H&K AG

Management Report and Consolidated Statements According to IFRS for the Financial Year 2020

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Group Management Report 2020

H&K AG, Oberndorf am Neckar

1. Trend in business and overall situation

Trend in business and corporate structure

The H&K AG Group with its parent company H&K AG is defined by both the military & governmental authorities and the commercial business areas of Heckler & Koch GmbH (HKO), its subsidiary in Oberndorf am Neckar, Germany, and HKO's subsidiaries in the US, England and France. US governmental authorities and military customers are served by Heckler & Koch Defense Inc. (HKD), Ashburn/Virginia, USA, while Heckler & Koch, Inc. (HKI), Columbus/Georgia, USA, serves the American commercial market.

HKO develops, manufactures and, together with its subsidiaries, markets and distributes infantry and sidearms primarily for governmental security forces, in particular in NATO countries and the EU, and is one of the leading businesses in this market segment; the operating companies also provide related services. In both business areas, we are concentrating on the development and introduction of new products.

H&K AG was formed in March 2014 through the change in legal status of the former Heckler & Koch Beteiligungs GmbH; this was entered into the commercial register on April 7, 2014.

Since July 28, 2015 H&K AG's shares have been listed under ISIN DE000A11Q133 on the Euronext free market ("Marché Libre") in Paris; 99.97% of our shares are held by a few main shareholders. Due to the very low free float, the average share price shown on the Euronext during 2020 was significantly higher than our calculated share value.

The product portfolio comprises portable infantry weapons such as pistols, machine pistols, assault rifles and machine guns, grenade launchers and specialist equipment, together with numerous training systems in various construction variants for almost all weapon categories, enabling realistic training. This provides a complete and flexible product range, in the form of weapon families, for military and governmental authority personnel that is specifically tailored to suit a large number of user scenarios and is globally special in covering all military and governmental authority small calibre small arms at this high quality level.

The H&K AG Group stands for technologically refined, innovative products and outstanding quality. To secure this situation, 12% (2019: 12%) of our employees work in Quality Management and 8% (2019: 9%) in Research and Development. HKO and its quality management system are certified to DIN EN ISO 9001:2015 and the NATO AQAP 2110:2016 quality standard.

The departments Finance, Information Management, Personnel, Purchasing, Risk Management and Compliance were certified to DIN EN ISO/IEC 27001:2017 in January 2021.

As a member of the defence industry located in Germany, Heckler & Koch GmbH is subject to current German weapon and export regulations for the manufacture of and trade in fire arms and components for fire arms. The export of controlled goods, such as firearms, weapons of war, their components, large proportions of the manufacturing equipment for these, as well as necessary software and technology, are governed by the approval requirements of Germany's Foreign Trade and Payments Act (AWG). The manufacture of and the trade in weapons of war are also subject to the stricter requirements of the Military Weapons Control Act (KrWaffKontrG).

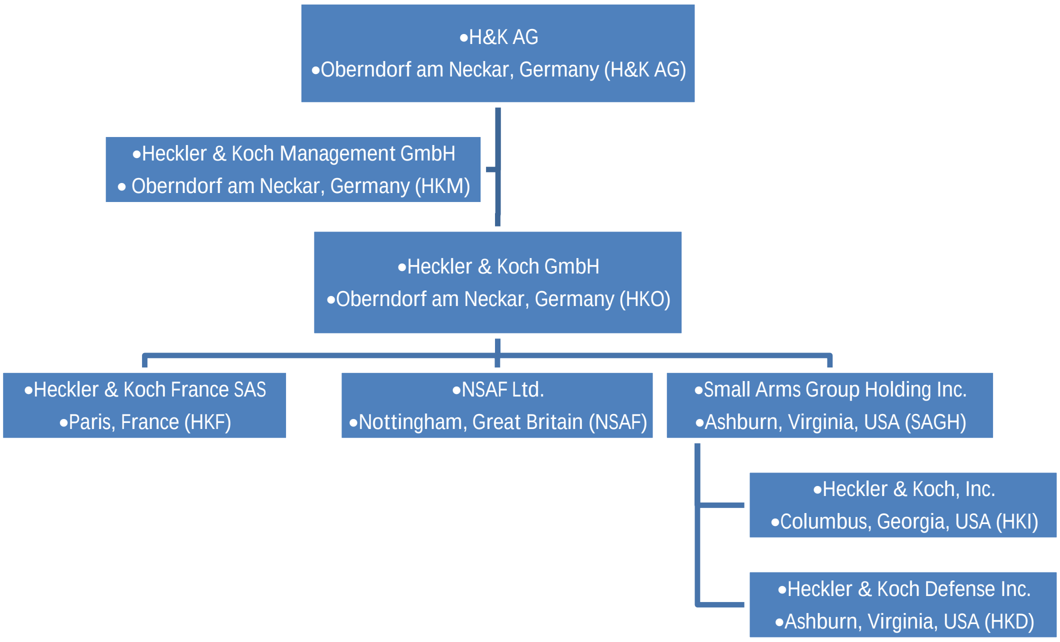
Corresponding US legal requirements such as the International Traffic in Arms Regulation (ITAR) and Export Administration Regulation (EAR) apply extraterritorially and therefore apply to the use of US technology or the trade in US goods outside the US.

Compliance with the complex regulations is of existential importance to the company. For more information on the associated organisational processes, please see Chapter 3 “Forecast and opportunities and risks report”, section “Legal risks”.

The directors have focussed HK's sales strategy on so-called "Green Countries". The “Green Country Strategy” is a self-imposed filter to the member countries of NATO, the EU and the NATO-equivalent countries (Switzerland, New Zealand, Australia, Japan). In addition, countries such as South Korea and Singapore, which are classed as partners by the German government, for which deliveries may be approved on a case-by-case basis. The “Green Country Strategy” is not only fully in line with the laws, regulations, requirements and restrictions that the German Government has issued for defence exports, but goes significantly further.

Group entities

H&K AG's consolidated financial statements comprise the following companies:



Internal planning and control system

H&K AG Group is managed based on a comprehensive internal reporting system and covers all departments and activities. A core element of this is a detailed five-year plan, which is updated each year. For the current financial year, the plan is prepared and reported at a monthly level. Current results are compared to target figures. Any variances and their causes are analysed with a view to defining and implementing any necessary mitigation measures. In addition to the financial figures, the reports include operating performance indicators used for the precision control of individual departments and processes on much shorter timescales, for example days or shifts.

Financial performance indicators

The main objectives are to meet the planned revenue and earnings targets and to manage investments and cash flows. To this end, status reports are prepared for the Group's executive board and the individual functions. This information is also used inter alia as a basis for the monthly management meetings, where current business developments, and potential budget variances and their causes are analysed, and decisions on any necessary measures are made. These performance indicators are also used by individual departments for their daily fine-tuning.

For the internal control of the H&K AG Group the key measure, in addition to revenue and operating performance (defined as revenues plus inventory movements and own work capitalised), is in particular earnings before depreciation, amortisation, financial result and taxes (EBITDA).

H&K AG Group also uses order intake and order book as performance measures. These figures are updated regularly. They provide an indication of expected production capacity utilisation and revenue trends.

As part of the Group's liquidity management, in addition to the monthly cash flow data, a detailed thirteen-week forecast is prepared weekly so that any necessary measures can be identified in good time. The analysis and control of cash flows for operating activities are a central element of liquidity management. The performance indicators used for this are operating cash flow (defined as net cash flows from operating activities according to the statement of cash flows), net working capital (defined as inventories, prepayments for inventories, trade receivables and prepayments for other current assets less trade accounts payable and contract liabilities) and unrestricted cash (cash and cash equivalents less such security deposits as are included in that position).

Non-financial performance indicators

The main non-financial performance indicator within the meaning of the accounting standards is the headcount.

In addition, the following are used to aid decision-making:

Area	Performance indicators
Operations	e.g. total plant efficiency, scrap,output quantities, down-times
Personnel	e.g. illness rate, staff turnover
Quality management	e.g. weapons shot, scrap
Purchasing	e.g. delays, supplier scrap

Further additional information about non-financial performance indicators can be found in Chapter 1 “Trend in business and overall situation”, in section “Research and development”, in Chapter 2 “Business situation” in section “Non-financial performance indicatorsNon-financial performance indicators” and in Chapter 3 “Forecast and opportunities and risks report”.

Research and development

The continuous development of its new and current products contributes significantly to the Group's strong market position. The R&D department is therefore integral to safeguarding the Group's future and correspondingly essential for corporate strategy. In 2020, €6.0 million development costs were capitalised, a capitalisation rate of 82% (2019: €5.1 million; 61%). See also information provided in “Trend in earnings, variances and significant changes” in Chapter 2 “Business situation”.

Heckler & Koch focuses its development activities on infantry weapon systems in the areas: long firearms, automatic grenade launchers and grenade launcher modules, machine guns and sidearms. The need to push for further development is evident from the competition in the market in general as well as the specific requirements of the military and law enforcement agencies, and in particular the special armed forces and special operation forces, in the EU and the US. The needs of the commercial market have to be met as well, which calls for the constant development of products specifically for this market. All in all, our aim is to offer our customers products of the greatest reliability, safety and utility. The H&K AG Group is therefore investing increasingly in research and development.

The primary factors for success in the market are the specialist knowledge and continual training and development, together with the motivation and commitment, of our employees. At the year-end, about 8% (2019: 9%) of our employees worked in Research and Development.

As an innovative group, Heckler & Koch protects key developments against copying by registering patents and industrial property rights as well as having internal procedures for the consequent protection of expertise, to contribute to maintaining a technological advantage.

2. Business situation

Macro-economic situation and business trends

According to preliminary calculations from the German Federal Statistical Office, real gross domestic product decreased by 5.0% in 2020. As a result, the overall economic performance fell significantly compared to the slight increase of 0.6% in the previous year. The corona pandemic has ended a decade of growth and pushed the German economy into a deep recession. The German defence budget for 2021 amounts to about €47 billion (previous year: about €45 billion); the expected expenditure for federal police in 2021 amounts to about €5 billion (previous year: about €4 billion).

Changes in the overall economic environment generally have a delayed effect on our business activities. In addition, the military and law enforcement part of our business hinges on public spending. Public sector customers usually have planning and implementation horizons stretching over many years and their tenders are therefore largely unaffected by short-term economic trends.

The market environment is defined by the defence policies of the Western nations and the resulting requirement for state-of-the-art weapons systems on the one hand but existing budget restrictions on the other hand. In addition, our market access is limited by weapons export regulations. Armed forces have to be highly mobile and carry the best possible equipment in order to make an effective military contribution, from humanitarian aid, stabilisation operations, monitoring missions and advice and support right up to combat missions. The increasing destabilisation of the Middle East and North Africa, the conflict in Ukraine and the terrorist attacks in Europe require security forces to refocus their equipment and training. The only way to ensure the most effective protection for a country's own soldiers during foreign deployment and peacekeeping missions is to keep investing in equipment. Because of the changed security situation, especially in Europe, we previously expected that the relevant budgets would continue to increase, or at least to remain stable. However, the effects of the corona pandemic do not currently allow a clear view of whether the German government’s planned additional increase in its defence budget will actually take place; the reduced income for the German Government due to the pandemic makes it more likely that, like all the other ministerial budgets, the defence budget will be reduced. This is also possible in other NATO and EU countries.

Access to the US market in general, and the sale of weapons in the USA in particular, subject to both greater restrictions on export licences from Germany and changing legislation in the USA and individual US states. It cannot be ruled out that the regulations for this market will be tightened in the future as well, making it more difficult to sell our products from Germany in this market, which is the largest commercial market in the world by far.

Business trend

For the H&K AG Group, 2020 was characterised by an increase in revenues compared to the previous year (14.9%); this can be explained by the numerous new projects acquired for governmental agency weapons and the increasing military and US-commercial business. The increased revenues were linked to significantly increased quantities, and therefore to higher production volumes and higher personnel expenses. These were mitigated by the positive effect of the supplementary-hours agreement from July 1, 2019 (covering July 1, 2019 to June 30, 2021, with the option of a follow-on agreement) under which weekly working hours were increased from 35 to 37.5 hours without additional remuneration. Due to the increased production volume the overall headcount, including agency workers, increased about 8% over the previous year. The purchase volumes for raw materials and bought-in parts increased correspondingly to the increased revenues.

In line with the forecast in the prior year report, the €275.0 million revenue generated in 2020 was higher than the €239.4 million generated in 2019. The increase was primarily due to the positive business development on the US commercial market together with the start of the SA80 assault rifle upgrade for the British Ministry of Defence and an overall improved product mix.

As forecast, order intake and order book were below the previous year’s figures. This is the consolidation of a very high level for our Group.

As a result of the significantly higher revenues and inventory movements, the operating performance also improved as forecast. The operating performance in 2020 was €289.4 million, €40.8 million higher than in the prior year (€248.6 million).

The EBITDA of €49.9 million (2019: €30.3 million) was significantly higher than in the prior year and exceeded the forecast too. The high investments in capacity and process optimisation, together with the cost-saving measures implemented, had a very positive effect on the result.

The result from operating activities (EBIT) also increased by €18.1 million to €39.0 million (2019: €20.9 million).

Consequently, the result before income tax was a profit of €20.2 million (2019: €5.8 million).

From the prior year figure of €86.4 million, net working capital increased by €9.1 million to €95.5 million during 2020 and was significantly higher than our forecast.

Contrary to the forecast, unrestricted cash (cash and cash equivalents less such security deposits as are included in that position) increased significantly from €23.1 million to €33.3 million at the end of 2020.

The operating cash flow (cash flows from operating activities) of €14.9 million in the previous year improved significantly by €26.6 million to €41.5 million in 2020. This was considerably higher than the forecast increase and was partly due to unusually high cash receipts shortly before the year-end.

The number of employees (excluding agency workers, but including trainees) as at the balance sheet date increased slightly, as forecast, by 84 from 958 in the prior year to 1,042 for the current year. After reducing in the US in the previous year due to restructuring, headcount rose from 74 to 83 during 2020 due to the increase in revenues.

In Oberndorf am Neckar, the number of employees for HKO (including trainees, but excluding agency workers) increased by 73 from 859 to 932 employees at the end of 2020; of this increase, the majority was in the production, development, logistics, IT and quality management departments.

During the year, the number of agency workers in the Group decreased by 1 to 36 (2019: 37).

The total headcount (including trainees and agency workers) increased by about 8% over the prior year.

Financial performance

Overview

Overall, the trends for the H&K AG Group's 2020 revenue and EBITDA exceeded expectations.

Trend in revenue and orders received

In 2020, H&K AG Group recorded revenue, net of sales deductions, of €275.0 million (2019: €239.4 million).

Group revenue (net of sales deductions) can be analysed as follows:

Regionen		Umsatz in TEUR	Anteil Umsatz in %
Germany (Domestic)	**2020**	**74,510**	**27%**
	2019	**77,264**	**32%**
USA	2020	94,818	34%
	2019	60,018	25%
UK	2020	22,127	8%
	2019	11,964	5%
France	2020	44,154	16%
	2019	46,178	19%
Other "Green Countries"	2020	39,372	14%
	2019	40,640	17%
Rest of world	2020	2	0%
	2019	3,352	1%
Total export	**2020**	**200,474**	**73%**
	2019	**162,153**	**68%**
Total	**2020**	**274,984**	**100%**
	2019	**239,417**	**100%**
of which "Green Countries"	2020	274,982	100%
	2019	236,065	99%

Domestic revenue fell slightly compared with the prior year and generated 27% of Group revenue in the period under review (2019: 32%).

The market in the USA, which is mainly served by our subsidiaries HKD and HKI, generated 34% (2019: 25%) of revenue. The increase was mainly due to higher sales to the commercial and the military markets.

The proportion of Group revenue generated in “Green Countries” increased to 100% compared to 99% in 2019.

Of the €275 million (2019: €239 million) Group revenue, 60% (2019: 65%) was to the military market, 11% (2019: 14%) to the police and governmental agencies market and 29% (2019: 21%) to the commercial market.

The H&K AG Group’s order intake in 2020 was €226 million (2019: €298 million).

The resultant order book at the end of 2020, excluding contracts with export licence risks, was €224 million (2019: €277 million). Of this order book, €186 million is scheduled for delivery in 2021 (2019: €197 million was scheduled for delivery in 2020).

Trend in earnings, variances and significant changes

The individual positions in the income statement present the following picture:

Revenue (net of sales deductions) increased by €35.6 million (+14.9%) to €275.0 million in the period under review compared to €239.4 million in the prior year.

The cost of sales includes the costs of materials, direct labour costs, overheads and depreciation incurred to achieve the revenue. Cost of sales increased from €175.8 million in the prior year to €187.4 million in the year under review (+6.6%). The higher revenues and the change in product mix, together with the unpaid increase in weekly working hours due to the supplementary-hours agreement, were contributory factors here. The ratio of cost of sales to revenue decreased to 68.2% (2019: 73.4%).

The research and development expenses comprise those personnel expenses, overheads and depreciation relating to these activities together with the costs of test materials and tools, to the extent that these costs do not meet the criteria for capitalisation under IAS 38. The normal amortisation and the retirement of capitalised development costs are also included. The gross expenses, prior to capitalisation, of €12.6 million (2019: €10.8 million) also include the retirement of previously capitalised development costs relating to projects that have been cancelled because of changed market conditions (€2.7 million; 2019: €0.1 million) and the amortisation of capitalised development costs (€2.6 million; 2019: €2.3 million). Deducting the capitalisation of €6.0 million development costs (2019: €5.1 million) results in net research and development expenses of €6.6 million (2019: €5.7 million).

Sales, marketing & distribution expenses increased by €1.7 million to €23.1 million (2019: €21.4 million); the increase is primarily due to the creation of provisions for onerous contracts, relating to options exercised from old contracts, together with higher project-related costs, offset by lower personnel expenses and other overheads.

General administration expenses increased by €2.0 million to €17.4 million (2019: €15.4 million). They include personnel expenses and overheads as well as depreciation relating to the administration function. The increase in costs is primarily due to higher personnel expenses, provisions for litigation and other administration overheads.

Other operating income decreased by €1.1 million to €1.5 million (2019: €2.6 million). This was primarily due to the cessation of fuel sales to employees from the company's fuel pumps, partially offset by an increase in insurance benefits.

Other operating expenses decreased by €1.7 million to €1.0 million (2019: €2.7 million), due in part to the cessation of expenses for fuel sales to employees from the company's fuel pumps and the release of a provision for the potential calling of guarantees.

In the reporting year the position "impairment loss on trade receivables net of reversals" relates primarily to an increase in the impairments determined in accordance with IFRS 9; in 2019 this position related primarily to an increase in the impairments determined in accordance with IFRS 9, offset by the net release of specific allowances.

The EBITDA of €49.9 million improved compared to the prior year (2019: of €30.3 million). As a result, in 2020, EBIT increased by €18.2 million to a profit of €39.0 million compared with a profit of €20.9 million in the prior year.

The net financial expense in the year under review was €18.8 million (2019: €15.1 million). In 2020 interest expenses of €13.4 million (2019: €12.8 million) were incurred, primarily relating to interest-bearing financing with a total nominal value of €242.7 million (2019: €237.2 million). These include the long-term financing loan (Senior Facilities Agreement, “SFA-loan”; nominal as at December 31: €83 million; 2019: €95 million), the €60 million bond (2019: €60 million) together with two loans from Compagnie de Développement de l’Eau S.A. (CDE) (originally €80 million, plus capitalised interest since then of €3.9 million; 2019: original nominal €80 million, plus capitalised interest since then of €2.2 million) and an unsecured €15 million loan granted and received in February 2020 from another main shareholder of H&K AG plus capitalised interest since then of €0.9 million; (2019: nil). In 2020 we recognised accretion for the bond, the SFA-loan, defined benefit and other obligations of €2.3 million (2019: €2.3 million). The net effect of foreign exchange gains and losses was a loss of €3.0 million (2019: loss of €0.1 million).

In the year under review, earnings before income tax were a profit of €20.2 million (2019: profit of €5.8 million).

Income tax expenses (including deferred taxes) amounted to €6.7 million in the year under review (2019: €4.2 million). Deferred taxes are calculated on the basis of statutory tax rates, or of tax rates which have been enacted as of the balance sheet date in each country, that are expected to be in place on realisation.

Due to the above developments, the Group recorded a consolidated result for the period of €13.5 million profit (2019: €1.6 million profit).

The trends in the different segments are illustrated by the following table (prior to consolidation):

	Germany		USA - Commercial		USA - Defence		Great Britain		France		Holding activities	
	2020	2019	**2020**	2019	**2020**	2019	**2020**	2019	**2020**	2019	**2020**	2019
Net revenues	**199.9**	179.8	**75.3**	46.0	**19.9**	14.6	**22.4**	12.7	**44.1**	46.1	**-**	-
Order Intake (*)	**180.7**	195.4	**93.8**	51.2	**1.6**	48.2	**5.3**	64.7	**25.2**	44.9	**-**	-
Order book	**187.7**	208.5	**27.3**	10.7	**30.3**	48.6	**42.4**	59.6	**24.5**	43.5	**-**	-
EBITDA	**34.8**	24.8	**5.9**	1.6	**3.3**	1.0	**2.4**	1.5	**3.7**	3.2	**(0.5)**	(0.2)
EBT	**17.0**	11.3	**4.6**	0.8	**2.9**	0.7	**2.4**	1.2	**3.7**	3.1	**64.5**	1.7
Employees (+)	**932**	859	**77**	70	**6**	4	**17**	17	**3**	3	**7**	5

** including order book adjustments*

+ including trainees; year-end positions

All figures in € millions apart from employee numbers

Financial position

Capital management policies and aims

The objective of the capital management is to secure the financing of current business activities, considering the obligations and the regular interest payments due to the SFA-loan and the bond, and in the medium-term to reduce the leverage significantly. The Group's internal policies require that return on capital is reviewed on all investments and generally all contract bid decisions. The Group aims to have a corporate and capital structure without material off-balance sheet financing. In the normal course of business, performance and advance payment guarantees are issued to our customers by banks and insurers on our behalf

Funding sources and financing expenses

As at December 31, 2020 the H&K AG Group had the following five financing loans:

- Secured, private financing agreement ("SFA-loan"), nominal €83 million
- Unsecured bond, nominal €60 million.
- Unsecured bridging loan, €30 million (excluding interest).
- Unsecured bridging loan, €50 million (excluding interest).
- Unsecured bridging loan, €15 million (excluding interest).

The funds relating to the H&K AG Group's defined benefit obligations in the amount of €63.4 million (2019: €64.5 million) are available to the company in the long term.

Secured private financing agreement (SFA-loan)

The €83 million (2019: €95 million) financing loan relates to a private, secured €150 million financing agreement from July 24, 2017, maturing on August 21, 2022, under which a total of €130 million was drawn down on August 21, 2017 (€80 million by H&K AG and €50 million by HKO) and in November 2018 €35 million was repaid by H&K AG. In 2020 H&K AG made two further repayments, €1.5 million in May and €10.5 million in October. The interest rate is 7.25% plus EURIBOR (if this is positive) and interest is payable at the end of each agreed interest period, which can be between one and six months.

Under the SFA-loan agreement, H&K AG and its subsidiaries are subject to strict limitations on certain transactions; the Group must also meet specified ratios between net debt and the contractually defined EBITDA ("Financial Covenants") and make partial repayments for example dependent upon the annual contractually defined "Excess Cashflow". The Group is permitted to partially or fully redeem the SFA-loan liability. However, the voluntary redemptions must comply with contractual conditions, including in some cases prepayment premia.

In March 2018 and December 2018, the SFA agreement was amended inter alia to permit H&K AG to draw unsecured bridging loans from CDE, to set a minimum cash resource level for the Group of €10 million and to adjust the required ratios of net debt to contractually defined EBITDA (Financial Covenant) for the quarters ending December 2017 through June 2018. In February 2020, the SFA agreement was amended inter alia to permit H&K AG to draw an unsecured bridging loan from a main shareholder during that month and to postpone the associated 70% partial repayment foreseen under the SFA agreement to October 2020, with the option of a further extension. In September, given the very positive business development and the liquidity generated thereby, the directors decided not to use the option of an extension but to make the repayment.

As security for the SFA-loan, the direct and indirect subsidiaries of H&K AG have also entered into the SFA agreement as guarantors. In addition, the shares in HKM and its direct and indirect subsidiaries together with, through floating charges and other security agreements, certain non-current assets, inventories, receivables and bank accounts (all other bank accounts serve as security deposits for bank guarantees and similar) are pledged to the trustee for the lenders.

Unsecured bond

The €60 million bond was created on December 15, 2017 by the conversion of a private note purchaser loan and matures on April 30, 2023. It has a fixed interest rate of 6.5% payable on April 30 and October 31. It is listed on the Euro MTF free market in Luxembourg.

Unsecured bridging loans

In 2018 CDE, one of H&K AG's main shareholders, agreed and paid out two unsecured bridging loans totalling €80 million with terms ending July 15, 2023; of these, in November 2018, €35 million was used for a partial repayment of the SFA-loan. The interest rate is 2%; accrued interest is added to the loan principal quarterly. These additional loans were granted as part of healing agreements relating to a financial covenant in the SFA agreement.

In February 2020, to ease compliance with certain SFA-loan conditions, H&K AG received an interest-bearing unsecured bridging loan of €15 million, with a term until July 15, 2023, from another of its main shareholders. The interest rate is 6.5%; accrued interest is added to the loan principal quarterly. As a result, the nominal value of this loan increased to €15.9 million on December 31, 2020 (nil on December 31, 2019).

Financing expenses

H&K AG Group's financing expenses are primarily interest expenses totalling €13.2 million (2019: €12.6 million) relating to the bonds, the SFA-loan, the loans from CDE and the loan granted and received in 2020 from another main shareholder; and accretion for the bonds, SFA-loan, defined benefit and other obligations amounting to €2.3 million (2019: €2.3 million).

Off-balance-sheet financing

In the period under review, as in the previous period, H&K AG Group did not make use of any significant off-balance sheet financing. Details of bank guarantees for customers are explained in the notes to the financial statements.

Capital expenditure

The H&K AG Group's capital expenditure on property, plant and equipment and intangible assets (excluding capitalised development costs) amounted to €16.8 million in 2020 (2019: €9.7 million). These were mainly for the segment Germany.

Cash and cash equivalents

Cash inflows and outflows, including effects of particular factors

On December 31, 2020, the Group's cash and cash equivalents amounted to €33.3 million (2019: €23.4 million).

Details of cash inflows and outflows are provided in the Consolidated Statement of Cash Flows. The performance indicator "operating cash flow" was positive in 2020 (€41.5 million inflow), €26.6 million above the prior year figure (€14.9 million inflow).

The main drivers for the change in operating cash flows were the higher Group profit and a lower negative effect due to changes in net working capital than in the previous year (see the Consolidated Statement of Cash Flows).

Solvency / going concern considerations

Due to the available cash and cash equivalents, and taking into account the additional financial measures described in Chapter 2 “Business situation” Section “Funding sources and financing expenses” the H&K AG Group companies were able to meet their payment obligations at all times during 2020.

The unrestricted cash as at December 31, 2020 was €33.3 million (2019: €23.1 million). The unrestricted cash (cash and cash equivalents less security deposits) at the end of 2020, together with the expected profits in 2021 and 2022, provide sufficient scope to cover operational payments that are due in 2021 and 2022 (excluding the business financing due in 2022). In addition, the maturity of the issued bond in 2023 cannot be covered from operating cashflows. The current five-year business plan includes cash inflows from operating activities for 2021 and beyond, which are expected to be sufficient to cover capital expenditure and contractual interest payments.

The continued existence of H&K AG and therefore of the H&K AG Group is dependent on the loans and the issued bond being punctually extended or replaced by other external financing or an equity increase. The extension or replacement of the financing is subject to the usual market uncertainties due to the equity situation of the Group. The directors of H&K AG are planning to replace the liabilities due in 2022 and 2023 with long-term financing in keeping with the market as soon as possible, taking into account contractual requirements and business considerations. Given the new ownership structure of H&K AG, the continuing significant improvements in profitability and the discussions that have commenced, there is currently no reason to doubt that this will be possible.

In addition, according to the current five-year plan, the directors of H&K AG are also planning, to the extent permitted by law, the conversion of shareholder loans into equity, which would significantly reduce indebtedness.

Financial position

Significant changes in financial position

Compared to December 31, 2019, the net assets at December 31, 2020 increased by €22.5 million to €274.9 million.

Non-current assets as at the balance sheet date increased to €118.1 million (2019: €111.6 million).

Current assets were €156.7 million; an increase of €15.9 million compared to the prior year. Inventories and prepayments for inventories increased by €4.7 million to €94.9 million (2019: €90.2 million). As at the balance sheet date, trade accounts receivable increased by €1.7 million year-on-year to €23.4 million (2019: €21.7 million). This balance sheet position depends on the date of delivery and order-specific payment conditions and is therefore subject to significant fluctuations. The position “Other deposits and derivatives” decreased by €0.2 million to €2.8 million (2019: €3.0 million).

Group equity at December 31, 2020 amounts to negative €108.3 million (2019: negative €120.9 million). The current H&K AG Group business plan for the next few years shows an improvement in the equity position and assumes the reduction of debt. The equity and the current and planned results of the main operating companies are positive.

Non-current liabilities increased by €5.4 million to €329.2 million (2019: €323.8 million). The bond, the SFA-loan, the loans from CDE and the loan granted and received in 2020 from another main shareholder are recognised in the balance sheet at their net amortised costs of €240.6 million (2019: €233.5 million). The associated accrued interest payables of €3.0 million (2019: €3.2 million) are recognised within other liabilities.

Current liabilities increased by €4.5 million to €54.0 million (2019: €49.5 million). This was primarily due to an increase in other provisions for personnel (employee bonuses) and tax liabilities.

The performance indicator net working capital increased from €86.4 million at the end of the previous year to €95.5 million on December 31, 2020. This was primarily due to an increase of €4.7 million in inventories and prepayments for inventories. Comparing opening and closing positions, trade receivables increased by €1.7 million while trade payables decreased by €3.4 million; contract liabilities (advanced and stage payments received) increased by €0.7 million.

Non-financial performance indicators

Ensuring the sustainability of its business model is a central strategic task at H&K AG Group. In addition to achieving our economic targets, this means being a responsible employer, a law-abiding member of society and a reliable partner for our customers and suppliers. Having a sustainable business model is essential for the Group, so as to be able to capitalise on business potential and minimise risks.

Our key activities in terms of sustainability are described in the following sub-sections.

Production and innovation

In order to improve business processes and reduce their complexity, it is important to Heckler & Koch to obtain the active involvement of our current employees and the input from new employees. The reduction of manufacturing throughput-times and the improvement of inventory turn as well as innovations and new technologies are the cornerstones of the Group's continued strategic development. Employees are always welcome to submit suggestions for process optimisation or innovative ideas for new products. To manage production, various indicators are available in the SAP system and sub-systems covering for example: inventory turn and range as well as throughput-times and machine utilisation.

Employees

At the H&K AG Group, sustainability also means taking responsibility for our employees. Qualified, highly motivated and committed employees are essential for achieving top performance and are therefore the bedrock of our economic success. Values such as honesty, legal compliance, fairness, acceptance and trust, helpfulness and regard for others, a sense of duty and reliability are understandably of utmost importance for the Group's workforce. In the light of our company's duties to society, whilst securing both facilities and jobs, our business activities across all company locations are shaped by the company's social, environmental and economic responsibilities. Besides profitability and efficiency, our corporate governance principles form the basis for our actions and commitment.

Summary statement on financial position, financial performance and cash flows at the time the management report was prepared

In 2020 revenue increased compared to the prior year. Due to mainly high-margin revenues, EBITDA increased significantly compared to the prior year. The increased net working capital affected net assets somewhat; however unrestricted cash increased even more significantly compared to the previous year.

The liability for the bond, the SFA-loan, the loans from CDE and the loan granted and received in 2020 from another main shareholder increased to nominal €243 million at the year-end (2019: €237 million) and increased the interest burden by €0.7 million compared to the prior year.

Overall, the executive directors regard business developments as positive and the business as being on a good path.

3. Forecast and opportunities and risks report

Outlook

Introduction

This report contains forward looking statements on business trends, which are based on the judgements, estimates and assumptions of the management. A number of factors, many of which are beyond Heckler & Koch's control, have an impact on its operating activities, success, business strategy and results of operations. These forward-looking statements are based on current business plans, targets, estimates and projections and take into account the state of knowledge up to the date that this report was prepared, but not beyond. If the assumptions on which the projections are based prove to be incorrect, actual results may differ from these estimates. These elements of uncertainty include changes in the political and economic environment, changes to national and international laws and regulations, swings in the market, fluctuations in foreign currency and interest rates, the impact of competing products and prices, the effect of changes in customer structures, changes in the company's business strategy and also economic effects resulting from the corona pandemic.

Economic outlook

Despite the corona pandemic situation, the World Bank is forecasting a recovery for global economic performance in 2021, however it will not recover to the extent hoped at the beginning of the pandemic. The recovery of the national economies will depend on the success of combating the pandemic and the widespread utilisation of highly effective vaccines. Recovery can vary significantly from region to region and is associated with a possible herd-immunity in the summer of 2021. The World Bank therefore forecasts 3.6% economic growth for the European region.

A further easing of monetary policy to combat the corona pandemic inevitably leads to a debt burden for countries and potentially to changes in budgets for the military and governmental agencies.

However, there are converse effects from developments in the local security situations in certain countries and also the military engagements of individual countries or the joint engagements, for example the VJTF (Very High Readiness Joint Task Forces) within the framework of the NRF (NATO Response Forces). The continuing conflicts around the world, together with the threat of terrorism, still require a large number of international military interventions and a higher level of police capabilities.

This makes it imperative to increase personnel, modernise the armed and law enforcement / governmental agency forces' equipment and to ensure continuity of responsible security policies. In addition, there is continuing pressure within NATO to meet the agreed defence investment target of 2% of GDP, for which Germany in particular needs to act. The slightly increased defence budget for 2021 should not obscure the fact that the additional strains on the public budgets due to the corona pandemic have the potential to cause a reduction in defence budgets in future years again.

So far, due to the preventative measures implemented by Heckler & Koch to protect our employees and our business, together with proactive communication with customers and suppliers, the corona pandemic has not led to significant restrictions on our delivery chain and the planned order intake and revenue numbers were exceeded.

The decision that was expected to be made in 2020 on the award for the delivery of the new assault rifle, including accessories, for the German Army, has been postponed into 2021. On March 2, 2021 the German Ministry of Defence officially announced that, following the exclusion of the last competitor from the procurement procedure due to formal errors, it is intended to award this contract to Heckler & Koch GmbH. The final decision is expected in the coming months as this competitor has taken legal steps against their exclusion.

In 2021, deliveries of MG5 machine guns to the German Army will continue and an increase and expansion of the framework contract is expected. Along with these machine gun deliveries, the delivery of spares, add-on sets and part sets for training simulators are expected.

An increase in the volume of maintenance for the G36 and P8 that are currently in service with the German Army is expected.

Heckler & Koch has expanded its partnership with the Latvian armed forces. After successful deliveries of G36 assault rifles and 40mm attachments, in 2020 additional G36 assault rifles and 40mm grenade machine guns were ordered for delivery in 2021 and 2022. The order volume is around €11.8 million.

The SFP9 pistol was successful over its competitors in the tender for the new service pistol for the Lithuanian armed forces. This is the first deployment of the SFP9 as a military pistol. The delivery took place in 2020 and a further option is expected to be exercised in 2021.

In 2019, the German Army ordered automatic grenade launchers of the type GMW 40mm from Heckler & Koch. The automatic grenade launchers are to be vehicle-mounted, in weapon-stations capable of remote-control, and are due for delivery in 2021.

In 2017, Heckler & Koch won the tender to provide the German Special Commando Forces and Naval Special Commando Forces with the HK416 A7 assault rifle. The new assault rifle was deployed by the Special Forces with the designation G95K. The HK416 A7 replaces the long-serving G36 K as the standard weapon for the German Special Forces. The HK416 A7 is a 5.56 calibre gas operated weapon. The new weapon impresses with its high precision, secure function and reliability. The contract is for a total of 1,745 HK417 A7 including accessories and should be completed in 2021.

In Hessen, Heckler & Koch won the state Ministry of the Interior's invitation to tender for the delivery of middle-distance weapons with calibre 5.56 and thereby successfully beat the models from its competitors. By the end of 2020 2,200 G38, together with accessories and training weapons, had been delivered.

Heckler & Koch received follow-on orders for the delivery of further pistols to the Lower Saxony Procurement Department (SFP9) and the federal police force (P30 and P30 CM training systems).

On September 22, 2016 Heckler & Koch was awarded a large contract by the French department of defence "Direction Générale de l'Armement (DGA)" for the delivery of the new French standard assault rifle HK416. Since 2017, members of the Army, Air Force and Navy are being equipped with the new service weapon. The contract calls for the supply of 102,000 HK416 assault rifles together with HK269 grenade launchers, accessories, ammunition, spares and support services over a period of up to fifteen years. The total volume of the contract is about €140 million. For 2021, the delivery of around 12 thousand weapons is planned.

The French Ministry of Defence began to replace their griffon and jaguar vehicles in 2019; the GMG grenade machine gun calibre 40mm was selected as weaponry for integration with the new vehicles. The majority of deliveries took place in 2020, Further deliveries are expected in 2021.

In 2019 the US Army awarded Heckler & Koch, via HKD, a contract for the delivery of M110A1 SDMR precision semi-automatic rifles calibre 7.62. In addition to the delivery of these rifles from the HK417 family, the agreement covers supply of spares, training and other services into 2022. SDMR deliveries commenced in 2020 and are expected to be completed in 2021. The exercise of an additional option for M27 assault rifles is also expected by HKD.

In 2019, the British Ministry of Defence awarded Heckler & Koch, via NSAF, a contract for the upgrade of the SA80 assault rifle. The three-year contract for the modification of the SA80 to the variant A3 includes an extension option and strengthens the relationship with the British Ministry of Defence (MoD). The first deliveries took place in 2020 and further deliveries are planned for 2021. In addition, we expect orders for additional SA80 upgrades and a framework contract for spares covering 5 years, with annual options called by the British customer.

All in all, Heckler & Koch is well positioned to continue for the foreseeable future as the main supplier for small arms, their spare parts and related services for the NATO and NATO-equivalent countries.

Expected financial performance in 2021 and forecast for non-financial performance indicators

The following forecasts are based on plans from the end of 2020 and include the effects of the corona pandemic known to us at that time.

Order intake and order book

For 2021 it is expected that order intake will be significantly higher than in 2020, while, due also to higher revenue, the order book at the year-end will be slightly lower.

Revenue, operating performance and EBITDA

For 2021, once again improvements are expected, for revenues in the low double-digit million range and for operating performance in the high single-digit million range. EBITDA is expected to be slightly lower, due in part to the end of the supplementary-hours agreement.

Operating cash flow

According to the budget for 2021, operating cash flow is expected to be lower than the high value achieved in 2020 (€41.5 million).

Net working capital

According to the budget for 2021, net working capital is expected to be slightly higher than on December 31, 2020 (€95.5 million).

Cash and cash equivalents

At the end of 2021, due to the refinancing assumptions used for the budget, cash and cash equivalents are expected to be significantly lower than at the end of 2020 (€33.3 million). However, we expect to be able to fulfil our contractual obligations throughout 2021.

Number of employees

The headcount in 2021 is expected to be slightly above the level of 2020.

Overall assertion

For 2021 the executive directors expect that, with slightly higher revenues compared to 2020, EBITDA will be slightly lower.

Opportunities

The German Government's current strategy paper to strengthen the security and defence industry (from 2020) is fundamentally an opportunity for Heckler & Koch. The previous paper from 2015 already led to Heckler & Koch moving from its previous position as the "chosen" local supplier of the German Army. This changed business view necessitated a more competitive set-up for the group. Linked to this was the requirement to leave the secure monopoly situation and to become more active with the already strong brand Heckler & Koch abroad. This did not harm the business, as demonstrated for example by the orders from Latvia, Lithuania and France.

In the 2020 strategy paper too, small arms are not classed as national and defence policy key technologies, they remain somewhere between "European" and "global". In contrast to "national key technologies", the technologies for the manufacture of small arms are not an element of the defence industry classed as being worthy of particular protection and support. At first sight this may appear to be a disadvantage, but it is not. While the export of products with "national key technologies", for example submarines, is likely to become more challenging even to NATO members for reasons of "national security", Heckler & Koch's classification brings with it the opportunity, with the support of the German government as clearly defined in the paper ("*[…] particularly promote and protect […] export promotion*") to export to the markets of EU and NATO member countries and NATO equivalent countries. In other words, the export of our products to EU and NATO member countries is, according to the German Government, significantly less critical than the export of "national key technologies". Consequently, the German Government gives our "Green Country Strategy" its blessing and even supports it. As a result, significant opportunities may open up in the next few years that should be taken by increasing activities in NATO, EU and NATO-equivalent countries.

The new strategy also offers Heckler & Koch good opportunities for the following three reasons:

1. It justifies quite clearly the societal relevance of our business for Germany. The strategy states: "*The fundamental tasks of a state include ensuring internal and external peace, and the security of its citizens. A key requirement for fulfilling this task is providing the civil security agencies, the Bundeswehr* [German Army] *and its allies with the best possible equipment*."
2. It expresses the opinion of the German Government that a business such as Heckler & Koch is needed in Germany. That is shown by the sentences: "*Industrial core capabilities and strategically relevant development capacities should be maintained and promoted at German and European sites. […] The availability of the identified key security and defence technologies must be ensured for essential reasons of national security.*" Accordingly, Heckler & Koch still counts as a business that uses key technologies, making it worthy of maintenance and promotion, but whose focus need not only be on the national market.
3. It includes the announcement by the German Government that it will "*accompany the implementation of this strategy paper with a number of dialogue forums to include the industry and representatives of our society*". An example of this is given as the "*dialogue with civil society and the industry on arms control […], led by the Federal Foreign Office*". This dialogue under the "moderation" of the German Government offers Heckler & Koch the opportunity to position itself with its "Green Country Strategy" correspondingly positively in a political and social environment that has up until now been difficult.

The H&K AG Group's market potential depends on the one hand, on the military procurement plans of customer countries. Opportunities arise from changes in the military equipment required by the armed and security forces in “Green Countries”, together with the need to replace equipment, which in some cases has not been renewed for years, with modern equipment. The changing threats and deployment scenarios also require the equipment used to have better mobility and increased performance capabilities, corresponding to the technical developments of the last years. High performance armament is central to affording security forces and soldiers the highest level of personal security and giving them the technical capability to accomplish their mission. As technological leader in the small arms market segment, this development offers the H&K AG Group the opportunity to build on its position as an industrial technological partner for highly developed armies, security forces and special forces and thereby to increase its revenue potential.

We believe that the sporting and commercial arms product segment has growth potential, particularly in the US market for pistols and long weapons. With an optimised sales and delivery structure and new products specially developed for the US market, and produced there, the sales volume should continuously increase. The market potential could not be fully achieved in the past years since, with bottlenecks, production was focussed on work for military and governmental agency customers, to whom we give priority. Various measures have been set up and implemented to enable a higher supply to American customers, despite the continuing high demand in Europe.

The executive directors and function managers have continued to follow and expand on the improvement programme, involving numerous initiatives, which was implemented at the end of 2018. These different improvement projects are anchored in a programme organisation known as “HK2022”. During the last two years, several programme items were successfully set-up and implemented, the effects of which contributed to the improved profitability of the business. This programme will be continued and additional projects added, the organisation and implementation of which are agreed with employee representatives, so that the H&K AG Group expects further sustainable improvements in our profitability and liquidity situation to result. In addition, we expect a strengthening of internal cooperation and consequently a positive effect on the company’s culture.

The overall opportunities for the H&K AG Croup are estimated as high.

Risks

External risks

Heckler & Koch's market access is restricted both geographically - to Germany, the EU, the NATO countries and NATO-equivalent countries - and because its customers are government authorities. It is paramount for the H&K AG Group to have the right technological and economic product developments to participate in the future procurement programmes of NATO countries. In addition, it is also important to grow in the US commercial market.

Changes to the export licence approval policy can complicate or prevent the export of defence technology products and related realisation of revenue potentials and therefore negatively affect the revenue situation. However, this risk is judged to be low for the sales markets to NATO countries.

The “Political principles of the German Federal Government governing the export of weapons of war and other defence goods” from June 26, 2019 cover three main aspects:

- The requirement from the coalition contract regarding the continuation of a restrictive approval practice for so-called third-countries (“Drittländer”, these are countries other than EU or NATO members or NATO-equivalent countries: Australia, Japan, New Zealand and Switzerland), in particular for the export of small arms, is implemented. This includes the requirement that the export of small arms to these countries should generally no longer be approved.
- The political support for defence cooperation at a European level, and the strengthening of the European defence industry basis is emphasised. Thereby the promotion of European defence cooperation already included in the Permanent Structured Cooperation (PESCO) and the European Defence Fund will also be taken into consideration for defence export decisions.
- The political principles from 2000 have been updated for changes since then of export control regulations at a European and an international level, such as the inclusion of the Arms Trade Treaty that came into force in 2014.

The “Political principles of the German Federal Government governing the export of weapons of war and other defence goods” largely correspond to the Green Country Strategy and so strengthen the directors’ focussed sales strategy for the Group. Our Green Country Strategy that we have chosen to implement is a clear commitment not only to our values as a business but also to the values of the Germany as expressed in the above “Political Principles”. We are a significant part of the security architecture for the Federal Republic of Germany, many European countries, NATO members and NATO-equivalent countries, as well as several countries that the German government classes as being of significant interest for German foreign and security policy. In principle, we will only serve these countries. Providing applicable valid export licences are received, the remaining contractual order book for other countries will be fulfilled, but for new tenders we are primarily seeking to serve “Green Countries”. We will only complete transactions after open, transparent and close coordination with, and the approval of, the appropriate German authorities.

It cannot be ruled out that in the USA too, the regulations for this market will be tightened, making it more difficult to sell our products in this commercial market, which is the largest in the world by far; this applies particularly to semi-automatic rifles. This is also the case for the future development of German export controls. Heckler & Koch is currently working on suitable measures to mitigate this negative scenario. However, at this time this risk is also classed as low.

As an internationally operating group, the company is exposed to risks arising from fluctuations in foreign currency exchange rates. The foreign currency risk in the company's operating activities arises primarily from USD-denominated invoices for sales in the USA. A renewed appreciation of the euro against the US dollar could have a negative effect on earnings from sales invoiced in US dollars. Heckler & Koch occasionally uses derivative financial instruments to partially hedge the expected receivables from these planned, but primarily not yet concluded, transactions from USD-denominated contracts against the exposure to changes in exchange rates. In its management of foreign currency risks, the H&K AG Group only uses generally accepted instruments to hedge existing transactions and planned sales, but never for speculative purposes. To reduce the risk of default, these hedges are contracted from a leading online broker.

Procurement risks arise from the fact that the raw materials, parts and components needed for the manufacturing process may not be sufficiently available in the required quality or quantity, or cannot be obtained in a timely manner. To ensure the security of supply and enable a prompt response to any changes, a close watch is kept on the procurement markets. In addition, procurement risks are mitigated by identifying alternative sources, monitoring supplier quality and reliability and holding suitable minimum inventory levels of raw materials. We class the procurement risks as medium.

Being part of the defence industry, the H&K AG Group is particularly in the public eye. The comprehensive regulations that affect this industry are often not known at all, or not to a full extent, while at the same time, articles about the defence industry take a prominent position in the media. As a purely defence business, with no significant products in other fields, Heckler & Koch is a particular focal point. Communication that is professional, factual and above all based on transparency is indispensable for maintaining our reputation and the value of our business, including, or even especially, with participants who are following different political objectives to those of the current German Government. Unfortunately, the risk that political players or other advocacy groups may wish to make their mark at the expense of Heckler & Koch, or the defence industry as a whole, must still be classed as high.

So far, due to the preventative measures implemented by Heckler & Koch to protect our employees and our business, together with proactive communication with customers and suppliers, the corona pandemic has not led to significant restrictions on our delivery chain and the planned order intake and revenue numbers were exceeded. However, at this point in time we cannot make predictions for 2021 particularly given the increasing numbers of virus mutations, since the measures taken by the Federal and State Governments could affect our supply-chains and production. At the moment we expect the risk for Heckler & Koch to be low.

Overall, the external risks for the H&K AG Group are considered to be at the same level as for the prior year.

Internal risks

The fulfilment of H&K AG's obligations depends on whether sufficient profits are transferred by HKO to H&K AG and thus on the continuing high operational earnings power of the companies. In our estimation, the internal risks for the H&K AG Group remain low.

Financial risks

The bond, the SFA-loan, the loans from CDE and the loan granted and received in 2020 from another main shareholder are recognised in the balance sheet at their net amortised costs of €240.6 million (2019: €233.5 million). The associated accrued interest payables of €3.0 million (2019: €3.2 million) are recognised within other liabilities. For additional details on these liabilities, please see Sections “Funding sources and financing expenses”, “Solvency / going concern considerations” in Chapter 2 “Business situation”.

According to the current five-year plan, for 2021 and future years a positive net cashflow from operating activities, sufficient to cover investment and interest payments for the current financial liabilities, is expected. In addition, according to the current five-year plan, the H&K AG directors are planning the conversion of shareholder loans into equity, to the extent permitted by law, which would reduce the indebtedness significantly.

The continued existence of H&K AG and therefore of the H&K AG Group is dependent on the loans received and issued bond being punctually extended or replaced by other external financing or equity. Due to the equity situation of the Group, the extension or replacement of the financing is subject to the usual market uncertainties. The directors of H&K AG are planning to replace the liabilities due in 2022 and 2023 with long-term financing in keeping with the market as soon as possible, taking into account contractual conditions and commercial requirements. Given the new ownership structure of H&K AG, the significant improvement in the Group’s profitability once again, and the discussions that have commenced, there is currently no indication that this will not be possible.

As reported in the notes on the financial position in the Section “Significant changes in financial position” in Chapter 2 “Business situation”, the H&K AG Group has negative equity of €108.3 million (2019: €120.9 million).

Risks arising from organisation and structure

The aim of our risk management, with its control and monitoring processes is to facilitate the timely identification of potential risks that could hinder the achievement of business targets and to implement suitable mitigating strategies and measures.

H&K AG’s risk management includes the related topics: compliance management, corporate governance, internal control system and internal audit for all companies within the H&K AG Group. The existing policy applies to all of the companies within H&K AG’s consolidated financial statements.

Due to the corona pandemic, the on-site training covering the Code of Ethics and Business Conduct (“code of conduct”) from October 2019 was replaced with online training sessions. The screening of new and existing business partners continues, initially concentrated primarily on all representatives for the military and governmental authority markets and for the commercial market. The draft of a guideline for such due diligence regarding business partners has been prepared.

The risk stocktake is still carried out twice a year at the ends of the half and full year.

We regard “Corporate Governance” as being “responsible business management”. In addition to legislators and shareholders, the stakeholders influencing corporate governance include employees, customers, suppliers, investors, non-governmental organisations or overall society through politics and the media. The precise form of our corporate governance is the responsibility of the executive board in close cooperation with its supervisory body, the supervisory board. The supervisory board is responsible for monitoring the adequacy and effectiveness of the corporate governance. This is done on the basis of information from the executive board. Management regularly reports the current developments in the Group’s material risks to the supervisory board.

Overall, the risks arising from organisation and structure for the H&K AG Group are still considered to be low.

Legal risks

These risks mainly include risks arising from product liability, competition and anti-trust laws, export law, weapons law, anti-corruption regulations, patent law, tax law and labour law. Any cases of damage and liability risks arising from ordinary activities are recognised in the balance sheet.

Heckler & Koch is engaged in the manufacture and distribution of small arms, particularly for governmental customers such as the German federal and state police and customs authorities, and domestic and foreign armed forces. The sale of small arms outside Germany takes place largely in the Member States of the European Union, NATO countries and NATO-equivalent countries. Heckler & Koch does not intend to generate new business with countries outside NATO's sphere of influence; in line with our "Green Country Strategy".

Since the export of weapons is only permitted with the approval of the German government, supply to critical countries is explicitly prohibited. In addition, when small arms are sold to foreign countries for military use, the recipient countries are required, before an export licence can be granted, to submit officially signed end-user certificates to the Federal Republic of Germany in which the recipient countries pledge not to re-export the proposed weapon supplies to other countries. In relation to the manufacture and sale of small arms, our company is subject to the constant control and regular monitoring of the following authorities: the Federal Ministry of Economics and Energy ("BMWi"), the Federal Office of Economics and Export Control ("BAFA"), the Wiesbaden Federal Office of Criminal Investigation, the Karlsruhe Regional Finance Office and the Rottweil District Administration Office. The underlying prerequisite for obtaining weapons and export approvals depends on the reliability of our company; for this reason, complying with the law is a top priority. Absolute compliance with the weapons and export regulations forms the basis of our company. We have therefore implemented strict monitoring procedures and control systems to monitor the operating, production, supply and approval processes. In particular, this includes the careful selection of staff, regular training, continuous monitoring, precise operating instructions and the use of an IT-supported control system which is integrated into our working processes. In view of this, export risks are considered to be low.

As a result of the Stuttgart Public Prosecutor's Office's preliminary investigation ("Mexico I") into former HKO employees, commenced in 2010, in which allegations of unauthorised export of rifles to Mexico between 2006 and 2009 are being probed, criminal charges have been made in the Stuttgart District Court against five former employees and the former agent in Mexico. HKO has cooperated fully with the authorities, both during the initial investigation and during the court case. The verdict by the court of first instance was that three former employees were found not guilty and two former employees were given suspended sentences of one year and five months and one year and ten months respectively. The accused also included two former directors, who were both found not guilty. Both not guilty verdicts are now legally binding. HKO was sentenced to pay over €3.7 million. HKO has appealed this verdict; the Public Prosecutor and the two accused who were sentenced have also appealed. See Note 40 "Subsequent Events" in the notes to the accounts.

In the meantime, another preliminary investigation ("Mexico II") relating to allegations of the bribery of local / foreign decision-makers has been discontinued entirely, unconditionally and without consequences by the Public Prosecutor, and without any prior indictment against the accused or HKO.

The third preliminary investigation ("Mexico III") related to an accusation of illegal transfer of technology to Mexico was closed before even entering the formal preliminary investigation stage, at the so-called pre-preliminary investigation stage and therefore without consequence and unconditionally and in particular, without any prior indictment against the accused or HKO.

Suitable provisions were created to cover risks from legal disputes and other litigation. The H&K AG Group recognises provisions for legal disputes and other litigation when the resulting liabilities are probable and their amount can be reliably measured. Because of uncertainties and the difficulty of predicting the outcome of court and governmental authority decisions, there is always the chance of costs being incurred which exceed the provisions and can have an impact on the company and its results.

The results of tax audits could lead to the additional payment of taxes. There is also the risk that changes to tax law or case law could have a negative effect on Heckler & Koch's tax expense. Overall, these risks are considered to be low.

H&K AG Group's accounting-related internal control system

Approval processes

The company has had its own internal binding regulations and guidelines for the areas of procurement, capital expenditure, product development, tenders, order intake, IT-security, data protection, accounting and travelling expenses for many years. Policies pertinent to employees are posted on the intranet.

Accounting-related IT-systems

Management controls in all areas require the timely availability of accurate information. The business information and reporting system is therefore very important. The SAP information system provides numerous reports and performance indicators which can be accessed daily by the finance department as well as all operational areas.

One of the main reporting instruments in the finance department is the extensive monthly reporting package. As part of the Group reporting system, all group companies provide detailed information on key items in their statement of financial position and income statement as well as ratios and explanations. These are requested, analysed and consolidated by the corporate finance department, which then reports them to Heckler & Koch's management.

Accounting organisation and policies

All group companies must comply with the applicable issue of the Group's accounting manual; this ensures the consistent recognition and valuation of all business transactions across the Group. Apart from the management, who are responsible for business operations in the particular market, the head of finance is responsible for the compliance with the legal and internally agreed accounting standards. The regular monitoring of key indicators, monthly reporting of subsidiary companies' financial results to the corporate finance department and the preparation of the five-year plan for each market are also part of the head of finance's remit.

Within the Group, besides supporting all group companies, HKO's corporate finance department is also responsible for developing and updating policies and job instructions for accounting-related processes. This mainly relates to the accounting manual and intercompany reconciliation instructions. Specific accounting or measurement questions of importance to the H&K AG Group are also centrally processed, analysed, documented and communicated.

Overall assertion

The aim of the internal control and risk management system in relation to the accounting process and preparation of the H&K AG Group financial statements, as highlighted above, is the proper recording, processing and valuation of transactions. The clear definition of responsibilities in the H&K AG Group's finance function and the appropriate training and further education of its staff, together with the use of suitable software and the issue of uniform accounting policies, form the basis for a sound, efficient and consistent accounting process.

Overall, it should serve to ensure that the assets and liabilities in the financial statements are completely and accurately recognised, measured and presented and thus to provide a fair and true view of the company's financial position, financial performance and cash flows.

Overall statement on the opportunities and risk situation

As in the previous periods, and as described in detail above, the Group's main risks arise from the volatility of revenue potentials and completely regulated market access opportunities, together with the interest payable and refinancing obligations due to the company's high leverage, combined with the limited cash reserves.

Through the HK2022 project that is underway, amongst other things, the value-adding functions production, logistics and quality, will be optimised in order to further reduce delivery bottlenecks and enable the delivery of the high order book on time and the achievement of the sales potentials.

With its highly innovative product portfolio, the H&K AG Group is well prepared for the future. In our current five-year plan, we anticipate an increase in operational performance, an improvement in the equity position and a reduction in leverage. For 2021 we expect a positive result for the year, slightly below the good level of 2020.

As a technological leader in the provision of small arms, the Group sees opportunities to expand its market position arising through the changing requirements for the deployment of military, law enforcement and special forces, due to its high-performance products, and in the US commercial market, with new product developments.

Oberndorf am Neckar, March 31, 2021

H&K AG

The Executive Board

Dr Jens Bodo Koch		Dr Björn Krönert

Consolidated Statement of Financial Position

(€ thousands)	§	31.12.2020	31.12.2019
Property, plant & equipment	17	57,665	50,176
Intangible assets - goodwill	16	5,149	5,149
Intangible assets - other	16	38,698	38,197
Other investments	18	1,620	1,806
Deferred tax assets	15	15,009	16,234
Total non-current assets		**118,141**	**111,562**
Inventories	19	94,489	90,185
Prepayments for inventories	20	451	32
Prepayments for other current assets	20	333	378
Other deposits & derivatives	18,29	2,774	2,996
Current tax assets		124	184
Trade receivables	20	23,444	21,709
Other receivables	20	1,774	1,956
Cash & cash equivalents	17	33,343	23,380
Total current assets		**156,731**	**140,821**
Total assets		**274,873**	**252,383**
Equity			
Share capital		27,641	27,641
Additional paid in capital		53,025	53,025
Other reserves		(20,412)	(19,529)
Consolidated retained earnings		(168,524)	(182,005)
Total equity	**22**	**(108,269)**	**(120,868)**
Liabilities			
Loans & borrowings	25	240,552	233,485
Lease liabilities	25	1,243	1,556
Employee defined benefit obligations	23	63,421	64,512
Provisions	24	2,990	2,958
Deferred tax liabilities	15	20,956	21,250
Total non-current liabilities		**329,162**	**323,761**
Trade payables	26	18,217	21,633
Other payables	26	11,614	10,901
Contract liabilities	27	5,001	4,275
Tax liabilities		3,265	982
Other provisions & accruals	24	15,883	11,698
Total current liabilities		**53,980**	**49,489**
Total liabilities		**383,142**	**373,250**
Total equity & liabilities		**274,873**	**252,383**

Consolidated Income Statement
For the period January 1 to December 31

(€ thousands)	2020	2019
Revenue	274,984	239,417
Cost of sales	(187,438)	(175,829)
Gross profit	**87,547**	**63,588**
Research & development expenses	(6,554)	(5,709)
Sales, marketing & distribution expenses	(23,108)	(21,424)
Administration expenses	(17,371)	(15,401)
Other operating income	1,450	2,588
Other operating expenses	(1,000)	(2,687)
Impairment loss on trade receivables, net of reversals	(1,970)	(45)
Results from operating activities	**38,995**	**20,910**
Interest income	14	52
Gains on valuation of derivative financial instruments	-	73
Gains on translation of foreign currencies	1,377	1,028
Total financial income	**1,391**	**1,153**
Interest expense	(13,397)	(12,750)
Accretion of non-current liabilities	(2,294)	(2,287)
Losses on val'n of other derivative financial instruments	(73)	-
Losses on translation of foreign currencies	(4,381)	(1,157)
Other financial expense	(70)	(86)
Total financial expense	**(20,216)**	**(16,281)**
Net financial result	**(18,825)**	**(15,128)**
Profit / (loss) before income tax	**20,170**	**5,782**
Income tax expense	(6,688)	(4,178)
Profit / (loss) for the period	**13,482**	**1,604**
Attributable to the shareholders of H&K AG	**13,482**	**1,604**
Earnings per share (€)	**0.49**	**0.06**

Consolidated Statement of Profit or Loss and Other Comprehensive Income
For the period January 1 to December 31

(€ thousands)	**2020**	**2019**
Profit / (loss) for the period	**13,482**	**1,604**
Other comprehensive income		
DBO actuarial gains / (losses)	(1,178)	(4,937)
Related deferred tax	331	1,386
Items that will never be reclassified to profit or loss	**(847)**	**(3,551)**
Forex translation differences for foreign operations	(36)	3
Items that are or may be reclassified to profit or loss	**(36)**	**3**
Other comprehensive income / (expense), net of tax	**(884)**	**(3,548)**
Total comprehensive income for the period	**12,598**	**(1,944)**
Attributable to the shareholders of H&K AG	**12,598**	**(1,944)**

Consolidated Statement of Changes in Equity For the period January 1 to December 31, 2020

(€ thousands)	Share Capital	Additional Paid in Capital	Translation Reserve	Reserve for Defined Benefit Obligations	Consolidated Retained Earnings	Shareholders' Equity
As of 01.01.2019	**27,641**	**53,025**	**(510)**	**(15,470)**	**(183,386)**	**(118,699)**
Effects of IFRS 16 implementation	-	-	-	-	(224)	(224)
Total recognised income & expense	-	-	3	(3,551)	1,604	(1,944)
As of 31.12.2019	**27,641**	**53,025**	**(507)**	**(19,021)**	**(182,005)**	**(120,868)**
Total recognised income & expense	-	-	(36)	(847)	13,482	12,598
As of 31.12.2020	**27,641**	**53,025**	**(543)**	**(19,869)**	**(168,524)**	**(108,269)**

Consolidated Statement of Cash Flows
For the period January 1 to December 31

(€ thousands)	2020	2019
Cash flows from operating activities		
Profit / (loss) for the period	13,482	1,604
Adjustments for:		
Depreciation	7,682	6,527
Amortisation of intangible assets	3,272	2,905
(Reversal of) impairment losses on intangible assets	2,693	69
Net interest expense	15,748	15,072
Change in fair value of derivatives	73	(73)
(Gain) / loss on disposal of property, plant & equipment	163	29
Income tax expense	6,688	4,178
	49,801	30,311
Change in inventories	(5,612)	(2,255)
Change in trade & other receivables	(2,348)	8,677
Change in prepayments	(395)	1,120
Change in trade & other payables	2,306	(14,742)
Change in provisions & employees' defined benefits	1,174	(5,529)
	44,926	17,582
Income tax paid	(3,400)	(2,681)
Net cash from / (used in) operating activities	**41,527**	**14,901**
Cash flows from investing activities		
Interest received	14	52
Proceeds from sale of property, plant & equipment	31	24
Acq'n of property, plant, equipment and intangibles	(16,827)	(9,737)
Movement in deposits with terms >3 months	335	13,193
Capitalised development expenditure	(6,007)	(5,138)
Net cash from / (used in) investing activities	**(22,455)**	**(1,607)**
Cash flows from financing activities		
Proceeds from loans	15,000	-
Repayment of loans	(11,970)	-
Interest paid	(11,163)	(11,903)
Repayment of lease liabilities	(432)	(413)
Net cash from / (used in) financing activities	**(8,565)**	**(12,316)**
Net cashflows	**10,507**	**978**
Cash & cash equivalents at 1st January	23,380	22,278
Effect of exchange rate fluctuations on cash held	(544)	123
Cash & cash equivalents at December 31	**33,343**	**23,380**

Notes to the consolidated financial statements for the year 2020

Contents

General disclosures

(1) Presentation of the consolidated financial statements

H&K AG, the parent company of the Group, is registered under HRB 748522 at the Stuttgart district court. The company's registered office is in Oberndorf am Neckar, Germany, and the postal address is H&K AG, Heckler & Koch-Str. 1, 78727 Oberndorf am Neckar, Germany. The articles of incorporation are from March 18, 2014 with an addendum from March 21, 2014 and last changed by a resolution on September 21, 2018; the registered name of the company is H&K AG. Since July 28, 2015 H&K AG's shares have been listed under ISIN DE000A11Q133 on the Euronext free market ("Marché Libre") in Paris; 99.97% of our shares are held by a few main shareholders. Due to the very low free float, the average share price shown on the Euronext during 2020 is significantly higher than our calculated share value. The financial year is the calendar year.

The purpose of H&K AG is to invest in any way in other domestic and foreign companies, to acquire other domestic and foreign companies, to hold, manage and sell its own companies and investments in companies, to determine the strategy of the company and the Group, and to manage and acquire land, buildings, leasehold rights and other assets for the above objectives.

The H&K AG Group is defined on the one hand by defence and governmental authority business activities and on the other hand by commercial business activities of Heckler & Koch GmbH (HKO) and its subsidiaries in the US, England and France. HKO develops, manufactures, markets and distributes, together with its subsidiaries, infantry and sidearms primarily for governmental security forces and is one of the leading businesses in this market segment in NATO and Europe; the companies also provide related services. For both sets of business activities, we are concentrating more on the development and introduction of new products. The directors have focussed HK's sales strategy on so-called "Green Countries". The "Green Country Strategy" is a self-imposed filter to the member countries of NATO, the EU and the NATO-equivalent countries (Switzerland, New Zealand, Australia, Japan). In addition, countries such as South Korea and Singapore, which are classed as partners by the German government, deliveries to which can be approved on a case-by-case basis. The "Green Country Strategy" is not only fully in line with the laws, regulations, requirements and restrictions that the German Government has issued for defence exports, but goes significantly further.

The consolidated financial statements have been prepared in euro. Unless otherwise stated, all financial information presented in euro has been shown to the nearest thousand (€k, EUR '000). As a result, the totals in this report may vary slightly from the exact arithmetic aggregation of the figures that precede them.

For the income statement, expenses have been classified by function. In order to enhance the clarity of presentation, various items in the balance sheet and in the income statement have been aggregated.

(2) Executive board approval

The board of directors of H&K AG finalised & approved the consolidated financial statements on March 31, 2021.

(3) Statement of compliance with applicable law and IFRS

The consolidated financial statements of H&K AG (H&K AG Group / Group) as at December 31, 2020, have been prepared in accordance with the International Financial Reporting Standards (IFRS) of the International Accounting Standards Board (IASB) as applicable in the EU, together with interpretations of the International Financial Reporting Interpretation Committee (IFRIC) and the supplementary German commercial law regulations pursuant to § 315e (1) in conjunction with (3) HGB. All IFRS's and IFRIC's which were effective for the financial year 2020 have been applied. The financial statements were prepared on a going concern basis. The continued existence of H&K AG and therefore of the H&K AG Group is dependent on the loans received and issued bond being punctually extended or replaced by other external loans or equity. Due to the equity situation of the Group, the extension or replacement of the financing is, as for other companies, subject to the usual market uncertainties. The directors of H&K AG are planning to replace the financing due in 2022 and 2023 with long-term financing in keeping with the market as soon as possible, taking into account contractual conditions and commercial requirements. Given the new ownership structure of H&K AG, the significant improvement in the Group's profitability once again, and the discussions that have commenced, there is currently no indication that this will not be possible. According to the current five-year business plan, the H&K AG directors are also planning the conversion of shareholder loans into equity, to the extent permitted by law, which would reduce the indebtedness significantly. See also the comments in “Liquidity risk and going concern considerations” in Note 28 and in “Solvency and going concern considerations”. Except for the changes below, the Group has consistently applied the policies described in Note 5 to all periods presented in these consolidated statements.

New requirements currently mandatory in the EU

Changes due to the following IFRS that were mandatory in the EU for the first time in 2020 are not material for the Group and are therefore not detailed here:

- Amendments to IFRS 9, IAS 39 and IFRS 7 - Interest rate benchmark reform (phase 1)
- Amendments to IFRS 16 - Covid-19-related rent concessions
- Amendments to references to conceptual framework in IFRS standards
- Amendments to IFRS 3 - Definition of a business
- Amendments to IAS 1 and IAS 8 - Definition of “material”

New standards not yet adopted

The following new or amended standards and interpretations have been issued by the IASB but are not mandatory until future periods and have not been applied in preparing these consolidated financial statements. The Group does not plan to adopt these standards early and at present does not expect material effects to result from these.

Endorsed by the EU

- Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 - Interest rate benchmark reform (phase 2)
  The amendments are effective for accounting periods beginning on or after January 1, 2021
- Amendments to IFRS 4 – extension of the temporary exemption from applying IFRS 9 in IFRS 4
  The amendments are effective for accounting periods beginning on or after January 1, 2021

EU endorsement pending

- Amendments to IAS 16 - Proceeds before intended use.
  The amendments are effective for accounting periods beginning on or after January 1, 2022; an earlier adoption would be permissible.
- Amendments to IAS 37 - Onerous contracts – costs of fulfilling a contract.
  The amendments are effective for accounting periods beginning on or after January 1, 2022; an earlier adoption would be permissible.
- Annual improvements 2018-2020 (IFRS 1, IFRS 9, IFRS 16, IAS 41,).
  The amendments are effective for accounting periods beginning on or after January 1, 2022; an earlier adoption would be permissible.
- Amendments to IAS 1 - Presentation of financial statements: classification of liabilities as current or non-current (published January 23, 2020)
  The amendments are effective for accounting periods beginning on or after January 1, 2022; an earlier adoption would be permissible.
- Amendments to IAS 1 - Presentation of financial statements: disclosure of accounting policies (published February 12, 2021)
  The amendments are effective for accounting periods beginning on or after January 1, 2023; an earlier adoption would be permissible.
- Amendments to IAS 8 – Definition of accounting estimates (published February 12, 2021)
  The amendments are effective for accounting periods beginning on or after January 1, 2023; an earlier adoption would be permissible.
- IFRS 17 Insurance contracts (published May 18, 2017)
  The amendments are effective for accounting periods beginning on or after January 1, 2023.
- Amendments to IAS 10 and IAS 28 - Sale or contribution of assets between an investor and its associate or joint venture
  The effective date has been postponed indefinitely.

(4) Group entities

Apart from the single entity statements of H&K AG, the consolidated financial statements of H&K AG as at December 31, 2020, include the annual financial statements of seven (2019: seven) foreign and domestic subsidiaries. Subsidiaries are companies, which the parent enterprise can control due to voting rights or for other reasons and for which it is exposed to positive and negative variable returns and has the ability to affect such returns through its control position.

Since July 2020, the majority of shares are held by Compagnie de Développement de l’Eau S.A., Luxembourg, Luxembourg (directly) and Sofi Kapital Ltd., Christ Church, Barbados (indirectly).

The following table shows a list of the subsidiaries included in the consolidation, together with their total equity and profit for the year figures from their financial statements, as prepared for consolidation purposes under IFRS, in their functional currencies:

	Abbreviation	Functional Currency	2020 % held	2020 Equity	2020 Profit	2019 % held	2019 Equity	2019 Profit
Direct holdings								
Heckler & Koch Management GmbH	HKM	EUR '000	100%	351,299	66,378	100%	351,299	9,750
Heckler & Koch GmbH	HKO	EUR '000	5.1%	121,299	17,264	5.1%	120,881	11,041
Indirect holdings								
Heckler & Koch GmbH	HKO	EUR '000	94.9%	121,299	17,264	94.9%	120,881	11,041
NSAF Limited, Nottingham, England	NSAF	GBP '000	100%	3,673	1,698	100%	2,855	897
Heckler & Koch France S.A.S., Paris, France	HKF	EUR '000	100%	2,605	2,645	100%	1,961	2,221
Small Arms Group Holding Inc., Ashburn, VA, USA	SAGH	USD '000	100%	17,019	-	100%	17,019	-
Heckler & Koch Defense Inc., Ashburn, VA, USA	HKD	USD '000	100%	(15,899)	2,682	100%	(18,581)	588
Heckler & Koch, Inc., Columbus GA, USA	HKI	USD '000	100%	15,203	4,078	100%	11,125	785

HKO and HKM, each located in Oberndorf am Neckar, have availed themselves of the German commercial law option §264 Abs. 3 HGB to not publish single entity accounts. This exemption clause was also applied by HKO regarding the preparation of a management report.

(5) Summary of significant accounting policies and basis of measurement

The consolidated financial statements have been prepared on a historical cost basis; where IFRS requires recognition at fair value, this has been applied.

The significant accounting policies and measurement methods applied in preparing the consolidated financial statements are described below:

Business combinations and consolidation methods

The Group accounts for business combinations using the acquisition method according to IFRS 3, with inclusion when control, as defined by IFRS 10, is transferred to the Group and derecognition when control is lost. On acquisition, the assets and liabilities acquired are generally measured at their fair value. To the extent that the fair value of the consideration transferred exceeds the net fair value of the identified assets and debts acquired, the difference is capitalised as goodwill and allocated to the cash-generating-units (CGUs) / groups of CGUs acquired, and to any other CGUs for which synergies are expected due to the business combination. If the acquisition costs are lower, the fair value of the assets and liabilities acquired and of the consideration transferred are reassessed. Any remaining negative goodwill (lucky buy) is recorded immediately in the income statement. Transaction costs are expensed.

In subsequent periods, the associated fair value adjustments to assets and liabilities are maintained, written off or released in accordance with the corresponding assets and liabilities. Capitalised goodwill is not amortised but, as described below, is subject to impairment testing at least annually as at the balance sheet date and during the year if there are indications that an impairment may have occurred.

The financial year of all companies included corresponds to the financial year of the parent company.

The assets and liabilities of the domestic and foreign companies included in the consolidated financial statements are recognised and measured using the accounting and measurement methods that apply uniformly for the H&K AG Group.

All receivables, liabilities, sales revenues, other income and expenses, including interest and dividends, within the scope of consolidation are eliminated. Unrealised profits from intra-group supplies are eliminated from inventories or fixed assets as appropriate.

Currency translation

The H&K AG Group reporting currency is the euro (€).

Foreign currency transactions are translated in the individual financial statements of H&K AG and its consolidated companies at the rates pertaining at the time of the transactions. As at the balance sheet date, assets and liabilities in foreign currency are measured at the spot rate on the balance sheet date. Differences arising on translation are recorded in the income statement.

The financial statements of the foreign companies are translated from their functional currencies into euro. Since subsidiaries operate their business independently, their functional currency is their individual local currency. In the consolidated financial statements, income and expenses from the financial statements of subsidiaries that are prepared in foreign currency are translated at the average rate for the year calculated from the daily rates. This method is used for simplicity since usually the local currency income and expenditure involved are fairly evenly spread throughout the year and consequently any potential variances are not material. Assets and liabilities are translated at the spot rate on the balance sheet date. Foreign currency translation variances are taken directly to the foreign currency translation reserve in equity. In the event of the disposal of a consolidated entity, associated accumulated foreign currency translation variances are recorded as part of the profit or loss on disposal.

The rates used for currency translation are shown in the table below:

Currency	Abbr.	Rate on balance sheet date 31.12.2020	Rate on balance sheet date 31.12.2019	Average exchange rate 2020	Average exchange rate 2019
US Dollar (USA)	USD	1.2271	1.1234	1.1422	1.1194
Pound (Great Britain)	GBP	0.8990	0.8508	0.8897	0.8775

Significant accounting policies

Goodwill

Goodwill is a separate asset representing the future economic benefits that cannot be individually identified and separately recognised from the net assets obtained through a business combination. Goodwill is allocated to the cash-generating-units (CGUs) / groups of CGUs acquired and to any other CGUs for which synergies are expected due to the business combination. Accordingly, the goodwill recognised by the Group is allocated to CGUs which correspond to the legal entities HKO (segment "Site location: Germany") and HKF (segment "Site location: France"):

EUR '000	31.12.2020	31.12.2019
Site location: Germany	4,016	4,016
Site location: France	1,133	1,133
Total	**5,149**	**5,149**

Goodwill is capitalised and, in accordance with IFRS 3, not amortised but instead, in line with IAS 36, subjected to impairment testing at least annually, as of the balance sheet date, and during the year if there is an indication that an impairment may have occurred. Additional information on this impairment testing for the reporting period is provided in note 16. If the carrying value is no longer recoverable, an impairment is recognised. Otherwise the prior year carrying value is retained. Any impairment recognised against goodwill is not reversed, even if the valuation exceeds the carrying value.

Goodwill from business combinations is capitalised; negative goodwill from an acquisition prior to the IFRS transition on January 1, 2006 has been offset against reserves. On divestment of a consolidated company any goodwill relating to it, other than negative goodwill, is included in the computation of the deconsolidation result.

Intangible assets

Purchased intangible assets, mainly trademarks, patents, licences and software, are capitalised at acquisition cost. Internally generated intangible assets, with the exception of goodwill, are capitalised if it is sufficiently probable that a future economic benefit will flow from the use of the asset and the costs of the asset can be determined reliably. The manufacturing costs of internally generated intangible assets are determined on the basis of directly attributable individual costs as well as a proportion of directly allocated overheads. Financing costs are only capitalised to the extent that they are directly attributable to the acquisition or production of a qualifying asset.

With the exception of goodwill and the trademark "Heckler & Koch", all intangible assets have finite useful lives and are amortised using the straight-line method over this period. The €8,393k (2019: €8,393k) trademark is allocated to the cash-generating unit HKO (segment "Site Location: Germany") and at least annually, as of the balance sheet date, but also during the year, if there is an indication that an impairment may have occurred, is subject to impairment testing in line with that described for goodwill. Additional information on this impairment testing for the reporting period is provided in note 16. Licences and software usually have useful lives of 1 - 10 years; capitalised development costs usually have useful lives of 8 years from the date that sales of the developed product commence. If the expected useful life for an individual asset is materially longer or shorter than these standard periods, the expected useful life is used. If there is an indication that an impairment may have occurred, the assets are subject to impairment testing.

Property, plant and equipment

Tangible assets which will be used in the business for more than one year are capitalised and valued at acquisition or manufacturing costs less depreciation calculated using the straight-line, use-related method, together with impairment if appropriate. The manufacturing costs of internally generated tangible assets are determined on the basis of directly attributable individual costs as well as a proportion of directly allocated overheads. Financing costs are not currently capitalised, since financing costs are only capitalised to the extent that they are directly attributable to the acquisition, construction or production of a qualifying asset, and this is not the case at present. The permitted alternative method of revaluation is not applied.

The following useful lives are applied for scheduled depreciation on owned assets throughout the Group:

Category of tangible asset	years
Buildings	25 - 40
Plant and machinery	3 - 10
Tooling	3
Vehicles	3 - 9
Fixtures, fittings and office equipment	3 - 15

The useful lives for right-of-use assets recognised in accordance with IFRS 16 are detailed in Note 5 section “Leases”.

The useful lives and methods of depreciation are reviewed regularly, and in individual cases, in order to ensure that these are in line with the actual expected economic use.

Impairment of tangible assets, intangible assets and right-of-use assets

If there are triggering events for impairment, material tangible assets, intangible assets and right-of-use assets are submitted to an impairment test in accordance with IAS 36. If the carrying value of an asset exceeds its recoverable amount, an impairment loss is recognised. The recoverable amount is the higher of (i) fair value less costs to sell and (ii) value in use. If the recoverable amount for an individual asset cannot be determined, an estimate is made of the recoverable amount at the level of next higher cash generating unit.

If, in the following periods the recoverable amount exceeds the carrying value, reversal of impairment is only made for the lower of the amount necessary to (i) bring the carrying value of the asset to its recoverable amount or (ii) to restore the asset to its pre-impairment carrying amount less subsequent depreciation or amortisation that would have been recognised.

The impairment and any reversal of impairment are recorded in the income statement.

Financial instruments

i. Recognition and initial measurement

Trade receivables and debt securities issued etc. are initially recognised when they are originated. All other financial assets and financial liabilities are initially recognised when the Group becomes a party to the contractual provisions of the instrument. A financial asset or financial liability is initially measured at fair value plus, for an item not at FVTPL, transaction costs that are directly attributable to its acquisition or issue.

ii. Classification and subsequent measurement

On initial recognition, a financial asset is classified as being measured at: amortised cost; FVOCI – debt investment; FVOCI – equity investment; or FVTPL.

Financial assets are not reclassified subsequent to their initial recognition unless the Group changes its business model for managing financial assets, in which case all affected financial assets are reclassified on the first day of the first reporting period following the change in the business model.

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

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

For 2020 the financial assets are primarily cash and cash equivalents, trade receivables, other receivables and deposit accounts. The financial liabilities include trade payables, liabilities to lenders, bondholders and lessors. Trade receivables and payables result from the delivery / receipt of goods and or services to / from third parties in the normal course of business.

As a result, in line with IFRS 9 - with the exception of the derivatives (during the year) - all of the financial instruments held by the Group during 2020 were classified and measured “at amortised cost”. The derivatives held during the year were classified and measured at “fair value through profit or loss”.

Financial assets at amortised cost

These assets are subsequently measured at amortised cost using the effective interest method. At present the Group does not recognise any such interest income since the assets do not have any related transaction costs to be recognised over the terms of the assets using this method. The amortised cost is reduced by impairment losses. Interest income, foreign exchange gains and losses and impairment are recognised in profit or loss. Any gain or loss on derecognition is recognised in profit or loss.

Financial liabilities

Financial liabilities are in particular trade payables, liabilities to lenders, bondholders or credit institutes, and other financial liabilities, including lease liabilities recognised according to IFRS 16.

All of the Group’s financial liabilities in the reporting period are subsequently measured at amortised cost using the effective interest method in accordance with IFRS 9 or, in the case of lease liabilities, at amortised cost using the effective interest method in accordance with IFRS 16. Interest expense and foreign exchange gains and losses are recognised in profit or loss. Any gain or loss on derecognition is also recognised in profit or loss.

iii. Impairment of financial assets

The Group recognises loss allowances for expected credit losses (ECLs) on financial assets measured at amortised cost.

IFRS 9 sets out three stages in the development of the credit risk of a financial instrument:

- Providing there has been no significant increase in credit risk since initial recognition, expected losses are to be measured as the current value of 12-month ECL. Interest income is calculated using the effective interest method, based on the gross book value (Stage I).
- If credit risk has increased significantly, but there is no evidence of an impairment, the allowance is to be increased to cover expected losses for the remaining term of the instrument. The method for recognition of interest remains unchanged (Stage II).
- If there is evidence of impairment, from this time onwards, interest income must only be accrued on the basis of the net book value (gross book value less allowances) of the instrument (Stage III).

When determining whether the credit risk of a financial asset has increased significantly since initial recognition and when estimating ECLs, the Group considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information and analysis, based on the Group's historical experience and informed credit assessment and including forward-looking information.

Lifetime ECLs are the ECLs that result from all possible default events over the expected life of a financial instrument.

12-month ECLs are the portion of ECLs that result from default events that are possible within the 12 months after the reporting date (or a shorter period if the expected life of the instrument is less than 12 months).

Impairment allowances for trade receivables are always measured as lifetime ECLs.

The maximum period considered when estimating ECLs is the maximum contractual period over which the Group is exposed to credit risk.

If there is evidence of a reduction in creditworthiness, for example due to the insolvency of a customer, a transfer from level II to level III is recognised.

The gross carrying amount of a financial asset is written down when the Group has no reasonable expectations of recovering a financial asset in its entirety or a portion thereof. For commercial market customers, based on historical experience of recoveries of similar assets, the Group has a policy of writing down the gross carrying amount when the financial asset is 90 days past due. For governmental agency customers, the Group individually makes an assessment with respect to the timing and value of write-downs based on whether there is a reasonable expectation of recovery. The Group expects no significant recovery from the amount written down. However, financial assets that are written down could still be subject to enforcement activities.

Impairment allowances against financial assets that are held at amortised cost are deducted from the gross carrying amounts of these assets.

iv. Derecognition

Financial assets

The Group derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards of ownership of the financial asset are transferred. A derecognition also occurs if the Group neither transfers nor retains substantially all of the risks and rewards of ownership and it does not retain control of the financial asset. The Group also derecognises a financial asset when its terms are modified and the cash flows of the modified asset are substantially different, in which case a new financial asset based on the modified terms is recognised at fair value.

Financial liabilities

The Group derecognises a financial liability when its contractual obligations are discharged or cancelled, or expire. The Group also derecognises a financial liability when its terms are modified and the cash flows of the modified liability are substantially different, in which case a new financial liability based on the modified terms is recognised at fair value.

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

v. Offsetting

Financial assets and financial liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Group currently has a legally enforceable right to set off the amounts and it intends either to settle them on a net basis or to realise the asset and settle the liability simultaneously.

vi. Derivatives

H&K AG Group policy is, dependent upon the exchange rates on offer and the conditions of potential forward cover contracts and taking expected USD developments into consideration, to cover a proportion of the expected USD ($) income and the associated foreign exchange transaction exposure with forward cover transactions. These derivatives are initially recognised at fair value; subsequently they are also valued at fair value, with changes in their fair value being recognised through profit or loss since these derivatives are not designated as hedges. The treatment of designated hedges will not be covered here since during 2019 and 2020 the Group did not have any.

Inventories

The inventories are recognised at acquisition or manufacturing costs or, if lower, their net realisable value. Raw materials, supplies and consumables as well as merchandise are measured at their adjusted average acquisition costs. The manufacturing costs of work in progress and finished goods are determined on the basis of directly attributable individual costs as well as a proportion of production-related overheads. The manufacturing costs do not include selling expenses, general and administrative expenses or financing costs. The net realisable value is the estimated selling price less the estimated cost of completion and the estimated costs necessary to make the sale. Provisions are made to recognise impairment of slow-moving inventories or to take account of reduced selling prices;

above and beyond this, an inventory range analysis is also carried out to ensure that impaired inventories are valued at net realisable value.

Non-current assets held for sale

Non-current assets (or disposal groups comprising assets and liabilities) that are expected to be recovered primarily through sale rather than through continuing use are classified as held for sale. These assets are held at the lower of their carrying values and their fair value less costs to sell. These assets are not depreciated. If any such assets or liabilities are held, they are shown separately in the statement of financial position.

Provisions for pensions and similar defined benefit obligations

The provisions for defined benefit obligations are computed using the projected unit credit method in accordance with IAS 19. Under this method, in addition to the pensions and vested rights known at the balance sheet date, expected future increases in pensions and salaries, with estimates of the demographic variances are also taken into consideration. The actuarial valuation is carried out by an actuary.

Actuarial gains and losses are recognised outside profit or loss, in the period in which they occur, in accordance with IAS 19. These are shown in the statement of comprehensive income.

In determining the discount interest rates in accordance with IAS 19, the actuaries refer to market yields on high quality corporate bonds at the balance sheet date.

Other non-current and current provisions

Other general liability provisions are recognised when a past event gives rise to a present obligation, it is probable that the obligation will be claimed and a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the expenditure required to settle the present obligation at the balance sheet date, or, if the effect of the time value of money is material, the present value thereof. Reimbursement claims are recognised separately if it is virtually certain that reimbursement will be received if the Group settles the obligation.

Leases

The Group applied IFRS 16 initially on January 1, 2019, using the modified retrospective approach. Therefore, the cumulative effect of adopting IFRS 16 has been recognised as an adjustment to the opening balance of retained earnings at January 1, 2019, and comparative information has not been restated.

The Group applied the practical expedient of retaining the definition of a lease on transition. This meant that it applied IFRS 16 to all contracts entered into before January 1, 2019 and identified as leases in accordance with IAS 17 and IFRIC 4.

At inception the Group assesses whether the contract is or contains a lease. This is the case if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. To assess whether a contract includes such a right, the Group uses the definition of a lease in IFRS 16.

i. Leases in which the Group is a lessee

The Group's main leases are for offices and vehicles.

Upon the commencement or modification of a lease, the Group recognises a right-of-use asset and a lease liability.

The lease liability is initially measured at the present value of the outstanding lease payments including expected payments for:

- any residual value guarantees,
- purchase or extension options, the exercise of which is reasonably certain, or
- potential penalties for the early termination of a lease, unless it is reasonably certain that such an early termination will not occur.

discounted using the interest rate implicit in the lease or, if this rate cannot be readily determined, the Group's incremental borrowing rate. Generally, the Group uses its incremental borrowing rate as the discount rate; at adoption and during 2019 and 2020, this was 7.25%.

The right-of-use asset is initially measured at cost, being the value of the lease liability adjusted for:

- any payments made on or before the commencement date,
- any initial direct costs;
- estimated dismantlement or similar costs; and
- any leasing incentives received.

Subsequently the right-of-use asset is amortised from the commencement date to the end of the lease term using the straight-line method. An exception to this occurs for contracts for which the exercise of a purchase option by the lessee is reasonably certain and the associated costs are included in the right-of-use asset. In such cases, the right-of-use asset will be amortised over the useful life of the underlying asset. In addition, when applicable the right-of-use asset is adjusted for impairment losses and under certain circumstances for remeasurements or modifications of the lease liability.

The lease liability is measured at amortised cost using the effective interest method. It is remeasured when there is a change in the future lease payments or term, when the estimated amount expected to be payable under any residual value guarantee changes and when the assessment of the likelihood that purchase, extension or early termination options will be exercised changes. If the lease liability is remeasured, a corresponding adjustment is made to the right-of-use asset, or is recorded in profit or loss if the carrying amount of the right-of-use asset has reduced to zero. In addition, if a contract is modified, adjustments are recognised within, or outside, profit or loss.

The Group shows right-of-use assets in "property, plant and equipment" and lease liabilities in liabilities in the statement of financial position.

ii. Short-term leases and leases of low-value assets

The Group has elected not to recognise right-of-use assets and lease liabilities for leases of low-value assets and short-term leases (with terms up to a maximum of 12 months). Leasing fees for these leases are recognised in the income statement. Leasing expenses are recognised on a straight-line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit or the variance between these methods and the actual leasing fees is immaterial.

iii. Leases in which the Group is a lessor

Since we had no such leases during 2019 or 2020, we will not go into further detail in this report.

Recognition of income and expense

Sale of goods and services

Revenue is measured based on the compensation agreed in a contract with a customer. The Group recognises revenue when control of the goods or services is transferred to a customer.

In principle, customers obtain control over our products when the goods are collected by the customer or his representative or are delivered to the customer's property. At this time, the invoice is generated. Revenues are recognised when the goods are collected by the customer or delivered to the customer's property.

Occasionally a customer may request that we store their goods separately for them for a while; in such cases ("bill-and-hold"), revenues are recognised when the goods are ready for shipment and are to be stored separately on our site. Such transactions are always for products produced specially for, approved by and registered to that customer.

Interest and other income

Interest income is recognised in the period to which it relates.

Other income is recognised in the period to which it relates, in accordance with the associated contract.

Other expenses

Other expenses are recognised on the basis of a direct link between the costs incurred and the related income in the income statement, either when the benefit is used or when the costs are caused.

Expenses for research and development

Research costs are expensed as they are incurred. Development costs are also expensed as they are incurred, unless they satisfy the criteria for recognition as internally generated intangible assets according to IAS 38.

Borrowing costs

Borrowing costs as defined in IAS 23 are capitalised to the extent that they are directly attributable to the acquisition, construction or production of a qualifying asset; the remaining borrowing costs are recognised as an expense in the period in which they are incurred. No borrowing costs were capitalised during the business year.

Income taxes and deferred taxes

The income tax expense represents the sum of current tax expense and deferred tax expense.

The current tax expense is determined on the basis of the taxable income for the relevant year. The taxable income is different from the pre-tax result shown in the income statement since it excludes expenses and income which will be tax deductible / taxable in other years or which will never be tax deductible or taxable. The liability of the group for current tax expense is computed on the basis of the valid tax rates or of tax rates which have been enacted by the balance sheet date.

Deferred taxes are the expected tax charge or relief arising from differences between the carrying values of assets and debts in the Group IFRS consolidated financial statements and their values in the tax accounts of the individual companies. The balance sheet-oriented liability method is applied. In general, deferred tax liabilities are recorded for all taxable temporary differences, and deferred tax assets are recorded to the extent that it is probable that taxable profits will be available for which the deductible temporary differences can be used. Such assets and liabilities are not recognised if the temporary difference arises from (i) the initial recognition of goodwill or (ii) from the initial recognition of other assets and liabilities in a transaction that affects neither the accounting profit / (loss) nor taxable profit / (loss). In addition, deferred taxes are recognised for the carry forward of unused tax losses to the extent that it is probable that it will be possible to utilise them in the future.

The carrying amount of deferred tax assets is reviewed each year at the balance sheet date and is reduced if it is no longer probable that sufficient taxable income will be available to allow the benefit of all or part of the deferred tax asset to be utilised.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date.

The changes in deferred taxes are recognised in the income statement as tax income or expense unless they relate to transactions recognised in other comprehensive income or directly in equity; in this case the deferred taxes are recognised in other comprehensive income and the associated equity position.

Contingent liabilities and contingent assets

Contingent liabilities are not recognised. If any are identified, they are disclosed in the notes unless the possibility of an outflow of resources embodying economic benefits is remote. Contingent assets are not recognised. They are disclosed in the notes, where an inflow of economic benefits is probable.

The use of estimates and assumptions

The preparation of the consolidated financial statements in compliance with the pronouncements of the IASB requires estimates to be made affecting the values recognised in the balance sheet, the nature and extent of contingent assets and liabilities identified at the reporting date and the value of income and expenses in the reporting period. The main assumptions and estimates for the H&K AG Group concern the impairment tests for goodwill and trademarks, the setting of useful lives, the recoverability of accounts receivable, the valuation of inventories, the recognition and measurement of provisions, the probability of future utilisation of deferred tax assets and the recognition and measurement of leases.

Guarantee and warranty obligations can arise from legal or contractual requirements. Provisions are recognised for the expected cost of meeting claims under guarantee or warranty obligations. Claims are particularly likely if the warranty period has not yet expired, if warranty costs have been incurred in the past or if particular warranty claims are known. The evaluation of the risk of warranty claims is based on past experience and is used in determining the level of provision required (Note 24).

Provisions for litigation risks are recognised if a company in the Group is a defendant in a law suit and a judgement against the defendant is more likely than not. A provision is made for the amount likely to be incurred by the company if the judgement is against it. This figure includes the payments likely to be made by the company, in particular compensation, damages and settlements, as well as the expected legal expenses. If a company in the Group is a defendant in a law suit and a judgement for the defendant is more likely than not, or if the company is the claimant, only litigation fees are provided for (Note 24).

Due to the adoption of IFRS 16 it must be determined whether a contract fulfils the definition of a lease according to IFRS 16; in such cases the Group must select a reasonable discount factor and judge whether the exercise of options to extend are sufficiently certain, in order to determine the period of the lease. Additional information on the effects of IFRS 16 are provided in notes 25 and 33.

The use of estimates in other positions in the Group balance sheet and income statement are described in the notes relating to the individual positions. In particular, these relate to: impairment of goodwill, trademarks and other intangible assets (Note 16), impairment of non-current tangible and right-of-use assets (Note 17), provisions for doubtful debts (Note 20), allowances for inventories (Note 19), the valuation of deferred tax assets (Note 15) and of pension provisions (Note 23).

Notes on the income statement

(6) Revenue

Net revenue increased by €35,567k to €274,984k compared with revenue of €239,417k in 2019. In accordance with IFRS 15, associated expenses for late delivery penalties are included in sales deductions (discounts, bonuses etc.). The revenue of the Group was made up as follows:

EUR '000	2020	2019
Sale of goods	270,339	237,855
Sale of services	8,334	4,578
Gross revenue	**278,673**	**242,432**
Discounts, bonuses, etc.	(3,689)	(3,016)
Net revenue	**274,984**	**239,417**

Breakdown by customer location:

EUR '000	2020	2019
Domestic (Germany)	76,042	78,229
Foreign - other "Green Countries"	202,629	160,851
Foreign - rest of the world	2	3,352
Gross revenue	**278,673**	**242,432**
Discounts, bonuses, etc.	(3,689)	(3,016)
Net revenue	**274,984**	**239,417**

The Group's revenues result primarily from transactions recognised at a point in time in line with IFRS 15.38.

The following table provides information about receivables and contract liabilities from contracts with customers:

EUR '000	31.12.2020	31.12.2019
Trade receivables	23,444	21,709
Contract liabilities	(5,001)	(4,275)
Gesamt	**18,443**	**17,434**

Contract liabilities primarily relate to advance consideration received from customers. Of the €4,275k contract liabilities recognised at the beginning of 2019 €17,495k at the beginning of 2019) €3,954k (2019: €16,346k) was recognised as revenue during the year. The amount of revenue recognised in the year relating to performance obligations satisfied (or partially satisfied) in previous periods was nil (2019: nil).

As permitted by IFRS 15, no information is provided about remaining performance obligations at December 31, 2020 that have an original expected duration of one year or less.

(7) Cost of sales

The cost of sales includes materials, production labour and overhead expenses and depreciation relating to the revenue. The cost of sales increased by €11,609k to €187,438k compared with €175,829k cost of sales in 2019; the increased revenues and a change in the product mix contributed to this.

(8) Research and development expenses

The research and development expenses comprise those personnel and overhead expenses and depreciation relating to these activities, together with the costs of test materials and tools that do not meet the criteria for capitalisation under IAS 38. In addition, the normal amortisation and the retirement of capitalised development costs are included. These research and development expenses increased by €845k to €6,554k compared with €5,709k in 2019; the amount included for the retirement of capitalised development costs relating to projects that have been cancelled because of changed market conditions increased by €2,624k to €2.693k compared with €69k in 2019.

(9) Sales, marketing & distribution expenses

The sales, marketing & distribution expenses mainly comprise personnel expenses, material and marketing costs as well as depreciation relating to the sales function and project-related costs. They increased by €1,683k to €23,108k compared €21,424k in 2019; the increase is primarily due to the creation of provisions for onerous contracts, relating to options exercised from old contracts, together with higher project-related costs, offset by lower personnel expenses and other overheads.

(10) Administration expenses

General administration expenses include personnel expenses and overheads as well as the depreciation relating to the administration function. They increased by €1,970k to €17,371k compared with €15,401k in 2019, primarily due to higher personnel expenses, provisions for litigation and other administration overheads.

(11) Other operating income

EUR '000	**2020**	**2019**
Fuel sales to employees	-	874
Insurance benefits	757	277
Profit on disposal of non-current assets	23	25
Income from the disposal of scrap etc.	265	283
Income from derecognition of liabilities	-	347
Other	405	781
Total	**1,450**	**2,588**

The other operating income includes out-of-period income of €1,087k (2019: €545k). This primarily relates to income from insurance benefits and refunds amounting to €1,064k (2019: €520k).

(12) Other operating expenses impairment loss on trade receivables and contract assets net of reversals

The other operating expenses include the following material items that are not allocated to functional areas:

EUR '000	2020	2019
Provision for the possible calling of bank guarantees	39	(1,020)
Prior year credit notes	-	229
Loss on disposal of non-current assets	(186)	(55)
Other taxes	(562)	(563)
Insurance for natural hazards and business interruption	(236)	(177)
Petrol for employees etc.	-	(878)
Other	(56)	(223)
Total	**(1,000)**	**(2,687)**

The other operating expenses include out-of-period net expenses of €319k (2019: €174k net income). In 2020, these relate mainly to losses on the disposal of non-current assets. In 2019 the out-of-period net income related primarily to the release of a provision for potential refunds following price audits (“prior year credit notes”).

In 2020, the position “impairment loss on trade receivables net of reversals” relates primarily to an increase in the impairments determined in accordance with IFRS 9 (Note 20); in 2019 this position related primarily to an increase in the impairments determined in accordance with IFRS 9, offset by the net release of specific allowances.

(13) Analysis of expenses by nature, showing EBITDA

The income statement shows operating expenses analysed by function; the following table shows operating profit, with expenses analysed by nature, and EBITDA.

EUR '000	2020	2019
Net sales	274,984	239,417
Material costs and movement in inventories	(122,836)	(117,054)
Capitalised costs	3,312	5,255
Other operating income	1,450	2,588
Payroll	(75,379)	(69,309)
Other operating expenses	(29,613)	(30,510)
Impairment loss on trade receivables, net of reversals	(1,970)	(45)
EBITDA	**49,949**	**30,341**
Depreciation and amortisation	(10,954)	(9,432)
Results from operating activities	**38,995**	**20,910**

No definition of EBITDA is given in IFRS; various methods can therefore be used to determine EBITDA.

(14) Financial result

EUR '000	2020	2019
Financial income		
Interest income	14	52
Gains on valuation of derivative financial instruments	-	73
Gains on translation of foreign currencies	1,377	1,028
Total financial income	**1,391**	**1,153**
Financial expenses		
Interest expenses	(13,397)	(12,750)
Accretion of non-current liabilities	(2,294)	(2,287)
Losses on valuation of derivative financial instruments	(73)	-
Losses on translation of foreign currencies	(4,381)	(1,157)
Other	(70)	(86)
Total financial expense	**(20,216)**	**(16,281)**
Financial result	**(18,825)**	**(15,128)**

The interest income includes interest on bank balances and tax refunds; currently no interest income results from using the effective interest method (Note 5). The losses and gains on valuation of derivative financial instruments result from forward cover contracts to reduce the currency risk for the conversion of expected USD cash flows. The gains and losses on translation of foreign currencies include gains and losses on unhedged transactions together with translation differences for balance sheet positions held by Group companies in currencies other than their own functional currency. The interest expenses are primarily due to interest on the bonds and on other long-term loans. The accretion of non-current liabilities relates to defined benefit and other long-term provisions, the bonds and the SFA-loan; (Note 25). Other financial expenses relate to guarantee costs, primarily for the provision of guarantees to our customers.

(15) Income taxes

Income taxes include German corporation tax (“Körperschaftsteuer”), trade income tax (“Gewerbesteuer”) and associated reunification surcharges (“Solidaritätszuschlag”) for the German companies, together with similar income taxes for the foreign subsidiaries. Through the German companies’ fiscal unity, from 2013 income taxes are due from the top-level company, H&K AG.

The companies in Germany have a calculated statutory tax rate of 28.075% (2019: 28.075%). Foreign taxation is calculated at the rates valid in each country; these vary between 19.0% and 28.0% (2019: between 19.0% and 31.0%). Deferred taxes are calculated on the basis of statutory tax rates, or of tax rates which have been enacted as of the balance sheet date in each country, that are expected to be in place on realisation.

The income tax expense comprises:

EUR '000	2020	2019
Current tax expense	(5,743)	(3,730)
Deferred tax income / (expense)	(945)	(448)
Income tax expense	**(6,688)**	**(4,178)**

Primarily due to the improved result before taxes of €20,170k profit (2019: €5,782k profit), the current income tax expense recognised increased to €5,743k (2019: €3,730k). Deferred tax expenses increased to €945k (2019: €448k income).

The following table shows a reconciliation of the expected tax using the current statutory tax rate for the parent company of 28.075% (2019: 28.075%) and the actual income tax shown for the Group:

EUR '000	2020	2019
Profit / (loss) before income tax	**20,170**	**5,782**
Expected tax rate (current German statutory rate)	**28.075%**	**28.075%**
Expected tax (expense) / income	**(5,663)**	**(1,623)**
Adjustments to expected tax expense due to:		
- change in tax rates	(3)	(199)
- non-tax-deductible expenses	(1,678)	(2,311)
- non-taxable income	8	-
- taxes relating to other periods	(78)	(367)
- differences in foreign tax rates	694	24
- effects resulting from the adoption of IFRS 16 on 01.01.2019	-	59
- other effects	31	239
Actual tax expense	**(6,688)**	**(4,178)**
Effective tax rate	**33.2%**	**72.3%**

Deferred tax relates to the following positions:

Balance Sheet Item EUR '000	Deferred tax assets 31.12.2020	Deferred tax assets 31.12.2019	Deferred tax liabilities 31.12.2020	Deferred tax liabilities 31.12.2019
Intangible non-current assets	-	-	16,336	16,497
Tangible non-current assets	129	161	4,148	3,945
Inventories	851	1,050	136	254
Trade accounts receivable	137	287	9	11
Other current assets	764	192	-	21
Employee defined benefit obligations	8,607	8,590	-	-
Other non-current provisions	634	528	-	-
Non-current financial liabilities	-	-	325	523
Other non-current liabilities	29	60	-	-
Current provisions	188	92	-	-
Trade accounts payable	-	2	2	-
Other current liabilities	852	901	-	-
Carryforward of unused tax losses	2,817	4,371	-	-
Total	**15,009**	**16,234**	**20,956**	**21,250**

During 2020, a net increase in deferred tax assets of €331k (2019: €1,386k) was recognised through other comprehensive income into equity since it related to the actuarial variances on defined benefit schemes. The variances due to the effects of changing exchange rates on the translation of deferred tax assets and liabilities in foreign subsidiaries' accounts are also recognised within "Forex translation differences for foreign operations" in other comprehensive income (2020: €317k net decrease; 2019: €102k net increase). Apart from these, all other changes in deferred tax assets and liabilities were recognised in the income statement.

Balance Sheet Item EUR '000	Deferred Tax 01.01.2019	Recognised in profit or loss	Recognised in other comprehensive income	Deferred Tax 31.12.2019	Recognised in profit or loss	Recognised in other comprehensive income	Deferred Tax 31.12.2020
Intangible non-current assets	(15,974)	(523)	-	(16,497)	161	-	(16,336)
Tangible non-current assets	(3,865)	97	(16)	(3,784)	(338)	103	(4,019)
Inventories	620	164	11	795	(51)	(29)	715
Trade accounts receivable	180	93	4	276	(133)	(15)	128
Other current assets	94	77	-	171	592	-	764
Employee defined benefit obligations	7,544	(307)	1,353	8,590	(282)	299	8,607
Other non-current provisions	717	(222)	33	528	75	31	634
Non-current financial liabilities	(679)	157	-	(523)	198	-	(325)
Other non-current liabilities	-	59	0	60	(30)	(1)	29
Current provisions	144	(55)	3	92	112	(15)	188
Trade accounts payable	1	1	-	2	(3)	-	(2)
Other current liabilities	853	32	16	901	29	(78)	852
Carryforward of unused tax losses	4,310	(22)	83	4,371	(1,273)	(281)	2,817
Total	**(6,056)**	**(448)**	**1,488**	**(5,016)**	**(945)**	**14**	**(5,947)**

Potential deferred tax assets of €229k (2019: €250k) relating to tax-losses carried forward by US subsidiaries have not been recognised since they relate to losses incurred prior to the current US fiscal unity and therefore cannot be utilised at present. Potential deferred tax assets of the parent company amounting to €32,543k (2019: €29,598k) relating to the tax carry-forward of interest expenses, have also not been recognised.

In 2020 income tax payments amounted to €3.4 million (2019: €2.7 million). Of these, €3.3 million (2019: €2.8 million) relate to advance payments for current year German income taxes, €1.7 million net refunds (2019: €0.6 million net refunds) relate to German income taxes for prior years while foreign income taxes account for €1.8 million net payments (2019: for €0.5 million net payments).

Notes on the balance sheet

(16) Intangible assets

EUR '000	Development costs (self-generated)	Goodwill (acquired)	Trade marks Patents, licences, software (acquired)	Total
Net carrying value at 01.01.2019	**25,815**	**5,149**	**9,605**	**40,568**
Acquisition / manufacturing costs				
Balance at 01.01.2019	**40,617**	**6,649**	**24,941**	**72,208**
Adjustment of gross balances from prior years	-	-	(69)	(69)
Effect of movement in exchange rates	(7)	-	30	23
Additions	5,138	-	598	5,737
Disposals / retirements	(69)	-	(264)	(333)
Balance at 31.12.2019	**45,679**	**6,649**	**25,236**	**77,565**
Amortisation & depreciation				
Balance at 01.01.2019	**(14,803)**	**(1,500)**	**(15,336)**	**(31,639)**
Adjustment of gross balances from prior years	(986)	-	1,055	69
Effect of movement in exchange rates	(0)	-	(8)	(8)
Amortisation for the year	(2,347)	-	(558)	(2,905)
Disposals / retirements	-	-	264	264
Balance at 31.12.2019	**(18,135)**	**(1,500)**	**(14,584)**	**(34,219)**
Net carrying value at 31.12.2019	**27,545**	**5,149**	**10,652**	**43,346**
Acquisition / manufacturing costs				
Balance at 01.01.2020	**45,679**	**6,649**	**25,236**	**77,565**
Effect of movement in exchange rates	(219)	-	(61)	(280)
Additions	6,007	-	738	6,745
Reclassifications	1,035	-	(1,035)	-
Disposals / retirements	(2,693)	-	(533)	(3,226)
Balance at 31.12.2020	**49,809**	**6,649**	**24,345**	**80,803**
Amortisation & depreciation				
Balance at 01.01.2020	**(18,135)**	**(1,500)**	**(14,584)**	**(34,219)**
Effect of movement in exchange rates	1	-	40	40
Amortisation for the year	(2,569)	-	(704)	(3,272)
Disposals / retirements	-	-	495	495
Balance at 31.12.2020	**(20,703)**	**(1,500)**	**(14,752)**	**(36,956)**
Net carrying value at 31.12.2020	**29,106**	**5,149**	**9,592**	**43,847**

As shown in the above table in 2019 corrections were made to the classification of certain gross values that were shown differently in the opening balances from 2018; these corrections had no effect on the overall net carrying value of intangible assets.

As described in Note 5, goodwill and other intangible assets with indefinite lives are subject to annual impairment testing. Goodwill is allocated to the CGUs acquired.

As shown in the above table, aggregate goodwill is unchanged from the previous year at €5,149k. This is the portion of the net book value of the goodwill (excluding trademarks), through acquisitions from independent third parties, held in the Defence Technology Sub-Group's consolidated financial statements under German GAAP at the date of that sub-group's transition to IFRS (January 1, 2006). Originally, the parent company of this Sub-Group was called Heckler & Koch Wehrtechnik Holding GmbH. This company acquired the design, manufacturing and distribution company Heckler & Koch Gesellschaft mit beschränkter Haftung, at the end of 2003. In 2004 the two companies were merged and renamed Heckler & Koch GmbH. As a result, the Group has goodwill of €4,016k allocated to the merged company, Heckler & Koch GmbH (HKO), a CGU that is equivalent to the segment "site location: Germany". The balance of €1,133k relates to the acquisition of Heckler & Koch France SAS (HKF) in 2004 and is therefore allocated to this CGU, equivalent to the segment "site location: France". On the acquisition of Heckler & Koch Gesellschaft mit beschränkter Haftung, at the end of 2003, the trademark "Heckler & Koch" was also recognised as an intangible asset (2020: €8,393k; 2019: €8,393k) and allocated to the CGU HKO. Since the Group's reputation is associated with this trademark, like goodwill, it is treated as being of indefinite life. The use of the trademark is charged to the other operating companies in the Group via internal pricing and certain licence fees; the impairment test for the trademark is therefore simply carried out at the level of the CGU HKO.

As described in Note 5, the Group conducts an impairment test of goodwill and trademarks at least annually. Since only a small proportion of H&K AG's shares are traded on a stock exchange, and comparable companies were not bought or sold regularly on an active market during the past year, it was not possible to base the impairment tests on market value. Instead, for the test, the recoverable value – the value in use – of the CGU is compared with its carrying value. The value in use of the CGUs is determined by discounting future cash flows. If, as a result of this calculation, there is indication of an impairment, the fair value less cost of disposal (FVLCOD) is also determined in order to measure the potential impairment.

The computations for the CGU HKO (goodwill €4,016k and trademark €8,393k) and the CGU HKF (goodwill €1,133k) are based on the following material assumptions:

> A detailed plan is made of the cash flows for the cash-generating units for the forecast period of five years. Subsequent periods are accounted for by a terminal value determined on the basis of the final year, adjusted for material one-off events and effects in the current order book and applying a 1% growth rate. The key assumptions for the determination of the value in use are the planned sales, taking account of order intake and order book, output and EBITDA. Plans are based on past experience together with available information over future requirements and take account of management recharges. The fulfilment of these plans assumes that the current regulation of market access continues and that the Group can maintain its strong competitive position. The IFRS 16 right-of-use assets increase the book values of the CGUs; the lease liabilities decrease these. The application of IFRS 16 did not have a material effect on the results used for the calculation of value in use, it increased the leverage slightly but did not have a material effect on the assessment of whether an impairment had occurred. IAS 36.134(f) does not apply.

The discount rates used for December 31, 2020 are pre-tax cost of capital rates determined using the CAPM.

	2020	2019
HKO	6.6%-7.1%; terminal value 6,0%	7.1%-7.5%; terminal value 6,3%
HKF	3.9%-5.0%; terminal value 4.4%	4.9%-6.5%; terminal value 4.8%

Changes within the reasonably possible interest range at the balance sheet date would not lead to an impairment of goodwill or of trademarks.

Under a security assignment agreement certain patents, trademarks and domains have been pledged as security for a long-term financing loan (*Senior Facilities Agreement*, “SFA-loan”) (net book value 2020: €8,393k; 2019: €8,393k); (Note 25).

The normal amortisation (2020: €3,272k; 2019: €2,905k) and the impairment of intangible assets is included in the following income statement positions; the impairments relate to the retirement of capitalised development costs for projects that have been cancelled due to changed market conditions (2020: €2,693k; 2019: €69k):

EUR '000	2020	2019
Cost of sales	120	106
Research and development expenses	5,306	2,462
Sales, marketing & distribution expenses	17	25
Administration expenses	523	381
Total	**5,965**	**2,974**

As at December 31, 2020 the Group had a balance of €602k (2019: €48k) on order for intangible assets.

(17) Property, plant and equipment

EUR '000	Land and buildings	Plant and machinery	Fixtures, fittings and other assets	Assets under construction	Total
Net carrying value at 01.01.2019	**24,334**	**9,199**	**7,831**	**4,265**	**45,629**
Acquisition / manufacturing costs					
Balance at 01.01.2019	**37,622**	**58,325**	**60,410**	**4,265**	**160,622**
Adjustment of gross balances from prior years	(104)	(54)	218	-	60
Effects of the initial application of IFRS 16 on 01.01.	2,216	-	413	-	2,629
Effect of movement in exchange rates	189	47	80	86	402
Additions	50	4,158	3,498	1,636	9,342
Reclassifications	-	2,503	19	(2,522)	-
Disposals	-	(191)	(916)	(13)	(1,119)
Balance at 31.12.2019	**39,973**	**64,788**	**63,721**	**3,453**	**171,935**
Amortisation & depreciation					
Balance at 01.01.2019	**(13,288)**	**(49,126)**	**(52,579)**	**-**	**(114,993)**
Adjustment of gross balances from prior years	104	54	(218)	-	(60)
Effects of the initial application of IFRS 16 on 01.01.	(924)	-	(175)	-	(1,099)
Effect of movement in exchange rates	(55)	(22)	(63)	-	(140)
Depreciation for the year	(1,166)	(2,506)	(2,854)	-	(6,527)
Disposals	-	191	869	-	1,059
Balance at 31.12.2019	**(15,330)**	**(51,410)**	**(55,020)**	**(0)**	**(121,759)**
Net carrying value at 31.12.2019	**24,643**	**13,379**	**8,701**	**3,453**	**50,176**
Acquisition / manufacturing costs					
Balance at 31.12.2019	**39,973**	**64,788**	**63,721**	**3,453**	**171,935**
Effect of movement in exchange rates	(718)	(435)	(353)	(106)	(1,612)
Additions	12	10,265	5,027	1,211	16,515
Reclassifications	(33)	207	43	(217)	-
Disposals	(779)	(3,958)	(1,105)	(136)	(5,978)
Balance at 31.12.2020	**38,454**	**70,867**	**67,333**	**4,206**	**180,860**
Amortisation & depreciation					
Balance at 01.01.2020	**(15,329)**	**(50,892)**	**(55,020)**	**(517)**	**(121,759)**
Effect of movement in exchange rates	205	115	275	-	596
Depreciation for the year	(1,126)	(2,953)	(3,603)	-	(7,682)
Reclassifications	19	-	(19)	-	-
Disposals	607	3,946	1,098	-	5,651
Balance at 31.12.2020	**(15,625)**	**(49,784)**	**(57,269)**	**(517)**	**(123,195)**
Net carrying value at 31.12.2020	**22,830**	**21,083**	**10,065**	**3,688**	**57,665**

As shown in the above table, in 2019 corrections were made to the classification of certain gross values that were shown differently in the opening balances from 2018; these corrections had no effect on the overall net carrying value of tangible assets.

Right-of-use assets for leasing agreements are recognised for land and buildings and for fixtures, fittings and other assets. At the end of 2020, land and buildings included such assets with net carrying values of €671k (2019: €1,107k) and fixtures, fittings and other assets included such assets with net carrying values of €496k (2019: €266k); these right-of-use assets are allocated to the applicable CGUs and segments and increase their book values accordingly (the associated lease liabilities are also allocated to the CGUs and segments). At the year-end there were no indications of potential impairments for these right-of-use assets. See Note 25 for details of the associated lease obligations and the reconciliation between the total minimum lease payments at the balance sheet date and their present values.

Under various floating charges and other security agreements almost all of the Group's property, plant and equipment has been pledged as security for a long-term financing loan ("SFA-loan"); (Note 25).

As at December 31, 2020 the H&K AG Group had a balance of €3,368k (2019: €10,362k) on order for tangible non-current assets.

(18) Non-current investments and derivatives and current deposits and derivatives

The non-current "Other investments" and the current "Other deposits and derivatives" include bank deposits of €1,620k (2019: €1,806k) recognised as non-current assets and bank deposits of €2,774k (2019: €2,923k) recognised as current assets since they have terms of more than three but less than twelve months. These deposits serve as security for certain bank guarantees and similar. In the prior year derivatives for currency forward-cover contracts were included in the current position; at the end of 2020 these contracts had been completed (2020: nil; 2019: €73k).

(19) Inventories

EUR '000	31.12.2020	31.12.2019
Raw materials, consumables and supplies	29,516	35,394
Work in progress	55,722	45,252
Finished goods and merchandise	9,252	9,539
Total	**94,489**	**90,185**

Within inventories, provisions of €13,225k (2019: €12,776k) have been made to account for marketability risks, slow-moving items and inventory range. These provisions reduce certain items of inventory to carrying values in line with their net realisable values as at December 31, 2020 of €5,993k (2019: €7,618k). Impairment losses of €1,133k (2019: €66k) were recognised as an expense. Impairment losses recorded in prior years have been reversed within cost of sales (2020: €314k; 2019: €2,314k) due to the sale or scrapping of related items and to improved inventory movements.

Under various floating charges and other security agreements almost all of the Group's inventories have been pledged as security for the SFA-loan; (Note 25).

(20) Trade receivables, prepayments and other assets

EUR '000	31.12.2020	31.12.2019
Trade receivables	23,444	21,709
Prepayments for inventories	451	32
Prepayments for other current assets	333	378
Other assets	1,774	1,956
Total	**26,001**	**24,076**

Trade receivables are not interest-bearing; they usually have due dates between 30 and 60 days; with the exception of normal trading ownership retention clauses, they are not secured. Under various floating charges and other security agreements certain of the Group's pledgeable trade receivables have been pledged as security for the SFA-loan; (Note 25).

The other assets are mainly for VAT & other tax claims arisen in the normal course of business, claims against suppliers and receivables from employees & directors (travel and salary advances).

If there is an indication that a trade receivable may be impaired, at the latest if it is over 90 days overdue, the possibility of an impairment is reviewed by the finance, sales and legal departments. In addition, due to the application of IFRS 9, general provisions for expected credit losses have been recognised; these relate to trade receivables from our US commercial market customers, since our other trade receivables are primarily against governmental authorities with very good credit-standing and therefore minimal risk of credit losses. Consequently, provisions have been made for expected credit losses within trade receivables; all impairments in the allowance account for this are determined on the basis of the expected credit losses over the lifetime of the trade receivables. The account has had the following movements during the reporting period:

EUR '000	2020	2019
Opening balance January 1	1,726	1,617
Creations	1,965	338
(Release) / (utilisation)	(918)	(246)
Effects of foreign currency conversion	(68)	16
Closing balance December 31	**2,706**	**1,726**

Expenses from the impairment of trade receivables and income from the reversal of such impairments are shown under a separate position in the consolidated income statement (Note 12). The impairment expenses in 2020 primarily relate to the creation of allowances for specific trade receivables; the reduction of allowances in 2020 was primarily due to the utilisation on derecognition of the associated irrecoverable receivables. Trade receivables with specific impairment allowances at the end of 2020 are still subject to collection procedures.

The aging of financial instruments that are trade accounts receivable is as follows:

EUR '000	31.12.2020	31.12.2019
Neither overdue nor impaired:	**19,669**	**15,682**
Overdue but not impaired:		
- within 30 days	2,291	1,682
- between 30 and 60 days	457	570
- between 60 and 90 days	47	1,044
- between 90 and 180 days	161	364
- after more than 180 days	742	3,060
Total:	**3,697**	**6,721**
General allowance	(623)	(694)
Impaired (gross)	**2,783**	**1,031**
Specific allowance(s)	(2,083)	(1,031)
Net trade accounts receivable	**23,444**	**21,709**

As at the balance sheet date, no evidence of reduced creditworthiness had been identified for any of the accounts receivable that were neither overdue nor impaired.

(21) Cash and cash equivalents

The position "cash and cash equivalents" includes cash balances, cheques, bank balances on current accounts and short-term deposits, the original term of which is less than three months. These are valued at nominal value. Information on potential credit risks is provided in Note 28.

One of the prerequisites for the provision of certain guarantee lines etc. is that we are required to maintain a varying level of deposits as security (Note 25). As at December 31, 2020 we had €0.0 million (2019: €0.3 million) such security deposits included in cash and cash equivalents. The remaining Group bank accounts have been pledged as security for the SFA-loan (2020: €33.3 million; 2019: €23.1 million); (Note 25).

(22) Shareholders' equity and earnings per share

H&K AG has a share capital of €27.6 million (2019: €27.6 million), divided into 27.6 million (2019: 27.6 million) no-par shares.

The calculation of the basic earnings per share of €0.49 profit (2019: €0.06 profit) is based on the following earnings attributable to ordinary shareholders and weighted-average number of ordinary shares outstanding:

EUR '000	2020	2019
Profit / (loss) for the year attributable to the owners of the parent company	13,482	1,604
of which not attributable to ordinary shareholders	-	-
Profit / (loss) attributable to ordinary shareholders	**13,482**	**1,604**

Thousands of shares	2020	2019
Issued ordinary shares at 01.01.	27,641	27,641
Weighted average number of ordinary shares at 31.12.	**27,641**	**27,641**

A calculation of diluted earnings per share would be based on the earnings attributable to ordinary shareholders and the weighted-average number of ordinary shares outstanding after adjustment for the effects of all dilutive potential ordinary shares. There were no dilutive effects for the reporting period.

The additional paid in capital arises from additional capital contributions from the shareholders.

The translation reserve comprises all foreign currency differences arising from the translation of the financial statements of foreign operations.

The reserve for defined benefit obligations comprises the cumulative actuarial gains and losses arising on the employee defined benefit obligation provisions, net of tax. The net increase is due to actuarial losses of €1,178k (2019: €4,937k losses) net of €331k (2019: €1,386k) deferred taxes.

The consolidated retained earnings include a reduction of €62,333k arising from the effects of the transition of the H&K AG Group (then Heckler & Koch Beteiligungs GmbH Group) to IFRS on January 1, 2008, mainly due to the valuation difference on the acquisition of treasury stock in November 2007. An additional reduction of €2,857k arose from the difference between the acquisition price and the associated net assets for each of the common control transactions involving the acquisition of Suhler USA, Inc. (since merged into SAGH), in April 2009, and Suhler Jagd- und Sportwaffen Holding GmbH (since merged into H&K AG), in May 2009.

The H&K AG Group shows a negative equity of €108.3 million (2019: €120.9 million) at the balance sheet date. The current H&K AG Group business plan shows an improvement in the equity position and assumes the reduction of debt.

Under the German companies act (AktG), the distributable dividend is determined by the retained earnings in the annual financial statements of the parent company, H&K AG, prepared in accordance with German accounting principles (HGB). The executive directors and supervisory board will propose that the shareholders' meeting resolve to carry forward that company's €96.2 million cumulative profits as at December 31, 2020.

(23) Provisions for pensions and similar employee defined benefit obligations

The pension schemes at the Group's foreign companies are defined contribution plans, while HKO has both defined benefit and defined contribution plans. The defined benefit schemes for employees were finally closed to new entrants in 2002. In addition, contributions are made to the applicable state pension schemes.

Under the defined contribution plans the company pays contributions to state or private pension schemes on the basis of statutory or contractual obligations or on a voluntary basis. Having paid the contributions, the company has no further obligations. The current contribution payments are shown as payroll expense for the relevant year: they amounted to a total of €4,839k (2019: €4,661k) for the Group.

The defined benefit plans are accounted for in the Group by setting up provisions for pensions and death benefits determined by the Projected Unit Credit Method in accordance with IAS 19. Under this method, in addition to the pensions and vested rights known at the balance sheet date, expected future increases in pensions and salaries, with realistic estimates of the demographic variables are also taken into consideration. The value is obtained from an actuarial report calculated using biometric actuarial assumptions (Prof. Dr Klaus Heubeck's 2018 G guideline tables).

Under the defined benefit schemes, on reaching the retirement age of 65, employees are entitled to benefits based on their length of service. The defined benefit schemes in operation before 1995 entitle members to benefits for the first ten years' service of 8% of the average monthly salary for the final year, plus 0.25% for each additional year of service. Increases are no longer possible since these schemes are closed and members' entitlements remain fixed.

Under the defined benefit scheme from January 1, 1995, members are entitled to benefits of a fixed sum per year of service depending on the member's grade. The relevant grade for active members is the grade on retirement. This scheme was closed to new entrants on November 30, 2002.

The following table shows the development of the defined benefit liability for asset-backed and non-asset-backed obligations:

EUR '000	Defined benefit obligation 2020	Defined benefit obligation 2019	Fair value of plan assets 2020	Fair value of plan assets 2019	Net obligation for defined benefit plans 2020	Net obligation for defined benefit plans 2019
Balance at January 1	**65,482**	**62,507**	**(970)**	**(907)**	**64,512**	**61,600**
Included in profit or loss						
Current service cost	472	423	-	-	472	423
Interest cost (income)	733	1,130	(11)	(17)	722	1,114
Total recognised in profit or loss	**1,206**	**1,553**	**(11)**	**(17)**	**1,195**	**1,536**
Included in other comprehensive income						
Actuarial loss (gain) arising from:						
- financial assumptions	2,093	6,359	-	-	2,093	6,359
- experience adjustments	(1,012)	(1,528)	-	-	(1,012)	(1,528)
Return on plan assets exc. interest income	-	-	(14)	(10)	(14)	(10)
Total recognised in OCI	**1,081**	**4,831**	**(14)**	**(10)**	**1,066**	**4,820**
Other						
Contributions paid by employer			(40)	(36)	(40)	(36)
Benefits paid	(3,312)	(3,409)	-	-	(3,312)	(3,409)
Total other	**(3,312)**	**(3,409)**	**(40)**	**(36)**	**(3,352)**	**(3,445)**
Balance at December 31	**64,456**	**65,482**	**(1,035)**	**(970)**	**63,421**	**64,512**
represented by:						
Net defined benefit obligation for funded plan	970	970	(1,035)	(970)	(65)	-
Defined benefit obligation for unfunded plans	63,487	64,512	-	-	63,487	64,512
Balance at December 31	**64,456**	**65,482**	**(1,035)**	**(970)**	**63,421**	**64,512**

The current service costs are shown within functional areas and the annual net interest expense is shown within the interest result. Actuarial gains and losses are not recognised in the income statement but are shown in the statement of comprehensive income and taken to reserves.

The fair market value of the plan assets relates solely to asset values from reinsurance policies and associated credit balance. The expected long-term returns from these plan assets are calculated at 0.90% (2019: 1.15%). This is based on the discount rate for the associated pension obligations. The actual earnings from the plan assets were €26k (2019: €27k). Contributions of about €40k are expected to be paid during 2021.

The calculated average duration of the pensions schemes is 12.9 years (2019: 11.9 years). The following table shows the principle actuarial assumptions at the reporting date:

	31.12.2020	**31.12.2019**
Discount rate	0.90%	1.15%
Future salary growth for active plan members	0.00%	0.00%
Future pension growth	1.50%	1.50%
Longevity rates according to	RT 2018 G	RT 2018 G
Invalidity rates according to	RT 2018 G	RT 2018 G

Reasonably possible changes at the reporting date to one of the relevant actuarial assumptions, holding other assumptions constant, would have affected the defined benefit obligation by the amounts shown below:

31.12.2020	Defined benefit obligation	
Effect in EUR '000	Increase	Decrease
Discount rate (0.5% movement)	(4,067)	4,579
Future pension growth (0.25% movement)	1,865	(1,785)

Although the analysis does not take account of the full distribution of cash flows expected under the plan, it does provide an approximation of the sensitivity of the assumptions shown.

(24) Other current and non-current general liability provisions

The current and non-current general liability provisions are as follows:

EUR '000	31.12.2020	31.12.2019
Current provisions & accruals	15,883	11,698
Non-current provisions	2,990	2,958
Total	**18,873**	**14,656**

The provisions comprise:

EUR '000	Personnel obligations	Warranty obligations	Other obligations relating to sales	Other risks	Total
Balance at 01.01.2020	**2,458**	**1,670**	**5,873**	**4,654**	**14,656**
Exchange rate difference / reclassification	-	(2)	(196)	-	(198)
Utilisation	(923)	(909)	(718)	(251)	(2,801)
Release	(12)	-	(246)	-	(258)
Creation	3,446	752	2,576	701	7,475
Balance at 31.12.2020	**4,969**	**1,511**	**7,289**	**5,105**	**18,873**

Provisions for the German early retirement scheme (“Altersteilzeit”) are included in the personnel obligations (€542k; 2019: €394k). These include the reduced pay taken by employees in this scheme during the working phase together with the accumulated additional costs to the company during the remainder of each early retirement period. The value is based on the associated contractual obligations and is obtained from actuarial reports; these use biometric actuarial assumptions from Prof. Dr Klaus Heubeck’s 2018 G guideline tables and discounted at 0.90% (2019: 1.15%). There are no material uncertainties with regard to the value of these provisions. These obligations are secured by certain securities; these plan assets are offset against the associated provisions. The current early retirement scheme agreements are for between two and six years. In the working phase (first half of early retirement agreement term) the provision is created; the outflows of economic benefits occur in the non-working phase (second half). Accordingly, the outflows of economic benefits for early retirement agreements are expected over up to six years, currently however primarily within the next four years.

Other personnel obligations also include provisions for long-service anniversary benefits, bonuses and similar obligations. These personnel provisions are determined based on the associated contractual obligations and the outflows of economic benefits are generally expected within twelve months, although the outflows for anniversary benefits (€733k; 2019: €633k) could be over a period of up to forty years. There are no material uncertainties with regard to the value of these provisions.

The provisions for warranties were recognised on the basis of past experience with regard to the Group liability for a warranty period of two years. Accordingly, the outflows of economic benefits are expected within two years. There are no material uncertainties with regard to the value of these provisions.

Provisions relating to sales include provisions for offset obligations, onerous conditions, late delivery and other contractual penalties, costs to complete and price-audits on certain contracts. These provisions have been recognised in line with the probability of their incidence, based on the associated contractual obligations and the current status; the outflows of economic benefits are generally expected within twelve months. There are no material uncertainties with regard to the value of these provisions.

The provisions for other risks relate mainly to litigation risks, recognised in line with the probability of their incidence. As at December 31, 2020 the outcome of most of the litigation is dependent on associated legal proceedings and accordingly these provisions are based on particular uncertainties. The outflows of economic benefits are generally expected within twelve months; however, the final conclusion of certain cases is not expected until later. The provision for litigation risks includes the following case:

> As a result of the Stuttgart Public Prosecutor's Office's preliminary investigation into former HKO employees, commenced in 2010, in which allegations of unauthorised export of rifles to Mexico between 2006 and 2009 are being probed, criminal charges have been made in the Stuttgart District Court against five former employees and the former agent in Mexico. HKO has cooperated fully with the authorities, both during the initial investigation and during the court case. The verdict by the court of first instance was that three former employees were found not guilty and two former employees were given suspended sentences of one year and five months and one year and ten months respectively. The accused also included two former directors, who were both found not guilty. Both not guilty verdicts are now legally binding. HKO was sentenced to pay over €3.7 million; this has been recognised in the provision. HKO has appealed this verdict; the Public Prosecutor and the two accused who were sentenced have also appealed. See Note 40.

The effects of accretion and changes in discount rates were material for the valuations of certain non-current general liability provisions. The financial result includes €14k net expense (2019: €21k net expense) due to discounting and accreting these other non-current provisions; this led to a corresponding increase in the value recognised for these provisions.

(25) Financial liabilities and credit lines

Financing loans and bond

As at December 31, 2020 the H&K AG Group has the following five financing loans:

- Secured, private financing agreement ("SFA-loan"), nominal €83 million
- Unsecured bond, nominal €60 million.
- Unsecured bridging loan, €30 million (excluding interest).
- Unsecured bridging loan, €50 million (excluding interest).
- Unsecured bridging loan, €15 million (excluding interest).

SFA-loan and bond

The H&K AG Group has two material non-current financial liabilities resulting from the refinancing during 2017: a secured financing loan amounting to €83 million (December 31, 2019: €95 million) and an unsecured bond listed on the Luxembourg Euro MTF (December 31, 2020: €60 million; December 31, 2019: €60 million). The financing loan relates to a private €150 million financing agreement ("SFA-loan") from July 24, 2017, maturing on August 21, 2022, under which a total of €130 million was drawn down on August 21, 2017 and, up to the end of 2020, a total of €47 million (up to the end of 2019: a total of €35 million) had been repaid. The interest rate is 7.25% plus EURIBOR (if this is positive) and interest is payable at the end of each agreed interest period, which can be between one and six months. The listed bond was created on December 15, 2017 by the conversion of a private note purchaser loan. This bond, maturing April 30, 2023 has a fixed interest rate of 6.5% payable six-monthly, on April 30 and October 31. Together with a €50 million short-term shareholder loan that was converted into equity as a contribution in kind in October 2017, the funds from the refinancing were primarily used on August 24, 2017 for the early redemption of HKO's 2011 bond, due May 2018, with accrued interest (€226 million).

Under the SFA-loan agreement H&K AG and its subsidiaries are subject to strict limitations on certain transactions; the Group must also meet specified ratios between net debt and the contractually defined EBITDA ("Financial Covenants") and make partial repayments for example dependent upon the annual contractually defined "Excess Cashflow". The Group is permitted to partially or fully redeem the SFA-loan liability. However, the voluntary redemptions must comply with contractual conditions, including in some cases prepayment premia.

As security for liabilities under the SFA-loan (nominal including accrued interest as at December 31, 2020: €85.3 million; December 31, 2019: €97.5 million), the direct and indirect subsidiaries of H&K AG have also entered into the agreement as guarantors. In addition, all shares in HKM and all of its direct and indirect subsidiaries together with, through floating charges and other security agreements, certain non-current assets, inventories, receivables and bank accounts (all other bank accounts serve as security deposits for bank guarantees and similar) are pledged to the agent for the lenders; (Notes 16, 17, 19, 20, and 21).

In March and December 2018, the SFA agreement was amended inter alia to permit H&K AG to draw unsecured bridging loans from a main shareholder, to set a minimum cash resource level for the Group of €10 million and to adjust the required ratios of net debt to contractually defined EBITDA (“Financial Covenants”) for the quarters ending December 2017 through June 2018. In February 2020, the SFA agreement was amended inter alia to permit H&K AG to draw an unsecured bridging loan from a main shareholder during that month and to postpone the associated 70% partial repayment foreseen under the SFA agreement to October 2020, with the option of a further extension. In September, given the very positive business development and the liquidity generated thereby, the directors decided not to use the option of an extension but to make the repayment.

Loans from related companies

On March 28, 2018 one of H&K AG’s main shareholders, Compagnie de Développement de l’Eau S.A. (CDE), agreed a €30 million interest-free, unsecured bridging loan to H&K AG with a term until July 15, 2019; funds were received in late April 2018. In November 2018 the duration was extended until July 15, 2023; in another amendment, an interest rate of 2% was agreed, charged retrospectively from the initial loan payment with accrued interest added to the loan principal quarterly. As a result, the nominal value of this loan increased to €31.7 million on December 31, 2020 (€31.1 million on December 31, 2019).

At the end of November 2018 CDE agreed and paid out an additional €50 million unsecured bridging loan to H&K AG with a term until July 15, 2023. The interest rate is 2%; accrued interest is added to the loan principal quarterly. As a result, the nominal value of this loan increased to €52.2 million on December 31, 2020 (€51.1 million on December 31, 2019).

At the end of February 2020, to ease compliance with certain SFA-loan conditions, H&K AG received an interest-bearing unsecured bridging loan of €15 million, with a term until July 15, 2023, from another of its main shareholders. The interest rate is 6.5%; accrued interest is added to the loan principal quarterly. As a result, the nominal value of this loan increased to €15.9 million on December 31, 2020 (nil on December 31, 2019).

Overview of the development of the financing liabilities

The bond and the SFA-loan are recognised in the statement of financial position at their amortised amounts totalling €140,844k (2019: €151,316k). The associated accrued interest liabilities totalling €2,955k (2019: €3,186k) are recognised within other liabilities. There were no material transaction costs for the bridging loans so their amortised amounts, amounting to €99,707k (2019: €82,170k), are identical to their nominal values (including quarterly reclassification of accrued interest, see above).

EUR '000	2020 Nominal	2020 Book value	2020 Associated interest liabilities	2019 Nominal	2019 Book value	2019 Associated interest liabilities
Balance at 01.01.	**237,170**	**233,485**	**3,186**	**235,524**	**230,688**	**3,898**
Accretion of SFA loan and 2017 bond	-	1,499	-	-	1,152	-
Interest expense for SFA loan and 2017 bond	-	-	10,708	-	-	10,937
Interest payments for SFA loan and 2017 bond	-	-	(10,939)	-	-	(11,649)
Partial repayment of SFA loan	(11,970)	(11,970)	-	-	-	-
Funds from refinancing - bridging loans	15,000	15,000	-	-	-	-
Interest expense for bridging loans	-	-	2,537	-	-	1,645
loans	2,537	2,537	(2,537)	1,645	1,645	(1,645)
Balance at 31.12.	**242,737**	**240,552**	**2,955**	**237,170**	**233,485**	**3,186**

Other Group credit lines

The other credit lines are only for the issue of advance payment or performance guarantees, including bid bonds and similar. The value of guarantees currently outstanding is not recognised in the statement of financial position. As of December 31, 2020, a total of €4.6 million (2019: €4.3 million) guarantees to customers were outstanding. As a prerequisite for the provision and maintenance of these and other guarantee lines, deposits must be provided as security. As at December 31, 2020 there were €0.0 million (2019: €0.3 million) such pledged security deposits included in cash and cash equivalents. Additional security for these lines is provided through bank deposits with terms in excess of three months recognised within other current investments (2020: €2.8 million; 2019: €2.9 million) (Note 18), and within other non-current investments (2020: €1.6 million; 2019: €1.8 million) (Note 18).

Group lease liabilities

As described in Notes 17 and 33, the Group uses certain leased assets (in particular offices and vehicles) for which right-of-use assets and lease liabilities are recognised and allocated to the applicable CGUs and segments.

The lease liabilities, for which corresponding right-of-use assets are recognised, are payable as follows:

EUR '000	Contractual Cashflows 31.12.2020	Contractual Cashflows 31.12.2019
Less than one year	472	522
Between one and five years	1,008	994
More than five years	92	260
Total lease payments	**1,572**	**1,777**
Effects of discounting and options	(329)	(221)
Lease liabilities recognised	**1,243**	**1,556**

Additional information on leases is provided in Note 33.

(26) Trade and other payables

Trade and other payables include outstanding liabilities from trade and operating costs, together with accrued interest payable on the SFA-loan and the bond.

EUR '000	31.12.2020	31.12.2019
Trade payables	18,217	21,633
Interest payables	2,955	3,186
Other liabilities	8,659	7,715
Total	**29,831**	**32,535**

With the exception of normal trading ownership retention clauses for the trade payables and security agreements relating to the interest liabilities for the SFA-loan (Notes 16, 17, 19, 20, 21, 25), these payables are not secured.

(27) Contract liabilities

The €5,001k (2019: €4,275k) contract liabilities comprise payments received from customers in advance of the delivery of the associated products or services.

Other disclosures

(28) Financial risk management

Market risk

Market risk is the risk that the fair value or the future cash flows of a financial instrument may change depending on market rates. Market risk includes three types of risk: currency risk, interest rate risk and other rate risks. These risks for the Group are covered individually below.

Currency risk

The H&K AG Group is exposed to currency risk on sales and purchases that are denominated in a currency other than the respective functional currencies of Group entities, primarily the euro (EUR), but also US dollars (USD) and Sterling (GBP). The majority of both costs and sales are in euro, so we only have foreign exchange transaction exposure for those sales in currencies different to the associated costs. H&K AG Group policy is, dependent upon the exchange rates on offer and the conditions of potential forward cover contracts and taking expected USD developments into consideration, to cover a proportion of the expected USD ($) income and the associated foreign exchange transaction exposure with hedging transactions. As at December 31, 2020 there were no such forward cover contracts in place (as at December 31, 2019 there were forward cover contracts in place for a total of $18.0 million).

Group policy is not to speculate with loans or deposits in foreign currencies. Financing and investing within the Group usually take place in the appropriate functional currency and any financial instruments are purely for operating purposes.

Four subsidiaries of H&K AG are outside the Euro zone. Since the H&K AG Group reporting currency is the euro, the income and expenses of these subsidiaries are converted to euro for consolidation. Through these subsidiaries the Group has assets and liabilities in local currencies outside the Euro zone that are also converted to euro for Group reporting. The conversion of these positions to euro is also affected by fluctuations in foreign exchange conversion rates. The change in valuation of these positions is reflected in the Group reserves.

The rates used for the consolidation are shown in the following table:

Currency	Abbr.	Rate on balance sheet date 31.12.2020	Rate on balance sheet date 31.12.2019	Average exchange rate 2020	Average exchange rate 2019
US Dollar (USA)	USD	1.2271	1.1234	1.1422	1.1194
Pound (Great Britain)	GBP	0.8990	0.8508	0.8897	0.8775

In order to quantify the possible effects of foreign exchange rate fluctuations on the Group EBITDA, sales and equity, a sensitivity analysis has been carried out:

If the euro had been 5% weaker against the US dollar compared to the rates used for the 2020 consolidation, (i.e. had been an average of €1 = $1.0851 and a spot of €1 = $1.1657), then 2020 sales would have been approximately €5.1 million higher, EBITDA would have been approximately €3.0 million higher and equity and reserves would have been approximately €2.8 million higher.

If the euro had been 5% weaker against the pound sterling compared to the rates used for the 2020 consolidation, (i.e. had been an average of €1 = £0.8452 and a spot of €1 = £0.8541), then 2020 sales would have been approximately €0.3 million higher, EBITDA would have remained roughly unchanged and equity and reserves would have been approximately €0.1 million higher.

Interest rate risk

Interest rate risk is the risk that the fair value or the future cash flows of a financial instrument may change depending on market interest rates. As at December 31, 2020 the Group's interest profile of its interest-bearing financial instruments consisted of fixed-rate instruments with a nominal value of €159.7 million (2019: €142.2 million) and variable rate instruments with a total nominal value of €83.0 million (2019: €95.0 million).

The Group's €83 million SFA-loan has a variable interest rate of 7.25% plus EURIOBR (if this is positive); the applicable rate is set at the beginning of each interest period (currently six months). A 100 basis-point (Bp) reduction in EURIBOR at each of the interest-fixing dates (August 21, 2019, February 21, 2020, August 21, 2020) would not have affected equity or profit or loss. A 100 basis-point (Bp) increase in EURIBOR at each of the interest-fixing dates would have reduced equity and profit or loss by approx. €0.6 million. This analysis assumes that all other variables, in particular tax-deductibility, remain constant. Since the reform of the EURIBOR - one of the most important IBORs - was completed in November 2019, this can still be used as a reference rate, so no effects are expected on the Group due to the IBOR-reform.

The Group's €60 million bond is an interest-bearing liability with a fixed interest rate of 6.5%; two bridging loans totalling €83.9 million bear interest at fixed rates of 2.0 % and one bridging loan of €15.9 million bears interest at a fixed rate of 6.5 %. The fair values of the bond and the bridging loans are dependent on market interest rates but these liabilities are not recognised at fair value and a change in interest rates at the balance sheet date would therefore not have had an effect on profit or loss or equity. This analysis assumes that all other variables remain constant.

The advance payment and performance guarantees we procure from banks in favour of our customers are not interest-bearing.

Commodity risk

The element of material costs relating to commodities is relatively small so the H&K AG Group's exposure to changes in purchase prices for raw materials is limited: for example, an increase in steel prices of 1% would have resulted in EBITDA being approx. €0.1 million lower while equity and reserves would have been around €0.1 million lower.

Credit risk

Credit risk is the risk of financial loss to the H&K AG Group if a customer or counter-party to a financial instrument fails to meet its contractual obligations, and arises principally from the Group's trade receivables. Risk concentrations arise for financial instruments of a similar nature, which react similarly to economic and other changes. Risk concentrations are determined per counterparty.

Trade receivables

Because the majority of the Group's trade receivables at the balance sheet date relate to sales to customers that are federal, state or local governmental agencies of NATO countries and NATO-equivalent countries, Group exposure to credit risk is limited. Goods are sold subject to retention of title clauses so that, in the event of a customer failing to pay, the H&K AG Group has a secured claim. Where management is of the opinion that the risk is not sufficiently secured by the retention of title clauses, we require letters of credit or prepayments. The Group has internal credit management processes to review and manage overdue positions and if necessary stop further deliveries or initiate legal action.

In addition, provisions are held for doubtful debts and general expected credit losses in accordance with IFRS 9 (Note 20). The maximum risk is the value shown as trade receivables in the balance sheet. The book values of trade receivables analysed according to their aging, together with the associated provisions, are shown in Note 20. To assess risk concentrations, all of a country's authorities are treated as a single counterparty.

Cash and cash equivalents

Cash and cash equivalents include cash balances, cheques, bank balances on current accounts and short-term deposits. The H&K AG Group is exposed to credit risks if the banks holding our deposits default on their obligations. To minimise this risk, the banks are selected with care and deposits are held by several banks in Germany and abroad. Since the effects are not regarded as material, the simplified impairment model is not used.

Liquidity risk and going concern considerations

Liquidity risk is the risk that the H&K AG Group may not be able to meet its financial obligations as they fall due. The target of the Group's approach to managing liquidity is to ensure that there will always be sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring losses or risking damage to the Group's reputation.

The Group mainly generates cash through its operating activities. The operating liquidity surplus is primarily used to finance fluctuations in working capital and capital expenditure, together with servicing the interest payment obligations from the SFA-loan and the bond.

According to the business plan, for 2021 and future years a positive net cashflow from operating activities, sufficient to cover investment and interest payments for the current financial liabilities, however not for the repayments coming due, is expected.

The continued existence of H&K AG and therefore of the H&K AG Group is dependent on the loans received and issued bond being punctually extended or replaced by other external loans or equity. Due to the equity situation of the Group, the extension or replacement of the financing is subject to the usual market uncertainties. The directors of H&K AG are planning to replace the financing due in 2022 and 2023 with long-term financing in keeping with the market as soon as possible, taking into account contractual conditions and commercial requirements. Given the new ownership structure of

H&K AG, the significant improvement in the Group's profitability once again, and the discussions that have commenced, there is currently no indication that this will not be possible. According to the current five-year business plan, the H&K AG directors are also planning the conversion of shareholder loans into equity, to the extent permitted by law, which would reduce the indebtedness significantly.

The following table shows the timing of contractual payments due for financial instruments that are accounts payable or loan interest or repayments.

EUR '000	Trade payables	Loans and bond inc. interest
Balance at 31.12.2020		
Book value	18,217	243,506
Related payments	18,217	272,051
Payments due:		
- within one month	13,640	-
- between one and three months	2,216	963
- between three & twelve months	1,606	8,433
- between one and five years	755	262,654
- after more than five years	-	-
Balance at 31.12.2019		
Book value	21,633	236,672
Related payments	21,633	278,007
Payments due:		
- within one month	20,089	-
- between one and three months	1,544	1,195
- between three & twelve months	-	9,102
- between one and five years	-	267,710
- after more than five years	-	-

Variances between book value and related payments arise where certain non-current liabilities, in particular the SFA-loan and the bond, are held at their amortised costs and cause additional interest payments. Additional information on the financial liabilities is given in Note 25.

Capital management

The objective of the capital management is to secure the financing of current business activities, considering the obligations and the regular interest payments due to the SFA-loan and the bond, and in the medium-term to reduce the leverage significantly. The Group's internal policies require that return on capital is reviewed on all investments and generally all contract bid decisions. The Group aims to have a corporate and capital structure, without material off-balance sheet financing. In the normal course of business, performance and advance payment guarantees are issued to our customers by banks and insurers on our behalf (Note 25).

All legal capital requirements were complied with during the period covered by these statements.

The Group's capital structure is as follows:

EUR '000	31.12.2020	31.12.2019
Equity	**(108,269)**	**(120,868)**
as a percentage of total financing	-39%	-48%
Long-term liabilities	329,162	323,761
Short-term liabilities	53,980	49,489
Debt	**383,142**	**373,250**
as a percentage of total financing	139%	148%
Total equity & liabilities	**274,873**	**252,383**

(29) Additional disclosures on financial instruments

This note provides an overview of the significance of financial instruments and provides additional information on the balance sheet positions containing financial instruments. The following asset positions in the statement of financial position include financial instruments:

EUR '000	31.12.2020	31.12.2019
Non-current assets		
Other investments & derivatives	1,620	1,806
Current assets		
Other loans, deposits & derivatives	2,774	2,996
Trade receivables	23,444	21,709
Other receivables	1,774	1,956
Cash and cash equivalents	33,343	23,380
Asset positions containing financial instruments	**62,954**	**51,847**
of which non-financial instruments	1,543	1,606
of which financial instruments	**61,411**	**50,241**

The following table shows the book values (BV) and fair values (FV) of the financial assets:

EUR '000	Cash and cash equivalents BV	Cash and cash equivalents FV	Trade accounts receivable BV	Trade accounts receivable FV	Derivative financial instruments BV	Derivative financial instruments FV	Other financial instruments BV	Other financial instruments FV
Balance at 31.12.2020								
	-	-	-	-	-	-	-	-
Recognised at amortised cost	33,343	33,343	23,444	23,444	-	-	4,625	4,625
Recognised at fair value through other comprehensive income	-	-	-	-	-	-	-	-
Recognised at fair value through profit or loss	-	-	-	-	-	-	-	-
Total financial assets	**33,343**	**33,343**	**23,444**	**23,444**	**-**	**-**	**4,625**	**4,625**
Balance at 31.12.2019								
	-	-	-	-	-	-	-	-
Recognised at amortised cost	23,380	23,380	21,709	21,709	-	-	5,078	5,078
Recognised at fair value through other comprehensive income	-	-	-	-	-	-	-	-
Recognised at fair value through profit or loss	-	-	-	-	73	73	-	-
Total financial assets	**23,380**	**23,380**	**21,709**	**21,709**	**73**	**73**	**5,078**	**5,078**

The fair values of accounts receivable are in line with their book values. This is mainly due to the short terms of these instruments.

The derivative financial instruments relate primarily to forward cover contracts for USD / EUR, held at fair value through profit or loss (2020: none; 2019: €73k).

The other financial instruments relate primarily to short and long-term bank deposits as security for certain bank guarantee lines etc. (2020: €4,394k; 2019: €4,729k) (Notes 18, 25); their aging is as follows:

EUR '000	31.12.2020	Other financial instruments 31.12.2019
Neither overdue nor impaired:	4,625	5,078
Net trade accounts receivable	**4,625**	**5,078**

As at the balance sheet date, no evidence had been identified to suggest that any of the above financial instruments that were neither overdue nor impaired were doubtful. Since the effects are not regarded as material, the simplified impairment model is not used. During the reporting period there were no reclassifications of financial assets between the IFRS 9 categories recognised “at amortised cost”, “at fair value through profit or loss” and “at fair value through other comprehensive income”.

The following liability positions in the statement of financial position include financial instruments:

EUR '000	31.12.2020	31.12.2019
Non-current liabilities		
Loans & borrowings	240,552	233,485
Lease obligations	1,243	1,556
Current liabilities		
Trade payables	18,217	21,633
Other payables	11,614	10,901
Liability positions containing financial instruments	**271,626**	**267,576**
of which non-financial instruments	8,580	7,673
of which financial instruments	**263,046**	**259,902**

The following table shows the book values (BV) and fair values (FV) of financial liabilities:

EUR '000	Trade payables BV	Trade payables FV	Bond and long-term loans BV	Bond and long-term loans FV	Other financial liabilities BV	Other financial liabilities FV
Balance at 31.12.2020						
Held at amortised cost	18,217	18,217	240,552	242,737	3,034	3,034
	-	-	-	-	-	-
Financial liabilities	**18,217**	**18,217**	**240,552**	**242,737**	**3,034**	**3,034**
Balance at 31.12.2019						
Held at amortised cost	21,633	21,633	233,485	237,170	3,228	3,228
	-	-	-	-	-	-
Financial liabilities	**21,633**	**21,633**	**233,485**	**237,170**	**3,228**	**3,228**

The fair values of the trade payables are in line with the book values. This is mainly due to the short terms of these instruments. The bond is held at amortised cost; its fair value at the balance sheet date is determined using its market price. The SFA-loan is held at amortised cost; its fair value at the balance sheet date is its nominal value. The bridging loans are held at amortised cost (identical to nominal values); their fair values at the balance sheet date largely correspond to their nominal values. The other financial liabilities mainly relate to the interest liabilities for the SFA-loan and for the bond (2020: €2,955k; 2019: €3,186k).

The following table shows an analysis of financial instruments carried at fair value, by valuation method. The different levels have been defined as follows:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities
- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices)
- Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

31.12.2020

EUR '000	Level 1	Level 2	Level 3
Derivative financial assets	-	-	-
Derivative financial liabilities	-	-	-

31.12.2019

EUR '000	Level 1	Level 2	Level 3
Derivative financial assets	-	73	-
Derivative financial liabilities	-	-	-

Net income / (expenses) due to financial instruments:

EUR '000	2020	2019
Recognised at amortised cost	(4,973)	173
Held at fair value through profit or loss	(73)	73

The net income / (expense) from loans and receivables and financial liabilities held at amortised cost include exchange gains and losses, impairments and reversals of previous impairments and relate to receivables in particular. The net income / (expense) from financial instruments held at fair value (derivatives) relates to the recognition of changes in the valuation of forward cover contracts.

The total interest income and expenses relating to financial assets and liabilities not held at fair value through profit and loss, including guarantee fees, are as follows:

EUR '000	2020	2019
Interest income	14	50
Accretion of non-current financial liabilities	(1,499)	(1,152)
Other interest expenses	(13,393)	(12,716)

(30) Cash flow statement

The Group cash flow statement shows the change in the H&K AG Group's cash and cash equivalents due to cash inflows and outflows during the year. Cash and cash equivalents include cash balances, cheques and bank balances; these last also include amounts serving as security for certain forward-cover and guarantee lines and for the SFA-loan (Note 21, 25).

As required by IAS 7, cash flows are analysed between operating, investing and financing activities. Cash flows from investing and financing activities are determined directly while those from operating activities are calculated indirectly from the net results. The changes in balance sheet positions used in the indirect calculation are adjusted to exclude the effects of foreign exchange rate variances and, if relevant, any changes in the companies consolidated into the Group. The changes in the balance sheet positions shown in the cash flow are therefore different to the euro changes in the Group balance sheet.

Interest received is classified as a cash flow from investing activities. Interest paid is shown as cash flows from financing activities.

Security deposits with terms longer than three months are shown in the statement of financial position under deposits or non-current investments (Note 18); movements in these are therefore shown under net cash from / (used in) investing activities in the statement of cash flows. However, these deposits serve as security for bank guarantees etc. (Note 25), rather than being made for the Group's investment purposes. The Group's net cash from / (used in) investing activities, adjusted to exclude these movements would be as follows:

EUR '000	2020	2019
Net cash from / (used in) investing activities	(22,455)	(1,607)
Less amounts relating to the movement in security deposits with terms >3 months	(335)	(13,193)
Adjusted net cash from / (used in) investing activities	**(22,790)**	**(14,799)**

(31) Segment reporting

The organisation and reporting structure of the H&K AG Group is marked by its operating activities in the defence technology line of business.

The Defence division is organised around five (2019: five) operating companies, three of which serve customers in the defence and law enforcement sector, whilst the fourth (HKI) serves the US commercial market and the fifth (HKO) serves customers in the defence and law enforcement sector, the other Group companies and the commercial markets in certain other countries. Correspondingly, the segments analysed are the site locations in Germany Great Britain, France and the United States, split into Defence and Commercial. Since these segments mainly represent legal entities, the figures shown for each segment are the values for the companies as included in the H&K AG Group's consolidated figures.

The activities in reporting segment Germany relate to the design, manufacture and distribution of defence and security products together with the provision of associated services. Reporting segment Germany mainly supplies to NATO member states and NATO-equivalent countries in which no Group subsidiaries are located and to Group companies and manufactures, sells and distributes commercial and security products to customers outside the US. The reporting segment "USA - commercial" has production, sales and distribution activities for commercial and security products and provides related services in the US.

The other reporting segments all have sales and distribution activities for defence and security products and provide related services. The sites located in the USA and France supply to these countries. The site located in Great Britain sells primarily to the United Kingdom; in the past it also served the British Commonwealth of Nations and certain other NATO allies. Due to the new strategic direction to focus on so-called "Green Countries" (Note 1), only the remaining order book for these countries will be served via site location Great Britain.

The "Other holding activities" reporting segment relates to H&K AG and HKM. As this reporting segment contains several companies, the figures reflect the amounts recognised for individual companies in the consolidated financial statements as well as certain consolidation adjustments within the segment.

Operating segments

Site Location	Germany		USA - Commercial		USA - Defence		Great Britain		France		Holding activities		Total pre-consolidation		Consolidation transactions		H&K AG Group	
EUR '000	2020	2019	2020	2019	2020	2019	##########	2019	2020	2019	2020	2019	2020	2019	2020	2019	2020	2019
Net external revenues	113,818	120,654	75,091	45,652	19,813	14,443	22,122	12,579	44,141	46,088	-	-	274,984	239,417	-	-	274,984	239,417
Inter-segment revenue	86,043	59,149	181	320	79	107	322	119	-	-	-	-	86,625	59,695	(86,625)	(59,695)	-	-
Total output	209,160	186,928	74,291	48,486	23,636	14,442	24,780	14,021	43,818	45,838	-	-	375,685	309,715	(86,295)	(61,155)	289,390	248,559
Depreciation and amortisation	(9,478)	(8,296)	(1,170)	(745)	(176)	(191)	(111)	(114)	(25)	(44)	(42)	(42)	(11,001)	(9,432)	47	-	(10,954)	(9,432)
EBITDA	34,787	24,781	5,902	1,590	3,252	990	2,412	1,520	3,726	3,175	(463)	(246)	49,617	31,810	332	(1,468)	49,949	30,341
Interest income	132	177	-	-	0	3	1	4	5	1	3,229	2,524	3,367	2,708	(3,353)	(2,656)	14	52
Interest expense	(8,397)	(7,951)	(2)	(4)	(131)	(148)	(43)	(49)	(5)	(19)	(10,537)	(9,608)	(19,114)	(17,780)	3,353	2,656	(15,761)	(15,124)
Income taxes	262	(299)	(1,028)	(135)	(586)	(134)	(448)	(224)	(1,056)	(892)	(3,760)	(2,815)	(6,616)	(4,499)	(73)	321	(6,688)	(4,178)
Profit / (loss) after tax	17,264	11,041	3,570	702	2,348	525	1,909	1,023	2,645	2,221	60,704	(1,131)	88,439	14,380	(74,958)	(12,776)	13,482	1,604
Other material non-cash items																		
- Impairment of assets	(1,965)	(89)	-	(250)	-	-	-	(15)	-	-	-	-	(1,965)	(353)	-	-	(1,965)	(353)
- Impairment losses reversed	-	293	168	403	40	188	-	-	-	-	56,599	-	56,807	883	(56,599)	-	208	883
Non-current assets other than deferred taxes and financial instruments	161,931	153,499	12,385	12,268	1,016	1,288	566	698	40	200	226	268	176,166	168,222	(74,653)	(74,700)	101,513	93,521
Capital expenditure, excluding capitalised development costs	(15,732)	(9,828)	(1,079)	(415)	(1)	-	(15)	(9)	-	-	-	-	(16,827)	(10,252)	-	515	(16,827)	(9,737)
Provisions and liabilities	213,769	199,081	23,633	26,618	23,901	25,391	5,582	4,926	5,165	8,742	263,398	311,416	535,449	576,175	(152,307)	(202,925)	383,142	373,250

The above table shows the revenues and results together with the assets and liabilities of the individual Group segments. With the exception of sales from the German segment to other segments, trading between segments is minimal. The trade relationships between segments have been consolidated. Trade between the segments is conducted at 'arm's-length' prices, as would have been agreed with informed and willing parties outside the Group. Due to the fiscal unity ("Organschaft"), the German taxes are all incurred by the parent entity, H&K AG. The €74.7 million for non-current assets shown in the column "consolidation transactions" relate to goodwill and trademarks recognised in segment Germany as the result of a merger in 2004. These arose primarily due to transactions within the Group and on consolidation are therefore reduced to the values acquired from third parties.

Geographical and product group segments

The value of revenues from customers in different regions of the world and the proportions of revenues due to the different product groups are shown in the following tables:

Region			Percentage of revenues
Germany (Domestic)	**2020**	**74,510**	**27%**
	2019	**77,264**	**32%**
USA	2020	94,818	34%
	2019	60,018	25%
UK	2020	22,127	8%
	2019	11,964	5%
France	2020	44,154	16%
	2019	46,178	19%
Other "Green Countries"	2020	39,372	14%
	2019	40,640	17%
Rest of world	2020	2	0%
	2019	3,352	1%
Total export	**2020**	**200,474**	**73%**
	2019	**162,153**	**68%**
Total	**2020**	**274,984**	**100%**
	2019	**239,417**	**100%**
of which "Green Countries"	2020	274,982	100%
	2019	236,065	99%

Product group		Percentage of revenues
Rifles	2020	32%
	2019	32%
Sub-machine guns & machine guns	2020	17%
	2019	21%
Pistols	2020	31%
	2019	24%
Development services	2020	1%
	2019	0%
Other products & services	2020	19%
	2019	23%
Total	**2020**	**100%**
	2019	**100%**

Major customers

IFRS requires customers known to be under common control to be treated as one customer. Since the H&K AG Group sells to government agencies, which include law enforcement agencies and armed forces, in various countries this requirement leads to all governmental agencies in a particular country being treated as one single joint customer.

On this basis the H&K AG Group's major customers, to whom more than 10% of sales were made in 2020, are the German governmental authorities (2020: €57 million; 2019: €61 million) shown in the segment Germany and the French governmental authorities (2020: €44 million; 2019: €46 million) shown in the segment France.

(32) Contingent liabilities and pledged assets

There are no material contingent liabilities as of December 31, 2020 or December 31, 2019; based on the current business plan (covering five years) no related claim is expected in this period. For information on bank guarantees for customers and the related security deposits see Note 25. Almost all of the other Group assets are pledged for the SFA-loan from July 24, 2017 under various floating charges and other security agreements. For details of pledged assets see Notes 16, 17, 18, 19, 20, 21 and 25. For liabilities relating to certain short-term and / or low value leases, see Note 33.

(33) Leases

The Group has no leases for which it is the lessor. The following information is for leases where the Group is the lessee.

Material leases

The Group leases offices; the lease agreements for these have original terms of between six and ten years, with the option to extend the leases beyond this period. Lease payments are generally renegotiated after around half of the lease term to reflect market rates; we can terminate contracts at this time.

The Group leases cars and other vehicles together with certain items of IT equipment; these lease agreements generally have original terms of between three and five years, with the option to extend the leases beyond this period.

i. Right-of-use assets

Due to the application of IFRS 16, from 2019 onwards, right-of-use assets are recognised within property, plant and equipment for rented property, which does not meet the definition of investment property, and for vehicles and certain items of IT equipment. Until the end of 2018, only finance leases according to IAS 17 were recognised within property, plant and equipment.

EUR '000	Land and buildings	Fixtures, fittings and other assets	Total
Net carrying value at 01.01.2019	**-**	**37**	**37**
Acquisition / manufacturing costs			
Balance at 01.01.2019	**-**	**82**	**82**
Effects of the initial application of IFRS 16 on 01.01.	2,216	413	2,629
Effect of movement in exchange rates	27	1	28
Additions	47	156	203
Disposals	-	(21)	(21)
Balance at 31.12.2019	**2,290**	**631**	**2,921**
Amortisation & depreciation			
Balance at 01.01.2019	**-**	**(45)**	**(45)**
Effects of the initial application of IFRS 16 on 0	(924)	(175)	(1,099)
Effect of movement in exchange rates	(9)	(1)	(9)
Depreciation for the year	(250)	(159)	(409)
Disposals	-	15	15
Balance at 31.12.2019	**(1,182)**	**(365)**	**(1,548)**
Net carrying value at 31.12.2019	**1,107**	**266**	**1,374**
Acquisition / manufacturing costs			
Balance at 31.12.2019	**2,290**	**631**	**2,921**
Effect of movement in exchange rates	(92)	(14)	(106)
Additions	-	426	426
Reclassifications	(33)	33	-
Disposals	(564)	(231)	(795)
Balance at 31.12.2020	**1,601**	**845**	**2,446**
Amortisation & depreciation			
Balance at 01.01.2020	**(1,182)**	**(365)**	**(1,548)**
Effect of movement in exchange rates	56	9	66
Depreciation for the year	(214)	(207)	(420)
Reclassifications	19	(19)	-
Disposals	392	231	623
Balance at 31.12.2020	**(930)**	**(350)**	**(1,279)**
Net carrying value at 31.12.2020	**671**	**496**	**1,167**

ii. amounts recognised in profit or loss

Amortisation amounting to €420k (2019: €409k) for right-of-use assets and interest expenses amounting to €94k (2019: €116k) for lease liabilities were recognised in profit or loss. The associated deferred taxes relating to these were minimal in both years, however the initial application of IFRS 16 on January 1, 2019 resulted in additional income from deferred taxes since, unlike the associated effects for the new assets and liabilities, these were not included in the initial adjustment to retained earnings.

iii. amounts recognised in the statement of cash flows

The leasing payments were split between interest payments of €96k (2019: €116k), and repayment of lease liabilities amounting to €432k (2019: €413k); both are shown within net cash flows from / (used in) financing activities.

Other leases

The Group has other leases which have one or both of the following characteristics: (i) term of less than one year; (ii) the associated assets are of low value. These leases are recognised as in prior periods, i.e. neither right-of-use assets nor lease liabilities are recognised for these.

The Group recognised expenses of €141k (2019: €148k) for short-term leases and €13k (2019: €12k) for leases for which the associated assets are of low value. As at the balance sheet date, the group had outstanding obligations arising from these leases that fall due as follows:

EUR '000	31.12.2020	31.12.2019
Up to one year	33	8
More than one and up to five years	2	0
More than five years	0	0
Total	**35**	**8**

(34) Number of employees

The number of employees in the H&K AG Group, as an annual average, was as follows:

	2020	2019
Germany	848	791
France	2	2
Great Britain	17	16
USA - Defence	5	5
USA - Commercial	73	75
Holding activities	5	3
Average employees	**950**	**892**

In accordance with HGB §314 para. 1 No. 4 1st HS, these numbers for 2020 and 2019 exclude directors, people on national service, apprentices and trainees; part-time employees are fully included.

(35) Personnel expenses

Personnel expenses in 2020 were €75,379k (2019: €69,309k). Of these expenses, €4,839k (2019: €4,661k) relate to employer's contributions to social security pension funds and similar defined contribution plans for pensions.

(36) Related party disclosures

Parent and ultimate controlling party

H&K AG is the parent of the H&K AG Group and is owned by private investors. It holds 94.9% of HKO indirectly and the 5.1% balance directly.

Since July 2020, the majority of shares are held by Compagnie de Développement de l'Eau S.A., Luxemburg, Luxemburg (direct) and Sofi Kapital Ltd., Christ Church, Barbados (indirect).

Other related party transactions

Transactions between the parent company and related parties that are its subsidiaries were eliminated in the course of consolidation and are not described in these disclosures in the Notes. Transactions with members of the governing bodies are covered in Note 38.

In addition, there are arm's-length business relationships between H&K AG Group companies and related parties as defined by IAS 24, as follows:

- In 2018, a main shareholder, CDE, granted H&K AG a €30 million unsecured bridging loan and a €50 million unsecured bridging loan. Both loans have terms to July 15, 2023 and agreed interest at 2%; accrued interest is added to each loan quarterly (Note 25).
- In February 2020, another main shareholder granted H&K AG a €15 million unsecured bridging loan with a term to July 15, 2023 and agreed interest at 6.5%; accrued interest is added to this loan quarterly (Note 25).

Transactions with related parties are generally carried out as if between willing, informed and independent third parties.

(37) Governing bodies of the Group

Executive Board of H&K AG

Dr-Ing. Jens Bodo Koch	CEO
Dr Björn Krönert	CFO

Supervisory Board of H&K AG

Dr Rainer Runte	Member (since September 23, 2020), Chairman (since September 29, 2020)
Nicolaus Bocklandt	Deputy Chairman (until July 12, 2019 and from September 29, 2020); in between, member
Dr Regina Engelstädter	Member (since September 23, 2020)
Harald Kujat, General (retired)	Chairman (from July 12, 2019 until August 27, 2020)
Dr Martin Heiner Sorg	Member (from April 29, 2019 until July 11, 2020), Deputy Chairman (from July 12, 2019 until August 27, 2020)

(38) Transactions with the members of the governing bodies

EUR '000	2020	2019
Short-term benefits for the supervisory board	246	179
Short-term benefits for the executive board	1,122	785
Gesamt	**1,368**	**964**

(39) Auditor's remuneration

EUR '000	2020	2019
Audit of the financial statements	265	247
Other confirmation services	6	-
Tax services	-	-
Other services	-	-
Total	**271**	**247**

(40) Subsequent events

On February 11, 2021, oral proceedings took place for the appeal before the Federal Court of Justice on questions of law regarding the Mexico case. The verdict was pronounced on March 30, 2021. The Federal Court of Justice's review on appeal of the Stuttgart District Court's verdict did not identify any legal errors. The Stuttgart District Court was found to have correctly affirmed the prerequisites for the confiscation and determined the confiscation amount of €3.7 million appropriately. However, due to a decision of the Federal Constitutional Court concerning confiscation for time-barred offences, which not known at the time of the main hearing, the Federal Court of Justice severed consideration of €0.7 million of this amount. The judgement is therefore substantially legally binding.

On March 2, 2021 our subsidiary, Heckler & Koch GmbH, was informed by the German Federal Office of Bundeswehr Equipment, Information Technology and In-service Support (BAAINBw) that, since the only other competitor has been excluded from the procurement procedure due to formal errors, it is intended that the HK 416 A8 be procured as the new assault rifle for the German Army. The final decision is expected in the coming months as this competitor has taken legal steps against their exclusion.

No other material operating or structural changes or transactions have occurred in the H&K AG Group between December 31, 2020 and the approval of these consolidated financial statements.

Oberndorf am Neckar, March 31, 2020

The Executive Board

Dr. Jens Bodo Koch Dr. Björn Krönert

TRANSLATION – GERMAN VERSION PREVAILS

INDEPENDENT AUDITOR'S REPORT

To H&K AG, Oberndorf am Neckar/Germany

Audit Opinions

We have audited the consolidated financial statements of H&K AG, Oberndorf am Neckar/Germany, and its subsidiaries (the Group) which comprise the consolidated balance sheet as at 31 December 2020, and the consolidated statement of profit or loss and other comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the financial year from 1 January to 31 December 2020, and the notes to the consolidated financial statements, including a summary of significant accounting policies. In addition, we have audited the group management report of H&K AG, Oberndorf am Neckar/Germany, for the financial year from 1 January to 31 December 2020.

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

- the accompanying consolidated financial statements comply, in all material respects, with the IFRS as adopted by the EU and the additional requirements of German commercial law pursuant to Section 315e (1) German Commercial Code (HGB) and, in compliance with these requirements, give a true and fair view of the assets, liabilities and financial position of the Group as at 31 December 2020 and of its financial performance for the financial year from 1 January to 31 December 2020, and
- the accompanying group management report as a whole provides an appropriate view of the Group's position. In all material respects, this group management report is consistent with the consolidated financial statements, complies with German legal requirements and appropriately presents the opportunities and risks of future development.

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

Basis for the Audit Opinions

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

Material Uncertainty Related to Going Concern

We refer to the explanations in the notes to the consolidated financial statements in the section “Liquidity risk and going concern considerations”, and in the group management report in the section “Solvency / going concern considerations”, in which the executive directors explain that the H&K AG’s and H&K AG Group’s ability to continue as a going concern depends on extending without delay the maturity dates of loans, that have been taken out, and bonds, that have been issued, or replacing the loans and bonds with other external financing or an increase in equity. The executive directors of H&K AG plan to repay the liabilities, becoming due for payment in 2022 and 2023, at the earliest possible date, taking into consideration contractual specifications and commercial requirements, and to replace them with market-conform longer-term financing. As described in these disclosures with reference to the Company’s equity situation, these events and conditions suggest that a material uncertainty exists that may cast significant doubt on the Company’s ability to continue as a going concern, and constitutes a risk defined in Section 322 (2) sentence 3 HGB threatening the Company's ability to continue as a going concern. Our audit opinion was not modified in respect of this matter.

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

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

In preparing the consolidated financial statements, the executive directors are responsible for assessing the Group’s ability to continue as a going concern. They also have the responsibility for disclosing, as applicable, matters related to going concern. In addition, they are responsible for financial reporting based on the going concern basis of accounting unless there is an intention to liquidate the Group or to cease operations, or there is no realistic alternative but to do so.

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

The supervisory board is responsible for overseeing the Group’s financial reporting process for the preparation of the consolidated financial statements and of the group management report.

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

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

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

We exercise professional judgment and maintain professional scepticism throughout the audit. We also

- identify and assess the risks of material misstatement of the consolidated financial statements and of the group management report, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our audit opinions. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls.
- obtain an understanding of internal control relevant to the audit of the consolidated financial statements and of arrangements and measures relevant to the audit of the group management report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an audit opinion on the effectiveness of these systems.
- evaluate the appropriateness of accounting policies used by the executive directors and the reasonableness of estimates made by the executive directors and related disclosures.

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

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

Stuttgart/Germany, 31 March 2021

Deloitte GmbH
Wirtschaftsprüfungsgesellschaft

Signed: (Franz Klinger)	Signed: (Anja Lustig)
Wirtschaftsprüfer	Wirtschaftsprüferin
(German Public Auditor)	(German Public Auditor)