principles of commercial prudence are recognized at the settlement amount. Accruals with a remaining duration of more than one year are discounted at a rate equal to the average market rate.

### **2.2.13 Liabilities**

Liabilities are stated at the settlement amount. The settlement amount of loans is the nominal value.

### **2.2.14 Deferred Income**

Deferred income is recognized for receipts reported in the current period as far as they represent income for a defined period after the reporting date.

### **2.2.15 Derivative Financial Instruments**

To some extent, ADVA Optical Networking SE uses derivative financial instruments to hedge against the risks from operating activities and from planned investments. Common instruments like forward contracts options are used to protect against changes in interest rates and foreign currency rates.

A provision is recognized for pending transactions. No financial instruments qualify for hedge accounting in the sense of §254 HGB in 2015 and 2014.

## **2.3 Currency Translation**

Conversion into EUR of fixed asset purchases is made at the exchange rate on the date of purchase. Accounts receivable, other assets and liabilities are converted at the spot exchange rate on the balance sheet date.

Gains and losses on currency translation are recorded in the income statement as other operating income and expenses.

The foreign exchange rates are:

	<b>Spot rate on Dec. 31, 2015</b>
USD	1.0926
GBP	0.7380
CHF	1.0814
PLN	4.2400
ILS	4.2606
CNY	7.0912
SGD	1.5449
HKD	8.4688
INR	72.5163
BRL	4.2589
JPY	131.5790
SEK	9.1878
NOK	9.6163

## **2.4 Revenues**

### ***Sale of Goods***

Revenue from the sale of goods is recognized when the significant risks and rewards of ownership of the goods have passed to the buyer, usually on delivery of the goods.

Product returns that are estimated according to contractual obligations and past revenues statistics are recognized as a reduction of revenues.

### ***Rendering of Services***

Revenues arising from the sale of services primarily derive from maintenance, installation services and training and are recognized when those services have been rendered. Installation services are recognized as revenue if the final installation has been approved by the customer. Generally, maintenance services are reported as deferred revenue and recognized as revenue straight-line over the contract period. Training is recognized as revenue immediately after supply of the service.

In arrangements with customers that include delivery of goods as well as rendering of services, the shipment of the goods is separated from the rendering of the services if the goods have a stand-alone value for the customer and the fair value of the service can be reliably determined. Both components of the transaction are measured at their proportionate fair value.

Discounts, rebates and other sales taxes or duties relating to the sales of goods and the rendering of services are deducted from revenues.

Revenues from licence agreements relate to compensations received from ADVA Optical Networking group companies for the usage of intellectual property rights and are recognized when they arise.

## **2.5 Cost of Goods Sold**

The cost of goods sold comprises the costs incurred in the production and rendering of services. This item subsumes both the direct cost of materials and production directly assignable to a product and indirect (overhead) costs, including the depreciation of production equipment, amortization of production related intangible assets and write-downs on inventories. The cost of goods sold also includes changes to the warranty provision. Income from the reversal of write-downs on inventories reduces the cost of goods sold, which also includes amortization of purchased technologies and amortization of capitalized research and development projects.

Licence payments to ADVA Optical Networking group companies relate to usage of intellectual property rights and are recognized in Selling and Marketing expenses.

### 3 Notes and Information on Selected Items of the Annual Financial Statements

#### 3.1 Balance Sheet

##### 3.1.1 Fixed Assets

The development of fixed assets is disclosed in the following schedule:

(in thousands of EUR)							Historic cost				Accumulated depreciation				Net book values	
	Jan. 1, 2015	Additions	Investment subsidies	Dispo- sals/ retire- ments	Reclas- sifica- tions	Dec. 31, 2015	Jan. 1, 2015	Depre- ciation of the period	Deprecia- tion on dispo- sals/ retire- ments	Dec. 31, 2015	Dec. 31, 2015	Dec. 31, 2014				
<b>I. Intangible assets</b>																
1. Self-constructed industrial and similar rights and assets, and licenses in such rights and assets	93,356	34,597	-	-	-	127,953	41,892	24,604	-	66,496	61,457	51,464				
2. Purchased industrial and similar rights and assets, and licenses in such rights and assets	20,183	4,966	-	1	-	25,148	18,325	1,474	1	19,798	5,350	1,858				
3. Goodwill	256	28	-	-	-	284	256	1	-	257	27	-				
4. Payments on account	-	265	-	-	-	265	-	-	-	-	265	-				
	<b>113,795</b>	<b>39,856</b>	<b>-</b>	<b>1</b>	<b>-</b>	<b>153,650</b>	<b>60,473</b>	<b>26,079</b>	<b>1</b>	<b>86,551</b>	<b>67,099</b>	<b>53,322</b>				
<b>II. Property, plant and equipment</b>																
1. Land, land rights and buildings including buildings on third-party land	9,830	14	2	26	-	9,816	4,265	389	13	4,641	5,175	5,565				
2. Plant and machinery	34,937	1,845	88	1,861	27	34,860	29,984	2,528	1,722	30,790	4,070	4,953				
3. Other equipment, furniture and fixtures	5,920	500	5	1,163	-	5,252	5,386	369	1,159	4,596	656	534				
4. Payments on account and assets under construction	29	135	-	-	-27	137	-	-	-	-	137	29				
	<b>50,716</b>	<b>2,494</b>	<b>95</b>	<b>3,050</b>	<b>-</b>	<b>50,065</b>	<b>39,635</b>	<b>3,286</b>	<b>2,894</b>	<b>40,027</b>	<b>10,038</b>	<b>11,081</b>				
<b>III. Financial assets</b>																
1. Shares in affiliated companies	34,965	264	-	102	-	35,127	6,105	1,573	-	7,678	27,449	28,860				
2. Loans to affiliated companies	8,787	1,511	-	1,987	-	8,311	6,086	-	-	6,086	2,225	2,701				
3. Investments	1,198	-	-	-	-	1,198	-	-	-	-	1,198	1,198				
4. Loans to investments	-	-	-	-	-	-	-	-	-	-	-	-				
	<b>44,950</b>	<b>1,775</b>	<b>-</b>	<b>2,089</b>	<b>-</b>	<b>44,636</b>	<b>12,191</b>	<b>1,573</b>	<b>-</b>	<b>13,764</b>	<b>30,872</b>	<b>32,759</b>				
<b>Total</b>	<b>209,461</b>	<b>44,125</b>	<b>95</b>	<b>5,140</b>	<b>-</b>	<b>248,351</b>	<b>112,299</b>	<b>30,938</b>	<b>2,895</b>	<b>140,342</b>	<b>108,009</b>	<b>97,162</b>				



### **3.1.2 Self-Constructed Industrial and Similar Rights and Assets, and Licenses in Such Rights and Assets**

Research and development expenses for the financial year as well as capitalized development projects are included in the table below:

(in thousands of EUR)	<b>2015</b>	<b>2014</b>
Research expenses	1,741	2,562
Development expenses	78,267	51,737
Research & Development expenses	80,008	54,299
Thereof capitalized development projects	-32,071	-25,479
<b>Total Research &amp; Development Expenses in income statement</b>	<b>47,937</b>	<b>28,820</b>

### **3.1.3 Purchased Industrial and Similar Rights and Assets, and Licenses in Such Rights and Assets**

Purchased Industrial and Similar Rights and Assets, and Licenses in Such Rights and Assets mainly include net book values of purchased technologies from Oscilloquartz SA, Saint-Blaise, Switzerland of EUR 2,643 thousand (prior year: EUR 0) and the technologies from the acquisition of materially all assets of FiSEC GmbH EUR 1,283 thousand (prior year: EUR 0). Furthermore EUR 968 thousand (prior year: EUR 1,344 thousand) relate to net book values for purchased software licenses.

### 3.1.4 Shares in Affiliated Companies

On December 31, 2015, ADVA Optical Networking SE holds directly or indirectly shares in 15 (December 31, 2014: 15) affiliated companies as follows:

(in thousands)			Equity	Net income/loss (-)	Share in Equity owned directly	owned indirectly
ADVA Optical Networking North America Inc. Norcross/Atlanta (Georgia), USA	USD	*	54,235	7,320	100%	-
ADVA Optical Networking Ltd. York, United Kingdom	GBP	**	4,414	221	100%	-
Oscilloquartz SA Saint-Blaise, Switzerland	CHF	*	7,786	8,694	100%	-
ADVA Optical Networking sp. z o.o. Gdynia, Poland	PLN	**	10,244	-2,264	100%	-
ADVA Optical Networking Israel Ltd. Ra'anana/Tel Aviv, Israel	ILS	*	1,359	-7,912	100%	-
ADVA Optical Networking (Shenzhen) Ltd. Shenzhen, China	CNY	**	42,777	5,758	100%	-
Oscilloquartz Finland Oy Espoo, Finland	EUR	****	-31	17	100%	-
ADVA Optical Networking Trading (Shenzhen) Ltd. Shenzhen, China	USD	*	646	-33	-	100%
ADVA Optical Networking Singapore Pte. Ltd. Singapore	SGD	**	2,670	105	100%	-
ADVA Optical Networking Hongkong Ltd., Hongkong, China	HKD	**	1,540	728	-	100%
ADVA Optical Networking (India) Private Ltd. Gurgaon, India	INR	***	10,382	6,631	1%	99%
ADVA Optical Networking Serviços Brazil Ltda. São Paulo, Brazil	BRL	*	973	229	99%	1%
ADVA Optical Networking Corp. Tokyo, Japan	JPY	*	79,348	2,946	100%	-
ADVA Optical Networking AB Kista/Stockholm, Sweden	SEK	**	1,362	184	100%	-
ADVA Optical Networking AS i.L. Oslo, Norway	NOK	**	7,000	-1,228	100%	-

\* Prepared in accordance with the International Financial Reporting Standards (IFRS) for the period ended December 31, 2015.

\*\* Prepared in accordance with local commercial law for the period ended December 31, 2014.

\*\*\* Prepared in accordance with local commercial law for the period ended March 31, 2015.

\*\*\*\* Prepared in accordance with the International Financial Reporting Standards (IFRS) for the short financial year from July, 23, 2014 to December 31, 2015

### **Acquisition of Time4 Systems Oy**

On July 23, 2015, ADVA Optical Networking SE acquired 100% of the share capital of Time4 Systems Oy, Espoo, Finland, for a purchase price of EUR 550 thousand. On September 24, 2015, the company has been renamed to Oscilloquartz Finland Oy.

The company, located near Helsinki, employs five employees, focused on the development of ultra-compact synchronization solutions. The underlying technology will further strengthen the Group's position in the market for synchronization and timing solutions.

### **Acquisition of a Development Division of FiSEC GmbH**

On December 1, 2015, ADVA Optical Networking SE acquired materially all assets of a development division of FiSEC GmbH, Meiningen, Germany at a total purchase price of EUR 1,365 thousand.

The underlying technology will further strengthen the Group's position in the market for monitoring solutions for optical data transport technology. The seven employees were transferred to ADVA Optical Networking SE effective December 1, 2015.

At the end of 2013, the Management decided to close ADVA Optical Networking AS i.L., Oslo, Norway. At December 31, 2015, the liquidation of the entity was not completed.

### **3.1.5 Loans to Affiliated Companies**

Loans to affiliated companies are due within one to five years.

The loans to affiliated companies can be analyzed as follows:

(in thousands of EUR)	2015	2014
ADVA Optical Networking Hongkong Ltd. Hongkong, China	110	110
ADVA Optical Networking Israel Ltd. Ra'anana, Israel	822	-
Oscilloquartz SA Saint-Blaise, Switzerland	-	1,663
ADVA Optical Networking sp. z o.o. Gdynia, Poland	943	928
Oscilloquartz Finland Oy Espoo, Finland	350	-
<b>Total</b>	<b>2,225</b>	<b>2,701</b>

### **3.1.6 Investments**

On December 31, 2015, ADVA Optical Networking SE holds 11% (prior year: 11%) of the shares of Saguna Networks Ltd., Nesher, Israel. On December 31, 2015, the book value of the investment amounts to EUR 1,198 thousand (December 31, 2014: EUR 1,198 thousand). ADVA Optical Networking SE does not have significant influence over Saguna Networks Ltd.

### **3.1.7 Trade Accounts Receivable**

Trade accounts receivable are non-interest-bearing and are due within 30 to 120 days in general. For specific projects other payment terms may be agreed.

Trade accounts receivable are due within one year.

Customer credit notes for volume discounts and similar reasons are offset from trade receivables if offsetting is mandatory.

On September 24, 2014, ADVA Optical Networking SE entered into an agreement on the sale of accounts receivable. The agreement entitles the Company to finance receivables from specific customers for a period of up to 45 or 60 days. ADVA Optical Networking SE pays annual interest amounting to EURIBOR plus 3% on the volume of the receivables transferred. In addition, a service charge of EUR 500 per transaction applies. The agreement applies to receivables which are due latest on December 31, 2015. In 2015, ADVA Optical Networking SE incurred interest expenses of EUR 2 thousand (prior year: EUR 7 thousand).

A further agreement to finance accounts receivable terminated in April 30, 2015 and was not utilized since Q3 2014. Therefore no interest expenses incurred in the current year (prior year: EUR 90 thousand).

### **3.1.8 Receivables From and Liabilities to Affiliated Companies**

Receivables from affiliated companies mainly include trade receivables for goods and services of EUR 28,802 thousand. Accounts receivables from affiliated companies are due within one year.

Liabilities to affiliated companies mainly include trade payables for goods and services of EUR 18,373 thousand. These payables are due within one year.

### 3.1.9 Other Assets

All other assets recognized on the balance sheet are due within one year, with the exception of EUR 372 thousand (prior year: EUR 378 thousand) for rental deposits which are due within five years.

### 3.1.10 Equity

#### *Common stock and share capital*

On December 31, 2015, ADVA Optical Networking SE had issued 49,374,484 (prior year: 48,096,431) no par value bearer shares (hereinafter "common shares"), each representing a notional amount of share capital of EUR 1.00.

The common shares entitle the holder to vote at the Annual Shareholder's Meeting and to receive dividends in case of a distribution. No restrictions are attached to the common shares.

#### *Capital transactions*

In connection with the exercise of stock options, 1,278,053 shares were issued to employees of the Company and its affiliates out of conditional capital in 2015 (in 2014 in connection with the exercise of stock options 73,604 shares). The par value of EUR 1,278 thousand (prior year: EUR 73 thousand) was appropriated to share capital, whereas the premium resulting from the exercise of stock options of EUR 1,939 thousand (prior year: EUR 47 thousand) was recognized within capital reserve.

#### *Authorized capital*

The authorized capital 2014/I has been completely canceled on the Annual Shareholders' Meeting on May 20, 2015, and replaced by a new authorized capital 2015/I. According to the Company's articles of association, the Management Board is authorized, subject to the consent of the Supervisory Board, to increase subscribed capital until May 19, 2020, only once or in successive tranches by a maximum of EUR 24,048 thousand by issuing new common shares in return for cash or non-cash contributions. Subject to the consent of the Supervisory Board, the Management Board is further authorized to decide whether to exclude stockholders' subscription rights. Stockholders' subscription rights can be excluded for capital increases for cash contributions as well as contributions in kind if during the term of this authorization and in exclusion of shareholder subscription rights, the shares issued against contributions in cash or in kind do not exceed 20% of the share capital.

#### *Conditional capital*

The Annual Shareholders' Meeting on May 20, 2015, resolved to decrease the conditional capital 2003/2008 by EUR 438 thousand to EUR 1,297 thousand. In addition, the conditional capital 2011/I has been increased by EUR 518 thousand to EUR 3,512 thousand. The resolutions were registered in the commercial register on June 3, 2015.

Considering the above described capital transactions, the total conditional capital on December 31, 2015, amounts to EUR 3,531 thousand.

The changes in share capital, authorized and conditional capital are summarized below:

(in thousands of EUR)	Share capital	Author-ized capital 2014/I	Author-ized capital 2015/I	Conditional capital 2003/2008	Conditional capital 2011/I
<b>Jan. 1, 2015</b>	<b>48,096</b>	<b>23,911</b>	<b>-</b>	<b>1,735</b>	<b>2,994</b>
Changes due to Annual Shareholders' Meeting resolutions	-	-23,911	24,048	-438	518
Stock options exercised	1,278	-	-	-1,014	-264
<b>Dec. 31, 2015</b>	<b>49,374</b>	<b>-</b>	<b>24,048</b>	<b>283</b>	<b>3,248</b>

#### *Capital reserve*

The capital reserve includes premium payments from the issuance of shares, as well as additional contributions to the Company's equity associated with the exercise of stock options.

In total 2,177,483 stock options were outstanding per December 31, 2015.

Premiums from outstanding stock options are not recognized in the capital reserve.

Additionally outstanding stock appreciation rights issued to employees of EUR 545 thousand are included in other provisions.

#### *Retained earnings*

As part of the first time application of BilMoG, the deferred taxes resulting from the revaluation effects on January 1, 2010 amounting to EUR 2,551 thousand were recorded in other retained earnings.

#### *Balance sheet profit*

The income statement was prepared in consideration of the partial profit appropriation. The accumulated profit carried forward of EUR 34,824 thousand (prior year: EUR 30,422 thousand) and the net profit for 2015 of EUR 17,568 thousand (prior year: EUR 4,402 thousand) resulted in an accumulated profit of EUR 52,392 thousand (prior year: EUR 34,824 thousand) on December 31, 2015.

#### *Restriction of dividend distribution*

Profits from the capitalization of development projects less deferred tax liabilities are blocked for dividend distribution.

The following amounts have been blocked on December 31, 2015:

(in thousands of EUR)	2015	2014
Net of capitalized development projects and its deferred tax liabilities	44,415	37,193
<b>Total profits blocked for dividend distribution</b>	<b>44,415</b>	<b>37,193</b>

#### *Voting rights*

According to section 21 paragraph 1 and section 26 of the German Securities Trading Law (Wertpapier-Handelsgesetz, WpHG) the Company published the following information on the ADVA Optical Networking homepage in 2015:

<b>Date of change in investment</b>	<b>Name of investment owner</b>	<b>Threshold limit</b>	<b>Share of voting rights</b>
Nov 30, 2015	DNB Asset Management AS, Oslo, Norway	below 3%	2.88%
Nov 24, 2015	UBS AG, UBS Group AG, Zurich, Switzerland	below 5%	3.73%
Nov 19, 2015	UBS AG, UBS Group AG, Zurich, Switzerland	above 5%	5.68%
Nov 18, 2015	UBS AG, UBS Group AG, Zurich, Switzerland	below 5%	4.62%
Nov 17, 2015	UBS AG, UBS Group AG, Zurich, Switzerland	above 5%	5.84%
Nov 16, 2015	UBS AG, UBS Group AG, Zurich, Switzerland	below 5%	4.46%
Nov 11, 2015	UBS AG, UBS Group AG, Zurich, Switzerland	above 5%	5.05%
Nov 10, 2015	UBS AG, UBS Group AG, Zurich, Switzerland	below 5%	4.98%
Nov 09, 2015	UBS AG, UBS Group AG, Zurich, Switzerland	above 5%	5.01%
Nov 06, 2015	UBS AG, UBS Group AG, Zurich, Switzerland	below 5%	0.00%
Nov 06, 2015	UBS AG, UBS Group AG, Zurich, Switzerland	below 5%	4.91%
Nov 05, 2015	UBS AG, UBS Group AG, Zurich, Switzerland	above 5%	5.05%
Nov 05, 2015	UBS AG, UBS Group AG, Zurich, Switzerland	above 5%	5.01%
Nov 02, 2015	UBS AG, UBS Group AG, Zurich, Switzerland	below 5%	3.75%
Sep 07, 2015	UBS AG, UBS Group AG, Zurich, Switzerland	above 5%	5.36%
Sep 04, 2015	UBS AG, UBS Group AG, Zurich, Switzerland	below 5%	4.90%
Aug 31, 2015	Dimensional Fund Advisors LP, Dimensional Holdings Inc., Austin, Texas, USA	below 3%	2.99%
Aug 26, 2015	Source Markets PLC, Dublin 2, Ireland / Source Holdings Limited, Georgetown, Grand Cayman, Cayman Islands / Source Investment Management Limited, Dublin 2, Ireland	below 3%	1.13%
Aug 25, 2015	UBS AG, UBS Group AG, Zurich, Switzerland	above 5%	5.86%

<b>Date of change in investment</b>	<b>Name of investment owner</b>	<b>Threshold limit</b>	<b>Share of voting rights</b>
Aug 25, 2015	Source Markets PLC, Dublin 2, Ireland / Source Holdings Limited, Georgetown, Grand Cayman, Cayman Islands / Source Investment Management Limited, Dublin 2, Ireland	above 3%	3.05%
Aug 25, 2015	DNB Asset Management AS, Oslo, Norway	below 5%	4.88%
Aug 20, 2015	Norwegian Ministry of Finance / Norges Bank, (the Central Bank of Norway), Oslo, Norway	below 3%	3.00%
Aug 05, 2015	UBS AG, UBS Group AG, Zurich, Switzerland	below 5%	4.07%
Aug 04, 2015	UBS AG, UBS Group AG, Zurich, Switzerland	above 5%	5.82%
Jul 29, 2015	UBS AG, UBS Group AG, Zurich, Switzerland	below 5%	4.39%
Jul 23, 2015	UBS AG, UBS Group AG, Zurich, Switzerland	above 5%	5.71%
Jul 20, 2015	Norwegian Ministry of Finance / Norges Bank, (the Central Bank of Norway), Oslo, Norway	above 3%	3.26%
Jul 16, 2015	UBS AG, UBS Group AG, Zurich, Switzerland	below 5%	3.82%
Jul 16, 2015	Dimensional Fund Advisors LP, Dimensional Holdings Inc., Austin, Texas, USA	above 3%	3.00%
Jul 15, 2015	Norwegian Ministry of Finance / Norges Bank, (the Central Bank of Norway), Oslo, Norway	below 3%	2.63%
Jul 10, 2015	UBS AG, UBS Group AG, Zurich, Switzerland	above 5%	5.60%
Jun 29, 2015	UBS AG, UBS Group AG, Zurich, Switzerland	below 5%	4.63%
Jun 25, 2015	UBS AG, UBS Group AG, Zurich, Switzerland	above 5%	6.28%
Jun 24, 2015	UBS AG, UBS Group AG, Zurich, Switzerland	below 5%	4.48%
Jun 23, 2015	UBS AG, UBS Group AG, Zurich, Switzerland	above 5%	5.03%



### 3.1.11 Provisions for Pensions and Similar Obligations

The provision for pensions and similar obligations relate to termination benefit payments to employees of the Italian branch office and is required due to local statutory regulations (Trattamento di fine rapporto, appr. TFR). This pension entitlement is comparable to a deferred compensation scheme and is based on the level of income and the number of service years. The annual contribution is 7.4% of the employees' annual salary. The accrued sum yields an interest of 1.5% plus 75% of the local inflation rate. For each eligible employee the annual pro-rate entitlement is accrued during his service time.

At termination of the employment in case of reaching the retirement age of currently 63 years as well as in case of early termination of the employment contract the employee is entitled to receive the accrued sum. Early payment of certain parts of the accrued sum is possible in case of specified conditions. In the event of death payment of the accrued sum is made to the dependants.

Similar to the defined benefit pension plans according to International Financial Reporting Standards (IFRS/IAS 19) the present value of the pension obligation is calculated applying the projected unit credit method (PUC). The pension obligation is unfunded and has to be considered as direct commitment to the entitled employees.

Following parameters were applied to calculate the present value of the entitlement:

(%)	Dec. 31, 2015	Dec. 31, 2014
Discount rate	3.97	4.58
Salary level trend	2.00	2.00

The biometric assumptions essential for the measurement of the pension obligations are RG 48 for life expectation and INPS FPD L Credito for invalidity.

The change in the present value of the pension obligation can be derived as follows:

(in thousands of EUR)	2015	2014
<b>Present value of the obligation on Jan. 1</b>	<b>361</b>	<b>286</b>
Interest expense	16	12
current service cost	41	63
Disbursements to employees	-6	-
Losses arising from changes in financial assumptions	34	-
Other changes	-64	-
<b>Present value of the obligation on Dec. 31</b>	<b>382</b>	<b>361</b>

Losses arising from changes in financial assumptions relate to the assumed discount rate and are included in interest expenses and similar expenses. Other changes mainly relate to changes in salaries and are reported as personnel expense

No provisions are included for indirect pension obligations to employees of the Swiss branch office. The deficit from unrecognized pension obligations according to article 28 section 2 EGHGB amounts to EUR 320 thousand.

### 3.1.12 Tax Provisions

Tax provisions of EUR 1,177 thousand (prior year: EUR 680 thousand) include expected tax payments due to fiscal authorities applying current tax rates and tax legislations.

In 2013, the tax authorities released a decision to appeals related to the finalized tax audit for 2001-2004 in favor of ADVA Optical Networking SE. A tax provision of EUR 645 thousand (prior year: EUR 645 thousand) for outstanding claims of the tax audit for 2001-2004 is recognized in the balance sheet.

In 2014 and 2015, the tax authorities in Munich conducted a tax audit for fiscal years 2007 to 2010 of ADVA Optical Networking SE. The final audit conclusion is still outstanding

### 3.1.13 Other Provisions

On December 31, 2015 other provisions can be analyzed as follows:

(in thousands of EUR)	2015	2014
Personnel provisions	1,651	1,414
Invoices not yet received	6,930	3,711
Provision for Tax audit	196	348
Vacation provisions	378	314
Warranty provisions	740	1,015
Sales allowances	283	212
Audit fees	238	160
Other provisions	41	-
<b>Total</b>	<b>10,457</b>	<b>7,174</b>

Personnel provisions include EUR 545 thousand for stock appreciation rights issued to employees of ADVA Optical Networking SE and its affiliated companies.

### 3.1.14 Liabilities

The maturity of the liabilities can be analyzed as follows:

(in thousands of EUR) on December 31, 2015	Total	within one year	Maturity between one and five years	more than five years
Liabilities to banks*	42,670	18,221	24,449	-
Advance payments received	2	2	-	-
Trade accounts payable	16,296	16,296	-	-
Payables to affiliated companies	18,373	18,373	-	-
Other liabilities	9,330	8,555	775	-
<i>thereof taxes</i>	<i>1,629</i>	<i>1,629</i>	<i>-</i>	<i>-</i>
<i>thereof social security</i>	<i>335</i>	<i>335</i>	<i>-</i>	<i>-</i>
<b>Total liabilities</b>	<b>86,671</b>	<b>61,447</b>	<b>25,224</b>	<b>-</b>

(in thousands of EUR) on December 31, 2014	Total	within one year	Maturity between one and five years	more than five years
Liabilities to banks*	34,983	7,293	27,690	-
Trade accounts payable	13,123	13,050	73	-
Payables to affiliated companies	14,225	14,225	-	-
Other liabilities	6,117	6,117	-	-
<i>thereof taxes</i>	<i>725</i>	<i>725</i>	<i>-</i>	<i>-</i>
<i>thereof social security</i>	<i>287</i>	<i>335</i>	<i>-</i>	<i>-</i>
<b>Total liabilities</b>	<b>68,448</b>	<b>40,685</b>	<b>27,763</b>	<b>-</b>

\* At the end of 2015 the IKB Deutsche Industriebank loan is secured by a registered land debt amounting to EUR 5,581 thousand (end of 2014: EUR 5,581 thousand) on the production and development site in Meiningen.

On December 31, 2015 other liabilities mainly include EUR 4,675 thousand (prior year: EUR 3,789 thousand) for bonus payments to employees and management board, EUR 1,629 thousand (prior year: EUR 725 thousand) for withholding taxes and EUR 961 thousand (prior year: EUR 976 thousand) for license fees. Furthermore other liabilities include EUR 1,110 thousand (prior year: EUR 0) outstanding payments in relation to the acquisition of assets of FiSEC GmbH and EUR 200 thousand for the acquisition of Time4 Systems Oy.

### 3.1.15 Deferred Taxes

Deferred tax is recognized applying the liability method on temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes as follows.

Balance sheet	Deferred tax category
Self-constructed industrial and similar rights and assets, and licenses in such rights and assets	liability
Property, plant and equipment	asset
Trade accounts receivable and trade accounts receivable from affiliated companies	liability
Inventory	liability
Goodwill	assets
Trade accounts payable and trade accounts payable due to affiliated companies	liability
Provisions	assets

The corporate income tax loss carry forward on December 31, 2015 amounts to EUR 133,289 thousand (prior year: EUR 136,402 thousand) and the trade income tax loss carry forward amounts to EUR 126,825 thousand (prior year: EUR 130,431 thousand). Deferred tax assets are recognized when it is certain that tax loss carry forwards can be utilized within the next 5 years and up to the amount of 60% of the net of deferred tax liabilities on temporary differences.

Deferred tax assets amount to EUR 11,575 thousand (prior year: EUR 9,321 thousand) and are offset against deferred tax liabilities of EUR 18,153 thousand (prior year: EUR 15,385 thousand).

When calculating deferred taxes, a combined tax rate of 27.73% was applied.

## 3.2 Income Statement

### 3.2.1 Revenues

In 2015 and 2014, revenues included EUR 19,976 thousand and EUR 17,076 thousand for services, respectively. The remaining revenues relate mainly to product sales.

Revenues by region, classified according to shipment destination, are as follows:

(in thousands of EUR)	2015	2014
Germany	77,678	67,715
Rest of Europe, Middle East and Africa	140,802	71,280
Americas	81,393	43,869
Asia-Pacific	27,401	21,545
<b>Total</b>	<b>327,274</b>	<b>204,409</b>

### 3.2.2 Material Expenses

Material expenses of the Company, classified pursuant to section 275 paragraph 2, number 5 HGB totaled EUR 177,346 thousand in the financial year 2015 (prior year: EUR 118,108 thousand). Thereof, EUR 174,956 thousand (prior year: EUR 116,471 thousand) relate to expenses for raw materials and supplies and EUR 2,390 thousand (prior year: EUR 1,637 thousand) to costs of purchased services.

### 3.2.3 Personnel Expenses

In 2015, personnel expenses of the Company, classified pursuant to section 275 paragraph 2, number 6 HGB, amounted to EUR 46,978 thousand (prior year: EUR 42,635 thousand). Thereof, EUR 40,664 thousand (prior year: EUR 36,556 thousand) were related to salaries and wages and EUR 6,314 thousand (prior year: EUR 6,079 thousand) were related to costs for social security. For pension plans EUR 10 thousand (prior year: EUR 85 thousand) were recognized in 2015.

### 3.2.4 Other Operating Income and Expenses

Other operating income and expenses can be analyzed as follows:

(in thousands of EUR)	2015	2014
Income from distribution of profits*		
ADVA Optical Networking Ltd. York, United Kingdom	-	9,542
ADVA Optical Networking North America Inc., Norcross/Atlanta (Georgia), USA	-	3,266
Other income		
Income from currency translation	8,107	3,775
Grants received for research projects	859	1,011
Other	892	1,037
<b>Other operating income</b>	<b>9,858</b>	<b>18,631</b>
Expenses from currency translation	7,848	4,413
Other	239	137
<b>Other operating expenses</b>	<b>8,087</b>	<b>4,550</b>

\* Due to changes in the group intercompany contracts the profit distribution as recorded in 2014 does not apply anymore in 2015.

Income and expenses for other accounting periods, which are included in other operating income and expenses, can be analyzed as follows:

(in thousands of EUR)	2015	2014
Income from release of provisions	427	339
Income from release of liabilities	80	70
Income from release of specific provisions for trade receivables	311	40
<b>Income for other accounting periods</b>	<b>818</b>	<b>449</b>
<b>Expenses for other accounting periods</b>	<b>5</b>	<b>-</b>

### 3.2.5 Income From Investments

Income from investments amounts to EUR 6,458 thousand and results from dividend payments from ADVA Optical Networking North America Inc., Norcross/Atlanta (Georgia), USA of EUR 4,580 thousand and from ADVA Optical Networking Norway AS i.L., Oslo of EUR 1,878 thousand.

### 3.2.6 Amortization of Financial Assets

Due to the termination of operations in ADVA Optical Networking AS i.L. in Oslo, Norway operating losses were realized, resulting in a permanent write down in the investment of EUR 1,573 thousand.

### 3.2.7 Income Taxes

The Company's income tax comprises corporate income tax (Körperschaftsteuer), solidarity surcharge (Solidarit t zuschlag) and trade income tax (Gewerbesteuer). This tax result also includes foreign income taxes for the Company's permanent establishments.

A reconciliation of income taxes based on the accounting profit and the expected domestic income tax rate of 27.73% (prior year: 27.73%) to effective income tax (expense) benefit, net, is presented below:

(in thousands of EUR)	2015	2014
<b>Accounting profit before tax</b>	<b>18,718</b>	<b>583</b>
<b>Expected statutory tax expense</b>	<b>5,190</b>	<b>162</b>
Taxes from prior years	130	-389
Loss carry-forward not recognized in prior years	-1,639	-3,870
Adjustments of deferred taxes from prior years	-1,386	-
Non-deductible expenses and tax-free income	-1,162	105
Differences from foreign branch offices	22	193
Other differences	-9	-36
<b>Income tax expense/benefit</b>	<b>1,146</b>	<b>-3,835</b>
<b>Effective tax rate</b>	<b>6.1%</b>	<b>-657.8%</b>

### 3.2.8 Audit Fees

The expenses for audit are itemized in the consolidated accounts.

## 4 Other Information

### 4.1 Other Financial Obligations and Contingent Liabilities

Other financial obligations can be analyzed as follows:  
(in thousands of EUR)

	Maturity		Total
	within one year	between one and five years	
Obligations from rent agreements	628	756	<b>1,384</b>
Obligations from car leasing agreements	576	392	<b>968</b>
Purchase commitments	7,104	-	<b>7,104</b>
other	1,229	2,297	<b>3,526</b>
<b>Total</b>	<b>9,537</b>	<b>2,445</b>	<b>12,982</b>

The Company granted an irrevocable guarantee of GBP 1,500 thousand (equivalent EUR 2,032 thousand) for liabilities of ADVA Optical Networking Ltd., York, United Kingdom, another guarantee of EUR 1,584 thousand for liabilities of ADVA Optical Networking (India) Private Ltd., Gurgaon, India, a guarantee of SGD 262 thousand (equivalent EUR 170 thousand) for liabilities of ADVA Optical Networking Singapore Pte. Ltd., Singapore, a guarantee of CHF 1,000 thousand (equivalent EUR 925 thousand) for liabilities of Oscilloquartz SA, Saint-Blaise, Switzerland and a rental guarantee for ADVA Optical Networking AS i.L., Oslo, Norway of NOK 1,025 thousand (equivalent to EUR 107 thousand).

The use of these guarantees is unlikely, as all subsidiaries are controlled for 100% by ADVA Optical Networking SE and appropriate countermeasures can be taken at an earlier stage.

### 4.2 Derivative Financial Instruments

#### Forward Rate Agreements

The Company entered into nine forward rate agreements between June 18 and December 4, 2015 to hedge foreign currency exposure of expected future cash. These agreements matures between March 29 and December 27, 2016.

In 2015, unrealized profits for eight foreign currency hedges amounted to EUR 1,833 thousand which, in accordance with the realization principle, will be recognized at maturity of the forward rate agreement. For one foreign currency hedge an unrealized loss of EUR 41 thousand was recorded.

Between May 7, 2014 and August 12, 2015, the company entered into eleven forward rate agreements that matured in 2015. A net gain of EUR 2,400 thousand was realized on these transactions.

#### Declaration About Fair Value

The fair value and nominal value of these financial instruments on December 31 is as follows:

(in thousands of EUR)	Fair value		Nominal value	
	2015	2014	2015	2014
Forward rate agreements	1,792	825	66,590	5,749

The nominal value is the accounting value from which payments are derived (underlying transaction). Since the nominal value itself is not at risk, it is the potential for changes in foreign exchange rates, interest rates and prices that is hedged.

The fair value reflects the credit risk of the instrument. Since the Company only uses standard instruments for its hedges, the fair value is determined using market prices and is not netted against any contrary trend in the value of underlying transactions.

### 4.3 Corporate Bodies of ADVA Optical Networking SE

#### 4.3.1 Supervisory Board

	<b>Resident in</b>	<b>Occupation</b>	<b>External mandates</b>
Nikos Theodosopoulos, Chairman	Manhasset (New York), USA	Founder and Managing Member, NT Advisors LLC, Manhasset, New York, USA	Member of the Board of Directors of Arista Networks, Inc., Santa Clara, CA, USA Member of the Advisory Board of Columbia Engineering Entrepreneurship, New York, NY, USA Member of the Board of Directors of Harmonic, Inc., San Jose, CA, USA Member of the Board of Directors of Gadget Software, Inc., Newark, New Jersey, USA
Johanna Hey, Vice Chairwoman	Cologne, Germany	Professor for Tax Law, University of Cologne, Cologne, Germany	Director of the Institut Finanzen und Steuern e.V., Berlin, Germany Member of the Supervisory Board of Gothaer Lebensversicherung AG, Cologne, Germany Member of the Supervisory Board of Cologne Executive School GmbH, Cologne, Germany
Eric Protiva, Member (until July 27, 2015)	Palo Alto (California), USA	Managing Director, EGORA Holding GmbH, Martinsried/Munich, Germany	Member of the Supervisory Board of AMS Technologies AG, Martinsried/Munich, Germany Member of the Board of Directors of Elforlight Ltd., Daventry, United Kingdom

#### 4.3.2 Management Board

	<b>Resident in</b>	<b>External mandates</b>
Brian Protiva Chief Executive Officer	Berg, Germany	Member of the Board of Directors of AMS Technologies AG, Martinsried/Munich, Germany
Christoph Glingener Chief Technology Officer & Chief Operating Officer	Jade, Germany	Member of the Board of Trustees of Fraunhofer Heinrich Hertz Institute, Berlin, Germany
Ulrich Dopfer Chief Financial Officer (since January 1, 2015)	Alpharetta (Georgia), USA	

#### 4.4 Employees

The Company employed an average of 524 employees and 14 apprentices (prior year: 523 employees and 13 apprentices), divided into the following functional areas:

<b>Employee after functional area</b> on December 31, 2015	<b>2015</b>	<b>2014</b>
Purchasing and production	173	162
Sales, marketing and service	120	144
Management and administration	87	85
Research and development	144	132
Apprentices	14	13
<b>Total</b>	<b>538</b>	<b>536</b>

#### 4.5 Compensation of the Management Board

In 2015 and 2014, the Management Board of the Company consisted of the members stated below. Ulrich Dopfer and Jaswir Singh received remuneration from the subsidiary ADVA Optical Networking North America Inc., Norcross/Atlanta (Georgia), USA. The total Management Board compensation was EUR 3,732 thousand in 2015 and EUR 1,943 thousand in 2014. This amount is analysed across the individual Board members as follows:

(in thousands of EUR)	<b>Fixed</b>	<b>Variable</b>	<b>Total 2015</b>	<b>Total 2014</b>
Brian Protiva Chief Executive Officer	275	1,586	1,861	538
Christoph Glingener Chief Technology Officer & Chief Operating Officer	272	1,166	1,438	451
Ulrich Dopfer Chief Financial Officer (since January 1, 2015)	247	186	433	-
Jaswir Singh Chief Financial Officer & Chief Operating Officer (until December 31, 2014)	-	-	-	954

Jaswir Singh left the Company at the end of 2014. A compensation of EUR 490 thousand (USD 660 thousand) has been agreed with Jaswir Singh. On December 31, 2015 the outstanding amount of USD 330 thousand is included in other liabilities from ADVA Optical Networking Inc., Norcross/Atlanta (Georgia), USA.

The fixed compensation includes contributions to unemployment insurance, statutory pension insurance and company car allowances.

The variable compensation relates to the short-term performance-based bonus for 2015, which is included in other current liabilities on December 31, 2015, as well as the relevant part of the long-term performance based bonus accrued in 2015, which is included in other provisions at year-end 2015. In addition, the variable compensation includes income from exercises of stock options in 2015.

The Company paid pecuniary damage liability insurance premiums on behalf of members of the Management Board totaling EUR 12 thousand both in 2015 and 2014 (in equal amounts for each Management Board member), respectively.

In 2015 and 2014, no loans were granted to the members of the Management Board. On December 31, 2015 ADVA Optical Networking SE recorded a receivable of EUR 62 thousand on Brian Protiva for wage tax due on stock option exercises. The receivable will be offset against remuneration paid in January and February 2016.

On December 31, the members of the Management Board held the following shares and had been granted the following stock options:

	<b>Shares</b>		<b>Stock options</b>	
	<b>2015</b>	<b>2014</b>	<b>2015</b>	<b>2014</b>
Brian Protiva Chief Executive Officer	401,030	401,030	185,000	335,000
Christoph Glingener Chief Technology Officer & Chief Operating Officer	-	-	180,000	325,000
Ulrich Dopfer Chief Financial Officer (since January 1, 2015)	500	500	153,000	9,667



The options to members of the Management Board were granted out of Plan IX, Plan IXb and Plan XIVA. These option rights authorize the Management Board to purchase the said number of common shares in the Company once the qualifying period has elapsed. Plan IXb and Plan XIVA include a profit limit of EUR 20.00 per option, whereas Plan IX has no profit limitations.

The strike price for these option rights is

- EUR 5.04 for 75,000 options granted on October 1, 2010,
- EUR 5.05 for 100,000 options granted on August 15, 2012,
- EUR 3.90 for 130,000 options granted on November 15, 2013,
- EUR 3.19 for 60,000 options granted on May 15, 2014,
- EUR 5.15 for 150,000 options granted on May 15, 2015, respectively.

Further information on compensation of the Management Board is included in the remuneration report in the Group Management Report.

#### 4.6 Compensation of the Supervisory Board

The fixed compensation to be paid to the Supervisory Board for 2015 and 2014 totaled EUR 215 thousand and EUR 224 thousand, respectively. This amount can be analyzed by the individual Board members as follows:

(in thousands of EUR)	2015	2014
Nikos Theodosopoulos Chairman	100	-
Johanna Hey Vice Chairwoman	90	90
Eric Protiva Member (until July 27, 2015)	25	45
Anthony Maher † Chairman (until November 22, 2014)	-	89

The fixed compensation for the Supervisory Board of ADVA Optical Networking SE for 2015 amounting to EUR 215 thousand is paid out in quarterly installments. The fixed compensation for Q4 2015 amounting to EUR 47 thousand was paid out in January 2016 and is included in other liabilities.

The Group paid pecuniary damage liability insurance premiums on behalf of members of the Supervisory Board totaling EUR 12 thousand in 2015 and 2014, respectively.

On December 31, members of the Supervisory Board held the following shares:

	Shares	
	2015	2014
Nikos Theodosopoulos Chairman	-	-
Johanna Hey Vice Chairwoman	-	-
Eric Protiva Member (until July 27, 2015)	-	320,000

#### 4.7 Declaration of Compliance With Corporate Governance Code

Pursuant to Section 161 of the German Stock Corporation Law (AktG), the Management Board and the Supervisory Board have issued a declaration of compliance with the German Corporate Governance Code. This declaration is published on the Group's website ([www.advaoptical.com](http://www.advaoptical.com)).

#### 4.8 Consolidated Financial Statements

The Company prepares consolidated financial statements for the smallest and biggest group of consolidation of affiliated companies. These consolidated financial statements can be viewed at the district court Jena under HRB number 508155.

## 5 Events After the Balance Sheet Date

On January 13, 2016, ADVA Optical Networking acquired 100% of the shares of Overture group, headquartered in Raleigh, North Carolina, USA. The acquisition expands ADVA Optical Networking's portfolio of Ethernet and cloud access solutions and increases its presence in North America including the local customer base. The Overture corporate group consists of two US companies and two subsidiaries in India and the UK. A large part of its revenue is generated in North America. The group currently employs 178 people worldwide. The purchase price totaled USD 40.0 million (EUR 36.9 million translated at the exchange rate of January 13, 2016: USD 1.0839 per EUR). USD 35.0 million (EUR 32.3 million) was payable in cash on the date of acquisition. In addition, a revenue-based earn-out component of USD 5.0 million was agreed. The purchase price has been financed through two bank loans totaling EUR 35.0 million. Both loans have a term of five years and a fixed interest rate of 1.4% per annum. The audited opening balance sheet on January 15, 2016, following IFRS and the results of the purchase price allocation, were not available at the time the preparation of the 2015 consolidated financial statement was finalized.

On February 1, 2016, ADVA Optical Networking submitted all required documents to court in order to appoint Prof. Dr.-Ing. Hans-Joachim Grallert to the Supervisory Board. Prof. Dr.-Ing. Hans-Joachim Grallert was lastly Head of the Department of Communications Engineering at the Technical University of Berlin. The appointment by the court was effective February 17, 2016.

Meiningen, February 23, 2016

Brian Protiva

Christoph Glingener

Ulrich Dopfer

## AFFIRMATIVE DECLARATION OF THE LEGAL REPRESENTATIVES

We, the members of the Management Board of ADVA Optical Networking SE, to the best of our knowledge affirm that, in accordance with the applicable reporting principles, the management report and the financial statements of ADVA Optical Networking SE represent a true and fair view of the net assets, financial position and performance of the Company, together with a description of the principal opportunities and risks associated with the expected development of the Company.

Meiningen, February 23, 2016

Brian Protiva

Christoph Glingener

Ulrich Dopfer

## INDEPENDENT AUDITOR'S OPINION

*The following independent auditor's opinion is a mere convenience translation from the German language and hence does not bear the auditor's seal and signatures. The German language version of the independent auditor's opinion only refers to the German language version of the 2014 financial statements and management report of ADVA Optical Networking SE.*

### Auditor's Report

We have audited the annual financial statements, comprising the balance sheet, the income statement and the notes to the financial statements, together with the bookkeeping system, and the management report of ADVA Optical Networking SE, Meiningen for the business year from January 1, to December 31, 2015. The maintenance of the books and records and the preparation of the annual financial statements and management report in accordance with German commercial law are the responsibility of the Company's Management Board. Our responsibility is to express an opinion on the annual financial statements, together with the bookkeeping system, and the management report based on our audit.

We conducted our audit of the annual financial statements in accordance with § (Article) 317 HGB ("Handelsgesetzbuch": "German Commercial Code") and German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (Institute of Public Auditors in Germany) (IDW). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the annual financial statements in accordance with (German) principles of proper accounting and in the management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Company and expectations as to possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the books and records, the annual financial statements and the management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the accounting principles used and significant estimates made by the Company's Management Board, as well as evaluating the overall presentation of the annual financial statements and management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.

In our opinion based on the findings of our audit, the annual financial statements comply with the legal requirements and give a true and fair view of the net assets, financial position and results of operations of the Company in accordance with (German) principles of proper accounting. The management report is consistent with the annual financial statements and as a whole provides a suitable view of the Company's position and suitably presents the opportunities and risks of future development.

Munich, February 23, 2016

PricewaterhouseCoopers  
Aktiengesellschaft  
Wirtschaftsprüfungsgesellschaft

sgd. Holger Graßnick

Wirtschaftsprüfer  
(German Public Auditor)

sgd. ppa. Sonja Knösch

Wirtschaftsprüferin  
(German Public Auditor)