ADVA Optical Networking SE Meiningen

Financial Statements and Management Report - December 31, 2016

ADVA Optical Networking

Contents

ADVA OPTICAL NETWORKING SE, MEININGEN – MANAGEMENT REPORT FOR THE FINANCIAL YEAR 2016

Forward-Looking Statements

This Group 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 anticipated 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’s SE 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 Group 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, 2016, 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[1], net liquidity[2] and as a non-financial criterion customer satisfaction as measured by the Net Promoter Score[3]. 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.

[1] 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.

[2] 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.

[3] 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 16 (prior year: 15) wholly-owned subsidiaries on December 31, 2016, as follows:

(in thousands)			Equity	Net income/loss (-)	Share in Equity owned directly	Share in Equity owned indirectly
ADVA Optical Networking North America, Inc. Norcross/Atlanta (Georgia), USA	USD	*	59,794	5,768	-	100%
ADVA Optical Networking Ltd. York, United Kingdom	GBP	**	12,250	3,839	100%	-
Oscilloquartz SA Saint-Blaise, Switzerland	CHF	*	7,247	-70	100%	-
ADVA Optical Networking sp. z o.o. Gdynia, Poland	PLN	**	5,073	-5,195	100%	-
ADVA Optical Networking Israel Ltd. Ra'anana/Tel Aviv, Israel	ILS	*	-9,997	-11,356	100%	-
ADVA Optical Networking (Shenzhen) Ltd. Shenzhen, China	CNY	**	45,381	3,112	100%	-
Oscilloquartz Finland Oy Espoo, Finland	EUR	*	9	39	100%	-
ADVA IT Solutions Pvt. Ltd. Bangalore, India	INR	***	43,651	19,835	-	100%
ADVA Optical Networking Trading (Shenzhen) Ltd. Shenzhen, China	USD	*	798	152	-	100%
ADVA Optical Networking Singapore Pte. Ltd. Singapore	SGD	**	2,999	323	100%	-
ADVA Optical Networking Hongkong Ltd. Hongkong, China	HKD	**	2,017	477	-	100%
ADVA Optical Networking (India) Private Ltd. Gurgaon, India	INR	***	15,869	6,631	1%	99%
ADVA Optical Networking Serviços Brazil Ltda. São Paulo, Brazil	BRL	*	1,202	229	99%	1%
ADVA Optical Networking Corp. Tokyo, Japan	JPY	*	81,954	2,606	100%	-
ADVA Optical Networking AB Kista/Stockholm, Sweden	SEK	**	1,537	175	100%	-
ADVA NA Holdings Inc. Atlanta (Georgia), USA	USD	*	60,687	-2	100%	-

* Prepared in accordance with the International Financial Reporting Standards (IFRS) for the financial year ended December 31, 2016.
** Prepared in accordance with local commercial law for the financial year ended December 31, 2015.
*** Prepared in accordance with local commercial law for the financial year ended March 31, 2016.

On January 13, 2016 ADVA NA Holdings Inc., Atlanta, Georgia, USA, a new established 100% subsidiary of ADVA Optical Networking SE, acquired 100% of the shares of Overture Networks Inc., Morrisville, North Carolina, USA, for a preliminary cash consideration due at the same date of USD 39,516 thousand (EUR 36,535 thousand, translated at the relevant exchange rate at the date of payment). In addition, an earn-out payment of USD 5,000 thousand in cash was agreed if specified sales volumes are reached. Furthermore, additional expenses of the acquisition amounting to EUR 293 thousand have been recognized immediately in the income statement. In the context of the acquisition of Overture Networks Inc., the US entities were merged into ADVA Optical Networking North America Inc. and its directly held shares were contributed to the newly established ADVA NA Holdings Inc. with the book value of the shares amounted to EUR 14.8 million.

In 2016 the liquidation of the entity – ADVA Optical Networking AS – was completed, which the company initiated in 2014.

Furthermore, in December 2016, Overture Networks Ltd. was liquidated. The business activity was transferred beforehand to ADVA Optical Networking Ltd. in York, UK.

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 (339 employees at year-end 2016). Branch offices are located in Berlin, focusing on software development for the Company’s products (50 employees) and in Martinsried/Munich, where the Company maintains its headquarter with all central functions and the sales & marketing organization (128 employees). On December 31, 2016, further branch offices were located in Hanover (10 employees), Courtaboeuf/Paris, France (16 employees), Machelen/Brussels, Belgium (2 employees), Madrid, Spain (3 employees), Helsinki, Finland (1 employee), Grottaferrata/Rome, Italy (10 employees), Vienna, Austria (3 employees), Zurich, Switzerland (2 employees), Dubai, United Arab Emirates (1 employee) and Centurion/Pretoria, South Africa (6 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 research and development activities are driven by the distinct emphasis on differentiating its innovative connectivity solutions for cloud and mobile services and working with customers and partners to identify and meet their current and future needs. The resulting key technologies and products profoundly simplify complicated network structures and supplement existing solutions. During 2016, research and development activities focused on enhancements to the scalable optical transport platform, timing delivery and synchronization features for Ethernet access as well as the virtualization of networks.

Products

ADVA Optical Networking SE develops, manufactures and sells networking solutions for a modern telecommunication infrastructure. Its products are based on fiber-optic transmission technology combined with Ethernet functionality and intelligent software for network management and virtualization. Furthermore the portfolio includes timing and synchronization solutions for networks.

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 2016

In its October 2016 edition of the *World Economic Outlook* the International Monetary Fund (IMF) stated that "Global growth is projected to slow to 3.1 percent in 2016 before recovering to 3.4 percent in 2017. The forecast, revised down by 0.1 percentage point for 2016 and 2017 relative to April, reflects a more subdued outlook for advanced economies following the June UK vote in favor of leaving the European Union (Brexit) and weaker-than-expected growth in the United States." Furthermore, the report states that "Although financial market reaction to the result of the UK referendum has been contained, the increase in economic, political, and institutional uncertainty and the likely reduction in trade and financial flows between the United Kingdom and the rest of the European Union over the medium term is expected to have negative macroeconomic consequences, especially in the United Kingdom. As a result, the 2016 growth forecast for advanced economies has been marked down to 1.6 percent."

While macroeconomic changes do not necessarily have a direct impact on the market for communications infrastructure technology, it is important to acknowledge that ADVA Optical Networking generated the majority of its 2016 revenue in developed countries, and more than 10% in the UK.

Market Environment for ADVA Optical Networking

The addressable market for ADVA Optical Networking is dominated by the market for optical networking hardware. The increasing demand for cloud applications, the rapid adoption of digital processes across all industry sectors and the ubiquitous consumption of high-definition video via fixed and mobile networks are the most important growth drivers for the market. Optical networking technology satisfies the rapidly increasing demand for more bandwidth in networks around the globe. It is the foundation for the digital economy and supports the internet content community including its base of smartphone user customers.

ADVA Optical Networking addresses important growth applications inside this market including transmission technology for data center interconnect (DCI) and carrier infrastructure. The Group is well positioned in the WDM market, the core segment of the overall optical networking market, and the adjacent market for Carrier Ethernet-based network access solutions. Additionally, ADVA Optical Networking offers solutions for network synchronization and for network virtualization. The total addressable market for ADVA Optical Networking is estimated to be USD 12.6 billion[4] in 2016, growing to USD 16.8 billion by 2021 at a CAGR (2016-2021) of 5.9%.

[4] Industry analyst estimates for metro and long-haul WDM equipment (optical) and access switching & routing (Ethernet) relevant to ADVA Optical Networking. Sources: Ovum, Optical Networks Forecast 2016-2021 and service provider switching and routing forecast 2016-2022, published January 2017.

Business Development and Operational Performance

In 2016, ADVA Optical Networking SE generated revenues of EUR 386.6 million, representing an increase of 18.1% compared to EUR 327.3 million in 2015. This increase in revenues mainly relates to improved enterprise business specifically driven by Internet content providers (ICPs) and the related business in the Americas. This increase is reflecting the continued network traffic growth due to increased adoption of cloud based services.

EMEA continued to be the most important sales region in 2016, followed by the Americas and Asia-Pacific. EMEA revenues decreased slightly by 1.5% from EUR 218.5 million in 2015 to EUR 215.2 million in 2016, representing 55.7% of total revenues after 66.7% in 2015. In the Americas, revenues increased again significantly by 75.4% from EUR 81.4 million in 2015 to EUR 142.8 million in 2016. This increase was mainly driven by the strong demand from Internet content providers showing their demand for additional transmission capacity required for connection of data processing centers. The corresponding share of total annual revenues increased from 24.9% to 36.9%. In the Asia-Pacific region, revenues were up by 4.7% from EUR 27.4 million in 2015 to EUR 28.7 million in 2016. The Asia-Pacific region comprised 7.4% of total revenues in 2016 after 8.4% in 2015 with solid sales of Carrier Infrastructure and Enterprise solutions to existing and new customers.

Cost of goods sold increased from EUR 219.8 million in 2015 to EUR 267.6 million in 2016, increasing the share in total revenue from 67.2% to 69.2% in 2016. The increase in cost of goods sold is primarily due to the increase of revenues and the proportional higher increase in the cost of goods sold.

Gross profit increased from EUR 107.4 million or 32.8% of revenues in 2015 to EUR 119.1 million or 30.8% of revenues in 2016. The development of the Group's gross margin in general is impacted by variations in regional revenue distribution and in product and customer mix.

Selling and marketing expenses decreased from EUR 29.8 million in 2015 to EUR 28.1 million in 2016. General and administrative expenses declined to EUR 15.1 million from EUR 17.0 million in 2015. After considering capitalization of development expenses, which increased from EUR 32.1 million in 2015 to EUR 36.7 million in 2016, Research and development expenses totaled EUR 63.7 million or 16.5% from revenues compared to EUR 47.9 million or 14.6% from revenues in the prior year. The increase mainly results from intercompany recharges. The other operating result (other operating income less other operating expenses) increased from EUR 1.8 million in 2015 to EUR 3.7 million in 2016.

The result from ordinary operating activities totaled EUR 18.2 million in 2016, compared to EUR 18.7 million in the prior year.

The Company generated a net profit of EUR 17.5 million in 2016, compared to a net profit of EUR 17.6 million in 2015.

Summary: Business Development and Operational Performance

Overall, the business development and operational performance did not substantially change in 2016, when compared with 2015, despite revenue growth over the period. This was driven by increased cost of goods sold and research and development expenses as well as lower income from investments over the corresponding period.

Net Assets and Financial Position

The balance sheet total increased by EUR 65.9 million from EUR 249.6 million at year-end 2015 to EUR 315.5 million at year-end 2016. Non-current assets increased from EUR 108.0 million to EUR 173.4 million on December 31, 2016, representing 55.0% of total assets after 43.3% at the end of the previous year. Current assets remained stable at EUR 140.6 million, representing 44.6% of total assets after 56.3% at the year-end 2015.

The increase in non-current assets was mainly driven by an increase in financial assets by EUR 39.3 million to EUR 70.2 million, as well as by an increase in intangible assets with EUR 25.3 million to EUR 92.4 million. Furthermore the tangible fixed assets increased from EUR 10.0 million to EUR 10.7 million. Mainly contributable to the net profit for the current year, stockholders' equity was up from EUR 137.3 million at year-end 2015 to EUR 155.2 million at year-end 2016 and represented 49.2% of the balance sheet total after 55.0% at the end of 2015. Liabilities increased from EUR 86.7 million to EUR 134.1 million. The increase in liabilities is primarily the result of the increase of the trade accounts payable, mainly due to the increase of the inventories, with EUR 29.4 million and the increase of liabilities to banks with EUR 16.7 million. Provisions have not substantially changed in 2016.

Capital Expenditures

Total capital expenditures amounted to EUR 112.1 million in 2016 (prior year: EUR 45.3 million). Thereof, EUR 4.0 million (prior year: EUR 2.5 million) were attributable to property, plant and equipment, EUR 53.0 million (prior year: EUR 39.9 million) to intangible assets and EUR 55.1 million to financial assets (prior year: EUR 3.0 million).

Investments in capitalized development projects are mainly driven by development activities in highly innovative connectivity solutions for cloud and mobile services.

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.

The increase of the financial assets was driven primarily by the loans to affiliated companies. In the reporting year were additions of EUR 40.1 million were recorded compared to EUR 1.5 million in the previous year.

Liquidity

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

Changes in cash at banks and in hand (in millions of EUR)	2016	2015
Operating cash flow	61.5	47.0
Investing cash flow	-96.1	-40.1
Financing cash flow	16.6	6.4
Net change in cash at banks and in hand	**-18.0**	**13.3**
Cash at banks and in hand at the beginning of the year	39.3	26.0
Cash at banks and in hand at the end of the year	**21.3**	**39.3**

The Company was able to meet all payment obligations at any point in time during 2016 and 2015.

Cash and cash equivalents of EUR 21.3 million on December 31, 2016, and of EUR 39.3 million on December 31, 2015, were denominated mainly in EUR and USD. Due to the decrease in cash and cash equivalents in 2016, ADVA Optical Networking SE´s net liquidity decreased from EUR -3.3 million in 2015 to EUR -38.1 million in 2016.

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. On December 31, 2016, the company had available EUR 8.0 million (on December 31, 2015: EUR 8.0 million) of undrawn committed borrowing facilities in respect of which all conditions had been met.

Liabilities to banks increased from EUR 42.7 million at year-end 2015 to EUR 59.4 million at the end of 2016. This increase is mainly due to two new loans of total EUR 35.0 million from IKB. All liabilities to banks were exclusively denominated in EUR at the end of 2015 and 2016.

The following table provides an overview on interest terms and the maturity structure of each financial liability at year-end 2016:

(in millions of EUR)	**Dec. 31, 2016**	**Interest terms**	**Maturity**		
			≤ 12 months	12 - 36 months	> 36 months
IKB Deutsche Industriebank loans*	25.0	Fixed rate, subsidized**	6.3	12.5	6.2
	10.0	Fixed rate, subsidized**	2.5	5.0	2.5
	9.4	Fixed rate, subsidized**	6.2	3.2	-
HSBC loan	15.0	Fixed rate, subsidized**	3.7	7.5	3.8
Total financial liabilities	**59.4**		**18.7**	**28.2**	**12.5**

* Key covenants refer to the Group's year-end debt/equity ratio and to the quarter-end net liquidity.
** Subsidized by the Kreditanstalt für Wiederaufbau (KfW).

Dividend Payments

In 2016 there were no dividend payments for 2015 (prior year: nil). ADVA Optical Networking SE does not plan to pay out a dividend for 2016.

Summary: Net Assets and Financial Position

The net assets of ADVA Optical Networking SE continue to develop favorably in 2016, although the net liquidity decreased.

Share Capital and Shareholder Structure

On December 31, 2016, ADVA Optical Networking SE had issued 49,498,934 no par value bearer shares (December 31, 2015: 49,374,484). No other class of shares had been issued during the reporting period.

At year-end 2016, EGORA Holding GmbH held a total of 7,456,749 shares or 15.1% of all ADVA Optical Networking SE shares outstanding (at year-end 2015: 7,656,749 shares or 15.5% of all shares outstanding). 5,930,902 of these shares or 12.0% of all shares outstanding (at year-end 2015: 5,930,902 shares or 12.0% of all shares outstanding) were held by EGORA Ventures GmbH, a 100% subsidiary of EGORA Holding GmbH, and the remaining 1,525,847 shares or 3.1% of all shares outstanding (at year-end 2015: 1,725,847 shares or 3.5% 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, 2016. Further details on share capital and shareholder structure are disclosed in note (3.1.10) to the financial statements.

Restriction of Voting Rights and Share Transfers

At year-end 2016, 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 (Aktiengesetz, 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 as of May 26, 2016. 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. According to the Company's articles of association, the Management Board of ADVA Optical Networking SE shall regularly consist of two individuals and the Supervisory Board shall have the right to determine and 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. In 2016, no appointments or dismissals of Management Board members have been made. 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 as of May 26, 2016. Accordingly, in principle any changes to the articles of association other than purely formal amendments 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 as of May 26, 2016 of ADVA Optical Networking SE. According to ADVA Optical Networking SE's current articles of association the Management Board is authorized with approval of the Supervisory Board to increase the capital stock by up to 24,048,215 new 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 (Authorized Capital 2015/I). As of December 31, 2016, the authorized capital amounted to EUR 24,048,215, so that at that time the Management Board have been capable of issuing up to 24,048,215 shares, commensurate to 48,6% of total shares outstanding. In addition, as of December 31, 2016, a total of two tranches of conditional capital amounting to a total of EUR 4,937,446 were recorded in the commercial register (Conditional Capitals 2003/2008 and 2011/I). The conditional capitals can only be used for granting stock option 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, when and insofar the holders of the option rights exercise these rights. 124,450 new shares were already created in 2016 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 4,812,996.

At year-end 2016, the Management Board was authorized to buy back up to a total of 10.0% of the existing share capital at the time of resolution by the Annual General Meeting or – if this value is lower – at the time the authorization will be exercised. This right was granted to the Management Board by a resolution of the Shareholders' Meeting on May 20, 2015 until May 19, 2020. Shares bought back may be used for all legally permitted purposes, in particular as consideration 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 pursuant to the legal provisions. The disclosures required of article 160 (2) AktG are contained in the point 3.1.10 of the notes.

Takeover Bid-Driven Change of Control Provisions

At year-end 2016, a loan with redemption value of nominally EUR 9.4 million (repayable in 16 equal quarterly installments since September 2014), a loan with redemption value of nominally EUR 15.0 million (repayable in 16 equal quarterly installments from March 2017), a loan with redemption value of nominally EUR 10.0 million (repayable in 16 equal quarterly installments from March 2017) and a loan with redemption value of nominally EUR 25.0 million (repayable in 16 equal quarterly installments from March 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.

As of December 31, 2016, 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 recommends 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 (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 the Supervisory Board, the Management Board and in both Leadership Levels below the Management Board

In 2016, ADVA Networking SE fulfilled the legal regulation for a gender rate of 33% in the Supervisory Board with one female Supervisory Board member out of three. All three Management Board members are male. As of December 31, 2016, the women's portion in ADVA Optical Networking SE at the first management level amounts to 7% (prior year: 7%) and at the second management level to 32% (prior year: 35%). On account of the low portion of female university graduates in relevant fields of study it is difficult for ADVA Optical Networking to achieve a desirable high women's portion in management. Therefore, 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 the Management and the Supervisory Board

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 two kinds of variable compensation which are assessed based either on short-term aspects or 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 2016, the fixed salaries of the CEO and CTO remained unchanged, while the fixed salary of the CFO has been converted from US-Dollar to Euro and matched with the fixed salary of the other two members of the Management Board. The short-term variable compensation was based on the Group's pro forma operating income[1] (40%), the Group's revenues (20%), and the Group's net liquidity[2] (20%) as well as individual goals agreed with each member of the Management Board at the beginning of the 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 long-term variable compensation focusing on the sustainable development of the Group was agreed in 2015 which 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. Moreover, ADVA Optical Networking SE 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 SE 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 and the goal to increase the share price by at least 20% has been reached.

Total Management Board compensation payable for 2016 and 2015 was EUR 2,429 thousand and EUR 1,764 thousand, respectively. During both years, there were no long-term service contracts for any member of the Management Board. In 2016 and 2015, 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. At December 31, 2016, no receivables outstanding from members of the management board have been reported.

Value of Benefits Granted for the reporting period

(in thousands of EUR)	Brian Protiva				Christoph Glingener				Ulrich Dopfer			
	Chief Executive Officer				Chief Technology Officer & Chief Operating Officer				Chief Financial Officer			
Benefits granted	**2016**	**2015**	**2016 (Min)**	**2016 (Max)**	**2016**	**2015**	**2016 (Min)**	**2016 (Max)**	**2016**	**2015**	**2016 (Min)**	**2016 (Max)**
Fixed compensation	253	253	253	253	253	253	253	253	253	230	253	253
Fringe benefits	15	14	15	15	11	11	11	11	15	17	15	15
Total	**268**	**267**	**268**	**268**	**264**	**264**	**264**	**264**	**268**	**247**	**268**	**268**
Short-term variable compensation (1 year)	226	314	-	536	152	213	-	360	135	118	-	320
Multi-year variable compensation:												
Long-term variable compensation (3 years)	-	89	-	-	-	60	-	-	-	37	-	-
Stock option plans (7 years)	417	-	-	3.000	403	-	-	2.900	296	341	-	2.133
Total	**911**	**670**	**268**	**3.804**	**819**	**537**	**264**	**3.524**	**699**	**743**	**268**	**2.721**

Actual Contribution for the reporting period

(in thousands of EUR)	Brian Protiva				Christoph Glingener				Ulrich Dopfer			
	Chief Executive Officer				Chief Technology Officer & Chief Operating Officer				Chief Financial Officer			
Contribution	**2016**	**2015**	**2016 (Min)**	**2016 (Max)**	**2016**	**2015**	**2016 (Min)**	**2016 (Max)**	**2016**	**2015**	**2016 (Min)**	**2016 (Max)**
Fixed compensation	253	253	253	253	253	253	253	253	253	230	253	253
Fringe benefits	15	14	15	15	11	11	11	11	15	17	15	15
Total	**268**	**267**	**268**	**268**	**264**	**264**	**264**	**264**	**268**	**247**	**268**	**268**
Short-term variable compensation (1 year)	226	314	226	226	152	213	152	152	135	118	135	135
Multi-year variable compensation:												
Long-term variable compensation (3 years)	-	-	-	-	-	-	-	-	-	-	-	-
Stock option plans (7 years)	-	1.183	-	-	-	893	-	-	-	35	-	-
Total	**494**	**1.764**	**494**	**494**	**416**	**1.370**	**416**	**416**	**403**	**400**	**403**	**403**

Prior year information has been adjusted to reflect the current disclosure structure.

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 2016 amounted to EUR 229 thousand, after EUR 215 thousand for 2015.

Furthermore, ADVA Optical Networking SE bears the cost of pecuniary damage liability insurance for all members of the Supervisory Board. During 2016, 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 and regulations, internal policies and ethical standards – otherwise known as compliance. The commitment to compliance is represented by the Management Board and all (line) managers of the Group. It is based on ADVA Optical Networking's core values, which translate into a holistic code of conduct and a range of Group-wide policies that govern the Group's business operations and are mandatory for all employees to follow.

ADVA Optical Networking's code of conduct and Group-wide policies are embedded into a robust compliance management system, which is structured according to the legal requirements and best practices of the Group's key countries of operation, as well as common international standards. The following elements are covered:

- Strong "tone from the top"
- Periodic risk assessments
- Proportionate risk-mitigating processes
- Periodic compliance trainings and regular communication
- Means for in-person as well as anonymous reporting
- Proportionate responses to compliance violations
- Continuous improvement of all compliance procedures

The Group's compliance management system is supported by a central compliance department and currently six regional compliance officers. Activities are coordinated by ADVA Optical Networking's Chief Compliance Officer who reports to the Chief Executive Officer and the Supervisory Board. Whenever employees have questions or suggestions related to compliance or suspect incidents of non-compliance, they are encouraged to speak-up. Besides a variety of clearly defined and actively communicated internal points of contact, 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.

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, 2016, ADVA Optical Networking SE had 571 employees, of whom 21 were apprentices (prior year: 549 employees, of whom 16 apprentices). This corresponds to an increase of 22 employee or 4.0% versus the end of the prior year. The breakdown of permanent employees by functional area is listed in the table below:

Employees by functional area (on December 31)	**2016**	**2015**	**Change**
Purchasing and production	168	171	-3
Sales, marketing and service	118	122	-4
Management and administration	88	90	-2
Research and development	176	150	+26
Apprentices	21	16	+5
Total employees	**571**	**549**	**+22**

Personnel expenses decreased from EUR 47.0 million in 2015 to EUR 44.7 million in 2016, representing 11.6% of revenues in 2016 compared to 14.4% in 2015.

The employee compensation packages comprise fixed and variable elements, and also include stock options. 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. 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 committed 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, excellence, 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 21 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.

In October 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.

Sustainability

ADVA Optical Networking’s commitment to ethical decision making extends to the Group’s operations and products. Related activities are typically referred to as sustainability. The importance of sustainability for ADVA Optical Networking is best illustrated by the Group’s successful track record in many of the concerned areas. To maintain and further strengthen the Group’s focus on sustainability, a dedicated Sustainability Department directly reports to the Chief Technology Officer.

ADVA Optical Networking’s sustainability program is based on a holistic model covering the broad range of all related aspects. It is shown in the following diagram:

Besides being used for sustainability assessments by large operators like British Telecom, the outlined model is also applied by QuEST Forum, the body which defines the TL9000 as the telecommunication industry’s version of the international quality standard ISO9001. It integrates a variety of different standards, which cover largely the same areas, and is divided into the three super-segments: ‘Operational’, ‘Organizational’ and ‘Commercial’ sustainability aspects.

In 2016, the sustainability model was further enhanced by a joint effort involving British Telecom and the QuEST Forum Sustainability Initiative, whereby a web-based sustainability assessment tool was introduced. Its use in the Group's supply-chain management, which began in late 2016, supports increased transparency and robust reporting on aspects of sustainability. Furthermore, the Group is regularly assessed regarding its sustainability performance by QuEST Forum, large customers and independent bodies like the Carbon Disclosure Project. The latest results from the end of 2016 showed a strong "High Silver" ranking across all segments of the described sustainability model.

In order to further strengthen the Group's sustainability efforts, ADVA Optical Networking has recently joined the Science-Based Targets Initiative (SBTi) as one of the first 200 companies worldwide. SBTi is a joint initiative by CDP, UN Global Compact, the World Resources Institute and the WWF. Its key aim is to support the restriction of global warming to within two degrees Celsius compared to pre-industrial temperatures.

Finally, details regarding the Group's sustainability program, performance and indicators are also summarized in ADVA Optical Networking's code of conduct and its annual Sustainability Report which is compiled according to the Global Reporting Initiative's G4 guidelines. Both resources can be found on the Group's website www.advaoptical.com (About Us / Corporate Responsibility).

Risk Report

ADVA Optical Networking's future development offers a broad variety of opportunities. It is, however also 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 internal control system that enables the Management Board to detect risks in a timely manner, to take corrective actions and to 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.

Risk Management System
Since ADVA Optical Networking was founded in 1994, its business has become more diversified. The Group 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 a risk management system 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. In order to support the Group's growing business operations and to ensure continuous improvement, relevant risk management processes and structures were reassessed in 2016.

ADVA Optical Networking's strategic goals are the basis for its 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 employee, so that every individual can focus and be evaluated on his/her own 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[1], and net liquidity[2] as well as a non-financial criterion, customer satisfaction measured by the Net Promoter Score[3]. 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.

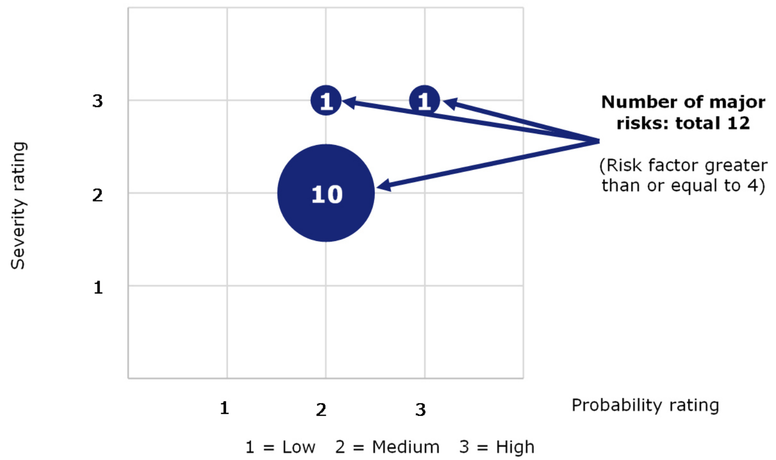
Moreover, budgets are reviewed on a monthly basis and adjustments are made if necessary. The Group's accounting, controlling and treasury departments provide globally consolidated reports on available cash funds and the development of margins and current assets (e.g. inventories and receivables) on a 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 produced and communicated to the Management Board. Moreover, the Group's accounting, controlling 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 of conduct 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 are each ranked "medium" or "high". The list of major risks is subject to change, driven by input from within the organization and 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. Adherence to this process is monitored by the Group's compliance department which conducts 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 compliance department.

At the end of 2016, ADVA Optical Networking ranked 12 risks as major risks (end of 2015: 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 the 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 a team of navigators 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 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)

Reliance on a single source supplier is a risky situation. This may happen due to many reasons but the Group has a detailed action plan to mitigate this risk. Otherwise, the consequences can be severe and include: 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 and business data from major companies have become the topic of frequent business headlines. To protect against reputational, financial and legal risks, ADVA Optical Networking entered into a Cyber Security Insurance policy to cover damages up to a significant amount. The integrity and availability of the Group's 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, GBP/USD, EUR/CHF and USD/CHF exchange rates.

In 2016, on a net basis, the Group saw significant GBP inflows and USD outflows. To combat fluctuations, the USD net cash flows in part are hedged against EUR using forward exchange agreements, based on the Group’s forecasted EUR/USD exposure for the current year and the next year, and taking into account ongoing fundamental analysis provided by a bank-independent foreign currency consultancy.

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. At the end of 2016 ADVA Optical Networking SE had no contracts in place to sell receivables from customers.

Loss of Key Customers (2;3)

The loss of key customers would have significant impact on ADVA Optical Networking’s business especially key customer with strategic value. This risk may originate to some extent from changes in customer demands and the Group’s ability to meet these requirements reliably and in a timely manner. For key customers, the Group constantly ensures performance and customer satisfaction through a dedicated team of professionals. As part of a consolidation effort, ADVA reduced relationships to five banks by the end of 2016 versus seven banks in 2015 and only considers highly rated institutes for hedging purposes.

Intensifying Price Pressure Resulting in Lower Margins (3;3)

In today's economic environment customers are squeezing every purchase for savings and therefore looking for lower pricing. Customers are conditioned towards paying less and less for high-tech products each year, especially when there are many vendors vying for their business. Large customers attempt to 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, the Group communicates 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 2016, inventory depreciation and cost related to scrapping amounted to EUR 4.0 million versus EUR 1.3 million in 2015.

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 monitors internal factory yields for unusual occurrences.

Legal Risks

Intellectual Property Risk (2;2)

ADVA Optical Networking 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 it. 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. 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 2016
During 2016, no changes of classifications for risks considered as major compared to 2015 took place. The general risk situation thus remains unchanged.

Other 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, the risk of early maturity of loans due to the breach of material contractual obligations in connection with loan agreements and committed borrowing facilities totaling EUR 67.4 million (financial covenants), 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 is largely identical to the processes, tools and concepts as described in the "risk management system" section above. The annual definition of the Group's opportunities are supported by the Management Board which has regular discussions with key customers and industry thought leaders in order to identify new opportunities and technological trends. Throughout the Group, agile processes maximize the Group's ability to take advantage of newly identified trends. Current opportunities are ranked as follows:

Internet Content Provider Demand (3;3)
The demand for cloud and mobile services continues to grow at a relentless pace, leading to a permanent expansion of the target market for innovative transmission technology. Internet content providers in particular continue to build new and larger data centers to offer their digital content and services at a global level. Optical transmission technology is strategically important for interconnecting these data centers as well as for accessing the cloud. Without additional bandwidth in the connectivity networks, internet content providers' business models will not scale. ADVA Optical Networking has strong traction with this customer group and a highly competitive product offering. The Company expects additional revenue growth and margin improvement from data center interconnect business, with high probability and high impact.

New Enterprise Verticals (3;2)
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. ADVA Optical Networking's security portfolio ConnectGuard™ brings competitive advantage and increased customer loyalty. The Group expects solid growth in this segment with better than average margins.

Metro Core Upgrade Cycle (3;2)
"On demand" high-definition video content is extremely popular forcing carriers to expand the capacity of their network infrastructure aggressively. This is true particularly in metro areas where a lot of the streaming content is buffered and where new data centers for content caching are being built and connected to the carrier infrastructure. Most carriers have completed the introduction of new-generation 100Gbit/s technology in their long-haul networks, and the investment focus is now shifting towards the metro core. Their metro networks often run on optical transmission technology that is no longer state-of-the-art. ADVA Optical Networking has a differentiated feature set, a significant installed base and a strong reputation as a solution provider for this part of the infrastructure. The Group expects additional growth.

Network Function Virtualization "NFV" (3;2)
With more and more enterprise applications and data moving into the cloud, service providers are re-thinking their strategies at the network edge. They are the ones that provide connectivity into the cloud and see the opportunity to convert some of the enterprise IT-spend into revenue for managed services. The virtualization of network functions helps them to seize that opportunity. Thanks to NFV, service providers can create and deliver new services quickly anywhere on the globe. In 2016, ADVA Optical Networking finalized a comprehensive update of its solution portfolio at the network edge. The FSP 150 portfolio, which includes fully integrated elements of the Overture hardware portfolio, is highly competitive. Combined with the ADVA Ensemble software suite, the Company has one of the most powerful, comprehensive and differentiated solutions on the market. 2016 was a year of trials and testing for many NFV applications. ADVA Optical Networking engaged with more than 20 carriers in proof-of-concept activities worldwide. The Group expects that some of these efforts will materialize in 2017 and will bring additional revenue streams.

Mobile Network Expansion (3;2)
There are additional market opportunities driven by the build-out of mobile networks, the upgrade to LTE-Advanced and the need for more accurate and precise synchronization solutions. ADVA Optical Networking's Oscilloquartz

portfolio is gaining traction at strategic customers and will provide an increasing contribution to the Group's revenue in 2017.

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 or endanger the future of the Group. ADVA Optical Networking's overall balance between opportunity and risk is at about the same level as it was at the time of the publication of the 2016 Group Management Report. The general macro-economic risk nevertheless appears to be somewhat higher than it was in 2015 due to the unknown impact of changes to trade rules and regulations in particular in the UK and the U.S.

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[5] 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 these 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, the 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 as well as at the consolidation level to ensure completeness of all closing steps. Periodic reviews by Group management are conducted to detect errors and omissions.

---

5 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.

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 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 about 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
ADVA Optical Networking maintains an internal audit function to regularly assess financial processes and systems.

Based on an annual risk assessment, the internal audit function develops an audit plan proposal for the upcoming year. The proposed plan is presented to, aligned with, and finally ratified by the Audit Committee. The internal audit function performs internal audit reviews throughout the year according to the audit plan. Audit results are discussed with responsible managers. In case of identified process or system weaknesses, the internal audit makes recommendations and improvement actions are defined and agreed with responsible managers. The progress of these and their success on removing the identified weaknesses is reviewed up by the audit function. The state of internal auditing is reported quarterly to the Audit Committee and includes feedback about the progress of audits performed versus the audit plan, about the results of terminated audit reviews and about improvements resulting from actions taken.

ADVA Optical Networking's risk management system is part of the internal audit universe and as such subject to recurring internal audit reviews.

Outlook

Based on the macroeconomic framework described above and analyst estimates of the Group's addressable core market[4], ADVA Optical Networking anticipates an annual market growth rate of 8.0% for the Group's addressable core market between the years 2016 – 2021. Internet content providers represent the customer group with the greatest growth potential due to their demand for data center interconnect solutions.

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

Further details on the projected market environment up to the year 2021 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 and profitability through extensive sales and marketing activities focusing on large customers, new customer acquisition and the service and software business.

- Expand the Group's proven innovation leadership and increase market share by meeting strategic customers' demand for innovative connectivity solutions.

- 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 employee turnover low.

Looking back at 2016, ADVA Optical Networking made good progress in meeting all of these strategic elements:

2016 revenues were up 28.2% compared to 2015. This exceeded the Management Board's expectations of moderately growing revenues as announced in the 2015 management report. The strong revenue growth was mainly driven by internet content providers (ICPs). In addition, the growth also includes revenues resulting from the acquisition of Overture. At EUR 23.4 million or 4.1% of sales in 2016, the pro forma operating result[1] of the Group was EUR 6.6 million below the EUR 30.0 million or 6.8% of sales reported in 2015. This was below the expectations of the Management Board announced in the group management report 2015, to further increase the pro forma operating result moderately. Operating profit in 2016 was with EUR 19.4 million, or 3.4% of sales, also lower than the EUR 26.8 million or 6.1% of sales generated in 2015. The decline is attributable to the integration costs of Overture, the weak margins in the business with ICPs and the decline of the British pound. Similarly the business development in ADVA Optical Networking SE exceeded the expectations of the Management board, in particular with regards to the increase in revenues.

As for innovation leadership, ADVA Optical Networking was able to make further progress in 2016. The integration of the Overture portfolio and the associated expansion of the FSP 150 product family have significantly strengthened the Company's competitiveness. Under the "One Network Edge" campaign, an advanced solution set for cloud access applications was introduced to the market. In addition, the software development efforts around Network Function Virtualization (NFV) were bearing fruit. The solutions, which are marketed under the "Ensemble" brand, have already been commercially implemented by several customers. Furthermore, the Ensemble portfolio won numerous innovation awards in 2016 and is currently being tested in more than 20 proof-of-concept environments by service providers around the world. In optical transmission technology, the FSP 3000 CloudConnect™ was successfully introduced to customers and the platform's feature set was enhanced by launching the innovative MicroMux™ module. Overall, the Company's solution portfolio is more versatile and competitive than before. The Group is thus well positioned to serve new network builds and expansions of its customers driven by cloud and mobile services and to capitalize on these mega trends.

Furthermore, ADVA Optical Networking boosted operational excellence in 2016. In an environment of continued price pressure, the Group remained disciplined in controlling its operational costs, thereby enabling it to significantly grow revenues whilst fully integrating the acquired Overture operation within six months. With strict controls in place and tight working capital management, ADVA Optical Networking maintained a strong cash position throughout the year and reached a solid net liquidity[2] position of EUR 25.5 million at the end of 2016. This was EUR 25.7 million below the EUR 51.2 million recorded at the end of 2015. Taking into account the acquisition price for Overture, this was in line with the 2015 projection that net liquidity will grow moderately.

As for customer satisfaction, ADVA Optical Networking uses the Net Promoter Score[3] metric to track progress. For 2016, the Group was able to further improve upon record levels of 2015. This development clearly exceeded the expectations of the Management Board. Significantly improved scores were achieved in all eight NPS categories. In the group management report 2015, the Management Board predicted a continued high value of the NPS ratio.

ADVA Optical Networking selectively hired additional employees in 2016. In addition, the number of employees grew through the acquisition of Overture. With attractive compensation programs and a rewarding work environment with comprehensive education opportunities, the Group maintained the high motivation of its employees and moderate turnover rates in 2016.

In 2017 the Company aims once again to achieve revenue growth above average market growth. In addition, the profitability of the Group is expected to be improved and returned to the level of 2015. The following factors, which are also described in the "Risk Report" section under "Opportunities", will play a decisive 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 and margin improvement in this application due to an improved cost structure.

- Large companies build geographically dispersed data protection and storage solutions, requiring optical transmission technology. The security package ConnectGuard™ and the BSI-certification in Germany bring competitive advantages and increased customer loyalty. ADVA Optical Networking expects solid growth in this application with good profitability.

- Carrier infrastructure upgrades will continue in 2017. The investment focus is shifting further towards metro networks, where ADVA Optical Networking is particularly well positioned.

- The expansion of the ADVA FSP 150 portfolio as well as the expansion of the relevant customer base, due to the acquisition of Overture strengthen ADVA Optical Networking's position in the cloud access market. The Company expects new customer wins and an expansion of existing business relationships in all regions.

- High-precision synchronization technology is rapidly gaining strategic importance. Specifically mobile operators, who are expanding existing LTE networks and preparing for upcoming 5G standards, are asking for network-based solutions to deliver and assure highly accurate time and frequency information. The Oscilloquartz solution portfolio is industry-leading and promises an above-average contribution to revenue growth and margins for 2017.

Despite the current uncertainty caused by the Brexit decision in the UK and the protectionist tendencies of the new US government, the global megatrends Cloud and Mobility continue to drive the growth for the network equipment industry. ADVA Optical Networking's commitment to being a trusted partner for Connecting, Extending and Assuring the Cloud, is positioning the company as an attractive supplier in important growth markets. The combination of application-optimized innovation, short development and delivery times, a broad and growing customer base, and a balanced distribution model distinguish ADVA Optical Networking from comparable companies 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 2017 pro forma operating income[1] to increase significantly, even exceeding the 2015 level. ADVA Optical Networking SE stand-alone is likely to develop correspondingly in 2017. Net liquidity[2] in 2016 was reduced through the acquisition of Overture, compared to the highs of 2015. The Management Board expects an increase from the new level in the lower double digit million Euro range by the end of 2017. 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 measured by Net Promoter Score[3] in 2017 will once again be at high positive levels of minimum 40%. 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 21, 2017

Brian Protiva

Christoph Glingener

Ulrich Dopfer

ADVA OPTICAL NETWORKING SE, MEININGEN – FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR FROM JANUARY 1 TO DECEMBER 31, 2016

Balance Sheet on December 31, 2016

(on December 31, in thousands of EUR)	Note	2016	2016	2015
Assets				
A. Fixed assets	3.1.1			
I. Intangible assets				
1. Self-constructed industrial and similar rights and assets, and licenses in such rights and assets	3.1.2	76,907		61,457
2. Purchased industrial and similar rights and assets, and licenses in such rights and assets	3.1.3	15,519		5,350
3. Goodwill		21		27
4. Payments on account		-		265
			92,447	**67,099**
II. Property, plant and equipment				
1. Land, land rights and buildings, including buildings on third-party land		4,826		5,175
2. Plant and machinery		4,815		4,070
3. Other equipment, furniture and fixtures		753		656
4. Payments on account and assets under construction		315		137
			10,709	**10,038**
III. Financial assets				
1. Shares in affiliated companies	3.1.4	27,449		27,449
2. Loans to affiliated companies	3.1.5	41,395		2,225
3. Investments	3.1.6	1,374		1,198
			70,218	**30,872**
B. Current Assets				
I. Inventories				
1. Raw materials, consumables and supplies		15,745		9,742
2. Work in process		1,883		2,801
3. Finished goods and merchandise		27,184		23,961
4. Payments on account		747		184
			45,559	**36,688**
II. Receivables and other assets				
1. Trade accounts receivable	3.1.7	39,123		33,808
2. Receivables from affiliated companies	3.1.8	31,042		28,802
3. Other current assets	3.1.9	3,554		1,970
			73,719	**64,580**
III. Cash at banks and in hand			**21,314**	**39,345**
C. Prepaid expenses			**1,577**	**940**
Total assets			**315,543**	**249,562**

(on December 31, in thousands of EUR)	Note	2016	2016	2015
Equity and liabilities				
A. Equity	3.1.10			
I. Subscribed capital (Conditional capital EUR 4,813 thousand) (prior year: EUR 3,531 thousand)		49,499		49,374
II. Capital reserve		33,241		32,944
III. Retained earnings				
Other retained earnings		2,551		2,551
IV. Accumulated profit		69,890		52,392
			155,181	**137,261**
B. Provisions				
1. Provisions for pension and similar obligations	3.1.11	452		382
2. Tax provisions	3.1.12	585		1,177
3. Other provisions	3.1.13	11,417		10,457
			12,454	**12,016**
C. Liabilities	3.1.14			
1. Liabilities to banks		59,364		42,670
2. Advance payments received		3		2
3. Trade accounts payable		45,684		16,296
4. Liabilities to affiliated companies	3.1.8	23,149		18,373
5. Other liabilities		5,906		9,330
- *thereof for taxes*		*901*		*1,629*
- *thereof for social security*		*244*		*335*
			134,106	**86,671**
D. Deferred income			**5,771**	**7,036**
E. Deferred tax liabilities	3.1.15		**8,031**	**6,578**
Total equity and liabilities			**315,543**	**249,562**

Income Statement for the Period from January 1 to December 31, 2016

(in thousands of EUR from January 1 to December 31)	Note	2016	2015
1. Revenues	3.2.1	**386,629**	**327,274**
2. Cost of goods sold	3.2.2 / 3.2.3	267,567	219,832
3. Gross profit		**119,062**	**107,442**
4. Selling and marketing expenses	3.2.3	28,074	29,819
5. General administrative expenses	3.2.3	15,085	17,014
6. Research and development expenses	3.1.2 / 3.2.3	63,725	47,937
7. Other operating income	3.2.4	13,387	9,858
- thereof currency translation		*9,791*	*8,107*
8. Other operating expenses	3.2.4	9,652	8,087
- thereof currency translation		*9,479*	*7,848*
9. Operating Income (EBIT)		**15,913**	**14,443**
10. Income from investments	3.2.5	800	6,458
- thereof from affiliated companies		*800*	*6,458*
11. Income from other securities and loans classified as financial assets		1,336	106
- thereof from affiliated companies		*1,336*	*106*
12. Other interest and similar income		332	10
13. Amortization of financial assets	3.2.6	-	1,573
14. Interest and similar expenses		181	726
- thereof interest expense for non-current provisions		*10*	*66*
- thereof from affiliated companies		*-*	*84*
		2,287	**4,275**
15. Result from ordinary activities		**18,200**	**18,718**
16. Tax expense (benefit), net	3.2.7	698	1,146
- thereof deferred taxes		*1,452*	*515*
17. Other tax expense (benefit), net		4	4
		702	**1,150**
18. Net profit for the year		**17,498**	**17,568**
19. Profit carried forward		52,392	34,824
20. Accumulated profit		**69,890**	**52,392**

Notes to the Financial Statements 2016

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 2016 were prepared in accordance with the regulations of the German Commercial Code (Handelsgesetzbuch, HGB) as amended by the Accounting Conversion Directives (BilRUG) and the SE regulations in connection with the German Corporation Law (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.

Applying the Accounting Conversion Directives (BilRUG) did not result in significant adjustments in the conversion year 2016.

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 and is registered at the district court Jena under HRB number 508155.

ADVA Optical Networking SE is classed as a large company in accordance with the Germany Commercial Code (HGB) § 267. The business year is equal to the calendar year. The financial statements for the year ended December 31, 2016 were authorized for issue in accordance with a resolution of the Management Board on February 21, 2017.

The company develops, manufactures and sells networking solutions for a modern telecommunication infrastructure. Its products are based on fiber-optic transmission technology combined with Ethernet functionality and intelligent software for network management and virtualization. Furthermore, the portfolio includes timing and synchronization solutions for networks.

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 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 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.

2.2.11 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.

2.2.12 Provisions
Provisions are made for all identifiable risks to an adequate extent considering the principles of commercial prudence are recognized at the settlement amount. Provisions with a remaining duration of more than one year are discounted at a rate equal to the average market rate over 7 years.

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 2016 and 2015.

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:

	Spot rate on Dec. 31, 2016
USD	1.0541
GBP	0.8562
CHF	1.0739
PLN	4.4103
ILS	4.0477
CNY	7.3202
SGD	1.5234
HKD	8.1751
INR	71.5935
BRL	3.4305
JPY	123.4000
SEK	9.5525
NOK	9.0863

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

Revenues for Licenses
Revenues for Licenses consists of payments to usage of intellectual property rights within ADVA Networking group companies and recorded at the time they are incurred.

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.

License 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, 2016	**Additions**	**Disposals/ retirements**	**Reclas- sifications**	**Dec. 31, 2016**	**Jan. 1, 2016**	**Depreciation* of the period**	**Depreciation on disposals/ retirements**	**Dec. 31, 2016**	**Dec. 31, 2016**	**Dec. 31, 2015**
I. Intangible assets											
1. Self-constructed industrial and similar rights and assets, and licenses in such rights and assets	127,953	39,107**	-	-	167,060	66,496	23,657	-	90,153	76,907	61,457
2. Purchased industrial and similar rights and assets, and licenses in such rights and assets	25,148	13,901	9	269	39,309	19,798	4,001	9	23,790	15,519	5,350
3. Goodwill	284	-	-	-	284	257	6	-	263	21	27
4. Payments on account	265	-	-	-265	-	-	-	-	-	-	265
	153,650	**53,008**	**9**	**4**	**206,653**	**86,551**	**27,664**	**9**	**114,206**	**92,447**	**67,099**
II. Property, plant and equipment											
1. Land, land rights and buildings including buildings on third-party land	9,816	22	-	-	9,838	4,641	371	-	5,012	4,826	5,175
2. Plant and machinery	34,860	3,119	118	20	37,881	30,790	2,376	100	33,066	4,815	4,070
3. Other equipment, furniture and fixtures	5,252	607	102	-	5,757	4,596	498	90	5,004	753	656
4. Payments on account and assets under construction	137	202	-	-24	315	-	-	-	-	315	137
	50,065	**3,950**	**220**	**-4**	**53,791**	**40,027**	**3,245**	**190**	**43,082**	**10,709**	**10,038**
III. Financial assets											
1. Shares in affiliated companies	35,127	14,811	22,489	-	27,449	7,678	-	7,678	-	27,449	27,449
2. Loans to affiliated companies	8,311	40,113	943	-	47,481	6,086	-	-	6,086	41,395	2,225
3. Investments	1,198	176	-	-	1,374	-	-	-	-	1,374	1,198
	44,636	**55,100**	**23,432**	**-**	**76,304**	**13,764**	**-**	**7,678**	**6,086**	**70,218**	**30,872**
Total	**248,351**	**112,058**	**23,661**	**-**	**336,748**	**140,342**	**30,909**	**7,877**	**163,374**	**173,374**	**108,009**

*Thereof depreciation of additions EUR 5,849 thousand in period 2016
**In 2016, borrowing costs of EUR 908 thousand (2015: EUR 360 thousand) related to development projects with an expected duration of more than 12 months were capitalized. Borrowing costs were capitalized applying the weighted average rate of the financial liabilities of 2.7%.

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 years 2015 and 2016 as well as capitalized development projects are included in the table below:

(in thousands of EUR)	**2016**	**2015**
Research expenses	2,196	1,741
Development expenses	98,218	78,267
Research & Development expenses	100,414	80,008
Thereof capitalized development projects	-36,689	-32,071
Total Research & Development Expenses in income statement	**63,725**	**47,937**

The following table analyzes the historical costs of the self-constructed industrial and similar rights and assets, and licenses in such rights and assets.

(in thousands of EUR)	**2016**	**2015**
Self-Constructed Industrial and Similar Rights and Assets, and Licenses in Such Rights and Assets on Jan. 1	**127,953**	**93,356**
Additions of capitalized development projects including borrowing costs	36,689	32,071
Additions of other capitalized development services	2,418	2,526
Total additions during the year	**39,107**	**34,597**
Self-Constructed Industrial and Similar Rights and Assets, and Licenses in Such Rights and Assets on Dec. 31	**167,060**	**127,953**

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

Net book values of purchased industrial and similar rights and assets and licenses in such rights and assets can be analyzed as follows:

(in thousands of EUR)	**Dec. 31 2016**	**Dec. 31 2015**
Purchased technology Oscilloquartz	1,968	2,643
Purchased technology FiSEC	993	1,283
Purchased hardware technology Overture	3,260	-
Purchased software technology Overture	3,520	-
Purchased technology Ringo	3,109	-
Purchased technology Acacia	1,181	-
Brand Ensemble	171	-
Other Software licenses	1,317	1,424
Total	**15,519**	**5,350**

3.1.4 Shares in Affiliated Companies

On December 31, 2016, ADVA Optical Networking SE held directly or indirectly shares in 16 (December 31, 2015: 15) affiliated companies as follows:

(in thousands)			Equity	Net income/loss (-)	Share in Equity owned directly	Share in Equity owned indirectly
ADVA Optical Networking North America Inc. Norcross/Atlanta (Georgia), USA	USD	*	59,794	5,768	-	100%
ADVA Optical Networking Ltd. York, United Kingdom	GBP	**	12,250	3,839	100%	-
Oscilloquartz SA Saint-Blaise, Switzerland	CHF	*	7,247	-70	100%	-
ADVA Optical Networking sp. z o.o. Gdynia, Poland	PLN	**	5,073	-5,195	100%	-
ADVA Optical Networking Israel Ltd. Ra'anana/Tel Aviv, Israel	ILS	*	-9,997	-11,356	100%	-
ADVA Optical Networking (Shenzhen) Ltd. Shenzhen, China	CNY	**	45,381	3,112	100%	-
Oscilloquartz Finland Oy Espoo, Finland	EUR	*	9	39	100%	-
ADVA IT Solutions Pvt. Ltd. Bangalore, India	INR	***	43,651	19,853	-	100%
ADVA Optical Networking Trading (Shenzhen) Ltd. Shenzhen, China	USD	*	798	152	-	100%
ADVA Optical Networking Singapore Pte. Ltd. Singapore	SGD	**	2,999	323	100%	-
ADVA Optical Networking Hongkong Ltd. Hongkong, China	HKD	**	2,017	477	-	100%
ADVA Optical Networking (India) Private Ltd. Gurgaon, India	INR	***	15,869	6,631	1%	99%
ADVA Optical Networking Serviços Brazil Ltda. São Paulo, Brazil	BRL	*	1,202	229	99%	1%
ADVA Optical Networking Corp. Tokyo, Japan	JPY	*	81,954	2,606	100%	-
ADVA Optical Networking AB Kista/Stockholm, Sweden	SEK	**	1,537	175	100%	-
ADVA NA Holdings Inc. Atlanta (Georgia), USA	USD	*	60,687	-2	100%	-

* Prepared in accordance with the International Financial Reporting Standards (IFRS) for the period ended December 31, 2016.
** Prepared in accordance with local commercial law for the period ended December 31, 2015.
*** Prepared in accordance with local commercial law for the period ended March 31, 2016.

Acquisition of Overture Networks Inc.
On January 13, 2016 ADVA NA Holdings Inc., Atlanta, Georgia, USA, a new established 100% subsidiary of ADVA Optical Networking SE, acquired 100% of the shares of Overture Networks Inc., Morrisville, North Carolina, USA, for a preliminary cash consideration due at the same date of USD 39,516 thousand (EUR 36,535 thousand, translated at the relevant exchange rate at the date of payment). In addition, an earn-out payment of USD 5,000 thousand in cash was agreed if specified sales volumes are reached. Furthermore, additional expenses of the acquisition amounting to EUR 293 thousand have been recognized immediately in the income statement.
In the context of the acquisition of Overture Networks Inc., the US entities were merged into ADVA Optical Networking North America Inc. and its directly held shares with the book value of EUR 14.8 million were contributed to the newly established ADVA NA Holdings Inc.

Liquidation of ADVA Optical Networking AS
In 2016 the liquidation of the company, already closed in 2014, was completed.

Liquidation of Overture Networks Ltd.
In December 2016 Overture Networks Ltd., which was acquired as part of the Overture acquisition, was liquidated. Business activities substantially had been transferred beforehand to ADVA Optical Networking Ltd. in York, UK.

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)	**2016**	**2015**
ADVA Optical Networking Hongkong Ltd. Hongkong, China	110	110
ADVA NA Holdings Inc. Atlanta (Georgia), USA	36,982	-
ADVA Optical Networking Israel Ltd. Ra'anana, Israel	3,953	822
ADVA Optical Networking sp. z o.o. Gdynia, Poland	-	943
Oscilloquartz Finland Oy Espoo, Finland	350	350
Total	**41,395**	**2,225**

3.1.6 Investments
On December 31, 2016, ADVA Optical Networking SE held 9% (prior year: 11%) of the shares of Saguna Networks Ltd., Nesher, Israel. On December 31, 2016, the book value of the investment amounted to EUR 1,374 thousand (December 31, 2015: 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.

3.1.8 Receivables from and Liabilities to Affiliated Companies
Receivables from affiliated companies include trade receivables for goods and services of EUR 31,042 thousand. Accounts receivables from affiliated companies are due within one year.

Liabilities to affiliated companies include trade payables for goods and services of EUR 23,149 thousand. These payables are due within one year.

3.1.9 Other Current Assets
Other current assets recognized on the balance sheet are due within one year, with the exception of EUR 346 thousand (prior year: EUR 374 thousand) for rental deposits which are due within five years.

3.1.10 Equity
Common stock and share capital
On December 31, 2016, ADVA Optical Networking SE had issued 49,498,934 (prior year: 49,374,484) 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, 124,450 shares were issued to employees of the Company and its affiliates out of conditional capital in 2016 (prior year: 1,278,053 shares). The par value of EUR 125 thousand (prior year: EUR 1,278 thousand) was appropriated to share capital, whereas

the premium resulting from the exercise of stock options of EUR 296 thousand (prior year: EUR 1,939 thousand) was recognized within capital reserve.

Authorized capital
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 (authorized capital 2015/I). 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 11, 2016, resolved to decrease the conditional capital 2003/2008 by EUR 104 thousand to EUR 179 thousand. In addition, the conditional capital 2011/I has been increased by EUR 1,511 thousand to EUR 4,759 thousand. The resolutions were registered in the commercial register on May 26, 2016.

Considering the above described capital transactions, the total conditional capital on December 31, 2016, amounts to EUR 4,813 thousand.

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

(in thousands of EUR)	**Share capital**	**Authorized capital 2015/I**	**Conditional capital 2003/2008**	**Conditional capital 2011/I**
Jan. 1, 2016	**49,374**	**24,048**	**283**	**3,248**
Changes due to Annual Shareholders’ Meeting resolutions	-	-	-104	1,511
Stock options exercised	125	-	-83	-42
Dec. 31, 2016	**49,499**	**24,048**	**96**	**4,717**

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 2,791,200 stock options were outstanding per December 31, 2016.

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

Additionally outstanding stock appreciation rights issued to employees of EUR 216 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 balance sheet was prepared in consideration of the complete profit appropriation. The net income for 2016 will be carried forward to new account. The accumulated profit carried forward of EUR 52,392 thousand (prior year: EUR 34,824 thousand) and the net profit for 2016 of EUR 17,498 thousand (prior year: EUR 17,568 thousand) resulted in an accumulated profit of EUR 69,890 thousand (prior year: EUR 52,392 thousand) on December 31, 2016.

Restriction of dividend distribution
Profits from the capitalization of development projects less deferred tax liabilities as well as changes in interest rates applied to discount pension provisions are blocked for dividend distribution.

The following amounts are blocked on December 31, 2016:

(in thousands of EUR)	**2016**	**2015**
Net of capitalized development projects and its deferred tax liabilities	54,934	44,415
Change of the average interest rate from pension provisions*	52	0
Total profits blocked for dividend distribution	**54,986**	**44,415**

* Pursuant to the HGB the valuation of pension obligations changed from 7 to 10 years according to the first sentences of Article 75 (6) EGHGB n.F. in conjunction with the first sentences of Article 253 (2) HGB n.F.

Voting rights

According to section 21 paragraph 1, section 25 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 2016:

Date of change in investment	Name of investment owner	Threshold limit	Share of voting rights
Dec 30, 2016	Ministry of Finance on behalf of the State of Norway, Oslo, Norway	above 3%	4.40%
Dec 27, 2016	Ministry of Finance on behalf of the State of Norway, Oslo, Norway	above 3%	4.01%
Nov 11, 2016	Ministry of Finance on behalf of the State of Norway, Oslo, Norway	above 3%	4.39%
Nov 10, 2016	Ministry of Finance on behalf of the State of Norway, Oslo, Norway	above 3%	4.37%
Nov 04, 2016	Ministry of Finance on behalf of the State of Norway, Oslo, Norway	above 3%	4.50%
Nov 01, 2016	Ministry of Finance on behalf of the State of Norway, Oslo, Norway	above 3%	3.33%
Oct 26, 2016	Ministry of Finance on behalf of the State of Norway, Oslo, Norway	above 3%	3.25%
Oct 13, 2016	Ministry of Finance on behalf of the State of Norway, Oslo, Norway	below 3%	2.77%
Oct 12, 2016	Ministry of Finance on behalf of the State of Norway, Oslo, Norway	above 3%	3.33%
Sep 27, 2016	Ministry of Finance on behalf of the State of Norway, Oslo, Norway	below 3%	2.79%
Sep 26, 2016	Ministry of Finance on behalf of the State of Norway, Oslo, Norway	above 3%	3.11%
Jul 15, 2016	Deutsche Asset Management Investment, Frankfurt, Germany	above 3%	5.00%
Jul 11, 2016	Deutsche Asset Management Investment, Frankfurt, Germany	above 3%	5.46%
Jan 11, 2016	Morgan Stanley, Wilmington, Delaware, United States of America	below 3%	1.63%
Jan 08, 2016	Morgan Stanley, Wilmington, Delaware, United States of America	above 3%	6.93%

3.1.11 Provisions for Pensions and Similar Obligations

The provision for pensions and similar obligations relate to termination benefit payments due to employees of the Italian branch office and are required due to local statutory regulations (Trattamento di fine rapporta, 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 the employee is entitled to receive the accrued sum. This applies in case of reaching the retirement age of currently 63 years as well as in case of early termination of the employment contract. 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 method). 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:

(in %)	**Dec. 31, 2016**	**Dec. 31, 2015**
Discount rate	4.04	3.97
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 FPDL Credito for invalidity.

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

(in thousands of EUR)	**2016**	**2015**
Present value of the obligation on Jan. 1	**382**	**361**
Interest expense	16	16
current service cost	38	41
Disbursements to employees	-34	-6
Losses arising from changes in financial assumptions	-6	34
Other changes	56	-64
Present value of the obligation on Dec. 31	**452**	**382**

Changes in financial assumptions relate to the assumed discount rate and are included in interest and similar expenses. Due to the longer than expected sustained low interest rate environment the average interest rate applicable for the valuation of pension obligations changed from 7 to 10 years according to the first sentences of Article 75 (6) EGHGB n.F. in conjunction with the first sentences of Article 253 (2) HGB n.F. As a result a difference of EUR 52 thousand was recorded in the current year. This difference is blocked for dividend distribution. Other changes mainly relate to changes in salaries and are reported as personnel expenses.

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 287 thousand.

3.1.12 Tax Provisions

Tax provisions of EUR 585 thousand (prior year: EUR 1,177 thousand) include expected tax payments due to fiscal authorities applying current tax rates and tax legislations.

3.1.13 Other Provisions

On December 31, 2016 other provisions can be analyzed as follows:

(in thousands of EUR)	**2016**	**2015**
Personnel provisions	1,509	1,651
Invoices not yet received	6,514	6,930
Provision for Tax audit	232	196
Vacation provisions	410	378
Warranty provisions	2,324	740
Sales allowances	177	283
Audit fees	251	238
Other provisions	-	41
Total	**11,417**	**10,457**

Personnel provisions include EUR 216 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, 2016	Total	Maturity within one year	more than one year	thereof between one and five years	thereof more than five years
Liabilities to banks	59,364	18,647	40,717	40,717	-
Advance payments received	3	3	-	-	-
Trade accounts payable	45,684	45,684	-	-	-
Payables to affiliated companies	23,149	23,149	-	-	-
Other liabilities	5,906	5,689	217	217	-
thereof taxes	*901*	*901*	-	-	-
thereof social security	*244*	*244*	-	-	-
Total liabilities	**134,106**	**93,172**	**40,934**	**40,934**	**-**

(in thousands of EUR) on December 31, 2015	Total	Maturity within one year	more than one year	thereof between one and five years	thereof more than five years
Liabilities to banks	42,670	18,221	24,449	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	775	-
thereof taxes	*1,629*	*1,629*	-	-	-
thereof social security	*335*	*335*	-	-	-
Total liabilities	**86,671**	**61,447**	**25,224**	**25,224**	**-**

On December 31, 2016 other liabilities mainly include EUR 3,451 thousand (prior year: EUR 4,675 thousand) for bonus payments due to employees and management board, EUR 901 thousand (prior year: EUR 1,629 thousand) for withholding taxes and EUR 438 thousand (prior year: EUR 961 thousand) for license fees. Furthermore, other liabilities include EUR 555 thousand (prior year: EUR 1,110 thousand) outstanding payments in relation to the acquisition of assets from FiSEC GmbH and EUR 200 thousand (prior year: EUR 200 thousand) for the acquisition of Time4 Systems Oy.

3.1.15 Deferred Taxes

Deferred taxes are recognized based on 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. When calculating deferred taxes, a combined tax rate of 28.57% was applied.

Balance sheet position	**Deferred tax category**
Self-constructed industrial and similar rights and assets, and licenses in such rights and assets	liability
Goodwill	asset
Property, plant and equipment	asset
Inventories	liability
Loans to affiliated companies	liability
Provisions	assets
Trade accounts payable and liabilities to affiliated companies	liability

The corporate income tax loss carry forward on December 31, 2016 amounts to EUR 132,342 thousand (prior year: EUR 133,289 thousand) and the trade income tax loss carry forward amounts to EUR 125,497 thousand (prior year: EUR 126,825 thousand).

Above listed temporary differences reveal a surplus of liabilities. Considering the minimum taxation rules according to Article 10 d (2) of the German Income Tax Act (ESTG), the company recognized deferred tax assets of EUR 13,452 thousand (prior year: EUR 9,834 thousand) on tax losses of EUR 47,084 thousand (prior year: EUR 43,238 thousand) which can be carried forward indefinitely.

Total deferred tax assets amount to EUR 15,103 thousand (prior year: EUR 11,575 thousand) and are offset against deferred tax liabilities of EUR 23,134 thousand (prior year: EUR 18,153 thousand).

As a result, the company recognized a deferred tax liability in the amount of EUR 8,031 thousand (prior year: EUR 6,578 thousand).

3.2 Income Statement

3.2.1 Revenues

In 2016 and 2015, revenues included EUR 22,290 thousand and EUR 19,976 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)	**2016**	**2015**
Germany	89,215	77,678
Rest of Europe, Middle East and Africa	125,997	140,802
Americas	142,750	81,393
Asia-Pacific	28,667	27,401
Total	**386,629**	**327,274**

The application of the Accounting Conversion Directives (BilRUG) did not impact the disclosure of the company´s revenues.

3.2.2 Material Expenses

Cost of goods sold include the material expenses of the Company, classified pursuant to section 275 paragraph 2, number 5 HGB. Material expenses totaled EUR 218,870 thousand in the financial year 2016 (prior year: EUR 177,346 thousand). Thereof, EUR 216,519 thousand (prior year: EUR 174,956 thousand) relate to expenses for raw materials and supplies and EUR 2,351 thousand (prior year: EUR 2,390 thousand) to costs of purchased services.

3.2.3 Personnel Expenses

Concerning the cost of sale method, the company´s personnel expenses are distributed according to the functional areas in cost of goods sold, selling and marketing, General and administrative as well as research and development expenses. In 2016, personnel expenses of the Company, classified pursuant to section 275 paragraph 2, number 6 HGB, amounted to EUR 44,667 thousand (prior year: EUR 46,978 thousand). Thereof, EUR 38,427 thousand (prior year: EUR 40,664 thousand) were related to salaries and wages and EUR 6,240 thousand (prior year: EUR 6,314 thousand) were related to costs for social security. For pension plans EUR 137 thousand (prior year: EUR 10 thousand) were recognized in 2016.

3.2.4 Other Operating Income and Expenses

Other operating income and expenses can be analyzed as follows:

(in thousands of EUR)	2016	2015
Income from currency translation	9,791	8,107
Grants received for research projects	1,419	859
Other	2,177	892
Other operating income	**13,387**	**9,858**
Expenses from currency translation	9,479	7,848
Other	173	239
Other operating expenses	**9,652**	**8,087**

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)	2016	2015
Income from release of provisions	1,602	427
Income from release of liabilities	98	80
Income from release of specific provisions for trade receivables	384	311
Income for other accounting periods	**2,084**	**818**
Expenses for other accounting periods	**72**	**5**

3.2.5 Income from Investments

Income from investments amounts to EUR 800 thousand and results from a dividend payment from ADVA Optical Networking AS i.L., Oslo, Norway.

3.2.6 Amortization of Financial Assets

There was no amortization of financial assets in 2016 (prior year: EUR 1,573 thousand).

3.2.7 *Income Taxes*

The Company's income tax comprises corporate income tax (Körperschaftsteuer), solidarity surcharge (Solidaritätszuschlag) 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 28.57% (prior year: 27.73%) to effective income tax expense (benefit), net, is presented below:

(in thousands of EUR)	2016	2015
Accounting profit before tax	**18,200**	**18,718**
Expected statutory tax expense	**5,200**	**5,190**
Taxes from prior years	-1,245	130
Loss carry-forward not recognized in prior years	-3,967	-1,639
Adjustments of deferred taxes from prior years	-164	-1,386
Non-deductible expenses and tax-free income	535	-1,162
Deductible tax expense	93	0
Change in tax rate	199	0
Differences from foreign branch offices	25	22
Other differences	22	-9
Income tax expense/(benefit)	**698**	**1,146**
Effective tax rate	**3.8%**	**6.1%**

Income taxes include deferred taxes in the amount of EUR 1,452 thousand (prior year: EUR 515 thousand).

3.2.8 Auditor´s Fees

The auditor fees 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**	**more than one year**	**thereof between one and five years**	**thereof more than five years**
Obligations from rent agreements	3,384	754	2,630	1,954	676
Obligations from car leasing agreements	1,227	621	606	606	-
Purchase commitments	36,490	36,318	172	172	-
Other	2,810	1,143	1,667	1,667	-
Total	**43,911**	**38,836**	**5,075**	**4,399**	***676***

The Company granted an irrevocable guarantee of GBP 1,500 thousand (equivalent EUR 1,752 thousand) for liabilities of ADVA Optical Networking Ltd., York, United Kingdom, another guarantee of EUR 2,184 thousand for liabilities of ADVA Optical Networking (India) Private Ltd., Gurgaon, India, a guarantee of SGD 262 thousand (equivalent EUR 172 thousand) for liabilities of ADVA Optical Networking Singapore Pte. Ltd., Singapore and a guarantee of CHF 1,000 thousand (equivalent EUR 931 thousand) for liabilities of Oscilloquartz SA, Saint-Blaise, Switzerland.

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 two forward rate agreements on January 28 and March 18, 2016 to hedge foreign currency exposure of expected future cash. These agreements mature on March 29 and June 28, 2017.

In 2016, unrealized profits for these foreign currency hedges amounted to EUR 903 thousand which, in accordance with the realization principle, will be recognized at maturity of the forward rate agreement.

Between June 18, 2015 and September 19, 2016, the company entered into fifteen forward rate agreements that matured in 2016. A net gain of EUR 1,217 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**	
	2016	**2015**	**2016**	**2015**
Forward rate agreements	903	1,792	16,075	66,590

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

	Resident in	Occupation	External mandates
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 Versicherungsbank VVaG, Cologne, Germany Member of the Supervisory Board of Gothaer Finanzholding AG, Cologne, Germany Member of the Supervisory Board of Cologne Executive School GmbH, Cologne, Germany
Hans-Joachim Grallert (since February 19, 2016)	Gröbenzell, Germany	Professor for Telecommunication Systems, University of Technology Berlin, Berlin, Germany	Chairman of the Management Board “Eduard Rhein Foundation”, Hamburg, Germany
Eric Protiva (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

	Resident in	External mandates
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	Alpharetta (Georgia),USA	-

4.4 Employees

The Company employed an average of 543 employees and 15 apprentices (prior year: 524 employees and 14 apprentices), divided into the following functional areas:

Employee after functional area on December 31, 2016	**2016**	**2015**
Purchasing and production	171	173
Sales, marketing and service	115	120
Management and administration	84	87
Research and development	173	144
Apprentices	15	14
Total	**558**	**538**

4.5 Compensation of the Management Board

In 2016 and 2015, the Management Board of the Company consisted of the members stated below. Ulrich Dopfer received remuneration from the subsidiary ADVA Optical Networking North America Inc., Norcross/Atlanta (Georgia), USA.

The total Management Board compensation according to § 314 Abs. 1 No. 6a HGB (German statutory regulations) was EUR 2,429 thousand in 2016 and EUR 1,764 thousand in 2015.

The value of benefits granted analyses across the individual Board members as follows:

(in thousands of EUR)	**Fixed**	**Variable**	**Total 2016**	**Total 2015**
Brian Protiva Chief Executive Officer	268	643	911	581
Christoph Glingener Chief Technology Officer & Chief Operating Officer	264	555	819	477
Ulrich Dopfer Chief Financial Officer	268	431	699	706

The fixed compensation includes non-performance based considerations and fringe benefits (company car allowances). The variable compensation considers components related to short-term performance goals that are reported as current liabilities on December 31, 2016, as well as components based on long-term performance goals amounting to EUR 1,116 thousand (prior year: EUR 341 thousand). Prior year information has been adjusted to reflect the current disclosure structure.

The Company paid pecuniary damage liability insurance premiums on behalf of members of the Management Board totaling EUR 12 thousand both in 2016 and 2015 (in equal amounts for each Management Board member), respectively.

In 2016 and 2015, no loans were granted to the members of the Management Board. At December 31, 2015, ADVA Optical Networking SE had a receivable of EUR 62 thousand outstanding from Brian Protiva regarding payroll tax related to stock option exercises. The receivable has been offset against the remuneration paid in January and February 2016. At December 31, 2016, no receivables outstanding from members of the management board have been reported.

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

	Shares		**Stock options**	
	2016	**2015**	**2016**	**2015**
Brian Protiva Chief Executive Officer	401,030	401,030	335,000	185,000
Christoph Glingener Chief Technology Officer & Chief Operating Officer	-	-	325,000	180,000
Ulrich Dopfer Chief Financial Officer	500	500	259,667	153,000

The options to members of the Management Board were granted out of Plan IXb, Plan XIV 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 XIV 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 103,000 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,
- EUR 8.70 for 401,667 options granted on May 15, 2016, respectively.

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

4.6 Compensation of the Supervisory Board

The fixed compensation to be paid to the Supervisory Board for 2016 and 2015 totaled EUR 229 thousand and EUR 215 thousand, respectively. This amount can be analyzed by the individual Board members as follows:

(in thousands of EUR)	**2016**	**2015**
Nikos Theodosopoulos Chairman	100	100
Johanna Hey Vice Chairwoman	90	90
Hans-Jochim Grallert Member (since February 19, 2016)	39	-
Eric Protiva Member (until July 27, 2015)	-	25

The fixed compensation for the Supervisory Board of ADVA Optical Networking SE is paid out in quarterly installments. The fixed compensation for Q4 2016 amounting to EUR 59 thousand was paid out in January 2017 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 2016 and 2015, respectively.
On December 31, members of the Supervisory Board held the following shares:

	Shares	
	2016	**2015**
Nikos Theodosopoulos Chairman	-	-
Johanna Hey Vice Chairwoman	-	-
Hans-Jochim Grallert Member (since February 19, 2016)	620	-

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).

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

There were no events after the balance sheet date that materially affected the net assets and financial position of the Group on December 31, 2016, or its financial performance for 2016. Similarly, there were no events considered material for disclosure.

Meiningen, February 21, 2017

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 21, 2017

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 2016 financial statements and management report of ADVA Optical Networking SE.

Auditors' 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, 2016. 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, complies with legal requirements, as a whole provides a suitable view of the Company's position and suitably presents the opportunities and risks of future development.

Munich, February 21, 2017

PricewaterhouseCoopers
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

sgd. Holger Graßnick

Wirtschaftsprüfer
(German Public Auditor)

sgd. ppa. Sonja Knösch

Wirtschaftsprüferin
(German Public Auditor)