Registered No: 3593238

ADVA Optical Networking Limited

Annual report and financial statements

31 December 2018

Directors and Advisors

for the year end 31 December 2018

Directors

Ulrich Maximilian Dopfer
Maurice Baarslag
Kristen Louise Clovis

Company secretary

Ian Blackburn

Independent auditors

PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Central Square
29 Wellington Street
Leeds LS1 4DL

Bankers

Deutsche Bank AG
99 Bishopsgate
London
EC2M 3XD

Registered office

Advantage House
Tribune Way
Clifton Moor
York
North Yorkshire
YO30 4RY

Strategic Report

for the year end 31 December 2018

The directors present their Strategic report of the Company for the year ended 31 December 2018.

Results and dividends

ADVA Optical Networking Limited ("the Company") made a loss before taxation of £0.5 million in 2018 (2017: profit of £1.9 million). The directors do not recommend the payment of a dividend for 2018 (2017: Nil).

Principal activities and review of the business

The Company's key performance indicators during the year were as follows:

KPIs	**2018**	**2017**	**Change**
	£m	£m	%
Revenue	44.7	53.7	(16.8)
Gross profit	6.0	8.2	(26.8)
(Loss)/ profit for financial year	(0.4)	1.4	(128.6)
Net assets	13.5	13.8	(2.2)
Current assets as % of Current liabilities	186%	235%	20.9
Average Number of employees at year end	106	113	(6.2)

Products

ADVA Optical Networking Limited assembles, markets and sells Optical and Ethernet networking solutions and related services for the development, management and delivery of dynamic communications networks and high-speed data services for various applications like data, storage, voice and video within metropolitan and regional areas. These areas comprise enterprise, metro access, metro core and regional networks capable of transmitting data over long distances. The portfolio of our hardware and software products is continuously expanding with new features and products.

Procurement

For the production of our products, we rely predominantly on ADVA Optical Networking SE (the parent company), which manufactures products at its facility in Germany as well as at contracted manufacturers based in China and the United States of America.

Profit and loss account

The revenue decreased from £53.7 million to £44.7 million in 2018. Furthermore the gross profit decreased from 15.2% in 2017 to 13.5% in 2018. Finally administrative expenses decreased from £6.5 million in 2017 to £6.4 million in 2018.

Strategic Report

for the year end 31 December 2018 (continued)

Employees

As of 31 December 2018, the Company had a total of 108 employees (2017: 113 employees). Personnel expenses decreased from £8.3 million to £7.9 million, representing 17.7% of total revenue (2017: 15.5% of total revenue). Our employee compensation package is comprised of fixed and variable components as well as stock options giving the possibility to acquire shares in our parent company. Furthermore, we offer extensive training opportunities to all our employees in order to support both their personal and professional development.

Principal risks and uncertainties

Competitive risks

The Company is for a large part dependent on a single customer and relies to a significant extent on contract manufacturing services from a limited number of providers of such services. A consolidation among the Company's component suppliers or negative developments in the businesses of the Company's component suppliers and contract manufacturers affecting their ability to supply the Company could adversely impact the availability of components and products on which ADVA Optical Networking Limited depends.

Outlook

The future positive development of our Company centers primarily on our ability to innovate, on the success of new features and products in the market and on the further growth of our business.

Overall, we are expecting to remain stable and to keep revenues at a similar level as in 2018.

The management board of ADVA does not consider a major impact on the company regarding the Brexit.

By order of the Board

Ian Blackburn
Company Secretary

29 August 2019

Directors' Report

for the year end 31 December 2018

The directors present their report and the audited financial statements of the Company for the year ended 31 December 2018.

Financial risk management

Credit risks

At present, no significant credit risks are identified as the Company actively monitors any overdue debtor balances on a weekly basis. On the other hand, the Company's main payment streams consist of payments to the parent company for transfer pricing and residual profit split as well as payments to contract manufacturers for purchased goods. The Company's cash and cash equivalents with banks as well as interest-bearing liabilities with banks and other parties result in interest income and expense cash flows that can be impacted adversely by changes in interest rates.

Currency risks

The Company's revenues are predominantly in British Pounds, whereas a large part of the purchases is in USD. No significant measures are taken to hedge currency fluctuations, as hedging is performed at parent company level.

Risk management

The Company develops and distributes technologically demanding products for use in optical networks. The Company thus operates in a highly competitive market which requires constant anticipation of an adaptation to future market demands. Risks arise through changing customer requirements, increased pricing and margin pressure from competitors, incorrect estimates about the development of new technologies and products, or insufficient protection of intellectual property and technology innovations from competitors. Risks on the procurement side centre on shortages at individual suppliers and potential further consolidation within the industry. To eliminate bottlenecks, the parent company attempts to procure each component from at least two suppliers. At present the directors see the competitive, currency and credit risks neither as threatening the ongoing existence of the Company nor as being higher than average.

The Company is part of the ADVA group of companies and a 100% owned subsidiary of ADVA Optical Networking SE in Germany, and as such the Company aligns its risk management with that of the parent company. The directors of the Company are part of the global ADVA management team. In order to ensure appropriate risk management, the ADVA global management team continuously analyses the potential risks and implements the necessary measures to guard against them to the greatest extent possible. In recent years, high investments in the further optimization of processes at the ADVA group have established a solid foundation for a results-driven controlling and reporting system within the Group. A risk management system has been established across all departments with the purpose of quickly uncovering potential risks and establishing controls in a timely manner.

These measures allow the Group and hence the Company to evaluate ADVA Optical Networking Limited's present and future situation at all times. A combination of monthly and ad-hoc reports present a thorough picture of current and future business developments.

The management board of ADVA does not consider any of these or other uncertainties to be likely or to have a major impact on the group regarding the Brexit.

Directors' Report

for the year end 31 December 2018 (continued)

Future developments and dividends

Likely future developments in the business of the Company and details of dividends paid and recommended activities are included within the Strategic Report.

Directors

The directors of the Company who were in office during the year and up to the date of signing the financial statements are listed on page 1.

Directors' qualifying third party indemnity provisions

The Company has in its articles reserved the right to grant its directors an indemnity against liability in respect of any proceedings brought by third parties, subject to the conditions set out in the Companies Act 2006. The Company has put in place a directors and officers liability insurance to cover itself for this liability. This insurance was in place during the year and up to the date of signing of the financial statements.

Disclosure of information to auditors

As far as each person who is a director at the date of approving this report is aware, there is no relevant audit information, being information needed by the auditors in connection with preparing its report, of which the auditors are unaware. Having made enquiries of fellow directors and the Company's auditors, each director has taken all the steps that he is obliged to take as a director in order to make himself aware of any relevant audit information and to establish that the auditors are aware of that information.

Statement of directors' responsibilities

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulation.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 101 "Reduced Disclosure Framework", and applicable law). Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing the financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- state whether applicable United Kingdom Accounting Standards, comprising FRS 101, have been followed, subject to any material departures disclosed and explained in the financial statements;
- make judgements and accounting estimates that are reasonable and prudent; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Directors' Report

for the year end 31 December 2018 (continued)

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006.

The directors are responsible for the maintenance and integrity of the company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Appointment of independent auditors

The Company has elected to dispense with the obligation to appoint auditors annually.

PricewaterhouseCoopers LLP have indicated their willingness to continue as auditors in 2019.

By order of the Board

Ian Blackburn
Company Secretary

29 August 2019

Independent auditors' report

to the members of ADVA Optical Networking Limited

Report on the audit of the financial statements

Opinion

In our opinion, ADVA Optical Networking Limited's financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2018 and of its loss for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 101 "Reduced Disclosure Framework", and applicable law); and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements, included within the Annual report and financial statements (the "Annual Report"), which comprise: the statement of financial position as at 31 December 2018; the statement of comprehensive income, the statement of changes in equity for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We remained independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

Conclusions relating to going concern

ISAs (UK) require us to report to you when:

- the directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

We have nothing to report in respect of the above matters.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the company's ability to continue as a going concern. For example, the terms on which the United Kingdom may withdraw from the European Union are not clear, and it is difficult to evaluate all of the potential implications on the company's trade, customers, suppliers and the wider economy.

Independent auditors' report

to the members of ADVA Optical Networking Limited (continued)

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Strategic Report and Directors' Report, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on the responsibilities described above and our work undertaken in the course of the audit, ISAs (UK) require us also to report certain opinions and matters as described below.

Strategic Report and Directors' Report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and Directors' Report for the year ended 31 December 2018 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic Report and Directors' Report.

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

As explained more fully in the Statement of the directors' responsibilities set out on pages 5 and 6, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

Independent auditors' report

to the members of ADVA Optical Networking Limited (continued)

Auditors' responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. 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 financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Use of this report

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other required reporting

Companies Act 2006 exception reporting

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the company, or returns adequate for our audit have not been received from branches not visited by us; or
- certain disclosures of directors' remuneration specified by law are not made; or
- the financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Victoria Coe

Victoria Coe (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Leeds

29 August 2019

Statement of comprehensive income

For the year end 31 December 2018

in thousands of £	Note	2018	2017
Revenue	2	44,669	53,657
Cost of sales		(38,642)	(45,494)
Gross profit		**6,027**	**8,163**
Administrative expenses		(6,409)	(6,492)
Other operating expense		(42)	-
Other operating income		-	297
Operating (loss)/ profit	3	**(424)**	**1,968**
Finance costs	5	(106)	(118)
(Loss)/ profit before taxation		**(530)**	**1,850**
Tax on profit/ (loss)	6	138	(404)
(Loss)/ profit for the financial year		**(392)**	**1,446**
Other comprehensive income for the year, net of tax		-	-
Total comprehensive (expense)/ income for the year		**(392)**	**1,446**

For the current and preceding financial year all activities are continuing.

Statement of financial position

at 31 December 2018

in thousands of £	Note	2018	2017
Fixed assets			
Intangible assets	7	582	1,227
Property, plant and equipment	8	669	504
Investments	9	-	-
Total fixed assets		**1,251**	**1,731**
Current assets			
Inventories	10	6,448	4,254
Trade and other receivables	11	8,058	3,863
Deferred taxes	6	14	19
Cash and cash equivalents		14,432	15,344
Total current assets		**28,952**	**23,480**
Creditors: amounts falling due within one year	12	(15,548)	(9,996)
Net current assets		**13,404**	**13,484**
Total assets less current liabilities		**14,655**	**15,215**
Creditors: amounts falling due after more than one year	13	(1,055)	(1,106)
Provisions for liabilities	14	(113)	(160)
Deferred tax liabilities	15	-	(119)
Net assets		**13,487**	**13,830**
Capital and reserves			
Called up share capital	16	137	137
Share premium account		4,634	4,634
Capital redemption reserve		1,724	1,724
Share option reserve		974	925
Profit and loss account		6,018	6,410
Total shareholders' funds		**13,487**	**13,830**

The financial statements on pages 10 to 34 were approved by the Board of Directors on 29 August 2019 and signed on its behalf by:

Maurice Baarslag
Director
29 August 2019

Statement of changes in equity

for the year ended 31 December 2018

In thousands of £	*Called up Share Capital*	*Share premium account*	*Capital redemption reserve*	*Share option reserve*	*Profit and loss account*	*Total Shareholders' funds*
At 1 January 2018	137	4,634	1,724	925	6,410	13,830
(Loss) for the financial year	-	-	-	-	(392)	(392)
Total comprehensive expense for the year	-	-	-	-	(392)	(392)
Share-based payment	-	-	-	49	-	49
At 31 December 2018	137	4,634	1,724	974	6,018	13,487

Notes to the financial statements

for the year ended 31 December 2018

1. Accounting policies

The following policies have been applied consistently throughout the financial statements.

Basis of preparation

The Company is a private limited company, incorporated and domiciled in the United Kingdom. The financial statement of ADVA Optical Networking Limited have been prepared in accordance with Financial Reporting Standard 101, 'Reduced Disclosure Framework' (FRS 101). The financial statements have been prepared under the historical cost convention and in accordance with the Companies Act 2006. The address of the registered office is Advantage House, Tribune way, Clifton Moor, York, North Yorkshire, YO30 4RY.

The preparation of financial statements in conformity with FRS 101 requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Company's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed below.

The following exemptions from the requirements of IFRS have been applied in the preparation of these financial statements, in accordance with FRS 101:

- IFRS 7, 'Financial Instruments: Disclosures.'
- Paragraphs 91 to 99 of IFRS 13, 'Fair value measurement' (disclosure of valuation techniques and inputs used for fair value measurement of assets and liabilities).
- Paragraph 38 of IAS 1, 'Presentation of financial statements' comparative information
- requirements in respect of:
    - (i) paragraph 79(a)(iv) of IAS 1; and
    - (ii) paragraph 73(e) of IAS 16 Property, plant and equipment.
- The following paragraphs of IAS 1, 'Presentation of financial statements':
    - 10(d), (statement of cash flows);
    - 10(f) (a statement of financial position as at the beginning of the preceding period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements);
    - 16 (statement of compliance with all IFRS);
    - 38A (requirement for minimum of two primary statements, including cash flow statements);
    - 38B-D (additional comparative information);
    - 40A-D (requirements for a third statement of financial position;
    - 111 (cash flow statement information); and
    - 134-136 (capital management disclosures).
- IAS 7, 'Statement of cash flows'
- Paragraph 30 and 31 of IAS 8 'Accounting policies, changes in accounting estimates and errors' (requirement for the disclosure of information when an entity has not applied a new IFRS that has been issued but is not yet effective)
- Paragraph 17 of IAS 24, 'Related party disclosures' (key management compensation)

The requirements in IAS 24, 'Related party disclosures' to disclose related party transactions entered into between two or more members of a group.

Notes to the financial statements

for the year ended 31 December 2018 (continued)

1. Accounting policies (continued)

Going concern

The Company meets its day-to-day working capital requirements through its cash reserves. After making enquiries, the directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. The Company therefore continues to adopt the going concern basis in preparing its financial statements.

New Standards, amendments and IFRIC interpretations

IFRS 9 and IFRS 15 are new accounting standards that are effective for the year ended 31 December 2018. There are no other amendments to accounting standards, or IFRIC interpretations that are effective for the year ended 31 December 2018 have had a material impact on the company.

IFRS 15 'Revenue from Contracts with Customers'

IFRS15 was issued by the IASB in May 2014 and became effective for accounting periods beginning on or after 1 January 2018. The standard outlines the principles entities must apply to measure and recognise revenue with the core principle being that entities should recognise revenue at an amount that reflects the consideration to which the entity expects to be entitled in exchange for fulfilling its performance obligations to a customer. IFRS 15 introduces a five-step approach to revenue recognition and far more prescriptive guidance has been added in IFRS 15 to deal with specific scenarios.

In accordance with the transition provisions in IFRS 15 the new rules have been adopted under the modified retrospective approach and apart from providing more extensive disclosure on the Company's revenue transactions, did not result in a material adjustment to the opening balance sheet or revenue recognition in the year. The business has assessed it's accounting policy for revenue recognition against the requirements of IFRS 15 and determined that no changes is required, except for the classification of contract assets and contract liabilities.

IFRS 9 'Financial Instruments'

IFRS 9 sets out requirements for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items. This standard replaces IAS 39 'Financial Instruments: Recognition and Measurement'.

The classification and measurement of financial liabilities and derivative instruments remains unchanged from IAS 39. Under IFRS 9, a financial asset is now classified on initial recognition as measured at: amortised cost; fair value through other comprehensive income (FVOCI) – debt investment; FVOCI – equity investment; or fair value through profit and loss (FVTPL). Applying this classification to the Company's financial assets does not result in changes to the accounting: trade receivables and cash and

Notes to the financial statements

for the year ended 31 December 2018 (continued)

1. Accounting policies (continued)

cash equivalents continue to be recognised at amortised cost and certain other non-current financial assets continue to be recognised at FVTPL.

In respect of accounting for trade and other receivables, the Company has applied IFRS 9's simplified approach to provisioning and has calculated this using expected credit losses. This calculation has had no material impact on the financial statements.

As a result of adopting IFRS 9, a new accounting policy for financial instruments has been created.

Related party transactions

As a subsidiary undertaking of ADVA Optical Networking SE, the Company has taken advantage of the exemption under FRS 101 not to disclose transactions with other wholly owned members of the group headed by ADVA Optical Networking SE.

Critical accounting estimates and judgments

Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances

The Company makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below.

(a) Useful economic lives of property, plant and equipment

The annual depreciation charge for property, plant and equipment is sensitive to changes in the estimated useful economic lives and residual values of the assets. The useful economic lives and residual values are re-assessed annually. They are amended when necessary to reflect current estimates, based on technological advancement, future investments, economic utilisation and the physical condition of the assets. See note 8 for the carrying amount of the property plant and equipment, and below policy for the useful economic lives for each class of assets.

(b) Inventory provisioning

The Company manufactures and sells optical and Ethernet-based networking solutions for telecommunication carriers and enterprises to deliver data, storage, voice and video services. As a result, it is necessary to consider the recoverability of the cost of inventory and the associated provisioning required. When calculating the inventory provision, management considers the nature and condition of the inventory, as well as applying assumptions around anticipated sale ability of the finished goods. See note 10 for the net carrying amount of the inventory and associated provision.

Notes to the financial statements

for the year ended 31 December 2018 (continued)

1. Accounting policies (continued)

(c) Impairment of trade receivables

The new impairment model changes the calculation of impairment from an incurred loss model to an expected credit loss model. ADVA Optical Networking calculates the impairment on trade receivables that are accounted for at amortized cost according to IFRS 9 based on the simplified approach on the basis of a provision matrix.

Property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation. Cost includes the original purchase price of the asset and the costs attributable to bringing the asset to its working condition for its intended use. Depreciation is provided at rates calculated to write off the cost, less estimated residual value, of each asset on a straight-line basis over its expected useful life as follows:

Leasehold improvements	4 – 15 years
Technical equipment and machinery	4 – 8 years
Factory and office equipment	3 – 10 years

Intangible assets

Patents and licences are stated at cost less accumulated amortisation. Amortisation is provided at rates calculated to write off the cost less estimated residual value of each asset on a straight-line basis over its expected useful life as follows:

Patents / Licences	2 – 5 years
Capitalised development projects	3 – 5 years

Amortisation is included within administrative expenses.

The carrying value of positive goodwill is reviewed for impairment at the end of the first full year following acquisition and in other periods if events or changes in circumstances indicate the carrying value may not be recoverable.

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost includes all costs incurred in bringing each product to its present location and condition and is determined based on the weighted average method. Provision is made where necessary for obsolete, slow moving and defective stocks. Net realisable value is determined on the basis of anticipated sales proceeds less estimated selling expenses.

Notes to the financial statements

for the year ended 31 December 2018 (continued)

1. Accounting policies (continued)

Investments

Shares in affiliated companies and investments are recognised at the cost of acquisition including transaction costs less impairment charges.

Foreign currencies

Monetary assets and liabilities expressed in foreign currencies are translated to sterling at rates of exchange ruling at the balance sheet date. Trading transactions denominated in foreign currencies are translated into sterling at the rate ruling when the transaction was entered into. Exchange gains or losses are included in the profit and loss account.

Financial assets

ADVA Optical Networking's financial assets include trade receivables and cash and cash equivalents.

In accordance with IFRS 9, financial assets are initially allocated to the category measured at fair value through profit or loss. Transaction costs of are expensed immediately.

For trade receivables with no significant financing component the company applies the simplified approach, which requires lifetime expected credit losses to be recognized from initial recognition of the receivables.

Revenue

Revenue, which excludes value added tax, represents the value of goods and services supplied.

Revenue is recognised to the extent that it is probable that economic benefits will flow to the Company and can be reliably measured. Revenue is measured at the fair value of the consideration received, net of discounts, rebates and other sales taxes or duty.

The following specific recognition criteria must also be met before revenue is recognised:

Sale of Goods

Revenue from the sale of goods is recognised when a performance obligation is satisfied i.e. when control of the goods is transferred to the customer. Control is passed either at a point in time or over time. When hardware is sold control is transferred at a point in time depending on the delivery terms. Software licenses are either sold together with the hardware or sold separately. Control in case of software is transferred when the customer is able to use the software.

Rendering of Services

Revenue arising from the sale of services primarily derives from installation services, maintenance and training and is recognised when those services have been rendered. In case of service level agreements or maintenance contracts as well as period-related software licenses revenue is recognized over a period of time provided that further services are to be rendered during the term of the contract. The customer receives and uses all services at the same time as they are provided by the company.

Notes to the financial statements

for the year ended 31 December 2018 (continued)

1. Accounting policies (continued)

Operating leases

Costs in respect of operating leases and contract hire agreements are charged against income on a straight-line basis over the term of the lease.

Pension costs

The Company operates a defined contribution pension scheme for the benefit of directors and staff. The assets of the scheme are held separately from those of the group in an independently administered fund. The amounts charged against profits represent the contributions payable to the scheme in respect of the accounting period.

Research and development

Research costs are expensed in the period in which they are incurred. Development expenses for new products are capitalised as development projects if

- they can be unambiguously assigned to those products,
- the products under development are technically feasible and can be marketed,
- there is reasonable certainty that the development activity will result in future cash inflows.

Capitalised development projects include all costs that can be directly assigned to the development process, including borrowing costs. After initial recognition of capitalised development projects as an asset, measurement is at historical cost, less accumulated amortisation and impairment. The straight-line method of amortisation is used from the start of production through the estimated selling periods for the products developed (generally between three and five years). Finished as well as unfinished development projects are tested for impairment on the balance sheet date and at other defined dates in the product life cycle.

Provisions for liabilities

A provision is recognised when the Company has a legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions for the expected costs of maintenance under guarantees are charged against profits when products have been invoiced.

Taxes

Current income tax

Current income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted on the balance sheet date.

Notes to the financial statements

for the year ended 31 December 2018 (continued)

1. Accounting policies (continued)

Deferred tax

Deferred tax is provided using the liability method on temporary differences on the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred tax liabilities are recognised for all taxable temporary differences.

Deferred tax assets are recognised for all deductible temporary differences as well as for tax losses carried forward to the extent that it is probable that taxable profit will be available against which the deductible temporary differences respectively tax losses carried forward can be utilised. The carrying amount of deferred tax assets is reviewed on each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow the deferred tax asset to be utilised. Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted on the balance sheet date. Future changes in tax rates are recognised on the balance sheet date if their impact is materially certain as part of the tax legislation process.

Share based payments

The cost of equity-settled transactions with employees is measured by reference to their fair value at the date of grant and is recognised as an expense over the vesting period, which ends on the date on which the relevant employees become fully entitled to the award. Fair value is determined by an external value using an appropriate pricing model. In valuing equity-settled transactions, no account is taken of any vesting conditions, other than conditions linked to the price of the shares of the parent company (market conditions).

No expense is recognised for awards that do not ultimately vest, except for awards where vesting is conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition is satisfied, provided that all other performance conditions are satisfied.

At each balance sheet date before vesting, the cumulative expense is calculated, representing the extent to which the vesting period has expired, and management's best estimate of the achievement or otherwise of non-market conditions determining the number of equity instruments that will ultimately vest, or in the case of an instrument subject to a market condition, be treated as vesting as described above. The movement in cumulative expense since the previous balance sheet date is recognised in the income statement, with a corresponding entry in equity.

Where the terms of an equity-settled award are modified or a new award is designated as replacing a cancelled or settled award, the cost based on the original award terms continues to be recognised over the original vesting period. In addition, an expense is recognised over the remainder of the new vesting period for the incremental fair value of any modification, based on the difference between the fair value of the original award and the fair value of the modified award, both as measured on the date of the modification. No reduction is recognised if this difference is negative.

Where an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation, and any cost not yet recognised in the income statement for the award is expensed immediately. Any compensation paid up to the fair value of the award at the cancellation or settlement date is deducted from equity, with any excess over fair value being treated as an expense in the income statement.

Notes to the financial statements

for the year ended 31 December 2018 (continued)

2. Revenue

Geographical analysis of revenue by destination:

in thousands of £	**2018**	**2017**
United Kingdom	41,489	49,885
Rest of Europe	3,113	3,683
Rest of World	67	89
Total revenues	44,669	53,657

Analysis of revenue by category:

in thousands of £	**2018**	**2017**
Sale of goods	40,060	47,888
Rendering of services	4,609	5,769
Total revenues	44,669	53,657

Liabilities related to contracts with customers:

The company has recognized the following assets and liabilities related to contracts with customers.

in thousands of £	**31 Dec 2018**	**31 Dec 2017***
Current Contract Liabilities	637	584
Non-Current Contract Liabilities	1,036	1,084
Total Contract liabilities	1,673	1,668

*see note 22.1 for details about changes in accounting policies.

Contract liabilities for expected service contracts have increase by £5,000. The increase in 2018 was due to an increase in overall contract activity.

Revenue recognised in the current reporting period which relates to carried-forward contract liabilities amounts to £507,000 (2017: £458,000).

Notes to the financial statements

for the year ended 31 December 2018 (continued)

3. Operating (loss)/ profit

The (loss)/ profit before taxation is stated after:

in thousands of £	**2018**	**2017**
Auditors' remuneration for audit services	10	9
Exchange loss/ (gain) on translation differences	247	(286)
Accumulated depreciation of property, plant and equipment	248	244
Amortisation of intangible assets	708	840
Operating lease charges	375	376
Other reversals of provisions	(42)	(65)
Inventory expenses/costs*	160	122
Research and development costs / (incomes)	28	(31)

*includes scrapping, stock taking adjustments and reserve

4. Staff costs

The monthly average number of persons, including executive directors, employed by the Company during the year is as below:

	2018	**2017**
by activity	No.	No.
Production	18	19
Sales and administration	85	90
Research and development	3	4
	106	113

in thousands of £	**2018**	**2017**
Staff costs during the year (including directors)		
Wages and salaries	6,501	6,940
Social security costs	927	923
Other pension costs (Note 21)	391	436
Share based payments (Note 19)	50	19
	7,869	8,318

Notes to the financial statements

for the year ended 31 December 2018 (continued)

in thousands of £	**2018**	**2017**
Directors' emoluments		
Aggregate emoluments paid or payable by the Company	3	3
Aggregate emoluments paid or payable by the ultimate controlling party ADVA Optical Networking SE, incorporated in Germany (total amount of £5,000 for divers affiliate companies)	4	6
Aggregate emoluments	7	9

	2018 No	**2017** No
Number of directors to whom retirement benefits are accruing under defined contribution pension schemes	1	1

5. Finance costs

In 2018 and 2017 Finance costs included £106,000 and £118,000 respectively for interest payables on invoice financing.

Notes to the financial statements

for the year ended 31 December 2018 (continued)

6. Tax on (loss)/ profit

in thousands of £	**2018**	**2017**
Current tax		
United Kingdom corporation tax on (loss)/ profit for the year at 19.00% (2017: 19.25%)	21	309
Current tax income from prior year	(45)	-
Total current tax	**(24)**	**309**
Deferred taxes		
Origination and reversal of temporary differences	(114)	47
Adjustments in respect of prior periods	-	39
Adjustment in respect of tax rate change	-	9
Income tax (credit) / charge	(138)	404

The tax for the year 2018 was lower (2017: higher) than that resulting from applying the standard rate of corporation tax of 19% (2017: 19.25%). The differences are explained below:

in thousands of £	**2018**	**2017**
(Loss)/ profit before taxation	(530)	1,850
Tax at 19% thereon (2017: 19.25%)	(101)	356
Expenses deductible	-	-
Non-deductible expenses	8	-
Adjustments in respect of prior periods	(45)	39
Adjustment in respect of tax rate change	-	9
Tax (credit)/ charge for the year	(138)	404

Deferred tax assets

Deferred tax assets, which have been recognised due to the certainty of their recoverability based on future profits in the foreseeable future, comprise:

in thousands of £	**2018**	**2017**
Excess of capital allowances over depreciation	-	6
Short term timing differences	14	13
As per year end	14	19

Notes to the financial statements

for the year ended 31 December 2018 (continued)

6. Tax on (loss)/ profit (continued)

The UK Corporation tax rate reduced to 19% from April 2017. The rate will further reduce to 17% from April 2020 and as at the balance sheet date, this future rate reduction has been substantively enacted. Deferred tax as at 31 December 2018 has been calculated upon substantively enacted rate of 17%.

7. Intangible assets

in thousands of £	*Goodwill*	*Capitalised R&D expenses*	*License and Patents*	*Total*
Cost				
At 1 January 2018	437	5,845	1,291	7,573
Additions	-	-	63	63
At 31 December 2018	437	5,845	1,354	7,636
Accumulated amortisation				
At 1 January 2018	-	5,219	1,127	6,346
Charge for the year	-	626	82	708
At 31 December 2018	-	5,845	1,209	7,054
Net book value				
At 31 December 2018	437	-	145	582
At 31 December 2017	437	626	164	1,227

Internally generated intangible assets

in thousands of £

Capitalised development projects	Remaining amortisation periods per 31 December 2018	Net book value at 31 December 2018	Net book value at 31 December 2017
FSP 150CC-XG210 R6.5.1	0 month	-	349
FSP 150CC-GE110 R7.1.1	0 month	-	277
		-	626

Notes to the financial statements

for the year ended 31 December 2018 (continued)

8. Property, plant and equipment

in thousands of £	Leasehold improvements	Technical equipment and machinery	Factory and office equipment	Total
Cost				
At 1 January 2018	426	3,664	1,863	5,953
Additions	12	356	45	413
Disposals	-	(46)	-	(46)
At 31 December 2018	438	3,974	1,908	6,320
Accumulated depreciation				
At 1 January 2018	273	3,451	1,725	5,449
Charge for the year	33	144	71	248
Disposals	-	(46)	-	(46)
At 31 December 2018	306	3,549	1,796	5,651
Net book value				
At 31 December 2018	132	425	112	669
At 31 December 2017	153	213	138	504

Notes to the financial statements

for the year ended 31 December 2018 (continued)

9. Investments

ADVA Optical Networking Limited holds a 1% share of the investment in group company ADVA Optical Networking Serviços Ltda., Sao Paulo, Brasil, representing USD 250 (£167).

The directors believe that the carrying value of the investment is supported by their underlying net assets.

10. Inventories

in thousands of £	*2018*	*2017*
Work in Progress	264	32
Finished goods and goods for resale	6,184	4,222
Total	6,448	4,254

The difference between purchase price or production cost of stocks and their replacement cost is not material.

The cost for 2018 of inventories for inventory reserve (£119,000), inventory scrap (£18,000) and for stock taking adjustments (£23,000) totaled at £160,000.

The inventory reserve at year end totaled at £787,710 (2017: £668,699).

11. Trade and other receivables

in thousands of £	*2018*	*2017*
Trade debtors	4,693	1,701
Debtors provision	(1)	(3)
Amounts owed by group undertakings	2,621	1,783
Corporation tax receivable	458	107
Prepayments and accrued income	287	275
Total	8,058	3,863

In 2008 the Company entered into an agreement to sell debts to Lloyds TSB Commercial Finance Limited on a non-recourse basis. Credit risks and settlement risks are transferred to the purchaser. At 31 December 2018 and 31 December 2017, the Company sold those trade debtors, where substantially all of the risk has been passed to the purchaser and cash has been transferred to the Company. At 31 December 2018 these transactions amounted to £10,982,000 (2017: £17,803,000).

Amounts due to group undertakings are unsecured, interest free, have fixed date of repayment and are repayable on demand.

Notes to the financial statements

for the year ended 31 December 2018 (continued)

12. Creditors: amounts falling due within one year

in thousands of £	***2018***	***2017***
Trade creditors	3,725	3,415
Amounts owed by group undertakings	8,621	3,018
Taxation and social security	960	1,185
Other creditors	368	335
Accruals and deferred income	1,237	1,459
Contract Liabilities	637	584
Total	15,548	9,996

Amounts due to group undertakings are unsecured, interest free, have fixed date of repayment and are repayable on demand.

13. Creditors: amounts falling due after more than one year

in thousands of £	***2018***	***2017***
Other creditors	19	22
Contract Liabilities	1,036	1,084
Total	1,055	1,106

Notes to the financial statements

for the year ended 31 December 2018 (continued)

14. Provisions for liabilities

in thousands of £	***2018***	***2017***
Warranty provisions	113	160
	113	160

in thousands of £	short-term	long-term	Total
Cost			
At 1 January 2018	89	71	160
Usage during the year	(52)	(8)	(60)
Addition	4	9	13
At 31 December 2018	41	72	113

Warranties

The calculation for the costs likely to be incurred under product warranties includes only costs incurred within the contractual average warranty period of 24 months.

15. Deferred tax liabilities

Deferred tax liabilities comprise:

in thousands of £	**2018**	**2017**
R&D capitalisation	-	119
Total	-	119

Notes to the financial statements

for the year ended 31 December 2018 (continued)

16. Called up share capital

in thousands of £	2018	2017
Authorised		
1,368,054 ordinary shares of 10p each (2017; 1,368,054)	137	137
Called up, allotted and fully paid		
1,368,054 ordinary shares of 10p each (2017; 1,368,054)	137	137

17. Capital and other commitments

The Company has non-cancellable operating leases, primarily for buildings and cars. There are no sub-lease agreements.

Lease payments for buildings including parking spaces amount to £295,000 and £283,000 in 2018 and 2017, respectively. Lease payments for cars consisting of monthly instalments plus servicing charges totaled £83,000 and £91,000 in 2018 and 2017, respectively.

The Company had the following future minimum lease payments under non-cancellable operating leases for each of the following periods:

Future lease installments	**2018**		**2017**	
in thousands of £	Land and Buildings	Other	Land and Buildings	Other
Less than 1 year	258	40	258	96
1 – 5 years	793	14	907	50
More than 5 years	-	-	102	-
Total	1,051	54	1,267	146

ADVA Optical Networking SE, Germany granted an irrevocable guarantee of £1.5 million for liabilities of ADVA Optical Networking Limited, York. In September 2018, ADVA Optical Networking Limited, York and ADVA Optical Networking North America Inc., Atlanta, USA together entered into a guarantee for ADVA Optical Networking SE, Germany for a syndicated loan agreement about € 75 million.

Notes to the financial statements

for the year ended 31 December 2018 (continued)

18. Related party transactions

The Company is wholly owned by the parent company and has taken advantage of the exemption in FRS 101 to not disclose transactions with its parent company and other wholly owned subsidiaries within the group.

19. Share options

To date, ADVA Optical Networking SE (the parent company) has issued stock options (Plan XIV) as well as stock appreciation rights (SARs) for employees (Plan XV) of ADVA Optical Networking Ltd. In 2018, Plan XV expired and all options were exercised. On December 31, 2018, one stock-based compensation program for employees was still in existence.

Both above mentioned contracts stipulate a four-year vesting period and a total contractual life of seven years for the respective rights issue. The rights may only be exercised if the volume weighted average of the parent company share closing prices on the ten stock exchange trading days before the first day of each exercise period in which the option is exercised is at least 120% of the purchase price. In addition, the calculation of the maximum bonus for stock appreciation rights is based on the share price at the date of exercise, with the share price being capped at EUR 20.00. The new program for issuance of option rights is referred to as Plan XIV and the program for issuance of stock appreciation rights is referred to as Plan XV.

In November 2018, new options for employees of ADVA Optical Networking Ltd. were issued from Plan XIV.

All option rights are non-transferable. They may only be exercised as long as the entitled person is employed on a permanent contract by the parent company or by a company in which ADVA Optical Networking SE has direct or indirect interest (affiliated company). Option rights issued to apprentices may only be exercised if the apprentices are hired by the holding company or by an affiliated company on a permanent contract. All option rights expire upon termination of the employment contract. In the event that the person entitled dies, becomes unable to work or retires, special provisions come into force.

The group of people to whom option rights can be issued is defined separately for each stock option program. According to the resolution on June 13, 2018, 30.0% of option rights - in total 1,492,066 options rights - authorized pursuant to Plan XIV could be issued to members of the management board, 5.0% - in total 248,678 options rights - to the management of affiliated companies, 25.0% - in total 1,243,388 options rights - to company employees, and 40.0% - in total 1,989,422 options rights - to employees of affiliated companies. The management board specifies the exact group of people entitled to exercise rights and the scope of each offer. In case management board gets option rights, supervisory board will do so.

Subject to the conditions under which option rights are issued, each option right entitles the individual to purchase one common share in the holding company. The SARs entitle the recipient to receive a bonus in the amount of the difference between the defined strike price and the stock market price at the date of exercise (cash settlement). The Company may opt to replace the granted SARs with other participation rights as long as such other participation right economically equals the replaced stock appreciation right. The conditions of issue specify the term, the exercise price (strike price), any qualifying periods and the defined exercise periods.

Notes to the financial statements

for the year ended 31 December 2018 (continued)

19. Share options (continued)

All option rights can be exercised over a total period of seven years. The option plans XIV und XV comprise a uniform vesting period of four years for all options and stock appreciation rights issued. The strike price equals the average stock price of the last ten trading days prior to the grant date. The minimum strike price is defined as the final auction price on the day when the option rights are issued. To exercise the options, certain exercise hurdles per tranche are to be considered. The exercise hurdle on Plan XIV comprises a surplus on the strike price of 20%.

Exercise periods are regularly linked to key business events in the holding company's calendar and each has a defined term. Certain other business events can lead to blocking periods, during which option rights cannot be exercised. Insofar as regular exercise periods overlap with such blocking periods, the exercise deadline shall be extended by the corresponding number of exercise days immediately after the end of such a blocking period. Option rights may be exercised only on days on which commercial banks are open in Frankfurt am Main, Germany.

The fair value of stock options and stock appreciation rights is estimated by simulation (Monte Carlo method) using a program that was especially adjusted to the underlying plans and based on the assumed strategy for the exercise (earliest possible date).

The following computation parameters apply for option rights issued in 2018:

	Plan XIV
Weighted average share price (in EUR)	7.73
Weighted average strike price (in EUR)	7.80
Weighted expected volatility (in % per year)	46.36%
Term (in years)	7
Weighted risk-free interest rate (in % per year)	(0.20%)

The volatility is specified as fluctuation of the share price compared to the average share price of the period. In each case, expected volatility is calculated based on historic share prices (historic volatility). The risk-free interest rate is based on information on risk-free investments with corresponding terms.

Notes to the financial statements

for the year ended 31 December 2018 (continued)

19. Share options (continued)

For the calculation of the fair value of options, ADVA Optical Networking assumed that no dividends have been paid to stockholders.

Changes in the number of option rights and stock appreciation rights outstanding are detailed in the tables below.

Stock option program 2011 (Plan XIV)

	Number of options	Weighted average strike price (in EUR)
Options outstanding on Jan. 1, 2017	**68,000**	**8.25**
Granted options	33,000	4.98
Exercised options	(11,500)	4.66
Forfeited options	(3,000)	10.16
Options outstanding on Dec. 31, 2017	**86,500**	**7.41**
Granted options	17,000	7.87
Exercised options	(7,000)	3.99
Forfeited options	(2,500)	3.57
Options outstanding on Dec. 31, 2018	**94,000**	**7.85**
Of which exercisable	-	-

Plan XIV is equity settled.

The weighted average remaining contractual life for option rights outstanding on December 31, 2018, was 5.25 years (December 31, 2017: 5.32 years). The strike price for these options is between EUR 4.98 and EUR 10.16 (December 31, 2017: between EUR 3.57 and EUR 10.16).

Stock options exercised in 2018 had an average share price of EUR 7.10 (2017: EUR 8.71) on the exercise date.

The average fair value of option rights granted in 2018 is EUR 3.15 (2017: EUR 1.83).

Notes to the financial statements

for the year ended 31 December 2018 (continued)

19. Share options (continued)

Stock Appreciation Rights (Plan XIa)

All rights from this plan were issued in the course of the stock option exchange offer on October 1, 2008:

	Number of stock appreciation rights	Weighted average strike price (in EUR)
Stock appreciation rights outstanding on Jan. 1, 2017	**5,500**	**3.57**
Exercised stock appreciation rights	(700)	3.57
Stock appreciation rights outstanding on Dec. 31, 2017	**4,800**	**3.57**
Exercised stock appreciation rights	(4800)	3.57
Stock appreciation rights outstanding on Dec. 31, 2018	**-**	**-**

Plan XV is cash settled. All stock appreciation rights were exercised in 2018.

The weighted average remaining contractual life for SARs outstanding on December 31, 2017 was 0.73 years. The strike price for these SARs on December 31, 2017 was EUR 3.57.

Stock appreciation rights exercised in 2018 had an average share price of EUR 6.73 on the exercise date.

Compensation expenses arising from stock option programs were as follows:

in thousands of £	**2018**	**2017**
Options (Plan IX, IXa and XIV)	49	19
Total	**49**	**19**

20. Parent company and ultimate controlling party

The Company is a subsidiary undertaking of ADVA Optical Networking SE, incorporated in Germany.

The largest and smallest group in which the results of the Company are consolidated is that headed by the ultimate controlling party ADVA Optical Networking SE, incorporated in Germany. The consolidated financial statements of this group are available to the public and may be obtained from ADVA Optical Networking SE, Fraunhoferstraße 9a, Martinsried/Munich, D-82152, Germany.

No other group financial statements include the results of the Company.

Notes to the financial statements

for the year ended 31 December 2018 (continued)

21. Pension scheme

The Company operates a defined contribution pension scheme. The pension cost charge for the year represents contributions payable by the Company to the fund and amounted to £391,000 (2017: £436,000). Contributions amounting to £ Nil (2017: £64,000) were payable to the fund at the end of the year and are included in creditors.

22. Impact on the Financial Statement due to new IFRS Standards

22.1 IFRS 15 Revenue from Contracts with Customers

IFRS 15 requires separate presentation of contract assets and contract liabilities in the balance sheet. As of January 1, 2018, this resulted in reclassifications of contract liabilities. Following items were identified and illustrate reclassifications as of January 1, 2018:

- Liabilities of £67,000 in relation to rights of returns previously presented as accruals will be presented as contract liabilities.
- Liabilities amounting to £1,591,000 in relation to prepaid service contracts previously recognized as deferred revenue will be reclassified to contract liabilities.

22.2. IFRS 9 Financial Instruments

Due to the first-time adoption of IFRS 9 impairment of trade accounts receivable as of January 1, 2018 have been decreased by £2,000 and. The transition effect has been reported in retained earnings.

(in thousands of £)	
Impairment	
As of Dec. 31, 2017, according to IAS 39	3
IFRS 9 transition effect	-2
As of Jan. 1, 2018, according to IFRS 9	**1**