NAPATECH

1ST QUARTER 2017
INTERIM REPORT

CONTENTS

MANAGEMENT STATEMENT

The Board of Directors and the Executive Management have discussed and approved the interim report of Napatech Group for the three months' period from 1 January to 31 March 2017.

The interim report has been prepared in accordance with IAS 34 Interim Financial Reporting, as adopted by the EU, and additional interim reporting requirements for listed companies.

In our opinion, the interim report gives a true and fair view of the Napatech Group's assets, liabilities and financial position at 31 March 2017, and of the results of the Napatech Group's operations and cash flows for the three months' period 1 January to 31 March 2017.

We also find that the Management's review provides a fair statement of developments in the activities and financial situation of the Group, financial results for the period and the general financial position of the Group, and describes the major risks and elements of uncertainty faced by the Group. The term Company below refers as well to the Group.

The interim report has not been subject to audit or review by our auditors.

Oslo, 9 May 2017

Executive Management

Henrik Brill Jensen, CEO	Niels Hobolt, CFO

Board of Directors

Lars B. Thoresen, Chairman	Howard Bubb
Bjørn Erik Reinseth	

LETTER FROM THE CEO

Dear fellow shareholders,

With a revenue growth of 24 percent in the first quarter of 2017, following an equally strong closing of 2016, I have no problem of stating that the Napatech team has had a busy, energetic and promising start of 2017. Our team continues to travel the world to meet existing and new customers to partner on how our technology can monitor, compile and analyze the ever increasing information flowing through their networks.

The market feedback is promising. We continue to see design wins converting into orders, and experiences an increased momentum for our design win pipeline. We will have quarter-to-quarter order fluctuations going forward, but the first quarter provided a solid platform for the rest of 2017 and we reiterate our 2017 growth guidance of 10 to 20 percent.

In early April 2017, we hosted our Capital Markets Day in Oslo where we reiterated that Napatech is in a pole position to deliver state-of-the-art products, software and technology to an ever-expanding range of customers, driven by global trends and the emerging SmartNIC opportunities for accelerated growth, a digital transformation, and migration to the cloud. We highlighted a number of market trends, such as increasing and more sophisticated internet independence, exploding volumes of data, demand for increased network speeds, and all services moving to the cloud, which are allowing us to expand to a new range of high-growth applications and virtualized servers in software defined networks.

Our strategic ambition is to be the number one vendor of SmartNIC solutions, based on our current position as the leader in FPGA-based solutions, which will inevitably become a part of every network. As such, we saw significant progress in business development during the quarter, and worked to repackage our solutions and technologies to fit diverse market needs. We were pleased to attend the Mobile World Congress in Barcelona in February-March, where we highlighted our entire product portfolio and debuted our latest offerings.

The Pandion product line were among the growth providers for Napatech in the first quarter of 2017, and is now sold in three different mix types:

- As a recorder solution for system integrators
- As recorder software and accelerators to OEM's
- As a DELL-branded recorder through DELL

The Pandion's share of sale increased to 8% in the quarter, compared to 1% in Q1 2016, where we also saw important Napatech design wins, including:

- 100 Gigabit solution for a European customer in the public safety vertical for a security solution
- 10 Gigabit design win for Japanese network monitoring company, for their own branded appliance
- Pandion design win for a North American customer in the financial vertical for a compliance solution

Recent design wins with new and existing customers reflect an important and continued expansion of our customer base, as our next steps are to be the preferred supplier of cloud networking solutions to largescale datacenter operators, fortune-5000 enterprises, service providers, and government operators. Major changes in communications created by cloud computing, 5G mobile and the Internet of Things have led to exploding volumes of users, devices and data, requiring organizations to rethink the way they design, deploy, operate and secure their networks and services. Napatech helps organizations to reimage their businesses with their SmartNIC platform, including FPGA-based accelerator cards for standard servers, leading networking software optimized for large- volume and high-growth applications, and advanced applications for FPGA-based NICs including Pandion 40 Gigabit line-rate capture and write-to-disk.

Napatech and Nokia completed during the quarter a POC on software compression in a virtualized environment using Napatech NFV NIC. The POC was built to prove the performance increase gained on the Nokia Airframe in connection with software compression, using the Napatech NFV NIC, one of the challenges when implementing virtualization in a Data Centre

Nokia Airframe Group had encountered a performance bottleneck related to the SW file compression of their storage application. They wanted to explore a HW acceleration solution to compress and store 40 Gigabit of raw data. The performance improvements achieved with this solution were 30 times faster compression time and 40 Gigabit sustained file compression for storage using only 1 CPU core. This was in contrast to the 40 cores utilized to achieve the same performance in SW only.

The cloud, 5G and IoT have combined to form one of the most significant growth forces in the age of networking, providing a massive market potential for our core FPGA technology and existing products. SmartNICs will become an inevitable part of every network, and as the leader in FPGA-based SmartNICs, we are in the pole-position to be deployed by a wider set of potential customers, benefiting an increased set of applications and services.

Consequently, we expect the profitable revenue growth to continue in 2017 and look forward to updating you on the developments during an exciting year.

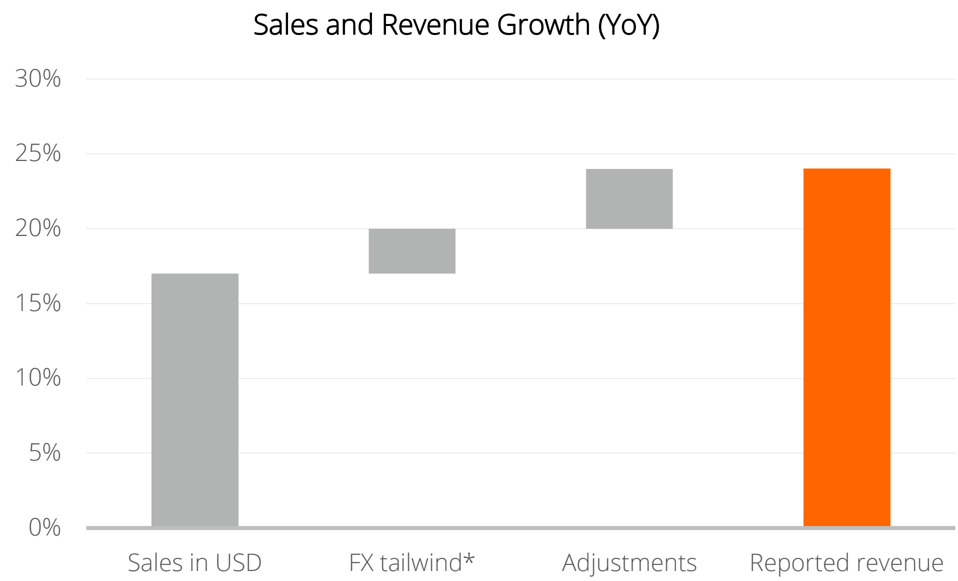
Best regards,

Henrik Brill Jensen
Chief Executive Officer

MANAGEMENT'S REVIEW

Highlights:

- Revenue for first quarter 2017 amounted to DKK 57.6 million, an increase of 24% compared to first quarter 2016.
- Pandion revenue was 8% of the total revenue in first quarter 2017.
- Gross margin for first quarter 2017 was 73% compared to 73% in first quarter 2016
- EBITDA for first quarter of 2017 amounted to DKK 9.4 million, an increase from DKK 6.2 million in first quarter 2016.
- EBITDA margin for first quarter 2017 was 16%, an increase from 13% in first quarter 2016.
- EBIT for first quarter amounted to negative DKK 0.1 million compared to negative DKK 2.3 million in first quarter 2016.
- EPS for first quarter 2017 was negative 0.07 DKK, improvement from negative 0.19 DKK in first quarter 2016.
- Cash was unchanged DKK 47million in the first quarter of 2017.



*Average bank rates

This is Napatech

Internet-of-things (IoT), cloud and mobile networking have each changed the way businesses operate, enabling them to rapidly deliver new applications and services to customers and employees. At Napatech, we aim to help organizations to reimagine their business, by harnessing the technologies born in hyper-scale designs, and making their benefits available to every network. Our SmartNICs platform brings cloud-scale performance, economics, innovation and security to datacenters in fortune-5000 enterprises, government agencies, service providers and cloud operators. The Virtual Networking Platform combines standard, low-cost, high-volume servers, with the agility of Napatech's FPGA-based programmable SmartNICs and software, to improve datacenter performance and reduce costs by returning valuable compute resources to applications, services and revenue.

Napatech. SMARTER DATA. DELIVERED.

Napatech operations.

The statements below are related to Napatech's development in first quarter of 2017 compared to first quarter of 2017, unless as otherwise stated. Additional information is available at www.napatech.com\investor.

Key figures and ratios.

	1st Quarter	
	2017	2017
Revenue, DKK'000	57,550	46,305
Gross profit margin, %	73%	73%
EBITDA, DKK'000	9,382	6,187
EBITDA margin, %	16%	13%
Loss before tax, DKK'000	(1,992)	(5,758)
EPS basic, DKK (please ref. Note 5)	(0.07)	(0.19)
EPS diluted, DKK	(0.07)	(0.19)
Equity, DKK'000	204,336	198,243
Cash and cash equivalents, DKK'000	46,968	69,754

Financial Review

Revenue

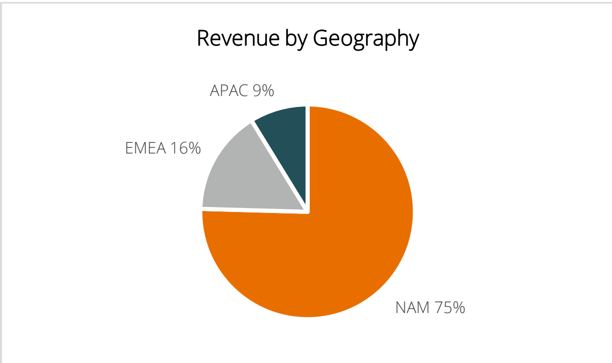
Napatech reports revenue of DKK 57.6 million in the first quarter, an increase of 24% compared to the same period in 2016. This quarter has shown progress on both our Accelerator business and our Pandion business. In first quarter 2016 we did not have any Pandion sales, and in this quarter, we realized 8% of the sales from Pandion.

Sales were distributed with 75% in NAM, 16% in EMEA and the remaining 9% in APAC. The share of revenue in North America is in the same level as we usual have seen.

Following the Napatech 2017 guidance, underlining that the short term visibility is limited and will be affected by quarter-to-quarter order volatility and general business uncertainty, the company will commence the reporting of the last twelve month (LTM) development to provide the financial market with an additional indicator of the longer term trends. In the first quarter of 2017, the LTM revenues and EBITDA ended at 12% and 28% respectively.

Gross Margin

Gross margin for first quarter 2017 was 73%. This was in line with the 73% in first quarter 2016, the gross margin is dependent on the product mix, The Pandion sales has contained less disk storage than expected, why the gross margin is a higher than expected initially.



MANAGEMENT'S REVIEW (CONTINUED)

Financial review (continued)

Costs

Total costs for first quarter 2017 were 32.4 million DKK compared to 27.8 million DKK for first quarter 2016, an increase of 17%. The difference is primarily due to timing of sales and marketing costs in this quarter as well as the comparing quarter, where the costs were lower than average. The increase in this quarter should not be seen as a general cost increase of 17%.

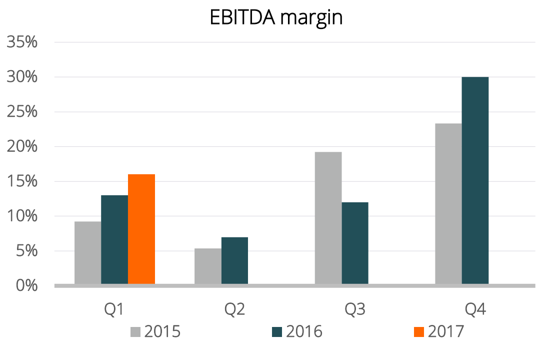
R&D costs for first quarter 2017 were DKK 3.7 million compared to DKK 2.7 million in the first quarter 2016. The increase in costs is related to the development activities in all three strategic focus areas; our Accelerators, Network Recorders and Virtualization efforts.

Sales and distribution costs for first quarter 2017 were DKK 20.2 million, compared to DKK 16.9 million in the first quarter of 2016. The increase in the Sales and Marketing costs are due to timing of different costs, and an increase in sales activities driving the growth.

Administrative expenses for first quarter 2017 were DKK 8.4 million compared to DKK 8.2 million in the first quarter 2016. The administration costs are in line with our expectations for this quarter.

EBITDA

EBITDA was DKK 9.4 million in the first quarter 2017, compared to DKK 6.2 million in the first quarter of 2016. The increase is driven by higher sales. The EBITDA margin of 16% is again an effect of the higher sales, and underline the scalability of Napatech.



Depreciation and amortization

Depreciation and amortization were DKK 9.5 million in the first quarter 2017, compared to DKK 8.4 million in the first quarter of 2016. Our depreciations are affected by the timing of the completion of our development projects, and the investment level in the past.

EBIT

EBIT for first quarter 2017 was negative DKK 0.1 million, an improvement compared to negative DKK 2.3 million in the first quarter of 2015, again is the improvement drive by the revenue growth for the quarter.

Financial Items

Financial items for first quarter 2017 were an expense of DKK 1.9 million compared to an expense of DKK 3.5 million in the first quarter of 2016. The financial items are primarily affected by the change in USD exchange rate, and it has decreased during first quarter 2017, compared to end of 2016 resulting in this expense.

Taxes

Taxes for the first quarter 2017 are an income of 0.4 MDKK. The effective tax rate is thus 22%. The taxable income in Denmark is subject to a lower taxation at a rate of 22%.

Investments

Total investments in first quarter 2017 were DKK 14.3 million. This was primarily related to new product development (capitalized development) with DKK 11.6 million. In first quarter of 2016, total investments were DKK 12.4 million, of which DKK 11.2 million was internal product development.

In first quarter 2017 there were several development projects related to the Pandion product, and development projects related to the Accelerator portfolio and development of our virtualization product.

Cash Flow

For the first quarter 2017, cash flow from operating activities was DKK 14.9 million, an increase of DKK 6.3 million from first quarter 2016.

Negative cash flow from investing activities was DKK 14.2 million in the first quarter 2017, an increase from DKK 12.4 million in the first quarter of 2016.

Napatech had a neutral cash flow in the first quarter of 2017. The total cash position of the Company was DKK 47.0 million by end of first quarter 2017, a decrease of DKK 22.8 million compared to the end of first quarter 2016. The negative cash flow is driven by change is operating cash flow and especially the build of inventory, as well as the investment activities conducted by the company.

Napatech has unused credit facilities of DKK 10 million in Denmark and USD 1 million in the US subsidiary as well at the end of first quarter 2016. Thus, the Company has available total funds of approx. 65 million DKK at the end of the first quarter of 2017.

Financial review (continued)

Shareholders and Share Information

Napatech as of March 31, 2017 issued 23,813,720 shares at DKK 0.25 each. The share capital is 5,953,430 DKK divided among the 377 shareholders.

Investor	Number of shares	% of total
VERDANE CAPITAL VIII	5.172.844	21,72%
STOREBRAND VEKST VER	2.367.716	9,94%
ARCTIC FUNDS PLC	2.270.021	9,53%
SILVERCOIN INDUSTRIE	1.456.849	6,12%
VERDIPAPIRFONDET DNB	1.171.021	4,92%
DNB NOR MARKETS, AKS	1.100.000	4,62%
THE BANK OF NEW YORK	980.000	4,12%
VINTERSTUA AS	937.199	3,94%
DANSKE BANK A/S	684.056	2,87%
SÆTER HAAKON MORTEN	670.000	2,81%
MARSTAL AS	520.000	2,18%
SKANDINAVISKA ENSKIL	500.000	2,10%
DNB LUXEMBOURG S.A.	360.177	1,51%
NORDNET BANK AB	323.884	1,36%
NORDEA BANK AB	294.337	1,24%
HOBOLT NIELS	263.872	1,11%
PEDERSEN TORE ANDRÉ	258.361	1,08%
EKNER PETER DAHL	247.200	1,04%
NORTHZEA MANAGEMENT	220.633	0,93%
TIGERSTADEN AS	213.405	0,90%
Total number owned by top 20	**20.011.575**	**84,03%**
Total 370 other shareholders	**3.802.145**	**15,97%**
Total number of shares	**23.813.720**	**100,00%**

Outlook for 2017

Major changes in communications created by cloud computing, 5G mobile and the Internet of Things (IoT) have led to exploding volumes of users, devices and data, requiring organizations to rethink the way they design, deploy, operate and secure their networks and services.

Napatech helps organizations to reimage their businesses with their SmartNIC platform, including FPGA-based accelerator cards for standard servers, leading networking software optimized for large- volume and high-growth applications, and advanced applications for FPGA-based NICs including Pandion 40 Gigabit line-rate capture and write-to-disk.

The increased demand for SmartNIC hardware, software and services provides the catalyst for growth from Napatech's existing products and solutions, and anchors the company's ambition of a 100 MUSD top-line by 2020. Building on the growth of 8% in 2016, the company expects profitable revenue growth to continue in 2017, but underlines that the short-term visibility is limited and will be affected by quarter-to-quarter order volatility and general business uncertainty.

The company reiterates the following guidance for 2017:

- Revenue growth of 10 to 20%
- Gross margin around 68%
- EBITDA margin around 20%

Napatech is comfortable with an accelerated growth path towards the ambition of 100 MUSD top-line by 2020.

Napatech has made a hedge of the USD net exposure, where approximately 52% of the USD revenue is hedged around 6.83 DKK (average for 2017 was 6.73) and the remaining 48% is naturally hedged against other USD denominated costs.

Oslo, 9 May 2017

The Board of Directors of Napatech A/S

INTERIM CONSOLIDATED INCOME STATEMENT

For the period ended 31 March 2017

DKK'000	Note	1st Quarter 2017	1st Quarter 2016
Revenue	3	57,550	46,305
Costs of goods sold		(15,776)	(12,304)
Gross profit		41,774	34,001
Research and development cost		(3,721)	(2,713)
Selling and distribution expenses		(20,239)	(16,943)
Administrative expenses	4	(8,432)	(8,158)
Operating profit before depreciation, amortisation and impairment (EBITDA)		9,382	6,187
Depreciation, amortisation and impairment		(9,450)	(8,449)
Operating loss (EBIT)		(68)	(2,262)
Finance income		-	4
Finance costs		(1,924)	(3,500)
Loss before tax		(1,992)	(5,758)
Income tax		438	1,267
Loss for the period		(1,554)	(4,491)
Earnings per share:	5		
Basic, DKK		(0.07)	(0.19)
Diluted, DKK		(0.07)	(0.19)

INTERIM CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the period ended 31 March 2017

DKK'000	Note	1st Quarter 2017	1st Quarter 2016
Loss for the period		(1,554)	(4,491)
Other comprehensive income to be reclassified to profit or loss in subsequent periods:			
Exchange differences on translation of foreign operations		(2)	(200)
Net movement on cash flow hedges		2	5,522
Income tax effect		-	(1,230)
Net other comprehensive income to be reclassified to profit or loss in subsequent periods		-	4,092
Total comprehensive income for the period		(1,554)	(399)

INTERIM CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 31 March 2017

ASSETS

DKK'000	Note	31 March 2017	31 December 2016	31 March 2016
Development projects, completed		68,884	75,689	63,343
Development projects, in progress		33,106	22,488	23,328
Patents		6,229	6,379	7,796
Other intangible assets		311	489	1,024
Intangible assets	6	108,530	105,045	95,491
Plant and equipment		6,121	5,186	6,612
Office improvements		1,547	1,173	1,466
Tangible assets	7	7,668	6,359	8,078
Leasehold deposits		2,309	2,312	2,313
Other non-current assets		2,309	2,312	2,313
Non-current assets		118,507	113,716	105,882
Inventories		32,851	18,675	14,601
Trade receivables	8	51,632	75,119	30,156
Other receivables	8	3,438	4,844	4,616
Income tax receivable	8	2,231	2,094	2,451
Derivative financial instruments	9	-	-	4,513
Cash and cash equivalents		46,968	46,951	69,754
Current assets		137,120	147,683	126,091
Total assets		255,627	261,399	231,973

INTERIM CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 31 March 2017

EQUITY AND LIABILITIES

DKK'000	Note	31 March 2017	31 December 2016	31 March 2016
Share capital	10	5,953	5,916	5,870
Share premium	10	217,584	216,429	213,600
Foreign currency translation reserve		508	510	(119)
Other reserves		49,081	39,830	23,031
Retained earnings		(68,790)	(58,276)	(44,139)
Equity		204,336	204,409	198,243
Deferred tax liability		8,057	8,427	4,875
Interest-bearing loans and borrowings		5,000	5,000	5,000
Non-current liabilities		13,057	13,427	9,875
Interest-bearing loans and borrowings		-	-	556
Trade payables		23,535	25,978	11,026
Other payables		12,696	15,902	11,922
Derivative financial instruments	9	1,312	1,314	-
Provisions		691	369	351
Current liabilities		38,234	43,563	23,855
Total liabilities		51,291	56,990	33,730
Total equity and liabilities		255,627	261,399	231,973

INTERIM CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the period ended 31 March 2017

DKK'000	Share capital	Share premium	Foreign currency translation reserve	Share based payment reserve	Cash flow hedge reserve	Reserve for develop-ment project costs	Retained earnings	Total equity
At 1 January 2016	5,822	210,675	81	9,981	(772)	-	(28,785)	197,002
Loss for the period	-	-	-	-	-	-	(4,491)	(4,491)
Additions to project development costs, net of tax	-	-	-	-	-	10,888	(10,888)	-
Exchange differences on translation of foreign operations	-	-	(200)	-	-	-	-	(200)
Cash flow hedges	-	-	-	-	5,522	-	-	5,522
Income tax effect	-	-	-	-	(1,230)	-	-	(1,230)
Total comprehensive income	-	-	(200)	-	4,292	10,888	(15,379)	(399)
Issue of shares	48	1,488	-	-	-	-	-	1,536
Reversal, exercised and lapsed share options	-	1,437	-	(1,462)	-	-	25	-
Share-based payments	-	-	-	104	-	-	-	104
Total transactions with shareholders	48	2,925	-	(1,358)	-	-	25	1,640
At 31 March 2016	5,870	213,600	(119)	8,623	3,520	10,888	(44,139)	198,243
At 1 January 2017	5,916	216,429	510	7,611	(1,025)	33,244	(58,526)	204,409
Loss for the period	-	-	-	-	-	-	(1,554)	(1,554)
Additions to project development costs, net of tax	-	-	-	-	-	8,960	(8,960)	-
Exchange differences on translation of foreign operations	-	-	(2)	-	-	-	-	(2)
Cash flow hedges	-	-	-	-	2	-	-	2
Income tax effect	-	-	-	-	-	-	-	-
Total comprehensive income	-	-	(2)	-	2	8,960	(10,514)	(1,554)
Issue of shares	37	1,155	-	-	-	-	-	1,192
Reversal, exercised and lapsed share options	-	-	-	-	-	-	-	-
Share-based payments	-	-	-	289	-	-	-	289
Total transactions with shareholders	37	1,155	-	289	-	-	-	1,481
At 31 March 2017	5,953	217,584	508	7,900	(1,023)	42,204	(68,790)	204,336

INTERIM CONSOLIDATED STATEMENT OF CASH FLOWS

For the period ended 31 March 2017

DKK'000	Note	YTD December 2017	YTD December 2016
Operating activities			
Loss before tax		(1,992)	(5,758)
Adjustments to reconcile profit before tax to net cash flows:			
Finance income		-	(4)
Finance costs		1,924	3,500
Amortisation, depreciation and impairment	6, 7	9,450	8,449
Share-based payment expense		289	104
Working capital adjustments:			
Change in inventories		(14,176)	(250)
Change in trade and other receivables		24,756	17,966
Change in trade and other payables and provisions		(5,327)	(15,424)
Cash flows from operating activities		14,924	8,583
Currency gains and losses		(1,861)	(3,441)
Interest received		-	4
Interest paid		(63)	(69)
Income tax received, net		-	(270)
Net cash flows from operating activities		13,000	4,807
Investing activities			
Purchase of tangible assets	7	(2,606)	(1,062)
Investments in intangible assets	6	(11,639)	(11,245)
Investments in leasehold deposits		-	(89)
Net cash used from investing activities		(14,245)	(12,396)
Financing activities			
Issue of shares	10	1,192	1,536
Repayment borrowings		-	(81)
Net cash flows from financing activities		1,192	1,455
Net change in cash and cash equivalents		(53)	(6,134)
Net foreign exchange difference		70	(33)
Cash and cash equivalents at the beginning of the period		46,951	75,921
Cash and cash equivalents at the end of the period		46,968	69,754

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

1 SIGNIFICANT ACCOUNTING POLICIES

The interim financial statements have been prepared in accordance with IAS 34, Interim Financial Reporting, as adopted by the EU and additional Danish disclosure requirements for listed companies.

The accounting policies are consistent with those applied to the consolidated financial statements for 2016.

The consolidated financial statements for 2016 contain a full description of accounting policies.

In 2016, the Group has created an equity reserve for capitalised development project costs in order to comply with a new provision in the Danish Financial Statements Act. This provision requires that capitalised amount less applicable amortisation is recognised under a separate equity reserve, which cannot be used for distribution of dividend and/or coverage of losses. If capitalised development project costs are subject to an impairment, the corresponding amount must be deducted from the equity reserve for capitalised development project costs. If the impairment is reversed in a subsequent period, the corresponding amount under equity must result in recovery of the equity reserve for capitalised development project costs.

New and amended standards and interpretations

The IASB has issued a number new standards, amendments to existing standards which will become operative for financial statements covering periods beginning on or after 1 January 2017. New and amended standards are expected to be implemented by their effective dates. The Following standards, amendments to existing standards and interpretations are expected to affect Napatech A/S' future annual reports:

- IFRS 9 Financial instruments and amendments to IFRS 9, IFRS 7 and IAS 39
- IFRS 15 Revenue from Contracts with Customers
- IFRS 16 Leases

The analysis of the expected effect of the implementation of the above standards has not yet been completed.

IFRS 15 "Revenue from Contracts with Customers", which replaces the existing revenue standards (IAS 11 and IAS 18) and interpretations, creates a new model for revenue recognition and measurement of revenue from contracts with customers. The standard becomes effective for annual periods beginning on or after 1 January 2018.

The new model is based on a five-step process which must be applied to all contracts with customers in order to identify when and how revenue is to be recognised in the income statement.

Compared to the current practice, the most significant changes in IFRS 15 are:

- Sales transactions must be recognised as revenue in the income statement when control (either at a single point in time or over time) of the goods or services is transferred to the customer (the current concept of "risk and rewards" is replaced by a concept of control).
- New and more detailed guidance on how to identify the components of a transaction in a contract and how to recognise and measure the individual components.
- New and more detailed guidance on the recognition of revenue over time.

Napatech A/S has performed an analysis of the potential impact of the new standard on the Group. Based on analyses of the Group's current product mix and types of contracts, it is Napatech A/S' assessment that the new standard will not affect the recognition and measurement of the Group's sales types which primarily consist of goods for resale and finished goods.

Overall, based on the analyses performed, it is assessed that the effect on recognition and measurement is immaterial based on the current product mix and types of contract.

IFRS 9 Financial instruments: The Group has few derivative financial instruments, but besides these only traditional financial assets and liabilities which mainly relate to trade receivables on which only a few and immaterial losses have incurred in the past and trade payables. The implementation of the standard which becomes effective for annual periods starting on or after 1 January 2018, is therefore expected to have only limited effect.

IFRS 16 Leases sets out the principles for the recognition, measurement presentation and disclosure of leases and requires lessees to account for all leases, with a few exceptions, under a single on-balance sheet model similar to the accounting for finance leases under IAS 17.At the commencement date of a lease, a lessee will recognise a liability to make lease payments (i.e., the lease liability) and an asset representing the right to use the underlying asset during the lease term (i.e., the right-of-use asset). Lessees will be required to separately recognise the interest expense on the lease liability and the depreciation expense on the right-of-use asset. Lessor accounting under IFRS 16 is substantially unchanged from today's accounting under IAS 17.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

1 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The Group has operating leases with minimum lease payments of approximately DKK 14,730 thousand corresponding to 5.8% of the Group’s assets. Based on analyses of the Group’s operating lease contracts, it is Napatech A/S’ assessment that the new standard will have some effect on the Group’s balance and cash flow statement, but only immaterial effect on the consolidated income statement. The standard becomes effective for annual periods starting on or after 1 January 2019.

In addition, the IASB has issued a number of new standards, amendments to existing standards and interpretations which are not relevant to the company and which are therefore not expected to affect its future annual and interim reports.

The interim consolidated financial statements

The interim consolidated financial statements comprise the parent company, Napatech A/S, and its subsidiaries. Subsidiaries are fully consolidated from the date of acquisition and/or incorporation, being the date on which the parent company obtains control, until the date when such control ceases. The interim financial statements of the subsidiaries are prepared for the same reporting period as the parent company interim financial statements, using consistent accounting policies. The interim consolidated financial statements are prepared as a consolidation of the parent company's and the subsidiaries' interim financial statements, eliminating all intra-group balances, transactions, unrealized gains and losses and dividends.

The interim consolidated financial statements are prepared on a historical cost basis, except for derivative financial instruments, which are measured at fair value.

The interim consolidated financial statements are presented in thousand Danish kroner (DKK’000).

2 SIGNIFICANT ACCOUNTING JUDGEMENTS, ESTIMATES AND ASSUMPTIONS

The preparation of the interim consolidated financial statements requires the management to make judgements, estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities.

The accounting judgements, estimates and assumptions that management make are the same for these interim consolidated financial statements as for the consolidated financial statements for 2016.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

3 OPERATING SEGMENTS

1st Quarter 2017:

DKK'000	EMEA	NAM	APAC	Consolidated
Revenue				
Total revenue	44,895	43,444	5,064	93,403
Inter-segment	(35,853)	-	-	(35,853)
Revenue, external customers	9,042	43,444	5,064	57,550
Cost of goods sold	(1,823)	(12,887)	(1,066)	(15,776)
Gross profit	7,219	30,557	3,998	41,774

1st Quarter 2016:

DKK'000	EMEA	NAM	APAC	Consolidated
Revenue				
Total revenue	31,745	35,635	3,552	70,932
Inter-segment	(24,627)	-	-	(24,627)
Revenue, external customers	7,118	35,635	3,552	46,305
Cost of goods sold	(1,429)	(10,026)	(849)	(12,304)
Gross profit	5,689	25,609	2,703	34,001

Explanation of abbreviations

EMEA	= Europe, Middle East and Africa
NAM	= Northern America
APAC	= Asia and Pacific

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

4 SHARE-BASED PAYMENTS

Employees and members of the management in both the parent company and the US-based subsidiary are eligable for share option schemes. They are granted a certain number of share options in the parent company in return for the services they provide to the Group.

Share options under these schemes are granted at fixed exercise prices. The right to share options can only be vested as long as the holder is an employee of the Group.

In February 2013, after the share options of the Group's employees and management had vested but prior to the exercise date, the management made modifications to some of the share-based payment agreements concluded with employees and management.

The management treats the change of terms as modifications to the existing share-based payment arrangements. Accordingly, the fair value determined at the original grant date has been charged to the income statement over the original vesting period.

In addition, an expense is recognised over the new vesting period, corresponding to the increase in the fair value of the share-based payment as a result of the change of terms. All granted share options are equity-based.

The share based payment expense is measured at fair value at the grant date using Black-Scholes model. The expense is recognised in the income statement with the counter item in the other reserves under the equity, and it is recognised over: (a) the period during share option holder has met the vesting conditions; or (b) the period in which an exercising event is likely to occur if this period is shorter.

In December 2013 the initial public offering (IPO) on the Oslo Stock Exchange (OSE) resulted in an exercising event in relation to all share option programmes. Therefore, the remaining vesting period of the share options has been accelerated. The general terms for share options are summarised as follows:

Earliest exercise date	1 year from grant date
Latest exercise date	9-10 years from grant date

In May 2014 the Board of Directors decided to issue share options to key employees in the Group. A total of 101,000 share options have been issed for subscription of 101,000 shares of a nominal value of DKK 1 at an exercise price of NOK 48.70 (DKK 43.00 at 1 July 2014). The share options' life time is 5 years. The first 2 years from the date of issue is a lock-up period during which the share options may not be exercised. The exercise of these share options may take place in the 3rd, 4th and 5th year and they vest with 1/3 in each of these 3 years.

The general terms for the 2014 share options programme are summarised as follows:

Earliest exercise date	2 years from grant date
Latest exercise date	5 years from grant date

In February 2016 the Board of Directors decided to issue share options to key employees in the Group. A total of 23,000 share options have been issed for subscription of 23,000 shares of a nominal value of DKK 1 at an exercise price of NOK 63.50 (DKK 53.10 at 22 February 2016). The share options' life time is 5 years. The first 2 years from the date of issue is a lock-up period during which the share options may not be exercised. The exercise of these share options may take place in the 3rd, 4th and 5th year and they vest with 1/3 in each of these 3 years.

In accordance with the decision made on the Annual General Meeting held on 20 April 2016, Napatech conducted a split of shares in the ratio of 1:4. This means that the nominal value of each share has been reduced from DKK 1.00 to DKK 0.25, whereby each shareholder previously holding one share with the nominal value of DKK 1.00 received four new shares with the nominal value of DKK 0.25.

The 1:4 share split has no direct impact on the value of share options and share option programs. When share options are exercised, the share capital will be increased by the same nominal amount at the same exercise price per share of DKK 1.00 nominal (multiples of four shares at nominally DKK 0.25). Consequently, the number and value of share options increases/decreases with the same ratio of 1:4. The principals of the 1:4 share spli have been applied on comparative figures in order to enable comparison and consistency with previous periods.

Based on the decision made on General Assembly in April 2016 to issue 400,000 share options, the Board of Directors issued 145,000 share options in August 2016 with the nominal value of DKK 0.25 at an exercise price of NOK 22.00 (DKK 18.04). The share options' life time is 5 years, where the share options holders are subject to a lock-up period in the first 2 years of the share options' life time. The share options vest with 1/3 in each of the remaining 3 years of the share options' life time.

4 SHARE-BASED PAYMENTS (CONTINUED)

The general terms for both 2016 share options programmes are summarised as follows:

Earliest exercise date	2 years from grant date
Latest exercise date	5 years from grant date

	Management		Others		Total	
Share options	Number	Average exercise price (DKK)	Number	Average exercise price (DKK)	Number	Average exercise price (DKK)
At 1 January 2017	714,548	8.41	700,436	10.71	1,414,984	8.82
Granted during the period	-	-	-	-	-	-
Exercised / expired during the period	(87,396)	8.00	(61,668)	8.00	(149,064)	8.00
At 31 March 2017	627,152	7.38	638,768	9.77	1,265,920	7.89
Exercisable at 31 March 2017	455,192	6.98	327,765	7.07	782,957	7.01
At 1 January 2016	1,032,848	8.60	620,780	8.80	1,653,628	8.67
Granted during the period	92,000	12.53	-	-	92,000	12.53
Exercised / expired during the period	(89,100)	8.00	(106,160)	8.00	(195,260)	8.00
At 31 March 2016	1,035,748	9.00	514,620	8.96	1,550,368	8.99
Exercisable at 31 March 2016	719,748	8.00	334,620	8.00	1,054,368	8.00

In the period ended 31 March 2017, 148,264 share options were exercised and 800 lapsed (period ended 31 March 2016: 191,900 exercised and 3,360 lapsed).

The following shows the exercise price of the outstanding share options and warrants:

Number of share options	As at 31 March 2017	As at 31 March 2016
Exercise price DKK 8.00	663,584	1,054,368
Exercise price DKK 10.75	365,336	404,000
Exercise price DKK 12.53	92,000	92,000
Exercise price DKK 18.04	145,000	-
Total number of outstanding stock options	1,265,920	1,550,368

The weighted average of the remaining contractual period of the outstanding share options from the 2013 share options program at 31 March 2017 is 3 months (at 31 December 2016: 6 months). The weighted average of the remaining contractual period of the outstanding share options from the 2014 share options program at 31 March 2017 is 2 years and 3 months (at 31 December 2016: 2 years and 6 months). The weighted average of the remaining contractual period of the outstanding share options from the 2016 share options program at 31 March 2017 is 4 years and 6 months (at 31 December 2016: 4 years and 3 months).

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

4 SHARE-BASED PAYMENTS (CONTINUED)

Assumptions for the calculation of the fair value of share options and warrants

The fair value of share options and warrants granted during 2013, 2014 and 2016 was estimated on the date of grant using the following assumptions:

	December 2013	May 2014	February 2016	August 2016
Volatility	47.92%	43.53% - 44.94%	49.00%	49.00%
Risk-free interest rate	1.65%	1.70% - 2.00%	0.50% - 0.60%	0.53% - 0.63%
Exercise price (DKK)	8.00	10.75	12.53	18.04
Exercise period (years)	2.27	3.00-5.00	3.00-5.00	3.00-5.00
Number of options	520,700	404,000	92,000	145,000

The volatility is calculated based on a peer group of seven similar companies listed on Nasdaq Stock Exchange in the USA. The fair value of the share options is determined using the Black-Scholes option pricing model.

For 1st quarter 2017, the Group has recognized DKK 289 thousand of share-based payment expense in the income statement (1st quarter 2016: DKK 104 thousand).

5 EARNINGS PER SHARE

	1st Quarter	
DKK'000	2017	2016
Net income attributable to equity holders of the parent company for basic earnings and the effect of dilution	(1,554)	(4,491)

	1st Quarter	
DKK'000	2017	2016
	Thousand	Thousand
Weighted average number of shares for basic earnings per share	23,812	23,396
Effect of dilution:		
Share options	-	-
Weighted average number of shares adjusted for the effect of dilution (nominal value of DKK 0.25)	23,812	23,396

6 INTANGIBLE ASSETS

DKK'000	Development projects, completed	Development projects, in progress	Patents	Other intangible assets	Total
Cost at 1 January 2017	205,129	22,488	9,279	2,139	239,035
Additions in the period	-	11,518	121	-	11,639
Transfers in the period	900	(900)	-	-	-
Cost at 31 March 2017	206,029	33,106	9,400	2,139	250,674
Accumulated amortization and impairment at 1 January 2017	129,440	-	2,900	1,650	133,990
Amortization for the period	7,705	-	115	178	7,998
Impairment for the period	-	-	156	-	156
Accumulated amortization and impairment at 31 March 2017	137,145	-	3,171	1,828	142,144
Carrying amount at 31 March 2017	68,884	33,106	6,229	311	108,530

Within the completed development projects there are two material development projects with carrying amount of DKK 9,336 thousand and DKK 10,099 thousand at 31 March 2017 respectively (31 December 2016: DKK 9,836 thousand and DKK 11,017 thousand respectively). The aim of the first project was to develop new 2 x 100G accelerator and the aim of the second project was to develop new 1 x 100G accelerator. The remaining amortisation periods of these two projects are 4 years and 8 months and 2 years and 9 months respectively.

Within the in progress development projects there is one material development project with carrying amount of DKK 11,539 thousand. The aim of the project is to develop next generation of our network recording platform. The project is not yet completed and therefore has not been amortized.

At 31 March 2017, the Group tested the intangible assets for impairment. In relation to this, the Group identified patents that are not expected to be utilised. Therefore, the Group recognised DKK 156 thousand as an impairment in respect of patents. There were no indications of impairment in relation to the Group's development projects and other intangible assets in the reporting period.

7 TANGIBLE ASSETS

DKK'000	Plant and equipment	Leasehold improvements	Total
Cost at 1 January 2017	34,622	4,630	39,252
Additions in the period	2,084	522	2,606
Currency adjustment	15	-	15
Cost at 31 March 2017	36,721	5,152	41,873
Accumulated depreciation at 1 January 2017	29,467	3,457	32,924
Depreciation for the period	1,148	148	1,296
Currency adjustment	(15)	-	(15)
Accumulated depreciation at 31 March 2017	30,600	3,605	34,205
Carrying amount at 31 March 2017	6,121	1,547	7,668

At 31 March 2017, the Group tested the tangible assets for impairment. There were no indications of impairment of the Group's tangible assets in the reporting period.

8 TRADE AND OTHER RECEIVABLES

DKK'000	31 March 2017	31 March 2016
Receivables recognized in the consolidated statement of financial position:		
Trade receivables	51,632	30,156
Other receivables	3,438	4,616
Income tax receivable	2,231	2,451
Total current receivables	57,301	37,223

The provision for bad and doubtful receivables is as follows:

DKK'000	2017	2016
At 1 January	2,103	1,815
Change in the period	-	-
At 31 March	2,103	1,815

Ageing analysis of past due but not impaired trade receivables is as follows:

DKK'000	31 March 2017	31 March 2016
Not past due	45,596	23,770
Past due less than 30 days	4,178	1,376
Past due between 30 and 60 days	341	261
Past due between 60 and 90 days	1,291	1,093
Past due after 90 days	226	3,656
Total maximum credit risk	51,632	30,156

9 DERIVATIVE FINANCIAL INSTRUMENTS

DKK'000	31 March 2017	31 March 2016
Derivative financial instruments at fair value, assets / (liabilities)	(1,312)	4,513

Derivative financial instruments are classified as Level 2 instruments in accordance with the IFRS fair value hierarchy. The fair value of the derivative financial instruments is based on observable market data, such as forward exchange rates. The fair value of derivative financial instruments approximates their carrying values.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

10 ISSUED SHARE CAPITAL AND RESERVES

Authorised shares	2017	2016
	Thousand	Thousand
Ordinary shares of DKK 0.25 each at 1 January	23,664	23,288
Increase in ordinary shares DKK 0.25 each	148	192
Ordinary shares of DKK 0.25 each at 31 March	23,812	23,480

11 COMMITMENTS AND CONTINGENCIES

Collaterals

The Group has issued a floating charge in the amount of DKK 10 million secured on receivables, inventories and equipment as collateral for bank debt.

Operating lease commitments

The Groups' operating lease commitments relate to cars and office facilities. Future minimum payments under operating leases at 31 March 2017 are DKK 14,730 thousand.

Finance lease commitments

The Groups has repaid all finance lease commitments relating to the equipment used in the research and development department.

Napatech A/S

Tobaksvejen 23A, 1
DK-2860 Søborg
Denmark

Phone: +45 4596 1500

www.napatech.com