paragon®

INVENTIONS.

ANNUAL REPORT 2016

At a Glance

Highlights of the Financial Year 2016

- Consolidated revenue grows 8.2% to € 102.8 million (prior year: € 95.0 million)
- EBITDA rises 13.2% to € 16.1 million (prior year: € 14.2 million)
- EBIT up 14.4% to € 8.9 million (prior year: € 7.8 million)
- Revenue growth to € 120 – 125 million expected for 2017 with an EBIT margin 9.0% – 9.5%

Group Key Figures (IFRS)

In € thousands or as indicated	**Jan. 1 – Dec. 31, 2016**	Jan. 1 – Dec. 31, 2015	Change in %	**Oct. 1 – Dec. 31, 2016**	Oct. 1 – Dec. 31, 2015	Change in %
Revenue	102,790	94,990	8.2	29,091	27,627	5.3
EBITDA	16,092	14,212	13.2	5,929	5,095	16.4
EBITDA margin in %	*15.7*	*15.0*	*n/a*	*20.4*	*18.4*	*n/a*
EBIT	8,929	7,808	14.4	3,831	3,228	18.7
EBIT margin in %	*8.7*	*8.2*	*n/a*	*13.2*	*11.7*	*n/a*
Group result	3,561	3,403	4.6	2,746	1,558	76.3
Earnings per share in €	0.84	0.83	2.1	0.61	0.38	60.9
Investments	23,262	33,120	-29.8	6,548	7,661	-14.5
Operating cash flow	16,798	12,853	30.7	8,355	6,236	34.0

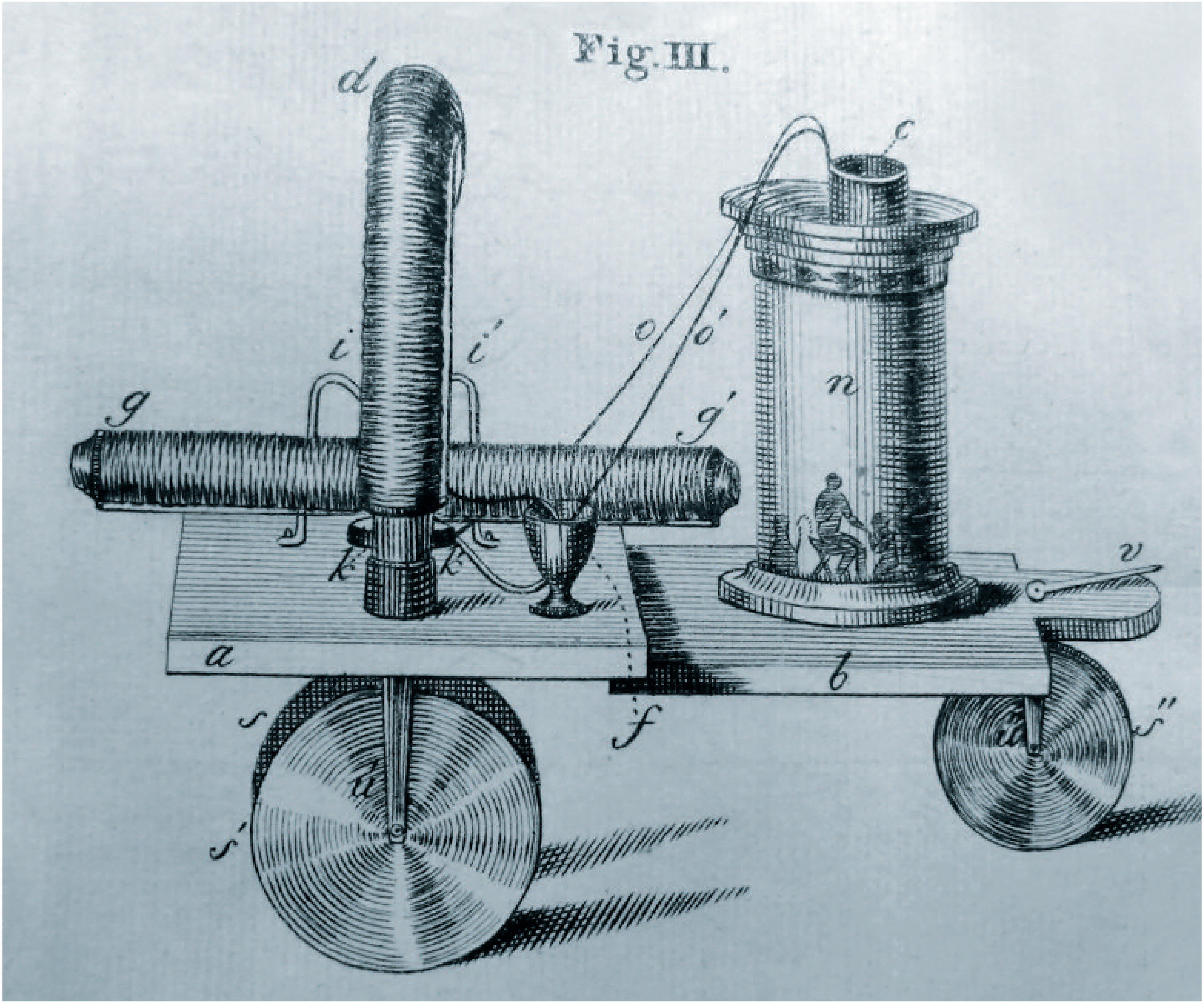
In € thousands or as indicated	**Dec. 31, 2016**	Dec. 31, 2015	Change in %	**Dec. 31, 2016**	Sep. 30, 2015	Change in %
Total assets	115,553	92,550	24.9	115,553	99,911	15.7
Equity	34,674	19,402	78.7	34,674	19,124	81.3
Equity ratio in %	30.0	21.0	n/a	30.0	19.1	n/a
Available liquidity	17,324	13,840	25.2	17,324	8,056	115.0
Interest-bearing liabilities	49,181	47,868	2.7	49,181	53,319	-7.8
Net debt[1]	31,857	34,028	-6.4	31,857	45,263	-29.6
Employees[2]	519	482	7.7	519	495	4.8

Share

	Dec. 31, 2016	Dec. 31, 2015	Change	**Dec. 31, 2016**	Sep. 30, 2016	Change
Xetra closing price in €	41.53	31.44	32.1%	41.53	34.70	19.7%
Number of shares outstanding	4,526,266	4,114,788	10.0%	4,526,266	4,114,788	10.0%
Market capitalization in € million	187.954	129.361	58.593	187.954	142.783	45.171

1 Net debt = Interest-bearing liabilities – available liquidity
2 Plus 107 temporary employees (December 31., 2015: 79; September 30., 2016: 85)

1835: Electric Car | Christopher Becker



The German instrument maker and manufacturer Christopher Becker (1805 – 1890), who was an ancestor of paragon CEO Klaus Dieter Frers, developed an electromagnetic vehicle in 1835. This vehicle, which was driven by a bipolar electric motor and drew its energy from a non-rechargeable primary cell, is considered one of the first steps towards the development of the electric car.

The bipolar design of this primary model was unsatisfactory, and so Christopher Becker continued refine his invention. The improved vehicle, which features a four-pole motor, is on display in the Louwman Museum in Groningen in the Netherlands.

Based on this initial step towards e-mobility, the high-performance batteries from Voltabox AG are a key pillar supporting paragon AG's continued success. Networked production (Industry 4.0) is also an ideal application area for this Voltabox technology.

Managing growth
Letter from the Management Board

Chief Executive Officer Klaus Dieter Frers (right) and Chief Technology Officer (Electronics) Dr. Stefan Schwehr

DEAR SHAREHOLDERS, CUSTOMERS, BUSINESS PARTNERS AND EMPLOYEES,

We can look back at an eventful year in our markets – and one where we also accomplished a great deal. In the past fiscal year, we have grown in every way. This can be seen in our key figures: Revenue increased 8.2% to € 102.8 million with an improved EBIT margin of 8.7%. This means that we achieved everything that we had set out to accomplish: Revenue growth of about 8% to over € 100 million with an EBIT margin of about 9%. Thanks to our clear strategic positioning, we were also able to grow much faster than the market again in 2016 – while increasing our profitability. At the same time, we achieved the highest operating result in our company's history with an EBIT of roughly € 9 million.

Here, we benefited from the very good sales performance of the German automotive industry. The European market alone grew 8.2% in the first quarter. From the second quarter onwards, the sales market for cars picked up on a global scale, though there were pockets of weaker regional performance. The notably greater demand in China and Western Europe in the first half of the year prompted the German Association of the Automotive Industry to raise its global sales growth forecast for 2016 to 3%. In the end, all of our most important customers (Audi, Volkswagen, Porsche, Daimler and BMW), with whom we generate about three quarters of our revenue, managed to post record sales and sell about 5% more cars at the global level. This is especially pleasing as 84% of the current models offered by these companies come with at least one paragon product available – and increasingly offered as standard.

Our unique portfolio of product innovations also grew. With our new particle sensor DUSTDETECT® (PM2.5 sensor), which monitors the fine-dust pollution in the passenger compartment, we have seized an important global trend at an early stage. The Chinese government in particular is placing a greater emphasis on reducing the health risks stemming from environmental pollution. With the high traffic levels in China, now the largest car market in the world, our air quality sensors in particular represent an excellent selling point for automotive manufacturers. This past year we gained the Chinese manufacturers Chang'an, GAC-Group and Geely as new customers for our latest air quality sensors. These were installed in several new models, creating an excellent basis for future business. We currently have a production area of 2,600 square meters in Kunshan. Starting in fiscal year 2018, the new particle sensor will be an additional growth driver. The discussions with various manufacturers for a series order have made great progress.

Our current generation of high-quality hands-free microphones have enjoyed increasing demand since the first half of 2016. In conjunction with other components, such as the innovative beltmic®, we are currently developing a revolutionary sound system that is based on bus technology. It represents the next generation of high-end automotive acoustics and will launch in 2018. Initial prototypes, with a modular and scalable sound system architecture and a range of additional features, will be produced this year. We have set the goal of offering the world's best sound system to automotive manufacturers.

With our MirrorPilot®, we can supply an important part of the human-machine interface in cars. This will become increasingly important in the automotive value chain as the trend for connectivity grows. The system is highly scalable, modularly structured, and enables manufacturers to develop a multiplicity of new, cloud-based business models with the wireless connection provided by the smartphone.

Multiple projects in our Body Kinematics unit relating to drive systems for freely adjustable rear spoilers for sports cars reached series production maturity in the past fiscal year. Serial production will begin in the first quarter of 2017. These will be produced on about 1,300 square meters of production space at our Artegastrasse site in Delbrück. This is an important step for the development of adjustable chassis components that improve the aerodynamics in these sports models as well as other vehicle types. Weight and aerodynamics will play a greater role for all cars in the future as they will be the decisive factors for a car's range.

The Electromobility segment experienced dynamic growth of its own in the past fiscal year. A core team of more than 65 specialized developers, constructors, testing engineers and production experts in Delbrück (Germany) and Austin, Texas (USA) develops and produces safe, high-performance lithium-ion batteries for use in special application areas in the capital goods industry. Here, the Voltabox team can draw on our long-established Group experience in the development and industrial series production of electronic component groups for the automotive industry, such as sensors and control devices. With revenue growth of 93%, our strategy of working with strong cooperation partners to concentrate on particular submarkets at an early stage has paid off, as these markets already show concrete demand for modern lithium-ion batteries. This means we are not dependent on the car market's conversion to e-mobility and its associated development of a charging infrastructure.

In the past fiscal year, we installed more than double the energy in the market than in the prior year – roughly 9 megawatt hours. If this were translated to the electric car market, this would approximately correspond to the energy capacity of all BMW i3 registered in Germany from January to July. Thanks to our niche strategy in e-mobility, we can already post an average annual growth rate of about 62% since starting our activities in 2013. As a result, electrification has become a core component of our Group portfolio. The large power poles next to the street on the cover of this year's report highlights this. In addition to use in trolleybuses in the field of public transportation, use in forklifts in the intralogistics industry also made a notable contribution to growth in 2016. Furthermore, the Voltabox team also started offering tailored battery modules for the North American intralogistics market this current fiscal year. Finally, Voltabox is present in the automated production industry with specialized battery systems – an environment in which we feel right at home. The first deliveries for KUKA's automated guided vehicles will occur in the first half of the current fiscal year.

The previously largest single order in the company's nearly 30-year history came last year from Joy Global, a leading supplier of mining equipment and services. In the first phase of this initial 10-year strategic partnership with mutual exclusivity, our American Voltabox subsidiary will develop intelligent battery systems for various underground mining vehicles and machinery. The advantages of lithium-ion technology, the forward-looking energy system design, the active thermal management and the intelligent battery management from Voltabox provide these vehicles and machines with performance and cost benefits that simply aren't possible with any other drive technology available on the market today. This will completely change the landscape of underground mining. The first prototypes are being delivered in the summer of 2017 and will be subjected to comprehensive quality assessments and approval processes. From 2018, this major application area will then significantly contribute to further revenue growth.

These dynamic developments have led us to expand the organizational framework for our future business activities true to the motto “structure follows strategy”. The business units of the paragon Group are now organized under the following operating segments as of January 1, 2017: Electronics (the Sensors, Acoustics and Cockpit units), and Electromobility and Mechanics (Body Kinematics unit and the production company productronic GmbH). This allows us to more quickly implement our dedicated growth strategy. We are also increasing transparency in our external financial reporting by introducing a correspondingly adjusted segment report in this current report.

The organizational improvements are also tied to another optimization of the operational processes. These will be ensured with the successive introduction of agile project management as part of our internal project “paragon process ideal”. Alongside this, we made the necessary personnel expansions. We are pleased that we were able to gain a number of highly qualified and motivated new employees and welcome them warmly as new members of the paragon family. We improved the operational infrastructure for our business activities with the introduction of Microsoft Dynamics AX as a unified ERP system in our Group-wide IT landscape.

We also created the necessary spatial conditions for this organizational growth at our headquarters in Delbrück and expanded our production facilities and offices at Artegastrasse in 2016. We now have 1,560 square meters of production space available here for e-mobility. We have another 1,280 square meters of production space with Voltabox of Texas, Inc. With the new, highly automated production line for battery modules in Delbrück and the expansion of the same line in Austin, Texas (USA) planned for this year, we will quadruple our production capacities in this segment. We are thereby optimally equipped for the next phase of growth.

At the beginning of October, we increased the company’s share capital from authorized capital by 10% at a placement price of € 32.50 per share to better take advantage of current business opportunities in dynamically growing submarkets. The share offer was oversubscribed three and a half times, and we added new qualified investors from Germany, the U.K., France, Spain and Finland. This degree of oversubscription within such a short time impressively reflects the great interest on the capital market in our unique growth story. With our new investors, we have paved the way for the next stage of corporate development, where we aim to advance our Electromobility operating segment more quickly with an improved balance sheet structure.

We have already used a portion of the funds from the capital increase and increased our investment volume in 2016 to about € 23 million. New products, such as the particle sensor DUSTDETECT® will therefore be brought to market more quickly than initially planned. New technical ideas will also reduce the costs of conversion for battery systems and microphones. Lastly, environmental and safety aspects as well as surface area expansion work have led to higher construction costs for the building expansion in Delbrück. Overall, we now have more than 5,600 square meters of production and storage space at this site. productronic GmbH has been allocated about 850 square meters for mechanical manufacturing, along with 9,500 square meters in our main facility in Suhl, 2,900 square meters at the plant in St. Georgen and 1,050 square meters at the Bexbach plant. As a result, the entire paragon Group currently possesses nearly 25,000 square meters in production and storage space. By the end of 2016, the number of production robots in use across the Group had risen to 21.

With our figures for 2016, we are well on our way to continuing our special growth story and maintaining growth that outpaces the market by a considerable margin. Specifically, we expect revenue of € 120 million to € 125 million and an EBIT margin of 9.0% to 9.5% for the current year. This will be predominantly achieved this year by the Electromobility operating segment, while the Electronics operating segment and, to a lesser extent, the Mechanics operating segment will contribute to Group growth more strongly in 2018 and beyond.

In the current year, we will be keeping an eye on certain topics, such as the effects of the Brexit decision and the reorientation of U.S. economic policy. We have no commercial premises in the United Kingdom and our direct sales to British premium markets totaled only around 3.1% of Group revenue in fiscal year 2016. We therefore expect that the British exit from the EU will not lead to any direct impairment of our business development.

We also do not see any specific risks for our business stemming from the future economic policies of the new U.S. government. We currently do not expect a drop in sales for our most important customers in the U.S. market related to potential protectionist policies. Our risks from such negative effects would be relatively small in any case due to our specific customer/product structure. However, we would benefit if, as the Trump administration announced, mining were promoted in the U.S. Joy Global is a leader in this market and one of our key U.S. customers.

We would like to take this opportunity to thank all employees for their outstanding work and our business partners, customers and shareholders for their trust

Klaus Dieter Frers
Chief Executive Officer

Dr. Stefan Schwehr
Chief Technology Officer (Electronics)

Extension of the office building in Artegastraße in the summer of 2016 (Development Voltabox and Body Kinematics)

Extension of the production building in Artegastraße in the summer of 2016 (expansion of manufacturing and storage areas for the Electromobility and Mechanics segments)

1857: Ozone Tube | Werner von Siemens

The German inventor and industrialist Werner von Siemens (1816 –1892) is regarded as the father of modern electrical engineering. He discovered the dynamo-electric principle and provided groundbreaking inventions, including the ozone tube. Werner von Siemens developed this apparatus, which uses electrically generated ozone to clean drinking water, in 1857. He believed the ozone tube had a promising future, since it made it possible to subject gases to electrolysis. This meant that chemical compounds could be formed using various gases.

paragon used this operating principle in the Sensors unit to develop the Ionair air enhancement system. It cleans the air in the vehicle interior and provides a fresh-air effect. By actively improving the air quality in the vehicle cabin, paragon ensures the well-being, safety and health of passengers.

Shaping E-mobility
Interview with Jürgen Pampel

Mr. Pampel, you have been working at the paragon Group for many years now and have held a wide variety of positions. You are currently responsible for sales at Voltabox. What is paragon's special appeal and what is the common thread tying your different positions and responsibilities together?

I find that the company provides me with conditions that optimally fit my personal style of working, my approach and my own desire for knowledge-based engineering work and an entrepreneurial freedom to act. The motivation and commitment of everyone working here are remarkably beyond the norm – and we feed off of that every day. All of this, coupled with fast decision-making processes, has deeply motivated me in all my previous positions at paragon and Artega, and continues to motivate me now at Voltabox.

The combination of electrification and mobility plays a key role for you. You are at the center of the most revolutionary shift in mobility since the invention of the wheel. How do you perceive the current market dynamics?

As far as the consumer market is concerned, momentum is still modest. The official registration figures from individual countries show that certain regions are already further along than Western Europe – particularly China, Scandinavia and Canada. In Germany only about 1,500 BMW i3 were registered last year, and around 1,900 of new registrations were for Teslas. On the whole, one could say that the growing hype around electric cars in the media has not yet found its way to the road. There are simply too many hurdles that remain before the big breakthrough can come – not just of a technological nature, but also with regard to the charging infrastructure and other framework conditions. We have therefore also continued to focus on other areas right from the beginning.

Can you briefly outline what makes the Voltabox approach to electrification unique?

Quite simply, we are looking for market niches where we can find real demand for our existing technologies. We do not want to "create" any markets and we certainly don't want to wait for markets to emerge. The submarkets that we focus on are in the capital goods sector and are driven by economically rational investment decisions. Diesel generators and lead-acid batteries are being replaced by modern lithium-ion batteries. They are not only much more environmentally friendly, but also much more cost-effective for the user over their entire service life.

At the same time, we view e-mobility as a whole. Not only does this include items like battery packs, but also power electronics, such as inverters, charge regulators, voltage converters and, of course, highly efficient electric motors. The market niches that we target all have particularly high demands regarding the safety, reliability and performance of our battery systems. Providing this is no easy feat. It requires a great deal of technological and application-oriented understanding of the respective end-customer applications.

Can you provide an example of this?

Imagine a modern gas pedal in a car that electrically, rather than mechanically, controls the gasoline injection and thus the vehicle speed. As a driver, you want to be able to rely on error-free functionality in every traffic situation because your life depends on it. As simple as this sounds, the development of such inherently safe functional units requires a great deal of know-how with regard to the control and regulation systems involved.

It is the same with our lithium-ion battery systems, which are used in public transport in addition to other applications. One hundred percent reliability is the basic prerequisite for the safety of passengers and users – and therefore also for our development engineers. Then there are, of course, the "normal" technological requirements for the design of the battery systems, such as a robust design for extremely harsh operating conditions – for instance in underground mining. This is where paragon's nearly three decades of experience as an automotive supplier come into play. Nevertheless, the first step was the most difficult...

That certainly applies to all start-ups… What was different at Voltabox and how did you enter the first market niche?

There were a number of different factors. We made the basic decision to enter the e-mobility market in the summer of 2011. At that time, we of course looked at the current market situation and the development status of lithium-ion technology. We very quickly came to the conclusion that coupling traditional paragon expertise in the field of complex control systems with modern power electronics was the perfect combination for the electrification of sophisticated mobility applications. That gave us the green light for developing our modular development approach. Early on, we were still licensing parts technology to speed up the transfer of expertise. This saved valuable development time and enabled us to present the first converted Eco-Carrier utility truck with its own Voltabox lithium-ion battery system at the IAA Commercial Vehicles 2012. The first major order came shortly after from Vossloh Kiepe for the development of lithium-ion battery systems for trolleybuses in Geneva.

So, having strong market partners as multipliers is part of the Voltabox recipe for success?

Absolutely! We are so pleased with the great partnerships that we have. While close cooperation at every level is also part of the daily routine for the Electronics and Mechanics operating segments in their work with the automotive manufacturers we have been supplying to for a long time, everything is new in Electromobility – and that is the fascinating thing about this operating segment. That is also why we, together with our project partners, are always confronted with the challenge of questioning existing solutions and further optimizing them to the application in question. Sometimes the spe-

The Voltabox headquarters in Germany

cifications change during the project, because the end result simply becomes better for the end user. All project partners benefit from this.

Can you take advantage of synergies that strengthen your competitive position in the dynamic e-mobility market?

Synergies are of course very valuable to us – particularly for maintaining our competitive advantages as long as possible. Externally, good business relationships are essential. These provide new important contacts. In the end, the young market for e-mobility is still very modest and word about new developments spreads quickly. Being embedded in the paragon Group is very helpful for us, as this clearly separates us from the "garage start-ups." Internally, we have created the synergies ourselves. Thanks to our modular development approach, we don't always have to start from scratch with new applications and can offer optimal, tailor-made solutions even for highly complex applications. We are constantly learning and constantly improving our battery systems with regard to design and software management. We can pass advances in cell technology directly on to our customers because our systems are not dependent on specific cell types – we call it "cell agnosticism." Last but not least, the addition of the highly automated production line this year once again provides a clear leap forward in quality for the mass production of battery modules.

And what about the personnel at Voltabox? After all, this enormous growth also has to be properly managed. You need good, motivated people to do this…

E-mobility is a very young discipline and this also applies to our developers, designers, test engineers and production experts. Everyone working here strives to find the best solutions every day. They do this with a great deal of personal commitment and achieve truly excellent results. This has created a unique culture at Voltabox that provides some freedom for trial and error and is characterized by a very respectful and cooperative atmosphere. In addition, the almost daily coordination with our colleagues at Voltabox of Texas in the U.S. provides an increasingly international start-up atmosphere that would otherwise be expected in Berlin, Hamburg or Munich. In fact, four developers were recently sent to Austin, Texas, for a year to support the development of Joy Global. Such moves also attract new young talent. Last year, we gained 20 highly qualified new employees at Voltabox.

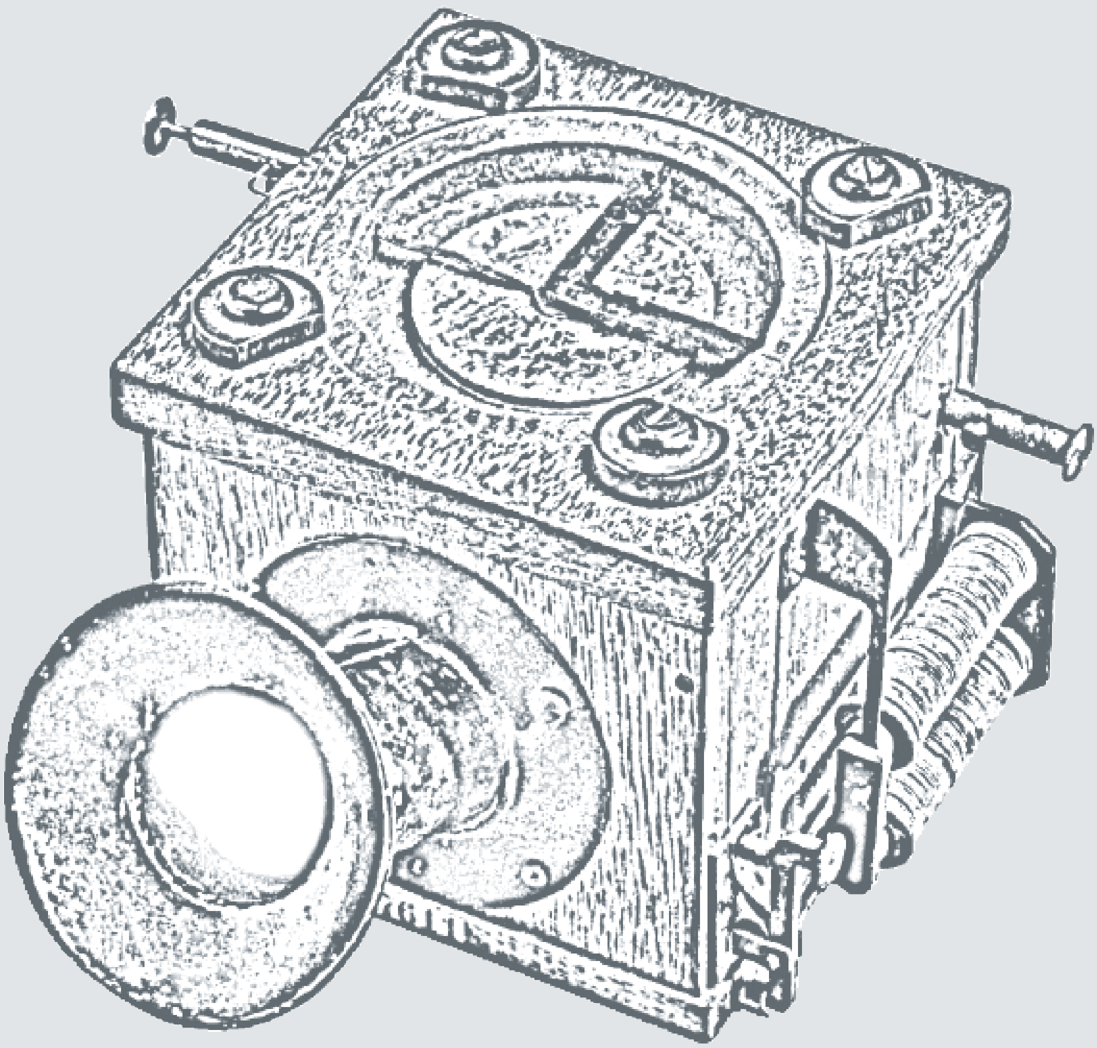
That sounds very promising. What's next for e-mobility? Will you enter the mass car market when it starts taking off?

We have been growing at an average annual rate of around 62 percent since 2012. And that's just with our first two applications: trolleybuses and forklifts. This dynamic growth shows the great potential of niche markets – and we are keeping a close eye on quite a few others. These include agricultural and forestry vehicles, utility vehicles for public utilities and waste disposal, construction vehicles and machinery, airport service vehicles, and so on. These will allow us to keep our growth dynamics at a very high level over the next few years. We are, in fact, already present in the consumer market with our starter batteries for motorcycles. Serial production will start in the second quarter of this year. We will continue to examine whether other market opportunities for our business model arise in the consumer market, such as with modern 48V lithium-ion battery systems for hybrid vehicles. One important prerequisite here is that we do not endanger our market position as a quality leader by giving into the price pressure typical of the mass market.

Mr. Pampel, thank you very much for the stimulating conversation. We wish you and your colleagues at Voltabox all the best and every success in shaping the company's future growth.

The Voltabox headquarters in Texas

1861: Origin of the Microphone | Philipp Reis



The German physicist and inventor Philipp Reis (1834 –1874) is mainly remembered for creating the first functioning device for transmitting sounds via electrical wires. He is therefore considered a key forerunner in the invention of the telephone. As part of his work, Philipp Reis also invented the contact microphone in 1861.

Philipp Reis used a wooden model of an ear when creating his device for electrically transmitting sound. The “eardrum” was a piece of natural gut casing with a thin platinum strip as a substitute for the auditory ossicle.

paragon’s state-of-the-art versatile hands-free microphones ensure that voice and data are transmitted in the vehicle without loss of quality. The latest products from the Acoustics unit stand out with features such as adaptive wind suppression, outstanding directional characteristics and high-precision transmission.

paragon | Investor Relations

Capital Market Environment

In the past year, the capital market was subject to a number of currency-related and geopolitical influences at the international level. Market participants regularly had to adapt their expectations to political developments, which led to an overall uneven performance in the stock markets.

The first quarter was characterized by volatile investor sentiment. This led to fluctuations, in some cases substantial, in German share prices. Professional investors adopted a neutral position, while foreign investors increasingly withdrew.

In the second quarter, the capital market was characterized by rapid mood swings. This was accompanied by a generally high level of uncertainty, and from June onwards it has been increasingly overshadowed by the U.K. Brexit referendum. While institutional investors were still largely expecting a further decline in prices in April, general market sentiment visibly improved again in May. After subsequent profit-taking, market participants became more inclined to take risks as confidence in a positive outcome for the referendum increased again from mid-June onwards. The victory achieved by those U.K. voters who preferred to leave the EU in the referendum on June 23 therefore came as a surprise for many investors. This led to, among other things, a pronounced downturn in the stock market at the end of June. Uncertainty about the macroeconomic impacts of this decision guided investor behavior.

As the third quarter started, the German capital market was still experiencing profit-taking while investor sentiment was growing increasingly dim. In addition to various geopolitical risks, one key aspect behind these trends was an increasing focus on maintaining cash reserves, which reached their highest levels since 2001. As this consolidation phase continued, overall sentiment remained uneven. In mid-August, market sentiment briefly improved, which could be largely attributed to the expansive monetary policies of the Bank of England. Short-term commitments dominated the markets while fundamental and technical indicators performed inconsistently. But by mid-September, investor sentiment was improving once again.

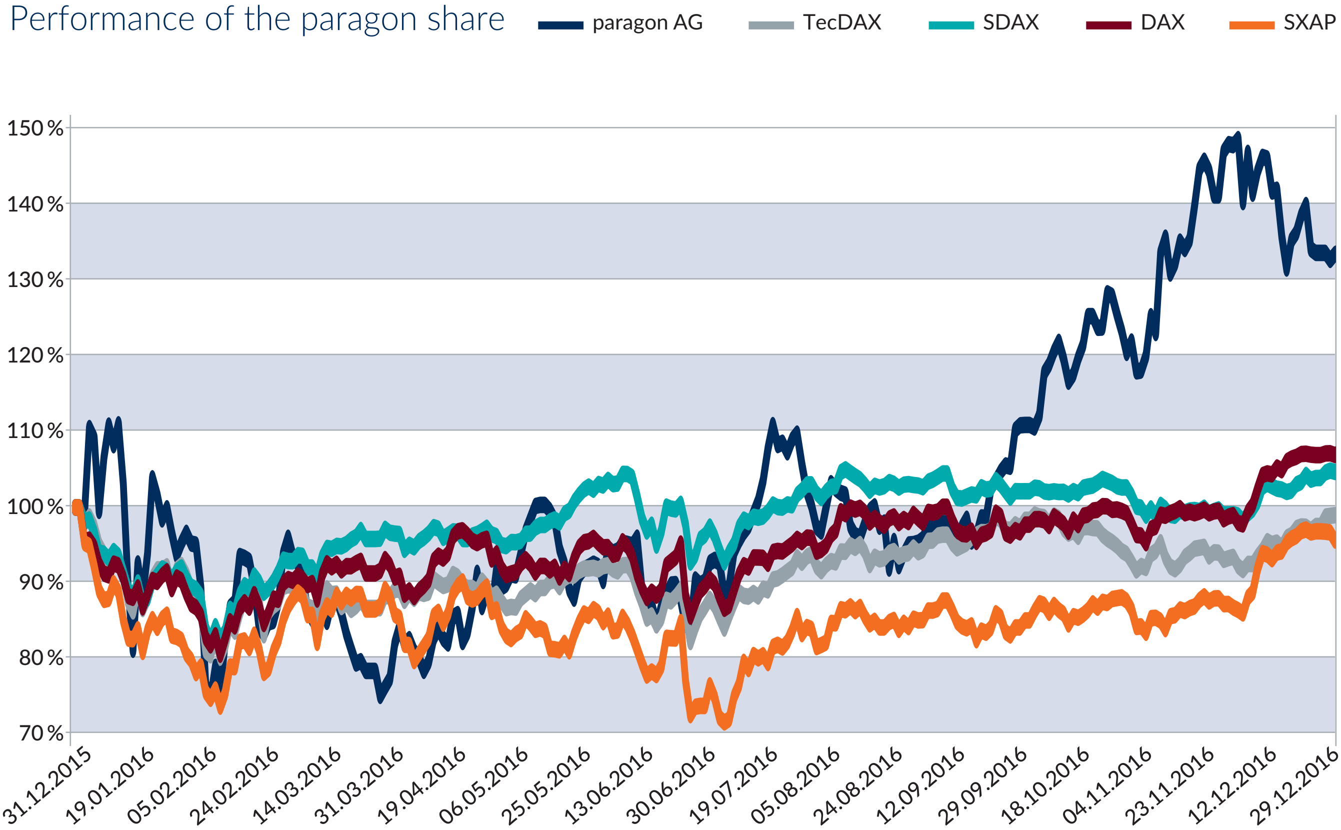
The final quarter of the year began with a continuation of the sideways trend, with market participants primarily assuming a neutral position. Particularly the weakness of the banking sector and the expectation that the European Central Bank would successively end its quantitative easing program impacted market sentiment. Despite the surprising result of the U.S. presidential election on November 8, the market developed positively in November. Due to lacking momentum, however, foreign investors mainly exercised restraint. In December, optimism spread among market participants in expectation of a year-end rally, which led to a general rise in the markets. At the end of the quarter, there was increased profit-taking to secure positions.

Share Price Performance and Trading Volumes

The price development of the paragon share was carried by increasingly positive dynamics in the past fiscal year. With an Xetra closing price of € 41.53 as of the reporting date (prior year: € 31.44), the share achieved a price increase of 32.1%. This corresponds to a growth in the company's market value of about € 58.6 million when taking into account the capital increase in October.

The paragon share was unable to escape the effects of the volatile and weaker overall market climate in the first quarter. Starting at an opening price of € 31.73, the share initially rose past the € 35 mark in mid-January, but nevertheless closed the quarter at € 24.90, not far

Performance of the paragon share



from its period low. This corresponds to a stock market value of around € 102.5 million for paragon AG as of the reporting date.

In the challenging market environment of the second quarter, the paragon share proved to be a comparatively stable investment with a value appreciation of 16%. With an opening price of € 26.06, which was close to the quarterly low of € 24.98, the share clearly exceeded the psychological barrier of € 30 again in mid-May and peaked at € 31.54. The quarter ended with a closing price of € 28.52, which corresponded to a stock market value of approximately € 117.3 million.

The paragon share finished the third quarter by posting above average-growth with a value increase of 22% in an overall positive market environment. The opening price of € 29.26, which was close to the quarterly low of € 28.00, was initially followed by a dynamic upward trend, peaking at € 34.70. This period ended in July and was succeeded by a consolidation phase that lasted through mid-September. However, the peak price of € 34.70 was achieved once again by the end of the quarter, which led to a stock market value of about € 142.8 million for the company.

In the final quarter, the paragon share again experienced particularly strong growth – up 20% despite a capital increase in October. From the opening price of € 34.70, which was close to its lowest price for the quarter of € 34.60, the share performed incredibly in October and November until reaching a new high at the start of December of € 46.00. December was characterized by profit-taking which resulted in a closing price of € 41.53 to end the year. This corresponds to a stock market value for the company of about € 188.0 million at the end of the year.

The trading volume developed stably over the course of the year and was in line with the overall market. While the summer months traditionally show reduced trading volumes, there was a considerable increase in activity in the fourth quarter due to the broadened shareholder base resulting from the capital increase. For the year, an average of nearly 10,000 shares were traded daily via the trading platforms of the Deutsche Börse AG and this accounted for about 70% of all trading activities. Trading via dark pools (i.e., internal bank and stock exchange trading) was therefore relatively low. The number of brokers actively trading paragon shares tripled over the course of the second half of the year.

Capital Increase

On October 4 of the past year, with the approval of the Supervisory Board the Management Board resolved a capital increase of 10% under partial utilization of the authorized capital. This was intended to support the company's planned dynamic growth in existing sales markets and its tapping into new submarkets as well as provide a balance sheet structure befitting of this growth.

The new shares were offered to qualified investors via an international private placement and were placed with an approximate oversubscription ratio of 3.5 in Germany, the U.K., France, Spain and Finland as well as with the company's CEO, majority shareholder and company founder Klaus Dieter Frers.

Upon completion, the company's share capital increased by € 411,478.00 to € 4,526,266.00 via the issue of 411,478 new no-par-value shares with a nominal value of € 1.00 each and full entitlement to dividends from January 1, 2016.

The resolution to implement the capital increase by the Management Board on October 5, 2016, was approved on the same day by the Supervisory Board. It was entered into the commercial register at Paderborn District Court on October 6, 2016. The share capital of the company now amounts to € 4,526,266.00.

The company now has access to the remaining authorized capital 2016/I of € 1,645,916.00 as of the reporting date.

Corporate Bond

In July 2013, paragon AG issued a corporate bond denominated in euros with a term lasting until July 2, 2018, and an annual interest coupon of 7.25%. It is tradable under WKN A1TND9 or ISIN DE000A1TND93. The corporate bond was traded at an average of 7.3% above its initial issue price throughout 2016. It closed the year trading at 106.1% of the issue price. The yield for the remaining term therefore amounted to approximately 3% on December 31, 2016. The rating of BB+ for paragon AG by Creditreform Rating AG expired on May 29, 2016. An extension was not requested.

Financial Communications

In the past fiscal year, the company reorganized its Investor Relations department with the development of internal capacities. This allowed the company to solidify and further expand its ongoing communications with institutional and private investors. Particularly in connection with the capital increase, existing and new shareholders made extensive use of the company's offer for direct dialogue at the Management Board and Investor Relations level.

A total of 193 individual meetings were held with institutional investors from Germany, the U.K., France, Finland, Sweden, Denmark, Luxembourg, the Netherlands, Switzerland, Austria, Italy, Spain and Poland. Over the course of the year, five research houses (prior year: four) published a total of 21 studies (prior year: eight) on paragon AG.

The company sees effective financial communication as the targeted reduction in the asymmetric flow of information between management and shareholders on the current economic situation and specific future potential of paragon AG. Accordingly, the ongoing dialogue with capital market participants is given a high priority. Furthermore, the company aims to provide the broader public with up-to-date and relevant information via diverse media channels.

In the current fiscal year, the expanded group of institutional investors will be accounted for with increased participation in investor and analyst conferences and road shows. Additionally, the company welcomes the new studies and evaluations from research institutions.

1973: Cell Phone | Martin Cooper

The American electrical engineer Martin Cooper (born in 1928) made a name for himself as the inventor of the cell phone. The son of Ukrainian immigrants, he worked for ten years at Motorola on a device with which he made the first cell phone call on April 3, 1973. The cell phone he used weighed about two kilograms, had no display and allowed a talk time of 35 minutes.

The rise of mobile communication led to a host of paragon product developments in the Cockpit unit. This includes the MirrorPilot, which combines different functions for integrating smartphones into vehicles. The product offers the full range of infotainment features including integration of navigation, telephone, music, news and internet radio and can replace the head unit in smaller vehicle classes. A universal charging tray allows wireless charging of smart-phones.

Supervisory Board Report

Prof. Dr.-Ing. Lutz Eckstein, Supervisory Board Chairman

Monitoring and Consulting in Continuous Dialogue with the Management Board

The Management Board and Supervisory Board of paragon AG uphold the obligation highlighted in the German Corporate Governance Code (GCGC) of ensuring the continued viability of the company and its sustained value creation (corporate interests) in conformity with the principles of the "social market economy". There were no conflicts of interest among the Management Board or Supervisory Board members in fiscal year 2016. The mandates of the Supervisory Board members are listed in the notes (note 44).

The Supervisory Board of paragon AG fulfilled the consulting and monitoring obligations incumbent upon it according to law, the Articles of Association, German Corporate Governance Code and rules of procedure with great care in fiscal year 2016. Here, the Supervisory Board supervised the company's management on an ongoing basis and made sure of its legal and regulatory compliance, appropriateness and effectiveness. Furthermore, the Supervisory Board was available to the Management Board for consultation and was involved in discussions and decisions regarding issues of material importance. Thanks to the good cooperation between the Supervisory Board members, even time-sensitive decisions were resolved quickly.

In February 2017, the Management Board and Supervisory Board updated the company's Declaration of Compliance according to Section 161 of the German Stock Corporation Act (AktG) and made it publicly available on the Investor Relations page of the paragon AG website. The deviations from the recommendations of the GCGC and additional information on corporate governance at paragon AG are also provided here.

The Management Board comprehensively informed the Supervisory Board in written and oral form in the Supervisory Board meetings on all proceedings of material importance, the company's general performance and its current situation. Here, it gave particular priority to the topics of strategy, planning, business development, risk situation and risk management. The Supervisory Board intensively reviewed the Management Board's reports and discussed them at its meetings. In addition to the Supervisory Board meetings and conference calls involving all members of the Management Board and Supervisory Board, the Supervisory Board Chairman and the Management Board discussed important matters when necessary. The Supervisory Board was fully informed about exceptional instances that were of material importance for assessing the year's results.

Supervisory Board Meetings

In fiscal year 2016, the Supervisory Board convened at four ordinary plenary meetings and held three conference calls. All Supervisory Board meetings were held with the participation of the Management Board. All of the Supervisory Board's conference calls were held with the participation of the CEO. The entire Supervisory Board was present for every meeting.

The focus of the first ordinary meeting of the Supervisory Board in Delbrück on March 3, 2016, was the assessment and verification of the annual financial statements for fiscal year 2015 as well as the assessment and approval of the consolidated financial statements for fiscal year 2015. The Supervisory Board also dealt with the nomination of the auditor for fiscal year 2016 and recommended Baker Tilly Roelfs AG Wirtschaftsprufungsgesellschaft, Düsseldorf, as the new auditor. During this meeting, the Supervisory Board also discussed the agenda of the Annual General Meeting and approved the invitation proposed by the Management Board. Finally, the Supervisory Board was informed about current business developments.

In its second meeting in Hövelhof on April 26, 2016, the Supervisory Board was informed about the company's performance in the first quarter and its current prospects. Further preparations for the Annual General Meeting were also on the agenda.

At its third meeting in Delbrück on August 15, 2016, the Supervisory Board discussed possible capital enhancement measures presented by the Management Board. It was also informed by the Management Board on the company's performance in the first half of 2016 and its current outlook.

During the first conference call on October 4, 2016, the Supervisory Board approved the Management Board's resolution to increase the company's share capital by € 411,478.00 to € 4,526,266.00 via the issue of 411,478 new no-par-value shares with a nominal value of € 1.00 each and full entitlement to dividends from January 1, 2016.

In the second conference call on October 5, 2016, and upon completion of the accelerated book building process, the Supervisory Board approved the resolution of the Management Board to set the issue price for the new shares at € 32.50 per share.

In its fourth meeting in Aachen on November 18, 2016, the Supervisory Board focused on the business developments from the first nine months and the company's current prospects. It also discussed the planning for fiscal year 2017 presented by the Management Board as well as the scheduling of the financial calendar for 2017.

During the third conference call on December 15, 2016, the Supervisory Board consulted with the Chief Executive Officer on the planned reorganization of internal management to take effect on January 1, 2017, by arranging the business activities into three operating segments: Electronics, Electromobility and Mechanics.

Forming Committees

As in the past, the three-member Supervisory Board did not form any committees in fiscal year 2016 and dealt with all issues as a single body.

Audit of the Annual Financial Statements and Consolidated Financial Statements for Fiscal Year 2016

Baker Tilly Roelfs AG Wirtschaftsprüfungsgesellschaft, Düsseldorf, was appointed by resolution of the Annual General Meeting on April 27, 2016 as auditor for the fiscal year from January 1 to December 31, 2016, and accordingly commissioned by the Supervisory Board Chairman. The Supervisory Board was provided a statement of independence from the auditor pursuant to No. 7.2.1 of the German Corporate Governance Code.

The scope of the audit included the annual financial statements prepared by the Management Board pursuant to the provisions of the German Commercial Code (HGB) for the fiscal year from January 1 to December 31, 2016, and the management report of paragon AG as well as the consolidated financial statements prepared by the Management Board pursuant to Section 315a HGB and on the basis of the International Financial Reporting Standards (IFRS) for the fiscal year from January 1 to December 31, 2016, and the Group management report of paragon AG.

Upon completion of the audit, Baker Tilly Roelfs AG Wirtschaftsprüfungsgesellschaft, Düsseldorf, provided an unqualified audit certificate for the annual financial statements and the management report of paragon AG as well as for the consolidated financial statements and Group management report of paragon AG.

The auditor also determined that the information and monitoring system established by the Management Board meets the statutory requirements and is suitable for recognizing developments that could endanger the continued existence of the company at an early stage.

The auditor made the documents submitted for auditing the annual financial statements, the management report, the consolidated financial statements, the Group management report, the proposal on the appropriation of the net income for the year and the report on the audit available to every member of the Supervisory Board. The audit was reported on and discussed at the Supervisory Board meeting on March 17, 2017. The auditors participated in the discussions on the annual and consolidated financial statements. They reported on the key audit results and were available to the Supervisory Board to answer any questions and provide additional information. Based on the final outcome of its examinations, the Supervisory Board approved the annual and consolidated financial statements.

The Supervisory Board also assessed the proposal from the Management Board on the appropriation of the balance sheet profits at its meeting on March 17, 2017, and discussed this with the auditor. The Supervisory Board subsequently agreed with the Management Board's proposal.

The Supervisory Board did not exercise its right to inspect the company's accounts and correspondence in the past fiscal year.

The Supervisory Board expresses its gratitude and appreciation to the members of the Management Board and all of the Group's employees for their hard work and personal commitment in 2016.

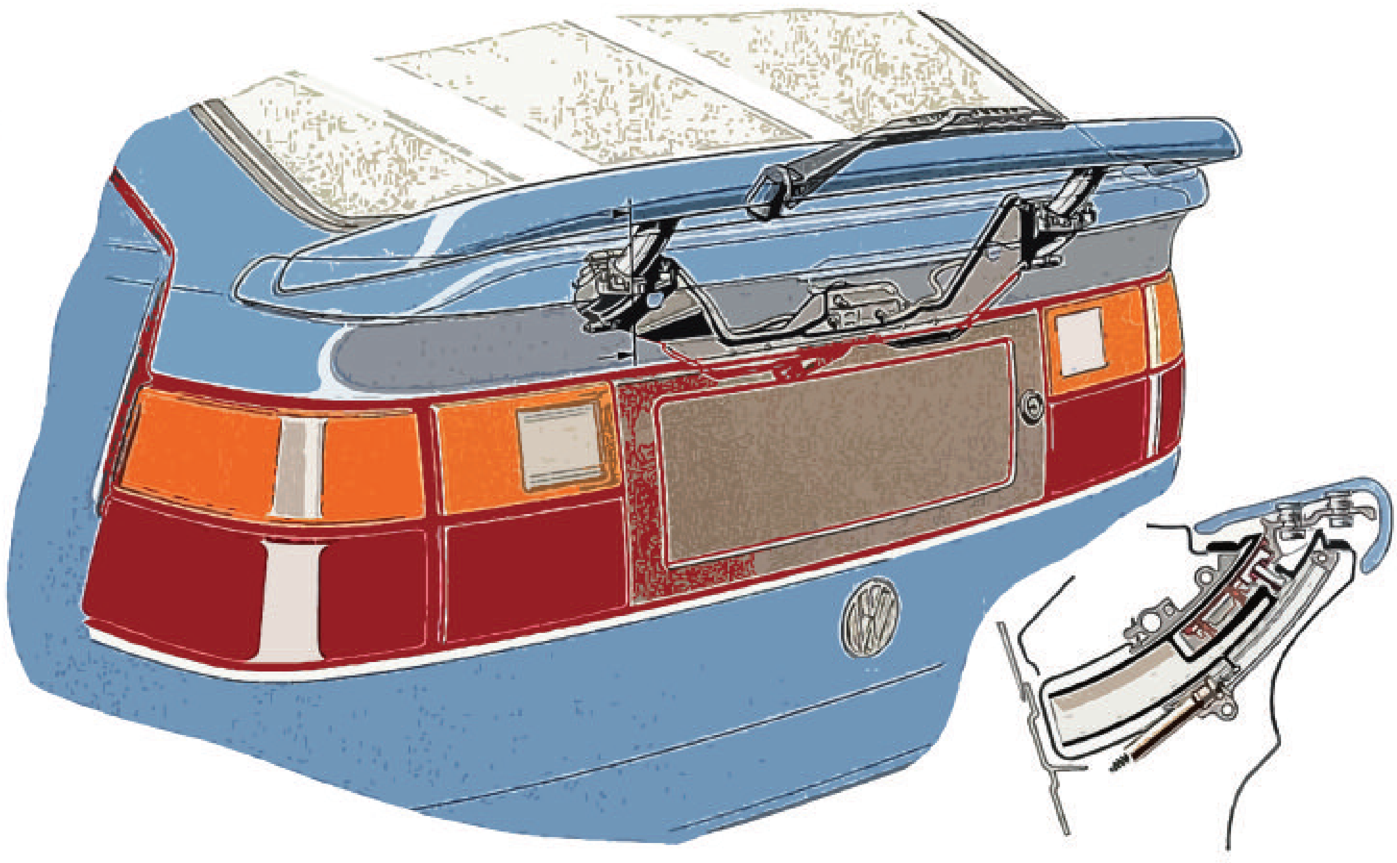
Delbrück, March 17, 2017

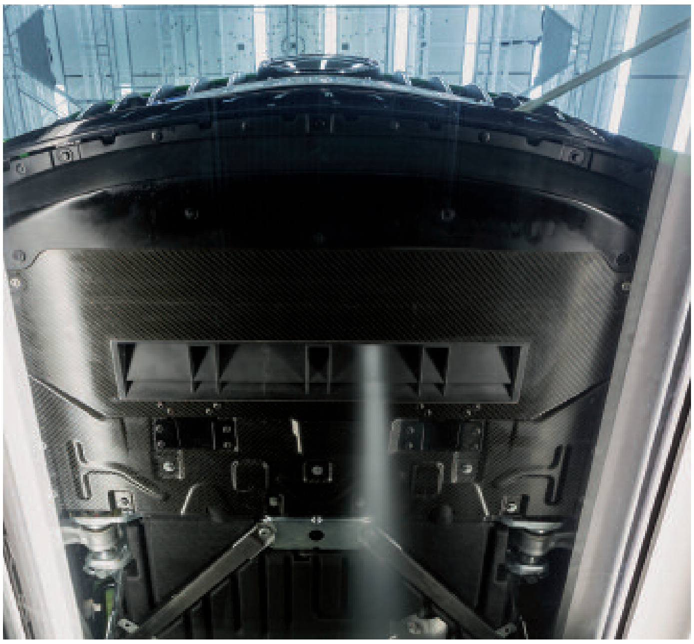
For the Supervisory Board,

Prof. Dr.-Ing. Lutz Eckstein

Supervisory Board Chairman

1988: Adjustable Rear Spoiler | VW





In 1988, the German automotive manufacturer Volkswagen fitted the VW Corrado with the first adjustable spoiler. The spoiler directed airflow and optimized the aerodynamics of the vehicle.

The rear spoiler of the VW Corrado was automatically extended upon reaching a speed of 120 km/h and retracted at 20 km/h – significantly reducing lift on the rear axle. A button under the dashboard also allowed the rear spoiler to be deployed manually.

In the Body Kinematics unit, paragon recently developed a new aerodynamic system that is installed toward the front of the underbody. This feature reduces the lift on the front axles by a remarkable 50 percent at maximum driving speed. The carbon element automatically lowers when the vehicle reaches a speed of 80 km/h.

Group Management Report

Group Management Report

Key Facts About the Group

Business Model

According to its Articles of Association, the business purpose of paragon AG (hereinafter also "company") is the research and development of microelectronics, the manufacture and sale of electronic devices, their corresponding peripherals and component groups as well as the management of patents, licenses and utility models. The company can found or purchase other companies, hold interests in companies, establish branches and implement all other measures and legal transactions that are necessary or serve to achieve or promote the company's aims.

The business model of the paragon Group (hereinafter also simply "paragon") is based on the independent development of product innovations at its own expense. To achieve this, a proven innovation system is used to keep the current product portfolio at a very high level of innovation. With the overall vehicle expertise that has been built up over the last three decades in the paragon Group, developments and prototypes are characterized by a deep understanding of the entire automotive manufacturing process.

The basic inspiration for the company's product innovation is influenced by the core idea of enhancing the driving experience for passengers of modern cars (end customers). Relevant innovation drivers are systematically identified from global megatrends. This allows paragon to accurately anticipate the demands of end customers for modern features and characteristics in future models.

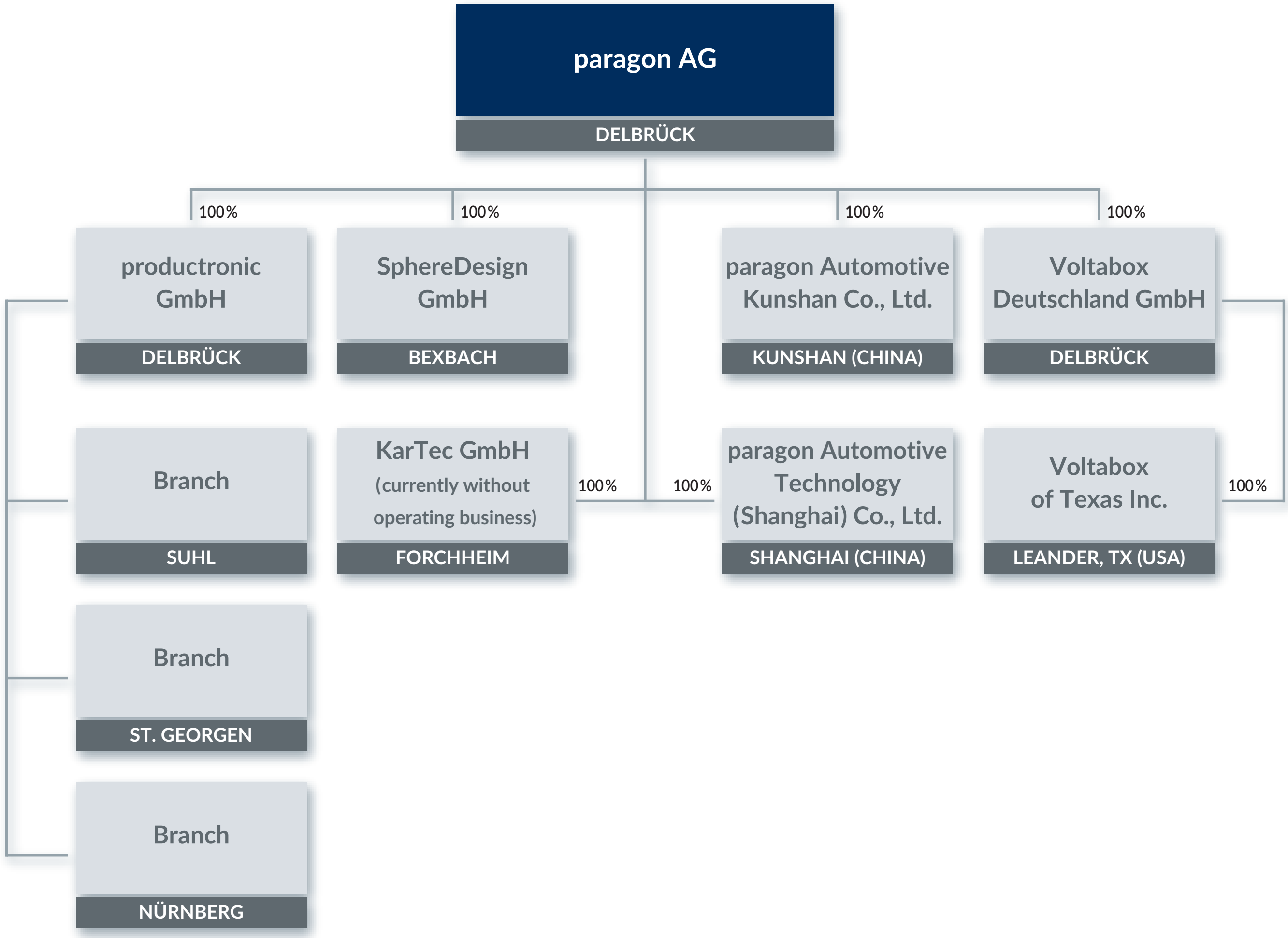
The market launch of product innovations follows the "push principle", where specific marketing with automotive manufacturers as direct customers only begins once functional prototypes (A-samples) and the corresponding patent applications have been established. This allows paragon to maintain a time advantage over its competitors even in shorter innovation cycles. With an optimized vertical range of manufacturing, paragon has also established itself as a reliable production partner for automotive manufacturers.

The level of automation in mass production is constantly being increased to improve the cost structure over the product life cycle of the individual product series. In this way, series production represents its own field of innovation within the company. At the end of the past fiscal year, 21 industrial robots were being used across the Group for manufacturing tasks.

Group Structure

paragon Aktiengesellschaft (hereafter "paragon AG") is a joint stock corporation incorporated under German law. The company's headquarters are in Delbrück, Schwalbenweg 29, Germany. paragon AG's shares are traded on the Frankfurt Stock Exchange in the Prime Standard segment. paragon AG has its administrative headquarters in Delbrück and central production facilities in Delbrück, Suhl, St. Georgen and Bexbach. It also has a branch in Nuremberg.

The scope of consolidation for the paragon Group (hereafter also "paragon") includes the wholly owned subsidiaries paragon Automotive Kunshan Co., Ltd.



(Kunshan, China), paragon Automotive Technology (Shanghai) Co., Ltd. (Shanghai, China), Voltabox Deutschland GmbH (Delbrück, Germany), Voltabox of Texas Inc. (Leander, Texas, USA) as well as SphereDesign GmbH (Bexbach, Germany) and KarTec GmbH (Forchheim, Germany).

Segment-specific Disclosures

The company's dynamic development was increasingly characterized by operative growth in the year under review. With the early adjustment of the organizational framework conditions, the requirements for future planned revenue growth have also been established along with the newly developed product innovations. This also made a reorganization of the Group's management structures necessary. The Management Board therefore organized the Group's activities into three **operating segments** effective as of January 1, 2017:

- **Electronics**
- **Electromobility**
- **Mechanics**

The **Electronics** operating segment comprises the previous Sensors, Cockpit and Acoustics units as well as the subsidiaries SphereDesign GmbH and paragon Automotive Kunshan Co., Ltd. Dr. Stefan Schwehr is the Management Board member responsible for this segment. This operating segment primarily develops and markets air quality sensors, instruments and microphones for the automotive industry.

The **Electromobility** operating segment contains the business activities of Voltabox Deutschland GmbH and Voltabox of Texas, Inc. CEO Klaus Dieter Frers is the Management Board member responsible for this operating segment. Here, battery systems based on lithium-ion technology are developed and marketed for specific applications in industrial markets.

The **Mechanics** operating segment comprises the Body Kinematics unit and the subsidiary productronic GmbH as well as the Group's material management. It is assigned to Dr. Burkhard Leifhelm, who is also the managing director of productronic GmbH. This operating segment primarily develops and markets electromechanical components for the automotive industry. Furthermore, this operating segment oversees the Group's mechanical manufacturing.

No comparative figures from fiscal year 2015 are provided in the segment reporting.

Corporate Strategy

paragon's corporate strategy is developed as part of a revolving process. This process involves the Management Board, the management of the operating segments Electronics, Electromobility and Mechanics and various staff positions, particularly in the financial department.

The strategic planning is based on the corporate mission statement of occupying lucrative market niches in the premium segment at an early stage. To accomplish this, technological innovations are developed based on existing megatrends in an institutionalized process. The growth potential that results from automotive manufacturers adapting to these megatrends in future model generations is addressed by the Electronics and Mechanics operating segments in a targeted manner.

From the global megatrends of climate change, urbanization, digitalization and electrification, paragon has derived priorities that are of central importance for R&D activities. As a result of global climate change, consumers are showing an increasing awareness for sustainability and health. Furthermore, the reduction of CO_2 emissions is supported by weight reductions and improved aerodynamics. Urbanization has led to a fundamental change in consumer behavior in terms of individual mobility and therefore to alternative mobility concepts, such as autonomous driving. In connection with the increasingly connected lifestyle due to advancing digitalization, themes such as security, comfort and connectivity are playing an ever growing role for car owners.

The rise of these megatrends is resulting in a dynamic shift in the automotive value chain. In this context, the importance of innovative product solutions from automotive suppliers is also rising on a system level. With increasingly shorter innovation cycles, new ecosystems are developing in the automotive industry that require horizontal integration and cooperation. Here, particularly in the Electronics operating segment, paragon addresses the fields for action that result from the changing demands of end customers.

In the Electromobility operating segment, the strategic focus is currently on submarkets for capital goods such as local public transport, intralogistics and automated guided vehicles. Here, existing submarkets are replacing their lead-acid batteries and diesel generators with modern lithium-ion battery systems. paragon can participate in the substitution effects in these submarkets that result from rational, economic investment decisions by the users. Market access in these submarkets is generally achieved through cooperation with leaders in the respective submarkets.

In the future, paragon will be expanding its focus in this operating segment to the submarkets of mining and mining vehicles, construction and agricultural machinery, vehicles for municipal services and airport service vehicles. As part of the global mass market for cars, paragon will soon address the segment for modern 48V lithium-ion battery systems for hybrid cars.

In summary, the paragon growth strategy comprises the following aspects:

- Constant development of product innovations based on megatrends (product development)
- Gaining new automotive manufacturers as customers (market penetration)
- Tapping into new sales areas (market development)
- Tapping into new submarkets with new product offers (diversification)

The competitive strategy of paragon can therefore largely be described as a niche strategy. This focus results in a high differentiation within the product portfolio. At the same time, the constant optimization of the company's automated mass production processes ensures cost leadership.

Control System

Alongside a high level of innovation, the organizational structure at paragon is characterized by flat hierarchies, fast decision-making and continual optimization of process management as part of the "paragon process ideal" (ppi) project. The Group has the character of an owner-operated, medium-sized company while combining a corresponding long-term strategic orientation with the integration abilities of a publicly traded company. Thanks to this unique organizational orientation, paragon is in position to successfully compete with substantially larger corporations and expand its position as a direct supplier to renowned automotive manufacturers.

The Management Board of paragon AG regularly compares the strategy pursued with the actual results achieved by the company. In review meetings, follow-up activities and optimization measures are determined at the management level as well as fundamental changes in direction when necessary.

In the year under review, production was spun off to optimize production processes throughout the Group. The goal of pooling paragon AG's domestic production activities in productronic GmbH is to have unified production management at the facilities in Delbrück, Suhl, St. Georgen and Bexbach. This should allow for a greater focus on efficiency, cost reduction and on minimizing error rates. The new structure, which pools paragon AG's production into a single subsidiary, also enables more professional management of the production processes, more detailed controlling of production costs and an optimal distribution of production across the various sites.

To provide the Group with a better overview of the economic situation as well as improved planning and management of operational processes, the ERP system Microsoft Dynamics AX is currently being rolled out across the Group. The system is already being used in the foreign sites in the U.S. and China. paragon AG has a comprehensive planning and control system for implementing its strategic planning into its operations. This includes constant monitoring of weekly, monthly and annual plans. Both the Management Board and the Supervisory Board of paragon AG receive a detailed report as part of a monthly review on business development. These reports document possible deviations from the planned figures in a target/actual comparison and provide the basis for decisions. Another important control instrument is the regular manager meetings, where the current developments in the individual business units and medium to long-term outlooks are discussed in addition to regular interdisciplinary and unit-related project status meetings.

Financial Performance Indicators

The Management Board regularly uses key figures to measure the economic success of the operative implementation of its corporate strategy. The control system takes into account the type and/or amount of one-time or extraordinary effects on the performance indicators, particularly regarding the new operating segments Electromobility and Mechanics. Due to these specific influences, the internal targets are generally set as bandwidths for measuring and managing operative performance, depending on the respective planning horizon. The relative development of the key figures consolidated revenue, EBIT margin and investments is observed using rolling medium-term planning that accounts for experience curve effects within a given corridor. Given the dynamic growth strategy, this facilitates forward-looking management in terms of both risk and opportunity-oriented corporate governance.

Group Revenue

The established range of electronic components offered on the market includes a broad portfolio of sensors, microphones and display instruments that are in various phases of their product life cycles. This is contrasted by the most recent product innovations, which represent future revenue drivers that are dependent on the launch of new car models or model generations by automotive manufacturers. A product's revenue contribution generally varies during the various phases of its life cycle. The take-rates of the products, which change over time, is another influencing factor.

paragon's business in the areas of e-mobility and adjustable body components, on the other hand, is aimed at young submarkets that are growing at different speeds. paragon has initially focused on premium sports cars in its development of drive controls for movable body components. These technologically challenging, safety-related products are currently being produced in relatively small quantities and their impact on revenue is correspondingly low. However, the significance of movable body components will continue to increase as aerodynamics and range also continue to grow in importance.

In the year under review, business in the Electromobility operating segment represents a significant share of Group sales. The future annual growth rates of revenue depend on the mix of the respective application areas. While trolleybuses use large and complex battery systems with multiple battery modules in larger quantities per order as part of project business, the manufacture of battery modules for use in forklifts comes closer to being definable as mass production.

As such, Group revenue is subject to a series of influences relating to type, scope and direction, which are all regularly evaluated. This fact is accounted for with the provision of a target corridor when providing forecasts.

EBIT Margin

EBIT represents Group earnings before interest and taxes and provides a general snapshot of a company's operative profitability or efficiency. Profitability can be compared over time and internationally – irrespective of varying financial structures and income taxes.

In terms of corporate management, however, EBIT is not defined by the Management Board as a stand-alone corporate monetary target (in absolute terms). Instead, the development of operative earnings is managed in such a way that the strategically defined growth course can be implemented with appropriate profitability. Taking into account the development of revenue, all relevant expenses are therefore included in the company's forward-looking management. This fact is accounted for with the provision of the EBIT margin as a relative key figure when providing forecasts. This means that medium-term planning also accounts for the dynamic effects that arise over time in expenditure and income positions.

Investments

For paragon, investments are a key performance indicator for managing the dynamic growth strategy as part of medium-term planning. Since this involves the long-term commitment of financial resources in property, plant and equipment and intangible assets, the investment decisions of the Management Board are made as a result of a structured and careful decision-making process. This process takes into particular account the impact of investment decisions on the non-monetary corporate objectives stemming from the corporate strategy. In addition to an early expansion into profitable market niches with independently developed product innovations that aim to take advantage of megatrends, the high technological and quality requirements in the serial production of large quantities is particularly relevant.

Furthermore, investment decisions are used to react to market developments within the framework of the dynamic growth strategy, thereby making the most of the potential for growth in the short and medium term. Finally, the investment decisions account for the Group's R&D activities. The forecast therefore shows the all planned investments to highlight the medium-term dynamics in the operational implementation of the growth strategy.

In the past fiscal year, paragon once again invested heavily in the further expansion of its business activities. Investments in intangible assets amounted to € 14.4 million (prior year: € 12.3 million). Of the development work capitalized of € 15.3 million (prior year: € 12.8 million), € 14.3 million related to own work pursuant to IAS 38 (prior year: € 11.8 million), about 40% of which can be attributed to the Electronics and Electromobility operating segments each and around 20% to the Mechanics operating segment. About € 0.6 million is attributable to the roll-out of Microsoft Dynamics AX as a unified Group-wide ERP system. Another € 0.5 million was distributed among various other projects.

Investments in property, plant and equipment amounted to roughly € 7.7 million (prior year: € 19.6 million). This amount was split between the expansion of the facilities at Artegastrasse and the Group-wide upgrading of technical equipment and machinery.

Non-financial Performance Indicators

As the company is strategically positioned as an innovative provider of technologically sophisticated and high-quality products and systems that are based on current megatrends, the Management Board also uses non-financial performance indicators as part of its corporate management. Employees and the areas of quality and environment are critical success factors for paragon in this respect.

Employees

The current megatrends are leading to a fundamental change in the value chain of the automotive sector. This also has an influence on the future qualification requirements of employees. The operational implementation of the growth strategy also necessitates an ongoing review and adaptation of both organizational and operational structures. At the same time, the business model of independently developing product innovations requires the targeted further development of the existing innovation culture within the company. Essential elements for this are the anchoring of entrepreneurial thinking and responsible, independent action along with barrier-free internal communication. Development processes are being converted to conform with the principles of agile project management in order to better meet the ever-shorter model generation and maintenance cycles of automotive manufacturers. Creativity, self-confidence and inspiration play a special role here. The formation of efficient project teams, even across different locations, has led to a typical start-up mentality. This is particularly the case among Voltabox employees given the dynamic market development in the field of e-mobility.

The successful sourcing, development and retention of qualified employees are therefore particularly important for the successful implementation of the growth strategy. In fiscal year 2016, 95 new employees were hired across the Group. Of these, 20 were hired by the Voltabox subsidiaries and 75 joined the other Group companies. As part of the hiring efforts, 55 new positions were created within the Group. The turnover rate was 11.8%. The share of female employees in the Group was down somewhat at 34.5% (prior year: 37.8%). At 31.8%, the number of employees with university degrees, however, was up slightly (28.0%). The average employee age dropped minimally to 42.8 years (prior year: 42.9).

The number of employees in the paragon Group broke down as follows as of the respective reporting date:

	2016	2015
Number of employees	519	482
Number of temporary employees	107	79

As of December 31, 2016, the paragon Group employed a total of 519 permanent employees (prior year: 482) and 107 temporary employees (prior year: 79). With 21 employees (prior year: 3) at paragon Automotive Kunshan Co., Ltd., 2 employees (prior year: 5) at paragon Automotive Technology (Shanghai) Co., Ltd. and 14 employees (prior year: 15) at Voltabox of Texas, Inc., a total of 37 employees were employed abroad (prior year: 23). In November, Voltabox Deutschland GmbH sent four employees to Voltabox of Texas for a year to ensure optimal technological cooperation between the two subsidiaries regarding new developments, particularly in the field of mining applications.

At the end of the year, 190 employees (prior year: 163) and 35 temporary workers (prior year: 9) were employed at the Delbrück site. Of this, 53 employees (prior year: 47) and 21 temporary workers (prior year: 4) were employed by Voltabox Deutschland GmbH. A total of 245 employees (prior year: 0) and 69 temporary workers (prior year: 0) were allocated to productronic GmbH. 212 employees (prior year: 209) and 65 temporary workers (prior year: 64) were employed at the Suhl production plant, 37 employees (prior year: 42) and no temporary workers (prior year: 0) were employed at the St. Georgen site, 23 employees (prior year: 24) and 2 temporary workers (prior year: 5) were employed at the Nuremberg site and 20 employees (prior year: 21) and 5 temporary workers (prior year: 1) were employed by SphereDesign GmbH at the Bexbach site. KarTec GmbH at the Forchheim site also remained without operational business during the year under review.

A total of 109 employees (prior year: 96) and 11 temporary workers (prior year: 7) were employed in development. Of these, 65 employees (prior year: 71) and 10 temporary workers (prior year: 6) were employed by paragon AG, 13 employees (prior year: 0) by productronic GmbH, 26 employees (prior year: 20) and 1 temporary worker (prior year: 1) by Voltabox Deutschland GmbH and 1 employee (prior year: 0) by Voltabox of Texas, Inc.

Personnel expenses totaled € 29.2 million in the reporting period (prior year: € 26.3 million). Of this, € 21.1 million was attributable to wage and salary costs (prior year: € 20.1 million), € 3.7 million to social contributions and pensions (prior year: € 3.3 million) and € 4.3 million to expenses for temporary workers (prior year: € 2.9 million).

Quality and the Environment

All paragon Group sites are certified according to the international standard IATF 16949. The established interactive and process-oriented management system provides continuous improvements while emphasizing error prevention and waste reduction.

Ongoing process optimization in production is ensured via smaller control loops. In conjunction with a consistent service and customer orientation, this results in a continuous improvement of internal quality standards.

A number of specific measures were in focus for fiscal year 2016. The establishment of an interactive management system through the use of innovative software systems is intended to secure existing process expertise and optimize the Group's interface management in production. This also established the foundation for a self-learning organization in production.

With increasing Group revenue, higher production volumes and the launch of new products, the introduction of smaller control loops in production also led to a reduction in quality costs. Defective goods and customer-related quality costs were reduced in this way by about 25% compared to the prior year.

Furthermore, environmental protection and occupational health and safety are an integral part of the corporate mission statement. paragon has integrated the requirements of DIN EN ISO 14001 into its management system. Its effectiveness is confirmed in annual audits. paragon also pursues sustainability through the use of state-of-the-art production technologies as well as the careful handling of raw materials and energy resources.

In the year under review, active environmental management has led to a reduction in the rate at which waste is produced. This was achieved, for instance, by increasing reusable packaging in the supply chain. An energy audit was carried out in the summer of 2016 at the relevant sites pursuant to the legal provisions of Sections 8 et seq. of the German Energy Services Act (EDL-G).

Energy consumption in the Electronics and Mechanics operating segments was reduced, in particular, by the continuation of plant modernizations. For instance, pneumatic cylinders were replaced by electric linear axes. This also reduced compressed air consumption. Furthermore, wave soldering irons were replaced with JBC soldering irons. Despite the significant growth in business activities, particularly in the Electromobility operating segment, the total costs for electricity at the German sites remained at the prior year's level of € 0.8 million as a result of the measures implemented.

paragon is also trying to minimize the use of hazardous substances. For example, the number of adhesives used in production was lowered from ten different types to a maximum of three in the past fiscal year.

Other Control Benchmarks

In addition to the most important financial and non-financial performance indicators, further control benchmarks are used to manage the paragon Group. These other control benchmarks are of subordinate importance compared to the performance indicators. The Management Board pays particular attention to the activities in research and development and materials management in addition to the available liquidity and equity ratio benchmarks as indicators for control and further development.

Research and Development

Specialist expertise and sufficient capacities in research and development (R&D) are key success factors for a business model of active, independent product development. Therefore, paragon has defined this department as another control benchmark. The responsibility for the development of new products lies with the five business units (Sensors, Cockpit, Acoustics, Electromobility and Body Kinematics), which are managed and coordinated in operating segments.

In fiscal year 2016, paragon spent € 15.2 million (prior year: € 12.8 million) on internal R&D activities. This corresponds to 14.8% of revenue (prior year: 13.5%). The ratio of capitalized development costs was approximately 86.8% (prior year: 84.4%) of overall research and development costs.

Across the period from 2011 to 2016, the ratio of cumulative capitalized development costs to total development costs was 65.3%. The Management Board views the corresponding capitalization of this internal work as appropriate compared to others in the industry.

The number of employees in research and development increased during the reporting year by 16.5% to 120 (prior year: 103). That figure accounts for 19% of all Group employees.

The primary goal of the R&D activities in the Cockpit unit during the year under review was to continue the cross-site unification of development processes, which began in 2015, in accordance with the Group-wide project to optimize process management “paragon process ideal” (ppi). A project that was successfully implemented according to the industry-specific standard Automotive SPICE® and included sample phase management up to the transfer to production was defined as an internal reference project for the Group.

In the Cockpit unit, various projects focused on predevelopments and conceptual enhancements. In addition to the establishment of cost-reducing production processes, this also included new functional product properties that provide greater added value for end customers. Examples include the development of a high-efficiency wireless smartphone charging infrastructure using the Qi standard and the use of Bluetooth Low Energy (BLE) to dramatically reduce power consumption. The world’s first smartphone cradle for motorcycles with wireless charging could be transferred to series production in the second quarter. Since mid-2016, the MirrorPilot® connectivity platform has been in development for series production as part of a car sharing program headed by a premium German manufacturer. Metallic surfaces with translucent properties were developed for first-time serial use in a new model generation of a German sedan in the premium sports car segment.

The main R&D activities in the Sensors unit during the reporting year were related to the transfer from A-samples, regarding the CO_2 sensor and the AQI air quality improvement system, to serial production. Activities also focused on broadening the product portfolio. This included the first-time development of a single-channel and dual-channel particle sensor DUSTDETECT®.

The key R&D activities in the Acoustics unit during the year under review centered on signal quality optimization for automotive sound systems and enriching sound systems with innovative additional features. Furthermore, solutions were developed for the cost-effective and flexible production of future sound systems. These include a 3D sound system that can be tailored for each passenger individually using an individual 3D-upmix algorithm as well as passenger communication features using the belt-mic® microphone. Finally, the next generation of the current hands-free microphone was conceptually developed. Activities also focused on the concrete development of various A-sample prototypes for presentation to potential customers in the current fiscal year. All development activities in this unit were carried out internally.

The R&D activities in the Electronics operating segment were performed almost exclusively in-house and were always oriented toward specific application possibilities.

In the year under review, the R&D activities of the Mechanics operating unit, which is represented by the Body Kinematics unit, primarily focused on achieving series maturity for the adjustable spoiler systems and their electrical drive systems in a standardized Group variant. Other R&D activities centered on actively adjustable aerodynamic systems for body components. The focus here was on a bug spoiler system for a German sports car manufacturer. The R&D activities in this operating segment were mainly performed in-house and were always geared towards specific application possibilities.

The main goal of the R&D activities in the Electromobility operating segment in the year under review was the introduction of powerful simulation tools for the optimization of battery systems with regard to electrical design, mechanical structural strength and thermal management. Thanks in large part to these developer tools, the Voltabox system kits were supplemented by special modules (based on pouch cells) for applications that require particularly high energy densities during the course of the year.

Focus was also placed on the expansion of existing kits for cylindrical and prismatic cells. This resulted in the development and maturation of further module voltage versions for applications in the North American market and additional components for further variants of battery cooling. The strategic Voltabox approach of ensuring short development times with standardized battery modules at the module level has now also been applied to the system level. This results in identical, interconnectable system modules for the flexible scaling of "plug and play" battery sets.

At Voltabox of Texas, Inc., a U.S.-based team of development engineers was set up in the fourth quarter of 2016 to support the design of battery systems for projects in North America. This project is supported by four Voltabox engineers from Germany, who will provide decisive support during a 12-month deployment and ensure an optimal transfer of expertise.

R&D activities in the Electromobility operating segment were predominantly internal and application-related. Only in the area of system validation were accredited battery testers commissioned. These had the necessary equipment for testing batteries with high to very high output capacities (large batteries with capacities up to 800 kWh). The development of first-time applications primarily related to a 48 LTO module for mild hybrid applications as well as the 36V/40V and 96V versions of the NMC modules in both air and liquid-cooled versions. The results from development work on battery packs culminated in a patent application for battery modules according to Voltabox's own design, with various independent and dependent claims.

Materials Management

Materials management plays a special role at paragon with its production-intensive plants and broad product portfolio. In the reporting year, the material input ratio was 56.2% (prior year: 58.4%). The operational implementation of the dynamic growth strategy, especially in the new operating segments, requires the targeted enhancement of existing structures and processes. As a result, materials management has the function of an internal benchmark.

The close cooperation with select high-performance suppliers and a demand-oriented purchasing policy also formed the basis for procurement in fiscal year 2016. The aim of this approach was to be able to achieve ambitious production targets even in the case of short-term and large-volume orders by automobile manufacturers as well as individual project developments in e-mobility.

In the fiscal year under review, the Group-wide cost optimization programs also made a particularly significant contribution to the reduction of structural and material costs. Due to the growth of the company, the number of employees in purchasing was also increased. Here, the focus was on acquiring additional technical expertise in tool making, various production techniques and construction.

The extraordinary growth in the area of e-mobility has also led to further internationalization, resulting in the establishment of a major global sourcing strategy in important subareas such as battery cells. In addition to this, further requirements for the expanded product mix had to be met in the purchasing and logistics departments of this segment.

In the past fiscal year, materials management involved a number of strategic make-or-buy projects to increase flexibility in procurement and intensify value added. In the future, this will reduce dependence on suppliers in the area of core technologies. As part of the Group-wide project for internal process optimization "ppi", the procurement and logistics processes in materials management were significantly tightened.

Enhanced strategic orientation will be pursued in materials management for future product innovations. One way this will be implemented is through early integration into the product creation process.

Available Liquidity

The business model of paragon AG requires the ongoing availability of sufficient liquid funds. Liquidity is also an important economic indicator for third parties looking to comparatively assess a company's business situation. In addition, the medium and long-term liquidity planning for servicing interest payments and repayments to outside creditors is constantly being reviewed. Finally, the company's liquidity planning contributes to the internal management of the balance sheet structure.

Available liquidity includes all funding that is available within the paragon Group and is not intended to be used. According to the definition of the company, the current net debt is therefore to be determined by subtracting available liquidity from interest-bearing liabilities.

Available liquidity developed as follows as of the reporting date:

In € thousands	2016	2015
Available liquidity	17,324	13,840

Equity Ratio

The equity ratio is used by the Management Board as an internal indicator for the management of the capital structure. The capital-intensive growth strategy of the company requires a comparatively high proportion of leverage in the current development phase in order to ensure adequate profitability of the equity capital employed by the shareholders (leverage effect). The equity ratio is the subject of the current forecast by the Management Board and reflects the respective current state of the investment cycle in the development of the new Body Kinematics and Electromobility units. In the long term, the Management Board sees an equity ratio of about 30% as optimal.

The equity ratio developed as follows as of the reporting date:

In Percent	2016	2015
Equity ratio	30.0	21.0

Financial Management

The financial management of the company does not include an independent target system. Rather, the Management Board uses internal financial management to plan and monitor the implementation of its growth strategy. In this context, comprehensive revolving financial planning is carried out on the basis of sales planning, from which investment and liquidity planning is then derived. In addition to the individual business units, the company's legal entities are viewed and consolidated at a Group level on a monthly basis. The introduction of Microsoft Dynamics AX as a uniform ERP system throughout the Group is intended to facilitate further expansion into integrated financial planning. In this way, strategic and operational management is supported by focused financial management.

Dividend Policy

Over the last few years, the Management Board has developed a dividend policy that is designed to meet the company's strategic goal of profitable growth. On the one hand, this is intended to enable paragon shareholders to increase the value of their shares through dividend inflows and provide an incentive for long-term investment decisions. On the other hand, the company's equity base should not be negatively impacted during its capital-intensive growth phase. Corporate profits are therefore largely reinvested. Upon completion of the dynamic growth phase, the Management Board would consider as appropriate a disbursement ratio in the range of 20% to 40% of paragon AG's balance sheet profit (as reported in the financial statements according to the German Commercial Code).

For the reporting year, the Management Board and Supervisory Board will propose a dividend of € 0.25 (prior year: € 0.25) per participating share to the Annual General Meeting. With a balance sheet profit of € 1,379,069.79 (prior year: € 2,450,399.87) for paragon AG, this corresponds to a payout rate of approximately 82% (prior year: about 42%).

Remuneration Report of the Management Board and Supervisory Board

The company is committed to a high degree of transparency in its reporting. This also applies to the remuneration of the Management Board, which is disclosed and explained in full in the remuneration report, together with all its components and on an individualized basis. The Management Board and Supervisory Board have therefore decided to use the Management Board remuneration sample tables provided by the German Corporate Governance Code (GCGC) in the remuneration report.

Management Board Remuneration

The remuneration of the members of the Management Board consists of an annual fixed remuneration, ancillary benefits and a one-year variable remuneration component. A cap (minimum/maximum) is not provided for the variable compensation component. A variable compensation component for multiple years has not been specified. Finally, the total remuneration still includes a service cost under IAS 19. This is recognized pursuant to the GCGC as part of total remuneration, even though this is not a newly granted contribution in the narrower sense, but a past decision of the Supervisory Board that continues to be effective.

The total remuneration of the Management Board contains salaries and short-term benefits of € 1,235 thousand (prior year: € 1,342 thousand) and includes fixed components of € 855 thousand (prior year: € 851 thousand) and variable components of € 380 thousand (prior year: € 489 thousand). The main variable remuneration components are oriented on EBITDA as defined by IFRS and the economic situation of the company. Expenses relating to share-based remuneration were not incurred in the year under review (prior year: € 0 thousand). Service costs amounted to € 2 thousand (prior year: € 2 thousand).

The following table shows the contributions granted to the members of the Management Board in the reporting year:

Benefits granted In €	**Klaus Dieter Frers** **Chief Executive Officer** **Date joined: 11. April, 1988**		**Dr. Stefan Schwehr** **Chief Technology Officer (Electronics)** **Date joined: 1. April, 2014**	
	2016	2015	**2016**	2015
Fixed compensation	600,000.00	600,037.56	200,000.00	200,000.00
Fringe benefits	44,421.00	42,421.00	9,209.28	8,687.87
Total	**644,421.00**	**642,458.56**	**209,209.28**	**208,687.67**
One-year variable compensation*	334,663.53	429,000.00	45,336.47	60,530.00
Total	**979,084.53**	**1,071,458.56**	**254,545.75**	**269,217.67**
Service cost	1,789.56	1,789.56	0.00	0.00
Total compensation	980,874.09	1,073,248.12	254,545.75	269,217.67

* Uncapped (minimum/maximum)

The following table shows the contributions paid to the members of the Management Board in the reporting year:

Allocation In €	**Klaus Dieter Frers** **Chief Executive Officer** **Date joined: 11. April, 1988**		**Dr. Stefan Schwehr** **Chief Technology Officer (Electronics)** **Date joined: 1. April, 2014**	
	2016	2015	**2016**	2015
Fixed compensation	600,000.00	600,037.56	200,000.00	200,000.00
Fringe benefits	44,421.00	42,421.00	9,209.28	8,687.87
Total	**644,421.00**	**642,458.56**	**209,209.28**	**208,687.67**
One-year variable compensation*	426,360.00	315,960.00	60,530.00	38,497.50
Total	**1,070,781.00**	**958,418.56**	**269,217.67**	**247,185.17**
Service cost	1,789.56	1,789.56	0.00	0.00
Total compensation	1,072,570.56	960,208.12	269,217.67	247,185.17

* EUncapped (minimum/maximum)

paragon AG incurred expenses for the allocation of provisions for pensions to Klaus Dieter Frers amounting to € 429 thousand (prior year: € 205 thousand).

Supervisory Board Remuneration

The remuneration of the members of the Supervisory Board is determined by the Annual Shareholders' Meeting in accordance with the company's Articles of Incorporation and consists of fixed remuneration. The Supervisory Board Chairman receives € 60 thousand and the remaining members of the Supervisory Board each receive € 30 thousand per fiscal year.

The members of the Supervisory Board received fixed remuneration totaling of € 120 thousand (prior year: € 120 thousand) in the year under review.

The following table shows the remuneration of the Supervisory Board members:

In € thousands	Prof. Dr. Lutz Eckstein Chairman of the Supervisory Board		Hermann Börnemeier		Walter Schäfers	
	2016	2015	**2016**	2015	**2016**	2015
Fixed compensation	60	60	30	30	30	30
Total compensation	**60**	**60**	**30**	**30**	**30**	**30**

Economic Report

Global Economic Conditions

The International Monetary Fund (IMF) indicated a generally cautious outlook for the global economy in its global economic outlook[1] published in October 2016. This is particularly due to the increased uncertainty about the necessary global economic policy adjustments resulting from the "Brexit" decision, the unexpectedly weak economic growth in the U.S. and the Chinese economic stimulus programs.

The IMF expects the final figures for 2016 to show a downturn in global economic growth to 3.1%. If this figure is confirmed, developed economies will have only contributed moderately with a growth rate of 1.6%, while the emerging markets achieved growth of 4.2%.

In particular, economic growth in the USA is estimated to have amounted to 1.6% in 2016, 1.7% in Europe, 1.7% in Germany and 6.7% in China.

Despite the increasingly restrained economic environment, the German economy proved largely robust in the past fiscal year. According to data from the German Federal Statistical Office ("Destatis")[2], following price, seasonal and calendar adjustment, gross domestic product (GDP) rose 1.2% in the fourth quarter of 2016. This follows increases of 1.5% in the third quarter %, 3.2% in the second quarter and 1.5% in the first quarter. Private consumer spending, which is important for the automotive industry, contributed strongly to the positive momentum in the fourth quarter. It posted an adjusted growth of 0.8% after 0.8% in the third quarter, 1.5% in the second quarter and 1.1% in the first quarter.

As a supplier to the automotive industry, paragon generated the lion's share of its revenue in fiscal year 2016 with automotive manufacturers – particularly those in the premium segment, in Germany and in the European Union. These, in turn, sell the vehicles they produce worldwide. Overall economic development is therefore important for paragon in that it affects the sales opportunities for the automotive manufacturers it supplies, and thus also indirectly affects the development of private consumer demand for paragon products.

Market Development 2016

In line with the general economic trend, the automotive industry also developed positively in the past fiscal year. Initially, the German Association of the Automotive Industry expected global growth[3] of 2% for the automotive market to 78.1 million units sold, with slightly weaker growth dynamics being seen in the three largest submarkets of the U.S., Europe and China. Its forecast was increased at the beginning of July to growth of around 3%[4] due to the good business development in the first half of the year.

1 https://www.imf.org/external/pubs/ft/weo/2016/02/pdf/text.pdf
2 Federal Office of Statistics, press release from February 23, 2017 – 062/17
3 VDA press release from December 1, 2015: German automotive industry increases 2015 sales, revenue, production output, exports and employment
4 VDA press release from July 4, 2016: German car market shows strong growth

Accordingly, the global sales market developed better than originally expected in the past fiscal year. With a total of 17.5 million vehicles sold, the U.S. market benefited to a considerable extent from the dynamic performance of light trucks. Around 60% of new registrations were accounted for by this group. For the Chinese market, the reduction in value-added tax enacted in October 2015 has been particularly significant for the sales of small-engine cars. As the tax rate was to be raised again at the start of 2017, a pull-forward effect arose at the end of the year under review. The European market also benefited from the positive developments seen in some Western European submarkets: Italy grew 16%, Spain by 11%, France and Germany each by 5% and the United Kingdom by 2%.

New registrations/sales of passenger cars[1] developed in the most important sales markets as follows:

million units	2016	2015	Change
USA	17.5	17.4	0.4%
Europa	15.1	14.2	6.5%
China	23.7	20.1	17.8%

paragon's five largest customers, Audi, Volkswagen, Porsche, Daimler and BMW sold around 12.3 million passenger cars worldwide in the past fiscal year (prior year: 11.8 million).[2] This corresponds to growth for this customer group of around 4.9%. Accounting for more than 30% of total global sales, China continues to be the most important sales market for German automotive manufacturers.[3]

All in all, paragon also experienced a positive economic environment during the past fiscal year.

Business Performance

The very good operative performance in the Electromobility operating segment was a key factor in the company's growth in fiscal year 2016.

in Mio. EUR	Elektronics	Electro-mobility	Mechanics	Total
Segment revenue (third-party)	85.3	14.3	3.2	102.8
Segment EBIT	12.7	-3.7	-0.1	8.9

The largest operating segment, Electronics, dominated Group activities with revenue of € 89.5 million. Of this amount, € 85.3 million were attributable to third-party revenue in the Sensors, Cockpit and Acoustics units, which corresponds to approximately 83.0% of Group sales. At € 34.6 million, revenue in the Sensors unit remained at the prior year's level (prior year: € 34.6 million). This is primarily due to life-cycle effects with simultaneously increasing take-rates in the current vehicle models with the latest sensor generation from paragon. In the Cockpit unit, revenue rose 5.5% to € 33.7 million (prior year: € 31.9 million), mainly due to the start of serial production for a new generation of cockpit instruments for a long-standing customer. The Acoustics unit recorded revenue growth of 5.7% to € 17.0 million (prior year: € 16.1 million) as a result of increased volumes of the current version of the premium hands-free microphones. Segment EBIT amounted to € 12.7 million.

Segment revenue in the Electromobility operating segment of € 14.3 million was achieved exclusively with third parties. This segment is represented by the Voltabox subsidiaries in Germany and the U.S. With an increase of 92.7%, this operating segment posted the highest growth dynamics. The largest growth driver was the serial production of battery modules for forklifts. In fiscal year 2016, the operating segment accounted for 13.9% of Group revenue. Segment EBIT amounted to € 3.7 million.

Segment revenue in the Mechanics operating segment amounted to € 60.3 million. Of this figure, € 3.2 million were attributable to third-party sales in the Body Kinematics unit, which corresponds to 3.1% of Group revenue. Segment revenue with third parties, which fell by 34.7% in the year under review, was decisively influenced by life cycle effects alongside several parallel series developments for fiscal year 2017. Prominent

1 VDA press release from January 17, 2017: 2016 was a good year for the international automotive market
2 Calculated from data provided in press releases by automotive manufacturers
3 FAKTEN-REPORT 2016, Automobilwoche, December 2016

among these development activities were the freely adjustable rear spoilers for optimized aerodynamics. Segment EBIT amounted to € -0.1 million.

Furthermore, the relative composition of the customer structure changed over the course of the year according to the successive implementation of the corporate strategy. This was mainly attributable to the significant growth in the Electromobility operating segment, which fed off of the particularly dynamic development in the intralogistics market.

Breakdown of revenue In € thousands	2016	Share in %	2015	Share in %	Change in %
Sensors	34,597	33.7	34,623	36.4	-0.1
Cockpit	33,682	32.8	31,925	33.6	5.5
Acoustics	17,001	16.5	16,078	16.9	5.7
Electromobility	14,271	13.9	7,404	7.8	92.7
thereof: Germany	10,585	10.3	3,581	3.8	195.6
thereof: USA	3,686	3.6	3,823	4.0	-3.6
Body Kinematics	3,239	3.1	4,960	5.2	-34.7
Total	102,790	100.0	94,990	100.0	n/a

Key Factors on Business Performance

The business performance of the paragon Group during the past fiscal year was mainly characterized by an increase in the take-rate for certain air quality sensors, an increase in the output volume of the latest generation of hands-free microphones and several production starts for display instruments. At the same time, production volumes for older product generations fell in line with their life cycles. This was the case, for example, in the Mechanics operating segment, where the previous two-position spoiler drive motors are being replaced by a new spoiler generation.

Some of the most recent product innovations were brought to serial maturity or transferred to series production this past year. In addition to the CO_2 sensor and the AQI air enhancement system, this included a smartphone cradle with wireless charging function for motorcycles as well as the drive for freely adjustable rear spoilers.

At the same time, the revenue share with the five largest customers in the Electronics operating segment fell slightly to 71% (prior year: 72%), while a further widening of the customer base in this operating segment was achieved by expanding activities with other customers. The different model cycles of the respective manufacturers and the time schedules for model maintenance and changes additionally influenced this development.

Finally, new customers, such as the Chinese manufacturers Chang'an, GAC Group and Geely, were acquired in the Electronics operating segment along with Joy Global and KUKA in the Electromobility operating segment. However, the revenue contributions from new customers were still very low in the year under review.

The dynamic revenue growth in the new Electromobility operating segment was decisively influenced by the expansion of business activities in two fields of application. While the increasing production of battery modules for forklifts installed by cooperation partner Triathlon Batteries was in the foreground in the field of intralogistics, the production of large battery systems for public transport continued to be dominated by typical project business with municipal operators of trolleybuses.

Assets, Financial Position and Earnings

Earnings

The paragon Group continued its dynamic growth in fiscal year 2016 with revenue growth of 8.2% to around € 102.8 million (prior year: € 95.0 million) and achieved its revenue forecast of approximately 8% growth. With a Group EBIT margin of 8.7%, the Management Board's earnings forecast of approximately 9% was likewise achieved.

The cost of materials developed more slowly, increasing only 4.0% to € 57.7 million (prior year: € 55.5 million). Apart from a modified product mix due to the establishment of new business units, this development is particularly down to various cost-cutting measures. The material input ratio was accordingly lower at 56.2% (prior year: 58.4%). Own work capitalized increased by 20.1% to € 15.3 million (prior year: € 12.8 million) as development services in the U.S. were incurred for the first time. This resulted in a gross profit for fiscal year 2016 of € 60.5 million (prior year: € 56.9 million), which corresponds to a gross profit margin of 58.9% (prior year: 59.8%).

Personnel costs increased particularly strongly by 11.2% to € 29.2 million (prior year: € 26.3 million) mainly as a result of new hires in connection with operational growth in the new Electromobility and Mechanics operating segments as well as in central Group functions. The personnel expense ratio was accordingly slightly higher at 28.5% (prior year: 27.7%). At € 15.2 million, other operating expenses remained well below the prior year's figure of € 16.3 million. This is due in particular to the absence of rental costs for the building at Artegasstrasse as a result of its acquisition. Earnings before interest, taxes, depreciation and amortization (EBITDA) therefore rose 13.2% to € 16.1 million (prior year: € 14.2 million), which corresponds to an EBITDA margin of 15.7% (prior year: 15.0%).

After a slight increase in depreciation and amortization to € 7.1 million (prior year: € 6.3 million), earnings before interest and taxes (EBIT) increased 14.4% to € 8.9 million (prior year: € 7.8 million) thanks largely to the € 1.1 million drop in other operating expenses. The EBIT margin therefore rose to 8.7% (prior year: 8.2%).

Despite a reduced financial result of € -3.2 million (prior year: € -2.8 million) stemming from a decline in financial income and higher financing expenses, earnings before taxes (EBT) managed to increase to € 5.8 million (prior year: € 5.0 million). Taking into account higher income taxes of € 2.2 million (prior year: € 1.6 million), the paragon Group generated a consolidated net income of € 3.6 million (prior year: € 3.4 million) in the year under review. This corresponds to earnings per share of € 0.84 (prior year: € 0.83).

Net Assets

The assets of paragon AG increased significantly to € 115.6 million (December 31, 2015: € 92.6 million) mainly as a result of the capitalization of development costs, the cash capital increase from authorized capital at the beginning of the fourth quarter, the expansion of the Artegastrasse building and the expansion of the production facilities at the Delbrück site as well as higher inventories as a result of the expansion to business activities.

Noncurrent assets increased to € 75.8 million (December 31, 2015: € 59.7 million). This increase was mainly due to higher capitalized development costs due to a large number of new projects in the reporting year amounting to € 15.3 million (prior year: € 12.8 million) in addition to investments in property, plant and equipment of € 7.7 million (prior year: € 19.6 million) in connection with the establishment of the new business units. These capitalized development costs related mainly to the Electronics and Electromobility operating segments, each of which represented roughly 40%. As a result of the cash capital increase, the Management Board had increased its initial forecast for the investment volume in the reporting year from around € 14 million on November 18, 2016, to around € 20 million.

Current assets increased to € 39.7 million (December 31, 2015: € 32.9 million). This is mainly due to the increase in cash and cash equivalents of € 14.3 million (December 31, 2015: € 8.5 million) as a result of the cash capital increase from authorized capital at the beginning of the fourth quarter. In addition, inventories increased to € 13.7 million (December 31, 2015: € 11.2 million) as a result of the expansion of business activities. Finally, trade receivables decreased as of the balance sheet date to € 8.4 million (December 31, 2015: € 10.4 million). This is due to the sale of receivables by the company.

Noncurrent provisions and liabilities decreased by € 1.1 million to € 44.9 million (December 31, 2015: € 46.0 million), which, in addition to higher deferred taxes, was mainly due to the decrease in long-term borrowings to € 20.4 million (December 31, 2015: € 23.8 million) stemming from repayments of € 3.8 million. On the other hand, current provisions and liabilities increased significantly to 36.0 million (December 31, 2015: € 27.1 million). In addition to the increase in short-term borrowings to € 12.4 million (December 31, 2015: € 8.7 million) due to an increase in current account lines, this development is particularly due to higher trade payables of € 16.4 million (December 31, 2015: € 10.7 million) resulting from the expansion of business activities.

paragon AG's equity increased 78.7% to € 34.7 million (December 31, 2015: € 19.4 million). In addition to the increase in profit carried forward to € 12.9 million (December 31, 2015: € 10.5 million), this is due in large part to the increase in capital reserves to € 15.2 million (December 31, 2015: € 2.5 million) in connection with the cash capital raised from authorized capital at the beginning of the fourth quarter. Given the sharp rise in total assets, the equity ratio increased, as expected, to 30.0% as of the reporting date (December 31, 2015: 21.0%).

Cash Flow

Cash flow from operating activities increased in the period under review to € 16.8 million (prior year: € 12.9 million). In addition to the higher earnings before tax (EBT), this is largely due to a smaller increase in inventories, an increase in trade payables and higher depreciation on noncurrent assets.

Cash flow from investment activity decreased in the period under review by 28.4% to € 23.2 million (prior year: € 32.3 million). This development is the result of the sharp decrease of 60.7% in payments for investments in property, plant and equipment, which amounted to € 7.7 million (prior year: € 19.6 million), while payments for investments in intangible assets were up 16.7% to € 14.4 million (prior year: € 12.3 million).

Cash and cash equivalents increased to € 14.3 million (prior year: € 8.5 million) as of the balance sheet date, mainly as a result of the cash capital increase from authorized capital at the beginning of the fourth quarter.

General Statement on the Company's Assets, Financial Position and Earnings

The company's assets, financial position and earnings developed as planned during the past fiscal year. The earnings situation has benefited greatly from revenue growth in the Electromobility operating segment. Furthermore, the markedly increased capitalized development costs and reduced other operating expenses particularly contributed to the improvement in the earnings situation as a result of the Group's expanded business activities. Correspondingly, net assets were particularly affected by the significant increase in intangible assets and a simultaneous increase in equity as a result of the cash capital increase, while the financial position improved as of the reporting date as a result of the cash inflow.

Opportunity and Risk Report

paragon has established a comprehensive risk management system to identify opportunities and risks in corporate development. All the business areas regularly issue risk reports, from which management is informed about the probability of occurrence and possible damages resulting from the risks identified. The risk reports contain an assessment of the risks as well as suggestions for appropriate countermeasures. For information on the risk management objectives and methods with regard to the use of derivative financial instruments, please refer to the notes to the financial statements (note 38).

Opportunity Report

Opportunities

The German Association of the Automotive Industry expects a further increase in sales for German automotive manufacturers in fiscal year 2017. There are opportunities associated with this for paragon in the Electronics and Mechanics operating segments. For years, the Management Board has pursued the goal of increasing the share of sales per vehicle by increasing take-rates with existing customers, winning new customers for existing products internationally and developing innovative products with a higher added value, for instance. Examples from fiscal year 2016 include the new CO_2 sensors and AQI air enhancement system, the unique belt-mic® microphone, the global launch of a smartphone cradle with wireless charging function for motorcycles in the second quarter and the acquisition of new Chinese customers in the fourth quarter.

In addition, numerous new product innovations from the Electronics operating segment are currently being intensively marketed. Due to its strategic positioning, paragon AG will be able to profit from changes in the automotive value chain that will arise from the megatrend developing around connectivity. In a joint study with the World Economic Forum published in July 2016[1], the Boston Consulting Group noted that 43% of consumers worldwide would pay a premium for an autonomous car. According to a study published by the consulting firm PwC's Strategy& team in September 2016[2], the global sales potential for the connected cars industry could reach approximately USD 156 billion by 2022.

As a result, paragon has the following opportunities, particularly in the medium term:

- Thanks to the business model focused on the independent development of product innovations, paragon can tap into strategic business advantages (pioneering advantage) in the Electronics operating segment due to the dynamic technology shift surrounding the megatrend of connectivity.

- The focus on the development of product innovations is increasingly shifting from the component level to the system level in the Electronics and Mechanics operating segments. As a result, paragon can successively increase its value added per vehicle.

- Due to the globally high levels of air pollution in heavily frequented, urbanized areas, in the future paragon will be able to benefit from potentially higher take-rates for air quality sensors in passenger cars, particularly with the DUSTDETECT® particle sensor currently in development. When breathed in, fine particulate matter (PM2.5) can reach the alveoli. Its small size allows it to remain in the atmosphere longer and be carried further distances. As a result, political strategies to reduce the health impacts of air pollution are gaining in importance internationally.

- In the past fiscal year, the Chinese automotive market grew to become the largest regional sales market with some 23.7 million new registrations. Further sales growth of around 6.5% is expected for fiscal year 2017. With paragon Automotive Kunshan Co., Ltd. paragon is present in China with its own production site, which currently has 21 employees and a production area of around 2,600 square meters. The Chinese government's five-year plan (2016–2020) provides concrete targets for the significant reduction of air pollution. The Chinese automotive industry is now one of the world's largest growth drivers for the rapid spread of resource-conserving technologies. This means there is particularly high sales potential in the Chinese automotive market for paragon in the medium term if it can acquire Chinese automotive manufacturers as new customers for air quality sensors with high take-rates and sales figures.

paragon's Electromobility operating segment also offers great opportunities for further applications for the lithium-ion battery systems developed by the Voltabox subsidiaries. The e-mobility megatrend has already led to the first applications in individual capital goods submarkets such as trolleybuses for public transport, intralogistics forklifts and automated guided vehicles in networked production as well as underground mining vehicles. With the help of strong cooperation partners, paragon is able to benefit from substitution effects here that stem from the economic advantages its battery technologies offer compared to the lead-acid batteries or diesel units used to date. In these fast-growing submarkets, paragon has the opportunity to significantly increase its relative market share within a short period of time and thus occupy a leading market position.

The niche strategy of diversification also offers large sales opportunities in further submarkets in the medium term as soon as similar substitution effects come into play there. These include, for instance, agricultural and forestry vehicles, commercial vehicles for utilities and waste management as well as construction vehicles and machinery, airport service vehicles and others. Often it is the complex requirements regarding the performance, safety and reliability of the lithium-ion battery systems developed by the Voltabox subsidiaries that play a decisive role.

Finally, paragon has already tapped a first segment of the global market for conventional and hybrid-powered vehi-

1 https://www.bcgperspectives.com/Images/BCG-Self-Driving-Vehicles-Robo-Taxis-and-the-Urban-Mobility-Revolution_tcm80-214440.pdf
2 http://www.strategyand.pwc.com/media/file/Connected-car-report-2016.pdf

cles with its starter batteries for motorcycles. An early presence on the market also offers the opportunity to be a major participant in the further market penetration of lithium-ion batteries in this very large market. As part of its presence in the global mass market for cars, paragon will also be able to occupy the segment for modern 48V lithium-ion battery systems for hybrid cars at an early stage.

Overall Assessment of Opportunities

Through the regular and structured monitoring of opportunities within the paragon Group and the relevant sales markets as well as the internal, barrier-free communication at the various levels of management, the Management Board is in a good position to identify opportunities for the Group. The consistent exploitation of business opportunities in the form of planning adjustments can make a significant positive contribution to the company's strategic and operational success. At the end of fiscal year 2016, both external and internal opportunities were identified that are basically unchanged compared to the prior year.

The significance of the listed opportunities as well as the resulting positive effects on the financial performance indicators projected for fiscal year 2017, and thus on the short-term development of the paragon Group as a whole, is classified as low. The Management Board therefore expects the positive development of business described in the forecast.

Risk Report

Risk Management

paragon uses a comprehensive risk management system as part of its risk-oriented corporate governance.

Risks are defined in the paragon Group not only as activities, events and developments endangering the company's existence, but also those affecting its business success. Particular attention is paid to risk concentrations, e.g. dependencies on individual customers, suppliers, products or countries. In the case of material risks, mutual dependencies and impacts are taken into account, since individual risks can mutually reinforce each other or cause compensation effects between them. In addition, opportunities are also subsumed under the risk concept. We understand business success in terms of measurable values, e.g. revenue and EBIT. Risks are therefore represented in these figures in the evaluations from the respective process owners. Risk assessment is always based on the risk outcome. A risk is the possibility that a threat exposes a vulnerability and causes damage to or the loss of an object and thereby directly or indirectly results in a negative impact. The aim is also to identify and evaluate these risks in order to be able to select suitable and appropriate countermeasures on this basis.

Risks are determined in terms of the following parameters:

- The value of the affected objects (extent of damage)
- The possibility of a threat exploiting a vulnerability
- The probability that a threat occurs
- Existing or planned measures that could reduce this risk

Strategic Governance and Risk Management

The aim of risk management is to secure the company's continued existence, i.e. securing its future development and profitability as well as reducing the risks of breaching the confidentiality, integrity and availability of the information or data used or contained in the performance of activities. The task of risk management is also to report deviations from the corporate objectives at an early stage and thereby enable timely countermeasures. Risk guidelines are defined in the risk manual.

Group-wide responsibility for risk management lies with the Management Board. Risk management at the respective sites is adequately covered and secured in regular (video and telephone) meetings with the respective senior management. This means that the Management Board is directly informed of the situation and the corresponding risks are continuously monitored and managed by the Management Board. In risk fields where quantification is not possible or useful, work is done to identify risk factors.

Central Risk Management

An important role in the risk management and control process belongs to central risk management. Within its responsibility for the risk situation of the company, the Management Board transfers the task of implementing permanent risk management activities to the central risk management team. Responsibility for central risk management lies with the Head of Controlling. paragon's central risk management team is responsible for coordinating all decentralized risk management functions, evaluating risk analyses and consolidating them into risk reporting as well as improving and enhancing the risk management system. Working with the Management Board, the central risk management team determines the reporting cycles and defines the thresholds for the risks which, when exceeded, require a risk control report to be prepared outside the obligatory reporting requirements. Both the threshold values and the reporting cycles are based on the relevance of the risks.

Central risk management supports the decentralized risk managers in the preparation of risk analyses and checks their returns and plausibility. It summarizes the individual risk profiles in a joint document. This means that interactions between the risks can be analyzed and the overall risk situation of the paragon Group can be recorded, evaluated and commented on. This summary is referred to as risk reporting. This task is of particular importance because the objective of an integrated risk management system is the holistic consideration of a company's risk situation. Risk reporting acts as the basis for the statements on the paragon Group's risk situation in the management report.

The decentralized risk managers are consulted whenever new risk management measures are established or existing measures are adapted.

Decentralized Risk Management

Decentralized risk management in the paragon Group is located within the company's individual departments and sites. The area and process managers are responsible for risk management in their respective areas of work as decentralized risk managers. The decentralized risk management team reports on the development of risks in these areas as part of risk control measures. For each reporting cycle, the decentralized risk managers write up a report on the risks for which they are responsible. The focus here is on the description of the expected development of the risk. With this, measures for future risk management or the improvement of existing measures are developed and included in the risk control report as proposed measures for implementation. The decision on implementation is the responsibility of the Management Board. In addition, the Management Board must be informed without delay of any risks incurred throughout the year (ad-hoc risk reporting). According to a resolution by the Management Board, regular meetings with all decentralized risk managers are no longer held. Instead, individual discussions are held with the decentralized risk managers.

Risk Monitoring

Risk monitoring is the task of decentralized and central risk management. Early warning indicators for critical success factors are defined by the decentralized risk managers. The task of central risk management is to monitor the defined early warning indicators. As soon as the defined thresholds are reached, a risk report is prepared by the decentralized risk manager, i.e. a forecast of the expected effects of the risk event for paragon.

These forecasts are to be supplemented by scenario analyses, which take into account different data constellations. Risk monitoring thus serves as a form of knowledge enhancement to assist with management decisions, as attempts are made to reduce uncertainty regarding the future development of the company or the risk situation.

Based on this information and the recommendations made by the decentralized risk managers and central risk management, the Management Board decides whether and to what extent measures are to be implemented or whether an adjustment of the company's objectives is necessary. The monitoring of the early warning indicators and their associated threshold values as well as the creation of scenario analyses is the responsibility of decentralized risk management.

Risiko-Reporting

The monthly report to the Management Board contains all new risks identified in the reporting month as well as risks that have changed by a degree greater than or equal to 50% from the prior month.

Central risk management is required to provide an ad hoc report to the Management Board in the case of risks with a change of 100% or more as compared to the previous month. The Management Board in turn is then obliged to provide a report to the Supervisory Board within 24 hours of being informed about the risk.

The risks continually analyzed by paragon as part of risk monitoring can be assigned to the following risk categories, each of which is divided into individual risks:

- Strategic and environmental risks
- Market risks
- Operating risks
- Financial risks
- Management and organizational risks

At the end of the reporting year, 25 individual risks were recorded in the paragon Group. In the opinion of paragon AG, none of these individual risks endangered the company's continued existence.

Risks

Strategic and Environmental Risks

Overall economic development is observed in the risk management system due to its possible influence on end customer behavior within the automotive industry. This can lead to fundamental changes to supply and demand behavior in the procurement and sales markets for paragon. For example, a longer-term economic downturn, possibly triggered by the economic policy measures of individual submarkets such as the U.S. or China, could have a negative impact on the company's assets, financial position and earnings. A politically motivated move away from the rule-based international trade system or its disturbance through isolated protectionist measures could lead to distortions in the global automotive value-added chain. As the paragon Group has its own production facilities in China and the U.S., and as it has a specific customer/product structure, the Management Board views the overall risk of protectionist influence on earnings as low.

Market Risks

For years, paragon has held a strong market position as a proven and innovative direct supplier to premium German manufacturers in the automotive industry. The three largest sales markets of China, Western Europe and the U.S. continued to grow in 2016, while other submarkets, such as Russia, Brazil and Japan, posted drops in sales to varying degrees. In fiscal year 2017, growth in the major submarkets, and as a result in the global sales market, is expected to slow somewhat.

Due to its specific customer/product structure, paragon grew significantly faster than the market in the past fiscal year. On the one hand, the Management Board sees this being due to the fact that paragon's largest customers are among the leaders within the sector, and that they boast very promising future prospects. The globally active premium German manufacturers Audi, Daimler, BMW and Porsche were again able to achieve record sales in fiscal year 2016 and are well-positioned to continue this development in the current fiscal year with a number of new models, despite the recent general economic conditions.

paragon's close ties to these key customers and its concentration on specific market niches shape the company's strategic positioning. Sales opportunities and risks are assessed through a comprehensive operative sales management system. Key components of this system are the analysis of market and competition data, rolling planning for the short and medium term and regular coordination between sales, production and development. The comparatively broad portfolio with around 200 individual products highlights the comparatively high independence of individual product groups and customers.

Nevertheless, the loss of a major customer could have a significant impact on the company's assets, financial position and earnings in the medium term. However, due to the multi-year contract periods for the various series, the loss of a key customer would be known at an early stage. This risk is counteracted by comprehensive development work on product innovations as well as detailed permanent order backlog analyses focusing on early risk identification.

The paragon innovation process is characterized by independent product development that takes the interests and wishes of car owners into consideration. In contrast to many other automotive suppliers, paragon does not wait for automotive manufacturers to make certain demands or specify requirements, but rather develops its own, innovative solutions, which are implemented in cooperation with pilot customers and subsequently offered to a wider customer base. As a growing number of automotive innovations are electronic in nature, paragon sees a wide range of market opportunities for its Electronics operating segment. However, it cannot be ruled out that a product development may not achieve its expected quantities or that its economic success may be lower or later than originally planned.

Operating Risks

In terms of operating risks, paragon is currently focusing on its research and development, materials management, production and information technology activities.

The market for automotive electrics, electronics and mechatronics is subject to increasingly dynamic, technological change. The future economic success of paragon will therefore depend on the ability to continuously develop new and innovative products on time and successfully introduce them to the market. Recognizing new technological developments at an early stage and implementing them in partnership with customers is key here. Should paragon not be able to, or not quickly enough, recognize and implement new trends, changing customer requirements or future technological advances or to develop new products and adapt existing products in accordance with business principles, this may have a detrimental effect on the company's assets, financial position and earnings.

In addition, development costs may not be recoverable if paragon's customers subsequently do not issue serial production orders or if the quantities paragon sells are significantly lower than expected. Given the high proportion of capitalized development activities on the balance sheet, a corresponding valuation allowance for intangible assets could have a negative impact on the company's assets, financial position and earnings.

In close cooperation with the development departments of key customers, paragon contributes to automotive product innovations with its wide range of development projects and innovative solutions. Significant deviations from the project objectives in terms of time and money may result in cost and legal risks (e.g. contractual penalties). Ongoing development and project monitoring is undertaken to limit associated risks.

Past experience has shown that through the use of the existing sales channels, paragon can generate additional business with new products. The company was also able to gain new customers, such as Chang'an Automobile, GAC Group and Geely, with its own product developments during the past fiscal year. With continuous investments in machinery and plants, paragon ensures that the production facilities at all of the Group's sites meet the high requirements of the automotive industry.

The past fiscal year was characterized by rising prices for aluminum, which is used in the production of battery modules and is also the base material for the production of printed circuit boards. paragon took advantage of the global price competition on all relevant procurement markets and secured a substantial portion of its procurement prices through framework contracts, annual agreements and long-term supplier relationships. The Group continues to purchase more than 80% of its purchasing volumes from European contract partners, while the rest is purchased directly in Asia and the U.S. The payment terms are regarded as above-average by the Management Board as compared with the industry. The most important purchasing currency is the euro, but the U.S. dollar is also being used increasingly (17%). The volume of purchases in U.S. dollars will continue to rise significantly as a result of the expected sales growth in the Electromobility operating segment. Currency risks arise primarily for purchases in U.S. dollars that are intended for the European currency area. These risks are minimized by price sliding clauses and other appropriate measures.

With the rapid spread of information technology (IT) and the ubiquitous connectivity provided by the internet, IT risks, such as hardware failures and unauthorized access to company data and information, are also on the rise. In order to avert possible dangers, paragon, in cooperation with specialized service companies, has established modern security solutions that protect its data and IT infrastructure. In fiscal year 2016, the company further modernized its IT infrastructure and connected additional plants to its IT landscape in Germany. This involved use of the servers and systems that have been assembled in recent years. This resulted in significant synergies in cooperation. Finally, various security measures have been established to protect the company from internet threats (cyber attacks).

Financial Risks

In addition to interest rate, liquidity and currency risks, paragon also monitors risks associated with the loss of receivables, balance sheet risks and tax risks in the financial risks category.

Interest rate risks are virtually meaningless for paragon, as fixed interest rates are currently agreed upon for most of its long-term liabilities. Financial covenants do not exist with any credit institutions.

The company's ability to pay is ensured by comprehensive planning and monitoring of liquidity. These plans are prepared on a short, medium and long-term basis. In addition, paragon has a rigorous receivables management system to ensure timely cash inflows. A substantial portion of the receivables is also hedged by means of a commercial credit insurance. An additional possibility for short-term financing exists in the form of factoring agreements.

The company's cash capital increase, which was successfully implemented at the beginning of October, led to a cash inflow of around € 13 million, thus enhancing the financial strength of the Group. The refinancing of the issued bond in mid-2018 will, from today's point of view, be partly covered by free cash inflows. The Management Board also evaluates alternative forms of financing.

The company monitors possible currency risks on the procurement and sales side by continuously tracking foreign currency exchange rates. At present, paragon does not use financial instruments to hedge currency risks.

Management and Organizational Risks

In this risk category, paragon is primarily observing risk factors resulting from the growth strategy. This includes personnel and organizational risks in particular, as well as management and communication risks. Clear assignments and demarcations in the respective areas of responsibility within the system of owner-oriented governance have been laid out in order to prevent cases of lacking interfaces and functional overlaps. Currently, the Management Board does not consider there to be any material risks to paragon in this area.

However, the company is fundamentally dependent on the retention of qualified personnel and persons in key positions. The future economic success of paragon depends to a considerable extent on the continued involvement of its executives, senior employees and employees in key positions. This is particularly the case for its founder, primary shareholder and CEO Klaus Dieter Frers, who is the company's engine and an important source of ideas. In addition, paragon also relies on qualified employees in the areas of management, research and development, and sales. The company cannot guarantee that it will be able to hold key executives, senior executives and employees in key positions or attract new executives and employees with appropriate qualifications. There is increasing competition for such qualified employees and the personnel market, particularly in regions outside major German cities, is comparatively small. This means that individual experts can only be replaced with difficulty or not at all. If paragon is unable to provide sufficient personnel in the future, the strategic and economic objectives of the company may not be achievable or only achievable at a later date. This could have a detrimental impact on the company's assets, financial position and earnings.

Overall Assessment of the Risk Situation

The company's risk management will continue to be adapted to the dynamic development of the paragon Group in the current year. The new organizational structure, with the Electronics, Electromobility and Mechanics operating segments, has been accounted for according to the new internal management system. The Management Board currently expects that the ongoing Group-wide monitoring of operating risks will become increasingly important as business activities expand.

In the future, paragon must also protect itself against general market risks in the automotive industry. In the reporting year, the share of sales with the largest five customers was still around 71% (prior year: 72%). The company's strategic positioning as a direct supplier to premium German manufacturers with long-standing, successful business relationships with these companies, however, significantly lessens the risk. Therefore, the relative dependence on economic fluctuations in the automotive industry's global sales markets will also be reduced in the future. Existing customer contacts also offer considerable opportunities to position new product innovations within the Electronics and Mechanics operating segments. The increasing diversification of the business model via the particularly high-growth Electromobility operating segment also provides a second pillar and reduces dependence on the economic development of the automotive industry in the medium term.

The strengthening of the medium-term financing structure through the cash capital increase at the beginning of the fourth quarter of 2016 further reduced the company's overall financial risk in fiscal year 2016. With paragon's capital-intensive growth strategy, the company's overall economic development remains closely linked to the economic development of the automotive industry and, particularly, its key customers.

As of the publication date of this report, no risks have been identified that could jeopardize the company's continued existence. A differentiated view on the development of the automotive industry shows that the company is positioned in forward-looking market segments or submarkets, has promising customer relationships and offers diverse niche products that are often without true competition on the market.

The potential impact from the various risks on the overall future performance of the paragon Group, as well as its financial and nonfinancial performance indicators for fiscal year 2017, are regarded as low by the Management Board as a whole. Accordingly, the Management Board expects that the business development described in the forecast will not be significantly impacted by the disclosed risks.

Description of the Key Characteristics of the Internal Control and Risk Management System with Regard to Group Accounting Processes (Section 315 (2) no. 5 HGB)

Since the internal control and risk management system is not legally defined, paragon based its definition on that of the Institut der Wirtschaftsprüfer in Deutschland e.V., Düsseldorf, Germany, regarding accounting-related internal control systems (IDW PS 261).

An internal control system is therefore understood as the principles, procedures and measures enacted by management that are aimed at the organizational implementation of management's decisions. The objectives are as follows:

a) Ensure the effectiveness and profitability of the business (including the protection of assets and the prevention and detection of asset damages);

b) Ensure the regularity and reliability of internal and external accounting;

c) Comply with the legal and statutory regulations applicable to the company.

The Group's risk management system includes all organizational regulations and measures for risk identification and handling risks related to entrepreneurial activity.

The Management Board of paragon AG bears the overall responsibility for the internal control and risk management system with regard to the accounting process. The principles, procedural instructions, procedural organization and processes of the accounting-related internal control and risk management system are laid down in organizational instructions that are adapted at regular intervals to current external and internal developments.

In view of the size and complexity of the accounting process, management has determined the scope and design of the control activities and implemented them in this process. Independent controls have also been established. The control activities address those control risks which, in terms of their probability of occurrence and their impact, could have a significant influence on the accounting and overall statement of the consolidated financial statements, including the Group management report. Key principles, procedures, measures and control activities include:

- Identification of the key control risks relevant to the accounting process.
- Process-independent controls for monitoring the accounting process and its results at the level of the Management Board of paragon AG.
- Control activities in the accounting and controlling departments of paragon AG, which provide essential information for the preparation of the annual financial statements and management report, including the required separation of functions and approval procedures.
- Measures that ensure the proper computerized processing of accounting-related information.

Forecast

Market Development 2017

The International Monetary Fund (IMF) published its outlook[1] for the global economy in October 2016, in which it described three key macroeconomic problems in greater detail. These are the slowdown of global trade, insufficient global price increases (inflation) in combination with limited monetary scope and carry-over effects from China's ongoing transition into a developed economy. In addition to these problems, there are a number of additional critical factors that could negatively impact growth prospects in the short term, particularly in the emerging markets. The accommodating economic policies in developed economies will continue to be necessary and will depend on supporting structural reforms to have their full impact.

In mid-January 2017, the IMF issued an update[2] highlighting the vast uncertainty surrounding the economic policy of the new U.S. government and its global implications. As there may well be major changes in the global economic landscape, it expressed reduced confidence in its forecasting accuracy for the year 2017. The IMF announced that it would review its assumptions in April and adjust its forecast as necessary.

In its baseline scenario, the IMF expects a slight upturn in global economic growth to 3.4% in 2017. Developed economies will only contribute moderately with a growth rate of 1.9%, while the emerging markets will achieve growth of 4.5%.

Specifically, the U.S. economy is expected to pick up steam, leading to economic growth of 2.3%, while growth in Europe (1.6%), Germany (1.5%) and China (6.5%) slows slightly.

Accordingly, the most important global markets for the automotive industry will continue to be characterized by a positive economic outlook in the current fiscal year. Similarly, the German Association of the Automo-

1 https://www.imf.org/external/pubs/ft/weo/2016/02/pdf/text.pdf
2 http://www.imf.org/external/pubs/ft/weo/2017/update/01/pdf/0117.pdf

tive Industry (VDA) expects global growth in sales[1] of passenger cars of around 2% to 83.6 million units in a flat growth curve. At the same time, however, the VDA also sees an increase in risks.

For the U.S. market, a sideways movement with sales of around 17.1 million passenger cars (including light trucks) is expected, while a stable development of almost 13.9 million units is forecast for Western Europe. According to the VDA, the Chinese passenger car market is expected to grow somewhat slower in 2017 at 5% or 24.2 million passenger cars.

The initial effects of the Brexit vote have already been taken into account in the VDA's forecasts. In the U.K., a drop in sales of 8% to just over 2.4 million passenger cars is expected in 2017. With reference to the overall increase in economic uncertainty, the VDA makes it clear that a possible "hard Brexit" would have a negative impact on both the Western European market and the U.K. in the medium and long term. Finally, the VDA emphasizes the increased uncertainty regarding future trade relations between the U.S. and Europe.

In the Electromobility operating segment, paragon operates in selected submarkets of the capital goods industry. These currently include:

- Trolleybuses used in public transport.
- Forklifts used in intralogistics.
- Automated industrial trucks used in networked production.
- Mining vehicles used in underground mining.

Development in these submarkets mainly involves a substitution process for lead-acid batteries – or diesel generators in the case of trolleybuses – with lithium-ion batteries, from which the paragon Group profits with its range of products and services. These are trends that have a period of several years and typically show a saturation curve with increasing market penetration. Such trends are mainly determined by an assessment of the total ownership costs, in which, in addition to the acquisition and operating costs, transaction costs and opportunity costs are also taken into account.

While these evaluations are not uniformly standardized and the individual submarkets cannot be reliably quantified on a yearly basis, the following presentation shows the economic advantage of the lithium-ion batteries offered by paragon compared to conventional lead-acid batteries in their relevant fields of application.

	Lithium-ion	Lead-acid
Energy density	95 to 140 Watt hours per kg	40 Watt hours per kg
Charging efficiency	Up to 95%	Up to 70%
Cycle life	More than 3,000	Approximately 1,200
Fast charging	90% less than 1 hour	50% in approximately 3 hours
Emissions	Zero	Gassing and water loss

As a result, the following assumptions are particularly important for establishing the paragon Group's forecast:

- Slightly positive economic environment.
- Appropriate regulatory implementation of the Brexit process.
- Continued rational, rule-based framework for global trade relations.
- Increase in global sales of passenger cars of around 2%.
- Continuous substitution of lead-acid batteries and diesel generators with lithium-ion batteries. in occupied submarkets.

1 VDA press release from December 2, 2016: German automotive industry goes on the offensive regarding future mobility

paragon Group

The Group's corporate planning is based on detailed sales and revenue planning and is broken down by customer to the product level. The main cost components are planned via individual planning models for a period of several years and are then updated in proportion to the development of revenue.

Significant parameters, such as price changes in purchasing or sales as well as possible cost increases in personnel or changes in the tax base, are integrated into the planning. The constantly updated risk management system allows the company to identify risks at an early stage and, if necessary, counter them accordingly.

Based on the current competitive position of paragon and the extensive investments made in recent years, particularly in the development of production sites in Germany, the U.S. and, most recently, in China, the Management Board continues to expect paragon to grow more quickly than the global automotive industry in fiscal year 2017.

Group sales are expected to grow to between € 120 million and € 125 million in the current fiscal year. An EBIT margin of around 9.0% to 9.5% is expected.

The Electromobility operating segment (represented by the Voltabox subsidiaries) is expected to contribute about half of the revenue growth, while the remaining revenue growth is predominantly generated by the Electronics operating segment. As of fiscal year 2018, the Electronics operating segment and, to a lesser extent, the Mechanics operating segment are also expected to increasingly contribute to the Group's growth.

The Management Board expects to see an investment volume of around € 27 million in the current year. Own work capitalized will amount to around 45% of the investment total for the current year.

The further significant expansion planned in the Electromobility operating segment is intended to make paragon more independent of macroeconomic factors in the automotive industry and broaden the customer structure.

Development of Key Performance Indicators

	2015	2016	Change in %	Forecast		
In € thousands or as indicated				2016		2017
Financial performance indicators				As of Dec. 3, 2015	As of Nov. 18, 2016	
Revenue	94,990	102,790	8.2	Approx. 8% growth	Approx. 8% growth	€ 120 million to € 125 million
EBIT margin	8.2%	8.7%	n/a	Approx. 9%	Approx. 9%	9.0% to 9.5%
Investments	33,120	23,262	- 29.8	Approx. 14,000	Approx. 20,000	Approx. € 27 million

General Statement on the Company's Expected Development

Based on the current product portfolio and the structural measures introduced in 2016 regarding the operational implementation of the growth strategy, the Management Board of paragon AG expects a positive overall development of the paragon Group. With the development of product innovations in the Electronics and Mechanics operating segments, paragon will continue to orient itself strategically with megatrends to consistently exploit the growth opportunities resulting from the corresponding changes in the automotive value chain. The vertical range of manufacturing will be further optimized in all segments to sustainably increase the operative profitability of the paragon Group.

At the same time, the new, highly automated production line in the Electromobility operating segment will create the basis for the future production of battery modules or battery systems in high quantities with consistent high quality.

Dynamic business growth that simultaneously secures and expands sustainable profitability are the core elements of this business orientation. In addition, the further organic and inorganic development of additional fields for action with regard to portfolio expansion is being pursued – with close proximity to the core business and under tight profitability and investment requirements.

Takeover-related Disclosures Pursuant to Section 315 (4) of the German Commercial Code (HGB)

Composition of the Share Capital

paragon AG's subscribed capital amounts to € 4,526,266.00 and is divided into 4,526,266 no-par-value shares with a nominal value of € 1.00 each. All shares are entitled to dividends. Each share grants one vote at the Annual General Meeting.

Stock Voting Right and Transfer Restrictions

The Management Board is not aware of any limitations affecting voting rights or the transfer of shares.

Holdings that Exceed 10 Percent of the Voting Rights

As of December 31, 2016, the CEO of the company held 50 percent plus one share of the company's share capital.

Shares with Special Rights of Control

There are no shares that confer special rights of control.

Voting Right Controls for Employees Participating in the Capital

Insofar as employees participate in the capital as shareholders, they cannot derive any special rights from them.

Appointment and Dismissal of Members of the Management Board and Amendments to the Articles of Association

Regarding the rules for appointing and dismissing the members of the Management Board, reference is made to the statutory provisions of Sections 84 and 85 of the German Stock Corporation Act (AktG).

Regarding the rules for amending the Articles of Association, please refer to the statutory provisions of Sections 133 and 179 AktG.

Authorization of the Management Board to Issue Shares

With the resolution of the Annual General Meeting on April 27, 2016, the Management Board is authorized, with the consent of the Supervisory Board, to increase the company's share capital once or several times by up to € 2,057,394.00 until April 26, 2021, inclusive, via the issue of up to 2,057,394 new no-par-value shares against contribution in cash and/or in kind (Authorized Capital 2016/I).

Shareholders are to be granted a subscription right. The Management Board is however authorized, with the consent of the Supervisory Board, to exclude the statutory subscription rights of shareholders in the cases specified in Section 5 (6) of the Articles of Association as updated in October 2016.

Upon completion of the capital increase resolved by the Management Board on October 5, 2016, and approved by the Supervisory Board on the same day, the company's share capital increased by € 411,478.00 to € 4,526,266.00 via the issue of 411,478 new no-par-value shares. The company still had access to an authorized capital of € 1,645,916.00 as of the reporting date (Authorized Capital 2016/I).

A resolution at the Annual General Meeting from May 9, 2012, approved the conditional increase in the subscribed capital of € 410,000.00 by issuing 410,000 new no-par-value shares (Conditional Capital 2012/I).

Conditional Capital 2012/I serves exclusively to secure the subscription rights that are issued to members of the Management Board and employees as part of the share option program 2012 authorized by the Annual General Meeting on May 9, 2012, which runs from that date until May 8, 2017, inclusive. The conditional capital increase will only be performed insofar as the subscription rights are issued and their bearers exercise their subscription rights for shares in the company and the company does not provide treasury shares or a cash compensation to fulfill these subscription rights. The new shares participate in profit-sharing from the beginning of the fiscal year in which they arise by exercising the subscription right. The Management Board is authorized, with the consent of the Supervisory Board, to determine the further details regarding the implementation of the conditional capital increase. Insofar as the Management Board is involved, the Supervisory Board is accordingly authorized to act. The Supervisory Board is also authorized to adjust the Articles of Association according to the respective utilization of the conditional capital.

Furthermore, a resolution at the Annual General Meeting from May 9, 2012, approved the conditional increase in the subscribed capital of € 1,647,394 by issuing 1,647,394 new no-par-value shares (Conditional Capital 2012/II).

The conditional capital increase (Conditional Capital 2012/II) was created exclusively to grant shares to holders or creditors of bonds with options and/or convertible bonds that are issued or guaranteed until May 8, 2017, inclusive, by the company or by Group companies as defined in Section 18 of the German Stock Corporation Act (AktG) in which the company, either directly or indirectly, has a shareholding of at least 90% based on the authorization by the Annual General Meeting on May 9, 2012.

The same resolution adopted by the Annual General Meeting authorized the Management Board, with the approval of the Supervisory Board, to issue options and/or convertible bonds with a total nominal amount of up to € 100,000,000.00 and a term of up to 20 years on one or on several occasions up to and including May 8, 2017 and to grant or impose option or conversion rights and/or obligations for a total of up to 1,647,394 no-par-value shares in the company with a share in subscribed capital totaling € 1,647,394.00 on the holders or creditors of the respective options or bonds in accordance with the requirements of those bonds.

Change of Control and Compensation Agreements

There are no special provisions for a change of control nor are there any compensation agreements for possible takeover offers.

Corporate Governance Statement Pursuant to Section 289a of the German Commercial Code (HGB)

The Management Board and the Supervisory Board of paragon AG are committed to the principles of a transparent and responsible corporate governance and control structure. They ascribe a high priority to the standards of good corporate governance. With the CEO as the majority shareholder, the working methods of the Management Board conform with the principles of the "honorable merchant" in terms of its entrepreneurial responsibilities. This includes the obligation to ensure the continued viability of the company and its sustained value creation (corporate interests) in conformity with the principles of the "social market economy".

The Corporate Governance Statement pursuant to Section 289a of the German Commercial Code (HGB) can be accessed at any time on the paragon website at http://www.paragon.ag/en/investors/corporate-governance.html. It contains the corporate governance declaration pursuant to Section 161 of the German Stock Corporation Act (AktG) and the corporate governance report pursuant to No. 3.10 of the German Corporate Governance Code (GCGC).

Delbrück, March 3, 2017

Klaus Dieter Frers Chief Executive Officer	Dr. Stefan Schwehr Chief Technology Officer (Electronics)

Consolidated Financial Statements 2016

Note: Rounding differences of +/- one unit (€ thousands) may occur in tables.

Consolidated income statement of paragon AG, Delbrück, for the period from January 1, to December 31, 2016 (IFRS)

In € thousands	Notes	Jan. 1 – Dec. 31. 2016	Jan. 1 – Dec. 31. 2015
Revenue	(10), (42)	102,790	94,990
Other operating income	(11)	1,086	3,184
Increase or decrease in inventory of finished goods and work in progress		- 924	1,440
Other own work capitalized	(12)	15,317	12,752
Total operating performance		118,269	112,366
Cost of materials	(13)	- 57,741	- 55,516
Gross profit		60,528	56,850
Personnel expenses	(14)	- 29,248	- 26,307
Depreciation of property, plant and equipment and amortization of intangible assets	(16)	- 7,126	- 6,293
Impairment of property, plant and equipment and intangible assets	(19)	- 37	- 111
Other operating expenses	(15)	- 15,188	- 16,331
Earnings before interest and taxes (EBIT)		8,929	7,808
Financial income	(17)	2	143
Financial expenses	(17)	- 3,169	- 2,930
Financial result		- 3,167	- 2,787
Earnings before taxes (EBT)		5,762	5,021
Income taxes	(18)	- 2,201	- 1,618
Group result		3,561	3,403
Earnings per share in € (basic)	(19)	0,84	0,83
Earnings per share in € (diluted)	(19)	0,84	0,83
Average number of shares outstanding (basic)	(19)	4,217,658	4,114,788
Average number of shares outstanding (diluted)	(19)	4,217,658	4,114,788

Consolidated statement of comprehensive income of paragon AG, Delbrück, for the period from January 1, to December 31, 2016 (IFRS)

In € thousands	Notes	Jan. 1 – Dec. 31. 2016	Jan. 1 – Dec. 31. 2015
Group result		3,561	3,403
Actuarial gains and losses	(32)	- 142	15
Currency translation reserve		- 245	- 186
Total comprehensive income		3,174	3,232

Consolidated balance sheet of paragon AG, Delbrück, as of December 31, 2016 (IFRS)

In € thousands	Notes	Dec. 31, 2016	Dec. 31, 2015
ASSETS			
Noncurrent assets			
Intangible assets	(20)	37,188	23,959
Goodwill	(21)	843	770
Property, plant and equipment	(22)	37,378	34,551
Financial assets	(23)	326	326
Other assets		88	86
		75,823	59,692
Current assets			
Inventories	(24)	13,716	11,216
Trade receivables	(25)	8,377	10,377
Income tax assets		1,210	1,282
Other assets	(26)	2,149	1,529
Liquid funds	(27)	14,278	8,454
		39,730	32,858
Total assets		115,553	92,550

In € thousands	Notes	Dec. 31, 2016	Dec. 31, 2015
EQUITY AND LIABILITIES			
Equity			
Subscribed share capital	(28)	4,526	4,115
Capital reserve	(28)	15,165	2,450
Revaluation deficite	(28)	- 908	- 766
Profit-/loss carried forward		12,867	10,492
Group result		3,561	3,403
Currency translation differences		- 537	- 292
		34,674	19,402
Noncurrent provisions and liabilities			
Noncurrent liabilities from finance lease	(29)	2,215	1,721
Noncurrent loans	(30)	20,369	23,785
Noncurrent bonds	(31)	13,186	13,023
Special item for investment grants	(34)	1,092	1,178
Deferred income tax liabilities	(18)	5,475	3,514
Pension provisions	(32)	2,516	2,087
Other noncurrent liabilities		0	723
		44,853	46,031
Current provisions and liabilities			
Current liabilities from finance lease	(29)	998	615
Current loans and current portion of non-current loans	(30)	12,413	8,724
Trade payables		16,383	10,715
Other provisions	(35)	18	21
Income tax liabilities	(36)	82	85
Other current liabilities	(33)	6,132	6,957
		36,026	27,117
Total equity and liabilities		115,553	92,550

Consolidated cash flow statement of paragon AG, Delbrück, for the period of January 1 to December 31, 2016 (IFRS)

In € thousands	Notes	Jan. 1 – Dec. 31. 2016		Jan. 1 – Dec. 31. 2015	
Earnings before taxes (EBT)		5,762		5,021	
Depreciation/amortization of noncurrent fixed assets		7,126		6,293	
Financial result		3,167		2,787	
Gains (-), losses (+) from the disposal of property, plant and equipment and financial assets		198		- 28	
Increase (+), decrease (-) in other provisions and pension provisions		312		165	
Income from the reversal of the special item for investment grants		- 88		- 88	
Other non-cash income and expenses		- 1,425		64	
Increase (-), decrease (+) in trade receivables, other receivables, and other assets		1,379		551	
Impairment of intangible assets		37		111	
Increase (-), decrease (+) in inventories		- 2,499		- 3,695	
Increase (+), decrease (-) in trade payables and other liabilities		6,169		5,253	
Interest paid		- 3,169		- 2,930	
Income taxes		- 171		- 651	
Cash flow from operating activities	(42)		**16,798**		**12,853**
Cash receipts from the disposal of property, plant and equipment		110		778	
Cash payments for investments in property, plant and equipment		- 7,709		- 19,609	
Cash payments for investments in intangible assets		- 14,398		- 12,342	
Cash payments for investments in financial assets		0		50	
Cash payments for the acquisition of consolidated companies and other business units		- 1,155		- 1,219	
Interest received		2		7	
Cash flow from investment activities	(42)		**- 23,150**		**- 32,335**
Distribution to shareholders		- 1,029		- 1,029	
Loan repayments		- 3,796		- 3,769	
Proceeds from insolvency dividend		0		607	
Proceeds from loans		4,757		19,466	
Repayments of liabilities from finance leases		- 883		- 602	
Proceeds from equity contributions		13,127		0	
Cashflow aus Finanzierungstätigkeit	(42)		**12,176**		**14,673**
Changes in cash and cash equivalents		5,824		- 4,809	
Cash and cash equivalents at the beginning of the period		8,454		13,264	
Cash and cash equivalents at the end of the period		14,278		8,454	

Schedule of changes in equity of paragon AG, Delbrück, for the period of January 1 to December 31, 2016 (IFRS)

In € thousands	Subscribed capital	Capital reserve	Revaluation deficit	Reserve from currency translation	RETAINED EARNINGS Profit carried forward	RETAINED EARNINGS Group result	Total
January 1, 2015	**4,115**	**2,450**	**- 781**	**- 106**	**11,521**	**0**	**17,198**
Group result	0	0	0	0	0	3,403	3,403
Actuarial gains and losses	0	0	15	0	0	0	15
Currency translation	0	0	0	- 186	0	0	- 186
Other result	0	0	15	- 186	0	3,403	3,232
Total comprehensive income	**0**	**0**	**15**	**- 186**	**0**	**3,403**	**3,232**
Dividend payout	0	0	0	0	- 1,028	0	- 1,028
December 31, 2015	**4,115**	**2,450**	**- 766**	**- 292**	**10,493**	**3,403**	**19,402**

In € thousands	Subscribed capital	Capital reserve	Revaluation deficit	Reserve from currency translation	RETAINED EARNINGS Profit carried forward	RETAINED EARNINGS Group result	Total
January 1, 2016	**4,115**	**2,450**	**- 766**	**- 292**	**13,896**	**0**	**19,402**
Group result	0	0	0	0	0	3,561	3,561
Actuarial gains and losses	0	0	- 142	0	0	0	- 142
Currency translation	0	0	0	- 245	0	0	- 245
Other result	0	0	- 142	- 245	0	0	- 387
Total comprehensive income	**0**	**0**	**- 142**	**- 245**	**0**	**3,561**	**3,174**
Capital increase	411	12,715	0	0	0	0	13,126
Dividend payout	0	0	0	0	- 1,029	0	- 1,029
December 31, 2016	**4,526**	**15,165**	**- 908**	**- 537**	**12,867**	**3,561**	**34,674**

Notes to the Consolidated Financial Statements 2016

Notes to the Consolidated Financial Statements 2016

(1) General Information

paragon Aktiengesellschaft (hereafter "paragon AG" or "paragon") is a joint stock corporation incorporated under German law. The company's headquarters are in Delbrück, Schwalbenweg 29, Germany. paragon AG's shares have been traded on the Frankfurt Stock Exchange in the Prime Standard segment of the regulated market since 2000. paragon AG is entered in the commercial register of the district court of Paderborn (HRB 6726). paragon develops and manufactures electronic components and sensors for the automotive industry.

The Management Board of paragon AG authorized the consolidated financial statements as of December 31, 2016, and the management report for the period from January 1 to December 31, 2016, for submission to the Supervisory Board on March 3, 2017.

The consolidated financial statements and management report of paragon AG for the period from January 1 to December 31, 2016, are published in the electronic Federal Gazette and are available as part of the Annual Report on the company's website (www.paragon.ag).

(2) Application of International Financial Reporting Standards (IFRS)

The consolidated financial statements of paragon AG as of December 31, 2016, have been prepared in accordance with the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB), London, as adopted by the European Union (EU) and applicable on the balance sheet date, and in accordance with the interpretations of the International Financial Reporting Standards Interpretations Committee (IFRSIC).

(3) Going Concern

The financial statements for the reporting period from January 1 to December 31, 2016, have been prepared under the going concern assumption. The carrying amounts of assets and liabilities were therefore determined on the basis of going concern values.

(4) Events After the Balance Sheet Date

The consolidated financial statements are prepared on the basis of the circumstances existing as of the balance sheet date. In accordance with IAS 10.7, events after the reporting period include all events up to the date the consolidated financial statements are authorized for issue. The consolidated financial statements as of December 31, 2016, were authorized by the Management Board and submitted to the Supervisory Board for approval on March 3, 2017. All information available up to that date with regard to the circumstances applying on the balance sheet date must be taken into account.

Under a shareholder resolution dated December 19, 2016, Voltabox Deutschland GmbH was converted to a joint stock corporation. The change had not yet been registered at the commercial register as of March 3, 2017.

(5) New Accounting Principles Due to New Standards

The following revised and new standards issued by the IASB, as well as interpretations from the IFRSIC, had been endorsed by the EU and required mandatory application for the first time as of December 31, 2016:

- In November 2009, the IASB issued the new standard IFRS 9 *Financial Instruments* concerning the classification and measurement of financial assets. This standard is the first of the three-part project intended to fully supersede IAS 39 *Financial Instruments: Recognition and Measurement*. Pursuant to the IFRS 9 methodology, financial assets must be measured either at amortized cost or at fair value. Allocation to one of the two measurement categories depends on how the entity manages its financial instruments (its "business model") and on the characteristics of the individual financial assets. In October 2010 the IASB issued requirements governing the recognition of financial liabilities that supplement IFRS 9 *Financial Instruments*, and completed the classification and measurement stage of the IASB project to supersede IAS 39 *Financial Instruments: Recognition and Measurement*. Under the new requirements, an entity that has selected the option to recognize its financial liabilities at fair value must recognize that part of the change in fair value resulting from the change in its own credit risk in equity as part of other comprehensive income, rather than in the income statement. With the amendments to IFRS 9 *Financial Instruments* and IFRS 7 *Financial Instruments: Disclosures* issued in December 2011, the IASB postponed the date of mandatory first-time application for IFRS 9 from January 1, 2013, to January 1, 2015, and, in addition, introduced the obligation to disclose adjusted prior year figures upon first-time application of IFRS 9. Earlier application is permitted. Instead, additional note disclosure obligations have been included in IFRS 7 that are intended to enable readers of financial statements to assess the effects resulting from first-time application of IFRS 9 on the recognition and measurement of financial instruments. In November 2013, the IASB issued supplements to IFRS 9 *Financial Instruments* ("Hedge Accounting and Amendments to IFRS 9; IFRS 7 and IAS 39"). The supplements to IFRS 9 involve a fundamental revision of hedge accounting requirements intended to enable entities to improve the presentation of their risk management activities in their financial statements. Furthermore, extensive disclosure obligations are required. Moreover, the date of mandatory first-time application from January 1, 2015, previously included in IFRS 9, has been suspended. A new date of first-time application will only be set once the entire IFRS 9 project is about to be completed. In July 2014, the IASB issued the final version of IFRS 9 *Financial Instruments*. The new version includes revised requirements concerning the classification and measurement of financial assets, and for the first time also includes requirements concerning the impairment of financial instruments. The new "expected loss model" brings forward the recognition of losses by recognizing both those losses that have already arisen and those that are expected to arise in the future. The new requirements require mandatory application in fiscal years beginning on or after January 1, 2018. First-time application must generally be retrospective and a variety of simplification options have been granted. Earlier application is permitted. The standard was endorsed by the European Union on November 22, 2016. The changes have had no effect on the consolidated financial statements.

- On May 28, 2014, the IASB and the FASB, the U.S. standard setter, published the long-awaited, jointly compiled standard on revenue recognition. IFRS 15 *Revenue from Contracts with Customers* creates standardized regulations for all issues relating to the recognition of revenue from contracts with customers. IFRS 15 requires a consistent approach to accounting for various transactions and across all industries which will enhance the global comparability of company revenue disclosures (top line of financial statements). The only exceptions are contracts within the scope of *IAS 17 Leases*, IFRS 4 *Insurance Contracts, and* IFRS 9 *Financial Instruments*. This standard replaces the existing standards and interpretations dealing with revenue recognition (IAS 11 *Construction Contracts*, IAS 18 *Revenue*, IFRIC 13 *Customer Loyalty Programmes*, IFRIC 15 *Agreements for the Construction of Real Estate*, IFRIC 18 *Transfers of Assets from Customers*, and SIC-31 *Revenue – Barter Transactions Involving Advertising Services*). Due to the amendment to IFRS 15 published in September 2015, the date of first-time mandatory application has been postponed from January 1, 2017, to fiscal years beginning on or after January 1, 2018. First-time application must generally be retrospective. However, various simplification options are available. Earlier application is permitted. The standard was endorsed by the European Union on September 22, 2016. The initial application of this standard will result in the following impacts on revenue, according to our findings so far:

  - The separation of performance obligations required under certain conditions in accordance with IFRS 15 and the resulting allocation of the transaction price will influence the temporal distribution of the recognition of revenue.

  - When applying the criteria for period-related revenue recognition as stipulated in IFRS 15, the percentage of completion method pursuant to IAS 11 may lead to a delayed revenue recognition in individual cases compared to previous accounting methods.

  The impact on the amount of revenue is not expected to be material.

- On December 18, 2014, the IASB issued amendments to the standards IFRS 10, IFRS 12, and IAS 28. The amendments have clarified the application of the consolidation exception in cases where the parent company meets the definition of an investment entity. The amendments provide explicit confirmation that the exemption from preparing consolidated financial statements applies for subsidiaries of an investment entity if such subsidiaries are themselves parent companies. A subsidiary that provides services that support the parent company's investment activities (investment-related services) does not require consolidation if the subsidiary is itself an investment entity. Similarly, simplified application of the equity method is permitted for companies that are themselves not investment entities, but nevertheless hold interests in an associate that is an investment entity. Investment entities that measure all of their subsidiaries at fair value are required to provide the disclosures on investment entities laid out by IFRS 12. These amendments require application in fiscal years beginning on or after January 1, 2016. The amendments were endorsed by the European Union on September 22, 2016. The amendments have had no effect on the consolidated financial statements.

The following standards and interpretations had already been issued but did not yet require mandatory application, and/or had not been endorsed by the European Union as of the date that the financial statements for the period from January 1 to December 31, 2016, were prepared:

- On September 11, 2014, the IASB issued amendments to IFRS 10 *Consolidated Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures* based on *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendments to IFRS 10 and IAS 28)*. This is intended to eliminate the previous inconsistency between IFRS 10 and IAS 28 concerning the question of full (IFRS 10) or partial (IAS 28) gain or loss recognition upon the loss of control of a subsidiary. Within IAS 28, the requirements governing gains and losses from transactions between an enterprise and its associate or joint venture have been amended (IAS 28.28–30). The new requirements refer exclusively to assets that do not constitute a business as defined in IFRS 3.3 (in conjunction with IFRS 3.B7 et seq.). Gains and losses from transactions with associates and joint ventures in respect of assets that constitute a business must now be fully recognized in the financial statements of the investor (IAS 28.31A). Enterprises must further review whether assets sold or contributed in separate transactions constitute a business and should be accounted for as a single transaction (IAS 28.31B). In IFRS 10, an exception to the complete recognition through profit or loss of any loss of control over a subsidiary has therefore been included in Paragraph B99A. This applies to the extent that the assets abandoned do not constitute a business, and in the event that the loss of control arises due to a transaction with an associate or joint venture recognized using the equity method. Guidelines have also been added that any gains or losses arising from such transactions may only be recognized in the income statement of the parent company in the amount of the share attributable to unrelated third-party investors in the associate or joint venture. The same applies to gains and losses resulting from the fair value measurement of interests in subsidiaries that now constitute associates or joint ventures and are measured using the equity method. The amendments originally required application in fiscal years beginning on or after January 1, 2016. On December 17, 2015, the IASB proposed postponing the date of first-time application indefinitely. The company is of the opinion that the amendments will have no material implications on the consolidated financial statements.

- On January 13, 2016, the IASB issued a new accounting standard, IFRS 16 *Leases*. The basic principle of the new standard is that lessees shall present all leases and the resulting contractual rights and obligations on the balance sheet. The obligation for the lessee to distinguish between finance leases and operating leases required to date under IAS 17 no longer applies. The lessee records a leasing liability in the balance sheet for the obligation to make lease payments in future periods in respect of all leases. At the same date the lessee records a right of use in respect of the underlying asset, which shall represent the present value of the future lease payments plus any directly attributable costs. The lease payments include all fixed payments, variable payments that are index-based, expected payments based on residual value guarantees, and, where applicable, the exercise price for a purchase option and penalties for the early termination of lease agreements. During the term of the lease agreement the leasing liability is carried forward in a manner similar to IAS 17 requirements for finance leases, while the right-of-use asset is amortized. This generally leads to higher expenses at the beginning of the contractual period of the lease. Simplified rules apply to short-term lease arrangements and to leased assets with a small value. For the lessor, however, the rules under the new standards are similar to those under the existing IAS 17 standard. Lease contracts will continue to be classified as either finance or operating leases. Leases which transfer all significant risks and rewards of ownership will be classified as finance leases, and all other leases will be classified as operating leases. The classification criteria under IAS 17 has been carried forward into IFRS 16. In addition, IFRS 16 includes a number of additional rules on disclosure requirements and requirements that apply to sale and leaseback transactions. The new requirements shall be applied to fiscal years beginning on or after January 1, 2019. Earlier application is permitted, provided that IFRS 15 is also applied. The European Union has not yet endorsed the new standard. At the present time the company cannot yet make a final estimate of the effect that the initial application of the new standard will have on the consolidated financial statements.

- On June 20, 2016, the IASB issued amendments to IFRS 2 *Classification and Measurement of Share-based Payment Transactions*. The amendments affect the following aspects:

  - The effects of vesting conditions (service conditions, market conditions, and other performance conditions) on the measurement of cash-settled share-based payment transactions: Following the amendments, market and non-vesting conditions are taken into account when estimating fair value. Service conditions and other performance conditions are taken into account by adjusting the number of awards.

  - The classification of share-based payment transactions with net settlement features for withholding tax obligations: If an entity withholds shares that would have otherwise been issued because it is required to fund the payment to the tax authority in respect of the employee's tax obligation associated with the share-based payment, and this net arrangement is provided for in the contract, then the remuneration – despite the partial settlement in cash – is to be accounted for as equity-settled share-based remuneration.

- The accounting for a modification to the terms and conditions of a share-based payment transaction that changes its classification from cash-settled to equity-settled: The equity-settled share-based payment transaction is measured at the (pro rata temporis) fair value of the equity instruments granted at the modification date. Any difference to the liability derecognized is recorded in profit and loss.

The amendments shall be applied to remuneration which is granted or modified in fiscal years beginning on or after January 1, 2018. Earlier application is permitted. A retrospective application is only permitted when the use of improved information obtained in hindsight is excluded. The European Union has not yet endorsed the amendments. The Group is currently of the opinion that the amendments will not have a significant effect on the presentation of the financial statements.

- On January 29, 2016, as part of its Disclosure Initiative the IASB issued amendments to IAS 7 *Statement of Cash Flows*. The amendments are intended to improve the reported information about an entity's financing activities. Following the amendments an entity is required to provide disclosures about the changes in financial liabilities whose cash inflows and outflows are shown in the statement of cash flows within financing activities. The disclosure requirements also relate to changes in associated financial assets (e.g., assets used for hedging purposes).

  Disclosure is required of changes from financing cash flows, changes arising from acquiring or disposing of businesses, the effect of changes in foreign exchange rates, changes in fair values, and other changes.

  The IASB proposes that the disclosures are made by providing a reconciliation between the opening and closing balances in the statement of financial position. Other forms of presentation are also permitted. The changes are effective for fiscal years which begin on or after January 1, 2017. Earlier application is permitted. Comparative figures are not required in the year of initial application. The European Union has not yet endorsed the amendment. The company is of the opinion that the amendments will have no material implications on the consolidated financial statements.

- The IASB issued an amendment to IAS 40 *Investment Property* on December 8, 2016. The amendment to IAS 40 is designed to clarify when the classification of a property as "investment property" begins and ends when the property is under construction or development. The complete list provided to date in IAS 40.57 did not provide sufficient clarification on the treatment of property under construction. The list is now explicitly described as not being exhaustive so that property under construction can be included in the definition. The amendment is effective from January 1, 2018. Earlier application is permitted. The European Union has not yet endorsed the amendment. The amendment will not have any effect on the consolidated financial statements.

- The IASB issued IFRIC 22 *Foreign Currency Transactions and Advance Consideration* on December 8, 2016. IFRIC 22 addresses an application question relating to IAS 21 *The Effects of Changes in Foreign Exchange Rates*. The interpretation clarifies the date on which the exchange rate used to convert a payment or receipt of advance consideration should be determined. The date to be used to determine the exchange rate for the underlying asset, income or expense is the date of initial recognition of the prepayment asset or deferred income liability. The interpretation is effective from January 1, 2018. Earlier application is permitted. The European Union has not yet endorsed the interpretation. The company is of the opinion that the amendments will have no material implications on the consolidated financial statements.

- The IASB issued the Annual Improvements to IFRSs (2014–2016) on December 8, 2016. Three standards were amended in the Annual Improvements to IFRSs (2014–2016). The amendments were as follows:

  - IFRS 1 *First-time Adoption of International Financial Reporting*: deletion of the remaining exemptions in IFRS 1 which were limited to specific periods in time. Appendix E (IFRS 1.E3–E7) for first time preparers.

  - IFRS 12 *Disclosure of Interests in Other Entities*: clarification that the disclosure requirements in this standard – with the exception of IFRS 12.B10–B16 – also apply to investments which fall within the application of IFRS 5.

  - IAS 28 *Investments in Associates and Joint Ventures*: clarification that the option to measure an investment in an associate or joint venture which is held by a venture capital entity or another qualifying entity can be exercised individually on an investment-by-investment basis.

The amendments to IFRS 12 are effective from January 1, 2017, and the amendments to IFRS 1 and IAS 28 are effective from January 1, 2018. Earlier application is permitted. The European Union has not yet endorsed the amendments. The company is of the opinion that the amendments will have no material implications on the consolidated financial statements.

In addition, debt consolidation was carried out, as was consolidation of income and expenses. The differences arising from the consolidation of income and expenses were offset through profit or loss.

(6) Scope of Consolidation

Name and registered office of the company	Shareholding	Consolidation	Currency	Revenue in local currency (prior to consolidation)
Germany				
paragon AG, Delbrück	n/a	n/a	EUR	125,691,136.37
KarTec GmbH, Forchheim	100 %	Consolidated subsidiary	EUR	201,446.00
Voltabox Deutschland GmbH, Delbrück	100 %	Consolidated subsidiary	EUR	14,182,589.90
productronic GmbH, Delbrück	100 %	Consolidated subsidiary	EUR	58,182,975.73
SphereDesign GmbH, Bexbach	100 %	Consolidated subsidiary	EUR	7,434,698.83
China				
paragon Automotive Technology (Shanghai) Co., Ltd.	100 %	Consolidated subsidiary	RMB	1,653,743.33
paragon Automotive (Kunshan) Co., Ltd.	100 %	Consolidated subsidiary	RMB	89,114.16
USA				
Voltabox of Texas, Inc.	100 %	Consolidated subsidiary	USD	4,279,382.67

In addition to the parent company, paragon AG, Delbrück, Germany, seven subsidiaries are fully consolidated. The balance sheet date for all companies is December 31.

Assets arising from intercompany deliveries that are recognized in noncurrent assets and inventories are adjusted for interim profit and loss.

Consolidation Methods

The consolidated financial statements are based on the separate financial statements of the companies included in the Group, which were prepared using uniform accounting policies under IFRS as of December 31, 2016. Adjustments were made to the audited annual financial statements of paragon AG prepared in accordance with German commercial law as of December 31, 2016, in order to prepare the financial statements in compliance with IFRS.

The consolidation was performed using the acquisition method in accordance with IAS 27.22 and IFRS 3. The carrying amount for the investments in associates recorded by the parent companies is replaced by the fair value of the assets and liabilities of the associates included in the consolidation. As a result, the equity of the subsidiaries is compared with the carrying amount of the investment recorded by the parent company. Any remaining excess from consolidation is reported as goodwill under noncurrent assets and is tested annually for impairment in accordance with IFRS 3 in conjunction with IAS 36.

(7) Currency Translation

In paragon's consolidated financial statements, receivables and liabilities denominated in foreign currencies are measured at the transaction rate in effect at the date they are initially recognized, and subsequently adjusted to the exchange rate applicable as of the balance sheet date. Exchange rate gains and losses are recognized in profit and loss within other operating income or other operating expenses.

Exchange rate losses arising on operating activities of € 136 thousand (prior year: € 140 thousand) and exchange rate gains of € 142 thousand (prior year: € 1,628 thousand) are recognized in the consolidated income statement. These exchange rate differences are reported within other operating expenses and other operating income, respectively.

The exchange rates of the currencies significant to the paragon Group were as follows:

Foreign currency for € 1	Balance sheet – mean rate as of Dec. 31, 2016	Profit & loss – average rate 2016	Balance sheet – mean rate as of Dec. 31, 2015	Profit & loss – 2average rate 2015
US dollar (USD)	1.0520	1.0538	1.0907	1.1103
Chinese renminbi yuan (RMB)	7.3062	7.3062	7.0805	6.9149

(8) Description of Accounting Polices and Measurement Methods

The consolidated financial statements were prepared in euros (€). The reporting currency as defined in IAS 21 *The Effects of Changes in Foreign Exchange Rates* is the euro. Unless stated otherwise, all amounts are stated in thousands of euros (€ thousand). The reporting period for paragon in these financial statements extends from January 1 to December 31, 2016. Individual items in the consolidated balance sheet and the consolidated income statement have been combined in order to provide better clarity and transparency. Where this has occurred, the items are explained individually in the notes to the financial statements. The consolidated income statement income is presented using the nature of expense method, as in previous periods. Assets and liabilities are classified into noncurrent and current assets and liabilities in the balance sheet; further details on their maturity are presented in the notes. Assets and liabilities are recognized as current if they mature within twelve months.

The consolidated financial statements comprise the consolidated income statement, the consolidated statement of comprehensive income, consolidated balance sheet, the consolidated cash flow statement, the consolidated statement of changes in equity and the notes to the consolidated financial statements. A Group management report has been prepared as a supplement to the above statements.

Intangible Assets

Intangible assets acquired for monetary consideration are recognized in the balance sheet at their acquisition cost, taking into account ancillary costs and any purchase price reductions.

Research costs are recognized as expenses in the period in which they are incurred. Costs incurred in connection with the development of patents and customer-specific solutions are only recognized as intangible assets at their production cost when the costs are clearly attributable to the asset as required by IAS 38 *Intangible Assets*, the technical feasibility and marketability or use is assured, and when the anticipated realization of future economic benefits has been demonstrated. The costs of production comprise all costs that are directly or indirectly attributable to the development process, as well as a proportionate share of necessary project-related overhead costs. If the asset recognition requirements are not fulfilled, development costs are directly expensed in profit or loss within other operating expenses in the year in which they are incurred. Subsequent to initial recognition, development costs are reported in the balance sheet at cost less cumulative amortization and cumulative impairment losses. Intangible assets that have limited useful lives are amortized on a straight-line basis over their useful economic lifetimes. Amortization starts as soon as the asset is available for use, i.e., when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Intangible assets with indefinite useful lives are subject to annual impairment tests. At each balance sheet date, the carrying amounts of such intangible assets are examined in order to determine whether there are indications that the value of the asset may be impaired. An impairment test pursuant to IAS 36 *Impairment of Assets* was performed where there are such indicators. The residual values, useful lives, and amortization methods are reviewed at the end of each fiscal year and amended as necessary.

The useful lives for internal development costs correspond to the expected product life cycles and amount to between three to four years. The useful lives for licenses, patents, and software range from three to ten years.

Goodwill is carried at acquisition cost and tested for impairment each year and, additionally, at other dates when there are any indications of potential impairment. Impairment losses are recognized under impairments of property, plant and equipment and intangible assets.

Property, Plant and Equipment

Additions to property, plant and equipment are measured at cost plus incidental acquisition costs and any purchase price reductions received. If the cost of individual components of an item of property, plant and equipment is significant when measured against the item's total purchase cost, then such components are recorded as separate assets and depreciated individually. Depreciation is recorded on a straight-line basis. The useful life for depreciation purposes ranges from 20 to 33 years for buildings, five to ten years for technical plants, and three to ten years for other equipment, operating and office equipment.

Fully depreciated noncurrent assets are presented under cost and accumulated depreciation until the asset is retired. Amortized cost and accumulated depreciation are deducted from the sales proceeds generated on disposal. Gains and losses generated on disposal (disposal proceeds less residual carrying amounts) are shown in the consolidated income statement within other operating income or other operating expenses. All residual values, useful lives, and depreciation methods are reviewed annually and amended as necessary.

At each balance sheet date, the carrying amounts of property, plant and equipment (which are depreciated in accordance with their useful lives) are examined in order to determine whether there are indications that the value of the asset may be impaired. If such indicators exist, an impairment test is performed.

Leases

Leases are classified as finance leases if all the risks and rewards associated with beneficial ownership of an asset are substantially transferred to paragon. Property, plant and equipment held under finance lease arrangements in accordance with IAS 17 *Leases* are capitalized at the lower of their fair value and the present value of the minimum lease payments at the beginning of the usage period. A liability is recognized in the balance sheet for the same amount, and, subsequent to initial recognition, measured at amortized cost using the effective interest method. The amortization methods and useful lives correspond to those of similar assets acquired under purchase arrangements.

If beneficial ownership in a lease falls to the lessor (operating lease), the leased asset is recognized in the balance sheet of the lessor. Expenses arising from such leases are shown under other operating expenses.

The determination as to whether an agreement contains a lease is based on the economic nature of the agreement at its inception. Therefore, an estimate is made regarding every lease as to whether fulfilling the contractual agreement is dependent on using a specific asset or specific assets and whether the agreement grants a right to use the asset.

A sale and leaseback transaction involves the sale of an asset owned and already used by the future lessee to the lessor, and the subsequent continued use of the asset by the lessee under a lease agreement. In this respect, two economically interdependent agreements are involved (purchase agreement and lease agreement). The transaction is accounted for as a single transaction, either as an operating lease or a finance lease, depending on the nature of the leaseback agreement.

Impairment of Nonfinancial Assets

At each balance sheet date, an assessment takes place to ascertain whether there are any indications that the value of nonfinancial assets (in particular intangible assets with definite useful lives) are impaired. If there are indications of impairment, an estimation of the recoverable amount of the relevant asset is made. In accordance with IAS 36.6 *Impairment of Assets*, the recoverable amount reflects the higher of fair value less cost to sell and value in use of the asset or an identifiable group of assets that represent a cash-generating unit (CGU). If the carrying amount of an asset or a CGU exceeds the recoverable amount, the asset is impaired and written down to its recoverable amount.

For property, plant and equipment and intangible assets other than goodwill, an assessment is made at each balance sheet date to establish whether there is any indication that a previously recognized impairment loss no longer exists or has decreased. If there are such indications, an estimate of the recoverable amount of the asset or the CGU is made. A previously recognized impairment loss is reversed only if the assumptions used in determining the recoverable amount have changed since the last impairment loss was recognized. The reversal of the impairment loss is limited in that the carrying amount of an asset may not exceed its recoverable amount or the carrying amount that would have resulted after taking depreciation and amortization into account if no impairment loss had been recorded for the asset in earlier years.

Financial Instruments

A financial instrument is a contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. A necessary requirement is that the rights or obligations are financial in nature, based on legal transactions in the form of agreements or contracts.

Financial assets primarily include cash and cash equivalents, trade receivables, loan receivables, other receivables, and primary and derivative financial assets held for trading. Financial assets are measured at either fair value or amortized cost depending on their classification. The fair values recorded in the balance sheet are generally measured using the market prices of the financial assets. Where no market prices are available, fair value is calculated using recognized valuation models and by referring to current market parameters.

Financial assets and derivative financial instruments held for trading are measured at fair value. Financial instruments classified as loans and receivables are accounted for at amortized cost. Amortized cost takes into account payments of principal and the amortization of any possible difference between the cost and the anticipated payment inflows at maturity, using the effective interest rate method, less any possible decreases from impairment due to uncollectibility.

As a rule, financial liabilities are contractual obligations to deliver cash or another financial asset. Pursuant to IAS 39 *Financial Instruments: Recognition and Measurement*, at paragon these consist in particular of trade payables and other current liabilities as well as liabilities to banks. paragon classifies financial liabilities under the measurement category of loans and receivables and measures them at amortized cost, taking into account principal payments and the amortization of any difference between the acquisition cost and the payment obligation due on maturity using the effective interest rate method.

Financial assets are derecognized once the contractual right to obtain cash flows from these financial assets has expired, or once paragon has transferred its contractual rights to obtain cash flows from the financial asset to a third party or has taken on a contractual obligation for immediate payment of the cash flows to a third party as part of an agreement that fulfills the conditions in IAS 39.19 (pass-through arrangement). If financial assets are transferred, paragon examines whether it has either (1) transferred all substantial risks and rewards connected with a financial asset, or (2) neither transferred nor retained any substantial risks or rewards associated with the financial asset, but has transferred the power to control the asset.

paragon recognizes a new asset, if (1) all contractual rights to cash flows from the asset have been transferred to paragon, or (2) the substantial risks and rewards associated with the asset have neither been transferred nor retained, but paragon has received the power to control the asset.

Financial liabilities are derecognized if the underlying obligation has been fulfilled, canceled or has expired. If an existing financial liability is replaced by another financial liability to the same creditor with significantly new contract terms, or if the terms of an existing liability are fundamentally changed, this replacement or change is treated as a derecognition of the original liability and the recognition of a new liability. The difference between the respective carrying amounts is recognized in profit or loss.

Financial assets and financial liabilities that are not denominated in euros are initially recognized at the average rate applicable on the transaction date and subsequently remeasured at each balance sheet date. Any currency translation differences that arise are recognized in profit or loss.

Financial assets and financial liabilities are shown as current in the balance sheet if they are either classified as held for trading or if they are expected to be settled within twelve months of the balance sheet date.

Income Taxes

Income taxes contain both taxes that are payable on income and deferred taxes.

Income taxes payable for current and earlier periods are measured at the amount at which a refund from or payment to fiscal authorities is anticipated. The calculation of that amount is based on the current status of tax legislation and therefore on the tax rates that are in effect or that have been announced as of the balance sheet date.

Deferred taxes are recognized using the balance sheet liability method in accordance with IAS 12 Income Taxes. Deferred tax assets and liabilities are recognized to reflect temporary differences between the carrying amount of a specific balance sheet item in the IFRS consolidated financial statements and its tax base (temporary concept). Deferred taxes are also recognized for future tax refund claims.

Deferred tax assets on deductible temporary differences and tax refund claims are recognized to the extent it can be assumed that they can be expected to be used in future periods, based on the availability of adequate taxable income.

The calculation of current and deferred taxes is based on judgments and estimates. If actual events deviate from these estimates, this could have a positive or negative impact on the assets, financial position and earnings. A deciding factor for the recoverability of deferred tax assets is the estimate of the probability of reversal of measurement differences or the usability of the tax loss carryforwards or tax benefits that led to recognition of the deferred tax assets. This is in turn dependent on the generation of future taxable profits during the period in which the tax loss carryforwards can be used. Deferred taxes are measured using the tax rates applicable at the time of realization based on the current legal situation as of the balance sheet date.

Current income tax assets and liabilities and deferred income tax assets and liabilities are only offset if it is legally permissible to do so and the deferred tax assets and liabilities relate to income taxes that have been levied by the same tax authority and if there is a legally enforceable right to offset current tax refund claims against current tax liabilities. Deferred taxes are reported as noncurrent in accordance with IAS 1.70.

Inventories

Inventories are measured at the lower of cost and net realizable value. In accordance with IAS 2 *Inventories*, the costs of conversion include all costs directly related to the units of production as well as a systematic allocation of fixed and variable production overheads. In addition to direct materials and direct labor, they therefore also contain proportional indirect materials and overheads. Administration and social welfare expenses are taken into account provided they can be attributed to production.

Financing costs are not recognized as part of the cost of acquisition or conversion because the assets do not meet qualification criteria. Inventory risks resulting from the storage period and reduced usability are taken into account during the calculation of the net realizable value by applying appropriate write-downs. Lower values at year-end resulting from reduced selling prices are also taken into account. Raw materials, consumables, and supplies as well as merchandise are primarily measured using the moving average method.

Trade Receivables and Other Current Assets

Trade receivables are classified as loans and receivables and measured at amortized cost less any necessary write-downs. Write-downs in the form of specific valuation allowances take sufficient account of the expected default risks. Specific defaults lead to the derecognition of the receivables concerned. The calculation of write-downs for doubtful receivables is primarily based on estimates and evaluations of the creditworthiness and solvency of the respective customer.

Other current assets are measured at amortized cost, taking into account necessary write-downs sufficient to cover the expected default risks. If recourse to the courts is made for the collection of these receivables, paragon firmly expects that the amounts recognized in the balance sheet will be fully enforceable. Where these represent financial assets (financial instruments), they are classified as loans and receivables.

Cash and Cash Equivalents

Cash and cash equivalents include cash and bank balances with original maturities of up to three months. They are measured at nominal value. Foreign currency positions are measured at fair value. The total of cash and cash equivalents reported in the cash flow statement corresponds to the cash and cash equivalents stated in the balance sheet (cash and bank balances). As of December 31, 2016, the Group reported receivables of € 734 thousand (prior year: € 544 thousand) relating to factoring agreements under cash and cash equivalents.

Provisions for pensions

Provisions for pensions are calculated using the projected unit credit method in accordance with the revised requirements of IAS 19 *Employee Benefits*. The key change was the elimination of the previously permitted accounting option to defer the recognition of actuarial gains and losses using the corridor method. Under the revised standard full recognition is required directly in equity in the revaluation reserve.

The projected unit credit method not only takes into account the pension benefits and benefit entitlements known as of the balance sheet date, but also the increases in salaries and pension benefits to be expected in the future based on relevant estimation factors. The calculation is based on actuarial calculations, using biometric actuarial principles. Amounts not yet recorded in the balance sheet arise from actuarial gains and losses due to changes in inventory and differences between the assumptions made and actual developments. Actuarial gains and losses occurring in the reporting period are recognized in full directly in equity within other comprehensive income. The service cost is shown under personnel expenses. The interest cost included in pension expenses is recorded in the financial result.

Other Provisions

Other provisions are recognized in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, when paragon has a legal or constructive present obligation to third parties as a result of a past event that is likely to lead to an outflow of resources. Provisions are measured based on a best estimate of the expenditure needed to discharge the liability. Reimbursement claims are not offset against these amounts. Each situation is evaluated separately to determine the probability that pending proceedings will be successful, or to qualify the possible amount of the payment obligations. In each case, the most probable settlement amount has been taken into account. Noncurrent provisions have been measured at their discounted settlement amount as of the balance sheet date.

Due to the uncertainty associated with these evaluations, the actual settlement obligation or the actual outflow of resources may deviate from the original estimates and, accordingly, from the amounts of the provisions made. In addition, estimates may change based on subsequent new information, which may have a substantial impact on the future earnings position.

Government Grants

Government grants are recognized in accordance with IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* and shown in the balance sheet under noncurrent liabilities. In accordance with IAS 20, government grants are recognized only if there is reasonable assurance that the conditions attaching to them will be complied with and that the grants will be received. Government grants are accounted for as a deferred liability and released to income over the average useful life of the assets subsidized. The grants are released to income over the expected assumed useful life of the assets subsidized and credited to other operating income.

Financial Liabilities and Equity Instruments

Financial liabilities and equity instruments are classified in accordance with the economic substance of the underlying agreements. Equity instruments are recognized at the value of the funds or other assets received less directly attributable external transaction costs.

Trade Payables and Other Current Liabilities

Trade payables and other current liabilities do not bear interest and are recognized at their nominal amounts.

Recognition of Income and Expenses

Income is recognized when it is probable that economic benefits will flow to paragon and the amount of the income can be measured reliably. Income is measured at the fair value of the consideration received. Sales tax and other levies are not included. If transactions provide for a declaration of acceptance on the part of the purchaser, the related revenue is only recognized once such a declaration has been issued. If the sale of products and services includes multiple delivery and service components (multiple element arrangements), such as varying remuneration agreements in the form of prepayments, milestone payments and similar payments, a review takes place to ascertain whether revenue should be recognized separately for partial sales at different points in time. Contractually agreed prepayments and other non-recurring payments are deferred reported in profit or loss over the period during which the contractually agreed service is performed.

Income from the sale of products is recognized once the significant risks and rewards associated with ownership of the products sold have been transferred to the purchaser. This normally occurs upon shipment of the products, consistent with the agreements entered into with customers. Revenue is shown after the deduction of discounts, rebates and returns.

Revenue from development services is recognized on the basis of the percentage of completion achieved as of the balance sheet date.

Interest income and interest expenses are recognized according to the effective interest method. Operating expenses are recorded in profit and loss when the relevant services are rendered or when the expenses are incurred.

Borrowing Costs

Borrowing costs are recognized as an expense in the period in which they are incurred. They are capitalized if they fulfill the requirements of a qualifying asset in accordance with IAS 23 *Borrowing Costs*.

(9) Use of Estimates and Assumptions

The preparation of the consolidated financial statements in accordance with IFRS requires assumptions and estimates to be made that impact on the assets and liabilities recorded, the disclosure of contingent liabilities as of the balance sheet date and the presentation of income and expenses during the period under review. If actual events deviate from these estimates, this could have a positive or negative impact on the assets, financial position and earnings.

When applying the accounting policies, the following estimates and assumptions were made that significantly influenced the amounts contained in the financial statements:

Measurement of the Fair Values of the Assets Acquired and Liabilities Assumed in Business Combinations

The fair values as well as the allocation of acquisition costs to the assets acquired and liabilities assumed were determined on the basis of experience and estimates regarding future cash inflows. The actual cash inflows may differ from the estimated amounts.

Goodwill

As described in the accounting principles, the Group tests goodwill for impairment once a year and when there are any indications that the value of goodwill may be impaired. This involves estimating the recoverable amount of the cash generating unit. This corresponds to the higher of fair value less costs of disposal and value in use. When determining the value in use, adjustments and estimates have to be made concerning the forecast and discounting of future cash flows. Although the Management Board believes that the assumptions used to determine the recoverable amount are appropriate, unforeseeable changes in these assumptions could lead to an impairment loss that could have a sustained negative influence on the assets, financial position and earnings.

Capitalized Development Costs

In order to measure capitalized development costs, assumptions have been made about the amount of anticipated future cash flows from assets, about the discount rates to be used and about the period of time during which these assets will generate anticipated future cash flows. The assumptions made regarding the timing and amount of future cash flows are based on expectations of the future development of orders on hand from those customers with whom development projects are being conducted.

Inventories

In specific cases, inventories are measured based on anticipated revenue less the estimated costs to completion and the estimated selling costs required. Actual revenue and the actual costs to completion may deviate from anticipated amounts.

Information about the measurement discounts can be found in the comments on inventories in the previous section (note 8).

Estimates are required for the recognition of income from the provision of services on the basis of the percentage of completion as of the balance sheet date. The main measurement parameter is the percentage of completion which is determined on the basis of a careful estimate of the total contract costs, the costs to be incurred up to the time of completion, the total contract revenue, the contract risks, and other assumptions.

Other Assets and Liabilities

Assumptions and estimates are also necessarily made when calculating allowances for doubtful receivables, when estimating contingent liabilities and other provisions, and when determining the fair value of long-lived assets included in property, plant and equipment and intangible assets.

In individual cases, actual values may deviate from the assumptions and estimates made, requiring an adjustment of the carrying amounts of the assets or liabilities concerned.

Deferred Tax Assets and Liabilities

Deferred tax assets are only recorded if a positive tax result is expected in future periods and as a result their realization appears sufficiently assured. The actual taxable income situation in future periods may deviate from the estimate made at the time the deferred tax assets were recognized.

Domestic deferred taxes were calculated as of December 31, 2016, at a combined income tax rate of 30.0% (prior year: 30.0%). This includes a corporate tax rate of 15% and a solidarity surcharge of 5.5%. The income tax rate also reflects trade taxes, taking into account the breakdown of the trade tax assessment rates among the municipalities in which the company's branches are located.

Deferred taxes for the foreign subsidiaries are calculated using a tax rate of 34.6% (prior year: 34.6% for Voltabox of Texas, Inc. and 30.0% for paragon Automotive Technology (Shanghai) Co., Ltd. and paragon Automotive (Kunshan) Co., Ltd. each).

Provisions for pensions

Expenses arising from defined benefit plans are calculated using actuarial valuation reports. The actuarial valuation reports are based on assumptions concerning discount rates, expected revenue from plan assets, future wage and salary increases, mortality rates and future pension increases. These estimates are subject to significant uncertainty due to the long-term nature of these plans.

The valuation as of December 31, 2016, was discounted using the expected long-term market rate of interest of 1.50% (prior year: 2.00%).

The remaining assumptions used in the actuarial valuation were a salary growth rate of 0% from 2009 onwards and pension growth of 2.00%, as in the prior year.

Other Provisions

The recognition and measurement of other provisions was based on the estimated probability of the future outflow of benefits and on experience values, and on the facts and circumstances known as of the balance sheet date. The subsequent actual outflow of benefits may therefore differ from the amount recorded within other provisions as of the balance sheet date.

Recognition of Revenue from Construction Contracts

Construction contracts are recognized using the percentage of completion (PoC) method. The percentage of completion to be recognized is determined using the cost-to-cost method. This method requires a precise estimate of the extent of the progress made with the contract. Further estimates are made of general contract-related risks. The controlling department at the operating company reviews all estimates required for construction contracts on an ongoing basis and amends these where necessary.

Legal Risks

From time to time paragon Group companies may become parties to legal disputes. Management regularly analyzes the latest information available for these cases and, where necessary, recognizes provisions to cover probable obligations, including the estimated amount of associated legal costs. External attorneys are consulted in the process of making these assessments. In determining the need for provisions, the Management Board accounts for the probability of an unfavorable outcome and whether the obligation can be measured with sufficient reliability. The filing of a lawsuit, the formal assertion of a claim or the presence of a disclosure for legal dispute in the notes does not automatically mean that a provision for the respective risk is appropriate.

(10) Revenue

Revenue consists of the proceeds from sales of products and services less any sales reductions. The total revenue for the reporting period amounted to € 102,790 thousand (prior year: € 94,990 thousand), of which € 70,251 thousand (prior year: € 65,297 thousand) was generated in Germany and € 32,539 thousand (prior year: € 29,693 thousand) was generated in foreign countries.

Other revenue of € 7,815 thousand (prior year: € 5,487 thousand) was generated from development services in the reporting period.

Revenue for the reporting period includes revenue generated under PoC contracts totaling € 190 thousand (prior year: € -925 thousand).

The breakdown and classification of revenue by strategic business activities and regions are shown in the "Segment Report".

(11) Other Operating Income

Other operating income primarily includes gains on the disposal of fixed assets of € 347 thousand (prior year: € 778 thousand), income from the use of company cars by employees of € 323 thousand (prior year: € 318 thousand), gains on foreign currency exchange of € 88 thousand (prior year: € 1,628 thousand), income from the release of deferred income for investment grants of € 88 thousand (prior year: € 88 thousand) and investment subsidies of € 10 thousand (prior year: € 71 thousand).

(12) Other Own Work Capitalized

For development projects which meet the requirements of IAS 38.21 and IAS 38.57 in the reporting period and for which project-related development costs have been capitalized, the capitalized development costs have been recognized in other own work capitalized. The amounts capitalized are recognized under intangible assets. Other own work capitalized also includes costs incurred in manufacturing test equipment.

In € thousands	Jan. 1 - Dec. 31, 2016	Jan. 1 - Dec. 31, 2015
Project-related development costs	14,313	11,847
Cost of test equipment	1,003	905
Other own work capitalized	**15,317**	**12,752**

(13) Cost of Materials

In € thousands	Jan. 1 - Dec. 31, 2016	Jan. 1 - Dec. 31, 2015
Raw materials and supplies	55,788	53,233
Cost of purchased services	1,953	2,283
Cost of materials	**57,741**	**55,516**

(14) Personnel Expenses

Personnel expenses amounted to € 29,248 thousand in the reporting period (prior year: € 26,307 thousand) and consist of the following:

In € thousands	Jan. 1 - Dec. 31, 2016	Jan. 1 - Dec. 31, 2015
Wages and salaries	21,186	20,117
Social security contributions / pension expenses	3,689	3,271
Expenses for temporary emloyees	4,373	2,919
Personnel expenses	**29,248**	**26,307**

The number of employees has changed as follows in comparison to the prior year:

	Jan. 1 - Dec. 31, 2016	Jan. 1 - Dec. 31, 2015
Salaried employees	333	291
Wage-earning employees	293	270
Total number of employees	**626**	**561**

(15) Other Operating Expenses

Other operating expenses primarily include building rental expenses and premises costs (€ 1,299 thousand, prior year: € 1,571 thousand), energy costs (€ 1,065 thousand, prior year: € 963 thousand), third-party development costs (€ 3,500 thousand, prior year: € 3,619 thousand), freight and packaging costs (€ 580 thousand, prior year: € 895 thousand), IT and telephone costs (€ 1,347 thousand, prior year: € 1,247 thousand), motor vehicle costs (€ 862 thousand, prior year: € 866 thousand), repair and maintenance costs (€ 787 thousand, prior year: € 807 thousand), legal and professional costs (€ 1,210 thousand, prior year: € 962 thousand), advertising and marketing costs (€ 818 thousand, prior year: € 694 thousand), and costs of plant insurance and leasing (€ 585 thousand, prior year: € 400 thousand). Other taxes recognized under other operating expenses during the reporting period amounted to € 56 thousand (prior year: € 39 thousand).

(16) Depreciation and Amortization

A breakdown of depreciation of property, plant and equipment, and amortization of intangible assets, can be found in the consolidated statement of noncurrent assets.

(17) Financial Result

In € thousands	Jan. 1 - Dec. 31, 2016	Jan. 1 - Dec. 31, 2015
Financial income	**2**	**143**
Interest income	2	143
Financial expenses	**- 3,169**	**- 2,930**
Other financial and interest expenses	- 3,169	- 2,930
Financial result	**- 3,167**	**- 2,787**

Other financial and interest expenses include interest expenses to banks of € 2,422 thousand (prior year: € 2,239 thousand).

(18 Income Taxes

In € thousands	Jan. 1 - Dec. 31, 2016	Jan. 1 - Dec. 31, 2015
Current taxes	253	5
Current domestic taxes	253	5
Current foreign taxes	0	0
Deferred taxes	1,948	1,613
Deferred domestic taxes	3,442	2,397
Deferred foreign taxes	- 1,494	- 784
Income taxes	2,201	1,618

Current taxes include corporate income tax and trade tax for prior years.

Deferred tax assets of € 4,522 thousand (prior year: € 2,946 thousand) at the end of the reporting period represent deferred tax balances in Germany of € 2,293 thousand (prior year: € 1,590 thousand) and foreign deferred taxes of € 2,229 thousand (prior year: € 1,356 thousand). Deferred tax liabilities of € 9,997 thousand (prior year: € 6,460 thousand) at the end of the reporting period represent deferred tax balances in Germany of € 9,849 thousand (prior year: € 6,317 thousand) and foreign deferred taxes of € 148 thousand (prior year: € 143 thousand).

Deferred tax assets and liabilities were recognized for the following items:

In € thousands	Dec. 31, 2016		Dec. 31, 2015	
	Deferred tax assets	Deferred tax liabilities	Deferred tax assets	Deferred tax liabilities
Intangible assets	0	9,576	0	6,005
Property, plant and equipment	281	0	295	0
Receivables and other assets	192	196	127	157
Pension privisitions	697	0	655	0
Bonds	0	86	0	135
Liabilities	0	148	0	163
Loss carried forward	3,352	0	1,869	0
Deferred tax assets and liabilities prior to netting	4,522	9,997	2,946	6,460
Netting	- 4,522	- 4,522	- 2,946	- 2,946
Deferred tax assets and liabilities after netting	0	5,475	0	3,514

The increase in deferred tax liabilities of € 3,537 primarily results from the capitalization of development costs in the reporting period reported within intangible assets (€ 3,562 thousand) and receivables € 39 thousand). On the other hand, the difference in the carrying values of bonds fell by € 49 thousand.

The increase in deferred tax assets of € 1,576 thousand primarily relates to deferred tax assets on tax losses carried forward of € 1,484 thousand. Tax losses in Germany can be carried forward and used for an indefinite period of time, subject to minimum taxation rules. Foreign tax losses carried forward relate to Voltabox of Texas, Inc., and their use is limited to a period of twenty years. In addition, the differences in carrying values for pension accruals (€ 42 thousand) and receivables (€ 65 thousand) increased while the differences in carrying values for property, plant and equipment fell (€ 14 thousand). An amount of deferred taxes of € 61 thousand (prior year: € 6 thousand) arising on pension provisions was recorded directly in equity within the revaluation reserve. This also corresponds to the amount of deferred tax assets in other comprehensive income.

Voltabox Deutschland GmbH has corporate income tax and trade tax loss carried forward amounting to € 1,189 thousand from the period prior to that company being included in the Group's tax pooling arrangements. No deferred taxes have been recognized for these tax losses carried forward.

Dividends to be paid by paragon AG in Germany in the future have no impact on the company's tax burden.

The following table shows a reconciliation between the actual tax expense and the expected tax expense, calculated as the product of accounting profit multiplied by the applicable tax rates in accordance with IAS 12.81 (c).

In € thousands	Jan. 1 - Dec. 31, 2016	Jan. 1 - Dec. 31, 2015
Earnings before taxes	5,762	5,021
Calculatory tax expense at a tax rate of 30.0% (prior year: 30.0%)	1,729	1,506
tax expenses relating to other accounting periods	224	4
Non-recognition of deferred tax assets on losses carried forward	0	78
Other	248	30
Current tax expenses	2,201	1,618

(19) Earnings per Share

Basic earnings per share are calculated by dividing the result for the reporting period by the weighted average number of shares issued. The weighted average number of shares issued in the reporting period was 4,217,658 (prior year: 4,114,788). The increase in the weighted average number of shares issued in the reporting period was calculated by attributing a 25% weighting to the new shares issued on October 5 as part of the company's cash capital increase.

Based on the result for the period of € 3,561 thousand (prior year: € 3,403 thousand) the basic earnings per share amount to € 0.84 per share (prior year: € 0.83).

The diluted earnings per share are calculated by adjusting the weighted average number of shares issued by the number of potentially dilutive shares.

Stock option plans generally result in a potential dilution of earnings per share. There were no share option rights to acquire paragon AG shares outstanding during the fiscal year from January 1 to December 31, 2016.

(20) Intangible Assets

The changes in and analysis of intangible assets, property, plant and equipment, and financial assets is shown in the consolidated statement of noncurrent assets. A description of investments made can be found in the management report.

Capitalized Development Costs

Intangible assets include capitalized development costs of € 30,950 thousand (prior year: € 17,819 thousand). Total development costs in the period amounted to € 15,193 thousand (prior year: € 12,816 thousand). This includes internal development costs of € 14,313 thousand (prior year: € 11,893 thousand) capitalized as intangible assets in the reporting period.

The primary focus of this development work was on communications, in particular car media systems, power train sensors, and display and operating instruments.

Depreciation and amortization in the reporting period totaled € 1,145 thousand (prior year: € 614 thousand)

The capitalized development costs were subject to an impairment test in accordance with IAS 36. For certain individual development projects a recoverable amount of € 0 thousand was determined. The recoverable amount of a specific project represents the fair value of the project determined on the basis of recent information on the marketability of the project. The impairment charge in accordance with IAS 36 totaled € 37 thousand in the reporting period (prior year: € 111 thousand).

The recoverable amount of internally generated intangible assets is determined based on the calculation of the value-in-use using estimated cash flows, which are in turn derived from sales forecasts approved by the Management Board. The sales forecasts cover a period of five years. For each product a growth rate is determined based on market analyses. A risk-adjusted discount factor of 4% is applied to the estimated cash flows.

Customer List

In the course of the business combination with SphereDesign GmbH completed with effect from January 1, 2015, the company identified a customer base as an intangible asset. This represents contractually agreed customer relationships that meet the criteria for recognition pursuant to IAS 38.8 et seq. The acquisition costs for the customer base of SphereDesign GmbH amounted to € 2,565 thousand. This item is recognized under "Licenses, patents, software/customer lists". In accordance with IAS 38 the customer list was classified as an intangible asset without a finite useful life of seven years. In the year under review, an adjustment of the purchase price of SphereDesign GmbH was agreed with the sellers.

In € thousands	
Customer list January, 1, 2016	2,199
Purchase price adjustment	245
Amortization in fiscal year	- 392
Carrying amount as of December 31, 2016	**2,052**

(21) Goodwill

In accordance with IFRS 3 *Business Combinations* and the two standards revised in this respect, namely IAS 36 *Impairment of Assets* and IAS 38 *Intangible Assets*, goodwill and internally generated intangible assets whose production is not yet complete are subject to regular impairment tests.

This involves goodwill and internally generated intangible assets whose production is not yet complete being tested for potential impairment once a year. In addition, the impairment test is also to be performed more frequently should any events or changes in circumstances indicate that a potential impairment has occurred.

The impairment tests performed at the paragon Group involve comparing the residual carrying amounts of individual cash-generating units (CGUs) with their respective recoverable amounts, i.e. the higher of their fair value less costs to sell and their value in use. Where the carrying amount of the cash-generating unit is higher than its recoverable amount, an impairment loss is recognized in the amount of the respective difference. The recoverable amount is determined by calculating the value in use by means of the discounted cash flow method. The cash flows used to calculate the value in use are determined on the based on management's medium-term planning. These budgets are based on past experience and on expectations as to future market developments, taking account of strategic and operative measures already initiated to manage the respective business field. The detailed planning period is usually a period of five years.

The cost of capital is calculated as the weighted average of equity and debt capital costs (weighted average cost of capital – WACC). Equity costs are derived from a peer group analysis of the relevant market sector, i.e., information which can be obtained from capital markets. To account for the different return and risk profiles of our different fields of activity, we calculate individual cost of capital rates for our companies (CGUs). The weighted average cost of capital, i.e., WACC before taxes used to discount cash flows, amounted to 4.0% (prior year: 4.0%).

Goodwill amounted to € 843 thousand as of the reporting date (prior year: € 770 thousand).

(22) Property, Plant and Equipment

Depreciation in the reporting period amounted to € 4,532 thousand (prior year: € 4,414 thousand). Land and buildings are subject to property charges as collateral for long-term bank loans.

Certain items of movable fixed assets are financed by finance leases. Generally these leases have terms of four to five years. The corresponding payment obligations for future lease installments are recognized as liabilities. The net carrying amount of assets capitalized under financial leases amounted to € 2,849 thousand as of December 31, 2016 (prior year: € 2,286 thousand). The corresponding payment obligations for future lease installments amounted to € 3,213 thousand (prior year: € 2,335 thousand) and are recognized as liabilities at their present value. The capitalized assets under finance leases wholly relate to technical plants and machinery. The majority of these lease arrangements provide for the transfer of ownership without further payments after full settlement of all obligations during the basic lease period (full amortization). No firm agreements have been entered into concerning the further use of the leased assets following expiry of the basic lease period. Nevertheless paragon assumes that the leased assets can be acquired at a favorable price after the basic lease period has expired or may continue to be used at a favorable lease rate.

Advance payments for machinery and equipment amounting to € 3,913 thousand were made in the reporting year (prior year: € 2,653 thousand).

The loss on disposal of property, plant and equipment amounted to € 307 thousand) (prior year: € 722 thousand).

(23) Financial Assets

Under a purchase and assignment agreement dated February 18, 2015, paragon AG acquired the entire share capital of SphereDesign GmbH, Bexbach, for an acquisition price of € 3,015 thousand. The acquisition was effective from January 1, 2015. This company is an established development service provider and system supplier to the automotive industry in the control and display element sector. A portion of the total purchase price amounting to € 1,796 thousand is payable in installments in the following two years and has therefore been recognized within other liabilities. paragon AG and Sphere Design GmbH entered into a profit and loss transfer agreement on March 20, 2015, taking effect as of January 1, 2016. In the annual financial statements as of December 31, 2016, the company reported equity of € 274 thousand (prior year: € 274 thousand) and net income of € 46 thousand (prior year: net loss of € -176 thousand).

Revenue of € 7,435 thousand generated by SphereDesign GmbH is included in the paragon Group's consolidated financial statements for the reporting year. Since the date of initial consolidation (January 1, 2015), the acquired company has contributed a net loss of € -277 thousand to the paragon Group. This includes the impact on earnings of the amortization of intangible assets acquired as part of the business combination (€ -392 thousand) and associated deferred taxes (€ 138 thousand).

productronic GmbH, Delbrück, was formed on November 25, 2015. The object of the company is to manufacture electronic and mechanical components, particularly for use in automobile production. paragon AG holds 100% of the shares in productronic GmbH. In the annual financial statements as of December 31, 2016, the company reported equity of € 7,819 thousand (prior year: € 24 thousand) and net income of € 1,693 thousand (prior year: net loss of € 1 thousand).

paragon Automotive (KunShan) Co. Ltd. was formed on September 15, 2015. The object of the company is to manufacture and market paragon products for the Chinese market. Production activities at the new plant in the "German Industrial Park" were launched on November 4, 2015. paragon AG holds 100% of the shares in paragon

Automotive (KunShan) Co. Ltd. In the annual financial statements as of December 31, 2016, the company reported equity of € 723 thousand (prior year: € 513 thousand) and a net loss of € -1,181 thousand (prior year: € -186 thousand).

On July 29, 2013, the share capital of KarTec GmbH, Forchheim, was acquired for an acquisition price of € 1,036 thousand following the exercise of a put option subject to conditions precedent set out in the purchase agreement. The parties agreed that the purchase price would be offset against a receivable of paragon AG in connection with a loan granted. In the annual financial statements as of December 31, 2016, the company reported equity of € 221 thousand (prior year: € 27 thousand) and net income of € 194 thousand (prior year: € 27 thousand).

paragon Automotive Technology Co. Ltd., Shanghai commenced operations in 2013. The full license applied for under Chinese law was granted on January 3, 2014. In the annual financial statements as of December 31, 2016 the company reported equity of € 44 thousand (prior year: € 31 thousand) and net income of € 14 thousand (prior year: € 26 thousand).

The Electromobility segment was spun off to an existing company, Voltabox Deutschland GmbH, as part of the strategic alignment of the Group's segments in 2014. This was effected by a notarized spin-off and takeover agreement dated April 23, 2014, with retrospective effect as of January 1, 2014. paragon AG holds 100% of the shares in Voltabox Deutschland GmbH. paragon AG and Voltabox Deutschland GmbH entered into a profit and loss transfer agreement on April 23, 2014, taking effect as of January 1, 2015. The net loss for 2016 reported in the annual financial statements as of December 31, 2016, amounting to € 4,449 thousand, was transferred to paragon AG (prior year: € 4,962 thousand). The company reported equity of € 205 thousand as of December 31, 2016 (prior year: € -595 thousand).

Voltabox of Texas, Inc., Austin, was formed on December 18, 2013. The CEO and President of this company is Klaus Dieter Frers. Since 2014, the company has been responsible for manufacturing and marketing activities for the Electromobility segment in the U.S. market. paragon AG holds 100% of the shares in Voltabox of Texas, Inc. In the annual financial statements as of December 31, 2016, the company reported equity of € -6,378 thousand (prior year: € -3,627 thousand) and a net loss of € -2,526 thousand (prior year: € -2,093 thousand).

paragon AG has assumed a directly enforceable fixed liability guarantee to a maximum amount of € 318 thousand and a directly enforceable guarantee of € 1,816 thousand for Voltabox Deutschland GmbH. In view of the over-indebtedness of Voltabox Deutschland GmbH, paragon AG has provided a qualified subordination for an amount of € 5,506 thousand for fiscal year 2014. A profit and loss transfer agreement has been in place between paragon AG and Voltabox Deutschland GmbH since fiscal year 2015.

In addition, paragon AG holds a limited partnership interest with a capital share of € 100 thousand in the limited partnership Bilster Berg Drive Resort GmbH & Co. KG, whose registered office is in Bad Driburg, Germany. This was acquired on September 19, 2013, for a price of € 120 thousand.

(24) Inventories

Inventories consist of the following:

In € thousands	Dec. 31, 2016	Dec. 31, 2015
Raw materials and supplies	5,764	4,493
Work in progress and finished goods and services	7,060	6,263
Advance payments on inventories	892	460
Inventories	**13,716**	**11,216**

There was no extraordinary impairment on inventories in the reporting period or in the prior year. In addition, no reversals were recognized in the reporting period, as in the prior year. Inventories with a carrying value of € 343 thousand were written down in the reporting period, primarily relating to salvage inventories and inventories of spare parts (prior year: € 274 thousand). At the balance sheet date, inventories of € 0 thousand served as collateral for liabilities (prior year: € 0 thousand).

(25) Trade Receivables

The carrying value of trade receivables is derived as follows:

In € thousands	Dec. 31, 2016	Dec. 31, 2015
Trade receivables, gross	8,492	10,467
Less impairment losses	- 115	- 90
Trade receivables	**8,377**	**10,377**

The company had PoC receivables of € 777 thousand (prior year: € 586 thousand). The Group generated revenue from PoC orders in the amount of € 190 thousand and PoC expenses of € 190 thousand in the year under review. The Group received prepayments totaling € 137 thousand for PoC projects (prior year: € 165 thousand).

The maturity structure of trade receivables for which no impairment allowances have been recorded as of the balance sheet date is as follows:

In € thousands	Carrying amount	thereof neither impaired nor past due	thereof past due but not impaired, as follows			
Dec. 31, 2016			0 - 30 days	30 - 60 days	60 - 90 days	> 90 days
Trade receivables	8,343	6,114	480	320	51	1,378
Dec. 31, 2015			0 - 30 days	30 - 60 days	60 - 90 days	> 90 days
Trade receivables	10,304	7,350	962	144	79	1,769

There were no indications as of the balance sheet date that debtors with receivables which are neither impaired nor overdue will fail to meet their payment obligations.

Based on this information the movement on allowances against receivables was as follows:

In € thousands	Dec. 31, 2016	Dec. 31, 2015
Impaired receivables before allowances for losses	149	163
Allowances for losses	- 115	- 90
Impaired receivables before allowances for losses	34	73

The expense arising on recording impairment losses and on derecognition of trade receivables is reported within other operating expenses. Income from receipts for derecognized receivables is reported under other operating income. There were no write-downs or derecognition of other financial assets in the reporting period or in the prior year.

(26) Other Current Assets

Other current assets were as follows:

In € thousands	Dec. 31, 2016	Dec. 31, 2015
Other current assets		
Purchase price retention related to factoring arrangements	1,110	676
Deferred income	189	342
Creditors with debit balances	267	224
Other assets	583	288
Other current assets	2,149	1,529

The overdue amounts included in other current assets as at the balance sheet date were as follows:

In € thousands	Carrying amount	thereof neither impaired nor past due	thereof past due but not impaired, as follows			
Dec. 31, 2016			0 - 30 days	30 - 60 days	60 - 90 days	> 90 days
Other current assets	2,149	2,149	0	0	0	0
Dec. 31, 2015			0 - 30 days	30 - 60 days	60 - 90 days	> 90 days
Other current assets	1,529	1,529	0	0	0	0

As of December 31, 2016, there were no indications that significant amounts included in other current assets would not be collectible.

(27) Cash and Cash Equivalents

Cash on hand and bank deposits are recognized at their nominal amounts. Cash and cash equivalents include € 14 thousand (prior year: € 15 thousand) in cash on hand and € 14,264 thousand (prior year: € 8,439 thousand) in bank deposits. Among other items, cash and cash equivalents include an amount of € 626 thousand held on the insolvency escrow account (prior year: € 500 thousand) and an amount of € 1,454 thousand on the insolvency dividend payout account (prior year: € 1,580 thousand). Both accounts are under the sole power of disposal of the former insolvency administrator. Changes in cash and cash equivalents are presented in the consolidated cash flow statement.

(28) Equity

The changes in the individual components of equity for the fiscal year from January 1 to December 31, 2015, and for the reporting period from January 1 to December 31, 2016, are presented in the consolidated statement of changes in equity.

Subscribed Capital

paragon AG's subscribed capital as of December 31, 2016, amounted to € 4,526 thousand (prior year: € 4,115 thousand) and is divided into 4,526,266 no-par-value shares with a notional share in the share capital of € 1.00 each. By resolution of the Annual General Meeting on May 9, 2012, and pursuant to Section 207 et seq. of the German Stock Corporation Act (AktG) governing capital increases from capital funds, the company's subscribed capital was increased to € 5,143,485 by transferring an amount of € 1,028,697 from the capital reserve, as reported in the balance sheet as of December 31, 2011, to subscribed capital. The increase in the subscribed capital was made without new shares being issued, but instead by increasing the notional share in the company's subscribed capital attributable to each share. Subsequently, in order to effect a repayment of a portion of the subscribed capital to the company's shareholders by means of a cash distribution of € 0.25 per share currently in issue, and pursuant to Section 222 et seq. of the German Stock Corporation Act (AktG) concerning ordinary capital reductions, the subscribed capital was reduced by € 1,028,697 from € 5,143,485 to € 4,114,788, divided into 4,114,788 no-par-value shares with a notional share in capital of € 1.25 each. The capital reduction was effected by reducing the notional share in the company's subscribed capital attributable to each share. The payment of the capital reduction amount totaling € 1,028,697 was made following registration of the capital reduction, which was completed on January 3, 2013. Under partial utilization of the authorized capital resolved by the Annual General Meeting on April 27, 2016, and with the consent of the Supervisory Board, the Management Board increased the company' share capital by € 411,478.00 to a total value of € 4,526,266.00 on October 5, 2016, via the issue of 411,478 new no-par-value shares with a notional share in capital of € 1.00 each and full entitlement to dividends from January 1, 2016.

Exchange rate differences arising from the translation of financial statements prepared in foreign currencies and on exchange rate differences arising during consolidation were recognized directly in equity in accordance with IAS 21.

Conditional Capital

Conditional Capital 2012/I Pursuant to the Resolution by the Annual General Meeting on May 9, 2012

A resolution approved at the Annual General Meeting on May 9, 2012, approved the conditional increase in the subscribed capital of € 410 thousand by issuing 410,000 new no-par-value shares (Conditional Capital 2012/I). Conditional Capital 2012/I serves exclusively to secure the subscription rights that are issued to members of the Management Board and employees as part of the share option program 2012 authorized by the Annual General Meeting on May 9, 2012, which runs from that date until May 8, 2017, inclusive. The conditional capital increase will only be performed insofar as the subscription rights are issued and their bearers exercise their subscription rights for shares in the company and the company does not provide treasury shares or a cash compensation to fulfill these subscription rights. The new shares participate in profit-sharing from the beginning of the fiscal year in which they arise by exercising the subscription right. The Management Board is authorized, with the consent of the Supervisory Board, to determine the further details regarding the implementation of the conditional capital increase. Insofar as the Management Board is involved, the Supervisory Board is accordingly authorized to act. The Supervisory Board is also authorized to adjust the Articles of Association according to the respective utilization of the conditional capital.

Conditional Capital 2012/II Pursuant to the Resolution by the Annual General Meeting on May 9, 2012

A resolution at the Annual General Meeting from May 9, 2012, approved the conditional increase in the subscribed capital of € 1,647 thousand by issuing 1,647,394 new no-par-value shares (Conditional Capital 2012/II). The conditional increase in the subscribed capital (Conditional Capital 2012/II) was created exclusively to grant shares to holders or creditors of bonds with options and/or convertible bonds that are issued or guaranteed until May 8, 2017 by the company or by Group companies as defined in Section 18 of the German Stock Corporation Act (AktG), in which the company has a shareholding of at least 90%, based on the authorization by the Annual General Meeting on May 9, 2012.

The same resolution adopted by the Annual General Meeting authorized the Management Board, with the approval of the Supervisory Board, to issue options and/or convertible bonds with a total nominal amount of up to € 100,000,000.00 and a term of up to 20 years on one or several occasions up to and including May 8, 2017, and to grant or impose option or conversion rights and/or obligations for a total of up to 1,647,394 no-par-value shares in the company, with a share in subscribed capital totaling € 1,647,394.00 on the holders or creditors of the respective options or bonds, in accordance with the requirements of those bonds.

The new shares will be issued at an option or conversion price to be determined in accordance with the aforementioned authorization. The conditional capital increase will only take place to the extent that the holders or creditors of the respective options or bonds created by the company or by Group companies, as defined in Section 18 of the German Stock Corporation Act (AktG) in which the company has a direct or indirect shareholding of at least 90%, based on the authorization granted to the Management Board by the Annual General Meeting on May 9, 2012, exercise or guarantee their option or conversion rights by May 8, 2017, or, to the extent that they are obliged to exercise their option or conversion rights, that they fulfill their option or conversion obligations, to the extent that own shares or payment of cash compensation is not used to settle the option or conversion rights or obligations. The new shares participate in the company's profit starting at the beginning of the fiscal year in which they are issued following the exercise of options or conversion rights or following the fulfillment of conversion or option obligations. The Management Board is authorized, with the consent of the Supervisory Board, to determine the further details regarding the implementation of the conditional capital increase. The Supervisory Board is authorized to adjust the Articles of Association according to the respective utilization of the conditional capital.

Authorized Capital 2016/I Pursuant to the Resolution by the Annual General Meeting on April 27, 2016

The Management Board was authorized, with the consent of the Supervisory Board, to increase the company's subscribed capital on one or on several occasions, by up to € 1,645,916.00 until April 26, 2021, by issuing up to 1,645,916 new no-par-value shares in exchange for contributions in cash and/or in kind (Authorized capital 2016/I). Shareholders are to be granted a subscription right. The statutory subscription right may also be granted by having the new shares taken over by a banking consortium with the obligation to offer the shares indirectly to shareholders for subscription pursuant to Section 186 (5) of the German Stock Corporation Act (AktG). The Management Board is however authorized, with the consent of the Supervisory Board, to exclude the statutory subscription rights of shareholders in the cases specified in Section 5 (6) of the Articles of Association as updated in October 2016. Upon completion of the capital increase resolved by the Management Board on October 5, 2016, and approved by the Supervisory Board on the same day, the company's share capital increased by € 411,478.00 to € 4,526,266.00 via the issue of 411,478 new no-par-value shares. The company still had access to an authorized capital of € 1,645,916.00 as of the reporting date (Authorized Capital 2016/I).

Capital Reserve

As of December 31, 2016, the capital reserve amounted to € 15,165 thousand (prior year: € 2,450 thousand). Pursuant to Sections 207 et seq. of the German Stock Corporation Act (AktG) concerning capital increases from capital reserve and based on a resolution adopted by the Annual General Meeting on May 9, 2012, the company's share capital was increased by transferring an amount of € 1,029 thousand from the capital reserve as reported in the balance sheet as of December 31, 2011.

The capital reserve increased in the reporting year by € 12,715 thousand as a result of the successful placement of 411,478 new no-par-value shares under partial utilization of the authorized capital approved by the Annual General Meeting on April 27, 2016.

Revaluation Reserve

In order to comply with the requirement to recognize actuarial gains and losses from provisions for pensions directly in equity in accordance with the revised IAS 19 Employee Benefits, amounts of € -426 thousand after deferred taxes recorded in profit or loss in prior years were reclassified from profit/loss carried forward to the revaluation reserve in the 2012 financial statements. In the reporting period, an amount of € 142 thousand net of deferred taxes (prior year: € 15 thousand) was recognized in the revaluation reserve.

Dividends

A proposal will be submitted to the Annual General Meeting that a dividend of € 0.25 per share shall be paid for the period ending on December 31, 2016. The distribution volume will amount to € 1,132 thousand.

(29) Finance Lease Obligations

Liabilities under finance leasing arrangements primarily relate to technical equipment and are recorded at their present value or amortized cost in accordance with IAS 17. The repayment obligations reported here are derived as follows:

In € thousands	Remaining term < 1 year	Remaining term between 1 and 5 years	Remaining term > 5 years	Dec. 31, 2016	Dec. 31, 2015
Minimum lease payments	1,089	2,305	0	3,394	2,499
Future interest payments	- 91	- 90	0	- 181	- 164
Liabilities from finance lease (repayment portion)	**998**	**2,215**	**0**	**3,213**	**2,335**
thereof reported under noncurrent liabilities				2,215	1,721
thereof reported under current liabilities				998	614

(30) Liabilities to Banks

Current and noncurrent liabilities to banks totaled € 32,782 thousand (prior year: € 32,508 thousand), and collateral for liabilities to banks was provided in the amount of € 32,782 thousand (prior year: € 32,508 thousand).

Liabilities to banks are secured by property charges for loan liabilities in the amount of € 16,818 thousand (prior year: € 14,801 thousand) and by charges over property, plant and equipment of € 5,127 thousand (prior year: € 5,860 thousand). The collateralization of raw materials and supplies and of work in progress and finished products dated June 16, 2010, was ended in August 2014.

Liabilities to banks mature as follows:

In € thousands	Remaining term < 1 year	Remaining term between 1 and 5 years	Remaining term > 5 years	Dec. 31, 2016	Dec. 31, 2015
Liabilities to banks	**4,657**	**23,282**	**4,844**	**32,782**	**32,508**
thereof reported under noncurrent liabilities				20,369	23,784
thereof reported under current liabilities				12,413	8,724

There is no exposure to interest rate risk for the loans with fixed interest rates. Loans with floating interest rates (€ 3,808 thousand) are subject to interest rate risk (further details are provided in note 38 “Interest rate risk”).

(31) Bonds

The company made a public bond subscription offer in 2013 in order to promote its further internationalization and to expand its existing business activities. In total a volume of € 10,000 thousand was placed with retail and institutional investors. The term bond has a maturity date of July 2, 2018. In 2014, the company placed a further tranche of € 3,000 thousand of the corporate bond previously issued in 2013. This tranche also has a maturity date of July 2, 2018. The transaction costs of € 790 thousand incurred in connection with the two placements are being amortized over the term of the bond using the effective interest method in accordance with IAS 39.47.

(32) Provisions for Pensions

paragon recognizes a provision for a defined benefit pension plan in accordance with the revised IAS 19 *Employee Benefits*. This relates to a single contractual commitment to the payment of a fixed amount from age 65 based on an individual contract arrangement. In addition to this existing pension agreement, a new commitment was made in fiscal year 2005. This involves a single contractual commitment to payments from age 65, the amount of which is based on length of employment and salary level. Provisions exist for pension commitments to members of the Management Board. In accordance with a resolution approved by the Supervisory Board on August 31, 2009, a portion of provisions for pensions amounting to € 794 thousand and the corresponding plan assets of € 1,425 thousand were transferred to HDI Gerling Pensionsfonds in fiscal year 2010. In accordance with a resolution approved by the Supervisory Board on December 10, 2013, another partial transfer of provisions for pensions to Allianz Pensionsfonds AG was effected in the amount of € 1,453 thousand during fiscal year 2013.

In June 2011, the IASB issued a revised version of IAS 19 requiring mandatory application in fiscal years beginning on or after January 1, 2013. The company decided to apply the amended standard early on a voluntarily basis and to account for provisions for pensions in accordance with the revised standard from fiscal year 2012. The key change is the elimination of the previously permitted accounting option to defer the recognition of actuarial gains and losses using the corridor method, and the related introduction of the full recognition directly in equity in retained earnings. The changes to the new rules have to be made retrospectively in accordance with IAS 8.22, with any adjustments recognized directly in equity. To comply with the requirement to recognize actuarial gains and losses directly in equity, the amounts recorded in profit or loss in earlier years were reclassified from profit/loss carried forward to the revaluation reserve.

An actuarial loss of € -142 thousand was recognized in other comprehensive income (prior year: gain of € 15 thousand).

The actuarial calculations are based on the following assumptions:

in percent	Dec. 31, 2016	Dec. 31, 2015
Discount rates	1.50	2.00
Expected return on plan assets	0.00	0.00
Salary increase (recommitment based on individual contracts until 2009, 0% thereafter)	0.00	0.00
Pension increase	2.00	2.00
Fluctuation	0.00	0.00

Actuarial gains or losses may arise from increases or decreases in the present value of the defined benefit obligations. These may be brought about by, among other things, changes in calculation parameters and changes in estimates of the risks related to the pension obligations, and may impact on the level of equity. The net pension provisions have been calculated as follows:

Present value of the defined benefit obligation:

In € thousands	Dec. 31, 2016	Dec. 31, 2015
Present value of defined benefit obligation at beginning of year	2,087	1,882
Service cost	185	188
Interest cost	41	38
Actuarial gains (-), losses (+)	203	- 21
Present value of defined benefit obligation as of record date	2,516	2,087

The actuarial losses incurred in fiscal year 2016 were recognized directly in equity in the revaluation reserve in accordance with the revised IAS 19. Changes in demographic assumptions had no effect on the level of actuarial losses in the reporting year.

Net amount of defined benefit obligation recognized for which there are no corresponding plan assets:

In € thousands	Dec. 31, 2016	Dec. 31, 2015
Present value of defined benefit obligation	2,516	2,087
Less fair value of plan assets	0	0
Unfunded defined benefit obligation as of record date	**2,516**	**2,087**

Movements on the net amount were as follows:

In € thousands	Dec. 31, 2016	Dec. 31, 2015
Unfunded defined benefit obligation at beginning of year	2,087	1,882
Pension expense	226	226
Actuarial gains (-), losses (+)	203	- 21
Settlements	0	0
Unfunded defined benefit obligation as of record date	**2,516**	**2,087**

The following amounts have been recognized:

In € thousands	Dec. 31, 2016	Dec. 31, 2015
Service cost	185	188
Interest cost	41	38
Losses from settlements	0	0
Actuarial gains (-), losses (+)	203	- 21
Pension expense	**429**	**205**

The actuarial gains and losses in the reporting year and prior years were classified in full to other comprehensive income.

In past years the financing status, consisting of the present value of all pension commitments and the fair value of plan assets, changed as follows:

In € thousands	Dec. 31, 2016	Dec. 31, 2015
Present value of defined benefit obligation	2,516	2,087
Less fair value of plan assets	0	0
Unfunded defined benefit obligation as of record date	**2,516**	**2,087**

Disclosures on sensitivities and risks:

In € thousands	Dec. 31, 2016	Dec. 31, 2015
DBO as of Dec. 31., 2016, interest rate 1.25% (prior year: interest rate 1.75%)	2,625	2,178
DBO as of Dec. 31., 2016, interest rate 1.75% (prior year: interest rate 2.25%)	2,414	2,001
DBO as of Dec. 31., 2016, pension increase 1.75% (prior year: pension increase 1.75%)	2,423	2,013
DBO as of Dec. 31., 2016, pension increase 2.25% (prior year: pension increase 2.25%)	2,615	2,164

Salary increase sensitivities have not been disclosed as there have been no such salary increases since the 2010 service period. There are no material extraordinary or company-specific risks in connection with the provisions for pensions reported.

(33) Other Liabilities

Other liabilities were as follows:

In € thousands	Dec. 31, 2016	Dec. 31, 2015
Other liabilities		
Financial liabilities		
Deferred Income	3,272	3,183
purchase price liabilities for company acquisition (discounted)	886	1,728
Old debt measured at insolvency ratio	1,454	1,580
Other liabilities	65	196
	5,677	6,686
Liabilities from other taxes	455	994
Other liabilities	**6,132**	**7,680**

Deferrals mainly contain personnel-related obligations.

Other liabilities mature as follows:

In € thousands	Remaining term < 1 year	Remaining term between 1 and 5 years	Remaining term > 5 years	Dec. 31, 2016	Dec. 31, 2015
Other liabilities	6,132	0	0	6,132	7,680
thereof reported under noncurrent liabilities				0	623
thereof reported under current liabilities				6,132	6,957

(34) Investment Grants

This represents investment grants recorded as deferred income in accordance with IAS 20. An amount of € 90 thousand (prior year: € 90 thousand) was amortized in the reporting period. The Group received government assistance of € 10 thousand in the reporting period (prior year: € 30 thousand).

(35) Other Provisions

Other provisions are all due within one year. The movements on the provisions were as follows:

In € thousands	Jan. 1, 2016	Utiliza-tion	Re-versal	Addit-ion	Dec. 31, 2016
Guarantees and ex gratia payments	21	5	0	2	18
Other provisions	21	5	0	2	18

(36) Income Tax Liabilities

This item relates exclusively to liabilities for trade tax and corporate income tax in respect of prior reporting periods.

(37) Additional Disclosures on Financial Instruments

This section provides an overview of financial instruments in use at paragon AG. The tables below show the carrying amounts (CA) and fair values (FV) of financial assets and financial liabilities as of December 31, 2016 and December 31, 2015:

	Dec. 31, 2016			
	Nominal amount		Amortized cost	
	Cash reserve		Loans and receivables	
In € thousands	CA	FV	CA	FV
ASSETS				
Liquid funds	14,278	14,278		
Trade receivables			8,377	8,377
Other assets			2,149	2,149
Total assets	14,278	14,278	10,526	10,526
EQUITY AND LIABILITIES				
Bonds			13,186	13,793
Liabilities to banks			32,782	34,447
Finance Lease			3,213	3,225
Trade payables			16,383	16,383
Other liabilities			6,132	6,132
Total equity and liabilities	0	0	71,696	73,980

	Dec. 31, 2015			
	Nominal amount		Amortized cost	
	Cash reserve		Loans and receivables	
In € thousands	CA	FV	CA	FV
ASSETS				
Liquid funds	8,454	8,454		
Trade receivables			10,377	10,377
Other assets			1,529	1,529
Total assets	8,454	8,454	11,906	11,906
EQUITY AND LIABILITIES				
Bonds			13,023	13,023
Liabilities to banks			32,508	35,359
Finance Lease			2,335	2,366
Trade payables			10,715	10,715
Other liabilities			7,680	7,680
Total equity and liabilities	0	0	66,261	69,143

Determining Market Values

The market value of cash and cash equivalents, current receivables, other assets, trade payables and other liabilities approximate their carrying amounts due to their short term to maturity.

paragon measures noncurrent receivables and other assets based on specific parameters such as interest rates and the customer's credit standing and risk structure. Based on these factors, paragon recognizes allowances for anticipated defaults on receivables.

paragon determines the fair value of liabilities under finance leases and the fair value of liabilities to banks by discounting the anticipated future cash flows using the interest rates applicable for similar financial liabilities with a comparable term to maturity.

A hierarchical classification was used to measure fair value in accordance with IAS 39.A71 et seq. The hierarchical fair value levels and their application to paragon's financial assets and liabilities are as follows:

Level 1: Quoted prices for identical assets or liabilities in active markets

Level 2: Measurement factors other than quoted market prices that are directly (for instance, from prices) or indirectly (for instance, derived from prices) observable for assets or liabilities

Level 3: Measurement factors for assets and liabilities not based on observable market data

Net Gains and Losses

Realized net gains and losses from financial instruments were as follows:

In € thousands	Dec. 31, 2016	Dec. 31, 2015
Receivables	- 93	470
Net gains / losses	- 93	470

The net gain/loss from receivables includes changes in impairment allowances, gains and losses from derecognition as well as payment inflows and reversals of impairment losses on receivables previously written down, which were recorded in profit or loss in the consolidated income statement.

Derivative Financial Instruments

In addition to primary financial instruments, paragon also makes use of various derivative financial instruments as needed. As part of its risk management process the company primarily uses derivative financial instruments to limit the risks associated with interest rate and exchange rate fluctuations. Further information on risk management strategies can be found in the section entitled "Management of Risks Associated with Financial Instruments." The company only enters into derivative financial instruments with financial institutions of the very highest credit standing.

Derivative Financial Instruments Used for Currency Hedging Purposes

As a result of the international nature of its activities, paragon is exposed to a number of financial risks. These include, in particular, the effects of changes in foreign exchange rates. paragon takes an integrated approach in hedging the risks associated with fluctuating exchange rates. Risks are centralized across the business and hedged where appropriate using derivative financial instruments. If necessary, paragon enters into forward exchange contracts as part of the hedging process. The company had no derivative financial instruments for currency hedging as of December 31, 2016.

Derivative Financial Instruments Used for Interest Rate Hedging Purposes

Interest rate risk results from the sensitivity of financial liabilities to changes in the market interest rate. paragon generally hedges these risks with the use of interest rate derivatives. The Group uses over-the-counter interest rate swaps to hedge interest rates. The transactions are exclusively entered into with banks of very high credit-worthiness. If the trade date and settlement date do not coincide, then initial recognition is based on the settlement date.

When hedging a potential interest rate risk, the company adopts an approach specific to the variable interest rate of the respective individual financial liabilities. Accordingly, swap contracts are tailored to the specific amounts and maturity of the variable-rate borrowings hedged. The Group does not apply hedge accounting as defined in IAS 39.85. The company had no derivative financial instruments for interest rate hedging as of December 31, 2016, or in the prior year.

(38) Management of Risks Associated with Financial Instruments

Market price fluctuations can involve substantial cash flow and profit risks for paragon. Changes in exchange rates and interest rates influence business operations as well as investing and financing activities. In order to optimize the Group's financial resources the risks associated with changes in interest rates and exchange rates are analyzed on an ongoing basis and used to manage and supervise current business and financial market activities. These risks are managed with the assistance of derivative financial instruments.

Fluctuations in currency exchange rates and interest rates can result in significant profit and cash flow risks. Accordingly, paragon centralizes these risks as far as possible and manages them in a proactive manner, which includes making use of derivative financial instruments. The management of these risks within the overall risk management system is a core responsibility of paragon AG's Management Board.

paragon has implemented an internal sensitivity analysis system based on a variety of risk analysis and risk management methods. The use of sensitivity analyses enables the Group to identify risk positions within the business units. Sensitivity analyses quantify the risks that can arise within given assumptions when certain parameters are changed in a defined range. They include the following assumptions:

- An appreciation of the euro against all foreign currencies by 10 percentage points

- A parallel shift in interest rate curves of 100 basis points (one percentage point)

The potential effects of the sensitivity analysis are estimates and are based on the assumption that the supposed negative market changes will occur. The actual effects may differ significantly if market developments deviate from assumptions made.

Foreign Currency Risks

Due to the international nature of its operations, paragon's ongoing business operations are exposed to foreign currency risk. The company makes use of derivative financial instruments to limit these risks. Exchange rate fluctuations can lead to undesirable earnings and liquidity fluctuations. For paragon the risk arises on foreign currency positions and possible changes in the relevant exchange rates. The uncertainty involved in future trends is referred to as exchange rate risk. paragon limits this risk by primarily settling purchases and sales of merchandise and services in the respective local currencies.

The sensitivity to potential fluctuations in foreign currency exchange rates is determined by aggregating the net currency positions of the operating business that are not denominated in the Group's functional currency. Sensitivity is calculated by simulating a 10% depreciation of the euro in relation to all foreign currencies. The simulated appreciation of the euro would have resulted in a change in future payment inflows in the amount of € -172 thousand as of December

31, 2016 (prior year: € -177 thousand). To the extent that future purchases are not hedged against currency exchange risks, a depreciation of the euro against other currencies would have a negative effect on the financial position and earnings as the Group's purchases in foreign currencies exceed its foreign currency cash inflows.

The following table provides an overview of the net foreign currency exchange risk by currency as of December 31, 2016:

In € thousands	Dec. 31, 2016		Dec. 31, 2015	
	USD	Other	USD	Other
Transaction-related currency risk				
Currency risk from balance sheet items	- 1,261	- 289	- 1,575	- 20
Currency risk from pending transactions	0	0	0	0
	- 1,261	- 289	- 1,575	- 20
Items economically hedged by derivatives	0	0	0	0
Net exposure to currency risk	**- 1,261**	**- 289**	**- 1,575**	**- 20**
Change in currency exposure from 10% appreciation of the euro	- 140	- 32	- 175	- 2

Interest Rate Risks

Interest rate risk refers to any change in interest rates that impacts the earnings or equity. Interest rate risk primarily arises in connection with financial liabilities.

The significant interest-bearing financial liabilities have fixed interest rates. Accordingly, changes in the interest rate would have an effect if the financial instruments were recorded at fair value. As this is not the case, the financial instruments with fixed interest rates are not subject to interest rate risks within the meaning of IFRS 7.

The interest rate risks associated with variable-rate financial liabilities are measured using cash flow sensitivity techniques. The paragon Group had variable-rate financial liabilities of € 3,808 thousand as of December 31, 2016. The cash flow risk associated with a +1/-1 percentage point change in interest rates is as follows:

Liquidity Risks

Liquidity risk, i.e., the risk that paragon might not be able to meet its payment obligations as they fall due, is managed by means of flexible cash management. As of December 31, 2016, paragon had cash and cash equivalents of € 14,278 thousand (prior year: € 8,454 thousand) at its disposal. Unused credit lines totaling € 4,501 thousand were available as of December 31, 2016 (prior year: € 6,966 thousand). In addition to the instruments providing assurance of liquidity described above, the Group follows developments on financial markets on an ongoing basis in order to take advantage of attractive financing opportunities as they become available.

In € thousands	Dec. 31, 2016		Dec. 31, 2015	
	+ 1%	- 1%	+ 1%	- 1%
Cash flow risk				
from financial instruments with floating interest rates	- 38	38	- 37	37

The following table shows the maturity date of installments, maturity repayments and interest arising on the financial liabilities recorded in the balance sheet as of December 31, 2016:

In € thousands	2017	2018 – 2021	2022 and thereafter
Non-derivative financial liabilities			
Liabilities from bonds	943	13,580	0
Liabilities to banks	5,530	17,565	4,492
Liabilities from finance lease	1,089	2,238	67
Trade payables	16,227	0	0
Other financial liabilities	6,276	0	0
Non-derivative financial liabilities	30,065	33,383	4,559

The net liquidity and net borrowing are derived from the sum of cash and cash equivalents less liabilities to banks and liabilities under finance leasing arrangements as shown in the balance sheet.

In € thousands	Dec. 31, 2016	Dec. 31, 2015
Cash and cash equivalents	14,278	8,454
Total liquidity	14,278	8,454
Current financial liabilities and current portion of noncurrent financial liabilities	13,411	9,339
Noncurrent financial liabilities	35,770	38,529
Total financial liabilities	49,181	47,868
Net debt	- 34,903	- 39,414

Credit Risks

Credit risk is defined as the financial loss that arises when a contract partner fails to meet its payment obligations. The maximum risk of default is therefore equal to the positive fair value of the respective interest rate instruments. The effective monitoring and control of credit risk is a core task of the risk management system. paragon performs credit checks for all customers requiring credit limits exceeding predefined amounts. The Group monitors credit risk on an ongoing basis.

(39) Capital Management

The primary goal of capital management is to maintain an appropriate equity ratio. The capital structure is managed and adapted to changing economic conditions. No significant changes in capital management goals, methods or processes were made in the fiscal year up to December 31, 2016.

Capital management refers exclusively to paragon AG equity as reported in the balance sheet. Changes in equity are shown in the statement of changes in equity.

paragon was not required to comply with any financial covenants by the terms of agreements made with banks providing loan capital during the reporting period up to December 31, 2016.

(40) Commitments, Contingent Assets, Contingent Liabilities and Other Financial Obligations

There were no commitments or off-balance sheet contingent assets or contingent liabilities as of December 31, 2016. Other financial liabilities are were as follows:

In € thousands	Remaining term < 1 year	Remaining term between 1 and 5 years	Remaining term > 5 years	Dec. 31, 2016	Dec. 31, 2015
Order commitments	34,555	0	0	34,555	27,401
Tenancy obligations	838	1,472	0	2,310	2,465
Other obligations	1,795	3,393	46	5,234	1,606
Other financial obligations	37,188	4,865	46	42,099	31,472

The order commitment includes purchase order items from fixed assets and inventories.

(41) Consolidated Statement of Movements on Noncurrent Assets

Consolidated Statement of Movements on Noncurrent Assets as of December 31, 2016

	ACQUISITION COST						DEPRECIATION, AMORTIZATION AND IMPAIRMENT LOSSES						CARRYING AMOUNTS	
In € thousands	Jan. 1, 2016	Change currency	Additions	Disposals	Re-classifications	Dec. 31, 2016	Jan. 1, 2016	Change currency	Additions	Impairments according to IAS 36/38	Disposals	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016
Intangible assets														
Licences, patents, software, customer list	23,398	9	528	0	- 1,034	22,900	19,824	- 113	1,128	0	0	20,840	3,574	2,061
Capitalized development costs	22,648	2	14,482	0	0	37,132	2,604	100	1,466	37	0	4,207	20,044	32,926
Goodwill	770	0	74	0	0	843	0	0	0	0	0	0	770	843
Advance payments made for intangible assets	340	0	911	0	950	2,201	0	0	0	0	0	0	340	2,201
Total intangible assets	**47,156**	**11**	**15,995**	**0**	**- 84**	**63,077**	**22,427**	**- 13**	**2,594**	**37**	**0**	**25,046**	**24,728**	**38,031**
Property, plant and equipment														
Land and buildings	29,947	230	361	0	85	30,623	8,412	44	939	0	0	9,395	21,535	21,228
Technical equipment and machinery	27,783	6	627	152	4,060	32,324	20,227	73	2,584	0	63	22,815	7,557	9,509
Other plant, office furniture and equipment	12,923	9	556	447	633	13,675	10,117	45	1,008	0	229	10,946	2,805	2,729
Advance payments	2,653	0	5,954	0	- 4,694	3,913	0	0	0	0	0	0	2,653	3,913
Total property, plant and equipment	**73,307**	**246**	**7,498**	**600**	**84**	**80,535**	**38,756**	**163**	**4,532**	**0**	**292**	**43,157**	**34,551**	**37,378**
Financial assets														
Equity investments	326	0	0	0	0	326	0	0	0	0	0	0	326	326
Total financial assets	**326**	**0**	**0**	**0**	**0**	**326**	**0**	**0**	**0**	**0**	**0**	**0**	**326**	**326**
Total	**120,788**	**257**	**23,493**	**600**	**0**	**143,938**	**61,183**	**149**	**7,126**	**37**	**292**	**68,203**	**59,605**	**75,735**

Note: Rounding differences of +/- one unit (€ thousands) may occur in tables.

Consolidated Statement of Movements on Noncurrent Assets as of December 31, 2015

	ACQUISITION COST							DEPRECIATION, AMORTIZATION AND IMPAIRMENT LOSSES						CARRYING AMOUNTS	
In € thousands	Jan. 1, 2015	Change currency	Additions	Additions from acqisitions	Disposals	Re-classifications	Dec. 31, 2015	Jan. 1, 2015	Change currency	Additions	Impairment in according to IAS 36/38	Disposals	Dec. 31, 2015	Dec. 31, 2014	Dec. 31, 2015
Intangible Assets															
Licenses, patents, software, customer list	20,423	12	343	2,566	0	53	23,398	18,876	20	928	0	0	19,824	1,547	3,574
Capitalized development costs	9,318	3	11,893	1,434	0	0	22,648	1,542	0	951	111	0	2,604	7,777	20,044
Goodwill	0	0	779	0	0	0	779	0	0	0	0	0	0	0	779
Advance payments made for intangible assets	115	0	278	0	0	- 53	340	0	0	0	0	0	0	115	340
Total intangible assets	**29,856**	**15**	**13,294**	**4,001**	**0**	**0**	**47,165**	**20,418**	**20**	**1,879**	**111**	**0**	**22,427**	**9,439**	**24,738**
Property, plant and equipment															
Land and buildings	16,155	0	5,316	160	0	8,316	29,947	7,477	0	935	0	0	8,412	8,678	21,535
Technical equipment and machinery	25,673	14	1,146	2	974	1,922	27,783	18,854	1	2,346	0	974	20,227	6,820	7,556
Other plant, office furniture and equipment	11,644	8	1,060	40	401	573	12,923	9,195	2	1,133	0	212	10,117	2,449	2,806
Advance payments	2,231	163	10,987	83	0	- 10,810	2,653	0	0	0	0	0	0	2,231	2,653
Total property, plant and equipment	**55,704**	**184**	**18,509**	**285**	**1,375**	**0**	**73,307**	**35,525**	**2**	**4,414**	**0**	**1,186**	**38,756**	**20,178**	**34,551**
Financial assets															
Equity investments	376	0	0	0	50	0	326	0	0	0	0	0	0	376	326
Total financial assets	**376**	**0**	**0**	**0**	**50**	**0**	**326**	**0**	**0**	**0**	**0**	**0**	**0**	**376**	**326**
Total	**85,936**	**199**	**31,803**	**4,286**	**1,425**	**0**	**120,798**	**55,943**	**22**	**6,293**	**111**	**1,186**	**61,183**	**29,993**	**59,615**

Note: Rounding differences of +/- one unit (€ thousands) may occur in tables.

(42) Notes to the Consolidated Cash Flow Statement

The consolidated cash flow statement shows the cash flows within a given fiscal year in order to present information about movements in the company's cash and cash equivalents in accordance with IAS 7 *Statement of Cash Flows*. The consolidated cash flow statement has been prepared pursuant to the indirect method as defined in IAS 7.18 b. Cash flows are classified separately as cash flows from operating activities, cash flows from investing activities and cash flows from financing activities.

Since the 2012 reporting year, the current cash inflows and outflows resulting from the factoring agreement entered into in 2011 with GE Capital Bank have been allocated to the cash flow from operating activities.

The cash and cash equivalents shown in the consolidated cash flow statement include all cash and cash equivalents reported in the balance sheet that are available for use at short notice.

In € thousands	Dec. 31, 2016	Dec. 31, 2015
Bank deposits	14,264	8,439
Cash on hand	14	15
Cash and cash equivalents	14,278	8,454

Among other items, cash and cash equivalents include an amount of € 626 thousand held on the insolvency escrow account (prior year: € 500 thousand) and an amount of € 1,454 thousand on the insolvency dividend payout account (prior year: € 1,580 thousand). Both accounts are under the sole power of disposal of the former insolvency administrator.

(43) Segment Reporting

Starting in 2017, the Group's business activities are allocated to and reported as three operating segments on a recurring basis based on the requirements of IFRS 8. The "Electronics" operating segment includes paragon AG's activities for the development and sale of sensors, microphones and instruments, primarily for the automotive industry, together with the SphereDesign GmbH and the paragon Kunshan Co., Ltd businesses. This operating segment generated segment revenue of € 89,518 thousand (thereof € 85,280 thousand with third parties) in 2016. The segment EBIT was € 12,705 thousand.

The "Electromobility" operating segment includes the activities of manufacturing battery systems and battery management systems for various industries within Voltabox Deutschland AG and Voltabox of Texas Inc. This operating segment generated segment revenue of € 14,493 thousand (thereof € 14,271 thousand with third parties) in 2016. The segment EBIT was € -3,676 thousand.

The "Mechanics" operating segment includes paragon AG's activities in developing and marketing electromechanical components for the automotive industry and the mechanical manufacturing of paragon Group's products at productronic GmbH. This operating segment generated segment revenue of € 60,261 thousand (thereof € 3,239 thousand with third parties) in 2016. The segment EBIT was € -100 thousand.

The various legal entities within the paragon Group enter into supply agreements with one another. Invoices for such supplies are raised on the same basis as with third parties, including an appropriate margin. Internal revenue primarily arises with productronic GmbH as this company is responsible for all manufacturing processes within the Group, and with paragon AG which is responsible for development work and central coordinating activities. This includes, among other things, central purchasing arrangements, human resources, and commercial management activities to the extent that these activities are not performed by the individual entities, as well as the Group's central management function. Also included are rentals paid by subsidiaries for the use of land, buildings, plant and other equipment owned by paragon AG. Charges made between the operating segments are based on the utilization made of the respective items charged. Segment assets and segment liabilities are presented on the same basis.

The segment analysis will be presented in this format from 2017 on a recurring basis. The reported amounts stated for 2016 have been generated retrospectively. Figures for previous periods are not presented as the data is not comparable.

In € thousands	2016 Electronics	Electromobility	Mechanics*)	Eliminations	Group
Revenue with third parties	85,280	14,271	3,239	0	102,790
Revenue intersegment	4,238	222	57,022	- 61,482	n/a
Segment revenue	**89,518**	**14,493**	**60,261**	**- 61,482**	**102,790**
Changes in inventory, other operating income, capitalized development costs	14,487	5,906	2,639	- 7,553	15,479
Expenses from intersegment accounting	- 57,244	- 4,878	- 6,913	69,035	n/a
Cost of materials, personnel expenses and other operating expenses	- 28,543	- 17,658	- 55,976	0	- 102,177
Segment EBITDA	18,218	- 2,137	11	0	16,092
Depreciation (incl. amortization)	- 5,513	- 1,539	- 111	0	- 7,163
Segment EBIT	**12,705**	**- 3,676**	**- 100**	**0**	**8,929**
Group Financial Result	n/a	n/a	n/a	n/a	- 3,167
Earnings before taxes	n/a	n/a	n/a	n/a	**5,762**
Assets	134,794	27,297	45,265	- 91,803	115,553
Investments	13,516	7,190	2,787	0	23,493
Debt	- 98,583	- 37,328	- 37,225	97,732	- 75,404

*) The segment has been presented as though productronic GmbH had already been an independent entity from January 1, 2016.

Information on Geographical Areas

The following table shows a geographical analysis of the Group’s revenue with external customers. The revenues generated with external customers for the purposes of the geographical analysis is based on the location of the registered head office of the respective external customer.

In € thousands	Domestic		EU		Rest of the world		Total	
	Jan. 1 – Dec. 31, 2016	Jan. 1 – Dec. 31, 2015	Jan. 1 – Dec. 31, 2016	Jan. 1 – Dec. 31, 2015	Jan. 1 – Dec. 31, 2016	Jan. 1 – Dec. 31, 2015	Jan. 1 – Dec. 31, 2016	Jan. 1 – Dec. 31, 2015
Revenue	70,251	65,297	25,943	23,312	6,596	6,381	102,790	94,990

Information About Transactions with Key Customers

In fiscal year 2016, two groups of companies exceeded the threshold of 10% in the revenue share according to IFRS 8.34. Of these, one group of companies, which is to be regarded as one customer because of its joint control, had a revenue share of 55.7%. Another group of companies, which is to be regarded as one customer due to its joint control, had a revenue share of 11.4%.

Supervisory Board Chairman

(44) Directors and Officers

In the period from January 1 to December 31, 2016, the Management Board of paragon AG comprised the Chief Executive Officer, Klaus Dieter Frers, and the Chief Technology Officer, Dr. Stefan Schwehr.

The following persons were members of the Supervisory Board:

Name	Profession	Membership in Supervisory Boards and other Supervisory Bodies
Prof. Dr. Lutz Eckstein Supervisory Board Chairman	University Professor, Dr. Ing., Director of the professorial chair and the institute for Automotive Engineering (ika), RWTH Aachen	Supervisory Board positions: • ATC GmbH, Aldenhoven (Member) Further positions: • Chairman of the Advisory Board of the „Forschungsgesellschaft Kraftfahrwesen Aachen mbH“ (fka) • Member of the VDI Advisory Board of the Society for Vehicle and Traffic Technologies (VDI-FVT) • VOSS Holding GmbH & Co. KG., Wipperfürth (Member of the Advisory Board)
Hermann Börnemeier	Diplom Finanzwirt and tax advisor, Managing Director of Treu-Union Treuhandgesellschaft mbH	
Walter Schäfers	Attorney-at-law, Partner Societät Schäfers Rechtsanwälte und Notare	

(45) Angaben zu nahestehende Unternehmen und Personen

Related parties as defined in IAS 24 Related Party Disclosures include members of the Management Board, the Supervisory Board and their immediate families as well as affiliated companies.

Treu-Union Treuhandgesellschaft mbH, Steuerberatungsgesellschaft, Paderborn, rendered services totaling € 98 thousand under an ongoing agreement in fiscal year 2016 (prior year: € 62 thousand). Hermann Börnemeier, a member of the Supervisory Board of paragon AG, is also managing director of the above company.

In fiscal year 2016, Societät Schäfers, Rechtsanwälte & Notare, Paderborn, rendered services in the amount of € 0 thousand (prior year: € 1 thousand). Walter Schäfers, a member of the Supervisory Board at paragon AG, is also a partner in this company.

In fiscal year 2016, Forschungsgesellschaft Kraftfahrwesen mbH Aachen rendered development services totaling € 74 thousand (prior year: € 129 thousand). Professor Dr. Lutz Eckstein, a member of the Supervisory Board at paragon AG, is the Chairman of the Advisory Board of this company.

Members of the Supervisory Board held 4,000 shares (prior year: 4,000) out of a total of 4,526,266 shares as of the balance sheet date.

Members of the Management Board held 2,263,134 shares (prior year: 2,114,680 shares) out of a total of 4,526,266 shares as of the balance sheet date (prior year: 4,114,788).

Payments of € 6 thousand (prior year: € 321 thousand) were made, primarily for building rents and associated building overhead costs, to Frers Grundstückverwaltungs GmbH & Co. KG, Delbrück, and to Artega GmbH & Co. KG in 2016 in accordance with contractual arrangements. Of these, € 6 thousand (prior year: € 294 thousand) related to the company building in Delbrück.

As of the balance sheet date, performance guarantees with a maximum amount of € 153 thousand had been provided by Klaus Dieter Frers with respect to paragon AG's liabilities to banks (prior year: € 153 thousand).

Brigitte Frers is employed under an employment contract consistent with market terms and conditions.

The outstanding balances for related parties were immaterial as of the reporting date.

We refer to note 23 "Financial assets" for further disclosures of transactions between paragon and its affiliated companies.

(46) Share Based Remuneration

Stock Option Plan 2012

In accordance with a resolution approved at the Annual General Meeting on May 9, 2012, the Management Board was authorized, subject to the approval of the Supervisory Board, to issue subscription rights for up to 410,000 shares of the company on one or more occasions up to and including May 8, 2017 in accordance with the rules set out in the following paragraphs. The authorization shall be exercised by the Supervisory Board where members of the Management Board are affected. As of the balance sheet date, all 410,000 subscription rights can still be utilized.

Beneficiaries

The beneficiaries shall be members of the Management Board and employees of the company. The Management Board, subject to the approval of the Supervisory Board, shall determine the precise group of beneficiaries and the amounts issued to the respective persons. The amounts to be issued to members of the Management Board shall be determined by the Supervisory Board.

Allocation of Subscription Rights

The allocation of subscription rights to individual groups of beneficiaries is as follows:

- Members of the company's Management Board: up to a total of 250,000 subscription rights

- Company employees: up to a total of 160,000 subscription rights

New subscription rights may be issued in lieu of subscription rights that have expired or have not yet been exercised.

Purchase Period

The subscription rights may be issued to the beneficiaries on one or more occasions during a period of one month after an Annual General Meeting or after the publication of a financial report (annual report, half-year financial report or quarterly report/interim management statement). These periods constitute the "purchase period".

Term

The subscription rights have a term of seven years, commencing on the first day after their issue date. After that, the subscription rights will lapse without compensation. The issue date is the last day of the purchase period in which the subscription rights were issued.

Holding Period

The subscription rights may be exercised no earlier than a period of four years after their issue date.

No options rights were issued under the Stock Option Plan 2012 in the reporting year.

(47) Auditor's Fee

Expenses of € 106 thousand were recognized in the period under report from January 1 to December 31, 2016, as fees for the audit of paragon AG's separate financial statements prepared in accordance with German commercial law, and for the audit of paragon AG's consolidated financial statements prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU, which were conducted by Baker Tilly Roelfs AG, Wirtschaftsprüfungsgesellschaft, Steuerberatungsgesellschaft (prior year: € 95 thousand). Of this total, € 63 thousand relates to auditing services and € 43 thousand to other services.

(48) Risk Management

The company's risk management is described in the management report.

(49) Application of the Exemption Provisions of Section 264 (3) of the German Commercial Code (HGB)

The following fully consolidated domestic subsidiaries make use of some of the exemption provisions for the year under review:

- productronic GmbH, Delbrück
- Voltabox Deutschland GmbH, Delbrück
- KarTec GmbH, Forchheim
- SphereDesign GmbH, Bexbach

(50) Declaration Pursuant to Section 160 (1) No. 8 of the German Stock Corporation Act (AktG)

Voting Right Notifications

In the year under report, the company received the following notifications pursuant to Section 26 (1) of the German Securities Trading Act (WpHG) that require disclosure in accordance with Section 160 (1) No. 8 of the German Stock Corporation Act (AktG):

- Otus Capital Management LP (represented by Otus Capital Management Limited, represented by Andrew Gibbs) informed the company that its shareholding fell below the 5% threshold on January 5, 2016. As a result its shareholding in paragon AG on that date was 4.99% (205,181 voting rights).
- Otus Capital Management LP (represented by Otus Capital Management Limited, represented by Andrew Gibbs) informed the company that its shareholding exceeded the 5% threshold on February 11, 2016. As a result its shareholding in paragon AG on that date was 5.05% (207,643 voting rights).

Directors' Dealings

Disclosure of transactions by management in accordance with Article 19 of the EU regulation No 596/2014 (MAR) on market abuse (market abuse regulation):

- Klaus Dieter Frers informed the company in his position as Chief Executive Officer that he acquired 120,533 shares in the company at a price of € 32.50 per share and for a total consideration of € 3,917,322.50 in a transaction not executed on a stock exchange on October 5, 2016, by subscribing for those shares as part of a capital increase.

Corporate Governance Declaration

The Declaration of Conformity with the German Corporate Governance Code (GCGC) required under Section 161 of the German Stock Corporation Act (AktG) was most recently submitted in February 2017, and is available to shareholders on a permanent basis on the company's website (www.paragon.ag).

Delbrück, March 3, 2017

Klaus Dieter Frers	Dr. Stefan Schwehr
Chief Executive Officer	Chief Technology Officer (Electronics)

Auditor's Report

We have audited the consolidated financial statements prepared by paragon AG – comprising the consolidated balance sheet, the consolidated profit and loss account, the consolidated statement of comprehensive income, the consolidated statement of changes in equity, the consolidated statement of cash flows, and the notes to the consolidated financial statements – together with the Group management report for the fiscal year from January 1, 2016, to December 31, 2016. The preparation of the consolidated financial statements and the Group management report in accordance with IFRS, as adopted by the EU, the additional requirements of German commercial law pursuant to Section 315a (1) of the German Commercial Code (HGB) and the additional provisions of the Articles of Association are the responsibility of the legal representatives of the company. Our responsibility is to express an opinion on the consolidated financial statements and on the Group management report based on our audit.

We conducted our audit of the consolidated financial statements in accordance with Section 317 HGB and the German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer [Institute of Public Auditors in Germany] (IDW). Those standards require that we plan and perform the audit such that misstatements and irregularities materially affecting the presentation of the Group's assets, financial position and earnings in the consolidated financial statements in accordance with the applicable accounting standards and in the Group management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Group and expectations as to possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the consolidated financial statements and the Group management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the annual financial statements of the companies included in the consolidation, the scope of the consolidation, the accounting and consolidation principles used, and the significant estimates made by the legal representatives, as well as evaluating the overall presentation of the consolidated financial statements and the Group management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.

In our opinion, based on the findings of our audit, the consolidated financial statements comply with IFRS as adopted by the EU and the additional requirements of the German Commercial Code pursuant to Section 315a (1) HGB, together with the supplementary provisions of the Articles of Association, and give a true and fair view of the assets, financial position and earnings of the Group in accordance with these requirements. The Group management report is consistent with the consolidated financial statements and as a whole provides a suitable view of the Group's position, complies with all statutory regulations and suitably presents the opportunities and risks of future development.

Düsseldorf, March 3, 2017

Baker Tilly Roelfs AG
Wirtschaftsprüfungsgesellschaft

Thomas Gloth	Christoph Tyralla
German public accountant	German public accountant

Declaration by the Legal Representatives

We declare that to the best of our knowledge and in accordance with the applicable accounting principles, the consolidated financial statements give a true and fair view of the assets, financial position and earnings of the Group, and that the Group management report presents the development of business, including the business results and the position of the Group, in such a way that a true and fair view is conveyed and the significant opportunities and risks of the Group's foreseeable development are described.

Klaus Dieter Frers
Chief Executive Officer

Dr. Stefan Schwehr
Chief Technology Officer (Electronics)

Financial Calendar

January 5/6, 2017	20. Oddo Forum, Lyon
February 15/16, 2017	11. German Conference, Frankfurt am Main
March 27, 2017	Annual Report – Consolidated Financial Statements 2016
May 10, 2017	Interim Release as of March 31, 2017 – 1. Quarter
May 10, 2017	Annual General Meeting, Delbrück
June 1, 2017	quirin Champions 2017, Frankfurt am Main
August 15, 2017	Interim Release as of June 30, 2017 – first half year
September 5/6, 2017	15. SCC Small Cap Conference, Frankfurt am Main
November 14, 2017	Interim Release as of September 30, 2017 – 9 Months
November 27 – 29, 2017	Eigenkapitalforum, Frankfurt am Main

IMPRINT

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