napatech

NAPATECH

1ST QUARTER 2018
INTERIM REPORT

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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 January 1 to March 31, 2018.

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 March 31, 2018, and of the results of the Napatech Group's operations and cash flows for the three months' period January 1 to March 31, 2018.

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, May 8, 2018

Executive Management

Henrik Brill Jensen, CEO

Niels Hobolt, CFO

Board of Directors

Lars Boilesen, Chairman

Howard Bubb

Lars B. Thoresen

Henry Wasik

Bjørn Erik Reinseth

LETTER FROM THE CEO

Dear fellow shareholders,

We had the pleasure of meeting the investor community at our Capital Markets Day 2018 in April, providing candid feedback and valuable input to our future development and the execution of our strategy. We got solid support for the efforts taken during 2017, and so far this year, to turn the tide and return to our growth journey as we are taking advantage of these changing markets.

As you all know, the sales in the first quarter 2018 ended below the corresponding period last year, following postponement of customer projects and inventory reductions. Based on the increasing demand for FPGA-based software solutions, combined with Napatech's strong portfolio of products and solutions, significant experience and strong market position, we expect the revenue growth to resume in 2018, although we may still see order volatility in the short term. To ensure investment focus on growth initiatives, cost-containment and other expense reduction measures have been implemented until normal customer demand returns in second half of 2018.

As we discussed in detail at the Capital Markets Day, Napatech is approaching a market where large and complex sales engagements take time, and since 2017, the company has taken several actions to support the company's growth ambitions and counter the recently experienced weaker sales development, including:

- Expansion of Napatech's board of directors, adding industry recognized experts with proven success in cloud, data center, server and software businesses.
- Strengthening of the executive management team, adding new Chief of Sales and marketing officers in the United States.
- Aligning product and technology plans by partnering with the leading suppliers of FPGA technologies and tools.
- Increasing the global sales force and technical support in the North American regions that represent the highest concentrations of customer growth and organizing around unique customer segments, who benefit from reconfigurable computing.
- Expansion of the worldwide channel sales organization to further leverage external resources to extend our reach to the emerging set of end-user customers who require our solutions.
- Expansion of Napatech's product portfolio to include more software offerings and professional services, enabling Napatech products to be deployed in any open and standard server platform.

As demonstrated by these actions, the company, together with our customers, are undergoing a transformation from a hardware-centric to a software centric world of software defined networking. The way networks are built, managed and operated have radically changed, creating incredible new opportunities for IT organizations of every size to reimagine their businesses. As a result of the major market trends, FPGA technology has now become pervasive, and are widely available to more users and applications, in many more network types and locations.

As one of the few companies in the world with the expertise to deliver world-class FPGA-based application-driven solutions, Napatech is perfectly positioned to take advantage of the market shift to reconfigurable computing platforms. Napatech's strategy is founded on four main pillars providing a firm foundation to win the emerging opportunities:

- Dominate: Napatech will continue to dominate the packet capture market and maintain the strategic relationships established with market leading key customers and partners.
- Expand: Napatech is engaged with key customers on defining reconfigurable computing solutions that expand beyond packet capture use cases, such as inline cyber security solutions.
- Establish: Napatech is establishing a beach-head in the virtualization solutions market based on current engagements with leading telecom carriers and vendors.
- Explore: Napatech is exploring the potential for delivering compute offload solutions that leverage FPGA technology deployed by cloud vendors or server ODMs.

Napatech is focused on managing and growing our existing business in a medium size market with relatively low growth to fund investment in new initiatives, approaching new segments characterized by higher growth and higher volumes. Napatech is expecting growth in new initiatives through 2022 to be a combination of:

- Cybersecurity solutions for both existing and new customers. Today, this is a large market with medium growth. This market is expected to contribute with up to 60% of future, long-term revenues.
- Virtualization solutions primarily for new customers. Today, this is a small market with massive growth. This market is expected to contribute with up to 60% of future, long-term revenues.
- Compute offload solutions for new customers. Today, this is a small market with massive growth. This market is expected to contribute with up to 20% of future, long-term revenues.

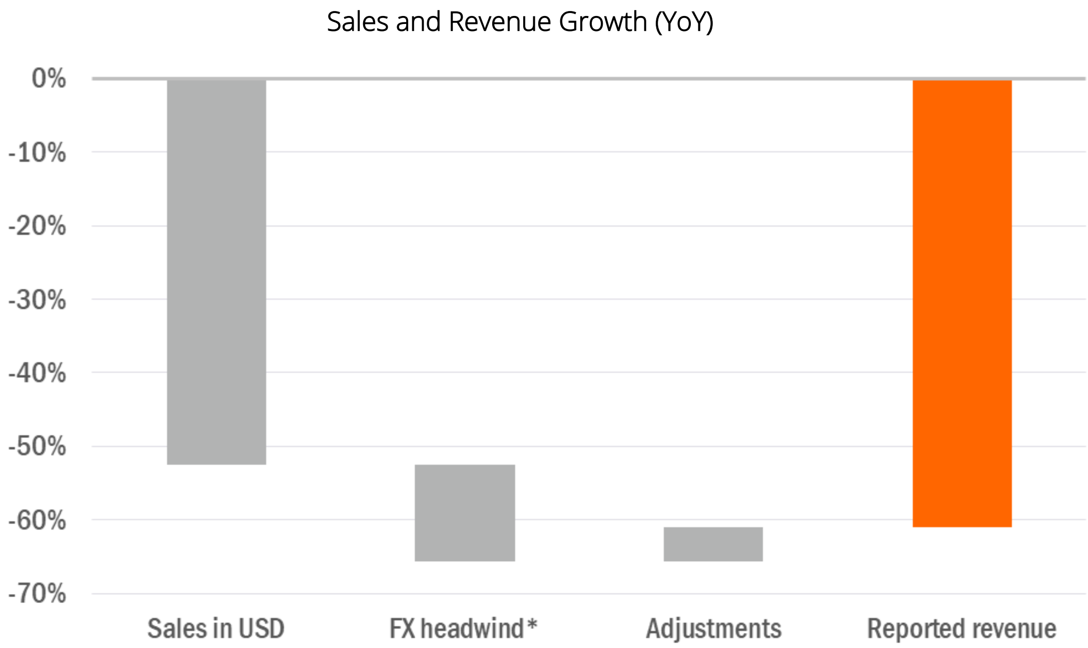
As a result of the changes that the markets, customers and Napatech are going through, the long-term outlook is promising as Napatech products and services become applicable to not only our current, but also new market segments. In other terms, we see a long-term potential significantly larger than our current business as we move to broader markets and support more applications, but underlines that the short term visibility is limited and will be affected by quarter-to-quarter order volatility and general business uncertainty. However, we are taking the right steps in these transformative times and are looking forward to the normal customer demand returns in the second half of 2018.

Best regards,

Henrik Brill-Jensen
Chief Executive Officer

Highlights:

- Revenue for the first quarter of 2018 amounted to DKK 22.3 million, a decline of 61% compared to last year.
- Pandion sales represented 11% of the total sales in the first quarter of 2018.
- Gross margin for the first quarter of 2018 was 68% compared to 73% in the first quarter of 2017.
- EBITDA for the first quarter of 2018 amounted to negative DKK 15.8 million, a decline from DKK 9.4 million in the first quarter of 2017.
- EBITDA margin for the first quarter of 2018 was -71%, a decline from 16% in the first quarter of 2017.
- EBIT for the first quarter amounted to negative DKK 26.4 million compared to negative DKK 0.1 million in the first quarter of 2017.
- Cash decreased to DKK 20.2 million in the first quarter of 2018. Including unused credit facilities the total available funds are approximately DKK 36 million.



*Average bank rates

This is Napatech

Napatech helps companies to reimagine their business by bringing hyperscale computing benefits to IT organizations of every size. We enhance open and standard virtualized servers to boost innovation and release valuable computing resources that improve services and increase revenue. Our reconfigurable computing platform™ is based on a broad set of FPGA software for leading IT compute, network and security applications that are supported on a wide array of FPGA hardware designs.

Napatech. SMARTER DATA. DELIVERED.

Napatech operations.

The statements below are related to Napatech's development in the first quarter of 2018 compared to the first quarter of 2017, unless as otherwise stated. Additional information is available at www.napatech.com\investor.

Key figures and ratios.

	1st Quarter	
	2018	2017
Revenue, DKK'000	22,298	57,550
Gross profit margin, %	68%	73%
EBITDA, DKK'000	(15,807)	9,382
EBITDA margin, %	-71%	16%
(Loss) / profit before tax, DKK'000	(28,111)	(1,992)
EPS basic, DKK (please ref. Note 5)	(0.92)	(0.07)
EPS diluted, DKK	(0.89)	(0.07)
Equity, DKK'000	161,766	204,336
Cash and cash equivalents, DKK'000	20,174	46,968

Financial Review

Revenue

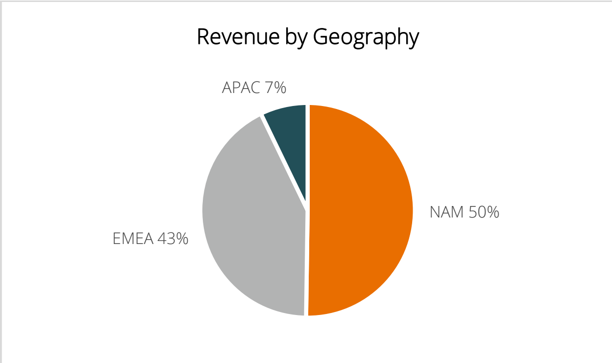
Napatech reports revenue of DKK 22.3 million in the first quarter of 2018, a decrease of 61% compared to the same period in 2017. The revenue for the period has been negatively influenced by the postponement of customer projects and inventory reductions. The sales are in line with the previously communicated expectations for the quarter.

This quarter showed a decline in on our Pandion business and in our Accelerator business due to fluctuations in our customers ordering pattern and inventory management. Pandion represented 11% of total sales in the quarter, compared to 8% in Q1 2017.

Sales were distributed with 50% in NAM, 43% in EMEA and the remaining 7% in APAC. The sale in NAM are lower than expected due to postponement of customer projects and inventory reductions.

Gross Margin

Napatech's gross margin for the quarter was 68%, down from 73% in the same period last year. The gross margin is dependent on the product mix, and the sales reported this quarter includes sale of accessory products with lower margin than normal.



MANAGEMENT'S REVIEW (CONTINUED)

Financial review (continued)

Costs

Total costs for the first quarter of 2018 were DKK 30.9 million, compared to DKK 32.4 million for the first quarter of 2017. Napatech's costs for the period are in line with the company's expectations.

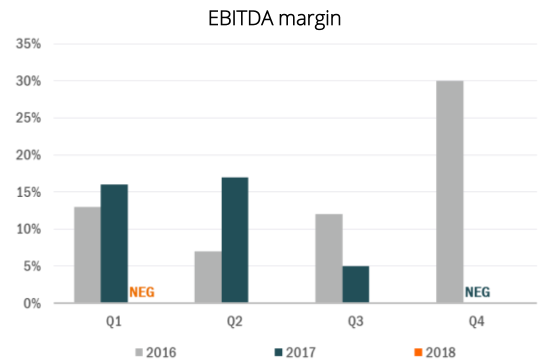
R&D costs for the first quarter of 2018 were DKK 3.7 million, compared to DKK 3.7 million in the first quarter of 2017. The level of the R&D costs is related to the timing of our development projects.

Sales and distribution costs for the period were DKK 18.4 million, compared to DKK 20.2 million in the same period last year. The decrease in the Sales and Marketing costs is due to the low revenue in the period causing commissions to be lower than usual.

Administrative expenses for the quarter were DKK 8.7 million compared to DKK 8.4 million in the first quarter of 2017. Administrative expenses in Q1 2018 were in line with our expectations.

EBITDA

EBITDA was negative DKK 15.8 million in the first quarter of 2018, compared to DKK 9.4 million in the first quarter of 2017. The decrease is driven by lower sales and lower margins than last year.



Depreciation and amortization

Depreciation and amortization for the quarter was DKK 10.6 million, compared to DKK 9.5 million in the first quarter of 2017. Depreciations are affected by the timing of completion of the company's development projects, and past investment levels.

EBIT

EBIT for the first quarter of 2018 was negative DKK 26.4 million, a decrease compared to negative DKK 0.1 million in the first quarter of 2017. The decrease is primarily driven by the revenue decline in the quarter.

Financial Items

Financial items for the first quarter of 2018 were an expense of DKK 1.7 million, compared to an expense of DKK 1.9 million in the first quarter of 2017. The financial items are primarily affected by the change in USD exchange rate, and it has decreased during the first quarter of 2018, compared to end of 2017 resulting in this expense.

Taxes

Taxes for the first quarter of 2018 are an income of DKK 6.2 million. The effective tax rate for the year is thus 22%.

Investments

Total investments in the first quarter of 2018 were DKK 11.6 million, primarily related to new product development (capitalized development), representing DKK 11.2 million of total investments in the quarter. In the first quarter of 2017, total investments were DKK 14.2 million, of which DKK 11.6 million was related to internal product development.

In the first quarter of 2018, there were several ongoing development projects related to the Pandion product, the Accelerator portfolio and development of our virtualization product.

Cash Flow

For the first quarter of 2018, net cash flow from operating activities was negative DKK 8.3 million, a decrease from DKK 13.9 million from the first quarter of 2017.

Negative cash flow from investing activities was DKK 11.6 million in the first quarter of 2018, a decrease from DKK 14.2 million in the first quarter of 2017.

Net cash from financing activities, was improved by DKK 0.3 million due to exercise of employee options.

The total cash position of the Company was DKK 20.2 million by the end of the first quarter of 2018, a decrease of DKK 26.8 million compared to the end of the first quarter of 2017. The negative cash flow is driven by the investment activities conducted by the company, as the current business not fully support the investment level needed for securing the future growth.

Napatech has unused credit facilities of DKK 10 million in Denmark as well as USD 1 million in the US subsidiary at the end of the first quarter of 2018. Thus, the Company has available total funds of approximately DKK 36 million at the end of the first quarter of 2018.

MANAGEMENT'S REVIEW (CONTINUED)

Financial review (continued)

Shareholders and Share Information

Napatech as of March 31, 2018 had 23,923,220 shares outstanding at DKK 0.25 each. The share capital is 5,980,805 DKK divided among the 412 shareholders.

Investor	Number of shares	% of total	TYPE	Country
VERDANE CAPITAL VIII	5.172.844	21,62%	Ordinary	DNK
ARCTIC FUNDS PLC	2.270.021	9,49%	Ordinary	IRL
STOREBRAND VEKST VER	1.502.364	6,58%	Ordinary	NOR
VERDIPAPIRFONDET DNB	1.388.024	5,80%	Ordinary	NOR
SILVERCOIN INDUSTRIE	1.306.223	5,46%	Ordinary	NOR
DNB NOR MARKETS, AKS	1.220.000	5,10%	Ordinary	NOR
THE BANK OF NEW YORK	980.000	4,10%	Nominee	GBR
DANSKE BANK A/S	913.927	3,82%	Nominee	DNK
SÆTER HAAKON MORTEN	686.539	2,87%	Ordinary	NOR
HOLTA INVEST AS	655.272	2,74%	Ordinary	NOR
UBS SWITZERLAND AG	633.042	2,65%	Nominee	CHE
VINTERSTUA AS	628.521	2,63%	Ordinary	NOR
DANSKE BANK A/S	581.178	2,43%	Nominee	DNK
TIGERSTADEN AS	517.108	2,16%	Ordinary	NOR
MARSTAL AS	420.000	1,76%	Ordinary	NOR
NORDEA BANK AB	307.083	1,28%	Nominee	DNK
HOBOLT NIELS	294.272	1,23%	Ordinary	DNK
NORDNET BANK AB	266.967	1,12%	Nominee	SWE
EKNER PETER DAHL	247.200	1,03%	Ordinary	DNK
SIX-SEVEN AS	203.950	0,85%	Ordinary	NOR
Total number owned by top 20	**20.194.535**	**84,41%**		
Total 392 other shareholders	**3.728.685**	**15,59%**		
Total number of shares	**23.923.220**	**100,00%**		

Significant events after the end of the period

No significant events have occurred that are not described in this interim report.

Outlook for 2018

Napatech's strategy is to be and be perceived as the global leader in reconfigurable computing solutions. Our strategy is to focus on delivering the solutions, technologies and expertise necessary to enable all organizations that rely on IT for their business to reap the benefits of reconfigurable computing. Our goal is to become the number one vendor of reconfigurable computing solutions.

The company expects the revenue growth to resume in 2018, but underlines that the short-term visibility is limited and will be affected by quarter-to-quarter order volatility and general business uncertainty. As also outlined, the business transition toward a more software focused business will take longer than expected.

The company expects that the inventory reductions at our major OEM's will still have some impact on second quarter revenue. However increased customer demands is expected in second half of 2018, based on our customers forecasting.

The initiatives established during 2017 demonstrate the ongoing transition with our customers from a hardware-centric to a software-centric world of software defined networking. As a result of the changes that the markets, customers and Napatech are going through, the long-term outlook is exceedingly bright as Napatech products and services become applicable to not only our current, but also new market segments. In other words, Napatech will serve an increasing addressable market going forward. Thus, as an established leader in FPGA technology, Napatech believes that it will see renewed and increased growth at the other side of the current transition.

2018 guidance for the company is the following:

- Sales growth of 0 to 10% in USD
- Gross margin around 68%
- EBITDA margin around 15%

The company is exposed to risks that might affect our ability to reach our goals such as currency fluctuations, general market uncertainty, and material changes in our large OEMs' needs for Napatech's products.

Disclaimer

This report contains statements regarding the future in connection with Napatech growth initiatives, profit figures, outlook, strategies and objectives. In particular, the section Outlook for 2018 contains forward-looking statements regarding the Group's expectations. All statements regarding the future are subject to inherent risks and uncertainties, and many factors can lead to actual profits and developments deviating substantially from what has been expressed or implied in such statements.

Oslo, May 8, 2018

The Board of Directors of Napatech A/S

INTERIM CONSOLIDATED INCOME STATEMENT

For the period ended 31 March 2018

DKK'000	Note	1st Quarter 2018	1st Quarter 2017
Revenue	3	22,298	57,550
Costs of goods sold		(7,230)	(15,776)
Gross profit		15,068	41,774
Research and development cost		(3,748)	(3,721)
Selling and distribution expenses		(18,386)	(20,239)
Administrative expenses	4	(8,741)	(8,432)
Operating profit before depreciation and amortisation (EBITDA)		(15,807)	9,382
Depreciation and amortisation		(10,560)	(9,450)
Operating profit / (loss) (EBIT)		(26,367)	(68)
Finance income		-	-
Finance costs		(1,744)	(1,924)
Profit / (loss) before tax		(28,111)	(1,992)
Income tax		6,184	438
Profit / (loss) for the period		(21,927)	(1,554)
Earnings per share:	5		
Basic, DKK		(0.92)	(0.07)
Diluted, DKK		(0.89)	(0.07)

INTERIM CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the period ended 31 March 2018

DKK'000	Note	1st Quarter 2018	1st Quarter 2017
Profit / (loss) for the period		(21,927)	(1,554)
Other comprehensive income to be reclassified to profit or loss in subsequent periods:			
Exchange differences on translation of foreign operations		(116)	(2)
Net movement on cash flow hedges		-	2
Income tax effect		-	-
Net other comprehensive income to be reclassified to profit or loss in subsequent periods		(116)	-
Total comprehensive income for the period		(22,043)	(1,554)

INTERIM CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 31 March 2018

ASSETS

DKK'000	Note	31 March 2018	31 December 2017	31 March 2017
Development projects, completed		93,811	68,416	68,884
Development projects, in progress		22,628	46,342	33,106
Patents		5,323	5,412	6,229
Other intangible assets		37	50	311
Intangible assets	6	121,799	120,220	108,530
Plant and equipment		4,760	5,166	6,121
Office improvements		941	1,079	1,547
Tangible assets	7	5,701	6,245	7,668
Leasehold deposits		2,276	2,283	2,309
Other non-current assets		2,276	2,283	2,309
Non-current assets		129,776	128,748	118,507
Inventories		39,555	36,124	32,851
Trade receivables	8	26,408	51,938	51,632
Other receivables	8	4,073	3,899	3,438
Income tax receivable	8	5,500	5,500	2,231
Derivative financial instruments	9	-	-	-
Cash and cash equivalents		20,174	39,967	46,968
Current assets		95,710	137,428	137,120
Total assets		225,486	266,176	255,627

INTERIM CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 31 March 2018

EQUITY AND LIABILITIES

DKK'000	Note	31 March 2018	31 December 2017	31 March 2017
Share capital	10	5,981	5,969	5,953
Share premium	10	220,405	219,729	217,584
Foreign currency translation reserve		(125)	(9)	508
Other reserves		5,631	6,361	6,877
Retained earnings		(70,126)	(48,883)	(26,586)
Equity		161,766	183,167	204,336
Deferred tax liability		1,156	7,425	8,057
Interest-bearing loans and borrowings		-	-	5,000
Non-current liabilities		1,156	7,425	13,057
Interest-bearing loans and borrowings		35,000	35,109	-
Trade payables		10,042	26,130	23,535
Other payables		17,040	13,855	12,696
Derivative financial instruments	9	-	-	1,312
Provisions		482	490	691
Current liabilities		62,564	75,584	38,234
Total liabilities		63,720	83,009	51,291
Total equity and liabilities		225,486	266,176	255,627

INTERIM CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the period ended 31 March 2018

DKK'000	Share capital	Share premium	Foreign currency translation reserve	Share based payment reserve	Cash flow hedge reserve	Retained earnings	Total equity
At 1 January 2017	5,916	216,429	510	7,611	(1,025)	(25,032)	204,409
Profit / (loss) for the period	-	-	-	-	-	(1,554)	(1,554)
Exchange differences on translation of foreign operations	-	-	(2)	-	-	-	(2)
Cash flow hedges	-	-	-	-	2	-	2
Income tax effect	-	-	-	-	-	-	-
Total comprehensive income	-	-	(2)	-	2	(1,554)	(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)	(26,586)	204,336
At 1 January 2018	5,969	219,729	(9)	6,361	-	(48,883)	183,167
Profit / (loss) for the period	-	-	-	-	-	(21,927)	(21,927)
Exchange differences on translation of foreign operations	-	-	(116)	-	-	-	(116)
Cash flow hedges	-	-	-	-	-	-	-
Income tax effect	-	-	-	-	-	-	-
Total comprehensive income	-	-	(116)	-	-	(21,927)	(22,043)
Issue of shares	12	366	-	-	-	-	378
Reversal, exercised and lapsed share options	-	310	-	(994)	-	684	-
Share-based payments	-	-	-	264	-	-	264
Total transactions with shareholders	12	676	-	(730)	-	684	642
At 31 March 2018	5,981	220,405	(125)	5,631	-	(70,126)	161,766

INTERIM CONSOLIDATED STATEMENT OF CASH FLOWS

For the period ended 31 March 2018

DKK'000	Note	1st Quarter 2018	1st Quarter 2017
Operating activities			
Profit / (loss) before tax		(28,111)	(1,992)
Adjustments to reconcile profit before tax to net cash flows:			
Finance income		-	-
Finance costs		1,744	1,924
Amortisation, depreciation and impairment	6, 7	10,560	9,450
Gain/loss on the sale of non-current assets		-	-
Share-based payment expense		264	289
Working capital adjustments:			
Change in inventories		(3,431)	(14,176)
Change in trade and other receivables		23,452	24,190
Change in trade and other payables and provisions		(12,354)	(5,278)
Cash flows from operating activities		(7,876)	14,407
Cash flow hedges in financial items		-	(413)
Interest received		-	-
Interest paid		(372)	(63)
Income tax received, net		(85)	-
Net cash flows from operating activities		(8,333)	13,931
Investing activities			
Purchase of tangible assets	7	(423)	(2,606)
Investments in intangible assets	6	(11,175)	(11,639)
Investments in leasehold deposits		(7)	-
Net cash used from investing activities		(11,605)	(14,245)
Financing activities			
Issue of shares	10	378	1,192
Repayment in borrowings		(109)	-
Net cash flows from financing activities		269	1,192
Net change in cash and cash equivalents		(19,669)	878
Net foreign exchange difference		(124)	(861)
Cash and cash equivalents at the beginning of the period		39,967	46,951
Cash and cash equivalents at the end of the period		20,174	46,968

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

1 SIGNIFICANT ACCOUNTING POLICIES

The interim consolidated 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, except for the following, consistent with those applied to the consolidated financial statements for 2017.

The consolidated financial statements for 2017 contain a full description of accounting policies.

New standards, interpretations and amendments adopted by the Group

With effect as of 1 January 2018 Napatech A/S has adopted the following standards, interpretations and amendments:

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

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 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:

- Focus on identifying the performance obligations in a contract and determine if the goods or services are distinct.
- 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.
- Considerations on how to identify the variable considerations in a contract.

The Group has adopted IFRS 15 using the cumulative effect method, but as the implementation of IFRS 15 has not had significant effect on the Group's financial statements, as revenue recognition under IFRS 15 is already in line with the Group's current revenue recognition policies, no effect has been recognised in equity 1 January 2018. This is due to the fact that the Group's sales types which primarily consist of goods for resale and finished goods and there are no complex discount agreements, variable considerations or other elements that could result in significant reversals of revenue already recognized.

IFRS 9 Financial instruments replaces IAS 39 Financial Instruments: Recognition and Measurement bringing together all three aspects of the accounting for financial instruments: classification and measurement, impairment and hedge accounting. As there is no significant impact on recognition and measurement for the Group, no effect has been recognised in equity 1 January 2018. That is due to the fact, that the Group on a historical basis has experienced very low losses on Trade receivables due to the fact that the Trade receivables is towards large companies with high solvency ratio.

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 2019. New and amended standards are expected to be implemented by their effective dates. The following standard is expected to affect Napatech A/S' future annual reports:

- IFRS 16 Leases

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

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 7,664 thousand corresponding to 3.4% 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 2017.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

3 OPERATING SEGMENTS

1st Quarter 2018:

DKK'000	EMEA	NAM	APAC	Consolidated
Revenue				
Total revenue	4,245	11,218	1,558	17,021
Inter-segment	5,277	-	-	5,277
Revenue, external customers	9,522	11,218	1,558	22,298
Cost of goods sold	(2,229)	(4,625)	(376)	(7,230)
Gross profit	7,293	6,593	1,182	15,068

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

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 eligible 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 issued 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 issued 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.

4 SHARE-BASED PAYMENTS (CONTINUED)

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 split 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.

Based on the same decision made on General Assembly in April 2016 to issue 400,000 share options, the Board of Directors issued 150,000 share options in May 2017 with the nominal value of DKK 0.25 at an exercise price of NOK 24,50 (DKK 19.41). 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.

Based on the same decision made on General Assembly in April 2016 to issue 400,000 share options, the Board of Directors issued the remaining share options in November 2017 with the nominal value of DKK 0.25 at an exercise price of NOK 19.00 (DKK 14.90). 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.

The general terms for all issues based on the 2016 share options programme are summarised as follows:

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

4 SHARE-BASED PAYMENTS (CONTINUED)

	Management		Others		Total	
Share options	Number	Average exercise price (DKK)	Number	Average exercise price (DKK)	Number	Average exercise price (DKK)
At 1 January 2018	793,200	11.77	664,568	11.54	1,457,768	11.66
Exercised / expired during the period	(23,548)	8.00	(116,500)	10.84	(140,048)	10.36
At 31 March 2018	769,652	11.88	548,068	11.69	1,317,720	11.80
Exercisable at 31 March 2018	446,895	8.77	315,679	9.34	762,574	9.01
At 1 January 2017	714,548	8.41	700,436	10.71	1,414,984	8.82
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

In the period ended 31 March 2018, 45,548 share options were exercised and 94,500 lapsed (period ended 31 March 2017: 148,264 share options were 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 2018	As at 31 March 2017
Exercise price DKK 8.00	483,552	663,584
Exercise price DKK 10.75	372,668	365,336
Exercise price DKK 12.53	92,000	92,000
Exercise price DKK 18.04	109,500	145,000
Exercise price DKK 19.41	150,000	-
Exercise price DKK 14.90	110.000	-
Total number of outstanding stock options	1,317,720	1,265,920

The weighted average of the remaining contractual period of the outstanding share options from the 2014 share options program at 31 March 2018 is 1 year and 3 months (at 31 March 2017: 2 years and 3 months). The weighted average of the remaining contractual period of the outstanding share options from the 2016 share options program at 31 March 2018 is 4 years and 0 months (at 31 March 2017: 4 years and 3 months).

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, 2016 and 2017 was estimated on the date of grant using the following assumptions:

	December 2013	May 2014	February 2016	August 2016	May 2017	November 2017
Volatility	47.92%	43.53% - 44.94%	49.00%	49.00%	50.50%	47.30% - 48.40%
Risk-free interest rate	1.65%	1.70% - 2.00%	0.50% - 0.60%	0.53% - 0.63%	0.80% - 1.10%	0.70% - 1.00%
Exercise price (DKK)	8.00	10.75	12.53	18.04	19.41	14.90
Exercise period (years)	2.27	3.00-5.00	3.00-5.00	3.00-5.00	3.00-5.00	3.00-5.00
Number of options	520,700	404,000	92,000	145,000	150,000	105,000

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 of 2018, the Group has recognized DKK 264 thousand of share-based payment expense in the income statement (1st quarter 2017: DKK 289 thousand).

5 EARNINGS PER SHARE

	1st Quarter	
DKK'000	2018	2017
Net income attributable to equity holders of the parent company for basic earnings and the effect of dilution	(21,927)	(1,554)

	1st Quarter	
DKK'000	2018	2017
	Thousand	Thousand
Weighted average number of shares for basic earnings per share	23,908	23,812
Effect of dilution:		
Share options	681	-
Weighted average number of shares adjusted for the effect of dilution (nominal value of DKK 0.25)	24,589	23,812

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

6 INTANGIBLE ASSETS

DKK'000	Development projects, completed	Development projects, in progress	Patents	Other intangible assets	Total
Cost at 1 January 2018	229,165	46,342	9,791	2,139	287,437
Additions in the period	-	11,099	76	-	11,175
Transfers in the period	34,813	(34,813)	-	-	-
Cost at 31 March 2018	263,978	22,628	9,867	2,139	298,612
Accumulated amortization and impairment at 1 January 2018	160,749	-	4,379	2,089	167,217
Amortization for the period	9,418	-	165	13	9,596
Accumulated amortization and impairment at 31 March 2018	170,167	-	4,544	2,102	176,813
Carrying amount at 31 March 2018	93,811	22,628	5,323	37	121,799

Within the completed development projects there are three material development projects with carrying amount of DKK 14,732 thousand, DKK 7,335 thousand and DKK 6,427 thousand at 31 March 2018 respectively (31 March 2017: nil, DKK 9,336 thousand and DKK 10,099 thousand respectively). The aim of the first project is to develop next generation of our network recording platform, the aim of the second project was to develop new 2 x 100G accelerator and the aim of the third project was to develop new 1 x 100G accelerator. The remaining amortisation periods of these three projects are 2 years and 9 months, 3 years and 8 months and 1 year and 9 months respectively.

Within the in progress development projects there is one material development projects with carrying amount of DKK 14,297 thousand. The aim of the project is to develop our new product aimed at the virtualization market primarily focused towards telecom and cloud providers. The project are not yet completed and therefore has not been amortized.

The annual impairment test for the intangible assets will be performed at 31 December 2018. As per 31 March 2018 the management has assessed, that there were no indications of impairment in relation to the Group's intangible assets in the reporting period.

7 TANGIBLE ASSETS

DKK'000	Plant and equipment	Leasehold improvements	Total
Cost at 1 January 2018	33,400	5,105	38,505
Additions in the period	423	-	423
Currency adjustment	(28)	(14)	(42)
Cost at 31 March 2018	33,795	5,091	38,886
Accumulated depreciation at 1 January 2018	28,234	4,026	32,260
Depreciation for the period	833	129	962
Currency adjustment	(32)	(5)	(37)
Accumulated depreciation at 31 March 2018	29,035	4,150	33,185
Carrying amount at 31 March 2018	4,760	941	5,701

The annual impairment test for the tangible assets will be performed at 31 December 2018. As per 31 March 2018 the management has assessed, that there were no indications of impairment in relation to the Group's tangible assets in the reporting period.

8 TRADE AND OTHER RECEIVABLES

DKK'000	31 March 2018	31 March 2017
Receivables recognized in the consolidated statement of financial position:		
Trade receivables	26,408	51,632
Other receivables	4,073	3,438
Income tax receivable	5,500	2,231
Total current receivables	35,981	57,301

The provision for bad and doubtful receivables is as follows:

DKK'000	2018	2017
At 1 January	1,360	2,103
Change in the period	(30)	-
At 31 March	1,330	2,103

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

DKK'000	31 March 2018	31 March 2017
Not past due	16,945	45,596
Past due less than 30 days	4,589	4,178
Past due between 30 and 60 days	890	341
Past due between 60 and 90 days	808	1,291
Past due after 90 days	3,176	226
Total maximum credit risk	26,408	51,632

9 DERIVATIVE FINANCIAL INSTRUMENTS

DKK'000	31 March 2018	31 March 2017
Derivative financial instruments at fair value, assets / (liabilities)	-	(1,312)

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	2018	2017
	Thousand	Thousand
Ordinary shares of DKK 0.25 each at 1 January	23,877	23,664
Increase in ordinary shares DKK 0.25 each	46	148
Ordinary shares of DKK 0.25 each at 31 March	23,923	23,812

11 COMMITMENTS AND CONTINGENCIES

Collaterals

The Group has issued a floating charge in the amount of DKK 30 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 2018 are DKK 7,664 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