H&K AG

Management Report and Consolidated Financial Statements According to IFRS for the Financial Year 2022

Group Management Report 2022

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. The US commercial market is served by Heckler & Koch, Inc. (HKI), Columbus/Georgia, USA, whilst American governmental authorities and military customers are served by Heckler & Koch Defense Inc. (HKD), Columbus/Georgia, USA.

HKO develops, manufactures and, together with its subsidiaries, markets and distributes infantry and small arms 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 stock exchange in Paris, on the "Euronext Access" multilateral trading facility (MTF). The average share price shown on the Euronext during 2022 was significantly higher than our calculated share value, due to the very low volume of trading.

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 level of quality.

The H&K AG Group stands for technologically refined, innovative products and outstanding quality. To secure this situation, as of December 31, 2022, 13% (2021: 12%) of our employees work in Quality Management and 8% (2021: 8%) 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, Compliance, Sales, Legal and Foreign Trade were certified to DIN EN ISO/IEC 27001:2017 in January 2022.

As a member of the defence industry located in Germany, HKO is subject to current German weapon and export regulations for the manufacture of and trade in firearms and components for firearms. 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).

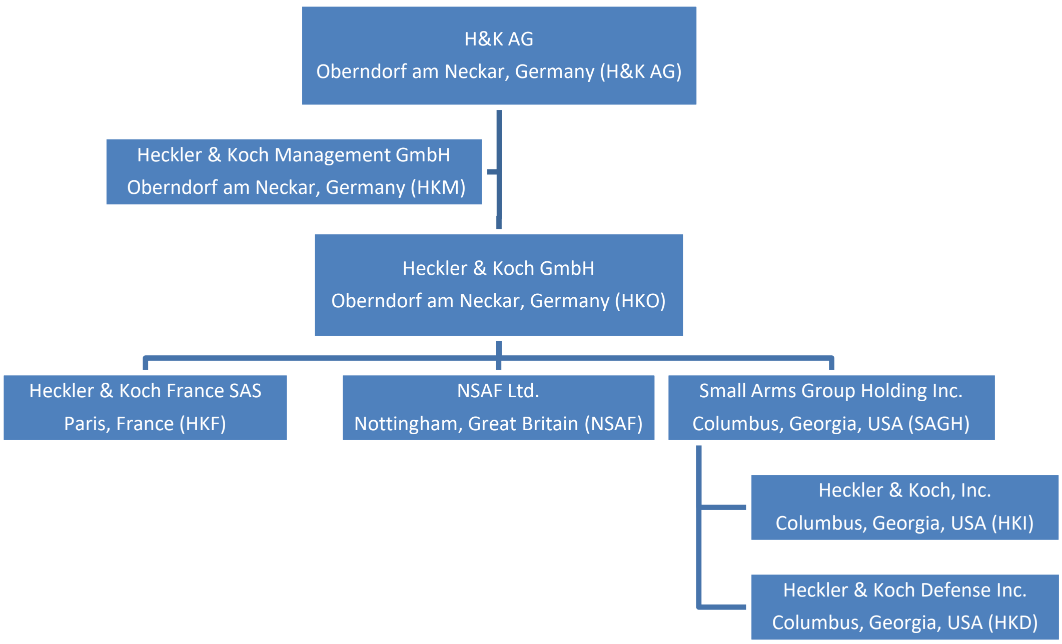
Corresponding US legal requirements such as the International Traffic in Arms Regulation (ITAR) and Export Administration Regulation (EAR) apply extraterritorially and therefore apply to the use of US technology or the trade in US goods outside the US.

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 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. The expenses for research and development, prior to effects of capitalisation, were €9.5 million in 2022 (2021: €9.9 million). In 2022, of these expenses, €5.2 million development costs were capitalised, a capitalisation rate of 55% and 1.7% of revenues (2021: €6.2 million; 63% capitalisation rate and 2.1% of revenues). 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, sub-machine guns and pistols. 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. Overall, 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% (2021: 8%) 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 the German Federal Statistical Office, in 2022, adjusted for price changes, real gross domestic product (GDP) increased by 1.8% over the previous year. Hopes for significant recovery, following the corona pandemic and associated economic slump, were only partially fulfilled. Due to the Russian attack on Ukraine, increasing energy prices and continuing high inflation with record figures, economic growth was significantly lower in the past year.

As a reaction to the much-heightened security situation on the Eastern borders of NATO and the European Union, Germany is investing more heavily in its security. The defence budget for 2023 only increased to approx. €50 billion, however the German Parliament also created a special fund of €100 billion to improve the material readiness of the German Army. In addition German Chancellor Olaf Scholz repeatedly avowed to fulfil NATO's so-called 2% target. The German Federal Ministry of the Interior's budget for 2023 is approx. €13 billion. Of this the expected expenditure for federal police in 2022 amounts to about €5 billion.

Changes in the overall economic environment generally have a delayed effect on our business activities. The war in Ukraine has caused a certain dynamic on the part of the customers, but the direct effect on the company cannot yet be fully predicted.

The military and law enforcement element of our business is generally determined by public spending policies. 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. In this regard the continuing discussions over a new defence export control law can be observed. The first key points from the Federal Ministry for Economic Affairs and Climate Action envisage expanding the definition of NATO-equivalent states to include South Korea, Singapore, Chile and Uruguay. This would expand the possible customers covered by our green country strategy.

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 under the criteria for state and national defence. The increasing destabilisation of the Middle East and North Africa, the Russian invasion of 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, peacekeeping missions and the defence of Germany and other NATO members, is to keep investing in their equipment. Due to the changed security situation, especially in Europe, a reduction in the relevant budgets is currently not expected.

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, 2022 was characterised by an increase in revenues compared to the previous year (5.1%); this can be explained in part by the increasing US-commercial business. The increased US commercial revenues were linked to increased quantities, and therefore to higher production volumes. The overall headcount, including agency workers, increased by about 4% over the previous year (2021: 4% increase). An associated increase in personnel expenses was also caused by the expiry of the supplementary-hours agreement on June 30, 2021.

The €305 million revenue generated in 2022 was higher than the €290 million generated in 2021. The increase was higher than forecast and primarily due to currency conversion effects (changed USD/EUR exchange rates) that supported the development of revenues by 5 percentage points, the positive business development in the US commercial markets and the positive effects of price escalation clauses. There were opposing effects from a partly scheduled reduction in the military business in the US, France and Great Britain.

As forecast, order intake was slightly higher than in 2021. Contrary to forecast, the order book increased slightly compared to the previous year's figure.

As a result of the higher revenues and inventory movements, the operating performance increased by €30.8 million to €325.0 million (2021: €294.2 million), a slightly higher increase than forecast.

The EBITDA of €82.0 million (2021: €58.0 million) was, contrary to the forecast, significantly higher than in the prior year. Both in prior years and in the reporting year high investments in capacity and process optimisation were made and cost-saving measures implemented; these continue to have an enduring positive effect on the result. Currency conversion effects supported the development of EBITDA by 18 percentage points.

The result from operating activities (EBIT) also increased by €24.1 million to €70.3 million (2021: €46.2 million).

Consequently, the result before income tax was €53.4 million (2021: €31.4 million).

From the prior year figure of €94.5 million, affected by factors related to the reporting-date, net working capital increased by €13.4 million to €107.9 million; this was consequently slightly higher than the forecast increase.

Unrestricted cash (cash and cash equivalents less such security deposits as are included in that position) was €35.8 million at the end of 2022, and was therefore, as forecast, lower than 2021 (€46.5 million).

The operating cash flow was €56.5 million in the previous year and as forecast decreased slightly, by €1.7 million, to €54.8 million in 2022.

The number of employees (excluding agency workers but including trainees) as at the balance sheet date increased slightly, as forecast, by 45 from 1,086 in the prior year to 1,131 for the current year.

In Oberndorf am Neckar, the number of employees for HKO (including trainees but excluding agency workers) increased by 45 from 966 to 1,011 employees at the end of 2022; of this increase, the majority was in the production and quality assurance departments.

Headcount in the US rose from 92 to 93 during 2022.

During the year, the number of agency workers in the Group decreased slightly to 31 (2021: 35).

The total headcount (including trainees and agency workers) increased by about 4% over the prior year.

Financial performance

Overview

Overall, the trends for the H&K AG Group's 2022 earnings performance (EBITDA) exceeded expectations significantly.

Trend in revenue and orders received

In 2022, H&K AG Group recorded revenue, net of sales deductions, of €305.1 million (2021: €290.2 million).

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

Region		Revenues EUR '000	Percentage of revenues
Germany (Domestic)	**2022**	**64,171**	**21%**
	2021	**62,835**	**22%**
USA	2022	131,938	43%
	2021	119,920	41%
UK	2022	23,231	8%
	2021	29,546	10%
France	2022	32,129	11%
	2021	40,722	14%
Other "Green Countries"	2022	52,993	17%
	2021	37,059	13%
Rest of world	2022	644	0%
	2021	126	0%
Total export	**2022**	**240,935**	**79%**
	2021	**227,373**	**78%**
Total	**2022**	**305,107**	**100%**
	2021	**290,207**	**100%**
of which "Green Countries"	2022	304,462	100%
	2021	290,081	100%

Domestic revenue increased slightly compared with the prior year and generated 21% of Group revenue in the period under review (2021: 22%).

The market in the USA, which is mainly served by our subsidiaries HKD and HKI, generated 43% (2021: 41%) of revenue. The increase was due to higher sales to the US commercial market, offset by a reduction in business with the US military market. Currency conversion effects supported the development of revenues by 5 percentage points. In addition, the military business in France and Great Britain also decreased.

The proportion of Group revenue generated in “Green Countries” remained at almost 100%, as in 2021.

Of the €305 million (2021: €290 million) Group revenue, 54% (2021: 60%) was to the military market, 4% (2021: 6%) to the police and governmental agencies market and 42% (2021: 34%) to the commercial market.

The H&K AG Group’s order intake in 2022 was €319 million (2021: €288 million). Currency conversion effects supported the development of order intake by approx. 4 percentage points.

The resultant order book at the end of 2022 was €230 million (2021: €219 million). Of this order book, €170 million is scheduled for delivery in 2023 (2021: €191 million was scheduled for delivery in 2022).

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 €14.9 million (+5.1%) to €305.1 million in the period under review compared to €290.2 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. Despite increased revenues and personnel expenses, the cost of sales decreased from €193.1 million in the prior year to €183.3 million in the year under review (- 5.1%). The ratio of cost of sales to revenue decreased to 60.1% (2021: 66.6%). This was primarily due to a change in the product mix. The increased revenues include positive effects from price escalation clauses and changes in the USD/EUR exchange rates; both of these affect cost of sales to a lesser extent than revenues.

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 previously capitalised development costs relating to projects cancelled due to changed market conditions are also included. The expenses, prior to effects of capitalisation, were €9.5 million (2021: €9.9 million). The amortisation of capitalised development costs was €2.3 million (2021: €2.6 million), less the capitalisation of €5.2 million development costs (2021: €6.2 million). In 2022, there was no retirement of previously capitalised development costs relating to projects cancelled due to changed market conditions (2021: €2.7 million). Resulting overall net research and development expenses were €6.5 million (2021: €8.9 million).

Sales, marketing & distribution expenses increased by €3.9 million to €26.5 million (2021: €22.6 million); the increase is primarily due to higher marketing, project-related and personnel expenses.

General administration expenses increased by €0.6 million to €20.7 million (2021: €20.1 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, partially offset by lower overheads, including for litigation.

The EBITDA of €82.0 million improved compared to the prior year (2021: €58.0 million). As a result, in 2022, EBIT increased by €24.1 million to €70.3 million compared with €46.2 million in the prior year.

The net financial expense in the year under review was €17.0 million (2021: €14.8 million). In 2022 interest expenses of €11.1 million (2021: €13.9 million) were incurred, primarily relating to interest-bearing financing. These include the financing loan (December 31, 2022: Term and Revolving Credit Facilities Agreement, "CFA-Loan" Facility A loan nominal €50 million, Facility B loan nominal €40 million, Facility C line €50 million; December 31, 2021: Senior Facilities Agreement, "SFA-loan" nominal €80 million), the bond (December 31, 2022: nil; December 31, 2021: €60 million) and in 2021 also two shareholder loans from COMPAGNIE DE DEVELOPPEMENT DE L'EAU S.A. (CDE) (originally €80 million, plus capitalised interest until the end of 2021 of €6.5 million) and an unsecured €15 million loan granted and received in February 2020 from another main shareholder of H&K AG plus capitalised interest until the end of 2021 of €1.9 million. In 2022 we recognised accretion of €2.2 million (2021: €1.8 million); this relates primarily to the CFA-loan, the bond and the SFA-loan, together with provisions for defined benefit and other obligations. As part of the refinancing, in August 2022, with retrospective effect from January 1, 2022, the three bridging loans from main shareholders were converted into hybrid loans totalling €95 million. Given the significant curtailment of the lenders' rights as a result of the conversion to hybrid loans, these bear interest at 10% p.a., however this interest only arises in certain circumstances. The lenders' entitlement to interest only applies if, in line with such a proposal from the executive directors, the Annual General Meeting ("AGM") of H&K AG resolves to distribute dividends to ordinary shareholders relating to the corresponding business year. These entitlements are therefore only recognised, if these prerequisites are satisfied, after the AGM takes place in the following year. The corresponding contingent liabilities as of December 31, 2022 total €9.6 million. The net effect of foreign exchange gains and losses was a loss of €3.4 million (2021: profit of €2.1 million).

In the year under review, earnings before income tax were a profit of €53.4 million (2021: profit of €31.4 million).

Income tax expenses (including deferred taxes) amounted to €2.7 million in the year under review (2021: €9.6 million). Deferred taxes are calculated on the basis of statutory tax rates, or of tax rates that have been enacted as of the balance sheet date in each country, which are expected to be in place on realisation. The deferred taxes altered from €3.8 million net expense in 2021 to €6.4 million net income in 2022; a €9.7 million partial release of the previous allowances against our interest carry-forwards was the primary factor in this change.

Due to the above developments, the Group recorded a consolidated profit for the period of €50.6 million (2021: €21.8 million).

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	
	2022	2021	**2022**	2021	**2022**	2021	**2022**	2021	**2022**	2021	**2022**	2021
Net revenues	**238.5**	208.5	**116.6**	89.7	**15.8**	30.6	**23.6**	29.8	**31.4**	40.1	**-**	-
Order Intake (*)	**247.4**	211.3	**97.8**	113.6	**6.2**	13.1	**43.8**	11.9	**50.8**	37.4	**-**	-
Order book	**198.7**	190.1	**27.1**	48.9	**3.1**	12.8	**44.7**	24.5	**41.2**	21.8	**-**	-
EBITDA	**66.7**	40.7	**11.0**	6.1	**1.7**	7.6	**2.0**	3.5	**1.6**	2.6	**(1.0)**	(1.1)
EBT	**47.1**	27.0	**9.4**	4.8	**5.1**	7.3	**1.9**	3.2	**1.6**	2.6	**45.3**	43.8
Employees (+)	**1,011**	966	**88**	86	**5**	6	**17**	19	**3**	3	**7**	6

** 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 our capital management is to secure the financing of current business activities, considering the obligations and the regular interest payments due to the CFA-loan, 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 on our behalf.

Funding sources and financing expenses

As at December 31, 2022, the H&K AG Group had the following two financing agreements:

- Secured financing agreement with a syndicate of banks (Term and Revolving Credit Facilities Agreement, “CFA-loan”), nominal €140 million.
- Unsecured shareholder loan (“Vendor Loan”), nominal €20 million.

As at December 31, 2021 the H&K AG Group had the following five financing loans:

- Secured, private financing agreement (“SFA-loan”), nominal €80 million.
- Unsecured bond, nominal €60 million.
- Unsecured bridging loan, €30 million (excluding accrued interest added).
- Unsecured bridging loan, €50 million (excluding accrued interest added).
- Unsecured bridging loan, €15 million (excluding accrued interest added).

The funds relating to the H&K AG Group's defined benefit obligations in the amount of €45.1 million (2021: €60.5 million) are available to the company in the long term.

CFA-Loan (Facilities A, B and C)

This syndicated loan is a €140 million financing agreement from August 17, 2022 (“CFA-Loan”) with an initial term of three years and the option of extensions of up to two additional years. The interest rate comprises a margin plus EURIBOR (if positive) and interest is payable at the end of each agreed interest period (either 3 or 6 months). Initially the margin is set at 3.5% and from 2024, dependent upon certain key figures, may vary between 1.6% and 3.5%. Commitment interest is charged on unutilised Facilities.

The H&K AG Group recognises two loan liabilities to banks under this agreement:

- **Facility A**, a secured financing loan to HKO (December 31, 2022: €50 million, of which €5 million are current; December 31, 2021: nil);
- **Facility B**, a secured financing loan to H&K AG (December 31, 2022: €40 million; December 31, 2021: nil).

In addition the CFA financing agreement includes:

- **Facility C**, a €50 million bank guarantee and overdraft facility; as of December 31, 2022, this was only utilised for bank guarantees and therefore, as a contingent liability, not recognised in the Statement of Financial Position (Note 32). The interest and other conditions of this facility are covered by additional ancillary agreements with the syndicate banks.

Under the CFA-loan agreement H&K AG and its subsidiaries are subject to strict limitations on certain transactions; the Group must also meet specified equity figures and ratios between net debt and the contractually defined EBITDA ("Financial Covenants"). The Group is permitted to partially or fully redeem the CFA-loan liability.

As security for liabilities under the CFA-loan (nominal including accrued interest as at December 31, 2022: €90.9 million; December 31, 2021: nil; utilisation of bank guarantee facility as at December 31, 2022: €14.7 million; December 31, 2021: nil), certain direct and indirect subsidiaries of H&K AG have also entered into the agreement as guarantors. In addition, all shares in HKM and certain of its direct and indirect subsidiaries together with, through floating charges and other security agreements, certain non-current assets, inventories, receivables and bank accounts are pledged to the agent for the syndicate banks.

Secured private financing agreement (SFA-loan)

The SFA-loan (December 31, 2022: nil; December 31, 2021: €80 million) was a private, secured €150 million financing agreement from July 24, 2017, maturing on August 21, 2022, and amounted to €74.6 million at that date. In the same month, the SFA-loan, including accrued interest, was repaid in full.

Unsecured bond

The €60 million bond was created on December 15, 2017 by the conversion of a private note purchaser loan. This bond had a term ending on April 30, 2023 and a fixed interest rate of 6.5% payable six-monthly, on April 30 and October 31. The bond was repurchased in full in December 2022 and thereby ceased prior to its maturity.

Unsecured bridging loans and shareholder 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 was 2%; accrued interest was 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 an amendment following the June 30, 2021 termination of the supplementary-hours agreement and considering the Group's significantly improved financial and earnings position, the interest rate was revised, within the contractually agreed range, to 6.5%, applicable from October 1, 2021. On August 18, 2022, through an Amendment and Restatement Agreement the loan conditions were changed with retrospective effect from January 1, 2022, and the original nominal values were converted into hybrid loans totalling €80 million. As a result of this conversion, according to IFRS, the hybrid loans are classed as equity ("Equity attributable to hybrid capital investors"). The interest accrued up to December 31, 2021, amounting to €6.5 million, was paid on November 30, 2022. From January 1, 2022, the loan bears interest at 10% p.a., however this interest only arises in certain circumstances. The lender's entitlement to interest only applies if, in line with such a proposal from the executive directors, the AGM of H&K AG resolves to distribute dividends to ordinary shareholders relating to the corresponding business year. These entitlements are therefore only recognised, if these prerequisites are satisfied, after the AGM takes place in the following year. The corresponding contingent liabilities as of December 31, 2022 total €8.1 million.

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 was 6.5%; accrued interest was added to the loan principal quarterly. On August 18, 2022, through an Amendment and Restatement Agreement the loan conditions were changed with retrospective effect from January 1, 2022, and the original nominal value was converted into a €15 million hybrid loan. As a result of this conversion, according to IFRS, the hybrid loan is classed as equity ("Equity attributable to hybrid capital investors"). The interest accrued up to December 31, 2021, amounting to €1.9 million, was paid on November 30, 2022. From January 1, 2022, the loan bears interest at 10% p.a., however this interest only arises in certain circumstances. The lender's entitlement to interest only applies if, in line with such a proposal from the executive directors, the AGM of H&K AG resolves to distribute dividends to ordinary shareholders relating to the corresponding business year. These entitlements are therefore only recognised, if these prerequisites are satisfied, after the AGM takes place in the following year. The corresponding contingent liability as of December 31, 2022 is €1.5 million.

On August 18, 2022, one of H&K AG's main shareholders that held our bond granted an unsecured loan (the vendor loan) of €20 million with a term of six years. The interest rate is 6.5% and accrued interest is to be added to the loan annually. Together with the utilisation of the CFA-loan €40 million Facility B, the bond was fully repurchased on December 16, 2022.

On August 18, 2022, one of H&K AG's main shareholders granted an unsecured loan (the "Additional Mezzanine Loan") of €40 million with a term of six years and an interest rate of 6.5% p.a. However the loan will only be utilised should certain prerequisites defined in the CFA-loan occur; if the loan were to be utilised, H&K AG would be obliged to repay Facility B of the CFA-loan in full. During the term of the CFA-loan, no repayments or interest payments may be made on this loan, so any accrued interest is to be added to the loan at the end of each interest period.

Financing expenses

H&K AG Group's financing expenses are primarily interest expenses totalling €11.0 million (2021: €13.7 million) relating to the CFA-loan, the vendor loan, the bond and the SFA-loan. In the prior year, in addition to interest expenses for the bond and the SFA-loan, interest for the loans from CDE and the loan received in 2020 from another main shareholder were included. Accretion for the bond, the CFA-loan and SFA-loan, defined benefit and other obligations amounting to €2.2 million (2021: €1.8 million) is also included.

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 €14.7 million in 2022 (2021: €12.6 million). This was mainly assets for the segment Germany. Capitalised development costs amounted to €5.2 million in 2022 (2021: €6.2 million).

Cash and cash equivalents

Cash inflows and outflows, including effects of particular factors

On December 31, 2022, the Group's cash and cash equivalents amounted to €35.8 million (2021: €46.5 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 2022 (€54.8 million inflow), €1.7 million below the prior year figure (€56.5 million inflow).

The main drivers for the change in operating cash flows were the higher Group profit, offset by a significantly higher increase in net working capital and provisions than in 2021 (see the Consolidated Statement of Cash Flows).

Solvency

Due to the available cash and cash equivalents, the H&K AG Group companies were able to meet their payment obligations at all times during 2022.

The unrestricted cash as at December 31, 2022 was €35.8 million (2021: €46.5 million). The unrestricted cash (cash and cash equivalents less security deposits) at the end of 2022, together with the expected profits in 2023 and 2024, provide sufficient scope to cover operational payments that are due in 2023 and 2024. According to the current five-year business plan, for 2023 and future years a positive net cashflow from operating activities, sufficient to cover capital expenditure and contractual interest payments, is expected.

According to the current five-year business plan, the H&K AG directors are also planning the conversion of hybrid loans into share capital and additional paid-in capital, to the extent permitted by law, which would reduce the interest charges in equity significantly and sustainably.

Financial position

Significant changes in financial position

Compared to December 31, 2021, the net assets at December 31, 2022 increased by €18.9 million to €328.2 million.

Non-current assets as at the balance sheet date increased to €135.7 million (2021: €128.4 million).

Current assets were €192.5 million; an increase of €11.6 million compared to the prior year. Inventories and prepayments for inventories increased by €20.4 million to €117.7 million (2021: €97.3 million). As at the balance sheet date, trade accounts receivable increased by €1.0 million year-on-year to €29.9 million (2021: €28.9 million). These balance sheet positions depend on the date of delivery and order-specific payment conditions and are therefore subject to significant fluctuations. The position "Other deposits" decreased by €1.9 million to €2.5 million (2021: €4.4 million).

Group equity, including equity attributable to hybrid capital investors, at December 31, 2022 amounts to €70.3 million (2021: negative €85.3 million). The current H&K AG Group business plan for the next few years shows a further improvement in the equity position and assumes the reduction of debt.

Facilities A and B of the CFA-loan and the vendor loan are recognised in the balance sheet in non-current and current liabilities at their net amortised costs of €107.2 million (2021: the bond, the SFA-loan, the loans from CDE and the loan received in 2020 from another main shareholder totalled €242.5 million).

Non-current liabilities decreased to €175.0 million (2021: €249.1 million), primarily due to the conversion of the bridging loans into hybrid loans, which are classed as equity.

Current liabilities decreased to €82.9 million (2021: €145.5 milli). This was primarily due to the repayment of the SFA-loan.

The performance indicator net working capital increased from €94.5 million at the end of the previous year to €107.9 million on December 31, 2022. This was primarily due to an increase in inventories and prepayments for inventories by €20.4 million and a €1.0 million increase in trade receivables affected by factors related to the reporting-date. Opposite effects were due to decreases of €5.7 million in contract liabilities and €2.2 million in trade payables.

Non-financial performance indicators and sustainability

Ensuring the sustainability of its business model is a central strategic task for the 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. Particular attention is given to both sustainable production and to securing enduring peace through our products.

Under our "Green Country Strategy" (see definition in Chapter 1. "Trend in business and overall situation", Section "Trend in business and corporate structure") we deliver to countries that sustainably achieve and maintain internal and external security.

We have developed our sustainability strategy with three pillars (Environment / Social / Governance). Detailed information and figures are in the Heckler & Koch annual Sustainability Reports. These are on the Group’s website www.heckler-koch.com (sustainability). The 2022 Sustainability Report is expected to be published there mid-2023.

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

Very well qualified, highly motivated and committed employees are essential for achieving top performance and are therefore the foundation of our long-term economic success. Values such as honesty, legal compliance, fairness, acceptance and trust, social behaviour 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 sustainability and business activities across all company locations are shaped by the company's social, environmental and economic responsibilities. Besides profitability and efficiency, the principles of our ESG management (Environment, Social, Governance) described above 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 2022, revenue increased slightly compared to the prior year. Given the increased, mainly high-margin revenues and the currency conversion effects, EBITDA increased substantially compared to the prior year. With a slightly increased level of net working capital and the effects of repaying the SFA-loan and interest on the bridging loans, unrestricted cash decreased significantly compared to the previous year, but remains at a very high level.

As a result of the refinancing and the conversion of the bridging loans into hybrid loans during 2022, debt decreased, to nominal €110 million at the year-end (2021: €244 million). The interest burden decreased by €2.8 million compared to the prior year. Equity including the hybrid loans is now positive €70.3 million (2021: negative €85.3 million).

Overall, the executive directors regard business developments as being extremely pleasing and the business as continuing to be on an excellent path.

For information about particularly significant transactions after the end of the business year, which are not recognised in the income statement or the statement of financial position, see Note 40 Subsequent Events in the notes to the consolidated financial statements.

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 conflict in Ukraine, including supply chain disruptions.

Economic outlook

In the January 2023 report "Global Economic Prospects", the World Bank forecast global growth "*to slow from 2.9% in 2022 to 1.7% in 2023 – substantially weaker than expected in June 2022 – before rebounding to 2.7% in 2024. Projected growth in 2023 is, Projected growth in 2023 is the third weakest in nearly three decades, over-shadowed only by the global recessions caused by the pandemic and the global financial crisis. The world's major engines of growth - the United States, the euro area, and China – are all expected to grow substantially below potential, and their contributions to global growth will be far below recent norms. […]*

In 2023, euro area growth is forecast at 0% - a downward revision of 1.9 percentage points, owing to ongoing energy supply disruptions and more monetary policy tightening than expected. Activity is expected to contract in the first half of 2023 before stabilizing later in the year. Inflation is envisaged to moderate as labour markets cool and energy prices decline." [1]

Expenditure to combat the pandemic and inflation inevitably leads to a debt burden for countries. A potential reduction in budgets for defence and internal security is currently not to be expected due to the Russian attack against Ukraine but could be implemented following a possible end of the conflict. Actual developments in the security situations in European countries, NATO members and future NATO members are currently inconsistent with a reduction in expenditure. The military engagements of affected countries or the joint engagements, for example the VJTF (Very High Readiness Joint Task Forces), particularly given the current situation on the Eastern border of Europe, are an example for this. 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.

[1] World Bank. 2023. Global Economic Prospects, January 2023. Washington, DC: World Bank. doi:10.1586/978-1-4648-1906-3. License: Creative Commons Attribution CC BY 3.0 IGO; *pp 27-28, 14*

This makes it imperative to increase and train 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 2% target. In particular Germany still has backlog investment requirements for this. However, at the end of February 2022, the German Chancellor announced that, following the Russian invasion of Ukraine, the 2022 national budget would provide a one-off sum of €100 billion. Some of these funds have already been used for necessary investments and armament projects. In addition, in future Germany would invest more than two percent of its gross domestic product in defence. However, with regard to this, the results of discussions over the 2024 German Federal Budget and the medium-term financial plans remain to be seen.

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 so far. The planned order intake and revenue numbers were in fact exceeded. However, Heckler & Koch cannot completely rule out the possibility that the significant increase in inflation, due to delivery problems during the corona pandemic and the conflict in Ukraine, will affect the purchase of raw materials and services in particular, and it may not be possible to pass this on to the market.

Overall, Heckler & Koch considers that it is well positioned to continue for the foreseeable future, with new products, as the main supplier for small arms, their spare parts and related services for the governmental agencies and armed forces of members of the EU, NATO and NATO-equivalent countries.

Expected financial performance in 2023 and forecast for non-financial performance indicators

The following forecasts are based on plans from the end of 2022 and include the effects of the Ukraine conflict known to us at that time.

Order intake and order book

For 2023 it is expected that order intake will be slightly lower than in 2022, however, due to lower planned revenue, the order book at the year-end is expected to be slightly higher.

Revenue, operating performance and EBITDA

For 2023, decreases are planned for revenues in the single-digit million range and for operating performance in the low double-digit million range. Given the very good result in 2022 (affected by currency conversion effects, amongst other things), EBITDA is expected to be significantly lower in 2023, but higher than in 2022.

Operating cash flow

According to the budget for 2023, operating cash flow is expected to remain at a high level, however lower than the very high value achieved in 2022 (€54.8 million).

Net working capital

According to the budget for 2023, net working capital is expected to be remain at a similar level to December 31, 2022 (€107.9 million).

Cash and cash equivalents

At the end of 2023, cash and cash equivalents are expected to be lower than at the end of 2022 (€35.8 million), due in part to the contractually agreed partial repayment of the CFA-loan. However, we expect to be able to fulfil our operating contractual obligations throughout 2023.

Number of employees

The headcount in 2023 is expected to be slightly above the level of 2022.

Overall assertion

For 2023 the executive directors expect that, with slightly lower revenues and lower operating performance compared to 2022, EBITDA will be substantially lower.

Opportunities

The Russian invasion of Ukraine in February 2022 has led to a paradigm shift in Germany. A few days after the beginning of the war, German Chancellor Olaf Scholz announced that a special €100 billion fund would be set up in 2022; in addition, the defence budget would be permanently increased to “more than two percent” of the gross domestic product, this should be written into the Constitution. It is highly likely that in addition to Germany, other NATO-members will increase their defence spending and invest more heavily in equipment for their Armed Forces. The consequence for Heckler & Koch is an increased demand for military weapons from current customers, and potentially also from new ones. For the business there is the possibility of strengthening its position as security partner of the liberal democracies and increasing its market share for military weapons in the EU and NATO. In the long view, for the business this exceptional and threatening situation concerning peace in the EU includes the opportunity of further establishing itself as a reliable defence supplier for NATO and the EU.

The German Government’s 2020 strategy paper to strengthen the security and defence industry 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, France and Japan.

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”. As a result, also under the new German Government, opportunities may open up in the next few years that should be taken by increasing activities in NATO, EU and NATO-equivalent countries.

The German Government’s strategy paper 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, 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 implemented at the end of 2018, involving numerous initiatives. These different improvement projects are anchored in a programme organisation at Heckler & Koch, from 2022 now known as "HK2025". During the last few years, numerous projects were set-up and successfully completed, the effects of which contributed to the improved profitability of the business. This programme will be consistently pursued and expanded by strategically oriented projects and projects to improve sustainability, the organisation and implementation of which are agreed with employee representatives. The H&K AG Group therefore expects further sustainable improvements in our profitability, liquidity and sustainability situation to result from this programme. In addition, we expect a strengthening of internal cooperation and a positive effect on the company's culture.

The overall opportunities for the H&K AG Croup continue to be ranked as high.

Risks

External risks

As a business in the defence industry, the H&K AG Group is exposed to cyber-attacks and risks of industrial espionage and sabotage. The risks, in particular of cyber-attacks, have increased due to the Russian invasion of Ukraine. It cannot be fully ensured that the protective measures and safeguards we have put in place to protect the integrity of our business data will be sufficient and successful. Incidents can have negative effects on our reputation, customer relationships, know-how and business situation. Consequently technical and organisational protective measures, together with the educating our employees to be careful with all business information and email correspondence, are important subjects for us. Given the current security situation and our protective measures, this risk is considered to be medium.

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 then 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. A similar discussion on the tightening of weapon controls is also taking place in Germany at present. This is also the case for the future development of German export controls. However, at this time this risk for our market segment is classed as moderate.

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 forward-cover contracts are arranged with a leading online broker or with the syndicate banks.

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. Unfortunately, the risk that political players or political 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 2023, since potential new measures taken by the Federal and State Governments for this or new pandemics could affect our supply-chains and production. We currently expect the risk for Heckler & Koch to be very low.

It is to be expected that the significant increase in inflation, due to the energy crisis following the Russian invasion of Ukraine, will affect the purchase of raw materials and services in particular. 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

As a result of the refinancing in 2022, the H&K AG Group has two main financing agreements as of December 31, 2022: a CFA-agreement (term three years with options to extend) amounting to €140 million and a €20 million vendor loan (term six years).

Facilities A and B of the CFA-loan are recognised in the statement of financial position at their amortised amounts totalling €87.2 million. Facility C of the CFA-loan is currently only being used as a guarantee line and is therefore shown within contingent liabilities. The associated accrued interest liabilities totalling €0.9 million are recognised within other liabilities.

Under the CFA-loan agreement H&K AG and its subsidiaries are subject to strict limitations on certain transactions; the Group must also meet specified equity figures and ratios between net debt and the contractually defined EBITDA (“Financial Covenants”). The Group is permitted to partially or fully redeem the CFA-loan liability.

As security for liabilities under the CFA-loan (nominal including accrued interest as at December 31, 2022: €90.9 million; December 31, 2021: nil; utilisation of bank guarantee facility as at December 31, 2022: €14.7 million; December 31, 2021: nil), certain direct and indirect subsidiaries of H&K AG have also entered into the agreement as guarantors. In addition, all shares in HKM and certain of its direct and indirect subsidiaries together with, through floating charges and other security agreements, certain non-current assets, inventories, receivables and bank accounts are pledged to the agent for the syndicate banks.

For additional details on these liabilities, please see Section “Funding sources and financing expenses” in Chapter 2 “Business situation”.

According to the current five-year plan, for 2023 and future years a positive net cashflow from operating activities, sufficient to cover capital expenditure and contractual interest payments, is expected. According to the current five-year business plan, the H&K AG directors are also planning the conversion of hybrid loans into share capital and additional paid-in capital, to the extent permitted by law, which would reduce the interest charges in equity significantly and sustainably.

As reported in the comments on the financial position in the Section “Significant changes in financial position” in Chapter 2 “Business situation”, the H&K AG Group has positive equity of €70.3 million (2021: negative equity of €85.3 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 risks, which 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.

Training sessions on the Code of Ethics and Business Conduct (“code of conduct”) take place regularly. 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. A corresponding guideline for due diligence relating to all business partners came into effect on September 20, 2021.

The risk stocktake is still carried out in all business areas twice a year, at the end of half and full years.

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. The Compliance Officer and Group Risk Manager also report to the supervisory board regularly.

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

Legal risks

These risks primarily include risks arising from product liability, competition and anti-trust laws, foreign trade law, weapons law, anti-corruption law, criminal and misdemeanour laws, 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 primarily 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 Economic Affairs and Climate Action ("BMWK"), 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 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 appealed this verdict; the Public Prosecutor and the two accused who were sentenced also appealed. In March 2021, the Federal Court of Justice (BGH) confirmed the Stuttgart District Court's verdicts and as a result, the suspended sentences against two former employees became legally binding, as did the confiscation of €3.0 million from HKO; the BGH severed its consideration regarding the confiscation of a further €0.7 million. The legal question involved is now awaiting a decision from the "Großen Senat" of the Federal Court of Justice since such a confiscation would change the legal interpretations of several other senates of the Federal Court of Justice. The confiscation of the €3.0 million has therefore also not yet taken place.

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 particularly 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 obligations due to the company's leverage, combined with the limited cash reserves.

Through the HK2025 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, a further improvement in the equity position and a reduction in leverage. For 2023 we expect a positive EBITDA, significantly below the very good level of 2022.

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.

The statements above result in the risk-bearing capability of the Group being classed as high.

Oberndorf am Neckar, April 6, 2023

H&K AG

The Executive Board

Dr Jens Bodo Koch

Dr Björn Krönert

Consolidated Statement of Financial Position

(€ thousands)	§	31.12.2022	31.12.2021
Property, plant & equipment	17	67,855	61,668
Intangible assets - goodwill	16	5,149	5,149
Intangible assets - other	16	43,504	40,310
Other investments	18	2,435	9,536
Deferred tax assets	15	16,770	11,780
Total non-current assets		**135,712**	**128,443**
Inventories	19	117,586	96,659
Prepayments for inventories	20	141	641
Prepayments for other current assets	20	168	341
Other deposits	18,29	2,538	4,418
Current tax assets		1,053	144
Trade receivables	20	29,898	28,943
Other receivables	20	5,253	3,229
Cash & cash equivalents	17	35,844	46,514
Total current assets		**192,482**	**180,890**
Total assets		**328,194**	**309,333**
Equity			
Share capital		27,641	27,641
Additional paid in capital		53,025	53,025
Other reserves		(9,313)	(19,238)
Consolidated retained earnings		(96,040)	(146,680)
Total equity attributable to H&K AG shareholders		**(24,687)**	**(85,251)**
Equity attributable to hybrid capital investors		95,000	-
Total equity	22	**70,313**	**(85,251)**
Liabilities			
Loans & borrowings	25	102,396	163,128
Lease liabilities	25	1,103	1,022
Employee defined benefit obligations	23	45,092	60,541
Provisions	24	2,453	2,890
Other payables	26	58	-
Deferred tax liabilities	15	23,914	21,553
Total non-current liabilities		**175,016**	**249,133**
		-	-
Loans & borrowings	25	4,848	79,410
Trade payables	26	21,217	19,049
Other payables	26	13,799	12,172
Contract liabilities	27	18,704	12,985
Derivatives	26,29	1,454	1,118
Tax liabilities		8,259	3,879
Other provisions & accruals	24	14,584	16,837
Total current liabilities		**82,865**	**145,451**
Total liabilities		**257,881**	**394,584**
Total equity & liabilities		**328,194**	**309,333**

Consolidated Income Statement
For the period January 1 to December 31

(€ thousands)	**2022**	**2021**
Revenue	305,107	290,207
Cost of sales	(183,257)	(193,149)
Gross profit	**121,850**	**97,058**
Research & development expenses	(6,506)	(8,930)
Sales, marketing & distribution expenses	(26,549)	(22,600)
Administration expenses	(20,703)	(20,127)
Other operating income	2,220	1,652
Other operating expenses	(332)	(720)
Impairment loss on trade receivables, net of reversals	362	(107)
Results from operating activities	**70,341**	**46,226**
Interest income	190	3
Gains on translation of foreign currencies	4,059	2,835
Total financial income	**4,248**	**2,838**
Interest expense	(11,125)	(13,945)
Accretion of non-current liabilities	(2,226)	(1,791)
Losses on val'n of other derivative financial instruments	(335)	(1,118)
Losses on translation of foreign currencies	(7,470)	(732)
Other financial expense	(78)	(54)
Total financial expense	**(21,235)**	**(17,641)**
Net financial result	**(16,986)**	**(14,803)**
Profit / (loss) before income tax	**53,355**	**31,422**
Income tax expense	(2,716)	(9,578)
Profit / (loss) for the period	**50,639**	**21,844**
Attributable to the shareholders of H&K AG	**50,639**	**21,844**
Earnings per share (€)	**1.83**	**0.79**

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

(€ thousands)	2022	2021
Profit / (loss) for the period	**50,639**	**21,844**
Other comprehensive income		
DBO actuarial gains / (losses)	13,518	707
Related deferred tax	(3,795)	(198)
Items that will never be reclassified to profit or loss	**9,723**	**508**
Forex translation differences for foreign operations	202	666
Items that are or may be reclassified to profit or loss	**202**	**666**
Other comprehensive income / (expense), net of tax	**9,925**	**1,174**
Total comprehensive income for the period	**60,564**	**23,018**
Attributable to the shareholders of H&K AG	**60,564**	**23,018**

Consolidated Statement of Changes in Equity
For the period January 1 to December 31, 2022

(€ thousands)	Share Capital	Additional Paid in Capital	Translation Reserve	Reserve for Defined Benefit Obligations	Consolidated Retained Earnings	Shareholders' Equity	Equity Attributable to Hybrid Capital Investors	Total Equity -
As of 01.01.2021	**27,641**	**53,025**	**(543)**	**(19,869)**	**(168,524)**	**(108,269)**	**-**	**(108,269)**
Total recognised income & expense	-	-	666	508	21,844	23,018	-	23,018
As of 31.12.2021	**27,641**	**53,025**	**122**	**(19,360)**	**(146,680)**	**(85,251)**	**-**	**(85,251)**
Conversion of loans to Hybrid Captial	-	-	-	-	-	-	95,000	95,000
Total recognised income & expense	-	-	202	9,723	50,639	60,564	-	60,564
As of 31.12.2022	**27,641**	**53,025**	**325**	**(9,637)**	**(96,040)**	**(24,687)**	**95,000**	**70,313**

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

(€ thousands)	2022	2021
Cash flows from operating activities		
Profit / (loss) for the period	50,639	21,844
Adjustments for:		
Depreciation of property, plant & equipment	8,769	8,305
Amortisation of intangible assets	2,938	3,445
(Reversal of) impairment losses on intangible assets	-	2,679
Net interest expense	13,240	15,788
Change in fair value of derivatives	335	1,118
(Gain) / loss on disposal of property, plant & equipment	142	(73)
Income tax expense	2,716	9,578
	78,780	62,684
Change in inventories	(19,984)	(720)
Change in trade & other receivables	(816)	(6,150)
Change in prepayments	676	(179)
Change in trade & other payables	6,999	7,976
Change in provisions & employees' defined benefits	(5,251)	(1,915)
	60,404	61,696
Income tax paid	(5,606)	(5,221)
Net cash flows due to operating activities	**54,797**	**56,475**
Cash flows from investing activities		
Interest received	50	3
Proceeds from sale of property, plant & equipment	48	124
Acq'n of property, plant, equipment and intangibles	(14,731)	(12,637)
Investments in other financial assets	(26)	-
Movement in deposits with terms >3 months	9,006	(9,560)
Capitalised development expenditure	(5,229)	(6,222)
Net cash flows due to investing activities	**(10,881)**	**(28,292)**
Cash flows from financing activities		
Proceeds from loans	90,000	-
Payment of transaction costs	(4,911)	-
Repayment of loans	(120,030)	(3,000)
Interest paid	(19,452)	(12,369)
Repayment of lease liabilities	(351)	(376)
Net cash flows due to financing activities	**(54,744)**	**(15,745)**
Net cashflows	**(10,828)**	**12,437**
Cash & cash equivalents at 1st January	46,514	33,343
Effect of exchange rate fluctuations on cash held	158	734
Cash & cash equivalents at December 31	**35,844**	**46,514**

Notes to the consolidated financial statements for the year 2022

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 stock exchange in Paris, on the "Euronext Access" multilateral trading facility (MTF). The average share price shown on the Euronext during 2022 was significantly higher than our calculated share value due to the very low volume of trading. 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, in particular in NATO countries and the EU, and is one of the leading businesses in this market segment; 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 and described in more detail in the notes.

(2) Executive board approval

The board of directors of H&K AG finalised & approved the consolidated financial statements on April 6, 2023.

(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, 2022, 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 2022 have been applied. The financial statements were prepared on a going concern basis.

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 2022 are not material for the Group and are therefore not detailed here:

- Amendments to IFRS 3 – reference to the framework concept.
- Amendments to IAS 16 - Proceeds before intended use.
- Amendments to IAS 37 - Onerous contracts – costs of fulfilling a contract.
- Annual improvements 2018-2020 (IFRS 1, IFRS 9, IFRS 16, IAS 41).

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 the directors do not expect material effects to result from these.

Endorsed by the EU

- Amendments to IAS 1 - Presentation of financial statements - and IFRS Practice Statement 2: disclosure of accounting policies.
  The amendments are effective for accounting periods beginning on or after January 1, 2023 and are to be applied prospectively; 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.
- Amendments to IAS 12 – Income Taxes: deferred taxes related to assets and liabilities arising from a single transaction.
  The amendments are effective for accounting periods beginning on or after January 1, 2023; an earlier adoption would be permissible.

- IFRS 17 Insurance contracts including amendments to IFRS 17 (published June 25, 2020) and initial application of IFRS 17 and IFRS 9 – comparative information (published December 9, 2021)
  The amendments are effective for accounting periods beginning on or after January 1, 2023 and are to be applied retrospectively.

EU endorsement pending

- Amendments to IAS 1 - Presentation of financial statements: classification of liabilities as current or non-current and – non-current liabilities with covenants
  The amendments are effective for accounting periods beginning on or after January 1, 2024 and are to be applied retrospectively; an earlier adoption would be permissible but must be declared.
- Amendments to IFRS 16 – Leasing liabilities in a sales and leaseback transaction (published September 22, 2022)
  The amendments are effective for accounting periods beginning on or after January 1, 2024; an earlier adoption would be permissible.
- 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, 2022, include the annual financial statements of seven (2021: 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 can affect such returns through its control position.

Since July 2020, the majority of shares are held by COMPAGNIE DE DEVELOPPEMENT 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:

		Functional		2022			2021	
	Abbreviation	Currency	% held	Equity	Profit	% held	Equity	Profit
Direct holdings								
Heckler & Koch Management GmbH	HKM	EUR '000	100%	351,299	16,828	100%	351,299	35,167
Heckler & Koch GmbH	HKO	EUR '000	5.1%	154,965	47,089	5.1%	127,967	26,984
Indirect holdings								
Heckler & Koch GmbH	HKO	EUR '000	94.9%	154,965	47,089	94.9%	127,967	26,984
NSAF Limited, Nottingham, England	NSAF	GBP '000	100%	3,914	1,321	100%	4,170	2,204
Heckler & Koch France S.A.S., St-Nom-la-Bretèche, France	HKF	EUR '000	100%	1,196	1,177	100%	2,519	1,914
Small Arms Group Holding Inc., Columbus, GA, USA	SAGH	USD '000	100%	20,919	3,900	100%	17,019	-
Heckler & Koch Defense Inc., Columbus, GA, USA	HKD	USD '000	100%	(3,726)	1,527	100%	(9,153)	6,746
Heckler & Koch, Inc., Columbus GA, USA	HKI	USD '000	100%	23,760	8,083	100%	19,577	4,374

On October 26, 2022, two off-the-shelf companies, “Kronen 2902 GmbH” and “Kronen 2902 GmbH & Co. Vorrats KG”, were acquired by HKO and renamed “H&K ITZ IMMOBILIEN Verwaltung GmbH” (ITZG) and “H&K ITZ IMMOBILIEN GmbH & Co. KG” (ITZK) respectively. These German companies are wholly owned but have been excluded from the consolidation due to lack of materiality; instead, they are included in the other non-current investments at their book value of €26k (2021: nil) (Note 18). These transactions had no material effect on these consolidated financial statements.

HKO and HKM, each located in Oberndorf am Neckar, have availed themselves of the German commercial law option § 264 (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 31.12.2022	Rate on balance sheet date 31.12.2021	Average exchange rate 2022	Average exchange rate 2021
US Dollar (USA)	USD	1.0666	1.1326	1.0530	1.1827
Pound (Great Britain)	GBP	0.8869	0.8403	0.8528	0.8596

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	31.12.2022	31.12.2021
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 (2021: €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, 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 2022 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 and lessors, and derivatives relating to currency forward-cover contracts with negative fair values at the balance sheet date. 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 - all the financial instruments held by the Group during 2022 were classified and measured “at amortised cost”. The derivatives are 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 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, 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, if 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 2021 and 2022 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

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; during 2021 and early 2022, this was 7.25%; after refinancing with a significantly lower margin, the rate for new projects was 4.4%, and, following increases in EURIBOR, 6.0% at the end of 2022.

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 2021 or 2022, 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 issued. 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, including interest expenses that are not yet deductible for taxation purposes, 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 (for example relating to interest carry-forwards) 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 lawsuit 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 lawsuit 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

Revenue increased by €14,900k to €305,107k compared with revenue of €290,207k in 2021. 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	2022	2021
Sale of goods	298,738	287,103
Sale of services	9,776	5,796
Gross revenue	**308,514**	**292,899**
Discounts, bonuses, etc.	(3,407)	(2,692)
Revenue	**305,107**	**290,207**

Breakdown by geographical market:

EUR '000	2022	2021
Domestic (Germany)	64,398	63,039
Foreign - other "Green Countries"	243,472	229,734
Foreign - rest of the world	644	126
Gross revenue	**308,514**	**292,899**
Discounts, bonuses, etc.	(3,407)	(2,692)
Revenue	**305,107**	**290,207**

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	31.12.2022	31.12.2021
Trade receivables	29,898	28,943
Contract liabilities	(18,704)	(12,985)
Gesamt	**11,194**	**15,958**

Contract liabilities primarily relate to advance consideration received from customers. Of the €12,985k contract liabilities recognised at the beginning of the year (€5,001k at the beginning of 2021) €9,310k (2021: €3,485k) 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 €1,539k (2021: nil).

As permitted by IFRS 15, no information is provided about remaining performance obligations at December 31, 2022 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. Despite increased revenues and personnel expenses, the cost of sales decreased by €9,892k to €183,257k compared with €193,149k cost of sales in 2021; this was primarily due to a change in the product mix. The increased revenues include positive effects from price escalation clauses and changes in the USD/EUR exchange rates; both of these affect cost of sales to a lesser extent than revenues.

(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 decreased by €2,424k to €6,506k compared with €8,930k in 2021; the decrease is primarily due to a reduction in the amount included for the retirement of capitalised development costs relating to projects that have been cancelled because of changed market conditions (2022: nil; 2021: €2.679k). In addition, development costs reduced by €421k and amortisation of capitalised development costs by €317k; this was partially offset by a reduction in the capitalisation of development costs by €993k.

(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 €3,949k to €26,549k compared €22,600k in 2021; the increase is primarily due to higher marketing, project-related and personnel expenses.

(10) Administration expenses

General administration expenses include personnel expenses and overheads as well as the depreciation relating to the administration function. They increased by €576k to €20,703k compared with €20,127k in 2021, primarily due to higher personnel expenses, partially offset by lower overheads, including for litigation.

(11) Other operating income

EUR '000	2022	2021
Settlements received	411	-
Relief for energy and electricity taxes	237	-
Insurance benefits	437	645
Profit on disposal of non-current assets	44	112
Income from the disposal of scrap etc.	656	576
Income from derecognition of liabilities	149	30
Other	285	288
Total	**2,220**	**1,652**

The other operating income includes out-of-period income of €1,402k (2021: €951k). This primarily relates to income from insurance benefits, settlements, tax relief and derecognitions amounting to €1,230k (2021: €675k).

(12) Other operating expenses impairment loss on trade receivables, net of reversals

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

EUR '000	2022	2021
Provision for the possible calling of bank guarantees	(227)	(148)
Prior year credit notes	27	(244)
Loss on disposal of non-current assets	(186)	(39)
Other taxes	(490)	(100)
Insurance for natural hazards and business interruption	(378)	(339)
Late delivery penalties, other periods	959	317
Other	(37)	(167)
Total	**(332)**	**(720)**

The other operating expenses include out-of-period net income of €800k (2021: €407k net income). In 2022 the out-of-period net income related primarily to the release of certain provisions for potential contractual penalties. In 2021 the out-of-period net income related primarily to the release of a provision for potential payroll back-taxes following a tax audit and of a provision for potential contractual penalties.

In 2022, the position "impairment loss on trade receivables, net of reversals" relates primarily to the utilisation of €490k specific allowances from 2020; the corresponding derecognitions resulted in the reversal of the associated revenues (€997k) and the return of the goods to inventories. In 2021 this position related primarily to an increase in specific allowances offset by a reduction in the general impairments determined in accordance with IFRS 9, (Note 20).

(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	**2022**	**2021**
Revenue	305,107	290,207
Material costs and movement in inventories	(108,615)	(124,327)
Capitalised costs	5,797	3,347
Other operating income	2,220	1,652
Payroll	(89,406)	(81,980)
Other operating expenses	(33,414)	(30,815)
Impairment loss on trade receivables, net of reversals	362	(107)
EBITDA	**82,049**	**57,976**
Depreciation and amortisation	(11,708)	(11,750)
Results from operating activities	**70,341**	**46,226**

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

(14) Financial result

EUR '000	2022	2021
Financial income		
Interest income	190	3
Gains on translation of foreign currencies	4,059	2,835
Total financial income	**4,248**	**2,838**
Financial expenses		
Interest expenses	(11,125)	(13,945)
Accretion of non-current liabilities	(2,226)	(1,791)
Losses on valuation of derivative financial instruments	(335)	(1,118)
Losses on translation of foreign currencies	(7,470)	(732)
Other	(78)	(54)
Total financial expense	**(21,235)**	**(17,641)**
Financial result	**(16,986)**	**(14,803)**

The interest income primarily includes interest on tax refunds and bank balances; currently no interest income results from using the effective interest method (Note 5). The losses 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 realised exchange variances 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 bond and on other long-term loans, including commitment fees relating to the new CFA-Loan (Note 25). In August 2022, with retrospective effect from January 1, 2022, three bridging loans from main shareholders were converted into hybrid loans; as a result no interest expenses were recognised for these in 2022, instead only related contingent liabilities are recorded (Notes 22, 25, 32, 36). The accretion of non-current liabilities relates to defined benefit and other long-term provisions, the bond, the SFA-loan and the new CFA-loan. 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% (2021: 28.075%). Foreign taxation is calculated at the rates valid in each country; these vary between 19.0% and 25.0% (2021: between 19.0% and 26.5%). 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. Deferred taxes relating to interest expenses carried-forward for taxation purposes are calculated at 25.0125%.

The income tax expense comprises:

EUR '000	2022	2021
Current tax expense	(9,096)	(5,807)
Deferred tax income / (expense)	6,380	(3,771)
Income tax expense	**(2,716)**	**(9,578)**

Primarily due to the improved result before taxes of €53,355k profit (2021: €31,422k profit), the current income tax expense recognised increased to €9,096k (2021: €5,807k). Deferred tax changed from an expense of €3,771k in 2021 to an income of €6,380k; this was primarily due to a €9,700k partial release of allowances against our interest carry-forwards.

The following table shows a reconciliation of the expected tax using the current statutory tax rate for the parent company of 28.075% (2021: 28.075%) and the actual income tax shown for the Group:

EUR '000	2022	2021
Profit / (loss) before income tax	**53,355**	**31,422**
Expected tax rate (current German statutory rate)	**28.075%**	**28.075%**
Expected tax (expense) / income	**(14,979)**	**(8,822)**
Adjustments to expected tax expense due to:		
- change in tax rates	(0)	(0)
- non-tax-deductible expenses	(417)	(1,597)
- non-taxable income	8	6
- taxes relating to other periods	265	(44)
- differences in foreign tax rates	820	978
- utilisation of tax losses not previously recognised	917	-
- utilisation of interest carry-forwards not previously recognised	936	-
- partial release of allowances against interest carry-forwards	9,700	-
- other effects	35	(100)
Actual tax expense	**(2,716)**	**(9,578)**
Effective tax rate	**5.1%**	**30.5%**

Deferred tax relates to the following positions:

Balance Sheet Item EUR '000	Deferred tax assets 31.12.2022	Deferred tax assets 31.12.2021	Deferred tax liabilities 31.12.2022	Deferred tax liabilities 31.12.2021
Intangible non-current assets	-	-	17,566	16,735
Tangible non-current assets	157	142	4,951	4,546
Inventories	1,255	1,200	176	101
Trade accounts receivable	169	159	10	12
Other current assets	122	110	436	1
Employee defined benefit obligations	3,777	8,013	-	-
Other non-current provisions	751	808	-	-
Non-current financial liabilities	-	-	731	96
Other non-current liabilities	22	31	-	-
Current provisions	218	96	-	-
Trade accounts payable	2	2	1	-
Other current financial liabilities	-	-	43	61
Other current liabilities	596	945	-	0
Carryforward of unused tax losses	-	273	-	-
Carryforward of interest expenses not yet deductible	9,700	-	-	-
Total	**16,770**	**11,780**	**23,914**	**21,553**

During 2022, a net increase in deferred tax assets of €3,795k (2021: €198k net increase) 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 (2022: €43k net increase; 2021: €144k 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 01.01.2021	Recognised in profit or loss	Recognised in other comprehensive income	Deferred Tax 31.12.2021	Recognised in profit or loss	Recognised in other comprehensive income	Deferred Tax 31.12.2022
Intangible non-current assets	(16,336)	(399)	-	(16,735)	(831)	-	(17,566)
Long term financial investments & derivatives	-	-	-	-	-	-	-
Tangible non-current assets	(4,019)	(289)	(94)	(4,403)	(317)	(73)	(4,793)
Inventories	715	360	24	1,099	(40)	19	1,079
Trade accounts receivable	128	7	12	147	2	10	159
Other current assets	764	(654)	-	109	(424)	-	(315)
Employee defined benefit obligations	8,607	(414)	(181)	8,013	(508)	(3,728)	3,777
Other non-current provisions	634	192	(17)	808	10	(67)	751
Non-current financial liabilities	(325)	229	-	(96)	(635)	-	(731)
Other non-current liabilities	29	1	1	31	(8)	(1)	22
Current provisions	188	(104)	11	96	118	4	218
Trade accounts payable	(2)	4	-	2	(0)	-	2
Other current financial liabilities	-	(61)	-	(61)	19	-	(43)
Other current liabilities	852	20	72	945	(412)	64	596
Carryforward of unused tax losses	2,817	(2,661)	117	273	(294)	21	-
Carryforward of interest expenses not yet deductible	-	-	-	-	9,700	-	9,700
Total	**(5,947)**	**(3,771)**	**(55)**	**(9,773)**	**6,380**	**(3,752)**	**(7,144)**

At the end of 2021, potential deferred tax assets of €248k (2022: nil) relating to tax-losses carried forward by US subsidiaries had not been recognised since they related to losses incurred prior to the current US fiscal unity, however in the meantime they have been utilised.

At the end of 2022, deferred tax assets of the parent company amounting to €9,700k (2021: nil) relating to the tax carry-forward of interest expenses were assessed to no longer be impaired since according to our current plans they can be utilised within the five-year planning horizon. This revised assessment is not only based on the current plan but also due to the completion of the refinancing and its conditions. Potential deferred tax assets of €22,995k (2021: €33,631k) relating to the tax carry-forward of interest expenses that will probably not be utilised until after our planning horizon are still allowed for in full.

In 2022, income tax payments amounted to €5.6 million (2021: €5.2 million). Of these, €2.8 million (2021: €3.3 million) relate to advance payments for current year German income taxes, €1.1 million net payments (2021: €0.4 million net payments) relate to German income taxes for prior years, while foreign income taxes account for €1.7 million net payments (2021: for €1.5 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 01.01.2021	**29,106**	**5,149**	**9,592**	**43,847**
Acquisition / manufacturing costs				
Balance at 01.01.2021	**49,809**	**6,649**	**24,345**	**80,803**
Effect of movement in exchange rates	213	-	40	252
Additions	6,222	-	1,347	7,569
Disposals / retirements	(2,693)	-	(559)	(3,252)
Balance at 31.12.2021	**53,551**	**6,649**	**25,172**	**85,372**
Amortisation & depreciation				
Balance at 01.01.2021	**(20,703)**	**(1,500)**	**(14,752)**	**(36,956)**
Effect of movement in exchange rates	(0)	-	(37)	(38)
Amortisation for the year	(2,583)	-	(862)	(3,445)
Accumulated amortisation on disposals / retirements	14	-	510	525
Balance at 31.12.2021	**(23,272)**	**(1,500)**	**(15,141)**	**(39,914)**
Net carrying value at 31.12.2021	**30,279**	**5,149**	**10,031**	**45,458**
Acquisition / manufacturing costs				
Balance at 01.01.2022	**53,551**	**6,649**	**25,172**	**85,372**
Effect of movement in exchange rates	157	-	29	187
Additions	5,229	-	747	5,976
Disposals / retirements	-	-	(607)	(607)
Balance at 31.12.2022	**58,937**	**6,649**	**25,341**	**90,928**
Amortisation & depreciation				
Balance at 01.01.2022	**(23,272)**	**(1,500)**	**(15,141)**	**(39,914)**
Effect of movement in exchange rates	-	-	(30)	(30)
Amortisation for the year	(2,266)	-	(672)	(2,938)
Accumulated amortisation on disposals / retirements	-	-	607	607
Balance at 31.12.2022	**(25,538)**	**(1,500)**	**(15,236)**	**(42,275)**
Net carrying value at 31.12.2022	**33,399**	**5,149**	**10,105**	**48,653**

As described in Note 5, goodwill and other intangible assets with indefinite lives are subject to annual impairment testing. Goodwill is allocated to the associated 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 (2022: €8,393k; 2021: €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. IAS 36.134(f) does not apply.

The discount rates used for December 31, 2022 are pre-tax cost of capital rates determined using the CAPM.

	2022	**2021**
HKO	7.7%-8.4%; terminal value 7.2%	7.5%-7.9%; terminal value 6.5%
HKF	5.0%-6.8%; terminal value 5.6%	4.9%-6.0%; terminal value 4.6%

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 corresponding security assignment agreement, certain patents, trademarks and domains have been pledged as security for a long-term financing agreement (2022: *Term and Revolving Credit*

Facilities Agreement, “CFA-Loan”; 2021: *Senior Facilities Agreement*, “SFA-loan”) (net book value 2022: €8,393k; 2021: €8,393k); (Note 25).

The normal amortisation (2022: €2,938k; 2021: €3,445k) 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 (2022: nil; 2021: €2,679k):

EUR '000	2022	2021
Cost of sales	241	122
Research and development expenses	2,308	5,311
Sales, marketing & distribution expenses	7	13
Administration expenses	383	679
Total	**2,938**	**6,124**

As at December 31, 2022, the Group had a balance of €142k (2021: €339k) 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 01.01.2021	**22,830**	**20,566**	**10,065**	**4,206**	**57,665**
Acquisition / manufacturing costs					
Balance at 01.01.2021	**38,454**	**69,909**	**67,477**	**4,206**	**180,046**
Effect of movement in exchange rates	652	392	362	121	1,527
Additions	82	6,777	3,203	1,343	11,405
Reclassifications	10	1,175	(80)	(1,105)	0
Disposals	(471)	(2,441)	(446)	-	(3,357)
Balance at 31.12.2021	**38,727**	**75,812**	**70,517**	**4,564**	**189,621**
Amortisation & depreciation					
Balance at 01.01.2021	**(15,625)**	**(49,344)**	**(57,413)**	**-**	**(122,381)**
Effect of movement in exchange rates	(200)	(124)	(297)	-	(621)
Depreciation for the year	(1,060)	(3,539)	(3,706)	-	(8,305)
Reclassifications	-	(56)	56	-	(0)
Accumulated amortisation & depreciation on disposals	471	2,441	444	-	3,355
Balance at 31.12.2021	**(16,414)**	**(50,623)**	**(60,916)**	**-**	**(127,953)**
Net carrying value at 31.12.2021	**22,313**	**25,190**	**9,601**	**4,564**	**61,668**
Acquisition / manufacturing costs					
Balance at 01.01.2022	**38,727**	**75,812**	**70,517**	**4,564**	**189,621**
Effect of movement in exchange rates	353	319	239	111	1,022
Additions	278	5,973	4,444	3,778	14,472
Reclassifications	-	9	187	(195)	-
Disposals	(129)	(1,166)	(1,237)	(151)	(2,683)
Balance at 31.12.2022	**39,230**	**80,947**	**74,149**	**8,107**	**202,432**
Amortisation & depreciation					
Balance at 01.01.2022	**(16,414)**	**(50,623)**	**(60,916)**	**-**	**(127,953)**
Effect of movement in exchange rates	(41)	(109)	(199)	-	(349)
Depreciation for the year	(1,083)	(3,813)	(3,873)	-	(8,769)
Reclassifications	-	1	(1)	-	-
Accumulated amortisation & depreciation on disposals	129	1,153	1,211	-	2,493
Balance at 31.12.2022	**(17,409)**	**(53,390)**	**(63,778)**	**-**	**(134,578)**
Net carrying value at 31.12.2022	**21,821**	**27,557**	**10,370**	**8,107**	**67,855**

Right-of-use assets for leasing agreements are recognised for land and buildings and for fixtures, fittings and other assets. At the end of 2022, land and buildings included such assets with net carrying values of €560k (2021: €551k) and fixtures, fittings and other assets included such assets with net carrying values of €463k (2021: €359k); 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 owned property, plant and equipment has been pledged as security for a long-term financing loan (2022: CFA-loan; 2021: SFA-loan); (Note 25).

As at December 31, 2022, the H&K AG Group had a balance of €4,988k (2021: €7,183k) on order for tangible non-current assets. See also Note 32 for information on the contingent liability for a pending transaction for the acquisition of a piece of land.

(18) Non-current investments and current deposits

The non-current "Other investments" and the current "Other deposits" include bank deposits of €2,410k (2021: €9,536k) recognised as non-current assets and bank deposits of €2,538k (2021: €4,418k) recognised as current assets since they have terms of less than twelve months. These deposits serve as security for certain exchange forward-cover contracts, bank guarantees and similar.

On October 26, 2022, two off-the-shelf companies, "Kronen 2902 GmbH" and "Kronen 2902 GmbH & Co. Vorrats KG", were acquired by HKO and renamed "H&K ITZ IMMOBILIEN Verwaltung GmbH" (ITZG) and "H&K ITZ IMMOBILIEN GmbH & Co. KG" (ITZK) respectively. These German companies are wholly owned but have been excluded from the consolidation due to lack of materiality; instead, they are included in the other non-current investments at their book value of €26k (2021: nil) (Note 4).

(19) Inventories

EUR '000	31.12.2022	31.12.2021
Raw materials, consumables and supplies	34,975	29,855
Work in progress	62,937	55,163
Finished goods and merchandise	19,673	11,640
Total	**117,586**	**96,659**

Within inventories, provisions of €16,412k (2021: €14,862k) 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, 2022 of €6,198k (2021: €6,458k). Impairment losses of €2,041k (2021: €1,508k) were recognised as an expense. Due to the sale or scrapping of related items and to improved inventory movements, impairment losses recorded in prior years of €150k (2021: €22k) have been reversed within cost of sales.

Under various floating charges and other security agreements almost all of the Group's inventories have been pledged as security for the CFA-loan (2021: SFA-loan); (Note 25).

(20) Trade receivables, prepayments and other assets

EUR '000	31.12.2022	31.12.2021
Trade receivables	29,898	28,943
Prepayments for inventories	141	641
Prepayments for other current assets	168	341
Other assets	5,253	3,229
Total	**35,461**	**33,154**

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 CFA-loan (2021: SFA-loan); (Note 25).

The other assets are mainly for VAT & other tax claims arisen in the normal course of business; in addition this position includes the remaining book value of the transaction costs from the 2022 refinancing that were allocated to Facility C of the CFA-loan (Facility C is a credit line for bank guarantees and overdrafts that had only been used for bank guarantees at the end of 2022 and is therefore not shown in the liabilities).

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, general provisions for expected credit losses have been recognised in accordance with IFRS 9; 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 a 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	**2022**	**2021**
Opening balance January 1	2,867	2,706
Creations	204	699
(Release) / (utilisation)	(581)	(592)
Effects of foreign currency conversion	45	54
Closing balance December 31	**2,535**	**2,867**

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 2022 primarily relate to the creation of allowances for specific trade receivables; the utilisation of allowances in 2022 was primarily due to the utilisation of €490k specific allowances from 2020; the corresponding derecognitions resulted in the reversal of the associated revenues (€997k) and the return of the goods to inventories.

Trade receivables with specific impairment allowances at the end of 2022 are still subject to collection procedures.

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

EUR '000	31.12.2022	31.12.2021
Neither overdue nor impaired:	**25,079**	**24,672**
Overdue but not impaired:		
- within 30 days	3,138	2,477
- between 30 and 60 days	380	123
- between 60 and 90 days	1,041	15
- between 90 and 180 days	182	(32)
- after more than 180 days	160	1,066
Total:	**4,900**	**3,650**
General allowance	(83)	(78)
Impaired (gross)	**2,454**	**3,489**
Specific allowance(s)	(2,452)	(2,789)
Net trade accounts receivable	**29,898**	**28,943**

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 potentially also 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.

As security for the CFA-loan (2021: SFA-loan), certain Group bank accounts have been pledged (2022: €29.4 million; 2021: €46.5 million); (Note 25).

(22) Shareholders' equity and earnings per share

H&K AG has a share capital of €27.6 million (2021: €27.6 million), divided into 27.6 million (2021: 27.6 million) no-par shares.

The calculation of the basic earnings per share of €1.83 profit (2021: €0.79 profit) is based on the following earnings attributable to ordinary shareholders and weighted-average number of ordinary shares outstanding:

EUR '000	2022	2021
Profit / (loss) for the year attributable to the owners of the parent company	50,639	21,844
of which not attributable to ordinary shareholders	-	-
Profit / (loss) attributable to ordinary shareholders	**50,639**	**21,844**

Thousands of shares	2022	2021
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 gains of €13,518k (2021: €707k gains) net of €3,795k (2021: €198k) 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.

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 to the shareholders' meeting that, out of the company's €183.6 million cumulative profits as at December 31, 2022, a dividend of €0.04 per share should be distributed and the remaining balance be carried forward.

As part of the refinancing, in August 2022 with retrospective effect from January 1, 2022, three bridging loans from main shareholders were converted into hybrid loans totalling €95 million (Note 25). As such, these unsecured loans with infinite terms cannot be cancelled or otherwise unilaterally terminated by the lenders and, in case of insolvency, would be subordinate to other creditors' claims. As a result, according to IFRS, the hybrid loans are classed as equity ("Equity attributable to hybrid capital investors"). Given the significant curtailment of the lenders' rights as a result of the retrospective conversion to hybrid loans, these bear interest at 10% p.a., however this interest only arises in certain circumstances. The lenders' entitlement to interest only applies if, in line with such a proposal from the executive directors, the Annual General Meeting ("AGM") of H&K AG resolves to distribute dividends to ordinary shareholders relating to the corresponding business year. These entitlements are therefore only recognised, if these prerequisites are satisfied, after the AGM takes place in the following year. The corresponding contingent liabilities as of December 31, 2022 total €9.6 million (Note 32).

Including equity attributable to hybrid capital investors, the H&K AG Group shows a positive equity of €70.3 million (2021: negative equity of €85.3 million) at the balance sheet date.

(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 €5,828k (2021: €5,360k) 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 2022	Defined benefit obligation 2021	Fair value of plan assets 2022	Fair value of plan assets 2021	Net obligation for defined benefit plans 2022	Net obligation for defined benefit plans 2021
Balance at January 1	**61,643**	**64,456**	**(1,102)**	**(1,035)**	**60,541**	**63,421**
Included in profit or loss						
Current service cost	474	487	-	-	474	487
Interest cost (income)	630	565	(12)	(9)	618	556
Total recognised in profit or loss	**1,104**	**1,052**	**(12)**	**(9)**	**1,092**	**1,043**
Included in other comprehensive income						
Actuarial loss (gain) arising from:						
- demographic assumptions	-	-	-	-	-	-
- financial assumptions	(14,322)	(1,235)	-	-	(14,322)	(1,235)
- experience adjustments	1,185	609	-	-	1,185	609
Return on plan assets exc. interest income	-	-	(141)	(18)	(141)	(18)
Total recognised in OCI	**(13,137)**	**(627)**	**(141)**	**(18)**	**(13,278)**	**(645)**
Other						
Contributions paid by employer			-	(40)	-	(40)
Benefits paid	(3,309)	(3,239)	46	-	(3,263)	(3,239)
Total other	**(3,309)**	**(3,239)**	**46**	**(40)**	**(3,263)**	**(3,279)**
Balance at December 31	**46,301**	**61,643**	**(1,209)**	**(1,102)**	**45,092**	**60,541**
represented by:						
Net defined benefit obligation for funded plan	1,209	1,102	(1,209)	(1,102)	-	-
Defined benefit obligation for unfunded plans	45,092	60,541	-	-	45,092	60,541
Balance at December 31	**46,301**	**61,643**	**(1,209)**	**(1,102)**	**45,092**	**60,541**

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. The expected long-term returns from these plan assets for 2022 were calculated at 1.05% (2021: 0.90%). This is based on the discount rate for the associated pension obligations. The actual earnings from the plan assets were €153k (2021: €28k). Since the investment phase is over, no further contributions will be paid in.

The calculated average duration of the pensions schemes is 10.5 years (2021: 13.5 years). The following table shows the principle actuarial assumptions at the reporting date:

	31.12.2022	31.12.2021
Discount rate	3.85%	1.05%
Future salary growth for active plan members	0.00%	0.00%
Future pension growth	2.00%	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:

31.12.2022	Defined benefit obligation	
Effect in EUR '000	**Increase**	**Decrease**
Discount rate (0.5% movement)	(2,235)	2,461
Future pension growth (0.5% movement)	2,191	(2,034)

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	31.12.2022	31.12.2021
Current provisions & accruals	14,584	16,837
Non-current provisions	2,453	2,890
Total	**17,038**	**19,727**

The provisions comprise:

EUR '000	Personnel obligations	Warranty obligations	Other obligations relating to sales	Other risks	Total
Balance at 01.01.2022	**5,540**	**1,401**	**5,896**	**6,890**	**19,727**
Exchange rate difference / reclassification	-	-	116	-	116
Utilisation	(3,715)	(509)	(1,843)	(1,928)	(7,996)
Release	(371)	-	(1,208)	(725)	(2,304)
Creation	6,150	209	617	519	7,494
Balance at 31.12.2022	**7,603**	**1,100**	**3,578**	**4,756**	**17,038**

Provisions for the German early retirement scheme (“Altersteilzeit”) are included in the personnel obligations (€531k; 2021: €499k). 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 3.85% (2021: 1.05%). 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 (€583k; 2021: €751k) 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 and expenses, recognised in line with the probability of their incidence. As at December 31, 2022, the outcome of a proportion of the litigation risks is dependent on associated legal proceedings and accordingly the provision for these is based on particular uncertainties; €3.0 million relate to a decided case that has not yet been enforced, accordingly the provision for this has few 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. HKO appealed this verdict; the Public Prosecutor and the two accused who were sentenced also appealed. In March 2021, the Federal Court of Justice (BGH) confirmed the Stuttgart District Court's verdicts and as a result, the suspended sentences against two former employees became legally binding, as did the confiscation of €3.0 million from HKO; the BGH severed its consideration regarding the confiscation of a further €0.7 million. The legal question involved is now awaiting a decision from the "Großen Senat" of the Federal Court of Justice since such a confiscation would change the legal interpretations of several other senates of the Federal Court of Justice. The confiscation of the €3.0 million has therefore also not yet taken place.

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 (2021: €12k 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

Significant financing agreements

As at December 31, 2022, the H&K AG Group has the following two financing agreements:

- Secured financing agreement with a syndicate of banks (Term and Revolving Credit Facilities Agreement, "CFA-loan"), nominal €140 million.
- Unsecured shareholder loan ("Vendor Loan"), nominal €20 million.

As at December 31, 2021, the H&K AG Group had the following five financing loans:

- Secured, private financing agreement ("SFA-loan"), nominal €80 million.
- Unsecured bond, nominal €60 million.
- Unsecured bridging loan, €30 million (excluding accrued interest added).
- Unsecured bridging loan, €50 million (excluding accrued interest added).
- Unsecured bridging loan, €15 million (excluding accrued interest added).

2022 Refinancing

During 2022, the H&K AG Group was able to refinance. In summary the following changes were made:

- May 11, 2022, €8 million partial repayment of the SFA-loan.
- August 17, 2022, signature of a secured financing agreement with a syndicate of banks (Term and Revolving Credit Facilities Agreement, "CFA-Loan") totalling nominal €140 million.
- August 18, 2022, signature of amendment and restatement agreements for the three unsecured bridging loans by which, with retrospective effect from January 1, 2022, their original nominal values totalling €95 million were converted into hybrid loans.
- August 22, 2022, drawing of €50 million under Facility A and, together with own funds, repayment of the SFA-Loan in full, including interest and surcharges.
- August 22, 2022, utilisation of Facility C as a bank guarantee line amounting to €14.2 million and thereby the release of security deposits in the same amount. Subsequently additional changes to the utilisation amount in the normal course of business.
- December 16, 2022, utilisation of €40 million under Facility B together with €20 million under a Vendor Loan and the listed bond, including accrued interest, was repurchased in full and subsequently cancelled.

CFA-Loan (Facilities A, B and C)

This syndicated loan is a €140 million financing agreement from August 17, 2022 ("CFA-Loan") with an initial term of three years and the option of extensions of up to two additional years. The interest rate comprises a margin plus EURIBOR (if positive), and interest is payable at the end of each agreed interest period (either 3 or 6 months). Initially the margin is set at 3.5% and from 2024, dependent upon certain key figures, may vary between 1.6% and 3.5%. Commitment interest is charged on unutilised Facilities.

The H&K AG Group recognises two loan liabilities to banks under this agreement:

- **Facility A**, a secured financing loan to HKO (December 31, 2022: €50 million, of which €5 million are current; December 31, 2021: nil);
- **Facility B**, a secured financing loan to HKAG (December 31, 2022: €40 million; December 31, 2021: nil).

In addition the CFA financing agreement includes:

- **Facility C**, a €50 million bank guarantee and overdraft facility; as of December 31, 2022, this was only utilised for bank guarantees and therefore, as a contingent liability, not recognised in the Statement of Financial Position (Note 32). The interest and other conditions of this facility are covered by additional ancillary agreements with the syndicate banks.

Under the CFA-loan agreement H&K AG and its subsidiaries are subject to strict limitations on certain transactions; the Group must also meet specified equity figures and ratios between net debt and the contractually defined EBITDA ("Financial Covenants"). The Group is permitted to partially or fully redeem the CFA-loan liability.

As security for liabilities under the CFA-loan (nominal including accrued interest as at December 31, 2022: €90.9 million; December 31, 2021: nil; utilisation of bank guarantee facility as at December 31, 2022: €14.7 million; December 31, 2021: nil), certain direct and indirect subsidiaries of H&K AG have also entered into the agreement as guarantors. In addition, all shares in HKM and certain of its direct and indirect subsidiaries together with, through floating charges and other security agreements, certain non-current assets, inventories, receivables and bank accounts are pledged to the agent for the syndicate banks; (Notes 16, 17, 19, 20, and 21).

SFA-loan and bond (fully repaid in 2022)

At the beginning of 2022, the H&K AG Group still had two material financial liabilities resulting from the refinancing during 2017: a secured financing loan (December 31, 2022: nil; December 31, 2021: €80 million) and an unsecured bond listed on the Luxembourg Euro MTF (December 31, 2022: nil; December 31, 2021: €60 million). The financing loan was under a private €150 million financing agreement ("SFA-loan") from July 24, 2017, that matured on August 21, 2022, under which a total of €130 million was drawn down on August 21, 2017 and, at that point amounted to a total of €74.6 million. In that month, the SFA-loan including interest was repaid in full. The interest rate was 7.25% plus EURIBOR (if positive), and interest was payable at the end of each agreed interest period. The listed bond was created on December 15, 2017 by the conversion of a private note purchaser loan. This bond had a term ending on April 30, 2023 and a fixed interest rate of 6.5% payable six-monthly, on April 30 and October 31. The bond was repurchased in full in December 2022 and thereby ceased prior to its maturity.

Loans from related parties

On March 28, 2018, one of H&K AG's main shareholders, COMPAGNIE DE DEVELOPPEMENT 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 and an interest rate of 2% was agreed, charged retrospectively from the initial loan payment, with accrued interest added to the loan principal quarterly. In another amendment following the June 30, 2021 termination of the supplementary-hours agreement and considering the Group's significantly improved financial and earnings position, the interest rate was revised within the contractually agreed range to 6.5%, applicable from October 1, 2021. As a result, the nominal value of this loan increased to €32.7 million on December 31, 2021. On August 18, 2022, through an Amendment and Restatement Agreement the loan conditions were changed with retrospective effect from January 1, 2022, and the original nominal value was converted into a €30 million hybrid loan. As a result of this conversion, according to IFRS, the hybrid loan is classed as equity ("Equity attributable to hybrid capital investors") (Note 22, 36). The interest accrued up to December 31, 2021, amounting to €2.7 million, was paid on November 30, 2022.

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. In an amendment following the June 30, 2021 termination of the supplementary-hours agreement and considering the Group's significantly improved financial and earnings position, the interest rate was revised within the contractually agreed range to 6.5%, applicable from October 1, 2021. As a result, the nominal value of this loan increased to €53.8 million on December 31, 2020. On August 18, 2022, through an Amendment and Restatement Agreement the loan conditions were changed with retrospective effect from January 1, 2022, and the original nominal value was converted into a €50 million hybrid loan. As a result of this conversion, according to IFRS, the hybrid loan is classed as equity ("Equity attributable to hybrid capital investors") (Note 22, 36). The interest accrued up to December 31, 2021, amounting to €3.8 million, was paid on November 30, 2022.

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 €16.9 million on December 31, 2021. On August 18, 2022, through an Amendment and Restatement Agreement the loan conditions were changed with retrospective effect from January 1, 2022, and the original nominal value was converted into a €15 million hybrid loan. As a result of this conversion, according to IFRS, the hybrid loan is classed as equity ("Equity attributable to hybrid capital investors") (Note 22, 36). The interest accrued up to December 31, 2021, amounting to €1.9 million, was paid on November 30, 2022.

On August 18, 2022, one of H&K AG's main shareholders that held the bond granted an unsecured loan (the "Vendor Loan") of €20 million with a term of six years. The interest rate is 6.5% and accrued interest is to be added to the loan annually. Together with the utilisation of the CFA-loan €40 million Facility B, the bond was fully repurchased on December 16, 2022.

On August 18, 2022, one of H&K AG's main shareholders granted an unsecured loan (the "Additional Mezzanine Loan") of €40 million with a term of six years and an interest rate of 6.5% p.a. However the loan will only be utilised should certain prerequisites defined in the CFA-loan occur; if the loan were to be utilised, H&K AG would be obliged to repay Facility B of the CFA-loan in full. During the term of the CFA-loan, no repayments or interest payments may be made on this loan, so any accrued interest is to be added to the loan at the end of each interest period.

Overview of the development of the financing liabilities

Facilities A and B of the CFA-loan are recognised in the statement of financial position at their amortised amounts totalling 87,244k (2021: the bond and the SFA-loan, €139,067k). Facility C of the CFA-loan is currently only being used as a guarantee line and is therefore shown within contingent liabilities; its proportion of the transaction costs is recognised in the other assets (Note 20) rather than being offset against the liability. The associated accrued interest liabilities totalling €940k (2021: for the bond and the SFA-loan €822k) are recognised within other liabilities. There were no material transaction costs for the loans from related parties so their amortised amounts, amounting to €20,000k (2021: €103,470k), are identical to their nominal values (2021: including quarterly reclassification of accrued interest, see above).

EUR '000	2022 Nominal	2022 Book value	2022 Associated interest liabilities	2021 Nominal	2021 Book value	2021 Associated interest liabilities
Balance at 01.01.	**243,500**	**242,537**	**822**	**242,737**	**240,552**	**2,955**
Accretion of SFA loan and 2017 bond	-	963	-	-	1,222	-
Interest expense for SFA loan and 2017 bond	-	-	9,558	-	-	9,972
Interest payments for SFA loan and 2017 bond	-	-	(10,380)	-	-	(12,104)
Repayment of SFA loan	(80,030)	(80,030)	-	(3,000)	(3,000)	-
Repayment of 2017 bond	(60,000)	(60,000)	-	-	-	-
Interest expense for bridging loans	-	-	-	-	-	3,763
Transfer of interest to principal for bridging loans	-	-	-	3,763	3,763	(3,763)
Interest payments for bridging loans	(8,470)	(8,470)	-	-	-	-
Converion of bridging loans to hybrid capital	(95,000)	(95,000)	-	-	-	-
Funds from 2022 refinancing - CFA loan	90,000	90,000	-	-	-	-
Transaction costs for 2022 refinancing - CFA loan, Facilities A, B & C	-	(4,911)	-	-	-	-
Transaction costs relating to Facility C (in other assets)	-	1,754	-	-	-	-
Accretion of CFA Facilities A, B & C	-	621	-	-	-	-
Element of accretion relating to Facility C (other assets)	-	(219)	-	-	-	-
Interest expense for CFA	-	-	1,245	-	-	-
Interest payments for CFA	-	-	(305)	-	-	-
Funds from 2022 refinancing - Vendor Loan	20,000	20,000	-	-	-	-
Interest expense for Vendor Loan	-	-	58	-	-	-
Balance at 31.12.	**110,000**	**107,244**	**1,044**	**243,500**	**242,537**	**822**

Other Group credit lines

The other credit lines are only for the provision 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, 2022, a total of €17.6 million (2021: 12.5 million) guarantees to customers were outstanding, of which €14.7 million (2021: nil) were issued using Facility C (see CFA-Loan above). As a prerequisite for the provision and maintenance of the other guarantees and our exchange forward-cover contracts, deposits must be provided as security. The security for these lines is provided through bank deposits recognised within other current investments (2022: €2.5 million; 2021: €4.4 million) (Note 18), and within other non-current investments (2022: €2.4 million; 2021: €9.5 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 31.12.2022	Contractual Cashflows 31.12.2021
Less than one year	451	462
Between one and five years	866	760
More than five years	-	-
Total lease payments	**1,317**	**1,222**
Effects of discounting and options	(214)	(200)
Lease liabilities recognised	**1,103**	**1,022**

Additional information on leases is provided in Note 33.

(26) Trade and other payables and derivatives

Trade and other payables include outstanding liabilities from trade and operating costs, together with accrued interest payable on the SFA-loan and the bond, in addition there are derivatives for forward cover contracts.

EUR '000	31.12.2022	31.12.2021
Trade payables	21,217	19,049
Interest payables	1,044	822
Other liabilities	12,812	11,350
Derivatives	1,454	1,118
Total	**36,527**	**32,340**

With the exception of normal trading ownership retention clauses for the trade payables, security agreements relating to the interest liabilities for the CFA-loan (2021: interest liabilities for the SFA-loan) (Notes 16, 17, 19, 20, 21, 25) and security deposits for forward cover contracts, these payables are not secured.

(27) Contract liabilities

The €18,704k (2021: €12,985k) 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, 2022, there were forward cover contracts in place for a total of $44.0 million (as at December 31, 2021: $24.0 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 31.12.2022	Rate on balance sheet date 31.12.2021	Average exchange rate 2022	Average exchange rate 2021
US Dollar (USA)	USD	1.0666	1.1326	1.0530	1.1827
Pound (Great Britain)	GBP	0.8869	0.8403	0.8528	0.8596

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 2022 consolidation, (i.e. had been an average of €1 = $1.0004 and a spot of €1 = $1.0133), then 2022 sales would have been approximately €6.9 million higher, EBITDA would have been approximately €5.0 million higher, and equity and reserves would have been approximately €3.9 million higher.

If the euro had been 5% weaker against the pound sterling compared to the rates used for the 2022 consolidation, (i.e. had been an average of €1 = £0.8102 and a spot of €1 = £0.8426), then 2022 sales would have been approximately €0.2 million higher, EBITDA would have been approximately €0.1 million higher, 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, 2022, the Group's interest profile of its interest-bearing financial instruments consisted of fixed-rate instruments (including hybrid capital) with a nominal value of €115 million (2021: €163.5 million) and variable rate instruments with a total nominal value of €90.0 million (2021: €80.0 million).

Under the CFA-loan's Facilities A and B, the Group has a total of €90 million loans with a variable interest rate of currently 3.5% plus EURIBOR (if 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 would have increased equity and profit or loss by approx. €0.1 million. A 100 basis-point (Bp) increase in EURIBOR at each of the interest-fixing dates would have reduced equity and profit by approx. €0.1 million. This analysis assumes that all other variables, in particular tax-deductibility, remain constant.

The Group's €20 million vendor loan is an interest-bearing liability with a fixed interest rate of 6.5% and the three hybrid loans totalling €95 million are hybrid equity bearing interest at a fixed rate of 10 %, however the lender's entitlement to interest only arises if, in line with such a proposal from the executive directors, the AGM of H&K AG resolves to distribute dividends to ordinary shareholders relating to the corresponding business year (Notes 22, 25). The fair values of the vendor loan and the hybrid 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.

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 counterparty 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

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 CFA-loan and, in future, the payment of dividends.

According to the current five-year business plan, for 2023 and future years a positive net cashflow from operating activities, sufficient to cover capital expenditure and contractual interest payments, is expected.

According to the current five-year business plan, the H&K AG directors are also planning the conversion of hybrid loans (in equity attributable to hybrid capital investors) into share capital and additional paid-in capital, to the extent permitted by law, which would reduce the interest charges in equity (Notes 22, 25) significantly and sustainably.

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 31.12.2022		
Book value	21,217	108,242
Related payments	21,217	110,998
Payments due:		
- within one month	15,575	-
- between one and three months	3,914	833
- between three & twelve months	1,727	5,107
- between one and five years	-	85,000
- after more than five years	-	20,058
Balance at 31.12.2021		
Book value	19,049	243,359
Related payments	19,049	263,961
Payments due:		
- within one month	13,125	500
- between one and three months	3,435	951
- between three & twelve months	2,490	86,450
- between one and five years	-	176,060
- after more than five years	-	-

Variances between book value and related payments arise where certain financing 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 our capital management is to secure the financing of current business activities, considering the obligations and the regular interest payments due to the CFA-loan, and in the medium-term to continue 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 potentially also insurance companies, on our behalf (Note 25).

The Group’s capital structure is as follows:

EUR '000	31.12.2022	31.12.2021
Total equity attributable to H&K AG shareholders	(24,687)	(85,251)
Equity attributable to hybrid capital investors	95,000	-
Equity	**70,313**	**(85,251)**
as a percentage of total financing	21%	-28%
Long-term liabilities	175,016	249,133
Short-term liabilities	82,865	145,451
Debt	**257,881**	**394,584**
as a percentage of total financing	79%	128%
Total equity & liabilities	**328,194**	**309,333**

(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	31.12.2022	31.12.2021
Non-current assets		
Other investments & derivatives	2,435	9,536
Current assets		
Other loans, deposits & derivatives	2,538	4,418
Trade receivables	29,898	28,943
Other receivables	5,253	3,229
Cash and cash equivalents	35,844	46,514
Asset positions containing financial instruments	**75,969**	**92,641**
of which non-financial instruments	5,144	3,094
of which financial instruments	**70,825**	**89,547**

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	Other financial instruments BV	Other financial instruments FV
Balance at 31.12.2022						
Recognised at amortised cost	35,844	35,844	29,898	29,898	5,083	5,083
Recognised at fair value through profit or loss	-	-	-	-	-	-
Total financial assets	**35,844**	**35,844**	**29,898**	**29,898**	**5,083**	**5,083**
Balance at 31.12.2021						
Recognised at amortised cost	46,514	46,514	28,943	28,943	14,089	14,089
Recognised at fair value through profit or loss	-	-	-	-	-	-
Total financial assets	**46,514**	**46,514**	**28,943**	**28,943**	**14,089**	**14,089**

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 other financial instruments relate primarily to short and long-term bank deposits as security for exchange forward-cover contracts, certain bank guarantee lines etc. (2022: €4,948k; 2021: €13,954k) (Notes 18, 25); their aging is as follows:

EUR '000	Other financial instruments 31.12.2022	Other financial instruments 31.12.2021
Neither overdue nor impaired:	5,083	14,089
Net trade accounts receivable	**5,083**	**14,089**

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	31.12.2022	31.12.2021
Non-current liabilities		
Loans & borrowings	102,396	163,128
Lease obligations	1,103	1,022
Trade and other payables	58	-
Current liabilities		
Loans & borrowings	4,848	79,410
Trade payables	21,217	19,049
Derivatives	1,454	1,118
Other payables	13,799	12,172
Liability positions containing financial instruments	**144,874**	**275,899**
of which non-financial instruments	12,855	10,570
of which financial instruments	**132,020**	**265,328**

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	Derivative liabilities BV	Derivative liabilities FV	Other financial liabilities BV	Other financial liabilities FV
Balance at 31.12.2022								
Held at amortised cost	21,217	21,217	107,244	110,000	-	-	1,002	1,002
Held at fair value through profit or loss	-	-	-	-	1,454	1,454	-	-
Financial liabilities	**21,217**	**21,217**	**107,244**	**110,000**	**1,454**	**1,454**	**1,002**	**1,002**
Balance at 31.12.2021								
Held at amortised cost	19,049	19,049	242,537	243,500	-	-	1,602	1,602
Held at fair value through profit or loss	-	-	-	-	1,118	1,118	-	-
Financial liabilities	**19,049**	**19,049**	**242,537**	**243,500**	**1,118**	**1,118**	**1,602**	**1,602**

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 derivative liabilities relate primarily to forward cover contracts for USD / EUR, held at fair value through profit or loss. The other financial liabilities mainly relate to the interest liabilities for the CFA-loan and for the vendor loan (2022: €940k; 2021: for the SFA-loan and for the bond €822k).

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).

31.12.2022

EUR '000	**Level 1**	**Level 2**	**Level 3**
Derivative financial assets	-	-	-
Derivative financial liabilities	-	1,454	-

31.12.2021

EUR '000	**Level 1**	**Level 2**	**Level 3**
Derivative financial assets	-	-	-
Derivative financial liabilities	-	1,118	-

Net income / (expenses) due to financial instruments:

EUR '000	**2022**	**2021**
Recognised at amortised cost	(3,050)	1,996
Held at fair value through profit or loss	(335)	(1,118)

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	**2022**	**2021**
Interest income	50	3
Accretion of non-current financial liabilities	(1,584)	(1,222)
Other interest expenses	(11,079)	(13,912)

(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 could also include deposits with original terms of less than three months (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 original 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	**2022**	**2021**
Net cash from / (used in) investing activities	(10,881)	(28,292)
Less amounts relating to the movement in security deposits with terms >3 months	(9,006)	9,560
Adjusted net cash from / (used in) investing activities	**(19,888)**	**(18,732)**

(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 (2021: 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	2022	2021	2022	2021	2022	2021	2022	2021	2022	2021	2022	2021	2022	2021	2022	2021	2022	2021
Net external revenues	118,561	100,628	116,261	89,434	15,670	30,483	23,224	29,537	31,390	40,125	-	-	305,107	290,207	-	-	305,107	290,207
Inter-segment revenue	119,931	107,892	319	223	156	138	384	289	-	-	-	-	120,790	108,541	(120,790)	(108,541)	-	-
Total output	253,497	214,603	123,959	95,600	14,125	26,504	22,727	27,469	31,384	40,054	-	-	445,692	404,230	(120,710)	(110,041)	324,982	294,189
Depreciation and amortisation	(10,059)	(10,223)	(1,364)	(1,180)	(90)	(112)	(121)	(113)	(17)	(19)	(56)	(41)	(11,708)	(11,688)	-	(63)	(11,708)	(11,750)
EBITDA	66,728	40,679	10,963	6,115	1,678	7,563	1,969	3,515	1,586	2,625	(957)	(1,081)	81,966	59,416	84	(1,440)	82,049	57,976
Interest income	251	105	-	-	0	-	10	0	0	2	4,098	3,807	4,358	3,914	(4,169)	(3,911)	190	3
Interest expense	(10,541)	(8,832)	(1)	(1)	(207)	(104)	(43)	(45)	(1)	(2)	(6,800)	(10,716)	(17,594)	(19,702)	4,165	3,911	(13,429)	(15,791)
Income taxes	(1)	(1)	(1,714)	(1,146)	71	(1,644)	(362)	(601)	(391)	(691)	(302)	(5,826)	(2,698)	(9,908)	(18)	330	(2,716)	(9,578)
Profit / (loss) after tax	47,089	26,984	7,676	3,699	5,154	5,704	1,549	2,564	1,177	1,914	44,969	37,956	107,614	78,821	(56,975)	(56,977)	50,639	21,844
Other material non-cash items																		
- Impairment of assets	(191)	(82)	(120)	(617)	(152)	-	(76)	(370)	(2)	(4)	-	-	(542)	(1,073)	-	-	(542)	(1,073)
- Impairment losses reversed	48	20	13	546	-	22	70	-	-	-	15,379	30,798	15,510	31,385	(15,379)	(30,798)	131	588
Non-current assets other than deferred taxes and financial instruments	176,464	167,388	13,001	12,692	973	1,001	431	493	5	21	285	186	191,160	181,780	(74,653)	(74,653)	116,507	107,126
Capital expenditure, excluding capitalised development costs	(13,781)	(11,708)	(882)	(910)	(2)	(16)	(65)	(3)	(1)	-	-	-	(14,731)	(12,637)	-	-	(14,731)	(12,637)
Provisions and liabilities	210,511	228,804	30,791	24,950	7,453	16,216	3,974	4,223	7,356	11,299	91,606	235,687	351,691	521,178	(93,810)	(126,594)	257,881	394,584

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 following tables show the proportions of sales (net of sales deductions) for customers in different regions of the world and the proportions of sales for the different product groups:

Region			Percentage of sales
Germany (Domestic)	**2022**	**64,171**	**21%**
	2021	**62,835**	**22%**
USA	2022	131,938	43%
	2021	119,920	41%
UK	2022	23,231	8%
	2021	29,546	10%
France	2022	32,129	11%
	2021	40,722	14%
Other "Green Countries"	2022	52,993	17%
	2021	37,059	13%
Rest of world	2022	644	0%
	2021	126	0%
Total export	**2022**	**240,935**	**79%**
	2021	**227,373**	**78%**
Total	**2022**	**305,107**	**100%**
	2021	**290,207**	**100%**
of which "Green Countries"	2022	304,462	100%
	2021	290,081	100%

Product group		Percentage of sales
Rifles	2022	39%
	2021	37%
Sub-machine guns & machine guns	2022	18%
	2021	17%
Pistols	2022	32%
	2021	30%
Development services	2022	0%
	2021	0%
Other products & services	2022	12%
	2021	16%
Total	**2022**	**100%**
	2021	**100%**

Major customers

IFRS 8 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 2022, are the German governmental authorities (2022: €51 million; 2021: €50 million) shown in the segment "Germany" and the French governmental authorities (2022: €31 million; 2021: €40 million) shown in the segment "France".

The following table shows that a large proportion of our revenues are to customers in the commercial market; the revenues to individual customers in this market segment are significantly lower than for military and governmental agency business.

Customer type			Percentage of sales
Military	**2022**	**164,670**	**54%**
	2021	**174,011**	**60%**
Law enforcement & similar	2022	11,718	4%
governmental agencies	2021	16,743	6%
Commercial	2022	128,719	42%
	2021	99,454	34%
Total	**2022**	**305,107**	**100%**
	2021	**290,207**	**100%**

(32) Contingent liabilities and pledged assets

As part of the refinancing, in August 2022 with retrospective effect from January 1, 2022, three bridging loans from main shareholders were converted into hybrid loans totalling €95 million (Note 25). As such, these unsecured loans with infinite terms cannot be cancelled or otherwise unilaterally terminated by the lenders and, in case of insolvency, would be subordinate to other creditors' claims. As a result, according to IFRS, the hybrid loans are classed as equity ("Equity attributable to hybrid capital investors").

Given the significant curtailment of the lenders' rights as a result of the retrospective conversion to hybrid loans, these bear interest at 10% p.a., however this interest only arises in certain circumstances. The lenders' entitlement to interest only applies if, in line with such a proposal from the executive directors, the Annual General Meeting ("AGM") of H&K AG resolves to distribute dividends to ordinary shareholders relating to the corresponding business year. These entitlements are therefore only recognised, if these prerequisites are satisfied, after the AGM takes place in the following year. The corresponding contingent liabilities as of December 31, 2022 total €9.6 million (Note 22). If a dividend is resolved by the 2023 AGM, this accrued interest relating to the business year 2022 will be added to the corresponding hybrid loans and from then on also bear interest. Payment would only be permissible after termination of the CFA-Loan.

For Information on purchase order commitments for non-current assets see Notes 16 and 17. As of December 31, 2022, our new non-consolidated subsidiary ITZK (Note 4) had a contingent liability relating to a pending transaction for the acquisition of a piece of land. The conditions for this were satisfied at the end of January 2023 and the property was acquired (acquisition cost: €2.5 million).

For information on bank guarantees for customers and the related security deposits see Note 25. A large proportion of the other Group assets are pledged for the CFA-loan from August 17, 2022 under various floating charges and other security agreements. For details of pledged assets see Notes 16, 17, 18, 19, 20, 21 and 25. Based on the current business plan (covering five years), it is not expected that bank guarantees or pledges will be called in the planned periods, or sufficient provision have been recognised for such potential calling of bank guarantees.

For liabilities relating to certain short-term and / or low value leases, see Note 33.

There are no other material contingent liabilities as of December 31, 2022 or December 31, 2021.

(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, 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.

The reclassifications shown for 2021 in the following table relate to the acquisition of certain assets at the end of the lease terms and the associated transfer from leased to owned assets.

EUR '000	Land and buildings	Fixtures, fittings and other assets	Total
Net carrying value at 01.01.2021	**671**	**496**	**1,167**
Acquisition / manufacturing costs			
Balance at 01.01.2021	**1,601**	**845**	**2,446**
Effect of movement in exchange rates	79	7	86
Additions	-	115	115
Reclassifications	-	(84)	(84)
Disposals	(466)	(196)	(662)
Balance at 31.12.2021	**1,214**	**687**	**1,901**
Amortisation & depreciation			
Balance at 01.01.2021	**(930)**	**(350)**	**(1,279)**
Effect of movement in exchange rates	(46)	(4)	(51)
Depreciation for the year	(153)	(226)	(379)
Reclassifications	-	56	56
Accumulated amortisation & depreciation on disposals	466	196	662
Balance at 31.12.2021	**(663)**	**(328)**	**(991)**
Net carrying value at 31.12.2021	**551**	**359**	**910**
Acquisition / manufacturing costs			
Balance at 01.01.2022	**1,214**	**687**	**1,901**
Effect of movement in exchange rates	(51)	2	(49)
Additions	174	314	488
Reclassifications	-	-	-
Disposals	-	(82)	(82)
Balance at 31.12.2022	**1,337**	**921**	**2,259**
Amortisation & depreciation			
Balance at 01.01.2022	**(663)**	**(328)**	**(991)**
Effect of movement in exchange rates	31	(0)	31
Depreciation for the year	(146)	(212)	(358)
Accumulated amortisation & depreciation on disposals	-	82	82
Balance at 31.12.2022	**(777)**	**(458)**	**(1,235)**
Net carrying value at 31.12.2022	**560**	**463**	**1,023**

ii. amounts recognised in profit or loss

Amortisation amounting to €358k (2021: €379k) for right-of-use assets and interest expenses amounting to €65k (2021: €81k) for lease liabilities were recognised in profit or loss. The associated deferred taxes were an expense of €8k (2021: €1k income).

iii. amounts recognised in the statement of cash flows

The leasing payments were split between interest payments of €65k (2021: €81k), and repayment of lease liabilities amounting to €351k (2021: €376k); 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 €297k (2021: €270k) for short-term leases and €24k (2021: €18k) 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	31.12.2022	31.12.2021
Up to one year	55	48
More than one and up to five years	13	1
More than five years	0	0
Total	**68**	**49**

(34) Number of employees

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

	2022	2021
Germany	939	900
France	2	2
Great Britain	16	17
USA - Defence	5	6
USA - Commercial	88	83
Holding activities	5	5
Average employees	**1,055**	**1,013**

These numbers for 2022 and 2021 exclude directors, people on national service, apprentices and trainees; part-time employees are fully included.

(35) Personnel expenses

Personnel expenses in 2022 were €89,406k (2021: €81,980k). Of these expenses, €5,828k (2021: €5,360k) 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 directly by COMPAGNIE DE DEVELOPPEMENT DE L'EAU S.A., Luxembourg, Luxembourg.

Notifications in accordance with §20 AktG:

1. COMPAGNIE DE DEVELOPPEMENT DE L'EAU S.A., Luxembourg, Luxembourg, informed us on July 16, 2020, in accordance with § 20 (1) and (4) AktG, that it holds more than quarter of the shares in H&K AG and simultaneously holds a majority interest in H&K AG.

2. Sofi Kapital Ltd., Christ Church, Barbados, informed us on June 8, 2020, in accordance with § 20 (1) and (4) AktG, that, due to attribution pursuant to § 16 (4) AktG via COMPAGNIE DE DEVELOPPEMENT DE L'EAU S.A., Luxembourg, Luxembourg, it indirectly holds more than quarter of the shares in H&K AG and simultaneously indirectly holds a majority interest in H&K AG.

3. Mr. Nicolas René Walewski, London, United Kingdom, informed us on June 23, 2022, that due to attribution pursuant to § 16 (4) AktG via Sofi Kapital Ltd., Christ Church, Barbados, and COMPAGNIE DE DEVELOPPEMENT DE L'EAU S.A., Luxembourg, Mr Walewski as trust settlor (i) indirectly holds more than quarter of the shares in H&K AG (notification in accordance with § 20 (1) AktG) and simultaneously (ii) indirectly holds a majority interest in H&K AG (notification in accordance with § 20 (4) AktG).

4. Mr. Gérard Philippe Emile Claude Lussan, Christ Church, Barbados, informed us on June 24, 2022, that, pursuant to § 16 (4) AktG via Sofi Kapital Ltd., Christ Church, Barbados, and COMPAGNIE DE DEVELOPPEMENT DE L'EAU S.A., Luxembourg, Luxembourg, due to attribution, he indirectly holds more than quarter of the shares in H&K AG (notification in accordance with § 20 (1) AktG) and simultaneously indirectly holds a majority interest in H&K AG (notification in accordance with § 20 (4) AktG).

5. Concorde Bank Limited, Bridgetown, Barbados, informed us on June 24, 2022, that, due to attribution pursuant to § 16 (4) AktG via Sofi Kapital Ltd., Christ Church, Barbados, and COMPAGNIE DE DEVELOPPEMENT DE L'EAU S.A., Luxembourg, it is the case that Concorde Bank Limited, as trustee, indirectly holds more than quarter of the shares in H&K AG (notification in accordance with § 20 (1) AktG) and simultaneously indirectly holds a majority interest in H&K AG (notification in accordance with § 20 (4) AktG).

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 had terms to July 15, 2023 and agreed interest at 2% until September 30, 2021, then 6.5% from October 1, 2021; accrued interest was added to each loan quarterly. On August 18, 2022, through an Amendment and Restatement Agreement the loan conditions were changed with retrospective effect from January 1, 2022, and the original nominal values were converted into hybrid loans totalling €80 million. As a result of this conversion, according to IFRS, the hybrid loans are classed as equity ("Equity attributable to hybrid capital investors") (Note 22, 25). The interest accrued up to December 31, 2021, amounting to €6.5 million, was paid on November 30, 2022. From January 1, 2022, the loan bears interest at 10% p.a., however this interest only arises in certain circumstances. The lender's entitlement to interest only applies if, in line with such a proposal from the executive directors, the AGM of H&K AG resolves to distribute dividends to ordinary shareholders relating to the corresponding business year. These entitlements are therefore only recognised, if these prerequisites are satisfied, after the AGM takes place in the following year. The corresponding contingent liabilities as of December 31, 2022 total €8.1 million (Note 32).
- 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 was added to this loan quarterly. On August 18, 2022, through an Amendment and Restatement Agreement the loan conditions were changed with retrospective effect from January 1, 2022, and the original nominal value was converted into a €15 million hybrid loan. As a result of this conversion, according to IFRS, the hybrid loan is classed as equity ("Equity attributable to hybrid capital investors") (Note 22, 25). The interest accrued up to December 31, 2021, amounting to €1.9 million, was paid on November 30, 2022. From January 1, 2022, the loan bears interest at 10% p.a., however this interest only arises in certain circumstances. The lender's entitlement to interest only applies if, in line with such a proposal from the executive directors, the AGM of H&K AG resolves to distribute dividends to ordinary shareholders relating to the corresponding business year. These entitlements are therefore only recognised, if these prerequisites are satisfied, after the AGM takes place in the following year. The corresponding contingent liability as of December 31, 2022 is €1.5 million (Note 32).
- On August 18, 2022, one of H&K AG's main shareholders that held our bond granted an unsecured loan (the vendor loan) of €20 million with a term of six years. The interest rate is 6.5% and accrued interest is to be added to the loan annually. Together with the utilisation of the CFA-loan €40 million Facility B, the bond was fully repurchased on December 16, 2022 (Note 25).
- On August 18, 2022, one of H&K AG's main shareholders granted an unsecured loan (the "Additional Mezzanine Loan") of €40 million with a term of six years and an interest rate of 6.5% p.a. However the loan will only be utilised should certain prerequisites defined in the CFA-loan occur; if the loan were to be utilised, H&K AG would be obliged to repay Facility B of the CFA-loan in full. During the term of the CFA-loan, no repayments or interest payments may be made on this loan, so any accrued interest is to be added to the loan at the end of each interest period.

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	Chairman
Nicolaus Bocklandt	Deputy Chairman
Dr Regina Engelstädter	Member

(38) Total remuneration for the executive and supervisory boards in the business year

EUR '000	2022	2021
Short-term benefits for the supervisory board	182	182
Short-term benefits for the executive board	1,242	1,199
Gesamt	**1,424**	**1,381**

(39) Auditor's remuneration

EUR '000	2022	2021
Financial statement audit services	271	252
Other confirmation services	6	6
Tax services	30	30
Other services	71	89
Total	**378**	**377**

(40) Subsequent events

During its session on December 14, 2022, the Budget Committee of the German Parliament approved funds for the successor to the G36 assault rifle. The "System Assault Rifle Bundeswehr", a new assault rifle from Heckler & Koch GmbH based on the HK416 A8, will replace the G36 as the standard assault rifle for the German Army. The first test weapons will be made available in 2023; series production is planned for 2025. The selection decision was actually made in the Spring of 2021, however review proceedings against the decision initiated by an unsuccessful tenderer delayed the contract signature. The contract was signed in January 2023.

Oberndorf am Neckar, April 6, 2023

The Executive Board

Dr. Jens Bodo Koch Dr. Björn Krönert

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 2022, the consolidated statement of profit and loss, the consolidated statement of 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 2022, 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 2022.

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 2022 and of its financial performance for the financial year from 1 January to 31 December 2022, 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.

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 (i.e., fraudulent financial reporting and misappropriation of assets) 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 judgement 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 the risk of not detecting a material misstatement 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, 6 April 2023

Deloitte GmbH
Wirtschaftsprüfungsgesellschaft

Signed:	Signed:
Franz Klinger	Anastasia Rothau
Wirtschaftsprüfer	Wirtschaftsprüferin
(German Public Auditor)	(German Public Auditor)