

THE FORMULA FOR SUCCESS  
ANNUAL REPORT 2010

## KEY DATA

	31/12/2010	31/12/2009
	€ M	€ M
<b>Results of operations</b>		
Revenues	211.0	218.4
Gross yield	104.3	106.2
Operating profit*	9.2	-2.7
Operating result*	0.6	-14.1
EBIT	-12.8	-42.8
Earnings per share in EUR	-3.09	-5.06
Order volume	218.6	210.9
Order backlog	101.7	98.0
<b>Net assets and financial position</b>		
Cash Flow	4.4	7.2
Working Capital	41.3	53.1
Shareholder's Equity	64.5	89.1
Equity ratio in %	43.1	53.1
Balance sheet total	149.7	167.8
Employees (annual average)	1,372	1,639

\*result before impairment charges and restructuring costs

## FUNKWERK AG

Funkwerk specialises in solution-oriented information and communication systems for such applications as transport and traffic, vehicles, security and data networks. Funkwerk systems automate, rationalise and secure the operating processes of customer target groups covering a wide range from private enterprises to public institutions. Based on different areas of application and appropriate target groups, Funkwerk today is an active technology provider with four strategic business units.

### TRAFFIC & CONTROL COMMUNICATION

- Communication systems
- Management systems
- Information systems

### AUTOMOTIVE COMMUNICATION

- Communication systems (ASM)
- Communication systems (OEM)
- Telematics
- Avionics

### ENTERPRISE COMMUNICATION

- Networks
- Voice
- Data security

### SECURITY COMMUNICATION

- Video systems
- Property protection
- Personal security systems
- Radio equipment for security functions

# LETTER TO THE SHAREHOLDERS



*Dear ladies and gentlemen, dear shareholders,*

Funkwerk AG marked its tenth anniversary, in 2010, which prompts me to provide a brief review of the company. We started in August 2000 as a small business with 280 employees and sales of EUR 38 million. Back then, we were proud to have increased our export turnover by 63 per cent to EUR 3.7m. Ten years later, Funkwerk has advanced to become a technology group with a diverse portfolio and numerous locations throughout Germany and Europe, as well as an export turnover that has multiplied more than tenfold compared to 2000.

This first decade was a highly eventful time, not only for Funkwerk. In November 2000, our company went public at a time when the euphoria of the »new economy« was already beginning to wane and the stars of the »new market« gradually lost their charm.

Funkwerk is one of the few technology companies that has not only survived the demise of the »new market«, but has also continued to grow significantly, even despite all the global economic upheaval that followed. This almost unspoiled and ideal period of growth lasted seven years. In that time, employee figures in the Funkwerk group multiplied fourfold, operational profit increased fivefold and sales rose eightfold.

As early as in 2008, however, we were forced to admit that rapid growth has its price. Our organisational structures were stretched beyond their limits, processes lost effectiveness, our product portfolio got out of hand, and we were facing excess capacities. As a consequence, our company underwent a phase of consolidation, adjustment and restructuring. When the first positive results from these measures began to set in for Funkwerk, the world markets plunged into a crisis, which they have still not completely overcome. Added to that, we had a special situation in Algeria, where our initially successful project business turned into a risk, due to incalculable political trends.

For Funkwerk, 2009 and 2010 therefore became a triple endurance test. We needed to cope with the negative trend of the global economy while also putting our group on a new, more efficient platform that would yield profit again. This meant adjusting not only our costs, but also our business model.

We are currently undergoing a change from an equipment provider for special niches towards a supplier of professional solutions for specific sectors of the industry, in order to avoid the standardisation and competitive pressures of mass production. We are concentrating our product portfolio on a few essential key components with greater technological value added. We are continuing to internationalise our business, preferably through cooperation with international infrastructure manufacturers. We are focusing our business operations on transport and security because we see attractive markets and lasting competitive advantages here in the long term. We are implementing a platform strategy, which will enable a better trans-sectoral use of resources, savings for cross-departmental functions and a better reuse of development results. We made good progress in implementing this strategy in 2010.

The 2009 financial year was the first year in which Funkwerk needed to report a loss. The Management was intent on achieving a positive operating result again the following year, especially as it would be our tenth anniversary. Although business did not revive, we managed to achieve this goal by reducing our cost base by some EUR 19 m. These lasting successes in restoring our operational profitability were, however, eclipsed by our Algeria business and by restructuring costs. These one-off impairments and expenses meant that Funkwerk again made a loss in 2010.

By implementing a strategy change and restructuring measures, and through conservative budgeting, Funkwerk has laid the foundations over the past couple of years that will help us again achieve profitable growth in all our segments in 2011. Based on our projections, Funkwerk as a group will report growth again and generate profit in the current financial year. In 2012 and 2013, this figure should rise further and increase our profit margin.

Our company has thus largely left the phase of consolidation behind and is back on firm ground. The alignment of our new business model and the cost adjustment will continue consistently in 2011, with priority given to exercising strategic options. Furthermore, the 2011 financial year will ring in the beginning of a new decade of growth for Funkwerk. To this end, we plan to continue what has been the key success factor of Funkwerk over the past ten years, and that is our innovations.

Funkwerk's innovations include the mobile radio amplifier, Compenser, which is already in use in over three million vehicles, and the GSM-R cab radios now installed in over 20,000 trains from Norway to China. We will benefit from sales of our electronic interlocking systems (Alister), our TETRA personal emergency call systems, and other innovations currently in development. The business segments served by innovative products such as these are all defined by strong dynamics. This will in future produce a number of opportunities and worthwhile development options for our company.

So, in 2011, we have started on a new path towards growth which will hopefully lead us back in the medium term to our past record sales and appropriate earnings. After this interim stage, we plan to advance Funkwerk in the long term to become one of the top 5 companies for professional communication, information and security solutions in Europe, and to generate lasting profit for our shareholders. We are wholly committed to this goal.

Thank you very much for your support and confidence in us!

For the Executive Board of Funkwerk AG:



Dr. Hans Grundner  
(Chairman)

# FUNKWERK IN A DIALOGUE



»THE COMPANY'S FUTURE LIES IN ITS POTENTIAL. FUNKWERK WILL BRING ITS RICH POTENTIAL SUCCESSFULLY ON THE ROAD.«

THE BOARD MEMBERS OF FUNKWERK AG DR. HANS GRUNDNER, CARSTEN AHRENS AND JOHANN SCHMID-DAVIS TALK TO MR. RIGOBERT KAISER – ECONOMIC AND EXCHANGE JOURNALIST, BAYRISCHER RUNDFUNK





Dr Hans Grundner (2nd from left),  
Carsten Ahrens (2nd from right),  
Johann Schmid-Davis (right)  
and journalist Rigobert Kaiser (left)

## THE EXECUTIVE BOARD TALKS TO RIGOBERT KAISER

In your letter to the shareholders it says, »The first decade of Funkwerk AG was exceptionally eventful«. Will the next phase until 2020 be calmer?

**MR DR GRUNDNER:** The phases in the life of a company depend not only on its strategy but also, of course, on internal and external influences. Statistics have shown that a phase of rapid growth in a company – which lasted for as long as seven years at Funkwerk – is often followed by a phase of consolidation for two to three years, in which the company makes efforts to reposition itself and gather new momentum. If you pass this phase successfully, you are ready for the next spurt of development. Looked at in this way, we do expect that Funkwerk will now begin a new phase of growth, so it won't be a calm phase.

Growth since your IPO in 2000 has been meteoric. Two sites turned into 12, sales multiplied almost sevenfold to EUR 212m. At what pace will the company continue?

**MR DR GRUNDNER:** Our strategy aims for controlled growth. During our consolidation phase in 2009 and 2010, we created the necessary structures and the management instruments for this to help us control the risks we face better. We will in future improve and continue to develop our central functions. This starts with standardising our IT and ERP system by introducing a central, uniform database for the whole group. It continues with the organisation of a central purchasing function with standardisation of our stock of articles. This will also help us reduce its diversity and ensure more balanced utilisation of production capacities. It is also very important that we introduce development platforms, i.e. tools designed to achieve greater productivity in our product development. It will at the same time lead to a better reuse of development results and components. All these are requirements which did not exist in the early life of Funkwerk in 2000. Currently, we believe growth will remain moderate in 2011 and 2012. It should, however, pick up quite rapidly in 2013 and 2014 with technologies and products that will have matured by then.

What are your sales and profit forecasts for the current year?

**MR SCHMID-DAVIS:** We started our budget planning as early as last October. It goes along with mid-term planning over three years including strategy planning. In the planning process, we work both from the bottom and the top to get the best possible result in our assessment. »From the top« means from the points of view of the market and the market shares to be planned; »from the bottom« means from the points of view of each individual project and current sales information, as well as cost budgets. Based on this, our sales revenue planning currently ranges at around EUR 230m; this will also lead to budgeted earnings before interest and taxes again.

What is your mid-term strategy?

**MR SCHMID-DAVIS:** Our mid-term strategy covers the years 2012 and 2013. Based on our current cost structure, we expect higher growth rates even as early as that, up by as much as 20 per cent on 2010. We are talking about organic growth here. Our projected growth figures can, of course, easily be exceeded through potential acquisitions of companies or divisions. Growth will largely depend on how quickly we are able to gain market shares with our new product groups »Alister interlocking system« and »TETRA«. From 2013, we also expect to see notable growth in our Automotive segment.



Can you say something about the financing of Funkwerk AG? Borrowing? Capital adjustments?

**MR SCHMID-DAVIS:** Our net cash assets at the end of last year totalled around EUR 12m. Due to the cyclical nature of our business and our strong project orientation, we especially need secured financing for our working capital, which fluctuates quite significant through the year, and for guarantees generally required in project business. We are currently looking quite intensively at various options in our planning. What we can say at this point is that we have not planned any short-term capital adjustments.

You have four business segments. The largest of these is Traffic, which supplies communication and radio data transmission technology to railway operators, and also to cruise ships. How is this segment developing?

**MR DR GRUNDNER:** Last year, our Traffic & Control Communication segment generated sales in the amount of EUR 103m. Our train radio systems have actually been part of the core business of Funkwerk right from the start. The segment developed very well in the first decade of Funkwerk. Today, we are proud to say we are global market leaders in radio terminals for trains. As many as 20,000 trains from Norway all the way to Australia already use our radio technology. We have a well-rounded portfolio with our other product groups, management systems and information systems. We deliver control systems that help monitor, schedule and simulate rail transport, but also highly modern interlocking systems. In the information systems sector, we lead the German market in dynamic passenger information and, in future, plan to focus even more still on equipping the trains themselves with state-of-the-art communication technology. We see the greatest growth potential in mobile passenger information and in interlocking systems.

You say you want to focus more strongly on Traffic & Control Communication and on Security Communication in the future. What exactly does this mean?

**MR DR GRUNDNER:** Over the past few years, we have built up our Enterprise Communication and Security Communication segments by, for example, taking activities out of the other segments and consolidating them there. We believe communication technology for transport and security is a long-term growth sector which will continue to gain in importance for the national economy. Mobility and security are basic needs of every person and can only be satisfied with modern communication technology. The increase in energy prices and progressive urbanisation will further accelerate this trend. We therefore see it as a challenge, but also as an opportunity, to concentrate particularly on these segments. Funkwerk has the best prerequisites here.



Security Communication is a field that has now also been discovered by major corporations.  
How can Funkwerk compete in this environment?

**MR AHRENS:** Size does not necessarily equal strength or speed. Funkwerk has special solutions in this area that major players in the field often do not cover, and we are a sought-after partner of major suppliers. A good example here is our personal emergency call systems that provide security at the workplace for persons at risk. Funkwerk has a real competitive differentiator here with precise location in buildings, which has made us the market leader in Germany by quite a margin. We are currently also the only supplier of TETRA-based personal emergency call systems. In video monitoring, we also have solutions that meet complex requirements for a wide range of applications as an unrivalled selling point, such as our unique hard shoulder release system on motorways.

The security technology sector has been predicted to grow quite significantly for years now, but companies continue to be rather restrained in their investments. Do you see signs that things are about to change here?

**MR DR GRUNDNER:** The professional security technology we sell is in demand not so much by companies, but by public institutions and system operators. Projects are planned, but quite often postponed because financing or government subsidy is delayed for budgetary reasons. We plan to tackle this situation by increasingly focusing on mid-sized applications based on high-end versions. This requires that we provide more standardised solutions, which we are currently working on.

How do you plan just now to drive growth in this area? Will there be new technologies?  
Is Funkwerk as an SME technologically ready here?

**MR DR GRUNDNER:** New technologies undergo rapid advances: the change from analogue video technology to an IP-based solution is one such example. In video monitoring, in the future we see the camera not only as an instrument to record a video film, but also increasingly as a universal sensor that can identify different parameters and characteristics through image processing. This opens up further automation applications that go far beyond mere video monitoring. In connection with classic functions, the nationwide TETRA security radio system also opens up new areas of application. In both these areas, Funkwerk is technologically ready for above-average growth.

The automobile industry is booming; worldwide, new vehicles sell like hot cakes. With your technology you ensure that drivers can phone without interference. Do you benefit from the upturn in this sector?

**MR AHRENS:** Funkwerk has a number of innovations in its Automotive segment that are already used in many vehicles today – especially in the mid and top range classes. The most prominent example is our Compenser, an amplifier that significantly improves mobile phone connections in the car. What we need is quantities, which means we need to place other products with car manufacturers if we want to grow. In the last two years, we therefore concentrated on creating a development platform. This will allow us to develop new communication devices and modules for cars more quickly and cost-effectively. We are currently involved in quite a few offers in this area. But the life cycle of vehicle generations is around three to four years, so we will be able to bring in the harvest from 2013.

The automobile industry is pushing into such emerging markets as China and India. Are there similar plans on your agenda?

**MR AHRENS:** Yes, internationalisation is a major issue for Funkwerk in finding extended markets. These markets are necessary in order to achieve critical sales levels that are necessary to finance the technological progress. We will, however, increasingly look for cooperation with other companies and more likely go for indirect sales. China and India, of course, play a big role in this area, and we are looking for partners.

At the Cebit in early February, Funkwerk formed a Cloud Printing Alliance with such PC and printer manufacturers as Dell, Konika and Minolta, to name but a few. What exactly does this mean?

**MR AHRENS:** More and more people use smartphones and tablets. The Cloud Printing Alliance ensures that users now have access to printers on the net to print out electronic content directly from their mobile devices. Since our Enterprise Communication segment is the leading supplier of WLAN solutions for companies and hot spots such as in hotels, for instance, we have joined this alliance and are now making our products and solutions compatible with these applications.

At the Cebit, you also presented a new LTE cable to connect rural areas to the Internet. What do you hope to gain from this technology?

**MR AHRENS:** After auctioning off digital dividend licences and the current ongoing extension of LTE networks, the next stage in Germany is to close what are known as »not spots«. The loss-free LTE cable allows users to connect an outside aerial to an LTE modem so they can use broadband Internet, even in regions with inadequate service. This Funkwerk solution is a spin-off of our expertise in mobile radio connection.

Technology is advancing at an ever faster pace. One only needs to look at the rapid advance of smartphones and tablet PCs. Can you as a smaller company keep up here in the long term?

**MR AHRENS:** We are not suppliers of consumer electronics for mass markets – we would probably have a hard time keeping up there. We therefore concentrate on special solutions with a high level of »added value«, which are not easily realised using standard products. And we want to make these special solutions accessible in a broad market. Two years ago, Funkwerk introduced a change in strategy, to develop away from manufacturing individual niche products towards becoming a supplier of professional solutions for specific requirements. To this end, we concentrate on a few proprietary key products, but which are then produced with a technological lead and increased added value. Standard products from third-party manufacturers are used and integrated into our own solutions.

Let's venture a look further ahead into the future. What could communication technology look like in ten years' time?

**MR DR GRUNDNER:** In ten years, communication technology will be integrated even more tightly than before into the general infrastructure and in the personal life of each individual. Anything that can reasonably be connected to communication networks will be connected – increasingly wirelessly. I no longer see ticket vending machines because passengers have their mobile device on them and are automatically logged in online when getting on a train and their accounts are charged immediately after alighting. This is only one example. Operating equipment will also become simpler. Increasingly, fewer people will be able to understand what goes on behind the scenes and in what ways their personal data are used. This, of course, poses a threat, and the possibilities of manipulation will increase. So, data security and the protection of privacy are central issues to which Funkwerk is already giving great attention.

High technology is always also a cost factor. What are the development costs at Funkwerk?

**MR SCHMID-DAVIS:** High technology is a major cost factor. On the whole, Funkwerk faces costs in the region of EUR 30m a year for general development work. Some EUR 5m of this amount are purely for contract developments. The remaining budget is used to work out basics and concepts, for product maintenance, and, of course, to develop innovative products. We have around 300 highly qualified engineers in total who work on our developments.

In August 2000, the issue price of your share was EUR 20; it is currently worth just under EUR 7. From your point of view, is this a fair market value?

**MR DR GRUNDNER:** If we look at the potentials and the significant diversity of technologies that Funkwerk masters, this price is definitely not justified. But we recognise the reasons for the current share price because Funkwerk is not currently generating profit and has had to overcome a triple burden: consolidation after rapid growth, the economic crisis, and, not least, the negative effects of our project business in North Africa. But we are convinced we will see a positive trend towards higher prices set in again, even this year.

Last time, your shareholders received a dividend of EUR 0.25 in 2007. When will you start making pay-outs again?

**MR DR GRUNDNER:** The Executive Board follows the principle whereby at least 1/3 of the earnings per share are paid out and the rest is made available to help the company advance. However, each financial year must be considered separately because pay-outs in the future will, of course, also depend on our financial situation and on our investment activities. Therefore, although I cannot give you a specific point in time, in principle we do, of course, want to return to our old dividend policy as quickly as possible.



## The Management Board of Funkwerk AG

### **DR.-INGENIEUR HANS GRUNDNER**

CHAIRMAN OF THE EXECUTIVE BOARD,  
RESPONSIBLE FOR: STRATEGY AND  
BUSINESS DEVELOPMENT

Dr Hans Grundner studied electrical engineering at the Technical University (TU) of Munich. After graduating as an electrical engineer and receiving his doctorate of engineering (Dr.-Ing.), he applied his academic knowledge as a systems engineer in the industry and held various management roles in major companies, where he was responsible for system development and mobile radio communication projects until the early 1990s. In 1991, he was appointed Managing Director of Hörmann GmbH and developed the medium-sized group to achieve a dramatic sales increase within a few years. In 1992, Dr. Grundner founded Hörmann Funkwerk Köllda GmbH, which was later to become Funkwerk AG. In November 2000, he successfully floated the company on the stock exchange and has been Chairman of the Executive Board ever since.

### **JOHANN SCHMID-DAVIS**

RESPONSIBLE FOR: FINANCE,  
PERSONNEL, LEGAL AND IR

Johann Schmid-Davis has been the CFO of Funkwerk AG since September 2009. An accounting and finance expert, he joined the Funkwerk group in January 2001 and was put in charge of acquisitions at the Enterprise Communications segment and of shaping its financial strategy. In 2004, Mr Schmid-Davis was appointed Chief Financial Officer of Funkwerk Enterprise Communications and was later responsible for its successful restructuring. Since then, he has held several positions in the management team. After his appointment to the Executive Board, the graduate business economist used his knowledge and experience to play a substantial role in restructuring and financing the group and optimising its business processes.

### **CARSTEN AHRENS**

RESPONSIBLE FOR: PORTFOLIO  
DEVELOPMENT AND STRATEGY

With over 20 years of experience in telecommunications and IT business, Carsten Ahrens is a technology expert who has been responsible on the Executive Board of Funkwerk AG for development of the group's portfolio and its communication and information technology strategy since 1 October 2010. Throughout his professional career as an electrical engineer, he has led various national and international business units in the multimedia, wireless communication and consulting sector to success. He plans to continue on this track as Chief Technology Officer of Funkwerk. In recent years Carsten Ahrens was also a member of the governing board of the German Association for Information Technology, Telecommunications and New Media (Bundesverband Informationswirtschaft, Telekommunikation und neue Medien e.V., BITKOM), the influential umbrella organisation of key companies in this sector.

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### OUR EMPLOYEES. OUR KNOW-HOW.

This year's photo pages introduce some of our employees at their workplaces and present to you the basis of our know-how and our products. We hope to give you an idea of the physical and technical complexity inherent in our products and services. We would be pleased if you took the time to get involved a little in our world. For further information visit [www.funkwerk.com](http://www.funkwerk.com).



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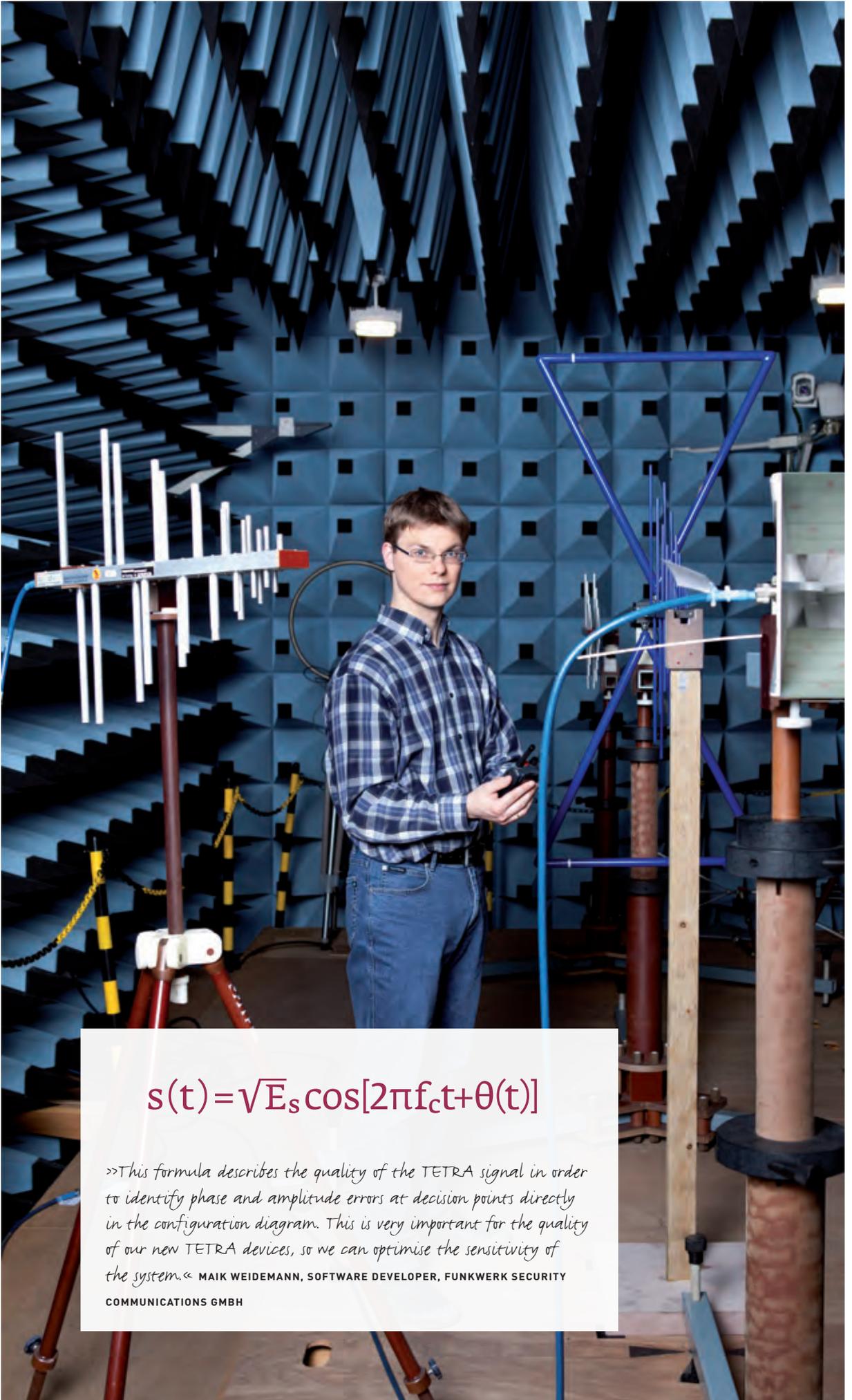
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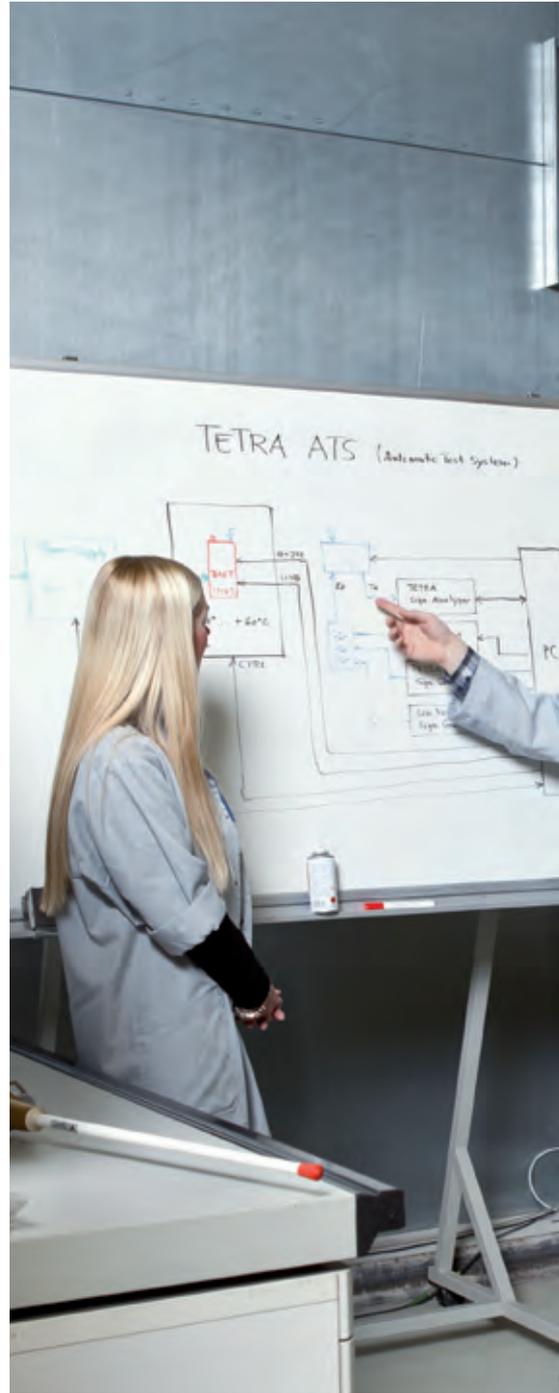
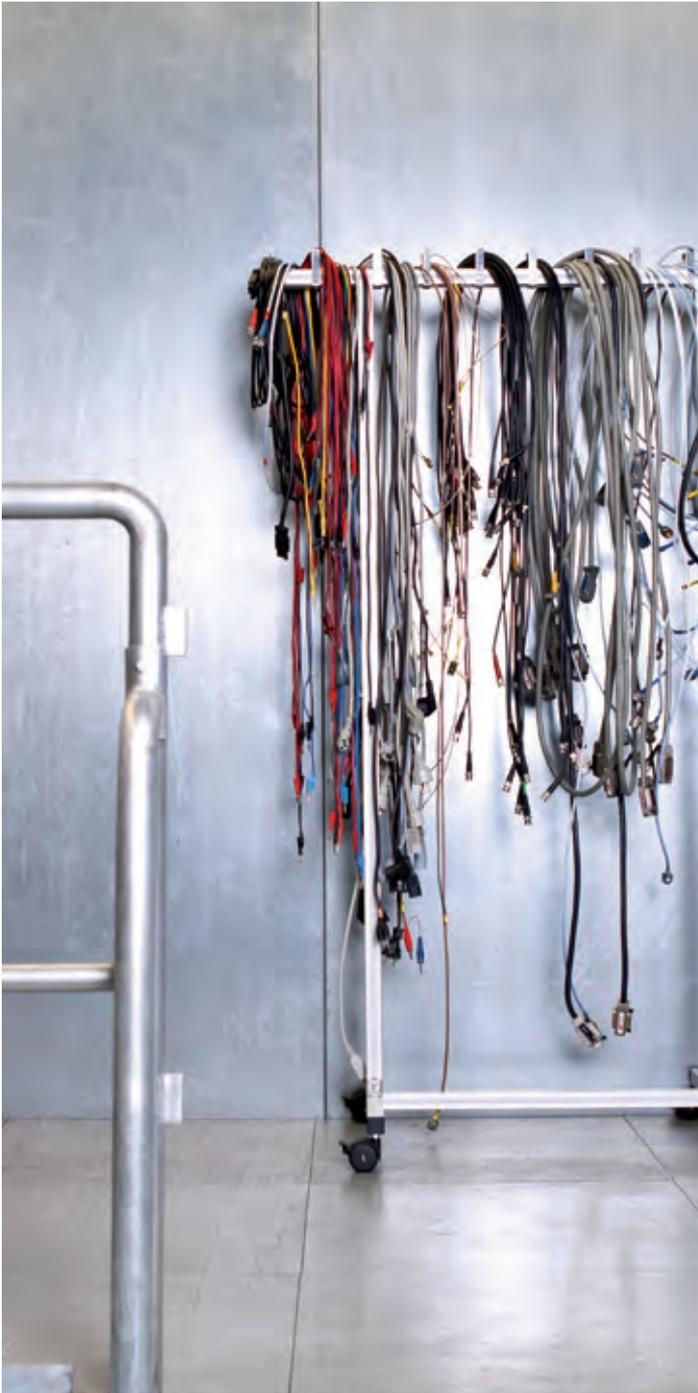
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$$s(t) = \sqrt{E_s} \cos[2\pi f_c t + \theta(t)]$$

*»This formula describes the quality of the TETRA signal in order to identify phase and amplitude errors at decision points directly in the configuration diagram. This is very important for the quality of our new TETRA devices, so we can optimise the sensitivity of the system.«*

**MAIK WEIDEMANN, SOFTWARE DEVELOPER, FUNKWERK SECURITY COMMUNICATIONS GMBH**



## Our know-how in Security Communication

The quality of information available is crucial wherever there are security and safety risks to people and premises. Funkwerk's professional security solutions play a vital part.

Funkwerk has developed security systems for high-security plants and industrial areas where there is a danger of explosion. These systems set new high standards with the use of cutting-edge radio transmission technology. The LAN-based TETRA Security System (TSS), for example, has a vital advantage compared to conventional systems due to its highly precise position finding, the stability of its wireless connections and a notably wider performance spectrum. Funkwerk's know-how is leading in this field.



To counter increasing violence in schools, Funkwerk has developed an emergency call system especially for schools. Each classroom is provided with a wireless emergency call tile, attached to the teacher's desk or near to the classroom door. If an alarm is triggered, the signal goes straight to the alarm control centre, which instantly locates the position of the emergency call and transmits it to mobile pagers. This ensures all responsible parties are promptly informed and no time is wasted in an emergency.

Our video security systems are based on the latest findings in science and research. To this end, we have entered into a research cooperations with such establishments as

the Austrian Institute of Technology (AIT), recognised for its leading international expertise in image processing. Together we are developing »next generation« intelligent image processing technologies to increase security for critical infrastructures and transport applications.

# BRIEFING

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016 Report of the Supervisory Board  
020 Corporate Governance Report



## REPORT OF THE SUPERVISORY BOARD

*Dear ladies and gentlemen, dear shareholders,*

The global economy in 2010 recovered exceptionally quickly, aided by the international measures. The rise in economic performance of around 5 per cent was driven by notably disproportionate growth in states outside Europe and the established major industrial nations. Gross fixed asset investments in particular – a key factor for Funkwerk – saw only minor improvement, while spending on infrastructure investments stagnated throughout 2010 due to restrictive fiscal policies in Europe. This led to infrastructure projects being prolonged or postponed entirely, adversely affecting our sales.

In the second half of the year, business was adversely affected quite significantly by political upheaval in Algeria. As a consequence, our property protection business in Algeria had to be suspended. After appraising that development and the likelihood of instability spreading to the whole of North Africa in late 2010 and early 2011, we acted accordingly, conscious of the risks, and revalued our entire involvement there. This had a significant and greatly detrimental impact on our year-end accounts, reducing our earnings by over EUR 9 m.

It was these effects, in particular, that prevented us in 2010 from getting back into the black. However, by intensively and consistently pushing our restructuring with resulting cost savings of around EUR 19 m, we were able to report a somewhat positive operating result, after a loss of around EUR 14 m in the previous year. Our cost reductions and conservative budgeting policy in 2010 have put us in a good position to take advantage of opportunities in 2011 while continuing our strategic focus, so we achieve further improvements in our results.

In the year under review, the Supervisory Board performed the duties incumbent on it by law and the Articles of Incorporation. It acted in an advisory capacity to the Executive Board of Funkwerk AG while monitoring its conduct of affairs. The Supervisory Board was directly involved in all decisions of fundamental significance to the company.

All measures required by law or the Articles of Incorporation to be approved by the Supervisory Board were discussed in detail and presented for a resolution. The chairman of the Supervisory Board, along with the remaining board members in individual matters, constantly kept in contact with the Executive Board all throughout the financial year. Transactions requiring reporting were disclosed on an ad hoc basis. Between the meetings, the chairman of the Supervisory Board promptly notified the members of the board both in writing and verbally of talks held with the Executive Board.

### **FOCAL POINTS OF THE SUPERVISORY BOARD MEETINGS**

In its five regular meetings in 2010, the Supervisory Board monitored the development of the group, as the Executive Board detailed the situation in the company and its trend of business. Based on these reports from the Executive Board, the Supervisory Board primarily discussed the economic situation including economic and liquidity planning, incoming orders, order volume, any concealed risks and key business transactions, projects of particular note, and the mid- and long-term strategy of the company including organisational matters and personnel planning.

In detail, the five Supervisory Board meetings were used to discuss the following issues with the Executive Board:

The meeting convened on 29 March 2010 focused on the annual accounts and the consolidated financial statements of Funkwerk AG as at 31 December 2009, including the management report and the report on relationships with associated companies as presented by the Executive Board. The Supervisory Board received a detailed report from the auditor explaining the results of the audit. Following exhaustive deliberations, the annual accounts and the consolidated financial statements along with the management report and the report on relationships with associated companies were adopted and approved by the Supervisory Board. Further focal points of the meeting included approval of the agenda proposed by the Executive Board for the annual shareholders' meeting set for 27 May 2010 and the composition of the Executive Board along with the appointment of a Chief Technology Officer.

In the constituent meeting on 27 May 2010, the new Supervisory Board was constituted and the chairman and deputy were elected.

In the meeting on 23 September 2010, the Supervisory Board discussed the trust and cooperation between the Executive Board and the Supervisory Board and the allocation of duties of the Executive Board. Standard topics were discussed, such as the economic trend and the personnel development of the company, liquidity planning, market trends and the order situation. In addition, the Board discussed a number of mid-term financing options, the restructuring process, the strategic focus of Security Communication and specifically, of Funkwerk plettac electronic GmbH. In connection with these discussions, the Executive Board reported in detail about the project status in Algeria.

The meeting on 11 November 2010 focused on the strategic orientation of the group and the related financing structure. The Executive Board also reported on the economic development in the first three quarters and on structured projections for 2010. In the context of risk reporting, the Executive Board explained the situation of project business in Algeria and the related political and legal development.

In the final meeting in fiscal 2010, held on 20 December 2010, the Executive Board reported on the current business trend and projections at year-end in due consideration of existing risks. A further report focused on the status of the individual financing components. Other issues included the introduction of the portfolio strategy and the business plan for 2011 – 2013. The Executive Board also briefed the Supervisory Board on the status of developments in Algeria.

#### **ANNUAL ACCOUNTS AND CONSOLIDATED FINANCIAL STATEMENTS**

The Executive Board prepared the annual accounts of Funkwerk AG as at 31 December 2010 including the management report and the report on relationships with associated companies, as well as the consolidated financial statements as at 31 December 2010 including the group management report.

The annual accounts and the management report of Funkwerk AG and the consolidated financial statements and group management report as at 31 December 2010 were audited and provided with an unqualified audit certificate by KPMG AG, Wirtschaftsprüfungsgesellschaft. The Berlin-based auditing firm was appointed at the shareholders' meeting as auditors of Funkwerk AG and as group auditors. The annual accounts and management report, the consolidated financial statements and group management report and the audit reports issued by the auditor were made available to all members of the Supervisory Board.

The annual accounts, the consolidated financial statements and the group management report were discussed in detail with the Executive Board and the auditors at the meeting of the Supervisory Board held on 18 March 2011. The auditors also reported on key results of their audit. Questions posed by members of the Supervisory Board were thoroughly answered. On the basis of its own examination, the Supervisory Board came to the conclusion that the audit procedure applied by the auditors was appropriate and adequate.

We conclusively checked the annual accounts, the management report as well as the consolidated financial statements and the group management report on 29 March 2011. No objections were raised. The Supervisory Board agrees with the audit result. The annual accounts prepared by the Executive Board of Funkwerk AG are therefore approved and the consolidated financial statements adopted.

KPMG AG, Wirtschaftsprüfungsgesellschaft, Berlin, also audited the report on relationships with associated companies (dependent company report) prepared by the Executive Board in compliance with Section 312 of the German Stock Corporation Act. The auditor issued the following audit certificate regarding the result:

»Following our dutiful audit and assessment, we hereby confirm that the actual information contained in the report is correct, payments of the company for the legal transactions specified in the report were not inappropriately high and no financial prejudices were made good, and that there were no facts in regard to the measures described in the report to suggest a fundamentally different assessment to that of the Executive Board.«

The Supervisory Board also examined the dependent company report. It raised no objections to the final declaration of the Executive Board in the report and the result of the audit conducted by the auditors.

#### **CORPORATE GOVERNANCE CODE**

The Supervisory Board was actively involved in implementing and monitoring compliance with the German Corporate Governance Code, taking into account the amendments to the Code on 26 May 2010. On 18 March 2011, the Executive Board and the Supervisory Board jointly revised their declaration of compliance in accordance with Section 161 of the German Stock Corporation Act (AktG). The revised version is available to shareholders as a permanent feature on the website of Funkwerk AG.

Pursuant to item 3.10 of the German Corporate Governance Code, the report of the Executive Board on Corporate Governance at Funkwerk AG also applies to the Supervisory Board.

Funkwerk AG complies with the recommendations of the Government Commission on the German Corporate Governance Code with only a few exceptions.

The existing D & O insurance does not provide for an excess payable by members of the Supervisory Board (item 3.8 of the Code), as the Executive Board and the Supervisory Board of Funkwerk AG hold the view that the due diligence and sense of responsibility could not be further optimised as a result.

Once again, no committees were set up in the preceding financial year. Since the Supervisory Board of Funkwerk AG does not comprise more than three members, the set-up of Supervisory Board committees (item 5.3.1 of the Code), specifically of an audit committee (item 5.3.2 of the Code) and a nomination committee (item 5.3.3 of the Code), currently is neither necessary nor practical in the interest of the company and its shareholders. These duties are performed jointly by the whole Supervisory Board.

The implementation of certain criteria for recommendations of candidates for the Supervisory Board (item 5.4.1 of the Code) will not be realised, as the Supervisory Board and Executive Board plan to decide individually on a case-by-case basis based on the given specific situation.

Based on the resolution passed at the annual shareholders' meeting on 27 May 2010, Funkwerk included the option of postal votes (item 2.3.3 of the Code) in its Articles of Incorporation. We believe that postal votes have not to date been sufficiently tested. As a result, we will not provide this option at the shareholders' meeting held in May 2011.

Changes to this declaration of compliance which may be necessary in the course of the financial year will be made in agreement with the Executive Board and be available to all shareholders on the website of Funkwerk AG.

The Supervisory Board is convinced that the implemented measures and the restructuring process initiated have provided the foundation for lasting stabilisation at Funkwerk. The Supervisory Board would like to thank all shareholders for their trust and confidence in the company. The Supervisory Board would also like to thank the Executive Board and all employees for their work and cooperation in the preceding financial year.

Kölleda, March 2011

For the Supervisory Board



Alfons Hörmann  
(Chairman of the Supervisory Board)

## CORPORATE GOVERNANCE REPORT

Corporate Governance represents responsible company management focused on long-term added value. We are committed to the principles of good Corporate Governance, which we consider a central part of our company policy.

Funkwerk AG follows the majority of recommendations of the German Corporate Governance Code (»the Code«), issued in 2002 and amended in May 2010. The Executive Board and the Supervisory Board have given much attention to the Code to ensure compliance with new guidelines. These were used as the basis for the revised declaration of compliance adopted on 18 March 2011. The revised version and the declarations of previous years are available on our website and are updated as and when required.

Over and above the Corporate Governance Code, the Executive Board and the management of Funkwerk AG act on the basis of a code of conduct drawn up internally to comply with strict insider regulations. The appropriate Insider Trading Policy and Publication Guidelines are published on the website of Funkwerk AG.

### TRANSPARENCY

Each body and committee at Funkwerk AG is committed to the principle of equal treatment of all shareholders. As a result, the Executive Board always notifies all interested market participants promptly and in detail of key events and the development of business. All ad hoc and press releases are distributed using modern communication media and are also made available to all shareholders and the public on the website of Funkwerk AG. The website also provides access to all financial reports and presentations. A financial calendar containing dates of such main recurrent events as the annual shareholders' meeting and the publication of the interim reports is published sufficiently in advance. It can be found in our annual report, the interim reports and on our website.

As part of our Investor Relations efforts, Funkwerk maintains close contact with its shareholders. We regularly meet analysts and institutional investors at capital market conferences, to engage in intensive dialogue. All presentations held on such occasions are also available on our website.

### SHAREHOLDERS AND THE SHAREHOLDERS' MEETING

Shareholders are provided in good time with relevant information on the shareholders' meeting as the central organ of Funkwerk AG. As well as the agenda and an explanation of conditions for participation in the shareholders' meeting, the website of Funkwerk AG also publishes all documents and information and, following the shareholders' meeting, a list of those present and the results of votes. Furthermore, shareholders are given opportunity via electronic communication to direct questions at the Investor Relations department.

At the shareholders' meeting, shareholders are given the opportunity to address the meeting on any agenda item and to ask related questions, or file motions. Shareholders may exercise their voting rights at the shareholders' meeting either in person, by a duly authorised representative, or by a proxy of Funkwerk AG subject to instructions. Instructions to the proxy can be issued via the Internet, before and during the shareholders' meeting, up until the start of voting on agenda items. The proxy could be reached throughout the 2010 shareholders' meeting. At the 2010 shareholders' meeting, the option was introduced for shareholders to submit their votes in writing without authorisation of a representative, using a postal vote. This option will not be put into effect in the 2011 shareholders' meeting.

The Chairman of the Supervisory Board was unable to attend the 2010 shareholders' meeting due to illness. The meeting was chaired by his deputy. The shareholders' meeting was not broadcast on the Internet. As in previous years, the addresses by the Chairman of the Executive Board and the CFO were recorded and made available to the public on the website of Funkwerk AG.

#### **RESPONSIBLE COOPERATION AND INTERRELATION OF EXECUTIVE BOARD AND SUPERVISORY BOARD**

Good and effective company management requires a strict separation of Executive Board and Supervisory Board. The German Stock Corporation Act prescribes this dual management system of independent management and leadership of the company by the Executive Board, on the one hand, and independent supervision and consulting by the Supervisory Board, on the other. For this purpose, the Executive Board and the Supervisory Board are at all times in close dialogue. The Supervisory Board is regularly, promptly and comprehensively informed of the development of the company, the business planning, and the development of risks and risk management. Furthermore, the Supervisory Board is involved in all decisions which may have a considerable effect on the financial or earnings position of the company. The reporting duties of the Executive Board are specified in the Rules of Internal Procedure for the Executive Board, which also include a catalogue of transactions requiring approval. In the event of a culpable breach of their duty of care, the Executive Board and the Supervisory Board are liable to the company. Consequently, Funkwerk AG has concluded a D & O insurance for both boards which, contrary to item 3.8 of the German Corporate Governance Code, does not include an excess. As stipulated in Section 93 (1) of the German Stock Corporation Act (AktG), the employment contracts of Executive Board members concluded or renewed from August 2009 include an excess of 10% of the damage up to at least one and a half times their fixed annual remuneration. This clause is contained in the current employment contracts of Mr Johann Schmid-Davis and Mr Carsten Ahrens.

#### **EXECUTIVE BOARD**

As the central management body of the group, the Executive Board is committed to bringing about an effective increase in the company value and to safeguarding the interests of the group. The Executive Board manages the company on its own authority for the whole management, decides on key issues of business policy, determines the strategic orientation of the company and ensures its implementation. It is also responsible for ensuring appropriate risk management and risk controlling in the group. Furthermore, the Executive Board is required to prepare the quarterly and interim statements of account, the annual accounts and the consolidated financial statements.

In the 2010 financial year, the Executive Board of Funkwerk AG comprised three members. Mr Carsten Ahrens was appointed by the Supervisory Board as a new member of the Executive Board with effect from 1 October 2010. Details of the composition and responsibilities are provided in the notes to the financial statements on page 128.

The Rules of Internal Procedure specify the work of the Executive Board, the allocation of areas of responsibility, matters which concern the entire Executive Board, the majority required for resolutions, and the rights and obligations of the chairman of the Executive Board. The Executive Board works in a collegial system and regularly obtains information on all key measures and processes in the company's various departments. The development of the Funkwerk group is discussed and necessary

measures decided in regular Executive Board meetings, which are held at least once a month. Each member of the board can request that a meeting be convened. The meetings are chaired by the chairman of the board.

Certain decisions of the Executive Board require the consent of the Supervisory Board. The Rules of Internal Procedure stipulate that the consent of the Supervisory Board is required for the annual corporate planning, for investment projects not included in the investment budget, and borrowing outside the budget. Other aspects requiring consent include structural changes to the business organisation, the acquisition or sale of investments, the establishment, takeover, sale and dissolution of companies where the value of these measures exceeds EUR 200,000, and the granting of sureties, guarantees for third-party commitments and employee loans of over EUR 50,000.

The members of the Executive Board are required to avoid any conflict of interest and, where necessary, inform the Supervisory Board. Second occupations, specifically seats on supervisory boards, require the consent of the Supervisory Board. In the period under review, the Executive Board did not pursue any second occupations, and no conflicts of interest occurred.

In the preceding financial year, none of the members of the Executive Board held a seat on a legally required Supervisory Board or comparable controlling body either in Germany or abroad.

#### **SUPERVISORY BOARD**

In the 2010 financial year, the Supervisory Board of Funkwerk AG comprised five members. The term of office of the board members ended with the annual shareholders' meeting held in May 2010. Two members did not stand for re-election. Two new members for the Supervisory Board were recommended to the shareholders' meeting and appointed by the latter for a statutory term of four years, which will end on conclusion of the shareholders' meeting that will decide on the discharge of the Supervisory Board for the 2014 financial year. Currently, the Supervisory Board comprises three members, the number required under Section 9 of the Articles of Incorporation. Details of the composition and responsibilities are provided in the notes to the financial statements on the pages 129 – 130.

The Supervisory Board in its current composition already meets most of the stipulations of item 5.4.1. para. 2 of the German Corporate Governance Code:

- The Supervisory Board is currently composed of three members with extensive international experience due to longer periods abroad.
- There is no conflict of interest for any of the current members of the Supervisory Board.
- An age limit has been specified for the members of the Supervisory Board.

The only stipulation not currently met is an appropriate degree of female representation.

In terms of its future composition, the Supervisory Board specified the following objectives in a resolution passed on 18 March 2011:

The Supervisory Board of Funkwerk AG aims for a composition of the Supervisory Board and the Executive Board which typifies especially the criterion of internationality. The Supervisory Board also aims for an appropriate degree of female representation. A specific number or quota of females has not been determined.

The Supervisory Board is of the opinion that decisions on Supervisory and Executive Board candidates should still be made on the basis of whether relevant candidates possess the knowledge, ability and expert experience required to complete properly the tasks of the Supervisory Board or the Executive

Board. In searching for suitable candidates, priority shall be given to the specific situation of Funkwerk AG and the resulting requirements. In this way, the Supervisory Board ensures that the Supervisory Board and the Executive Board are composed in the company's best interests based on the qualification and suitability of the candidates.

Future recommendations by the Supervisory Board will take these objectives into account, in due consideration of the existence of the necessary knowledge, ability and expert experience required to properly complete the tasks of the Supervisory Board.

The Supervisory Board advises and supervises the Executive Board in its management of the company. Consequently, it is involved in all corporate decisions which may have an effect on the financial, earnings or net worth position of the company. At regular intervals, the Supervisory Board comments on the business trend and planning as well as on the strategy and its implementation. It checks the annual accounts, the management report, the consolidated financial statements, and the group management report. Its duties further include verification of the quarterly and interim statements of account, adoption of the annual accounts of Funkwerk AG and approval of the consolidated financial statements, each in consideration of the audit reports provided by the auditor.

It appoints and removes members of the Executive Board, decides on the remuneration system for Executive Board members, and determines their total emoluments. The Rules of Internal Procedure for the Supervisory Board settle the assignment of tasks and responsibilities of the members. They also include detailed provisions on confidentiality, on the reporting duties of the Executive Board, and on resolutions adopted by the Supervisory Board.

In order to ensure independent consulting and supervision of the Supervisory Board, the company has not concluded any consulting or other service and work contracts with members of the Supervisory Board. In the preceding financial year, the members of the Supervisory Board did not maintain business or personal relations with Funkwerk AG or any of the members of the Executive Board. Mr Alfons Hörmann was appointed to the Supervisory Board of Funkwerk AG at the 2010 shareholders' meeting. He has been active in the management of the majority shareholder of Funkwerk AG, Hörmann Funkwerk Holding GmbH & Co. KG, registered in Kirchseeon, since 30 December 2010. There are no former members of the Executive Board in this body, nor do members of the Supervisory Board fulfil functions in any executive body of competitors of Funkwerk AG. This ensures independent consulting and supervision of the Executive Board.

Pages 129-130 of the annual accounts specify the seats of the Supervisory Board members in legally required Supervisory Boards or comparable controlling bodies in Germany and abroad.

#### **REMUNERATION REPORT**

The following remuneration report is a component part of the group management report (see page 63) and describes the remuneration systems of the Executive Board and the Supervisory Board.

For years, Funkwerk has provided details explaining the remuneration systems in comprehensible and transparent form as a key aspect of good corporate governance. According to the German Adequacy of Managerial Salaries Act (VorstAG) and the guidelines of the German Corporate Governance Code, the Supervisory Board is required when determining the total emoluments of each member of the Executive Board to ensure that these are appropriate for the duties and performances of each member and the situation of the company and that they do not exceed the usual remuneration without a specific reason. The Supervisory Board determines the remuneration structure and the key elements of contracts concluded with the members of the Executive Board and regularly reviews these contracts for appropriateness.

### **Remuneration system of the Executive Board**

The current remuneration system is based on criteria that ensure adequacy of the remuneration in terms of the duties of each member of the Executive Board, their personal performance, the economic situation, the success and future prospects of the company, but also on the usual remuneration with regard to comparable companies in the field and the remuneration structure generally applied in the company.

The remuneration of members of the Executive Board comprises a non-performance-related component and a performance-related component. Their amount and structure are determined by the Supervisory Board.

The non-performance-related component comprises a fixed salary plus ancillary benefits, which includes private use of a company car and insurance premiums. This component is not dependent on reaching specific targets. It is paid on a monthly basis.

The performance-related remuneration depends on the achievement of quantitative and possibly qualitative targets. It is divided into a management bonus and components with a long-term incentive. The amount of the variable component related to the quantitative targets of the active members of the Executive Board is based on the development of the EBIT and the cash flow. Members of the Executive Board who are on the board for only part of the financial year receive a proportionally lower remuneration.

These components of the remuneration are due to all members of the Executive Board and are subject to taxation based on the personal situation of each member. Furthermore, each Executive Board member is entitled to a retirement pension insurance (pension commitments). This is concluded separately for each member. No management bonus will be paid for fiscal 2010.

Under the pension commitments made to the members of the Executive Board, contributions are paid into a pension fund. The variable component of the remuneration is always paid in May, after the Executive Board has been discharged at the shareholders' meeting. The non-performance-related and the variable components of the Executive Board remuneration define what is known as the annual target income and are decided by the Supervisory Board for the entire contractual period. The individualised remuneration for the 2010 financial year is specified in the table on page 129 of the notes to the financial statements.

In addition to the two components of the Executive Board remuneration detailed above, the Executive Board is granted share options as a component with long-term incentive. The number of options to be issued is determined by the Supervisory Board. The terms on which the members of the Executive Board may exercise these options are identical with those of other allottees. A detailed description of the share options plans is included in section E of the notes to the financial statements. Members of the Executive Board hold share options under the 2005, 2008 and 2010 share option plans. In the reporting year, each member of the Executive Board was each granted 6,000 options at a current market value of EUR 10,080. In the 2010 financial year, the members of the Executive Board were not able to exercise any options.

### **Remuneration system of the Supervisory Board**

The remuneration of the Supervisory Board is governed by Section 12 of the Articles of Incorporation of Funkwerk AG. It is divided into a fixed and a variable component plus an attendance fee. In addition to the reimbursement of expenses, the members of the Supervisory Board receive a fixed component of EUR 5,000 and an attendance fee of EUR 1,300 per session. It is stipulated that the chairman receives twice, and his/her deputy 1.5 times, the annual pay and attendance fee. The variable component of the remuneration is set at EUR 1,000 for every 5 cents of dividend paid out. Members of the Supervisory Board who are on the board for only part of the financial year, receive a proportionally lower remuneration. If a member of the Supervisory Board is unable to attend a meeting, the remuneration will reduce proportionally. All components of the remuneration for the preceding financial year are payable on conclusion of the annual shareholders' meeting at which the annual accounts for the preceding financial year are presented and, where applicable, a resolution on the appropriation of profits is passed.

The individualised remuneration for the 2010 financial year is specified in the table on page 130 of the notes to the financial statements.

### **ACCOUNTING AND AUDITING BY KPMG**

Since the year 2000, Funkwerk AG has prepared its consolidated financial statements and the quarterly reports in conformity with the International Financial Reporting Standard (IFRS) in accordance with the current regulations of the International Accounting Standards Board (IASB), thus complying with the legal provisions.

The individual accounts, which are decisive for taxation and dividend payments, are prepared in compliance with national regulations (German Commercial Code – HGB). The consolidated financial statements are prepared by the Executive Board, audited by the appointed auditor, and subsequently presented to the Supervisory Board for approval. The resolution on the appropriation of profits is passed at the shareholders' meeting. The Supervisory Board appointed KPMG AG Wirtschaftsprüfungsgesellschaft, Berlin, as auditors for the 2010 financial year. The company was instructed to audit the individual accounts and the consolidated financial statements. Its appointment was based on the vote passed at the shareholders' meeting in 2010. In compliance with the German Corporate Governance Code, the Supervisory Board obtained a declaration of independence from KPMG AG prior to submitting its proposal of candidates. Neither the auditing company nor its organs maintain any business, financial, personal or other relations with the company audited or any members of its bodies.

### **DECLARATION OF COMPLIANCE**

#### **Deviations from the recommendations of the German Corporate Governance Code**

1. The German Corporate Governance Code recommends for D&O insurances for the Supervisory Board the agreement of an excess of at least 10% of the damage up to at least one and a half times the fixed annual remuneration (item 3.8 of the Code). The D&O insurance contract concluded for the bodies of Funkwerk AG in 2000 does not provide for an excess. Funkwerk AG does not hold the view that the due diligence and sense of responsibility which the members of the Supervisory Board exercise in the performance of their duties could be increased through agreement of an excess.
2. The German Corporate Governance Code recommends that the Supervisory Board set up professionally qualified committees depending on the specific circumstances of the company and the number of its members (item 5.3.1 of the Code). Since the Supervisory Board does not comprise more than three members, the setup of committees is considered impractical. The duties assigned to these committees are performed jointly by the whole Supervisory Board.

3. The German Corporate Governance Code recommends that the Supervisory Board set up an audit committee, which specifically deals with issues relating to accounting, risk management and compliance, the required independence of the auditor, the award of the audit assignment, the determination of focal points of the audit and the agreement of fees (item 5.3.2 of the Code). Since the Supervisory Board does not comprise more than three members, the setup of committees is considered impractical. The duties assigned to the audit committee are performed jointly by the whole Supervisory Board.
4. The German Corporate Governance Code recommends that the Supervisory Board set up a nomination committee made up exclusively of shareholder representatives to recommend suitable candidates to the Supervisory Board for its proposal to the shareholders' meeting (item 5.3.3 of the Code). Since the Supervisory Board does not comprise more than three members, the setup of committees is considered impractical. The duties assigned to the nomination committee are performed jointly by the whole Supervisory Board.

#### **Current declaration of compliance of 18 March 2011**

Declaration by the Executive Board and the Supervisory Board of Funkwerk AG on the recommendations of the »Government Commission on the German Corporate Governance Code« based on Section 161 AktG

The Executive Board and the Supervisory Board of Funkwerk AG, Kölleda, hereby declare compliance – both currently and in the past – with the recommendations of the »Government Commission on the German Corporate Governance Code« as amended on 26 May 2010 and published by the Federal Ministry of Justice in the official section of the electronic Federal Gazette:

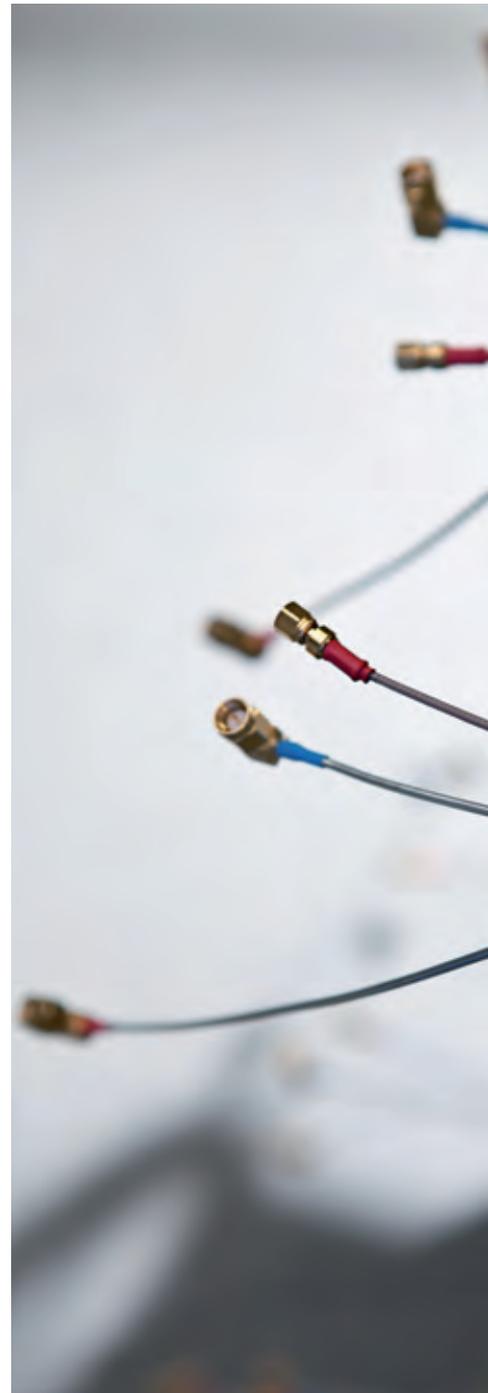
1. The German Corporate Governance Code recommends that the company also assists the shareholders in the use of postal votes and proxies (item 2.3.3 of the Code). Funkwerk AG has already taken the precaution through the resolution passed at the shareholders' meeting on 27 May 2010 of introducing a new clause in its Articles of Incorporation authorising the Executive Board to allow a postal vote in accordance with the option granted in Section 118 (2) AktG. We believe that postal votes have not to date been sufficiently tested. Against this background and in consideration of the administrative work involved in a postal vote and the option of instructing a representative appointed by the company to exercise shareholders' voting rights, the Executive Board does not intend to utilise its authorisation to allow a postal vote at the annual shareholders' meeting in 2011.
2. The German Corporate Governance Code recommends for D & O insurances for the Supervisory Board the agreement of an excess of at least 10% of the damage up to at least 1.5 times the fixed annual remuneration (item 3.8 of the Code). The D & O insurance contract concluded for the Supervisory Board of Funkwerk AG does not provide for an excess. The Executive Board and the Supervisory Board of Funkwerk AG hold the view that the due diligence and sense of responsibility which the members of the Supervisory Board already exercise at all times in the performance of their duties could not be further optimised through agreement of an excess.

3. The German Corporate Governance Code recommends that the Supervisory Board set up qualified committees (item 5.3.1 of the Code), specifically an audit committee (item 5.3.2 of the Code) and a nomination committee (item 5.3.3 of the Code). Since the Supervisory Board does not comprise more than three members, the setup of committees is considered impractical. The duties assigned to the audit committee are performed jointly by the whole Supervisory Board.
  
4. The German Corporate Governance Code recommends that the Supervisory Board specifies solid objectives regarding its composition which, whilst considering the specifics of the company, take into account the international activities of the company, potential conflicts of interest, an age limit to be specified for the members of the Supervisory Board and diversity, and stipulation of an appropriate degree of female representation (item 5.4.1 of the Code). The Supervisory Board is of the opinion that decisions on Supervisory Board candidates should still be made on the basis of whether relevant candidates possess the knowledge, ability and expert experience required to complete properly the tasks of the Supervisory Board. The implementation of the solid objectives recommended in item 5.4.1. para. 2 of the Code regarding specific criteria for recommendations of candidates for the Supervisory Board opposite other criteria will not be realised. The Supervisory Board intends to continue determining recommendations for its composition on a case-by-case basis, based on the specific situation at the time.


$$s(t) = a(t) e^{i[\omega_0 t + \int_0^t \omega(\tau) dt + \phi(t)]}$$

*»This formula describes various types of modulation and is a mathematical basis for all radio communication systems. At Funkwerk, we use this formula to develop our new range of train radio equipment.«*

**MAREN KELLER, SOFTWARE DEVELOPER, HÖRMANN FUNKWERK KÖLLEDA GMBH**



## Our know-how in Traffic & Control Communication

Funkwerk's technology is used wherever there is a need to ensure secure and eco-nomical mobility, to control and rationalise processes and traffic flows, and to provide people with the information they need and seek. And it is growing in importance.

Take our cab radios, for example: Funkwerk digital train radio devices connect mobile and stationary infrastructures in rail transport. This is one of the basic requirements for secure, punctual and reliable rail transport. It is also the only way to ensure cross-border interoperability of rail transport, increasingly required for globalisation. In 2010, Funkwerk delivered its 20,000th mobile radio terminal. This makes our cab radios the world's most



successful mobile radio device for rail traffic control. Or take our sophisticated Alister electronic interlocking systems. Such systems are increasingly important for efficient and safe railway operations. The Alister system from Funkwerk is technologically groundbreaking because it makes operations safer and more reliable while reducing operating costs. Alister has proven its effectiveness many times over, even under extreme conditions in Europe north of the Arctic Circle as well as in tropical Indonesia.

Then there's our passenger information system used in ICE trains, which allows operators to provide up-to-date transport information in real time, along with new ser-

vices and infotainment. It's all thanks to the latest communication technology from Funkwerk. Display systems were upgraded to improve the transmission and presentation of up-to-the-minute transport information, and a train-wide Ethernet network was installed. This is complemented by a central infotainment server as a platform for distribution of contents, which can also be provided via external systems.

# GROUP MANAGEMENT REPORT

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# GROUP MANAGEMENT REPORT

## 1. Business model, organisation and strategy

Founded in the 2000, Funkwerk AG is a technology leader and supplier of innovative communication, management, information and security systems for applications such as transport and traffic, vehicles, security and data networks. Funkwerk systems automate, rationalise and secure the operating processes at a wide variety of private businesses and institutions around the world.

Our products and solutions are based on cutting-edge radio, communication and data processing technologies, to create new user and service opportunities for companies and private individuals. As a result, Funkwerk contributes significantly to the challenges facing business and society.

### STRUCTURE OF OPERATIONS

Funkwerk has organised its operations into four strategically independent business segments based on applications of products and their target groups, Segment reporting follows the same lines:

- **Traffic & Control Communication** covers the development, production and sale of communication, management, control and information systems for transport and logistics companies and transport infrastructure manufacturers.
- **Security Communication** specialises in the development, production and sale of electronic security systems and components used to protect people, properties and plants.
- **Automotive Communication** designs, produces and sells communication equipment for vehicles and aircraft as well as telematics systems and solutions for fleet management.
- **Enterprise Communication** develops, produces and supplies professional voice and data network solutions, as well as data security solutions developed especially for small- to mid-sized customer target groups.

The individual business segments are themselves each divided into product groups and product sectors operated as competence centres which generally operate as independent corporate units. Funkwerk has also established its own branches and subsidiaries in key markets. Currently, Funkwerk has twelve sites throughout Germany. We operate through our own subsidiaries in France, Great Britain, Italy, Austria, Poland, Sweden and Spain.

### PRINCIPLES OF CORPORATE STRATEGY

The key strategic objective of Funkwerk is to grow both organically and through complementary acquisitions, as well as continuous advancement of the technology used in successful products and solutions. We are continuing the change initiated in 2008 to turn Funkwerk AG from a supplier of individual devices and components in specific niche markets into a solution-oriented system provider with indispensable key products. Only by entering larger market segments and increasing our range of solutions will we be able to grow and avoid the technological and price-related competitive pressures of mass producers. We want to become and remain the first choice partner for our customers.

To this end, we develop and pursue very specific mid- and long-term strategies for our four business segments, which are geared to appropriate market segments and customer target groups. By analysing the market and the environment, based on trends, we define future scenarios for our market segments. Benefits for specific target groups and our own potential shares are defined within the complete value chain.

This analysis is complemented by a situational analysis which initially helps us determine our position compared with the competition based on key benchmarks. These benchmarks are then consolidated and used for a potential analysis which allows us to plan our relative market share in an addressable market.

From this, we then derive short, medium and long term objectives and carry out projections for alternative scenarios. Comparing these with the company's position, we formulate a general strategy on which we base our product development and use of resources.

#### **KEY DATA FOR STRATEGY DEVELOPMENT AND CONTROLLING**

Funkwerk uses key data and success parameters for strategy development and controlling.

In order to assess the attractiveness of the market segments, Funkwerk not only uses data on absolute market volumes and their growth rates, but also determines the addressable market. This is complemented by a »market and customer concentration«, which is the ratio of sales of the three largest market participants to the addressable market, or the number of customers that make up 50 per cent of sales. We also consider in this context the average investment intensity and the level of threat; the probability that the product/market segment is substituted by new market developments within a few years.

To determine the current and target positions of Funkwerk amongst the competition, we examine the product quality, the sales share of new products and the development intensity as further key success factors besides the absolute and relative market share. To identify the performance position of our operating units, we use the result along with other key data and control quantities, such as value added per employee, the ratio of working capital to sales, the investment intensity and the turnover ratio. These management tools based on key data will be further developed as part of our strategy.

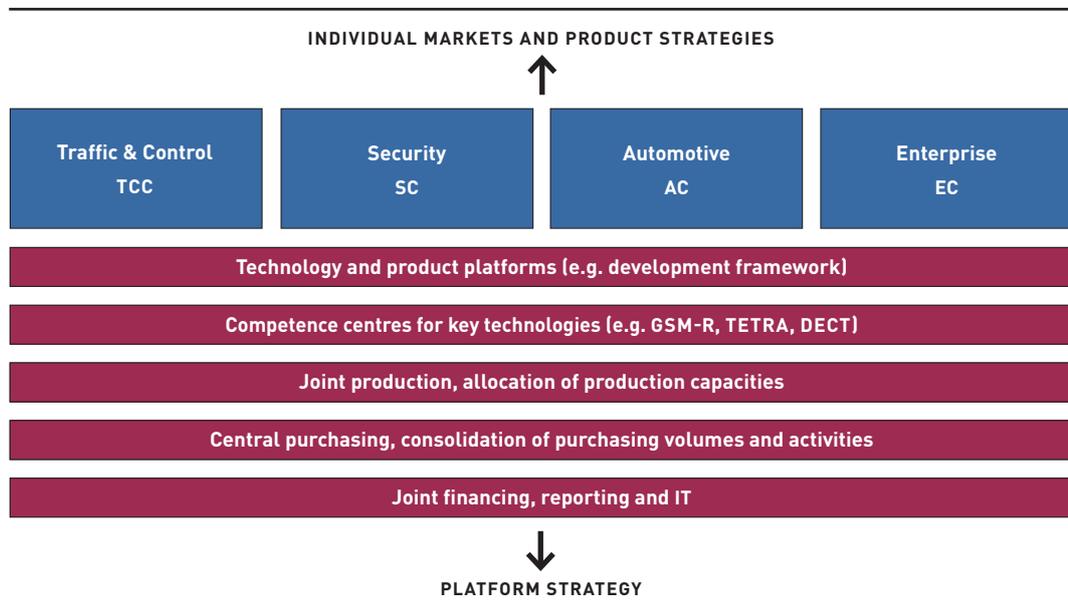
#### **PLATFORM STRATEGY WITH SYNERGY EFFECTS**

To improve the key capital and cost figures and to increase our productivity, Funkwerk created a cross-divisional platform strategy in 2010 which is advanced from development and resource planning, through purchasing, financing and production all the way to a standardised »business intelligence« and IT systems, including risk and contract management.

Through joint use of resources, we may as a result see significant synergies between our business segments. A crucial point of this platform strategy is the introduction of group-wide, standardised ERP and IT systems with a standardised database. Following preparatory measures in 2010, this will now be implemented in 2011 and 2012.

Furthermore, we will create competence centres for product development and technology which all our business segments can access. A common data and software basis also helps us improve exchanges of technical experiences and to optimise our development processes. We are aiming to standardise the development methods and tools used. One of our central goals here is to ensure reusability of our development results.

Our three main production sites in Germany will be specialised to focus on specific technology expertises and product types. This will allow us to distribute production volumes more efficiently depending on requirement and utilisation and to consolidate purchasing volumes at a central location.



#### **FAST INCREASE IN EFFICIENCY AND SUSTAINABLE COMPETITIVENESS**

The rapid growth of Funkwerk between 2000 and 2007 overstretched our organisation and resulted in excessive use of development resources. Aggravated by the effects of the global economic crisis, we were faced with an urgent need for consolidation. As a result, we have made great efforts since 2009 to reduce our excess capacities, discontinue peripheral activities and lower our overheads.

These restructuring projects were rigorously continued in 2010. At the same time, we started phase two of our programme which focuses on increasing our efficiency and restoring our profitability. Our aim here is to return the company to profitability and a sustainable competitive position.

Processes are now continuously optimised to further improve our cost structure. By keeping our focus on security and transport, we are also hoping to improve our productivity and competitive ability. At the same time, we want to increase the value added within our core skills while continuing to adjust our product portfolio in non-central areas and to streamline our operations. To this end, we will also concentrate our purchasing, production, service and administrative activities across the segments. Further strategic options include the sale of products or even of business sectors.

All these measures will help us even in the short term to improve the operating efficiency of the Funkwerk group. They are, however, also prerequisites for sustainable competitive strength, with moderate growth from as early as 2011. In Traffic & Control Communication and Security Communication especially, but also in Automotive Communication, we can see attractive growth markets that hold considerable potential for Funkwerk in the future.

**SEGMENT ORGANISATION AND STRATEGY****Traffic & Control Communication**

Our Traffic & Control Communication segment develops, provides and integrates communication, management, control and information systems for its target groups – transport companies, manufacturers of transport infrastructure and rolling stock, and industrial enterprises – in order to rationalise and secure their operating processes. Our systems are also used to improve passenger information, to provide greater passenger convenience and to manage traffic more efficiently. A crucial factor in this is the reliability and security of our systems: they meet the highest standards and entail a significant degree of complexity, thanks to their variety of interfaces. Funkwerk concentrates especially on rail transport with applications requiring mobile radio systems, control and security technology, and information technology. In 2010, our electronic interlocking systems for regional and shunting operations (Alister) also opened up a new market sector in security technology which we will be developing.

In the communication systems product sector Funkwerk concentrates on the development and production of mobile and stationary communication infrastructures for transport companies. We believe Funkwerk is the global market leader in GSM-R radio terminals. These radio devices enable voice and data communication between moving trains and with control centres. The future introduction of autonomous train services (ETCS) depends on GSM-R radio technology. Along with radio devices, we provide complete infrastructure solutions for train communication (also with analogue technology) specifically in threshold countries, and telecommunication systems.

In the management systems sector, Funkwerk provides transport operators with solutions that ensure economical operations management. These systems centralise all aspects of monitoring, control, planning and training, and ensure automation and optimisation of rail transport. Alongside these, Funkwerk offers Alister-Cargo as an electronic interlocking systems for marshalling systems. Control systems and management systems from Funkwerk are products which are also used by energy suppliers and the process industry for such aspects as managing and monitoring natural gas supply facilities, bio diesel reactors, tank farms, and combined heat and power plants.

In our product group of stationary and mobile information systems for rail transport, Funkwerk provides integrated solutions from one source, along with control systems, displays, public address and video monitoring systems for stations and stops, and also in rolling stock. Funkwerk holds a significant market share in stationary information systems for rail transport in Germany. Integrated mobile information systems are steadily gaining in importance. Here, Funkwerk invests more and more in IP network technology and increasingly uses the generic development platform from its Automotive Communication segment.

The operable key market for Funkwerk is divided primarily into the rail transport, local public transport, and road transport sectors, while industrial applications are a peripheral sector. Increasingly, proprietary systems are replaced in the transport sector by more cost-efficient solutions using standard industrial components. This lowers the barriers to market entry and increases the competitiveness. Funkwerk implements this change with such products as its Alister system. On the whole, information and telecommunication technology (ITC for short) will continue to increase in importance for transport companies, although the investment behaviour of such businesses generally tends to be protracted and hard to predict due to their dependence on public authorities.

### Objectives of Traffic & Control Communication

Over the next few years, Funkwerk plans to extend and defend its good market position in Traffic & Control Communication, as well as its market leadership in GSM-R radio terminals, information systems for railway companies and at rail traffic control centres in Germany. Our successful range of radio terminals was extended in 2010 with the addition of handheld devices based on the GSM-R and DMR standards. These will help us quickly penetrate the market in the future.

In mobile information systems, Funkwerk plans to become a leading supplier of integrated information systems for rolling stock manufacturers during the next few years. Organic growth in this sector is to be achieved specifically through consolidation of our existing expertise in IP-based networks and through development of technological platforms that ensure a high degree of reusability, even for specific requirements.

Due to the cost-effective design of Alister, Funkwerk seeks to penetrate the market for regional transport applications, in Germany and abroad. Part of our efforts will involve the development of cooperative relationships with established infrastructure providers. As the number of market players in this product sector is limited due to considerable access barriers, Funkwerk also plans to market Alister interlocking systems internationally in the short term.

The segment will also likely see further growth through systematic internationalisation. We will focus our market development here on specific countries in Eastern Europe, Russia, Asia and North America which are currently developing their rail transport and require considerable capital investment. To this end, Funkwerk is following a clear concept with three stages in order to proceed purposefully and keep expenditure within limits. Firstly, we will implement an initial project through local partnerships, then, in a second stage, establish an effective business which will hopefully lead to a permanent presence.

In addition, we hope to generate sustainable growth by setting up new, and developing existing, product sectors through cooperation and acquisitions.

### Security Communication

Our Security Communication segment, with special communication systems and security technology components, addresses industrial and energy companies, authorities and organisations with security functions (BOS), the local public transport sector, railways and airports, transport infrastructure, and correctional and forensic facilities. Its service spectrum includes products and solutions focused on personal security and alerting (messaging and voice), video monitoring, building security and property protection. Our solutions here are designed to protect individuals and physical assets, help identify potential accident situations and prevent or solve criminal and terrorist attacks. Our systems also help prevent dangers and direct emergency teams.

Solutions provided by Security Communication satisfy the increasing need in society for objective and subjective safety and security, and to avoid damage to businesses, individuals and society. As a result, our solutions are steadily gaining in importance all over the world. In our personal security product group, Funkwerk therefore provides personal emergency call systems and professional mobile radio devices for any area which has increased security requirements, based on current technical standards and regulations stipulated by trade associations and security authorities. This includes explosion-proof devices based on ATEX guidelines.

The Funkwerk security management system Webnet-2 combines personal security with all known security systems. It can integrate such applications as fire alarm, video or access control systems in a single system. As a generic control system, Webnet-2 monitors and manages connected systems and installations using a standardised operating interface.

In the video systems product group, Funkwerk provides professional video monitoring solutions with automatic alarm function for roads/motorways, ports/airports, football stadiums, pedestrian zones, railway stations, power plants and penal facilities. Our key expertise here is in system integration using special transmission and management systems and cameras with efficient and robust pan and tilt functions. In addition to our own key products, Funkwerk integrates cameras and hardware from third-party manufacturers into its own systems.

In our video monitoring sector, industry solutions are gaining in importance. For example, hard shoulders on motorways are being monitored using highly specialised video technology (Argoscan). In the recent past, Funkwerk implemented important strategic projects which put our company in a unique position. Funkwerk aims to produce further sector solutions, such as automatic parking management and forest fire detection.

Comprehensive electronic protection for individuals and properties is being progressed through technological development towards convergent networks on IP basis and the new radio standard for security functions (TETRA). A further major challenge here is the integration of all subsystems into a uniform communication system, with appropriate interfaces to authorities and organisations with security functions.

As a mid-sized product manufacturer and system supplier, Funkwerk invests in special solutions to differentiate itself at a technological level and to protect its excellent market position against the dominance of major corporations. Funkwerk should be able to gain further market share through strategic key components for position fixing in buildings (inductive localisation transmitters, or IOS), messaging servers and special radio and video products, as well as such software applications as image processing, sensor fusion and network management. This is supported by initial successes in such areas as property protection, personal security and video detection.

#### Objectives of Security Communication

Funkwerk plans to grow through internationalisation of the personal security sector. To this end, we are seeking partnerships with international infrastructure suppliers. The Executive Board has decided to focus on personal emergency call systems based on the DECT and TETRA standards and to adapt these systems to meet international requirements and to advance their technology. Funkwerk also intends to diversify into the open market for professional radio devices for security functions, specifically by providing special applications and extra functions that lead to competitive product ranges.

In our video systems product group, Funkwerk believes it occupies a good position in sophisticated applications (high-end range) and intends to grow by gaining further market shares particularly in mid-sized applications and through focused development of national and international markets. Along with our project business, we will market such key products as special cameras, pan/tilt heads and transmission technology through system integrators.

Our strategy for Security Communication further includes the setting up of a building management product group. As a first step, we will link the interfaces of our personal security and video systems product groups using universal control systems. This will make it possible to integrate other sub-sections of security systems into complete systems and increase our offering.

Funkwerk plans to launch new products in Security Communication in 2011, including a DoIP (DECT over IP) based PNA system including software extension of terminals, TETRA handheld radio terminals (FT4 Ex) with IIC T4 and IIB T3 certification, and TETRA devices with GPS and encryption function and professional messaging. We will also develop new transmission modems with bandwidth control, new IP cameras and a scalable new management system into marketable products.

### Automotive Communication

In Automotive Communication, Funkwerk serves the market for vehicle communication equipment in the automobile industry (OEM market) and the after-sales market. Funkwerk develops, produces and sells signal amplifiers, hands-free systems and integrated communication solutions (e.g. WLAN routers, telematics units, USB hubs) to ensure reliable and secure mobile radio communication in the vehicle and help link mobile devices with the vehicle. This market is expected to see significant growth in the next few years.

Funkwerk is a global leader with its Compenser technology, a signal amplifier system especially developed for wireless applications in the vehicle, to enable consistent, high-quality data and voice transmissions from and to the vehicle. Equally important is the UMTS/GSM Multimode Compenser from Funkwerk. This technology amplifies the wireless signal between a mobile phone and an outside aerial to ensure the full transmitting power of the vehicle aerial and full receiving power of the mobile phone. These patented technologies are second to none in the world and are used by numerous well-known automobile manufacturers as standard equipment that supports all European mobile radio standards.

Funkwerk also provides forwarding agents and operators of sizeable fleets, as well as special sectors of the industry, with innovative realtime fleet management through integration of mobile radio applications and telematics systems. In this sector, Funkwerk has developed a telematics system which allows the connection of ERP systems including operating data acquisition, but can also grow with the customer's requirements through gradual extension of its functionalities. Along with customised telematics solutions, Funkwerk offers »easyfleet« as a standardised telematics service, which is made available centrally via the website at [www.easyfleet.de](http://www.easyfleet.de). For traditional telematics applications, Funkwerk has developed a special range of on-board computers, which are a combination of hands-free unit, navigation and operating terminal.

The product range in our avionics sector includes radio equipment, transponders and displays for small and light aircraft. Funkwerk also takes on special projects for contracting authorities and system companies in the general aviation industry in Europe. The growing trend towards standardisation of display and navigation equipment among European small aircraft manufacturers is met by Funkwerk with the development of an integrated cockpit (»glass cockpit«).

### Objectives of Automotive Communication

Over the last few years, Funkwerk has set up an efficient technology platform for product development in Automotive Communication. As a system kit, this platform enables the effective development of new products in the area of integrated vehicle communication. This approach ensures that function modules are modularised and standardised to ensure reusability of the development results. This leads to considerably cuts in development time and easier product maintenance. It also takes account of the trend towards increasing integration of functions and ease-of-operation.

As a further aspect, Funkwerk will in future focus on increasing its product range for Internet and multimedia in the vehicle. Examples here are such new wireless standards as WLAN as well as the Car-2-Car and Car-2-Infrastructure technology. Demand in the OEM market is expected to grow.

Funkwerk further expects assistance systems to play a greater role in automobile transport in the future. We believe that Funkwerk occupies an excellent position in this market thanks to our telematics products and fleet management systems. Our strategic goal is primarily to continue developing our services and products and to add further functions. The development of a modular range of on-board units with a high degree of flexibility for the vehicles will play a significant role. In addition, Funkwerk is developing new applications and technology capabilities for such aspects as radio-based broadband access solutions for vehicles and rural areas.

### Enterprise Communication

Business data and communication networks continue to undergo rapid technological changes, with the convergence of different services in a standardised IP-based network being the driving factor here. Thanks to high-speed technology, we will in future have sufficient bandwidth to design intelligent networks with customised features. These intelligent networks will be a key milestone on the way to a standardised voice, data and multimedia network known as the next generation network (NGN).

Future data networks will enable a wealth of new solutions for communication within and across companies. On the other hand, the complexity of the systems is increasing, requiring appropriate tools for configuration, administration and network protection.

As a specialist in integrated communication solutions, Funkwerk satisfies this increasing demand through our Enterprise Communication segment. Funkwerk realises professional, sector-specific solutions, for small to mid-sized companies, with a well-rounded product portfolio, which comprises all the necessary devices and components (routers/gateways; management systems and WLAN) including data security for private data networks in addition to classic TC systems,.

Funkwerk takes account of the current transition from classic telephone system to integrated IP solutions through new products built on the IP-based communication platform »hybird«. These are based on a proprietary operating system including a development platform, which is optimised for high data throughput.

Under the »Bintec« brand, Funkwerk markets data network components and access solutions, such as routers and gateways in different performance classes. Among the focuses here are solutions for setting up virtual networks to connect different branches or sites as cost-effectively and securely as possible. By extending the functionalities to provide configurable media gateways, it is increasingly possible in cooperation with manufacturers of application software for unified communication to create system solutions with exclusive performance features for specific markets.

### Objectives of Enterprise Communication

Our Enterprise Communication segment will continue to change its strategy from individual component supplier to integrated solution provider. The Executive Board feels that the segment's extensive product portfolio for data and voice communication provides a suitable basis for this. Through further advancement of management systems and tools for configuration and administration of the communication networks, we hope to differentiate ourselves in terms of technological systems despite the progressing standardisation at component level.

We will make efforts to increase our share of the corporate communications market by specialising in solutions for small- and mid-sized companies and by rigorously focusing on IP-based networks and services. This will go hand-in-hand with the launch of our innovative IP-PBX architecture »hybird« as well as a new generation of intelligent routers.

The investments already made in development and the launch of our »hybird« communication platform at the end of 2010 has laid the foundation for future growth. Through cooperation, Funkwerk now plans to open up additional sales channels for its products as an OEM partner in the Enterprise Communication segment.

## 2. Business trend in 2010 and situation: Growth potential

### GENERAL ECONOMIC SETTING

After the worst recession in the post-war period, in 2010 the global economy managed to return to growth very quickly, thanks to a number of measures introduced to stimulate the economy. Some of the crisis-related losses of previous years could be recovered. Global economic performance rose by around 5 per cent, after a 0.6 per cent drop in 2009. The driving force of this upswing was not, however, the established industrialised nations in Europe and America, but rather the emerging markets and new superpowers in Asia and South America, which alone made up for two thirds of global economic growth. Countries such as Brazil, Russia, India and China (the BRIC states) improved most significantly, by up to 10 per cent.

The Eurozone saw a number of highly divergent trends. Countries such as Portugal, Ireland, Italy, Greece and Spain (PIIGS) are facing the challenge of having to demonstrate with credibility how they are planning to put their budgets back on a solid basis and avoid the collapse of their economies. As a consequence, the PIIGS countries are still in the throes of the recession, whereas the classic industrialised nations of Western Europe are recovering with Germany at the head. With a growth rate of 3.6 per cent in 2010, Germany gained the status of prime mover in Europe. Along with its export-oriented industry, domestic demand here for the first time became a key driver promoting economic recovery. Growth, however, remained at a rather low level.

The leading economic research institutes predict that export business will ebb in 2011. On the whole, the gross domestic product of the established industrialised nations is not expected to rise above 2.5 per cent in fiscal 2011. The EU states and Great Britain may fare even worse.

As a system and infrastructure component supplier, Funkwerk is particularly attentive to the trend of gross fixed capital formation. After a drastic drop in the double-digit percentage range in the previous year, this indicator barely improved in 2010, up by less than one per cent in Funkwerk's main markets. Again, the BRIC states are an exception here, as they are likely to continue investing at a much higher level in 2011. These markets, therefore, are the focal point of further internationalisation at Funkwerk.

In 2010, the balancing act between necessary investments in systems and infrastructure, on the one hand, and the necessity of consolidating budgets, on the other, also had a determining influence on the markets for communication and information systems in which Funkwerk is mainly active. Although economic stimulus packages initiated in the years prior meant that 2010 saw numerous new contracts put out to tender, more restrictive fiscal policies resulted in dragged-out infrastructure projects and in delayed contract decisions at transport operators in the further course of the year.

As a result, a number of sectors experienced a backlog of investment projects, which should be cleared in the medium term, as it will otherwise jeopardise the efficiency of infrastructures (energy, transport, supply). Germany especially faces a considerable backlog of public investments. This applies particularly to transport infrastructures, where for years investments have lagged behind the demand. Further investments in the billions which still have not got under way are needed in connection with the EU agreed provision of an interoperable operations control system for Europe's rail transport infrastructure and of interlocking technology.

Further growth prospects come from the many announcements by companies to invest in communication and information technology using the Internet over the next few years, to secure their competitive positions. Along with the development of blanket broadband access, another issue with special significance is security, two areas in which Funkwerk is well-positioned as a supplier of integrated solutions.

On the whole, the European Information Technology Observatory (EITO) expects that the global IT and telecommunications markets, in which Funkwerk generates the lion's share of its sales, will grow by some 5 per cent in 2011. The growth rates for the BRIC states alone are estimated to range between 7 and 26 per cent, whereas spending in the EU is believed range at EUR 715m, up by around 1.5 per cent on the previous year.

**SUMMARY OF THE BUSINESS TREND AND GENERAL STATEMENT ON THE ECONOMIC SITUATION**

The 2010 financial year for Funkwerk was defined by lasting success in restoring our operational profitability while business continued to develop at a measured pace. The net operating result (before impairment and restructuring costs) climbed back up into the black through cost savings of around EUR 19m, whereas sales fell further by a small margin year-on-year due to a number of different factors. Factors with a particularly detrimental effect on sales and earnings included politically related events in Algeria, which led to an extraordinary write-down of almost the entire commitment of Funkwerk in that country.

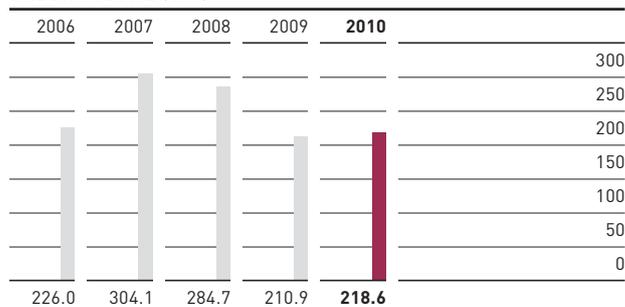
On the whole, the trend in the four business segments of Funkwerk lagged behind the general economy. This is due, on the one hand, to the fact that Funkwerk primarily provides information and communication systems as infrastructure for transport operators, companies and public institutions. Economic activity in these sectors follows the general economic trend with a certain time lag and is dependent on public budgets. Our rigorous restructuring measures and the related focusing on our earnings and liquidity further helped to prevent an expansionary sales policy in 2010.

Affected by considerable public debt and the resulting necessity to consolidate public budgets, transport operators and companies with infrastructure facilities that greatly depend on public spending were particularly reluctant to invest and postponed acquisitions. In some cases, the budgets for information systems and communication technology were cut further still. This left its mark on business at Funkwerk until well into the third quarter. The situation marginally improved towards the end of the year, which was reflected in our sales and incoming business.

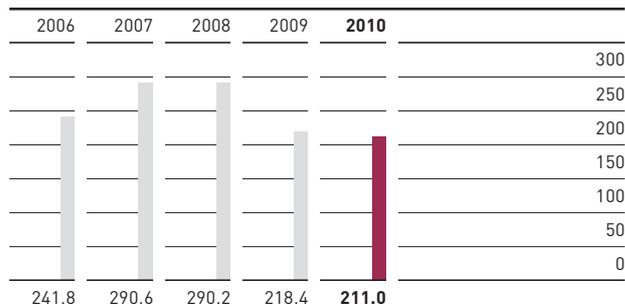
At EUR 61.6m, sales generated in the last quarter of 2010 were up by around 22 per cent on the previous year (EUR 50.5m). This increase was not enough, however, to close the budget gap which had appeared by the end of September. Over the year, Funkwerk generated revenues of around EUR 211m, down by 3.4 per cent on the previous year (EUR 218.4m).

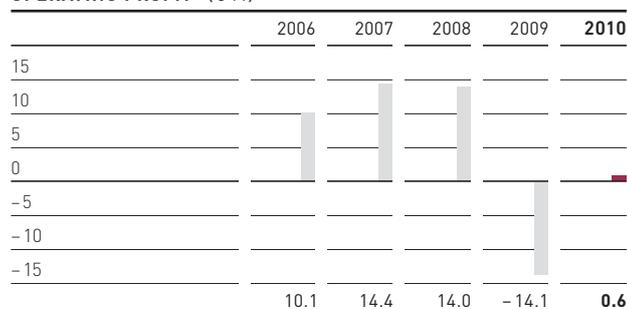
It must be noted here, however, that the drop in sales on the previous year is due solely to a deconsolidation effect of around EUR 7m relating to our former subsidiary Bouyer S.A.S, France, and to the politically induced stoppage of business activities in Algeria of around EUR 13m. In addition, Funkwerk deliberately discontinued several product groups and their related sales contributions, as part of its restructuring measures.

**ORDER VOLUME (€ M)**



**REVENUES (€ M)**



**OPERATING PROFIT\* (€ M)**

\* before restructuring and impairment costs

The restructuring programme continued in 2010, with costs involved reducing from EUR 8.9m in the previous year to EUR 2.2m. At EUR -3.4m, the revaluation of intangible assets required as a result of such aspects as the decline in sales and the discontinuation of product ranges also proved significantly less in the reporting period than in the previous year (EUR -19.8m).

To exclude balance sheet risks for 2011, the Executive Board decided to write down virtually the whole project business in Algeria and, with it, the tied-up current assets. In 2006, Funkwerk was contracted by an Algerian industrial enterprise to set up major security systems for key oil and gas plants in Algeria. Due primarily to political upheaval in the country, however, business was temporarily discontinued in 2010. Consequently, the 2010 consolidated financial statements factor in impairment and other costs of EUR

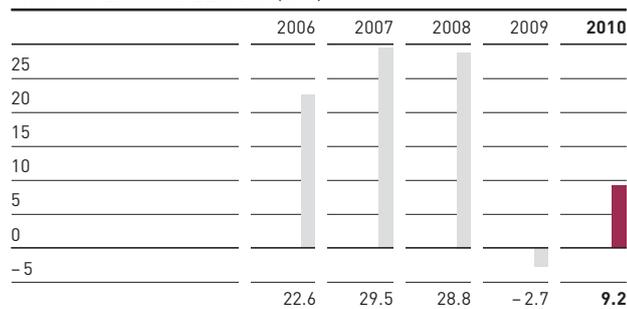
9.1m for our project business in Algeria. Of this amount, EUR 7.8m are reported separately, EUR 0.9m are posted in the financial result, and EUR 0.5m as tax expenditure. If the projects are resumed in 2011 or in any of the following years, this would be reflected accordingly in our operating result.

On the whole, this produced a negative operating result of EUR -12.8m in 2010 (2009: EUR -42.8m). Due to a negative financial result and an earnings tax burden of EUR 7.6m, the consolidated annual net loss therefore totalled EUR -24.9m (2009: EUR -40.8m). This corresponds to earnings per share of EUR -3.09 (2009: EUR -5.06).

As the working capital had again dropped quite considerably on 2009, Funkwerk was nevertheless able to achieve a positive operating cash flow of EUR 4.4m for 2010 (2009: EUR

7.2m). Investments of around EUR 12m to develop future growth potential remained at prior-year level (2009: EUR 12.3m), but the free cash flow stood at EUR -8.2m (2009: EUR -5.1m). On the whole, Funkwerk had a net liquidity of EUR 11.6m on 31 December 2010 (2009: EUR 19.8m).

The Executive Board believes that the strategy and restructuring measures advanced in 2010 have considerably improved our starting position in the current financial year. Together with the potential created through investment in new products and solutions and our continued strategic focusing, Funkwerk should be able in 2011 to be back on the path to growth.

**GROUP OPERATING EBITDA\* (€ M)**

\* before restructuring and impairment costs

**ORDER SITUATION**

Incoming business in the four business segments of Funkwerk generally lags behind the general economic trend, as our main customer target groups do not tend to make investment and spending decisions until a clear trend towards recovery is manifest or government subsidies are made available. In 2010, the markets for communication and information systems, in which Funkwerk is mainly active, were also determined by a balancing act between necessary investments in systems and infrastructure, on the one hand, and the necessity to consolidate budgets, on the other.

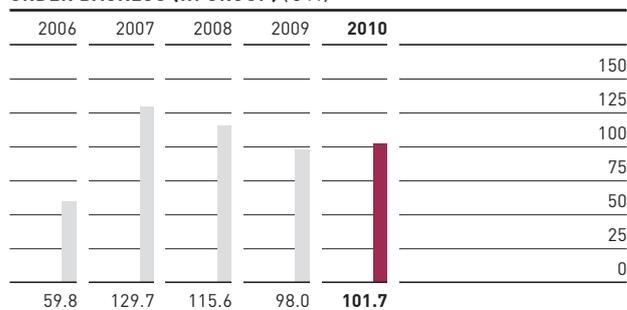
As a result, many of our customers held back orders until the fourth quarter. Transport operators and companies with infrastructure facilities that greatly depend on public spending were particularly reluctant to invest and postponed acquisitions. Budgets for information systems and communication technology were cut even further. Due to the turbulence involving the Euro and the poor economic trend in some European markets, foreign demand also remained at a low level. It was not until towards the end of the reporting period that Funkwerk finally felt new impetus in terms of contract placement.

In the fourth quarter, Funkwerk booked new orders of around EUR 58m. This is quite an improvement both on the previous quarter and the previous year (EUR 54.4m), though at a comparatively low level. Nonetheless, it indicates a tentative growth trend, which is further confirmed by the ratio of orders taken to sales (known as the book-to-bill ratio).

Over the year, incoming orders in the Funkwerk group totalled EUR 218.6m (2009: EUR 210.9m). This results in a book-to-bill ratio of 1.04 for 2010 (2009: 0.97), which shows again that Funkwerk has bottomed out and is on its way up again. It must also be borne in mind here that sizeable order potential did not materialise due to the discontinuation of peripheral activities, the deconsolidation of a French subsidiary, and the loss of our Algerian business.

For these reasons, the volume of orders as at 31 December topped the prior-year level only marginally at EUR 101.7m (2009: EUR 98.0m).

**ORDER BACKLOG (IN GROUP) (€ M)**

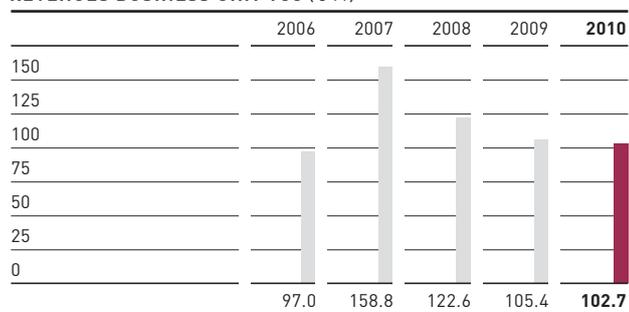


**BUSINESS TREND BY SEGMENTS**

**Traffic & Control Communication: Steady earnings anchor**

Customers of the largest segment of Funkwerk, Traffic & Control Communication (TCC), tend to be international operators whose operations greatly depend on trends in rail freight and passenger transport and on government investment subsidies. Since the losses in the rail transport sector caused by the global economic crisis still had not been recovered in 2010, their investment propensity remained restrained. This was aggravated by the fact that against the background of consolidating public budgets, the budgets of railway operators for information systems and communication technology were also cut. Contrary to announcements and existing commitments, product call orders under framework contracts were delayed as a result. A Western European railway company, for instance, postponed its roll-out of GSM-R terminals, which alone lost Funkwerk over EUR 5m in sales.

REVENUES BUSINESS UNIT TCC (€ M)



As a result, sales at TCC on the whole remained behind our expectations in 2010, though we were able, by focusing business over the past two years and through our lead in mobile radio terminals and management systems for railway companies, to keep the level comparatively steady. We also noticed a satisfactory pick-up in the fourth quarter of 2010, so revenues of around EUR 30.9m from October to the end of December meant sales were up by around 18 per cent on the previous year (EUR 26.2m).

This helped us reduce the drop in sales to less than 3 per cent for the whole year. Revenues relating to business with communication, management and information systems

for transport, logistics and industry totalled EUR 102.7m in 2010 (2009: EUR 105.4m), though it must be borne in mind here that a deconsolidation effect reduced sales by some EUR 7m on the previous year.

Through cost savings and adjusting its capacities, TCC was able, despite the low volume of business, to increase its positive operating result before restructuring and impairment costs to EUR 4.8m. As a consequence of successful restructuring, the segment therefore improved its performance by over EUR 6m on the previous year (2009: EUR -1.2m).

The strongest product group was once again mobile radio terminals, with GSM-R as the supporting technology on the verge of becoming a global standard. This presents Funkwerk as a market leader and partner of major vehicle manufacturers and infrastructure providers with growth potential over the next few years, all the more so since we extended our portfolio of dual-mode handheld devices in 2010. Cost-effective DMR technology is yet another radio standard which could increasingly be used as a platform for future communication systems in the railway sectors of the BRIC states. Through involvement in various bodies, Funkwerk takes an active role in its development and produced appropriate technical developments in 2010.

Funkwerk is also a leading supplier of management systems for railway companies in Central Europe. Over the past few years, we have developed our electronic interlocking system Alister here, which helps railway companies significantly reduce their investment and operating costs. Despite a widening installation base for shunting operations, the expected market breakthrough failed to materialise in 2010 due to delayed approval from the Federal Railway Authority. We do, however, expect increasing sales contributions here from as early as 2011, especially in light of new orders received from Austria and Slovakia in 2010.

Business with management systems for energy suppliers and chemical companies developed positively in 2010. Sales here were up by around 6 per cent to EUR 16.7m (2009: EUR 15.8m), with an operating income margin of around 7 per cent. We expect growth to continue here in 2011 and 2012.

In 2010, our information systems product group suffered particularly under the investment restraint of European railway companies. At the same time, new products needed to be developed to be able to meet the modernisation requirement in the area of stationary and mobile passenger information expected in the next few years. With sales contributions slightly down, expenditure increased in 2010 to secure our competitive position. Funkwerk ensures that its products are of a high standard, as problems with cheaper and not very reliable solutions have made quality an issue of increasing importance, particularly for European railway companies wanting to modernise their systems. Business in information systems for industrial applications was stable in 2010, once again generating a positive earnings contribution.

We expect that demand for communication technology in the railway sector will rise in 2011 as the global economy continues to pick up and rail transport is promoted to save resources, and also as infrastructure in the BRIC states and in other threshold countries will be the focus of development. While

European railway companies will remain our key customers, the dynamics of the market which Funkwerk is able to address here will shift towards those regions and our internationalisation strategy will be focused accordingly. Along with Eastern Europe and Russia, new target markets include the Middle East, India, Australia and North America. Information systems in particular promise good potential due to the modernisation of Russian railway stations and the introduction of passenger information systems for Indian railways.

In Central Europe, which is the key target market for Funkwerk, railway companies are facing the challenge of having to increase the capacities of rail transport using new, intelligent infrastructures, while at the same time making it more economical, customer and environmentally friendly. This is possible only through use of cutting-edge communication, management and information system, such as provided by Funkwerk as a leading supplier in this area.

On the whole, we therefore believe that TCC is looking at a positive business trend again, with moderate growth from 2011. This is confirmed by the book-to-bill ratio at the end of December, which stood at 1.04 (2009: 1.03). Of great importance for our further internationalisation and the development of the Asian/Pacific region was our first major contract from Australia for a GSM-R train radio system, worth several millions of euros. Funkwerk also booked a key success in Finland, winning a contract to equip 200 railway stations with an integrated information system. The order volume for TCC as at the end of December totalled EUR 71m, which was up by around 3 per cent on the previous year (EUR 69m).

**Security Communication: Restructuring success eclipsed by extraordinary impairment and other expenses**

In 2010, Funkwerk progressed well with the restructuring of its various operating units and readjustment of the business model in our Security Communication (SC) segment. Concentrating our technological expertise, streamlining our processes, and capacity adjustments in this segment brought about lasting cost savings of around EUR 7m. Through exclusive features in TETRA and DECT based solutions and explosion-proof mobile radio devices (ATEX), SC was able to maintain its lead in the market for personal emergency call systems as well as in the area of video systems and video components for property protection.

The success of our operations here was, however, eclipsed by the negative developments of project business in Algeria. It seemed wise here to revalue Funkwerk’s commitment in the 2010 financial statements on grounds of the political confrontations which were coming to a head in the country. As already pointed out, this led to impairment and other expenses totalling EUR 9.1m.

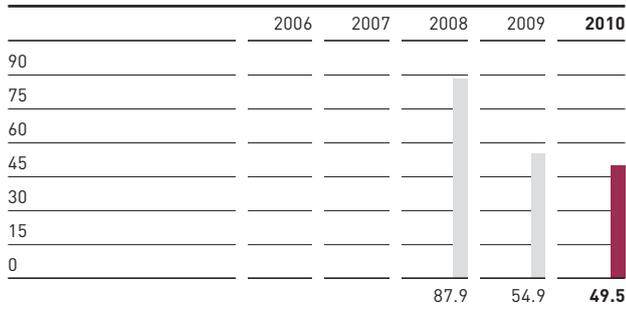
Without these impairments and the loss of sales through stoppage of our Algeria business, Security Communication would have managed a turnaround as early as in the fourth quarter of 2010. At EUR 15.3m from October to the end of December, the segment generated 30 per cent more in revenues than in the prior-year reference period (EUR 11.8m). Over the whole year, sales losses reduced to less than 10 per cent as a result. On the whole, segment sales amounted to EUR 49.5m (2009: EUR 54.9m).

Due to the positive trend in the fourth quarter, SC managed to reduce its operating loss (without restructuring and impairment costs) to EUR -3.9m (2009: EUR -11.4m). Allowing for these extraordinary one-off expenses, segment earnings (EBIT) came to EUR -13.7m (2009: EUR -17.2m).

**OPERATING PROFIT BUSINESS UNIT TCC\* (€ M)**

	2006	2007	2008	2009	2010
					15
					12
					9
					6
					3
					0
					-3
	1.6	13.5	12.4	-1.2	4.8

\* before restructuring and impairment costs

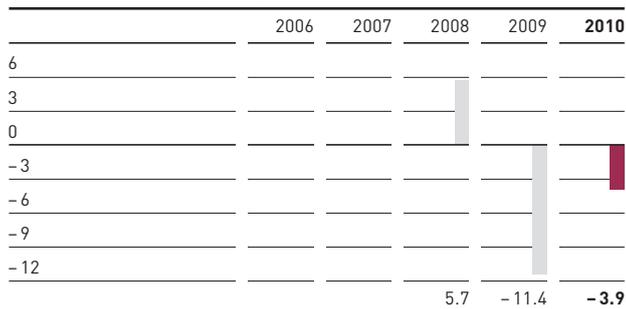
**REVENUES BUSINESS UNIT SC (€ M)**

In terms of incoming orders (EUR 53.6m), the pick-up was confirmed towards year-end with a gain of 32 per cent on the previous year (EUR 40.6m). Our focus on product sectors with unique selling points is already paying dividends here. In personal security, for instance, the segment won new projects to equip penal facilities and industrial plants, and in the video sector, for monitoring power plants (Sweden) as well as airports (Frankfurt) and railway stations (Turin). The new TETRA handheld devices with special functions are already enjoying increased demand and have the potential of generating additional sales for 2011 in the global market. Funkwerk has also established itself as an OEM

supplier here, expecting substantial growth in the next few years.

Furthermore, we are anticipating continuous sales contributions from a long-term framework contract with an energy company in France which is equipping its power plants with personal security systems based on DECT technology from Funkwerk. Further device models of TETRA handhelds will be ready for the market in the next few months. We also plan to address a wider market of users (organisations with security functions (BOS), fire brigades, ambulance services) with standard devices and BOS-specific performance features to open up additional sales potential.

As a system supplier of optical security solutions, Funkwerk boasts technological key expertise in the development and production of video cameras, sensors, pan/tilt heads, video transmission systems, video management systems, and video detection and image processing. Initial success was posted after boosting our industry solutions business in Germany. This will increasingly be extended to export. For this purpose, we have also developed scalable versions of our video management system p.o.s.a., which are easier to place for our sales partners and can be operated with less training required for the end customer.

**OPERATING PROFIT BUSINESS UNIT SC\* (€ M)**

\* before restructuring and impairment costs

In terms of personal security and video monitoring, Funkwerk will in future increasingly specialise in energy, industry, local and long-distance transport and supply, and will expand business at international level through cooperation with infrastructure suppliers. Demand for the integration of facility management and security management is increasing. Towards this, Funkwerk is developing an integrated system, which will meet all these requirements and contribute to sales from 2012. In 2010, operations at SC were reorganised and streamlined.

In the medium term, Funkwerk expects to see more significant growth in the SC segment in line with the rising demand for intelligent solutions for the protection of

individuals, buildings, public places and properties worldwide. Authorities and organisations with security functions (BOS) such as police and the fire brigades, operators of industrial sites and the raw material industry in particular will increasingly need to invest in security systems. Funkwerk has many years of experience in pertinent communication technology and is a leading specialist in personal security and video monitoring systems in the global market.

In addition, great interest is being shown globally in Argoscan, a worldwide unique, video-based control system for hard shoulder release on motorways, which Funkwerk developed. We also see additional potential here through new applications, such as the equipment of road and rail tunnels, car parks and motorway stations.

For 2011, we expect SC to continue stabilising its positive earnings position achieved in the fourth quarter of 2010. This trend should carry on with increased intensity in 2012.

**Automotive Communication: Funkwerk in demand as automobile supplier**

After a measured start in 2010, our Automotive Communication (AC) segment benefited from growth in the automobile industry in the latter half of the year. OEM business particularly with amplifier and connectivity units for commercial vehicle manufacturers picked up quite significantly. Business with radio transponders in our avionics sector developed just as satisfactorily.

Segment revenues in the last quarter rose further to EUR 8.0m, so were up on both the previous year (2009: EUR 7.5m) and the previous quarter. Over the year, sales improved by some 7 per cent to EUR 30.5m (2009: EUR 28.5m). The trend towards increasing growth could also be seen in incoming business; at EUR 30.6m it topped not only the prior-year figure by 5 per cent (2009: EUR 29.2m), but also sales.

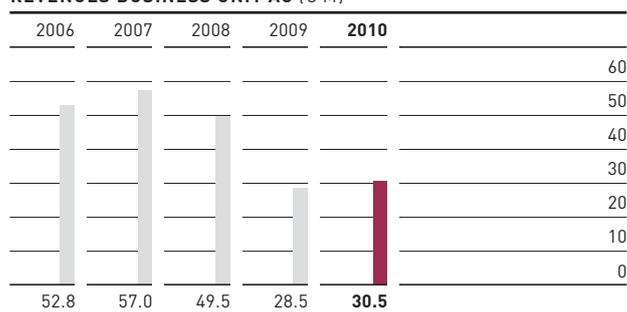
These results are evidence not only of the effects of general economic revival in the automobile and aviation sectors, but also from our focusing our sales efforts to provide more intensive support for our key customers. New contracts were generated for wireless connection of mobile phones (coupling chamber) to the vehicle antenna and the supply of WLAN routers for use in vehicles to German premium manufacturers.

In addition to supplies for the automobile industry, the positive trend at AC was aided by our radio transponder business for general aviation. Sales in our avionics product sector increased from EUR 2.7m to EUR 3.3m, generating an operating result of EUR 0.2m. Our telematics product sector generated some EUR 4.5m in revenues (2009: EUR 5.2m) and a marginally positive operating result of EUR 0.1m.

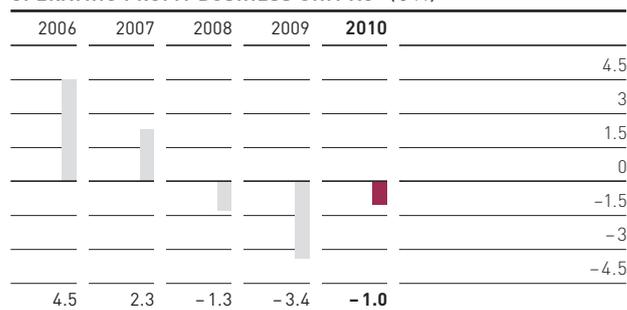
Due to optimisation of processes, organisation, production and development, AC was able to reduce its cost base quite significantly in 2010 to achieve a virtual turnaround of operations by the end of the year. On the whole, AC generated an operating result before impairment and restructuring costs of EUR -1.0m in 2010, which compared to the previous year (EUR -3.4m) meant an improvement by around EUR 2.4m.

In 2010, AC focused its activities on finalising its development platform. Funkwerk addresses a number of target groups in the after-sales market, from commercial vehicles, automobiles and avionics through to transport service providers and other vehicle fleet operators. All target groups increasingly require a wide range of functions integrated into compact models with standard operation. This produces considerable synergies which can be increased through availability of a general, generic hardware and software platform. This will drastically reduce the development periods while ensuring reusability of the development results.

REVENUES BUSINESS UNIT AC (€ M)



OPERATING PROFIT BUSINESS UNIT AC\* (€ M)



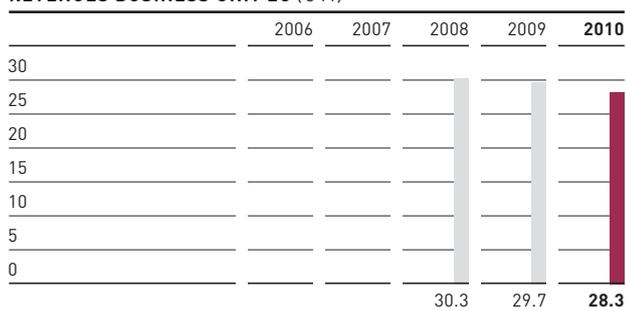
\* before restructuring and impairment costs

Our new platform was used for the first time to develop of a communication unit for a well-known commercial vehicle manufacturer. Additional potential results from newly developed WLAN routers, coupling chambers and USB hubs for leading German premium manufacturers. The development of a »glass cockpit« in our avionics product group could lead to a pick-up in sales from 2011.

The after-sales market continues to produce a deficit amidst intense competitive pressures. Funkwerk lacks sufficient market share here to achieve sufficient economies of scale. Nonetheless, we see positive synergetic interaction between OEM and after-sales market. New potentials are arising here, particularly through the use of »apps« in the vehicle; these potentials can be used through continuous market cultivation.

This growth trend should continue in 2011 and over the next few years, as electronics and communication systems are central for the use of all new functions (Internet, telematics, infotainment) in vehicles. The increasingly popular, safe use of »apps« on mobile phones while driving particularly requires communication equipment such that already supplied by Funkwerk.

REVENUES BUSINESS UNIT EC (€ M)



#### Enterprise Communication: Sustainable growth in sight

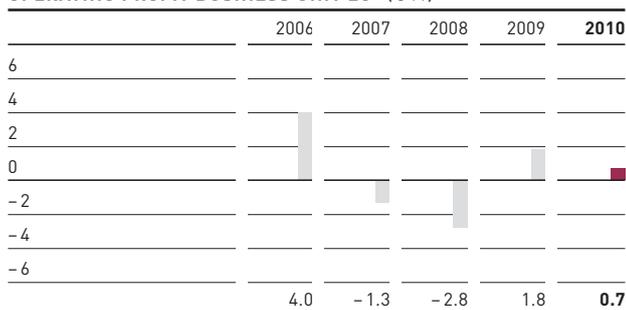
After the successful completion of restructuring measures, our Enterprise Communication (EC) segment is back on track with positive revenue. The creation of an efficient product portfolio with focus on sector-specific solutions for small and mid-sized companies is now starting to pay off, as are our intensified sales efforts in looking after specialist dealers, telecom operators and other key accounts. Through a very wide spectrum of sales partners (approx. 4,000), EC is very close to SME customers with short sales channels and local support. Our »Symbiosis« partner programme, introduced in the latter half of 2010 for specialist

dealer distribution, proved a success and will now be extended to include international marketing.

Business with TC systems, network and data security solutions continued to rise steadily in the fourth quarter of 2010. Compared to the prior-year reference period, sales improved by around 43 per cent to EUR 7.3m (2009: EUR 5.1m).

Over the year, segment revenues totalled EUR 28.3m, after EUR 29.7m in the previous year. The concentration of our product range in 2010, however, also meant loss of sales potential, while demand for ISDN-based compact TC systems is declining for technology-related reasons. At EUR 0.7m (2009: EUR 1.8m), the operating result in this segment remained positive.

OPERATING PROFIT BUSINESS UNIT EC\* (€ M)



\* before restructuring and impairment costs

Funkwerk anticipated the technology change towards IP-based communication solutions and successfully launched its new »hybird« IPTC system at the end of 2010. This gives rise to hopes of a surge in demand especially for 2011.

A key factor for the future growth of EC could be the trend towards »cloud computing«. An increasing number of telecommunication and business application services are virtualised and made available to users via central platforms. This requires fundamental changes to the business models of service providers and system suppliers, along with various products for the intermediate phases of the transition process from independent, private network to

the »cloud«. Appropriate access systems and solutions to secure applications, data and voice transmissions, as already supplied and developed by Funkwerk, are increasingly needed.

By cooperation with partners and additional sales channels for products in the OEM sector, Funkwerk expects that EC will overall be profitable again in 2011 and continue this trend in 2012 and 2013.

### 3. Earnings position: Turnaround in operating income

The 2010 financial year for Funkwerk was defined by lasting success in restoring its operational profitability while business remained measured. Sales of around EUR 211m achieved in the year lagged behind our expectations, which meant contribution margins we had taken into account failed to materialise. Nevertheless, Funkwerk managed through its completed measures to adjust capacities and reduce fixed costs, to achieve an operational turnaround (before restructuring and impairment costs).

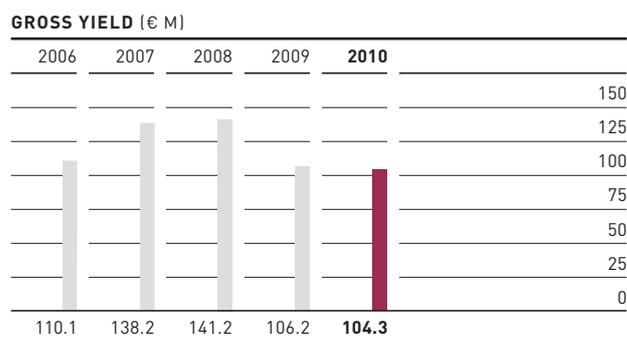
After attaining a virtually balanced operating result as early as in the third quarter, the operating result (before restructuring and impairment costs) at group level returned to positive the fourth quarter, up from EUR -1.5m in 2009 to EUR 3.1m. This was due to rigorously continuing our restructuring and focusing on our course. Through optimising the structure of our operations, a more productive use of resources, adjustment of our product portfolio and the discontinuation of peripheral activities, we were able over the year to achieve cost savings of around EUR 19 m across all our segments.

All major expense items could be reduced disproportionately. Despite drastic rises in raw materials and energy prices, our cost of materials decreased by 6 per cent to EUR 107.1m (2009: EUR 114.4 m). Personnel expenses shrank by almost 12 per cent due, partly to the reduced number of full-time jobs, down from EUR 92.2m in 2009 to EUR 81.2m. The other operating expenses could be cut by over 20 per cent to EUR 31.4 m (2009: EUR 39.8 m).

The gross yield margin (without internally produced and capitalised assets and other operating income) thus rose to 49.4 per cent (2009: 48.6 per cent), while the personnel expense rate reduced to 38.5 per cent, after 42.2 per cent in the previous year. We expect further improvement in both expense figures for the current financial year.

Compared to the previous year, the turnaround in operating income achieved in 2010 was particularly evident in the EBITDA (operating result before regular depreciation, restructuring and impairment costs) and in the operating result adjusted for special effects. The EBITDA (before restructuring and impairment costs) at the end of December amounted to EUR 9.2m. This is an improvement on the previous year (EUR -2.7m) by around EUR 11.9m. The operating result (before restructuring and impairment costs) increased by almost EUR 15m on the previous year, to EUR 0.6m (2009: EUR -14.1m), because scheduled depreciation also reduced to EUR 8.5m (2009: EUR 11.4m).

This lasting success in restoring our operational profitability was, however, eclipsed by the effects of the negative development in our Algeria business. In view of the uncertain political situation in the country, the Executive Board decided to write down virtually the whole project business in Algeria. As a result, the 2010 financial statements account for one-off impairments of projectrelated items in the current assets amounting to EUR 9.1m for project business in Algeria. If these projects are resumed in 2011 or in any of the following years, this would be reflected accordingly in our operating result.



Due primarily to the decline in sales, the revaluation of our Algeria commitments, the discontinuation of product lines and unprofitable business activities, impairment charges of EUR 3.4 m (2009: EUR 19.8 m) were necessary against goodwill and intangible assets.

After completing our restructuring programme related to necessary capacity adjustments in 2010, the pertinent expenditure reduced from EUR 8.9 m in 2009 to EUR 2.2 m, dragging down the result.

Taking account of all these factors, Funkwerk generated earnings before interest and taxes (operating result) of EUR -12.8 m at group level (2009: EUR -42.8 m). The negative result of financial assets valued at equity (EUR -0.8 m, compared to EUR -0.7 m in 2009) and the negative net financial investment (financial expenses minus expenditure) of EUR -3.8 m (2009: EUR -1.6 m) produced earnings before taxes of EUR -17.3 m (2009: EUR -45.0 m). In 2010, Funkwerk also depreciated capitalised tax-loss carry-forwards of around EUR 5.8 m, a significant contributing factor to the total income tax expenditure of EUR 7.6 m. Due to earnings in the previous year, Funkwerk had had tax savings of EUR 4.2 m in 2009.

In 2010, the after-tax loss in the Funkwerk group thus stood at EUR 24.9 m, after EUR 40.8 m in the previous year. This corresponds to undiluted earnings per share of EUR -3.09 (2009: EUR -5.06).

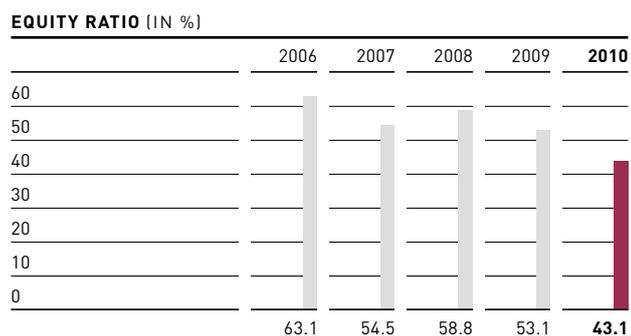
By pushing our restructuring measures in 2010 and following a conservative accounting policy, Funkwerk has set the stage in all its segments for a return to profitability in 2011. Funkwerk will also continue to optimise the processes in all our operating units as well as consolidate our sales and service structures and develop our technology platforms to ensure further improvement in our profitability.

#### 4. Financial and net worth position: Net liquidity still satisfactory

The financial and net worth position of Funkwerk in 2010 was defined by two divergent trends. The successes of the restructuring programme and the measures initiated to optimise our working capital contrasted with a barely satisfactory business trend and the unusual effect of revaluation of our Algeria

project in Security Communication. In the final analysis, Funkwerk as a group was able to maintain a positive operating cash flow, good net liquidity, and a solid balance sheet structure in 2010.

Total assets reduced by EUR 18.1 m, or around 11 per cent, to EUR 149.7 m (2009: EUR 167.8 m) in the preceding financial year, not only due to annual net loss and the depreciation and impairments effected, but also to the operating working capital measures; the equity ratio remained at a high level. On the whole, the equity capital reduced due to the negative annual result, down by EUR 24.6 m to EUR 64.5 m (2009: EUR 89.1 m), while the equity ratio dropped to 43.1 per cent (2009: 53.1 per cent).



Driven by the capitalised development costs necessary for further growth, the intangible assets on the assets side increased by EUR 2.8 m to EUR 35.7 m (2009: EUR 32.9 m). This asset increase, however, must be seen against a reduction of deferred tax assets by EUR 2.3 m to EUR 0.0 m (2009: EUR +2.3 m). This and the depreciation or impairments reduced our long-term assets by 7 per cent to EUR 49.9 m in 2010 (2009: EUR 53.6 m).

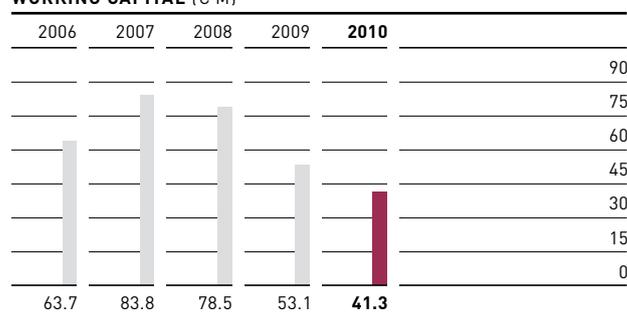
The short-term assets were also down by 12.7 per cent to EUR 99.8 m (2009: EUR 114.3 m). This primarily reflects the optimisation of our working capital and the impairments of existing projects in Algeria.

Short-term liabilities increased by 9 per cent to EUR 70.8 m (2009: EUR 64.9 m), the pivotal factor here being the increase in trade accounts payable (from EUR 23.3 m to EUR 29.4 m) for the optimisation of our working capital. Financial liabilities in the amount of EUR 1.9 m were reduced to EUR 0.4 m.

**WORKING CAPITAL HALVED IN TWO YEARS AND OPTIMISED TO LONG-TERM TARGET**

Our increased efforts from the end of 2009 to optimise net current assets tied up in operations in the Funkwerk group (working capital) once again showed success in 2010. Compared to the previous year, the figure here could once more be reduced by almost EUR 12m to EUR 41.3 m as at the end of December (2009: EUR 53.1m). Some EUR 8 m of this amount is attributable to adverse events in Algeria. Compared to 2008 and due to the declining business trend, our working capital therefore virtually halved (end of 2008: EUR 78.5m). The ratio of working capital to sales improved quite drastically within these two years, from 27.1 to 19.6 per cent (2009: 24.3 per cent) to fall below even our long-term target of around 20 per cent.

**WORKING CAPITAL (€ M)**



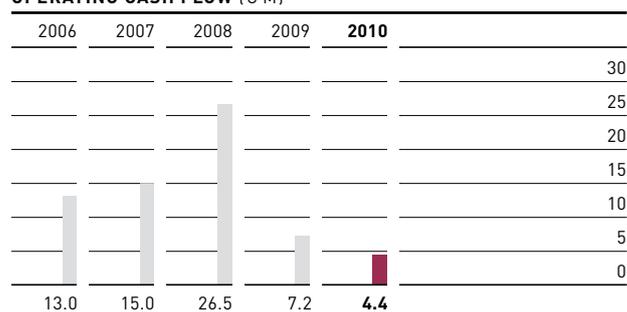
**OPERATING CASH FLOW POSITIVE DESPITE LOSS**

As central objectives, these optimisations and the measures taken in 2010 to secure our liquidity had a positive effect on our operating cash flow. Despite the annual loss of EUR 24.9 m, cash flows from operations generated by year-end totalled EUR 4.4 m (2009: EUR 7.2 m). In the last quarter alone, Funkwerk recorded an inflow of almost EUR 15 m.

In view of new growth potential, Funkwerk kept investment activities at prior-year level in 2010. Once again, spending on development activities totalled around EUR 9.4 m (2009: EUR 10.7 m). Since no cash inflow was generated from the sale of consolidated divisions, contrary to the previous year, cash outflow from investment activities rose to EUR 12.6 m (2009: EUR 12.3 m); this includes a deconsolidation effect in the amount of EUR -1.1 m.

Operating and investment activities therefore resulted in a negative free cash flow for 2010 of EUR -8.2 m (2009: EUR -5.1 m). As a result, we again missed our target of generating a positive free cash flow for the whole year.

**OPERATING CASH FLOW (€ M)**



Since our financial credit of EUR 1.9 m was repaid at the same time, the financial resources of the group reduced to EUR 12.1 m on the cut-off date (2009: EUR 22.1 m). At EUR 11.6 m, our net liquidity nonetheless remained at what the Executive Board believes to be a satisfactory level. As at the time of reporting, Funkwerk still had open-ended credit in current account of EUR 8.5 m.

Based on a contract dated 24 March 2011, Funkwerk concluded a multiyear syndicated loan agreement with three German commercial banks, which grants a guaranteed credit line in the amount of EUR 58 m along with a short-term operating credit line of up to EUR 17.5 m. For details please refer to item 12 »Events after the cut-off date« in this report.

## 5. Resource management and value added

### **PARTNERSHIPS FOR ADDITIONAL GROWTH IMPULSES AND ACQUISITIONS**

In the 2010 financial year, Funkwerk made concentrated efforts to push its restructuring course and continued to focus on technological key expertise and on business activities with considerable market shares. Part of these focusing efforts involved the discontinuation of peripheral activities. In view of the company's situation in the preceding financial year, we opted to refrain from acquisitions and investments as a strategic instrument to consolidate our market position and open up new potential. However, to help us break into new market segments without acquiring companies, to push our internationalisation and to extend our technology platform, Funkwerk increasingly seeks the cooperation with specific providers in all its segments while increasing the value added of our own key products.

In order to internationalise our business in TCC, Funkwerk seeks partnerships both in Germany and abroad which enable even a mid-sized company such as Funkwerk to be present in major infrastructure projects. These are partnerships with infrastructure suppliers and vehicle manufacturers. This is also our preferred strategy for the setup of OEM business with our electronic interlocking system Alister and our radio systems. In terms of industrial management systems, we hope to speed up project business through strategic cooperation with system manufacturers.

Entering into strategic partnerships with globally operating system suppliers is also a priority for SC in order to limit the risk involved in major projects and to gain further market shares at a global level. SC hopes to see technological impetus from cooperation with the AIT Austrian Institute of Technology. To this end, a cooperation contract was signed in 2010 with the aim of developing optical security technologies together which will set new standards. Within the scope of a first research contract, the partners will join to develop intelligent next-generation image processing technologies of the to increase security for critical infrastructures. Automotive Communication was able to win two potent partners for market penetration in telematics solutions.

The aim for Funkwerk as a group in 2011 and subsequent years is to increase efforts to open up new growth potential. In our focused segments, Traffic & Control Communication and Security Communication, this will be achieved through complementary acquisition of additions to our technological portfolio and development/opening up of international markets.

### **FUNKWERK STAFF EXCEPTIONALLY WELL TRAINED**

For a high technology company such as Funkwerk, staff know-how and expertise are key factors for success. As a consequence it is one of our main priorities to ensure support and advancement for all Funkwerk staff and to provide opportunities for further qualifications. In view of the demographic trend, it is also essential for our future competitive position to attract appropriate junior staff in sufficient numbers to Funkwerk. On the other hand, the economic development in our company over the last two years made it necessary to cut our personnel levels. In the 2010 financial year, Funkwerk all but completed the necessary adjustment of capacities. As a result of these job cuts, personnel expenses have reduced disproportionately by a total of 370 since the end of 2008. This has served to strengthen the competitive position and profitability of Funkwerk.

Compared to the previous year, the number of employees in all segments once again reduced in 2010. At year-end, Funkwerk as a group employed 1,363 people. This is 13 per cent fewer than the previous year (2009: 1,568).

Now the number of employees in all business segments has been adjusted to the level of guaranteed capacity utilisation. Peak order times and seasonal fluctuations in production will be compensated, where possible, by adding temporary staff and similar measures.

Although Funkwerk will continue to optimise its business processes and its focusing efforts in the current financial year, new jobs are likely to be created in view of our expected growth.

Even during the crisis, Funkwerk continued to show exceptional commitment to staff training and further education. Today, the company again provides training beyond its own requirements. In 2010, an annual average of 67 trainees (2009: 79) at our various sites were prepared for work in commercial and industrial fields and in information technology.

In 2010, we continued to develop our programme aimed to provide further vocational training and qualification for managerial functions. At various locations, we cooperate closely with universities in various projects and participate in their research. In cooperation with the university of cooperative education, for instance, Funkwerk provides committed and motivated employees with the opportunity to study business administration or engineering. This alternative to university or technical college extends over three years and ends with a state-approved academic degree (German 'Diplom').

About 600 employees at our production sites are involved in production itself. Around 300 staff work in sales and 100 in administration. Approximately 300 employees are involved in development. This means Funkwerk has slimmed significantly in »non-productive« functions compared to a few years ago. As a result, Funkwerk staff are exceptionally well trained: 45 per cent of employees are university graduates and about half are skilled workers. In order to maintain the innovative strength of Funkwerk, a quarter of all employees are involved in research and development and almost the same number again in marketing our products.

#### **DIVERSITY FOR INTERNATIONAL COMPETITIVENESS**

As a technology group operating at international level, Funkwerk increasingly employs people of different languages, nationalities, religions and ideologies. Today, we are active on all continents and therefore employ staff from many different nations with different cultural and ideological backgrounds. This diversity contributes considerably to the international competitiveness of Funkwerk. All our employees are given the same opportunities to develop their skills and talents at Funkwerk in a social environment that helps improve performance.

Equal opportunities and shared values are the basis of our corporate culture at Funkwerk. These parameters, which are binding for all our staff, apply across the borders to all parts of our group. One of the management objectives of Funkwerk is to continue developing this common basis and to create a positive and productive working environment for our employees that provides equal opportunities for all staff, without exception, for professional fulfilment and to achieve their career goals. Therefore, where appropriately qualified, all employees have equal access to management positions.

#### **PROCUREMENT AND PRODUCTION**

The raw materials and supplies needed to produce our products are procured from different sources worldwide to avoid dependencies and procurement bottlenecks. Our individual segments work closely together to ensure cost-effective purchases. Joint framework agreements are regularly concluded with our suppliers for short periods to benefit from more favourable prices. Combining our purchasing volumes in the group also enabled us in the preceding financial year to achieve cost savings. This helped us reduce our cost of materials at a disproportionate level.

Funkwerk largely produces products developed in-house. At times, particularly in the case of cost-efficient serial products, Funkwerk outsources production to partners in Asia. Where components used as mass products in Funkwerk systems cannot be developed and produced at optimal cost, these components are increasingly procured through partners, while in-house production is phased out. Specific high-quality components integrated in Funkwerk solutions (e.g. IP video cameras) are procured from third parties.

Software creation plays an ever more important role in the production of Funkwerk's complex systems. In order to standardise the production and ensure the required quality, we use professional development environments for design, encryption and testing.

Within the group, Funkwerk also exploits opportunities to coordinate and optimise capacity. Expertise is increasingly concentrated at specific locations to reduce our fixed costs still further. The production and repair service expertise of our Security Communication and Enterprise Communication segments, for instance, is now combined at Funkwerk Electronic Services (FES) GmbH at our Salzgitter site. FES is also the group's specialised production service provider specifically for handheld radio devices, but now also works successfully for other companies in the Hörmann group and for third parties.

The production site for Traffic & Control Communication is the head office of Funkwerk AG in Kölleda near Erfurt. The value added at this facility ranges from order picking and packaging in the warehouse to module production (printed circuit board assembly), equipment and system assembly and the commissioning of systems. A special service centre has been set up for the maintenance of mobile and stationary communication systems. The expertise in management and information systems is concentrated at Funkwerk Information Technologies in Kiel and Karlsfeld which also use our site in Kölleda for production.

Security Communication has its production site at Funkwerk Electronic Services GmbH in Salzgitter. This is where professional DECT, TETRA and radio paging products, as well as personal security and building management systems, are assembled. At our Fürth site, Funkwerk plettac electronic GmbH develops and assembles high-end video monitoring systems. This includes cameras, pan/tilt heads, other hardware and image analysis systems, and video management systems. To optimise the production capacities, we will outsource the production of electronics components to Salzgitter and Kölleda.

The production of equipment for Enterprise Communication is also mainly handled by Funkwerk Electronic Services GmbH in Salzgitter. Production in our Automotive Communication segment is concentrated in Dabendorf. This site now also handles the manufacture of products for our telematics and avionics sectors. Funkwerk Avionics GmbH based in Waal/Bavaria develops and assembles transponders and radio equipment along with project-specific system solutions for general aviation. Funkwerk Eurotelematik GmbH at its site in Ulm develops and configures software-intensive, complex and technologically sophisticated systems used to monitor and manage vehicle fleets.

#### **INSTALLATION UND SERVICE**

Installation of Funkwerk systems is always subcontracted to assembly firms, preferably from the region. The commissioning is handled by Funkwerk itself. This applies especially to Traffic & Control Communication and to Security Communication. The installation work involved in our other segments is minimal. In complex projects it is imperative that we supervise and guide installations through our own staff.

Due to the historical development of Funkwerk's business segments, our service business is still rather decentralised. There is rationalisation potential here through concentration of our activities and organisation as cross-divisional functions. In future, Funkwerk also increasingly intends to use remote diagnostics methods to ensure effective service provision using outside resources.

## **SALES AND MARKETING**

For reasons of customer proximity and greater flexibility in the Funkwerk group, sales and marketing are managed by the individual operating units as decentralised aspects. Traffic & Control Communication primarily sells products and solutions directly to rail transport operators and major vehicle manufacturers. Our various segments and regions employ sales staff and project managers who are responsible for the customers. The tasks involved in sales and project management overlap. Funkwerk uses partnerships with infrastructure suppliers, international trade fairs and publications in relevant magazines to aid sales. Sales and marketing at Security Communication are based on a regional sales structure and handled by account managers. To aid marketing and sales, Funkwerk uses partnerships with infrastructure suppliers and with full service providers of security and monitoring solutions. In Automotive Communication, Funkwerk as a supplier primarily supplies the automobile industry (OEM) as well as specialist dealers (in the after-sales market) through an indirect sales channel. Customers are assisted by account managers. Our Automotive Communication segment is also regularly present at the CeBIT and other trade fairs.

Funkwerk Avionics sells products directly to small and light aircraft manufacturers and through specialist dealers to end customers. Customer care is the responsibility of two sales staff. Funkwerk also handles special projects for contracting authorities and system companies involved in general aviation in Europe. Business is initiated directly by the management.

In Enterprise Communication, products and solutions are sold directly to telecommunication providers (OEM) and system suppliers and indirectly through specialist dealers. At Funkwerk, the latter includes around 4,000 partners which are supplied through distributors, but are partly supervised and supported directly by Funkwerk's own staff.

## **QUALITY MANAGEMENT**

As a technology supplier, all business processes at Funkwerk are subject to quality controls. The development, production and installation of products are constantly monitored to enable immediate detection of deviations from the norm. Each operating establishment maintains a quality management system with appropriate rules and regulations and is certified to the ISO standard. Several operating sites also hold special certification for the relevant sectors and customer target groups.

In addition, we have set up internal rules and regulations including organisational guidelines, project management guidelines, calculation guidelines, and others, which are applicable both to customer contracts and to internal development projects. This quality management helps us identify defects promptly to ensure quick remedial action. Consequently, Funkwerk systems and solutions are usually developed and produced to meet the most stringent quality standards. Our quality systems are clearly defined and documented in appropriate handbooks relating to each site, and are rigorously applied.

## **SUSTAINABILITY AND SOCIAL RESPONSIBILITY**

Sustainable economic success for the economy in general and, especially, for Funkwerk as a technology leader, is based on conservation of our natural resources and on maintaining an intact environment. Products and solutions from Funkwerk are used most significantly to increase the economic and ecological efficiency of transport companies, in terms of transport and logistics, and in the industry. Our communication, management and information systems contribute to reducing the energy consumption, emissions and the use of raw materials both in the economy and in society.

Sustainability management is equally a priority within our company, however, and goes beyond mere compliance with statutory requirements and the stipulations and regulations of environmental authorities. For us, it also includes active waste reduction and waste separation at our various sites and

extends to construction and production. Wherever possible, Funkwerk opts for recyclable, environmentally friendly and reusable materials. In addition, our internal IT technology is increasingly virtualised (Green IT) to reduce electricity costs.

A significant part of our research and development spending is used to improve the eco-balance of products and processes. All three production sites maintain their own environmental management systems, which are certified in accordance with the applicable national and European environmental standards.

At all our corporate sites, Funkwerk and its employees directly and indirectly take social and community responsibility. We directly support various initiatives and charitable organisations in the regions in which we are active. We also indirectly support our employees in their social activities. Individual measures include promotion of youth work and junior programmes in clubs relevant to society, protection of historical monuments and regional help for those in need.

#### **INVESTMENT VOLUME GEARED TO GROWTH**

In order to maintain a competitive position, Funkwerk continuously needs to invest in new technologies and product developments. Funkwerk always invests in good time to participate as promptly as possible in new market opportunities and create a good basis both for development and production. Risks are avoided in that each investment of over EUR 0.5m is structured as a separate project with its own feasibility study and continuously monitored in the various phases by our Controlling division.

In the 2010 financial year, Funkwerk maintained spending on investments for development of new products comparatively high in order to ensure growth according to plan. In contrast, capital expenditure was kept to a bare minimum.

At EUR 2.6m in 2010, spending on tangible and intangible assets (without capitalised development activities) therefore reduced to around two thirds of the prior-year level (EUR 4.1m).

At EUR 9.4m (2009: EUR 10.7m), investments in product developments, on the other hand, remained at a high level. Some EUR 2.8m of this amount were invested in Traffic & Control Communication. Here, EUR 1.4m were used for the further development of our electronic interlocking system Alister and around EUR 1.3m for the development of our integrated mobile IP train information system with energy-saving LED backlight technology.

At Security Communication, investments focused on the further development of our universal TETRA handheld device FT4 and on a personal emergency call system based on the TETRA standard, totalling around EUR 2.6m.

Automotive Communication concentrated on the creation of a generic development platform with an investment volume of EUR 2.2m. At Enterprise Communication, on the other hand, the focal point was the development of the hybrid telecommunication platform hybrid, investing a total of EUR 2.1m.

## **6. Research and development report**

Research and development are given top priority in each of our segments, as crucial factors towards ensuring a competitive position and sustainable growth. This is demonstrated by the fact that round 25 per cent of our employees were involved in research and development at the end of 2010. Rather than restricting ourselves to basic research, we concentrate on the development of products and systems that meet the needs of our customers. In view of the technological changes, Funkwerk also develops concepts and preliminary services for new market potential.

Development projects are defined, structured, and planned right from the brainstorming stage and implemented with feedback from the market and the customer. Completion of the milestones and quality standards is regularly ensured. To improve our productivity in development and to accelerate the marketability of our products, Funkwerk increasingly uses generic development platforms in its segments. We also plan to improve the exchange of information across our sectors and segments, such as in regular development manager meetings and in working groups. Furthermore, we will introduce product development competence centres, in which know-how will be consolidated beyond the individual business segments.

EXPENDITURE F & E (€ M)

2006	2007	2008	2009	2010
19.8	27.4	28.7	31.8	27.9

In 2010, spending on research and development at Funkwerk totalled EUR 27.9m, 12.3 per cent less than in the previous year (EUR 31.8m). In terms of sales, this results in a ratio of 13.2 per cent (2009: 14.6 per cent). Spending for product and concept development totalled around EUR 16m, which roughly corresponds to a rate of 8 per cent of sales.

In 2010, development in all our segments focused on the technological enhancement of our product portfolio, to round off our range of solutions while integrating the latest technologies. Across the group, key development projects involved our electronic interlocking system Alister and the new TETRA radio devices. The four business segments primarily dealt with the following development issues:

**Traffic & Control Communication**

- Development of a new generation of handheld radio devices on GSM-R basis for rail transport
- Development, completion and documentation of the electronic interlocking system Alister
- Development of an integrated mobile IP information system for trains

**Security Communication**

- Development and launch of the universal TETRA handheld radio device FT4
- Development of a personal emergency call system based on the TETRA standard
- Adaptation of the DECT product range to conventional TC systems for multicellular wireless operation

**Enterprise Communication**

- Development and launch of the hybrid IP TC system
- Development of network management systems and W-LAN controllers
- Modernisation and technological development of the product portfolio

**Automotive Communication**

- Preparation of the generic development platform
- Development of the Audio 2010 hands-free unit
- Development of the »Active Antenna« for improved broadband connection in the vehicle and of the »Home Compenser« for regions with poor reception

## 7. Risk report, risk management and report in compliance with Section 315 (2) no. 5 HGB

Although the global economy has somewhat recovered, the general political and economic risks for the markets in which Funkwerk operates have remained the same. Along with rising raw material and energy prices, it is the debt problems of many industrialised nations, the resulting currency fluctuations and the political unrest in many oil exporting states that overshadows the prospects of future economic development. Furthermore, the global economy is affected by more frequent natural disasters.

Risk management in the Funkwerk group, in the form of Controlling and Risk Management, has been improved, constructively integrating our experiences of project business in Algeria. We have initiated a new, modern and standardised ERP system for the whole of Funkwerk to ensure through a standardised database that transparency in the group significantly improves by 2012.

Over and above this, Funkwerk has comprehensively updated its accounting standards and, as a result, has created a uniform, risk-oriented accounting basis, specifically in regard to capitalising and valuing development work, inventories, projects in progress, and future commitments for guarantees and suchlike. An even more rigorous and consistent application of the existing guidelines for calculation, risk analysis and project management should enable us to control business risks better than in the past and to recognise them earlier on. To help us control product development risks better, we have introduced appropriate tools and created development platforms. We have also created and filled the management post of Chief Technology Officer (CTO).

### COMPANY-SPECIFIC AND MARKET RISKS

The market for professional communication systems relevant to Funkwerk is a comparatively young market and is subject to rapid technological change. Our business development therefore always depends on the extent to which Funkwerk is able to maintain or consolidate its market position and technology leadership while reacting flexibly to market changes. In order to reduce the development-related risk, it is crucial that new products are developed using the right technology and launched at just the right time. The requirements and changes in the market therefore need to be constantly monitored. The pressure to be innovative makes it necessary for us to continuously modernise and upgrade our product range.

This requires that we recognise and implement new technological trends in good time. We particularly face the risk that competitors launch improved or innovative products earlier or cheaper than Funkwerk. And we cannot always guarantee that improved or new products are accepted accordingly by the market.

If Funkwerk fails in the future to recognise and implement new customer requirements or technological advances and to further develop its own products in compliance with appropriate business standards, or does so too late, this can have a detrimental effect on the net asset, financial and earnings position of Funkwerk.

Due to its operations, Funkwerk is also subject to cyclical swings in economic activity in the electronics industry, specifically the dynamic product life cycles of electronic components. Suppliers, for instance, replace components and assemblies with new ones within short lead times, so Funkwerk is continuously forced to adapt its products to new components and assemblies. This goes hand in hand with the risk that Funkwerk could not be able to provide the development resources required for adaptation of its products.

Since Funkwerk needs to guarantee a spare part stock for over 10 years due to warranties agreed with customers particularly in Traffic & Control Communication and in Security Communication, we have a significant stock on hand. This may lead to impairments of inventories over and above the regular depreciation.

Due to the highly dynamic behaviour of technology, the scalability of serial production and the innovative and competitive pressures, the market for communication technology relevant to Funkwerk is defined by price deterioration. Especially in periods of economic crisis, competitors increasingly try to gain market shares through rock-bottom prices. Even with a technology lead, the risk remains that competitor products prevail on the market because of their low prices. These can have a detrimental effect on the net asset, financial and earnings position of Funkwerk.

To manufacture our products, Funkwerk needs a variety of components and assemblies that are purchased from a limited number of suppliers. Some components, especially electronic, are specially produced for Funkwerk. Should the supplier of such components no longer supply Funkwerk, we may not be able to change to components of other suppliers. This could result in a production stop at Funkwerk. The recent disastrous events in Japan raise the risk of component shortages, which cannot at present be quantified but may have a detrimental effect on the net asset, financial and earnings position of Funkwerk.

#### **DEPENDENCE ON POLITICAL DECISIONS AND CONTRACTING PRACTICES**

In international business, Funkwerk is exposed both to the economic developments at global level and to the specific political and economic circumstances in each country. In 2010 this was obvious in our Algerian business. Major projects abroad always pose a potential risk for business development at Funkwerk if the particular country falls into a political crisis.

A large fraction of business at Funkwerk depends to quite a degree on political decisions based on which funds are made available to the contracting authorities and customers of Funkwerk. Our Traffic & Control Communication and Security Communication segments, in particular, depend on investments in the public sector in railway equipment, personal security, property protection systems, motorways and infrastructure measures. Delays or cancellations of investment projects and subsidies, particularly against the background of the budget consolidation pressure currently experienced in many European states and declining tax income, may have a detrimental effect on public contracting and, as a result, on the business development at Funkwerk.

#### **DEPENDENCE ON EMPLOYEES AND PROJECT MANAGEMENT**

The future success of Funkwerk depends quite considerably on the further involvement and performance of its executives, managerial staff and employees in other key positions, specifically in research and development. The development of Funkwerk's products particularly requires qualified personnel, especially to ensure satisfactory quality, continuous product innovations and further developments. If Funkwerk fails in the future to find appropriately qualified personnel, the strategic and economic targets of Funkwerk may be in jeopardy, with detrimental effect on the net asset, financial and earnings position of Funkwerk.

Funkwerk is involved in project business. When project contracts are placed, both the customer and Funkwerk may act on the basis of different premises and requirements, which may jeopardise the implementation of the project. Since Funkwerk is paid in project business after completion of specific performance stages, the termination of a project may mean that preparatory efforts or expenses and costs incurred are not fully compensated. Furthermore, the risk assessment carried out prior to submitting offers for projects may be incorrect or incomplete for a specific project so that the agreed payment bears no relation to the expenses actually incurred by Funkwerk.

Funkwerk always assesses the risks involved in a project prior to submitting an offer to the customer. The implementation of the project is continuously monitored to allow us, where necessary, to react early in case of budget variances. For each central project, Funkwerk implements a project plan with constant progress monitoring. This controlling system enables us to identify deviations from the

specified time and cost and from reaching specific milestones and, in case of deviations from the target, initiate appropriate countermeasures in good time. Calculations, the order situation, and the project progress are constantly monitored for a target-performance analysis.

If they materialise, the risks related to project business may have a significantly detrimental effect on the net asset, financial and earnings position of Funkwerk.

#### **UNCERTAIN PARAMETERS AND DEPENDENCE ON INTERNATIONAL MARKETS**

Due to the uncertain general economic setting, it is difficult to predict the business trend and recognise risks which may impact our operations. If Funkwerk as a group fails to react efficiently and appropriately to changes resulting from a persistently difficult macroeconomic environment, this could have further significantly detrimental effects on the operations and the net asset, financial and earnings position of Funkwerk.

The focal point of Funkwerk to date has been on Germany and other European countries. In Traffic & Control Communication and Security Communication, in particular, Funkwerk plans to concentrate more intensely on internationalising operations into non-European countries. The further internationalisation of operations at Funkwerk, however, poses risks. These primarily include risks arising from the general economic, legal and tax parameters existing in the various countries, exchange risks, and the necessity to comply with current technical standards. If Funkwerk is unable to control these risks, this may have a significantly detrimental effect on our net asset, financial and earnings position.

A further uncertain factor is the question as to whether the substantial pickup in economic activity in Asia, Russia and Latin America will last. A slump in demand from these markets may not be compensated by rising demand in other markets and therefore have a detrimental effect on the sale of Funkwerk products.

The vast majority of sales at Funkwerk are generated in Euros, and in a number of other currencies. Components and assemblies, on the other hand, are purchased largely in foreign currencies, most often in US dollars. Therefore, we face a not inconsiderable exchange risk which may affect sales, the purchase prices, the valuation of receivables, currency reserves, liabilities, and with it, the results of Funkwerk. The use of exchange rate hedging at Funkwerk may not be enough to compensate all exchange rate fluctuations between other currencies and the Euro, which could have a significantly detrimental effect on our net asset, financial and earnings position.

#### **DEPENDENCE ON CUSTOMERS AND CERTIFICATIONS**

Funkwerk has customers which each generate business of up to 10 per cent, and in one case slightly over 10 per cent, of total sales. The pro-rated sales volume produced by these customers, compared to sales generated in the relevant segment, is considerably higher in some cases involving key accounts.

If several key accounts cease purchasing products in the same quantities from Funkwerk, it may have a significant detrimental effect on the net asset, financial and earnings position of Funkwerk.

The business success of Funkwerk also depends on such factors as obtaining sector-specific licences and certification, and complying with prescribed standards and technical regulations which govern the introduction of new products and technologies.

If Funkwerk is unable to develop products which comply with prescribed standards and technical regulations, or fails to obtain the approval required to market and sell its products in a specific country, this could impact business at Funkwerk.

### **COMPLIANCE AND ACQUISITION RISKS**

In view of the complexity of our business and the geographical location of Funkwerk, violations of the law and criminal acts on the part of our employees may not necessarily be discovered and prevented in time.

If employees or third parties acting for Funkwerk leverage or provide unfair advantages in connection with business initiations, or use any other illegal business practices, we may face legal sanctions such as fines, exclusion from tenders and loss of contracts, and also considerable damage to the reputation of Funkwerk. Funkwerk cannot guarantee that its existing and future risk management and control procedures are appropriate to cover every conceivable legal requirement in every country and are fully observed by all employees and other parties acting for Funkwerk, which could have a detrimental effect on the net asset, financial and earnings position of Funkwerk.

Funkwerk does not rule out a further acquisition of companies or divisions to round off its technology base and increase market shares. Strategic additions are conceivable particularly in our Traffic & Control Communication and Security Communication segments.

### **INFRINGEMENT OF PROPERTY RIGHTS AND PATENT VIOLATIONS**

To date, Funkwerk has registered, or applied for registration of, a large number of patents and other industrial property rights for its products in various countries. Funkwerk cannot guarantee that patents based on pending or future patent applications are granted or that Funkwerk will always be able to protect current and future developments, applications and computer programs by patent. Even if patents have been, or are, granted, it is not certain that the scope of current or future patents is sufficient to provide protection vis-à-vis third parties that is economically significant or guarantees Funkwerk potential competitive advantages.

The success of Funkwerk in developing and marketing its products depends quite considerably on such aspects as ensuring that third-party property rights are not violated. It cannot be ruled out that current or future new and further developments of Funkwerk will violate third-party property rights and that third parties, as a consequence, will assert claims against Funkwerk because of a violation and may therefore be entitled to damages or payment of royalties from Funkwerk.

Products of Funkwerk may be flawed. These flaws may be the responsibility of Funkwerk or of its suppliers and result in warranty or liability claims from customers or third parties, or adversely affect the products' acceptance in the market and, as a result, lead to a drop in sales. The fact that no significant claims have to date been asserted against Funkwerk does not mean that Funkwerk will not be subject in the future to considerable warranty and liability claims, or to demands of payment of contractual penalties on the part of customers or sales partners. Claims of this nature may have a significantly detrimental effect on the net asset, financial and earnings position of Funkwerk. There is also the risk that if a liability case becomes public, there will be damage to the reputation of our products and the destroying of the trust we enjoy with our customers, so adversely affecting acceptance of our products.

### **RISKS FROM LEGAL DISPUTES**

Companies in the Funkwerk group are defendants in various legal and out-of-court disputes, sometimes with considerable amounts involved. The outcome of these proceedings is uncertain and there is a risk that we may lose a case or aspects of it. Where claims are likely, appropriate provisions have been set up to cover any eventualities.

**RISKS FROM OUR ALGERIA BUSINESS**

Funkwerk plettac electronic GmbH, a subsidiary of Funkwerk AG, is involved in a joint venture under Algerian law. By order of the largest state-owned enterprise in Algeria, this joint venture has been commissioned in several property protection projects to secure important oil and gas plants and their residential bases. It involves the installation of video monitoring and access systems. Two of the three projects were completed, accepted and paid: this also applies particularly to the appropriate subcontracts for Funkwerk plettac electronic GmbH. Due to the aggravated political instability in North Africa, Algeria is also experiencing political upheaval. This, among other things, has led to a change in management at the aforementioned state-owned company, which is the client of the Algerian joint venture. As a result, the completion of business was discontinued for the time being in 2010. In the course of the political developments described above, a preliminary investigation was opened against a number of companies and individuals suspected of corruption and illegal price increases. Affected parties include the joint venture, the Algerian partner and, along with other foreign companies, also Funkwerk plettac electronic GmbH, but not its management or other employees in the Funkwerk group or individuals locally involved. In the course of these investigations, the accounts of the joint venture were frozen with the result that funds totalling around EUR 4m, which had been duly paid after completion of work performed and which are due exclusively to Funkwerk plettac electronic GmbH, cannot currently be transferred to Germany and therefore will not be freely available to the Funkwerk group in the foreseeable future. The interruption of the third project also currently hinders the export of valuable project inventories to Algeria and the billing of work of about EUR 8m performed by Funkwerk plettac electronic GmbH.

Funkwerk was granted bank guarantees totalling EUR 17 related to these projects. These bank guarantees were issued by Algerian banks based on appropriate counter-guarantee agreements with a number of German banks. Some EUR 3.3m of these bank guarantees were returned in early 2011. Based on the contracts with the client, around a further EUR 10m of the remaining EUR 13.7m approx. in bank guarantees should no longer be at risk of claims against Funkwerk due to fulfilment of the underlying supply and performance obligations and expiry of the contractual warranty periods, and due to failure to observe the time limit of the guarantees. There is, however, a remaining risk involving the bank guarantees not yet returned, in so far as the German banks have issued »real« counter-guarantees on first request to the Algerian banks.

If the account blocking and stoppage of the project continues or, even worse, if an action is brought against the Algerian joint venture or Funkwerk plettac electronic GmbH, this could have a significantly detrimental effect on the net asset, financial and earnings position of Funkwerk. As these risks relate to a implementation of the project and settlement of accounts in the future, Funkwerk included risk-oriented impairments of around EUR 9.1m, based on the principle of caution in the annual financial statements as at 31 December 2010 affecting the inventories, the accounts receivable and the other assets including cash in banks and the other expenses for risk management.

**RISKS RELATED TO THE REPAYMENT OF GRANTS AND TO TAX AUDITS**

Funkwerk was and is granted or promised government investment subsidies for several development projects and business measures. Use of these funds is generally earmarked and subject to appropriate terms and conditions. If Funkwerk is unable to ensure and demonstrate earmarked use of these funds in compliance with these terms and conditions, we may have to repay these investment subsidies.

In the 2009 financial year, Funkwerk was subjected to a tax audit. The audit covered the assessment periods from 2001 to 2005 for corporate, trade and value added tax. The effects of this audit were accounted for in the annual financial statements as at 31 December 2009. With respect to periods and taxes not included, Funkwerk believes that the tax returns prepared are complete and correct. Nonetheless, there is a risk of additional retrospective tax demands due to different views of facts, particularly with respect to debt claims of EUR 14.7m and EUR 12.0m of Vossloh AG, the former share-

holder and seller, which Vossloh AG waived in the preliminary stages of our sale of Funkwerk Information Technologies GmbH, Kiel, and Funkwerk Information Technologies Karlsfeld GmbH, Karlsfeld. We believe these debt claims are recoverable. There is, however, a tax risk regarding assessment of the value of these claims by the tax authorities, which may result in a subsequent taxes of up to EUR 4.6m plus supplementary interest payments from the assessment year 2007. Tax back-payments could have a significantly detrimental effect on the net asset, financial and earnings position of Funkwerk.

#### **REPORT ACCORDING TO SECTION 315 (2) NO. 5 HGB (GERMAN COMMERCIAL CODE)**

##### **Risk management and control instruments**

Funkwerk uses its own risk management system, set up to allow for the size of the company. Along with early risk detection, it also helps identify and use opportunities. The system is mandatory for all companies in the group and includes all its activities. A systematic and permanent review of projects and the current business situation ensures a high level of transparency and facilitates the prompt implementation of measures. The risk management system (RMS) is intrinsically tied to the internal control system (ICS). Based on guidelines, checklists and regular reports, both form the framework for identification, analysis, assessment, control, documentation and communication of risks and opportunities and for monitoring these activities.

It has become evident, however, that even appropriate and functioning systems are not an absolute guarantee that risks are identified and controlled. This is why our risk management system and the internal control system including reporting to Executive Board and Supervisory Board are constantly improved.

##### **Objectives**

Acting in combination, the RMS and the ICS must be able to identify and assess any risks to the company. The primary aim of risk management is not to prevent any and all potential risks. Rather, it is designed to provide scope of action, so the company can take chances in full awareness of these risks knowing their implications. Handling these risks in such controlled manner should help us use existing opportunities and increase the value of our company.

##### **Organisational structure**

###### **Risk management**

The risk management system (RMS) of Funkwerk AG is stipulated centrally and comprises guidelines and working documents including checklists. These are designed to standardise processes and ensure a systematic and continuous review of operational and non-operational risks, but also to define opportunities. Along with risk management and new compliance guidelines, other guidelines are directed at accounting, project management and costing to ensure a comprehensible and uniform approach in 2011.

The RMS is implemented autonomously by the management of each company in the group and, where so required, extended to include specific issues relating to the company. The reporting forms the framework linking the RMS and ICS. While it is stipulated centrally, it is also complemented by company-specific reports for the purpose of managing operations. In terms of reporting, the ICS is thus largely specified centrally, but – complemented by company-specific regulations – is also defined and implemented directly by the companies. The synergy of the two systems effectively working together is ensured through a continuous review, analysis and discussion of the current business figures and projects. Both the Executive Board and Investment Controlling are intensively involved at a higher level in discussions and analyses.

Each company evaluates its projects using a risk checklist which allows a systematic identification and assessment of risks. The focus here is both on quantitative and qualitative criteria. Where defined

risk thresholds are exceeded, Investment Controlling is notified. The latter then prepares the data for the Executive Board and ensures prompt assessment, discussion, where necessary a definition of measures and, finally, agreement with the Executive Board.

The progress of these projects and the general trend of business including risks – in any area, whether or not related to operations – are discussed in detail at least once a month and appropriate measures are deliberated and initiated. In addition to these monthly meetings, an overall risk inventory is carried out at least once a year as part of the planning. The risk checklist used as the basis for this inventory is specified centrally, but complemented by company-specific issues and reviewed annually. Investment Controlling analyses the data at group level and considers a repackaging of risks. Based on this analysis, the Executive Board assesses the current risk situation and agrees appropriate measures with the Supervisory Board in important cases.

#### Internal control system in the financial reporting process

As part of the process of preparation of the (consolidated) financial statements, the risks identified relate both to the financial statements as such and to the illustration of individual types of transactions and individual account balances and statement details. Specific risks for Funkwerk AG may result from such events as the conclusion of unusual or complex transactions, specifically towards the end of a financial year due to time sensitivity. Furthermore, transactions which are not routinely processed involve a latent risk. Accounting risks related to derivative financial instruments are explained in the notes to the consolidated financial statements.

Accounting transactions are currently still recorded in the individual accounts of the subsidiaries and group companies of Funkwerk AG using various accounting systems. All subsidiaries have been issued annually revised group accounting guidelines with explanatory notes to ensure uniform group accounting. For the preparation of the consolidated financial statements of Funkwerk AG, the subsidiaries and group companies provide their individual accounts along with further information in standardised reporting packages. These reports are further processed by the group accounting department of Funkwerk AG using new consolidation software. The consolidation processes for preparation of the consolidated financial statements of Funkwerk AG, such as the consolidation of capital, assets and liabilities, or revenue and expenditure including equity valuation, are carried out by means of automated consolidation assistants and via manual adjustments.

#### Measures to ensure effectiveness of the RMS/ICS

The measures of the internal control system are designed to ensure compliance and reliability. They provide certainty that all transactions are recorded in full and promptly in compliance with the legal and statutory requirements. They also ensure that inventories are carried out properly and that assets and liabilities are recognised, valued and reported accurately in the consolidated financial statement. These control activities also make certain that the accounting documents provide reliable and comprehensible information. To ensure correct preparation of the tax balance sheets, each company uses the services of a national tax consulting firm.

Regular discussions and follow-up in monthly meetings, complemented by individual reviews, provide assurance that the measures taken are, and remain, effective. At the same time, this platform is used to make changes to existing systems and thus is a starting point for a continuous improvement process.

Furthermore, the information provided is analysed on the basis of key figures. This allows us to identify weak points. Investment Controlling is also responsible for verifying efficiency through spot checks and, where necessary, making appropriate changes. The implementation of the risk management system is verified by our auditors as part of their annual audit. Regular reporting to the Supervisory Board on opportunities and risks will be intensified.

## 8. Corporate Governance Report

The Corporate Governance Report is fully disclosed on our website at [www.funkwerk.com](http://www.funkwerk.com).

## 9. Remuneration report

The following remuneration report describes the remuneration system for the Executive Board and the Supervisory Board.

For years now, one of the key aspects of good corporate governance for us has been to explain the remuneration system in comprehensible and transparent form. Based on the German Act on the Appropriateness of Executive Board Remuneration (VorstAG) and the specifications of the Corporate Governance Code, the Supervisory Board is required when determining the total emoluments of each member of the Executive Board to ensure that it is in appropriate proportion to the responsibilities and work performed by the members of the Executive Board and to the situation of the company and that it does not exceed the usual remuneration without good reason. The Supervisory Board determines the remuneration structure and the key elements of the contracts for the members of the Executive Board and regularly verifies the adequacy of these contracts.

### REMUNERATION SYSTEM FOR THE EXECUTIVE BOARD

The remuneration of members of the Executive Board comprises a non-performance-related component and a performance-related component. The amount and structure of the remuneration are determined by the Supervisory Board of Funkwerk AG. In addition, each Board member receives fringe benefits and a pension commitment. In fiscal 2010, the remuneration of the Executive Board was reviewed by the Supervisory Board.

The remuneration system for the Executive Board of Funkwerk AG specifies as follows:

The fixed-term employment contracts concluded with the members of the Executive Board provide for a target income for each year of service which is composed of a fixed and a variable component. The fixed component is composed of a fixed basic salary plus fringe benefits which include the use of a company car and insurance premiums. The members of the Executive Board are entitled to a pension insurance which is concluded individually for each member. The variable, or performance-based, component depends on the performance of the company. The bases of assessment of the company's performance and thus of the variable component under the employment contracts effective in 2010 are earnings before interest and taxes (EBIT) and the cash flow. Where members of the Executive Board take or vacate their seat during the financial year, this component is granted on a prorated basis.

The employment contracts effective in 2010 for the Chairman of the Executive Board, Dr Hans Grundner, and the CFO, Mr Johann Schmid-Davis, provide for an unlimited target achievement bonus as part of the variable component where the EBIT counts for 2/3 and the cash flow for 1/3. The variable component of the contract concluded with Mr Carsten Ahrens in 2010, on the other hand, is based on a fixed percentage of profit sharing in the EBIT and cash flow generated. The annual variable remuneration is limited to 1.25 times the basic salary, of which 20 per cent are retained to offset negative amounts which may subsequently accrue.

In addition, the Executive Board receives share options with a longer-term incentive effect. The issue of options is determined by the Supervisory Board. The terms and conditions for exercising these options are identical with those stipulated for other allottees among our employees. The share option plan is described in detail in the notes to the financial statements. In the 2010 financial year, the members of the Executive Board were each granted 6,000, thus 18,000, options at a fair value of EUR 30,240 (2009: 12,000 share options, fair value of EUR 26,280). No options were exercised in the reporting year.

In the 2010 financial year, the non-performance-based remuneration of all members of the Executive Board totalled EUR 469,7k (2009: EUR 417,7k), the total remuneration amounted to EUR 538,9k (2009: EUR 532,9k). The total remuneration includes the taxable component of private use of a company car. Pension plan payments came to EUR 39k (2009: EUR 64k). An individual account of Executive Board remuneration is found in Section I of the notes to the financial statements.

#### REMUNERATION OF THE SUPERVISORY BOARD

The remuneration of the Supervisory Board is governed by Section 12 of the Articles of Incorporation of Funkwerk AG. It is divided into a fixed and a variable component as well as a meeting attendance fee. The members of the Supervisory Board receive a fixed component of EUR 5,000 per financial year for their duties on the Supervisory Board and a performance-oriented remuneration of EUR 1,000.00 for every full 5 cents of dividend paid per share in the financial year. The members of the Supervisory Board further receive an attendance fee of EUR 1,300.00 per session. The chairman receives twice, his deputy 1.5 times, the annual pay and attendance fee.

Members of the Supervisory Board who have not served on the Board for a full financial year receive a prorata fixed and performance-related remuneration. All components of the remuneration for the preceding financial year are payable on conclusion of the annual shareholders' meeting at which the annual accounts for the preceding financial year are presented or approved and, where applicable, a resolution on the appropriation of profits is passed. Section 113 (2) AktG remains unaffected by this.

The members of the Supervisory Board are further reimbursed for their expenses and for any VAT applicable to their remuneration and expenses. In the 2010 financial year, the total remuneration amounted to EUR 56,3k (2009: EUR 45,9k). An individual account of Supervisory Board remuneration is found in Section I of the notes to the financial statements.

#### SHAREHOLDINGS OF THE EXECUTIVE BOARD AND THE SUPERVISORY BOARD

Pursuant to the Corporate Governance Code, all security transactions by individual Executive Board and Supervisory Board members and any persons closely related to these must be reported immediately. This disclosure requirement includes any acquisition or sale exceeding EUR 5,000 per calendar year. Funkwerk AG publishes any such transactions promptly. No transactions were concluded by members of the Executive Board and the Supervisory Board in fiscal 2010.

## 10. Particulars of capital stock and own shares

There were no changes to the subscribed capital (capital stock) in the reporting period. Hence, the subscribed capital of Funkwerk AG as at 31 December 2010 was divided into 8,101,241 (2009: 8,101,241) non-par-value shares with an accounting value of EUR 1 each. The main shareholder was Hörmann Funkwerk Holding GmbH with 4,280,00 shares, which corresponds to 52.83% of the capital. As at 31 December 2010, Funkwerk AG held 41,579 own shares.

Each share grants one vote in the shareholders' meeting and the right to participate in agreed dividend payouts. There are no restrictions relating to the voting rights.

Based on a decision passed at the annual shareholders' meeting on 28 May 2009, the Executive Board is authorised, with the approval of the Supervisory Board, to increase the capital stock of the company by up to EUR 4,050,000 by 27 May 2014, through a single or repeated issue of new, ordinary bearer shares in the form of non-par shares against contributions in cash and/or in kind (approved capital for 2009).

Where the shareholders are granted subscription rights, the shares may also be offered to a credit institution or a company operating in compliance with Section 53 subsection 1 sentence 1 or Section 53 b subsection 1 sentence 1 or subsection 7 of the German Banking Act (KWG), with the undertaking to

offer them to the shareholders for subscription (indirect subscription right). The Executive Board was also authorised, with the approval of the Supervisory Board, to suspend the statutory subscription rights of the shareholders

- to exclude subscription rights for fractional amounts,
- in case of capital increases against assets in kind in the form of companies, divisions, investments in companies, or receivables from the companies if the shares issued to the exclusion of subscription rights do not exceed 4,050,000 shares in total,
- in case of capital increases against cash investments if the amount for which the shares are issued is not substantially less than the market price of the shares at the time when this amount is determined by the Executive Board and the shares issued to the exclusion of the subscription rights do not exceed 810,000 shares in total.

The Executive Board was authorised by the shareholders' meeting of 27 May 2010, with the approval of the Supervisory Board, to acquire its own stock up to a share of 10% of the current capital stock by the end of 26 May 2015. Together with other own stock held by the company or attributable to it under Sections 71 a ff AktG, the shares acquired must not at any point exceed 10 % of the capital stock. The time limit only applies to the acquisition, not to ownership of the shares. The shares must be acquired at the stock exchange or through a public offer to buy or a public request for submission of such an offer.

Under Section 5 (7) - (9) of the Articles of Incorporation, the increase in conditional capital is used to issue option rights on shares. Option holders may be members of the Executive Board of the company, members of the management of affiliated companies, executives of the company and the affiliated companies, and other employees of the company and affiliated companies. The conditional increase in capital stock is effected only where option rights have been issued and are exercised by the authorised parties.

Under Section 5 (10) of the Articles of Incorporation, the increase in conditional capital (conditional capital IV) is used to issue convertible and/or warrant bonds. Conditional capital will only be increased in so far as the holders or creditors of convertible and/or warrant bonds which the Executive Board was authorised to issue based on the resolution passed at the shareholders' meeting held on 27 May 2010 exercise their conversion privilege or option on the shares of the company or meet their conversion obligations under these convertible and/or option bonds.

Sections 84, 85 and 133, 179 of the German Stock Corporation Act have been implemented in the Articles of Incorporation.

## 11. Closing statement on the dependent company report

The Executive Board of Funkwerk AG hereby declares that all legal transactions concluded with affiliated companies involved adequate compensation, and that neither party was prejudiced in any way. Reference is made to Section 312 (3) sentence 1 of the German Stock Corporation Act.

## 12. Events after the cutoff date

To ensure lasting financial stability, Funkwerk AG as the borrower and 15 of its direct and indirect subsidiaries as co-debtors, concluded a multiyear syndicated loan agreement of EUR 75.5m with three German commercial banks on 24 March 2011, subject to being granted a government indemnity bond.

The syndicated loan is made up of a revolving money market loan in the amount of EUR 17.5m and a guaranteed credit line of EUR 58m. Up to EUR 5m of the money market loan may also be utilised as credit in current account.

Funkwerk AC and its subsidiaries have provided collateral in the form of blanket assignments of trade receivables of individual subsidiaries, assignment of inventories of all companies in the Funkwerk group, and land charges on company property in Dabendorf and Kölleda. The loan has a term of three years with a renewal option of a further two years.

As further collateral for the syndicated loan agreement, Funkwerk is to receive an 80 per cent indemnity bond for EUR 9.0 m of cash credit and a 60 per cent indemnity bond for EUR 10.6 m of guaranteed credit for a term of five years from the Federal Government/Laender programme »Germany funds«, which is a key condition for being granted part of the loan.

In a contract dated 15 February 2011, Funkwerk Enterprise Communications GmbH sold all 49 per cent of its shares in VTech Funkwerk IAD GmbH, Kiel, at a purchase price of EUR 1 with economic effect from the end of 31 December 2010.

No other events of special significance which are not described in the management report have to date occurred since the conclusion of the financial year.

### 13. Forecast report: Opportunities and prospects

All four business segments of Funkwerk operate in growth markets which are characterised by great vitality. This results in a wide variety of opportunities and worthwhile development possibilities with appropriate risks. The fields of infrastructure, transport and security, in particular, offer attractive potential for the future. The government is contemplating additional investment programmes in these sectors, which could stretch the size of the addressable market for Funkwerk many times over. Irrespective of this, the market for information and communication technology is gaining in importance and opens up good prospects for our company, as Funkwerk is a key manufacturer here in the Europe market.

Germany especially faces a considerable backlog of public investments. This applies particularly to the transport infrastructure, where for years the investments have lagged behind the demand. In connection with the EU agreed provision of an interoperable operations control system for Europe's rail transport infrastructure and in interlocking technology, further multi-billion investments are needed in which Funkwerk can be involved. In terms of electronic interlocking systems, we can also see a new market open up for cost-effective systems which can be used particularly for efficient automation of branch lines. Before long, Funkwerk expects to gain a significant share in the German market here with our proprietary system Alister.

Further market opportunities for our TCC segment may open up, especially in Eastern Europe where there is planned renewal of infrastructure facilities. This also applies to Asian countries, such as India and Russia, and to North African and Arab states which plan to introduce digital train radio systems as a standard over the next few years. Further market opportunities will come from Great Britain where the 2012 Olympic Games will be held and, as a result of which, the entire transport infrastructure is currently being modernised.

The increasing need for safety and security of individuals and companies, due to the rise in threats, also ensures that the overall market for personal, building and object protection systems will grow over the coming years. Funkwerk satisfies this demand in its Security Communication segment by providing video monitoring and personal security components, as well as complete system solutions. In Germany, Funkwerk has already established itself as a leading supplier of personal security and professional video monitoring systems and is increasingly building on its good reputation at a global level. This provides us with above-average growth prospects. In addition, Funkwerk seeks partnerships with international infrastructure and system suppliers which would considerably increase our sales potential on successful conclusion.

Argoscan, the unique video-based control system developed by Funkwerk for hard shoulder release on motorways, could also very quickly turn into a »star product« if appropriate investments are subsidised by the government. We also see additional potential here through new applications, such as the equipment of road and rail tunnels, car parks and motorway stations.

In our Automotive Communication segment, the sale of Funkwerk products could be boosted by fast market penetration of »infotainment« offers and service solutions. Along with mobile radio signal amplifiers, Funkwerk supplies communication systems here with appropriate interfaces linking them with the vehicle and the outside. We also expect assistance systems to play a greater role in automobile transport in the future. The quicker these systems are used by the automobile industry, the sooner Funkwerk will benefit from it.

Business data and communication networks continue to undergo a rapid technological development, with the convergence of different services in a standardised network being the driving factor. These intelligent networks are a key milestone on the way to a unitary voice, data and multimedia network, known as the next generation network (NGN). On the other hand, the complexity of the systems is increasing, requiring appropriate tools for configuration, administration and protection of the networks. As a specialist in integrated communication solutions, Funkwerk serves this growing but highly competitive market through our Enterprise Communication segment.

A key factor in the future growth of EC could be the trend towards »cloud computing«. An increasing number of telecommunication and business application services are virtualised and made available to users via central platforms. Appropriate access systems and solutions to secure applications, data and voice transmissions, as already supplied and developed by Funkwerk, are more and more needed.

Funkwerk therefore has excellent potential to achieve above-average growth in all its business segments. Funkwerk plans to use these growth opportunities through appropriate acquisitions to further develop and extend our market and complement our technologies. Funkwerk also plans to exercise other strategic options to focus on promising operations.

## **PROSPECTS**

After the surprisingly quick and strong recovery of the global economy, business experts at the OECD and IMF predict a slight decline in growth dynamics for the current financial year. The gross domestic product in Germany, which is the main market for Funkwerk with a sales share of 60 per cent, is not expected to grow by more than 2.2 per cent. The other EU states, in which Funkwerk sells some 30 per cent of its products, should even grow somewhat more slowly. Capital investments in the BRIC states should once again grow considerably more. These markets, therefore, are the focal point of further internationalisation at Funkwerk.

In 2011, the balancing act between necessary investments in systems and infrastructure on the one hand, and the necessity of consolidating budgets on the other, will continue to have a determining influence on the markets for communication and information systems, in which Funkwerk is mainly active. The current backlog of investment projects should be cleared in the medium term, as it will otherwise jeopardise the efficiency of infrastructures (energy, transport, supply).

On the whole, the European Information Technology Observatory (EITO) expects the global markets for IT and telecommunication, in which Funkwerk generates the lion's share of its sales, to grow by some 5 per cent in 2011. The growth rates for the BRIC states alone are estimated to range between 7 and 26 per cent, whereas spending in the EU is believed range at EUR 715m, up by around 1.5 per cent on the previous year.

Against this background, Funkwerk will focus primarily on the transport and security growth markets. The launch of new products and solutions prepared in 2010 and fully taking effect in 2011, and specific internationalisation, give rise to hopes of organic growth in these segments. Appropriate strategic acquisitions to complement our technological portfolio and extend or develop international markets could further accelerate our growth.

For Traffic & Control Communication, we expect the demand for communication technology in the railway sector to increase in 2011, as the global economy will continue to pick up, rail transport will be advanced to save resources, and infrastructure is due for development in the BRIC states and in other threshold countries. In Central Europe, which is the key target market for Funkwerk, railway companies are facing the challenge of increasing of rail transport capacities with new, intelligent infrastructures, while at the same time making them more economical, customer friendly and environmentally friendly. This is possible only through use of cutting-edge communication, management and information system such as provided by Funkwerk as a leading supplier in this business. The cost savings achieved and new sales potential opened up for TCC should be reflected in a sustainable, positive business trend with moderate growth in 2011. The growth dynamics in this segment are expected to increase in 2012 and 2013.

Our Security Communication segment is expected to grow more significantly in the medium term, in line with the growing demand for intelligent solutions for the protection of people, buildings, public places and objects. Authorities and organisations with security functions, such as police and fire brigades, operators of industrial sites and the raw material industry, will in particular increasingly need to invest in security systems. Funkwerk has many years of experience and expertise in personal emergency call systems and video monitoring and is considered a leading specialist in this area on the global market. Funkwerk will in future increasingly specialise in energy, industry, local and long-distance transport, and supply and expand business at international level through cooperation with infrastructure suppliers to increase sales as early as from 2011. This trend should continue even more strongly 2012, so that this segment, too, should see lasting improvement in its earning position. Growth here is expected to range above the average in the medium term.

The growth trend in Automotive Communication should continue in 2011 and over the next few years, as electronics and communication systems are central for the use of all new functions (Internet, telematics, infotainment) in vehicles. The increasingly popular, safe use of »apps« on mobile phones while driving requires communication equipment such as that already supplied by Funkwerk. The product innovations and market extensions initiated should enable us to close the existing product gap quickly. Based on the offers submitted and serious business initiations, we expect to see considerable growth here.

In Enterprise Communication, Funkwerk anticipated the technology change towards IP-based communication solutions and successfully launched its new »hybird« IPTC system as a central business communication unit. This gives rise to hopes of a surge in demand, especially in 2011. Management systems for network administration are crucial for further growth in the area of solutions. Appropriate solutions to secure applications, data and voice transmissions, as increasingly required for »cloud computing«, are key market drivers. Through cooperation with partners and additional sales channels for products in the OEM sector, Funkwerk expects EC overall to be profitable again in 2011 and continue this trend in 2012 and 2013.

The Executive Board believes that the various internal restructuring measures have significantly improved our position in the current financial year. Together with the investments made in new products and solutions, our strategic focusing and further efforts made to improve our structure, Funkwerk should effectively generate profit again in 2011. Therefore, Funkwerk will continue in all its segments to optimise the processes, consolidate sales and service structures, and develop our technology platforms to further increase our profitability.

The rising trend in contracting which was evident towards the end of the reporting period should continue to increase in 2011. Based on our current group structure, this gives rise to hopes of a profitable increase in sales of around 8 per cent and positive earnings before interest and taxes. Growth in 2012 and 2013 should be stronger still, with the result that we will see a significant increase in earnings. In 2011, the financial position in the group should be favourable compared with 2010, so that preliminary project financing throughout the year and the resulting increase in working capital should result in a utilisation of available bank loan facilities early in the fourth quarter of 2011, which should be balanced again through project completions by the end of 2011. We anticipate a balanced liquidity situation at 31 December 2011.

The Executive Board believes that effective focal points of our expertise will in future include such technologies as radio communication, data transmission and data processing. An additional OEM market should open up for Funkwerk through further increases in the value added of special technologies. This applies particularly to such technologies as DECT, TETRA, DMR and key video components. Based on this, Funkwerk will, in the long run, become one of the top five companies for communication, information and security solutions, with higher added value in key components for infrastructures in Europe, and an indispensable supplier for vehicle manufacturers and infrastructure suppliers.

Kölleda, March 2011

— The Executive Board —



Dr. Hans Grundner



Johann Schmid-Davis



Carsten Ahrens

### Responsibility statement by the legal representatives

To the best of our knowledge and in accordance with the applicable reporting principles for financial reporting, the consolidated financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss of the group, and the group management report includes a fair review of the development and performance of the business and the position of the group, together with a description of the principal opportunities and risks associated with the expected development of the group.

Kölleda, March 2011

— The Executive Board —



Dr. Hans Grundner



Johann Schmid-Davis



Carsten Ahrens



$$X_n = \frac{1}{N} \sum_{k=0}^{N-1} \hat{x}_k e^{i2\pi \frac{kn}{N}}$$

*»Fourier transformation is used to transform signals between the time domain and frequency domain, in order to analyse their characteristics. The findings help optimise the transmission signals – a basis for high quality and optimal performance.«*

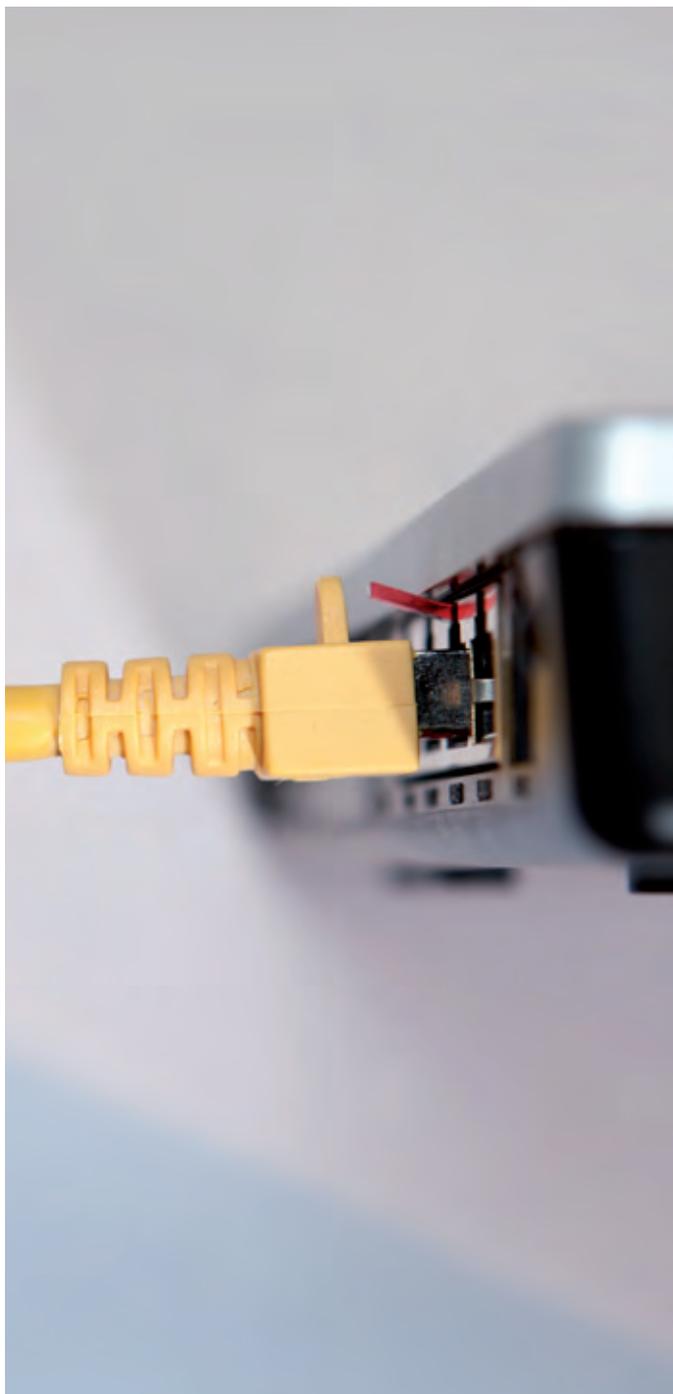
**CLEMENS CONRAD, SYSTEM ANALYST,  
FUNKWERK ENTERPRISE COMMUNICATIONS GMBH**



## Our know-how in Enterprise Communication

Digital communication technology is progressing with incredible speed. New high-speed technologies increase the spectrum for intelligent networks and allow customised features, which enable a wealth of new solutions for communication within and across companies. Yet as the complexity of these systems increases, they require the right tools to configure, administer and protect the networks. As a specialist in integrated communication solutions, Funkwerk satisfies this increasing demand through its Enterprise Communication segment.

Funkwerk has come to the rescue with its latest communication solution: elmeg hybrid. It not only provides the wide range of performance features you need in a modern



business telephone system, but also integrates existing terminals in an overall voice-over-IP system. It means you can use existing resources while you expand, and increase as you wish in the future. It provides a variety of scenarios, such as the connection of mobile staff and external sites, and even customer integration.

Security is increasing in importance both for data networks and access solutions. As a result, Funkwerk has developed Unified Threat Management (UTM) systems which combine all relevant security systems and much more on a single platform. Instead of a variety of products from different manufacturers, users only need a single device from Funkwerk for secure data and information exchange.

Top performance with maximum security were »must-haves« when Funkwerk developed its integrated ITC solutions. So Funkwerk's developments point towards a unitary voice, data and multimedia network known as the next generation network (NGN).

# FINANCIAL STATEMENTS

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- 072 Consolidated Statement of Financial Position according to IFRS
- 074 Statement of Comprehensive Income according to IFRS
- 075 Consolidated Statement of Cash flows according to IFRS
- 076 Consolidated Statement of Changes in Equity according to IFRS

# CONSOLIDATED STATEMENT OF FINANCIAL POSITION

ACC. TO IFRS AS AT 31 DECEMBER 2010

ASSETS		31.12.2010	31.12.2009
	NOTES	EUR K	EUR K
<b>A. Long-Term Assets</b>			
1. Intangible assets	E. (1)	35,658	32,887
2. Tangible assets	E. (1)	14,224	16,804
3. Financial assets reported using the equity method	E. (1)	0	1,530
4. Other assets	E. (1)	43	67
5. Deferred taxes	E. (2)	0	2,303
		<b>49,925</b>	<b>53,591</b>
<b>B. Short-Term Asset</b>			
1. Inventories	E. (3)	43,560	42,568
2. Trade accounts receivable	E. (4)	27,629	25,282
3. Receivables from projects in progress	E. (5)	8,017	15,206
4. Due from affiliated companies	E. (6)	206	682
5. Tax refund claims*	E. (7)	1,304	2,539
6. Other assets*	E. (8)	3,026	4,813
7. Financial assets	E. (9)	3,969	950
8. Liquid assets	E. (9)	12,056	22,141
9. Long-term assets available for sale	E. (10)	0	76
		<b>99,767</b>	<b>114,257</b>
		<b>149,692</b>	<b>167,848</b>

\* prior-year figure adjusted.

LIABILITIES		31.12.2010	31.12.2009
	NOTES	EUR K	EUR K
<b>A. Liabilities</b>	E. (11)		
1. Subscribed capital		8,101	8,101
2. Capital reserve		63,422	63,270
3. Retained earnings (revenue reserve)		38,211	38,211
4. Own shares		-1,062	-1,062
5. Net loss for the year		-43,976	-19,096
6. Foreign currency items		-237	-323
Equity of Funkwerk AG shareholders		<b>64,459</b>	<b>89,101</b>
7. Non-controlling interest		0	14
		<b>64,459</b>	<b>89,115</b>
<b>B. Long-Term Liabilities</b>			
1. Pension obligations	E. (12)	12,525	13,021
2. Deferred investment subsidies	E. (13)	874	748
3. Deferred taxes	E. (14)	1,071	0
4. Financial liabilities	E. (15)	12	23
		<b>14,482</b>	<b>13,792</b>
<b>C. Short-Term Liabilities</b>			
1. Financial liabilities	E. (15)	422	2,264
2. Trade accounts payable	E. (16)	29,368	23,263
3. Advance payments received on orders	E. (17)	8,735	7,349
4. Due to affiliated companies	E. (18)	56	58
5. Tax liabilities	E. (19)	3,867	2,852
6. Accrued liabilities	E. (20)	14,323	11,289
7. Deferred investment subsidies	E. (13)	138	403
8. Other liabilities	E. (21)	13,842	17,463
		<b>70,751</b>	<b>64,941</b>
		<b>149,692</b>	<b>167,848</b>

# STATEMENT OF COMPREHENSIVE INCOME

ACC. TO IFRS

FOR THE FINANCIAL YEAR FROM 1 JANUARY TO 31 DECEMBER 2010		2010	2009
	NOTES	EUR K	EUR K
<b>1. Sales revenues</b>	F. (22)	<b>210,968</b>	<b>218,440</b>
2. Increase in finished goods inventories and work in progress		390	2,218
3. Other own work capitalised		9,439	10,650
4. Other operating income	F. (25)	8,019	12,488
<b>5. Total operating performance</b>		<b>228,816</b>	<b>243,796</b>
6. Cost of materials	F. (23)	107,093	114,447
7. Personnel expenses	F. (24)	81,178	92,214
8. Planned depreciation		8,518	11,447
9. Other operating expenses*	F. (26)	31,395	39,805
<b>10. Operating result before impairment charges and restructuring costs*</b>		<b>632</b>	<b>- 14,117</b>
11. Depreciation and other expenses from the project business Algeria	F. (27)	7,816	0
12. Impairment charges for intangible assets	F. (27)	3,432	19,789
13. Restructuring costs	F. (28)	2,152	8,864
<b>14. Operating result*</b>		<b>- 12,768</b>	<b>- 42,770</b>
15. Earnings from financial assets reported using the equity method		- 786	- 650
16. Financial income		528	328
17. Financial expenses		4,288	1,884
18. Financial results	F. (29)	- 4,546	- 2,206
<b>19. Earnings before taxes*</b>		<b>- 17,314</b>	<b>- 44,976</b>
20. Taxes on income	F. (30)	- 7,566	4,226
<b>21. Earnings after taxes / result for the year</b>		<b>- 24,880</b>	<b>- 40,750</b>
<b>Amounts directly included in equity</b>			
22. Currency differences		86	56
<b>23. Other period results</b>		<b>86</b>	<b>56</b>
<b>24. Total</b>		<b>- 24,794</b>	<b>- 40,694</b>
<b>The result for the year comprises</b>			
Funkwerk AG shareholders	E. (11)	- 24,880	- 40,753
Non-controlling interest	E. (11)	0	3
<b>The amounts directly included in equity comprise</b>			
Funkwerk AG shareholders		86	56
Non-controlling interest		0	0
<b>Earnings per share acc. to IAS 33</b>			
Earnings per share (undiluted) in EUR	E. (11)	- 3.09	- 5.06
Earnings per share (diluted) in EUR	E. (11)	- 3.09	- 5.06

\* prior-year figure adjusted

# CONSOLIDATED STATEMENT OF CASH FLOWS

ACC. TO IFRS

FOR THE FINANCIAL YEAR FROM 1 JANUARY TO 31 DECEMBER 2010		2010	2009
	NOTES	EUR K	EUR K
<b>1. Annual result</b>		<b>24,880</b>	<b>40,750</b>
2. Income tax expenditure/revenues	F. (30)	7,566	-4,226
3. Depreciation of development costs	E. (1)	4,554	15,261
4. Amortisation of goodwill	E. (1)	1,000	9,104
5. Depreciation of tangible assets and intangible assets	E. (1)	6,475	6,871
6. Writedown of investments	F. (29)	0	195
7. Earnings from financial assets reported using the equity method	F. (29)	786	650
8. Other non-cash expenditure and income	G. (31)	7,395	1,822
9. Reversal of investment subsidies	F. (25)	-236	-733
10. Changes in reserves		1,249	954
11. Profit / loss from disposal of fixed assets		-330	42
12. Changes in inventories, receivables and other assets		-3,315	29,750
13. Changes in advance payments received on orders		1,386	3,505
14. Changes in other debts		3,627	-14,124
15. Interest income	F. (29)	-145	-328
16. Interest expenditure	F. (29)	1,347	1,689
17. Interest paid		-569	-971
18. Interest received		34	150
19. Paid / received income tax		-1,582	-1,650
<b>20. Cash flow from operating activities*</b>	G. (31)	<b>4,362</b>	<b>7,211</b>
21. Receipts from the disposal of fixed assets		432	14
22. Payments for investments and development costs		-9,438	-10,665
23. Payments for investments in intangible assets without goodwill and development costs		-847	-1,222
24. Payments for investments in fixed assets		-1,774	-2,900
25. Receipts from investment subsidies		126	441
26. Payments for the acquisition of consolidated companies less acquired cash and cash equivalents	G. (33)	0	-200
27. Acquisition of participating interests		51	-49
28. Receipts from the sale of consolidated companies and participating interests	G. (34)	0	2,233
29. Payments for deconsolidationg	G. (35)	-1,144	0
<b>30. Cash flow from investing activities</b>	G. (32)	<b>-12,594</b>	<b>-12,348</b>
<b>31. Free Cash Flow</b>	G. (36)	<b>-8,232</b>	<b>-5,137</b>
32. Receipts from take-up of (financial) credit		0	1,913
33. Payments for the redemption of loans and (financial) credit		-1,853	0
<b>34. Cash flow from financing activities</b>	G. (37)	<b>-1,853</b>	<b>1,913</b>
35. Net change in cash and cash equivalents		-10,085	-3,224
36. Cash and cash equivalents at beginning of period		22,141	25,365
<b>37. Cash and cash equivalents at end of period</b>	G. (38)	<b>12,056</b>	<b>22,141</b>

# CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

ACC. TO IFRS

	NOTES	SUBSCRIBED CAPITAL	CAPITAL REVERSE	REVENUE REVERSE	OWN SHARES
		EUR K	EUR K	EUR K	EUR K
<b>January 1, 2009</b>		<b>8,101</b>	<b>63,017</b>	<b>38,211</b>	<b>-1,062</b>
Group profit for the year	E. (11)	0	0	0	0
Foreign currency items		0	0	0	0
<b>Total</b>		<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
Share options (IFRS 2)	E. (11)	0	253	0	0
Change in minority interests	E. (11)	0	0	0	0
<b>Transactions with owners</b>		<b>0</b>	<b>253</b>	<b>0</b>	<b>0</b>
<b>December 31, 2009</b>		<b>8,101</b>	<b>63,270</b>	<b>38,211</b>	<b>-1,062</b>
<b>January 1, 2010</b>		<b>8,101</b>	<b>63,270</b>	<b>38,211</b>	<b>-1,062</b>
Group profit for the year	E. (11)	0	0	0	0
Foreign currency items		0	0	0	0
<b>Total</b>		<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
Share options (IFRS 2)	E. (11)	0	152	0	0
Change in minority interests	E. (11)	0	0	0	0
<b>Transactions with owners</b>		<b>0</b>	<b>152</b>	<b>0</b>	<b>0</b>
<b>December 31, 2010</b>		<b>8,101</b>	<b>63,422</b>	<b>38,211</b>	<b>-1,062</b>

NET PROFIT/ LOSS FOR YEAR	FOREIGN CURR. ITEMS	EQUITY OF FUNKWERK AG SHAREHOLDERS	MINORITY INTERESTS	TOTAL
EUR K	EUR K	EUR K	EUR K	EUR K
21,657	-379	129,545	11	129,556
-40,753	0	-40,753	3	-40,750
0	56	56	0	56
-40,753	56	-40,697	3	-40,694
0	0	253	0	253
0	0	0	0	0
0	0	253	14	253
-19,096	-323	89,101	14	89,115
-19,096	-323	89,101	14	89,115
-24,880	0	-24,880	0	-24,880
0	86	86	0	86
-24,880	86	-24,794	0	-24,794
0	0	152	0	152
0	0	0	-14	-14
0	0	152	-14	138
-43,976	-237	64,459	0	64,459



$$G = \frac{S_{\max} \cdot 4 \cdot \pi \cdot r^2 \cdot \eta}{P_s}$$

*>>We use this formula to calculate the antenna gain and therefore the efficiency of our antennas. It helps us guarantee optimal connection of our coupling chamber to the mobile phones used in the market and so ensure consistent reception quality.<<* KAI MEISSNER, HEAD OF

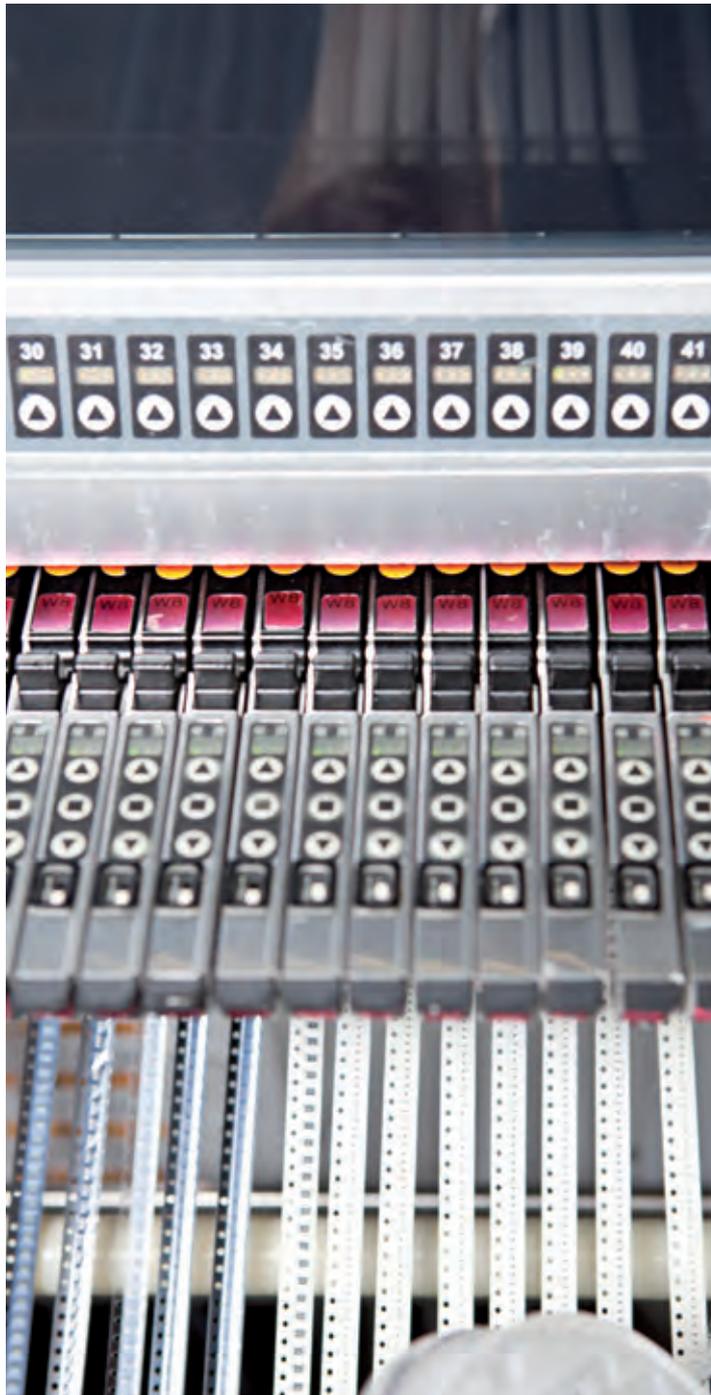
DEVELOPMENT, FUNKWERK DABENDORF GMBH



## Our Know-how in Automotive Communication

Today's »online generation« is used to phoning, surfing the net and using their »apps« anywhere at any time. This requires stable, secure and reliable wireless communication technology. It's where Funkwerk has specialised in its Automotive Communication segment for almost 20 years. This reliable Funkwerk technology now also provides reliable wireless communication for applications on land, on sea and in the air.

Although Internet applications are increasingly important everywhere, surfing the net in vehicles is still difficult because the car body, low-e glass and even the vehicle's speed weaken mobile radio signals. Funkwerk solved this problem with its UMTS WLAN router. Specially designed



for vehicles, it links notebooks, mobile phones and other mobile terminals in the vehicle to the outside world at up to 7.2 megabits per second. It doesn't interfere with wireless networks and vehicle electronics, so is far superior to conventional solutions.

That's just one way Funkwerk demonstrates its expertise. Reliable wireless communication is also crucial when to save lives after vehicle accidents. At CeBIT 2010, Funkwerk introduced a system which supports the emergency call system eCall, planned for Europe-wide installation. When the airbag system is activated, this Funkwerk technology establishes contact with the nearest rescue coordination centre and automatically transmits key data such

as time, location, direction of travel and the vehicle's identity. This enables rescue teams to reach the accident scene quickly using the most direct route. As a result, Funkwerk's know-how may even save lives.

In addition, our sector-specific telematics systems for transport and logistics companies help users reduce material, operating and personnel costs significantly.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## // 04

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# NOTES ON THE 2010 CONSOLIDATED FINANCIAL STATEMENTS

## A. Description of group relations

### PARENT COMPANY

The parent company is Funkwerk AG, Im Funkwerk 5, 99625 Kölleda, (hereafter also referred to as »Funkwerk« or the »corporation«) entered in the Jena Commercial Register, Division B, under number 111457.

Funkwerk AG is quoted on the German Stock Market in Frankfurt/Main and is listed in the Prime Standard (WKN: 575 314). It is also quoted on other German stock markets.

The group is divided into the following business segments:

The Traffic & Control Communication segment of Funkwerk provides innovative solutions involving communication technologies geared to automate and rationalise operations in transport, logistics and industry, and meet ever more stringent security standards. The key focus of this segment is on mobile radio solutions, management systems and information systems for transport services, forwarders and logistics companies, and industry.

In Automotive Communication, Funkwerk concentrates on innovations for secure, interference-free mobile communication and on ensuring their accessibility to vehicle users anywhere. The emphasis is on high quality products, simple operation with user-friendly functions and infotainment.

The aim of Enterprise Communication is to supply customised communication solutions tailored to meet the business communication requirements of its customers efficiently, economically, and reliably. The product portfolio comprises network components, telecommunication systems and products for data security, which are intensively focused on integrated infrastructure solutions for small and medium-sized data networks.

The Security Communication (SC) segment uses special and security-orientated communication systems in towards of personal and building security, video monitoring and property protection. Its target groups are industrial and energy companies, authorities and organisations with security functions (BOS), public transport, railways, airports, transport infrastructure, correctional facilities and forensic institutes.

Under 291 para. 2 of the German Commercial Code (§ 291 Abs. 2 HGB), the companies Hörmann - Funkwerk Kölleda GmbH, Funkwerk Dabendorf GmbH, Funkwerk Enterprise Communications GmbH, Funkwerk Security Communications GmbH and Funkwerk Information Technologies GmbH are exempt from the preparation of consolidated financial statements. In compliance with Section 315a of the HGB, the consolidated financial statements of Funkwerk were drawn up in line with the IFRS; the prerequisites for this are satisfied.

The companies of the Funkwerk group are included in the consolidated financial statements of Hörmann Holding GmbH & Co. KG, Kirchseeon. The consolidated financial statements of the group company Hörmann Holding GmbH & Co. KG, Kirchseeon, are deposited with the electronic register of the Munich District Court under Division A no. 88 202.

## B. Accounting rules

### A) PRINCIPLES FOR APPLYING THE IFRS STANDARDS

Funkwerk's consolidated financial statements have been prepared in compliance with the International Financial Reporting Standards (IFRS) passed and published by the International Accounting Standards Board (IASB), as were endorsed by the European Union at the time of releasing the consolidated financial statements and were mandatory on said date. These contain the IAS and IFRS that were mandatory on the reporting date of 31 December 2010 and their corresponding interpretations (SIC/IFRIC).

No application was made of the possibility of making early use of new standards, revisions of standards and interpretations, which had already been passed by 31 December 2010 and adopted by the European Union before the release of the consolidated financial statements.

The following amendments published by the IASB and standards and interpretations passed by the European Union are currently not yet used. Their use would not likely have led to any essential changes in the accounting and valuation principles:

Improvement to IFRS (2010)	IAS 1.34, IFRIC 13
IAS 24 (rev 2009)	Related Party Disclosures
Amendments to IFRS 7	Disclosures – Transfers of Financial Assets
IFRS 9	Financial Instruments

In addition, there are no relevant amendments published by the IASB to standards and interpretations that are currently not yet applied and still require adoption by the EU into European law.

For the application of special IFRS regulations, please refer to the explanations on individual balance sheet items further below in these Notes.

The financial statements were prepared on the basis of historic purchase and production costs, with the exception of certain financial instruments which were reported at the fair market value.

Unless otherwise stated, all figures of the consolidated financial statements are stated in thousands of euro (EUR k).

The balance sheet format follows the provisions of IAS 1.54 to 1.76. Short-term and long-term assets and short-term and long-term liabilities are shown on the balance sheet as separate classifications.

The statement of income and accumulated earnings was prepared with due regard to the provisions of IAS 1.82 to 1.96 and structured using the aggregate cost method. Since the 2009 financial year, the breakdown of the statement of income and accumulated earnings have been expanded to give better comparability. In the transition to the operating result (EBIT), an intermediate result is shown as the operating result before impairment charges and restructuring costs as well as separated expenditure items, impairment charges relating to intangible assets and restructuring costs. Furthermore, for the 2010 financial year, an additional expenditure item was also shown separately: impairment charges from the Algerian project business.

**B) ADJUSTMENT OF THE PREVIOUS YEAR'S FINANCIAL STATEMENTS**

In addition, the previous item Other taxes is now reported under the item Other operating expenditure. The adjustment is made retrospectively. The table below shows the items of the statement of income and accumulated earnings for the period 1 January to 31 December 2009, which have been adjusted over and against the figures shown in the consolidated financial statements of December 31, 2009.

	2009 PUBLISHED	ADJUSTMENT	2009 ADJUSTED
	€ K	€ K	€ K
Other operating expenses	39,283	-522	39,805
<b>Operating result before impairment charges and restructuring costs</b>	<b>-13,595</b>	<b>-522</b>	<b>-14,117</b>
<b>Operating result</b>	<b>-42,248</b>	<b>-522</b>	<b>-42,770</b>
<b>Earnings before taxes</b>	<b>-44,454</b>	<b>-522</b>	<b>-44,976</b>
Other taxes	-522	522	0
<b>Earnings after taxes / result for the year</b>	<b>-40,750</b>	<b>0</b>	<b>-40,750</b>

Furthermore, only those claims that are from taxes on income are reported under the item Tax refund claims. The adjustment is made retrospectively. The table below shows the balance sheet items as on 31 December 2009, which have been adjusted over and against the figures shown in the consolidated financial statements of 31 December 2009. The EUR 1,416k concern refund claims from turnover tax.

	2009 PUBLISHED	ADJUSTMENT	2009 ADJUSTED
	€ K	€ K	€ K
Tax refund claims	3,955	-1,416	2,539
Other assets	3,397	+1,416	4,813
<b>Assets</b>	<b>167,848</b>		<b>167,848</b>

**C) OTHER**

The financial year is the calendar year.

On 28 March 2011, the Executive Board of Funkwerk AG approved the 2010 consolidated financial statements for forwarding to the Supervisory Board. It is incumbent on the Supervisory Board to audit the consolidated financial statements and to state whether it endorses it.

## C. The Consolidated Group

### 1. CONSOLIDATED COMPANIES

The consolidated financial statements of Funkwerk AG include all companies that are controlled directly or indirectly by the parent company. Control is deemed to be acquired if the company is able to determine the financial and business policy of a subsidiary in order to gain benefit from the subsidiary's activity. The results of the subsidiaries bought or sold during the course of the year are reported correspondingly in the statement of income and accumulated earnings as from the actual date of acquisition or until the actual date of sale. As and where necessary, the subsidiaries' annual financial statements have been adjusted in order to match the accounting and valuation principles to suit those used within the consolidated group.

In addition to Funkwerk AG, the following companies are fully consolidated in the consolidated financial statements (Germany, unless otherwise stated):

DIRECT SUBSIDIARIES	REGISTERED OFFICE	VOTING RIGHTS
		IN %
Hörmann-Funkwerk Kölleda GmbH (HFWK)	Kölleda, Thuringia	100
ALPHA Meß-Steuer-Regeltechnik GmbH (Alpha)	Neustadt/Weinstraße, Rhineland-Palatinate	100
Funkwerk Dabendorf GmbH (FWD)	Zossen, Brandenburg	100
Funkwerk Enterprise Communications GmbH (FEC)	Nuremberg, Bavaria	100
Funkwerk Information Technologies GmbH (FIT)	Kiel, Schleswig-Holstein	100
Funkwerk Security Communications GmbH (FSC)	Salzgitter, Lower-Saxony	100
INDIRECT SUBSIDIARIES	REGISTERED OFFICE	VOTING RIGHTS
		IN %
Funkwerk eurotelematik GmbH	Ulm, Baden-Württemberg	100
Funkwerk Avionics GmbH	Waal, Bavaria	100
Funkwerk Enterprise Communications Iberia S.L.	Madrid, Spain	100
Funkwerk Enterprise Communications France S.A.S.	Gradignan Cedex, France	100
Funkwerk Enterprise Communications Italia S.R.L.	Mailand, Italy	100
Funkwerk Aphona GmbH	Wien, Austria	100
Funkwerk IP-Appliances GmbH	Nuremberg, Bavaria	100
Funkwerk Information Technologies Karlsfeld GmbH (FITK)	Karlsfeld, Bavaria	100
Funkwerk Information Technologies York Limited	York, Great Britain	100
Funkwerk Information Technologies Malmö AB	Malmö, Sweden	100
Funkwerk IT Polska Sp. z o.o.	Warschau, Poland	100
Microsyst Systemelectronic GmbH	Weiden, Bavaria	100
Funkwerk plettac electronic GmbH	Fürth, Bavaria	100
Funkwerk Systems Austria GmbH	Wien, Austria	100
Funkwerk Akademie GmbH	Beichlingen, Thuringia	100
Funkwerk Electronic Services GmbH (FES)	Salzgitter, Lower-Saxony	100
Funkwerk Engineering GmbH	Kiel, Schleswig-Holstein	100
FunkTech GmbH (anciently FunkTech Funkwerk VTech GmbH)	Nuremberg, Bavaria	100

FunkTech GmbH was consolidated into the group for the first time on 1 January 2010, having been not fully consolidated in previous years due to its low level of business activities.

On 12 January 2010, following several failed attempts to agree on a social compensation plan, the management of the French subsidiary Bouyer S.A.S., Montauban, filed for insolvency. This already had an effect on the 2009 consolidated financial statements, devaluing the assets by a total of EUR 3,854k. This is distributed amongst the following items: fixed assets (EUR 540k), inventories (EUR 2,669k) and trade accounts receivable (EUR 645k) and shown on the statement of income and accumulated earnings under restructuring costs. As a result of the loss of control over the company, a final consolidation of the company was made as per 1 January 2010. Due to the value adjustments made in the previous year, the final consolidation did not lead to any effects on the 2010 consolidated statement of income and accumulated earnings.

The final consolidation of Funkwerk Ungarn Kft, Budapest, made on 31 August 2010, resulted in a loss of EUR 19k.

The book value of the shareholding in VTech Funkwerk IAD GmbH, Kiel, has been reported in the consolidated financial statements at equity since May 2009. In the year under review, this led to a result adjustment of EUR -786k. In addition, the book value of the shareholding reported on the balance sheet at equity, amounting to EUR 744k, was completely depreciated by 31 December 2010.

## **2. BALANCE SHEET CLOSING DATE**

The financial year of Funkwerk AG and its subsidiaries ends every year on 31 December.

## **3. CONSOLIDATION METHODS**

The consolidated financial statements include the annual accounts of the company, its majority-owned subsidiaries and its associated companies. All receivables and payables and all transactions between the consolidated companies are eliminated in the consolidated financial statements. Both the receivables and payables, and the expenses and income between the consolidated companies are offset against each other. The group inventories and the fixed assets are adjusted by intermediate results. Consolidation processes affecting net income are subject to the adjustment of deferred taxes, with deferred tax assets and liabilities being balanced if a legal entitlement exists for offsetting the recorded amounts against each other and it is intended either to achieve the balance on a net basis or, simultaneous with the realisation of the asset concerned, to redeem the relevant liability. Minority interests in the net assets (except for goodwill) of the consolidated subsidiaries are reported separately from the equity capital of the group. They consist of the amount of such interests on the date of the original company merger and the minority interest in the changes of equity capital as of the merger date. The share of companies acquired by minority shareholders is reported at their share of contribution to the net current market value of the assets, liabilities and contingent liabilities upon their inclusion.

When acquiring the companies that are to be included in the consolidated group, the assets and liabilities are assessed at their respective market value at the time of acquisition. If the acquisition costs are higher than the group share in the thus determined equity of the company, this results in goodwill, which is to be carried as an asset, for the respective planning unit. The disclosed hidden reserves and liabilities are continued within the scope of subsequent consolidations according to the corresponding assets and liabilities. The goodwill accounting is subject to IFRS 3. If, however, the acquisition costs are lower than the group share in the thus calculated equity capital of the company, no deficit amount is carried as a liability. Instead, in accordance with IFRS 3, this difference was immediately recorded, affecting the operating result.

When companies that were included in the consolidated group were sold, the assets (including goodwill) and liabilities were taken off the books at their book value at the time of the loss of control. The fair market value of the return consideration received from the transaction was calculated and the profit/loss transferred from equity capital into the result.

Increases in majority shareholdings are taken into consideration using the equity transaction method.

#### 4. CURRENCY CONVERSION AND TRANSACTIONS

##### Currency conversion

Funkwerk Information Technologies York Limited, Great Britain, Funkwerk Information Technologies Malmö AB, Sweden, and Funkwerk IT Polska Sp. Z.o.o., Poland are not domiciled in the EURO region.

The functional currency of all other subsidiaries included in the consolidated financial statements is the euro, since these subsidiaries are exclusively registered in the euro region. Annual accounts prepared in foreign currencies were converted as follows: the equity capital was valued at the historical exchange rates on the date of acquisition, the balance sheet at the mean rates on the closing date, and the items of the statement of income and accumulated earnings at the average rates on a monthly basis.

The currency differences from this conversion were recorded in the equity capital without affecting the operating result. In the remaining result of the 2010 financial year, EUR 86k were due to currency differences (2009/2009: EUR 56k).

In the preparation of the financial statements of the individual group companies, any transactions made in currencies other than the working currency of the group company were converted using the exchange rates valid on the day of the transaction.

	HISTORICAL RATE	CUT-OFF DATE RATE	AVERAGE RATE
Sweden (in EUR/SEK)	0.10972	0.11154	0.10467
Great Britain (in EUR/GBP)	1.51768	1.16178	1.17007
Poland (in EUR/PLN)	0.25821	0.25157	0.24916

##### Currency transactions

The company has entered into hedging transactions in order to secure transactions in foreign currencies. These hedging transactions are limited to the period in which the risk exists and minimise the effects of exchange rate fluctuations on the earnings position of the companies. In the 2010 financial year, hedging transactions were effected with regard to the US dollar, Australian dollar, Swiss franc, Hungarian forint and Swedish krona.

#### 5. AFFILIATED COMPANIES

Affiliated companies are defined as companies that are directly or indirectly controlled by the corporation or by Hörmann Holding GmbH & Co. KG.

The corporation is the parent company of all direct and indirect subsidiaries, which consequently are also considered affiliated companies within the meaning of Section 271 para. 2 of the HGB (German Commercial Code), and in accordance with IAS 24. All direct and indirect subsidiaries, associated companies and key management personnel are considered as affiliates.

Within the meaning of Section 271, para. 2 in conjunction with Section 290 of the HGB (German Commercial Code), the corporation itself is an affiliated company of Hörmann Holding GmbH & Co. KG, Kirchseeon, and is listed in the consolidated financial statements of that company.

Consequently, the following subsidiaries of Hörmann Holding GmbH & Co. KG, Kirchseeon, are also affiliated companies of Funkwerk AG:

AFFILIATED COMPANIES	REGISTERED OFFICE
Hörmann GmbH	Kirchseeon
Hörmann Kommunikationsnetze GmbH	Kirchseeon
Hörmann Funkwerk Holding GmbH	Kirchseeon
Hörmann Holding Verwaltungs GmbH	Kirchseeon
Hörmann International Trading GmbH	Kirchseeon
Hörmann GmbH Stade	Stade

In addition, Hörmann Holding GmbH & Co. KG consolidates other companies with which Funkwerk does not have any business relations.

## D. Accounting and valuation principles

### 1. INTANGIBLE ASSETS AND GOODWILL

Intangible assets acquired for a consideration, primarily software, patents and intangible assets with a determinable useful life are carried as assets at purchase cost and their loss in value calculated on a straight-line basis by planned depreciation throughout their economic life, typically three to four years.

Development costs are carried as assets if the development of a new product (or process) can be clearly defined, is technically feasible and is intended either for own use or for sale. Carrying as assets further requires reasonable certainty that these development costs can be covered by future incoming funds. Development costs carried as assets are depreciated systematically over the expected selling period of the products or useful life of the processes (principally up to five years). Research costs are shown as current expenditure in accordance with IAS 38. The purchase cost here includes any costs directly attributable to the development process and appropriate shares of the development-related overhead. Where the requirements for carrying as assets are not met, the expenditures are allocated to the year of their accrual affecting net income.

The intangible assets, which are still at the development stage and therefore do not yet undergo planned depreciation, are audited in accordance with IAS 36. If the higher value of the net sales price and the value in use of the asset in question falls below the book value (impairment test), unplanned depreciation is made as and when necessary. For individual development projects, the achievable amount is calculated in the form of the fair market value.

According to IFRS 3, positive goodwill represents the excess between the purchase cost of a company and the acquired, revalued assets and liabilities including contingent liabilities, which remains after a purchase price allocation and consequently, the identification of all assets and liabilities acquired. Within the scope of this purchase price allocation, the identified assets and liabilities are taken into

account not at their previous book values but at their current market values. Goodwill is recognised as an asset and assessed annually at a specific time (typically as at the closing date) in impairment reviews to measure their initial value less accumulated impairment losses.

For the purposes of the impairment test, both the goodwill and the development costs are allocated to the appropriate cash generating units (CGU). The CGUs correspond to the independent legal entities of the company. In the SC and EC segments, legal entities of the company that deviate from this and generate cash independent of each other were each grouped together to form one CGU. The value impairment costs are calculated on the basis of the amounts achievable by each CGU, whereby the latter is calculated on the basis of the value in use. It is refrained from calculating the fair value less cost to sell because there are no indications that this value is higher than the value in use.

The calculations are based on the cash flow projections approved by the Executive Board and submitted to the Supervisory Board for the following three financial years. The planning is drawn up based on figures gained from experience taking current market developments into consideration. The cash flows of the CGUs are primarily driven by the planned sales revenues of the periods, whereby sales increases up until the 2013 financial year amounting to consolidated sales of up to approximately EUR 300 m were also taken into account.

For any periods exceeding these three years, the cash flows will be adjusted. A sustained growth of 1 per cent, which is typical for the industry, is taken as the basis for this.

The cash flows were discounted at the risk-adjusted pre-tax interest rate in line with the market. The discount rate before tax was calculated in accordance with IAS 36.55. The discount factors at the reporting date were calculated on segment level and applied to the cash flow predictions of the respective CGUs:

BUSINESS UNIT	INTEREST RATE IN % (PREVIOUS YEAR)
Traffic & Control Communication	11.4 (11.7)
Automotive Communication	11.4 (12.1)
Security Communication	12.5 (13.0)
Enterprise Communication	13.1 (12.9)

## 2. TANGIBLE ASSETS

Tangible assets are valued at purchase cost less accrued depreciations. The tangible assets are depreciated on a straight-line basis over their expected utilisation period. Investment subsidies are always shown as »Deferred investment subsidies«. Production costs are valued on the basis of directly allocable direct costs and pro-rata material and production overhead less depreciations. Maintenance and repair costs are expensed, while replacement and expansion investments extending the expected utilisation period or increasing the capacity are capitalised. The tangible assets were not revalued based on the option under IAS 16.

The depreciations are based on the following utilisation periods:

DESCRIPTION	USEFUL LIFE
Buildings	15 to 50 years
Plant and machinery	3 to 12 years
Other fixtures and fittings, tools and equipment	1 to 10 years

In accordance with IAS 36, unplanned depreciations of tangible assets are effected if the higher value of net sales price and the utilisation value of the asset in question falls below the book value. If the reasons for an unplanned depreciation effected in previous years do not apply, we carry out the appropriate appreciations.

**3. FINANCIAL ASSETS CARRIED ON THE BALANCE SHEET USING THE EQUITY METHOD AND OTHER LONG-TERM ASSETS**

When reporting as per the equity method, the shares are initially reported at their acquisition costs, but this is subsequently adjusted by any changes in the owner's share in the net assets of the associated company. The owner's profit or loss includes their share in the profit or loss of the associated company. The corresponding income/expenditure is reported in a separate item of the statement of income and accumulated earnings.

The other long-term assets include the amounts stated for shareholdings in affiliated companies which, taking into account the principle of materiality, are not shown in the balance sheet in compliance with the provisions of IAS 27, participations, and other investments. These are valued at their net book value less the required depreciation.

**4. INVENTORIES**

Inventories are valued at the lower amount of purchase and production cost and net sales value. In addition to the direct costs, the purchase/production costs also include appropriate shares of the necessary material and production overhead and production-related depreciations directly attributable to the production process. Administration costs are taken into account where attributable to the production. If the values are lower as at the closing date due to sagging prices on the sales market, these are reflected. The valuation of similar items of inventories is always based on the average cost method. Payments on account for inventories are valued at purchase cost. Depreciations of the inventories are reported under material expenses.

**5. RECEIVABLES FROM PROJECTS IN PROGRESS**

Sales and profits from long-term production orders are reported following the percentage of completion method in accordance with IAS 11. The degree of completion of the individual orders is determined according to the ratio of total costs estimated as at the cutoff date to costs incurred as at the closing date (cost-to-cost method). Losses from long-term orders are immediately recorded in full in the financial year in which the losses are obvious, irrespective of their degree of completion. Depending on the amount of advance payments requested, long-term orders valued in line with the percentage of completion method are shown under receivables from production orders or carried as advances from customers. These are valued at production cost plus a pro-rata profit corresponding to the degree of completion. Where a reliable estimate is not possible, the zero-profit method is used. The production costs include any costs directly attributable to the order and, where appropriate, shares of the overhead.

**6. TRADE ACCOUNTS RECEIVABLE AND OTHER ASSETS**

Due to their short-term nature, trade accounts receivable do not bear interest and are reported at their nominal value less value adjustments due to anticipated bad debt losses. Bad debt losses and value adjustments of receivables are reported under other operational expenses. The other assets are valued at net book value. Recognisable risks of non-payment are taken into account by making appropriate value adjustments.

#### **7. TAX REFUND CLAIMS / TAX LIABILITIES**

The tax refund claims contain receivables from current taxes on income.

The tax liabilities contain obligations from current taxes on income and from the findings of audits conducted, insofar as these exceed the amounts paid as prepayments before the cutoff date.

#### **8. FINANCIAL ASSETS**

Listed under this item are securities classified as current assets (held for trading) and shown at their market value on the cutoff date pursuant to IAS 39.

Also reported under this item are current bank credit balances in Algeria that are either unavailable in the short term or are blocked. These are reported at the nominal value under consideration of the exchange rate on the cutoff date.

#### **9. LIQUID FUNDS**

Items under cash and cash equivalents include cheques, cash on hand and on deposit in banking accounts.

#### **10. LONG-TERM ASSETS HELD FOR SALE**

Long-term assets that according to IFRS 5 are classified as being available for sale are carried and valued at the lower amount of their original book value and at the current market value less costs of sale. Such a classification is always made whenever the sale is highly probable and the asset is available for immediate sale in its current state.

#### **11. CAPITAL RESERVES**

IFRS 2 requires the effects of share-based payments, including the expense for the share options granted to the corporate management and employees, to be shown in the statement of income and accumulated earnings. Where share-based payments are settled by way of equity instruments, they are shown at their current market value.

#### **12. DEFERRED INVESTMENT SUBSIDIES**

Some subsidiaries receive subsidies from public funds used both for research and development projects and for the acquisition of tangible fixed assets.

According to IAS 20.24, any investment subsidies from public funds received by the corporation must be itemised as a separate liability item. The transfer was made on the basis of the fulfilled statutory entitlement requirements and the appropriated grants for investments effected by the corporation. The release affected the earnings corresponding to the utilisation period of the subsidised fixed assets.

Other public subsidies, which were collected in order to balance out expenses or losses already arisen or for purposes of immediate financial support, were reported affecting the net income in the period in which the need arose.

**13. DEFERRED TAXES**

The deferred taxes are reported and evaluated as per IAS 12 »Income Taxes«.

Deferred tax assets and liabilities are formed for future tax consequences from the difference of the book values in the IFRS balance sheet and the trade balance sheet and from tax loss carry-forwards.

The accruals and deferrals are effected at the rate of the anticipated tax burden or relief of following financial years on the basis of the tax rate effective at the time of applicability. To determine future rates of taxation, reference is made to the tax legislation and regulations that are valid or announced by the cutoff date. Tax consequences of dividend distributions are only taken into account at the time of the resolution on the disposal of corporate profits. Accruals are only reported when the realisation of future tax advantages seems improbable.

**14. PENSIONS ACCRUED**

In accordance with IAS 19, these accruals are calculated using the projected unit credit method (PUCM). Here, future liabilities are valued using actuarial procedures with a conservative estimate of the relevant impacting factors.

**15. ACCRUED LIABILITIES**

According to IAS 37, accrued liabilities are set aside where there is a current obligation towards third parties due to a past event that is expected to lead to an outflow of resources and can be estimated reliably.

Accrued liabilities that will not lead to an outflow of resources in the following year are valued at their settlement amount discounted as at the cutoff date, with the market interest rates forming the basis for the discounting. The settlement amount also covers any increases in costs to be taken into account on the cutoff date. Accrued liabilities in foreign currency are converted using their current rate.

**16. LIABILITIES**

Liabilities are valued at their amount repayable.

Long-term liabilities not bearing interest are included in the balance sheet at their cash value. Differences between the cash value and the amount repayable are taken into account according to the effective interest rate method.

**17. REALISATION OF SALES REVENUES**

Sales revenues are shown for existing contractual relations, where delivery has been made, the opportunities and risks have transferred to the buyer, the price has been agreed or can be determined, and the collection of the debt is probable. Sales for products requiring installation at the customer are recognised after delivery and installation at the customer. The sales recognition in regard to production orders is explained under item 5. The revenues are realised after deducting price reductions such as cash discounts, customer bonuses, and rebates.

A reserve for warranties is set up as at the cutoff date for realised sales. The reserve is based on estimates and experience figures. Where specific risks are recognisable, appropriate reserves are formed. For all other sales, a bad-debt provision is established to allow for the general risk of utilisation.

### 18. DERIVATIVE FINANCIAL INSTRUMENTS

Within the scope of active control of currency management, Funkwerk primarily uses derivative financial instruments mainly in the form of future exchange transactions.

The derivative financial instruments which we use are recorded on conclusion of the contracts. At that time and subsequently, they are valued at their fair market value (reported as on the day of trading). In case of a positive or negative market value, they are either carried as an asset or a liability. The market value of these non-listed derivatives is calculated using recognised actuarial models.

Derivative financial instruments are concluded by Funkwerk exclusively with financial institutes with impeccable financial standing. The market value depends on the respective type of financial instrument.

The derivative financial instruments available as at the cutoff date do not qualify for hedge accounting. Changes in the fair value of these derivatives are directly recorded in the financial results in the statement of income and accumulated earnings. Derivative financial instruments are exclusively used by Funkwerk for hedging purposes.

The market values of the derivative financial instruments available as at the cutoff date were as follows:

	31/12/2010		31/12/2009	
	ASSETS	LIABILITIES	ASSETS	LIABILITIES
	€ K	€ K	€ K	€ K
Future exchange transactions	344	212	31	107
Currency options	39	0	23	0
<b>Total</b>	<b>383</b>	<b>212</b>	<b>54</b>	<b>107</b>

The derivatives are carried as assets under »other assets« and as liabilities under »other liabilities«.

### 19. DISCLOSURES PURSUANT TO IFRS 7 - FINANCIAL INSTRUMENTS

A financial instrument is a contractual agreement that leads to the creation of a financial asset in one company while simultaneously leading to a financial liability or an equity instrument with another party. A compound financial instrument is one which contains both an equity and a borrowed capital component.

Financial assets in the sense of IAS 39 are classified into four classes at the time of their initial recognition:

- Financial assets held for trading
- Loans and receivables
- Held-to-maturity investments
- Available-for-sale financial assets

Financial liabilities in the sense of IAS 39 are classified as »financial liabilities at fair value through profit or loss« or as »financial liabilities measured at amortised cost using the effective interest method.«

Financial assets and liabilities are recognised as on the day of trading.

The initial measurement is made at fair value. When calculating the initial recognition, directly allocable transaction costs are also included (except for assets and liabilities at fair value through profit or loss). Financial assets and liabilities are only balanced out when a right to set-off exists for the amounts concerned and it is intended to balance on a net basis.

Where the Funkwerk group has extended »Credits and loans« and issued »Financial liabilities« in the sense of IAS 39, these are valued at their amortised cost/net book value always using the effective interest method. This principally concerns the balance sheet's trade accounts receivable and payable as well as liabilities on current account due to banks and loan liabilities.

Non-consolidated holdings are allocated to the category of »Available-for-sale financial assets« and on each balance-sheet cutoff date they are valued at fair value. Unless a sustained decrease in value is to be assumed, changes in value are reported in the equity capital under the »Reserve for time evaluation« item without effect on the operating result, whereby deferred taxes are taken into account. For instruments traded on an organised market, the fair value is calculated with reference to the respective market price.

If realised by disposal or if a lasting drop in the market value below the purchase costs is foreseeable, then the market changes will affect the operating result. Market increases are always reported without effect on the operating result, even if there was a prior devaluation affecting net income.

At every balance sheet closing date, Funkwerk checks the book values of the financial assets measured at fair value through profit or loss to see if there are any substantial indications for a value impairment. If, for the financial assets categorised as »available for sale«, it is found that a lasting impairment does exist, then impairments previously reported in the equity capital without effect on the operating result are removed from the equity capital and transferred to the statement of income and accumulated earnings with effect on the operating result. If the value recovers at a later point in time due to events that arose after the original value impairment, then the impairment must be returned to the respective level.

Value impairments of financial assets of the »available for sale« category that were valued with the purchase costs must not be reversed.

Financial assets are taken off the books when the company loses power of control over them. A financial liability is taken off the books when the obligation on which it was based is fulfilled or cancelled.

Shown under Held for Trading are financial assets that are held for trading as well as financial assets that, at their first ever measurement, are classified at fair market value through profit or loss. This category includes derivative financial instruments concluded by the group as well as securities. Changes to the fair market value are reported in the statements of income and accumulated earnings in the financial results.

The market values of liquid funds, of short-term receivables, of accounts payable and other liabilities correspond to the book values. This is due to the short-term nature of these financial instruments.

**Market value of financial assets and liabilities**

The financial assets and liabilities can be divided into valuation categories with the following book values and fair values:

	VALUE CATEGORIES AS PER IAS 39	BOOK VALUE 31/12/2010	BOOK VALUE 31/12/2009	NET BOOK VALUE	FAIR VALUE 31/12/2010	FAIR VALUE 31/12/2009
	€ K	€ K	€ K	€ K	€ K	€ K
<b>ASSETS</b>						
Other long-term assets	AfS	43	67	43	43	67
Accounts receivable (trade)	LaR	27,629	25,282	27,629	27,629	25,282
Due from affiliated companies	LaR	206	682	206	206	682
Receivables from work in progress	LaR	8,017	15,206	8,017	8,017	15,206
Financial assets	FAHfT	969	950	969	969	950
Other financial assets		3,000	0	3,000	3,000	0
Liquid funds		12,056	22,141	12,056	12,056	22,141
Derivatives	FAHfT	383	54	383	383	54
		<b>52,303</b>	<b>64,382</b>	<b>52,303</b>	<b>52,303</b>	<b>64,382</b>
<b>LIABILITIES</b>						
Long-term financial liabilities	FLAC	12	23	12	12	23
Short-term financial liabilities	FLAC	422	2,264	422	422	2,264
Accounts payable (trade)	FLAC	29,368	23,263	29,368	29,368	23,263
Due to affiliated companies	FLAC	56	58	56	56	58
Derivate	FLHfT	212	107	212	212	107
		<b>30,070</b>	<b>25,715</b>	<b>30,070</b>	<b>30,070</b>	<b>25,715</b>

**OF WHICH, AGGREGATED ACCORDING TO VALUATION**

**CATEGORIES AS PER IAS 39**

Available for Sale (AFS)	43	67	43	43	67
Loans and Receivables (LaR)	35,852	41,170	35,852	35,852	41,170
Financial Assets Held for Trading (FAHfT)	1,352	1,004	1,352	1,352	1,004
Financial Liabilities Measured at Amortised Cost (FLAC)	29,858	25,608	29,858	29,858	25,608
Financial Liabilities Held for Trading (FLHfT)	212	107	212	212	107

### Fair value hierarchy

The table shows the financial instruments reported at fair value according to their valuation method. The various methods are defined as follows:

- Stage 1: The prices listed on active markets for identical assets or liabilities (taken over unchanged).
- Stage 2: Input factors that do not concern the listed prices considered in stage 1 but which can be observed for the asset or liability either directly (i.e. as price) or indirectly (i.e. derived from prices).
- Stage 3: Factors for the valuation of the asset or liability that are not based on observable market data (non-observable input factors).

31/12/2010	STAGE 1	STAGE 2	STAGE 3	TOTAL
	€ K	€ K	€ K	€ K
Financial assets at fair value through profit or loss (FAHfT)*	969	-	-	969
Derivative financial assets (FAHfT)	-	383	-	383
<b>Sub total</b>	<b>969</b>	<b>383</b>	<b>-</b>	<b>383</b>
Derivative financial liabilities (FAHfT)	-	212	-	212
<b>Total</b>	<b>969</b>	<b>171</b>	<b>-</b>	<b>1,352</b>
<hr/>				
31/12/2009				
Financial assets at fair value through profit or loss (FAHfT)*	950	-	-	950
Derivative financial assets (FAHfT)	-	54	-	54
<b>Sub total</b>	<b>950</b>	<b>54</b>	<b>-</b>	<b>1,004</b>
Derivative financial liabilities (FAHfT)	-	107	-	107
<b>Total</b>	<b>950</b>	<b>-53</b>	<b>-</b>	<b>897</b>

\* Securities held in connection with the securing of entitlements for partial retirement.

### Net earnings from financial instruments

The net earnings from financial instruments were as follows:

	2010	2009
	€ K	€ K
Financial assets and liabilities at fair value through profit or loss (FAHfT/FLHfT)	210	-22
Available-for-sale financial assets (AFS)	0	-195
Receivables (LaR)	-7,261	-279

The net earnings as per IFRS 7 comprise interest, dividends, value adjustments, reinstatements of original values, and earnings from the valuation of financial instruments at fair value.

**Maturity analysis for financial liabilities:**

The following table shows all contractually agreed (non-discounted) interest and redemption payments of the original financial liabilities and the derivative financial instruments at 31 December 2010:

	2011	2012-2015
	€ K	€ K
Non-derivative financial liabilities		
Long-term interest-bearing financial debt	0	12
Short-term financial debt	422	0
Accounts payable (trade)	29,355	13
Derivative financial liabilities	160	52

**Breakdown of the previous years' figures:**

	2010	2011-2014
	€ K	€ K
Non-derivative financial liabilities		
Long-term interest-bearing financial debt	0	23
Short-term financial debt	2,264	0
Accounts payable (trade)	23,211	52
Derivative financial liabilities	107	0

**Management of financial market risks**

Due to the nature of its operations, the group is subject to various financial risks: the market risk (consisting of foreign exchange risk and interest rate risk), the credit risk and the liquidity risk. The comprehensive risk management of the group is prepared for the unpredictability of the development of financial markets and is geared to minimising the potentially negative effects on the financial situation of the corporate group.

The risk management is handled by the group's financial department as specified by the Executive Board. Funkwerk identifies, values and hedges financial risks in close cooperation with the operating units of the group. The Executive Board specifies guidelines for risk management, along with principles for specific areas, such as the handling of foreign exchange risks, interest rate risks and credit risks, for the use of derivative and non-derivative financial instruments, and for the use of liquidity surpluses.

Both the Executive Board and the Supervisory Board are regularly updated on the financial risk factors of the group.

We refer here in particular to the explanations on risk reporting in the Management Report.

### Financial risk factors

The companies of the Funkwerk group mainly source their material supplies from the euro zone. Outgoing invoices are also mainly issued in euros.

Foreign exchange risks particularly relate to the US dollar, which is required mainly for purchases of material. The rate hedging using currency options and currency futures dealing for the subsidiaries is handled centrally by Funkwerk AG. The volume of US dollars hedged on the balance sheet closing date using currency futures was USD 12,000k; of which, USD 3,000k were only hedged for a maximum of three months. The volume of US dollars hedged on the balance sheet closing date using currency options was USD 6,000k; of which USD 1,500k was only hedged for a maximum of three months.

The essential book values of the financial assets reported in the group as well as the liabilities in foreign currencies represent the risk positions on 31 December 2010:

	CHF	DKK	SEK	USD	HUF	GBP	DZD
	€ K	€ K	€ K	€ K	€ K	€ K	€ K
Financial assets	641	173	459	52	0	1,602	3,000
Financial liabilities	40	31	131	1,045	990	76	0
Foreign exchange risk from balance sheet item	601	142	328	-993	-990	1,526	3,000

The foreign currencies CHF, USD, HUF, GBP and DZD represent significant risk for the group with regard to financial instruments. A sensitivity analysis as per 31 December 2010 for these financial assets and liabilities is shown below.

	EARNINGS BEFORE INCOME TAX	RESERVE FOR CURRENCY CONVERSION	GROUP EQUITY
	€ K	€ K	€ K
CHF (Appreciation in 10 per cent)	60	0	60
CHF (Depreciation in 10 per cent)	-60	0	-60
USD (Appreciation in 10 per cent)	-99	0	-99
USD (Depreciation in 10 per cent)	99	0	99
HUF (Appreciation in 10 per cent)	-99	0	-99
HUF (Depreciation in 10 per cent)	99	0	99
GBP (Appreciation in 10 per cent)	153	154	-1
GBP (Depreciation in 10 per cent)	-153	-154	1
DZD (Appreciation in 10 per cent)	300	0	300
DZD (Depreciation in 10 per cent)	-300	0	-300

In view of the low level of debt due to banks, the interest rate risk is only of minor significance for the group.

Delinquency risk or credit risk is understood as the risk of a loss for the group if one contractual party does not honour its contractual obligations. The corporate guidelines stipulate that business relations must only be entered into with creditworthy contractual parties and, if appropriate, taking receipt of collateral to mitigate the risk of loss due to the non-fulfilment of obligations. The maximum delinquency risk is the amount of the book value of the financial assets (without consideration of insurance policies taken out).

There are receivables from goods and services and receivables from work in progress from a large number of customers from different business segments and geographical regions. Credit checks are constantly being conducted on the financial status of the receivables. Bad-debts insurance is taken out where appropriate.

A liquidity risk exists in terms of a possible impairment of creditworthiness, which could lead to a withdrawal of existing current account credit lines. Funkwerk sees the short-term probability of this risk arising as low. A further risk is the loss of banks as creditors. The latter is limited by having free current account credit lines at different banks.

Liquidity risks are covered in the group-wide financial planning, which is prepared at three-year intervals. The planning always identifies positive net cash items. Continuous monthly liquidity forecasts are prepared for the short-term sector, while optimising measures are discussed and decided in Board meetings (e.g. Factoring; cf. E.4., G.39).

#### Capital management

The group capital is managed and controlled with the aim of maximising the revenues of the company participations through optimisation of the equity and borrowed capital ratio. This ensures that all group companies can operate on the premise of continuation. The capital structure of the group comprises debts, cash and cash equivalents, and the equity capital due to the equity capital providers of the parent company. This is composed of issued shares, the capital reserve, the revenue reserve and the net profit for the year.

The financial security is measured primarily using the equity ratio. Components of this ratio are the balance sheet total of the consolidated financial statements and the equity capital shown in the consolidated balance sheet, which also provides the capital in the Funkwerk group within the meaning of IAS 1. The equity ratio is used with investors, analysts, banks and rating agencies as a key ratio.

The capital structure of Funkwerk can be controlled by way of adjusting dividends, decreasing the capital or emissions of new shares and the issue of financial instruments, which are qualified as equity capital under IFRS. The aim is to achieve a capital structure in line with the business risk.

Funkwerk is subject to the minimum capital requirements for stock corporations. Compliance with these requirements is constantly monitored. All requirements were met in 2010.

	2010	2009	VARIANCE
			IN %
Equity capital (in € k)	64,459	89,115	-27.7
Balance sheet total (in € k)	149,692	167,848	-10.8
Equity ratio according to book values (in %)	43.1	53.1	

The reduced equity ratio is essentially attributable to the negative annual result in the year under review, which is heavily influenced by one-off special costs from the project business in Algeria at EUR 9,128k, impairment charges on intangible assets at EUR 3,432k and restructuring costs at EUR 2,152k.

**20. SIGNIFICANT SCOPE FOR DISCRETION IN ACCOUNTING AND MAIN SOURCES OF ESTIMATION UNCERTAINTY**

When applying the group accounting rules with regard to those book values of assets and liabilities that cannot simply be obtained from other sources, the management must consider the facts and circumstances and also make estimations and assumptions. The estimations and the assumptions on which they are based are determined from empirical values from past experience and from other factors deemed as being relevant. The actual values may deviate from the estimates. The assumptions on which the estimations are based are subject to regular scrutiny.

The management views that the most important assumptions pertaining to the future and the main sources of uncertainty in the estimates are as follows: the goodwill impairment test with regard to the planning and the discount rate (cf. D.1.); the share-based remuneration with regard to the valuation parameters entered into the estimation of the current market value (cf. E.11.); the capitalisation of deferred taxes to tax losses carried forward with regard to the future tax planning strategies (cf. E.30.); the pension payments with regard to the parameters entered into the actuarial calculations (cf. E.12.); value adjustments on receivables (cf. E.4.); the probable utilisation of reserves with regard to appraising the facts relevant to the reserves (cf. E.20.) and the development work carried as assets with regard to the estimations on economical and technical feasibility and/or on the level of cash flow expected in future (cf. D.1.).

The estimates regarding the deferred taxes on losses carried forward are largely dependent on the trend of earnings. As a result, the estimates could deviate from figures that actually arise in later periods. Changes to the pertinent assumptions or estimations will be taken into consideration with effect on the result as and when they become known. The estimates are based on the conditions prevailing at the time of drawing up the consolidated financial statements and on the future development of the sector environment as it relates to the expected future performance of the Funkwerk group.

## E. Notes to the consolidated balance sheet

### — Assets —

#### (1) FIXED ASSETS

In regard to the composition and movement of the individual fixed assets, please refer to the fixed-asset movement schedule (cf. Notes, last page).

#### Goodwill, intangible assets

The following breakdown shows the development of goodwill attributable to the individual cash generating units / business segments:

	OPENING BALANCE 01/01/2010 € K	VALUE IMPAIRMENTS 2010 € K	CLOSING BALANCE 31/12/2010 € K
<b>GOODWILL</b>			
Microsyst Systemelectronic GmbH	2,592	500	2,092
Funkwerk Information Technologies Karlsfeld GmbH	2,583	500	2,083
Funkwerk Information Technologies GmbH	1,700	0	1,700
Funkwerk Information Technologies York Limited	900	0	900
ALPHA Meß-Steuer-Regeltechnik GmbH	1,886	0	1,886
<b>Traffic &amp; Control Communication segment</b>	<b>9,661</b>	<b>1,000</b>	<b>8,661</b>
Funkwerk eurotelematik GmbH	400	0	400
Funkwerk Avionics GmbH	100	0	100
<b>Automotive Communication segment</b>	<b>500</b>	<b>0</b>	<b>500</b>
<b>Total</b>	<b>10,161</b>	<b>1,000</b>	<b>9,161</b>

In the 2009 financial year, additions at EUR 200 k were made to the goodwill; this stood over and against value impairments at EUR 9,104 k. Of the value impairments in 2009, EUR 1,139 k was made to Funkwerk eurotelematik GmbH and EUR 1,314 k to Funkwerk Avionics GmbH. A further EUR 6,651 k concerned goodwill that was completely value-adjusted.

The auditing of the goodwill reported on the balance sheet led to a value impairment in the 2010 financial year amounting to EUR 1,000 k. All else remaining the same, an additional devaluation of goodwill of approx. EUR 700 k would be necessary if the cash flows in the three-year planning period turn out to be 5 per cent lower.

Other than goodwill, the company did not have any intangible assets with indeterminable useful lives.

Expenditure on research and development in the financial year was EUR 27,857 k (previous year: EUR 31,820 k), of which EUR 9,439 k (previous year: EUR 10,650 k) were carried as assets.

In the group, key development projects involved our electronic interlocking system Alister (book value of EUR 9,576 k) and the new TETRA radio devices (book value of EUR 2,066 k).

In the 2010 financial year, value impairments amounting to EUR 2,432k were made to development costs carried as assets. The value impairments concern the following business segments:

	31/12/2010
	€ K
<b>TRAFFIC &amp; CONTROL COMMUNICATION</b>	
Funkwerk Information Technologies Karltsfeld GmbH	301
<b>AUTOMOTIVE COMMUNICATION</b>	
Funkwerk Dabendorf GmbH	936
<b>SECURITY COMMUNICATION</b>	
Funkwerk plettac electronic GmbH	1,195
<b>Total</b>	<b>2,432</b>

#### Financial assets reported using the equity method

On the cutoff date of 31 December 2010, there were the following shares in joint ventures:

	31/12/2010	31/12/2009
	€ K	€ K
VTech Funkwerk IAD GmbH, Kiel (shortly: VTech)	0	1,530

Funkwerk has a 49 per cent interest in VTech (previous year: 49 per cent). The financial year of VTech ends on 31 March of the calendar year. The adjusted valuation, with a proportionate annual deficit, for the period from 1 January 2010 to 31 December 2010 is calculated at EUR 786k. In addition, due to the company's anticipated course of business, a depreciation of EUR 744k was also necessary.

#### Other long-term assets

The following participating interests are included in the other long-term assets:

	31/12/2010	31/12/2009
	€ K	€ K
Funkwerk Beteiligungsgesellschaft mbH (formerly: BR Beteiligungsgesellschaft mbH), Kölleda (100%, 2009: 100%)	32	32
WHSDnet GmbH, Potsdam (25%, 2009: 25%)	6	6
Patil Vossloh Rail IT Systems Private Ltd., India (51%, 2009: 51%)	4	4
Funkwerk ES Iberia S.L., Spain (54%, 2009: 54%)	1	1
FunkTech Funkwerk VTech GmbH, Nuremberg (100%, 2009: 100%)	0	24
<b>Total</b>	<b>43</b>	<b>67</b>

FunkTech Funkwerk VTech GmbH, Nuremberg, was consolidated on 1 January 2010 and now trades under the name FunkTech GmbH.

**(2) DEFERRED TAXES**

The deferred tax assets resulted from the following expected future tax relief:

	31/12/2010	31/12/2009
	€ K	€ K
Temporary differences between the valuations of the tax balance sheet and of the consolidated financial statements	7,793	8,024
Future tax savings due to losses carried forward	4,395	6,623
Balancing with deferred tax liabilities	- 12,188	- 12,344
<b>Total</b>	<b>0</b>	<b>2,303</b>

For details on the deferred taxes, see also E.14 and E.30.

**(3) INVENTORIES**

The inventories for 31 December 2010 comprised the following:

	GROSS	VALUE	NET
		ADJUSTMENTS	
	€ K	€ K	€ K
Raw materials and supplies	35,240	14,948	20,292
Work in progress	15,022	2,147	12,875
Finished goods and merchandise	12,140	2,999	9,141
Advance payments	1,252	0	1,252
<b>Total inventories</b>	<b>63,654</b>	<b>20,094</b>	<b>43,560</b>

The figures for 31 December 2009 were as follows:

	GROSS	VALUE	NET
		ADJUSTMENTS	
	€ K	€ K	€ K
Raw materials and supplies	38,207	17,773	20,434
Work in progress	12,697	2,860	9,837
Finished goods and merchandise	14,779	3,052	11,727
Advance payments	570	0	570
<b>Total inventories</b>	<b>66,253</b>	<b>23,685</b>	<b>42,568</b>

The inventory value adjustment developed as follows:

	2010	2009
	€ K	€ K
At 1 January	23,685	18,591
Transfer/utilisation	- 3,591	5,094
<b>At 31 December</b>	<b>20,094</b>	<b>23,685</b>

**(4) TRADE ACCOUNTS RECEIVABLE**

The trade accounts receivable consist of the following:

	2010	2009
	€ K	€ K
Trade accounts receivable	28,236	26,859
Discounts	-607	-1,577
<b>Trade accounts receivable net, at 31 December</b>	<b>27,629</b>	<b>25,282</b>

All our subsidiaries grant supplier loans within the scope of their ordinary operations, in individual cases with a term of up to 180 days. The creditworthiness of their customers is verified on a regular basis and discounts entered to cover established risks. The residual maturity of the trade accounts receivable is less than one year. At the end of 2010, the group was involved in real factoring to the amount of approx. EUR 7.5m (2009: EUR 7.5m) with a German commercial bank.

In the period under review, the discount on accounts receivable developed as follows:

	2010	2009
	€ K	€ K
At 01 January	1,577	1,298
Transfer	336	1,132
Reversal/utilisation	1,306	853
<b>At 31 December</b>	<b>607</b>	<b>1,577</b>

The value adjustments are heavily based on estimations and assessments of individual receivables which are in turn based on the creditworthiness of the customer in question, on the current economic trend and on the analysis of historic losses of receivables.

On 31 December 2010, gross receivables of EUR 991k (previous year: EUR 1,617k) were assigned with individual value adjustments (specific allowances for bad debts). In compliance with IFRS 7.37 (a), the maturity structure of the accounts receivable not subject to value adjustments is as follows:

	31/12/2010	31/12/2009
	€ K	€ K
gross receivables	27,245	25,242
of which not overdue	20,851	15,524
Overdue in the following time frames		
less than 30 day	4,413	6,412
between 31 and 60 days	1,062	1,900
between 61 and 90 days	418	948
between 91 and 180 days	209	337
between 181 and 360 days	73	74
more than 360 days	219	47

In regard to the neither value-adjusted nor overdue amount of accounts receivable, there was no indication as at the cutoff date to suggest that the debtors would not meet their financial obligations. In addition, relevant bad-debts insurance also exists on trade accounts receivable amounting to EUR 2,865k (2009: EUR 1,106k).

**(5) RECEIVABLES FROM PROJECTS IN PROGRESS**

Future accounts receivable from production orders develop as follows:

	31/12/2010	31/12/2009
	€ K	€ K
<b>BALANCE</b>		
Work in progress	19,581	21,352
Advance payments received	-11,564	-6,146
<b>Total</b>	<b>8,017</b>	<b>15,206</b>
<b>COMPREHENSIVE INCOME</b>		
Sales	-8,043	-8,047
Costs	3,133	4,489
<b>Profit share</b>	<b>-4,910</b>	<b>-3,558</b>

The contracts on which the receivables are based were fully completed in the 2011 financial year.

In the financial year, value adjustments were made on receivables from projects in progress over EUR 6,056k. This largely concerns receivables from the Algerian project business.

**(6) DUE FROM AFFILIATED COMPANIES**

The accounts receivable from affiliated companies totalled EUR 206k (2009: EUR 682k), and were due to sales and services. The accounts receivable were attributable to unconsolidated, affiliated companies at EUR 0k (2009: EUR 291k) and to other affiliated companies at EUR 206k (2009: EUR 391k).

**(7) TAX REFUND CLAIMS**

This item predominantly comprises receivables from tax offices due to excessive advance payments on corporate income tax and commercial income tax during the financial year on account of lower, taxable income in the year of assessment as against the previous year.

**(8) OTHER ASSETS**

	31/12/2010	31/12/2009
	€ K	€ K
Prepayments and accrued income	731	1,292
Partial retirement	309	0
Claims from subsidies, grants and investment subsidies	379	696
Deposits	185	175
Advances to personnel	86	88
Interest receivables	6	6
VAT refund claims	495	1,416
Other	835	1,140
<b>Total</b>	<b>3,026</b>	<b>4,813</b>

**(9) FINANCIAL ASSETS AND LIQUID FUNDS**

The item Financial assets not only includes securities but also liquid funds that are either unavailable in the short term or are blocked; these amount to EUR 3,000k and are held in Algerian bank accounts.

The securities held are allocable exclusively to current assets. They have been invested in money market-related funds.

This item developed as follows:

	2010			2009		
	PURCHASE	CURRENT	EFFECT ON	PURCHASE	CURRENT	EFFECT ON
	COST	MARKET VALUE	RESULT	COST	MARKET VALUE	RESULT
	€ K	€ K	€ K	€ K	€ K	€ K
Securities	930	969	39	919	950	31

The trend of the liquid funds is shown in the consolidated cash flow statement.

The credit interest in the euro zone ranges between 0 per cent and 1.47 per cent (2009: 0 per cent to 1.72 per cent).

The fund requirements of the subsidiaries is controlled and monitored centrally via a cash pool. The cash is invested in accordance with the defined investment standards. The investment in shares (excluding own shares) or financial derivatives is explicitly excluded.

**(10) LONG-TERM ASSETS HELD FOR SALE**

A company property, including land, in Gradignan, France, which was sold in the 2010 financial year, is reported under this item as per 31 December 2009 at its book value. A profit of EUR 335k was made from the sale and this has been channelled into the earnings position of the Enterprise Communication segment.

## — Liabilities —

### (11) EQUITY CAPITAL

The equity capital trend of Funkwerk AG is shown in the Statement of Changes in Shareholders' Equity.

#### Subscribed capital

The capital stock of Funkwerk AG is shown at its nominal value. The capital stock amounts to EUR 8,101,241.00 and is divided into 8,101,241 shares in the form of bearer shares with a nominal value of EUR 1 each and is fully paid in. The number of shares in circulation remains unchanged at the previous year's figure of 8,059,662.

On the cutoff date, Hörmann Funkwerk Holding GmbH, Kirchseeon, held 52.83 per cent (2009: 52.83 per cent) of the shares in Funkwerk AG, which corresponds to 4,280,000 shares. Hörmann Funkwerk Holding GmbH is fully owned (100 per cent) by Hörmann Holding GmbH & Co. KG, Kirchseeon.

#### Approved capital

Based on a decision passed at the annual shareholders' meeting on 28 May 2009, the Executive Board is authorised, with the approval of the Supervisory Board, to increase the capital stock of the company by up to EUR 4,050,000 by 27 May 2014, through a single or repeated issue of new, ordinary bearer shares in the form of non-par shares against contributions in cash or in kind (approved capital for 2009). Furthermore, the Executive Board was also authorised, with the approval of the Supervisory Board, to exclude the legal subscription right of the shareholders

- in order to prevent the subscription right of the shareholders leading to peak amounts,
- if, where capital increases against contributions in kind in the form of companies, parts of companies, participating interests in companies or debt claims against the company are concerned, the shares issued when excluding the subscription right do not exceed 4,050,000 shares in total,
- if, where capital increases against cash contributions are concerned, the amount for which the shares are issued is not significantly lower than the stock exchange price of the shares at the time the Executive Board fixes the said amount and the shares issued when excluding the subscription right do not exceed 810,000 shares in total.

#### Conditional capital

The shareholders' meetings of 29 September 2000, 18 May 2005 and 14 May 2008 decided on a conditional increase in the capital stock of the company by issuing bearer shares (the »shares«) for servicing the option rights granted to the parties entitled under the share option plan.

Conditional capital I	29 September 2000	500,000 shares
Conditional capital II	18 May 2005	367,965 shares
Conditional capital III	14 May 2008	232,525 shares

The annual shareholders' meeting on 27 May 2010 decided on a conditional increase of the capital stock by up to 365,000 shares and to re-divide the conditional capital. At the extraordinary shareholders' meeting on 29 September 2000, the 2000 Share Option Plan was passed and the conditional capital I was created to service that plan. Following this, a conditional capital of EUR 500,000 and 500,000 opti-

on rights were made available. The authorisation of the Executive Board and of the Supervisory Board to issue share options under the 2000 Share Option Plan expired on 28 September 2005. Options from the 2000 Share Option Plan are no longer in circulation. The 2010 annual shareholders' meeting increased the conditional capital I without substitution.

At the ordinary shareholders' meeting on 18 May 2005, the 2005 Share Option Plan was passed and the conditional capital II was created to service that plan. Following this, a conditional capital of EUR 367,965 and EUR 367,965 option rights were made available to the company. Individual share certificates have not yet been issued under this Share Option Plan and the conditional capital II therefore remains at EUR 367,965. The authorisation to issue share options under the 2005 Share Option Plan was given a time limit of until 18 May 2009. This means that no more share options can be issued from the 2005 Share Option Plan. Since the authorisation has expired and a total of 155,375 options were not issued, the conditional capital II of that same amount, i.e. EUR 155,375, was cancelled. The conditional capital II was renamed as conditional capital I.

The shareholders of Funkwerk AG passed the 2008 Share Option Plan at the ordinary shareholders' meeting on 14 May 2008 and created the conditional capital III to grant that plan. Following this, a conditional capital of EUR 232,525, i.e. 232,525 option rights, was available to the company. Individual share certificates have not yet been issued under this Share Option Plan and the conditional capital III therefore remains at EUR 232,525. The conditional capital III was renamed as conditional capital II.

At the ordinary shareholders' meeting on 27 May 2010, the 2010 Share Option Plan was passed and, for this purpose, a conditional capital III of up to EUR 365,000 and 365,000 option rights were created.

Conditional capital I	27 May 2010	212,590 shares
Conditional capital II	27 May 2010	232,525 shares
Conditional capital III	27 May 2010	365,000 shares

This conditional increase of capital stock will be effected only where option rights have been issued and are exercised by the authorised parties. The new shares will share in the profit from the beginning of the financial year in which they come into existence through exercise of the option right. The statutory subscription right of the shareholders is excluded in this respect. The nominal value of the conditional capital decided in compliance with Section 192 para. 2 no. 3 of the German Stock Corporation Law for the establishment of share option plans must not exceed 10 per cent.

#### **Conditional capital IV**

At the annual shareholders' meeting on 27 May 2010, the Executive Board was authorised to issue convertible and/or warrant bonds. With the agreement of the Supervisory Board, the Executive Board can, until the expiry of 26 May 2015, issue once or repeatedly bearer and/or registered convertible and/or warrant bonds for a total nominal amount of up to EUR 30,000,000 and can grant the owners/creditors of these convertible bonds conversion privileges and can grant owners/creditors of these warrant bonds option rights on up to a total of 3,200,000 new bearer shares of the company. The term of the convertible and/or warrant bonds can be up to ten years.

To grant shares to the owners/creditors of convertible and/or warrant bonds, the annual shareholders' meeting passed a resolution to create a new conditional capital IV and, thereby, decided to conditionally increase the capital stock of the company by up to EUR 3,200,000 by issuing up to 3,200,000 new bearer shares. The conditional capital increase is only made to the extent that the owners/creditors of convertible and/or warrant bonds exercise their conversion privileges and option rights and/or fulfil their conversion obligations from such convertible and/or warrant bonds. The new shares bear dividends as of the beginning of the current financial year in which they were issued.

### 2005 Share Option Plan

The ordinary shareholders' meeting of 18 May 2005 authorised the corporation, inter alia, to issue option rights to a maximum of 367,965 shares once or in several stages to members of the corporate Executive Board, members of the executive management of affiliated companies (Section 15 of the German Stock Corporation Act), executive staff at the second management level of the corporation and affiliated companies, and to other employees of the corporation and of affiliated companies (2005 Share Option Plan – SOP 2005). Instead of lapsed or as yet unexercised option rights, it is possible for new option rights to be given.

The following conditions apply to both issue and exercise:

- Allottees must be members of the Executive Board or staff of the group.
- At the time of issuing, the allottees must be in permanent employment at a company of the Funkwerk group.
- The option rights may be issued to the authorised parties once or several times during a period of ten trading days, beginning twelve trading days after a shareholders' meeting or after the publication of an annual or quarterly report (»issuance period«). The decision as to whether and to what extent option rights are granted to an employee is made at the discretion of the corporate management. There is no legal claim to a future granting of option rights.

The option right has a life of four years, beginning with the end of the applicable issuance period. The option right lapses without compensation on the last day of the life of the option right at the latest.

The option right may be exercised for the first time after a period of two years from the end of the respective issuance period (»waiting period«). After the waiting period, the option right can only be exercised during a period of 10 trading days following the day of the ordinary shareholders' meeting or the publication of a quarterly report of the company (»exercise periods«).

A trading day is defined as any day during which the German Stock Market is open for trading.

The option right may only be exercised by the authorised parties within the exercise period if at any time since the granting of option rights the average closing price of the corporate share in XETRA trading has exceeded the exercise price once by at least 16 per cent (»performance target«). Once the upside target for the option rights has been reached, they can be exercised irrespective of the further price performance of the share during the term of the option right within the exercise periods.

### 2008 Share Option Plan

The ordinary shareholders' meeting of 14 May 2008 authorised the corporation, inter alia, to issue option rights to a maximum of 500,000 shares once or in several stages to members of the corporate Executive Board, members of the executive management of affiliated companies (Section 15 of the German Stock Corporation Act), executive staff at the second management level of the corporation and affiliated companies, and to other employees of the corporation and of affiliated companies (2008 Share Option Plan – SOP 2008). Instead of lapsed or as yet unexercised option rights, it is possible for new option rights to be given. The terms and conditions for the options for the SOP 2008 do not deviate in any instance from the SOP 2005. For this reason, the details are not repeated here.

### 2010 Share Option Plan

The ordinary shareholders' meeting of 27 May 2010 authorised the corporation, inter alia, to issue option rights to a maximum of 365,000 shares once or in several stages to members of the corporate Executive Board, members of the executive management of affiliated companies (Section 15 of the German Stock Corporation Act), executive staff at the second management level of the corporation and affiliated companies, and to other employees of the corporation and of affiliated companies (2010 Share Option Plan). Instead of lapsed or as yet unexercised option rights, it is possible for new option rights to be given.

The terms and conditions for the options for the SOP 2010 deviate in one instance from the SOP 2000 and 2005:

Unlike the previous option plans, the option right has a term of six years beginning from the end of the respective issue period. The option right expires without compensation with the expiry of the last day of the term at the latest. In contrast to the previous option plans, the option right can be exercised for the first time after the expiry of four years, beginning with the end of the respective issue period (»waiting period«).

For a further presentation of the terms and conditions for the options, please refer to the 2005 Share Option Plan.

The following table shows the issued options (of all active share option plans) as per 31 December 2010:

	ISSUE DATE	QUANTITY	ISSUE PRICE
Tranche 2007	28/11/2007	104,760	14.60 EUR
Tranche 2008	08/12/2008	106,225	5.41 EUR
Tranche 2009	07/12/2009	98,055	5.90 EUR
Tranche 2010	25/11/2010	114,385	6.76 EUR
<b>Total</b>		<b>423,425</b>	

The following breakdown shows the stock development of the shares authorised for subscription and the issue prices in the period under review:

	WEIGHTED AVERAGE EXERCISE PRICE PER SHARE 2010 €	NUMBER OF OPTIONS 2010 €	WEIGHTED AVERAGE EXERCISE PRICE PER SHARE 2009 €	NUMBER OF OPTIONS 2009 €
Outstanding at the start of the reporting period	10.23	428,535	19.43	562,250
Options granted in the reporting period	6.76	114,385	5.90	103,425
Options forfeited in the reporting period	9.99	22,305	17.17	31,087
Options lapsed in the reporting period	15.01	97,190	31.06	206,053
Options outstanding at the end of the reporting period	8.17	423,425	10.23	428,535
Options exercisable at the end of the reporting period	14.60	104,760	15.01	101,750

No options could be exercised in the period under review. The weighted average of the remaining contractual period as at 31 December 2010 was 3 years.

The current market value of the options granted in the 2005 to 2010 financial years, which were used to calculate the expenses and the comparative data of the previous year, was determined on the basis of the binomial option price model. The following table shows the valuation premises applied:

	2010	2009	2008	2007	2006	2005
Risk-free interest rate (in %)	4.0	2.23	2.7	4.25	3.5	2
Term in years	6	4	4	4	4	4
Expected volatility	44	55	50	45	50	30
Expected dividend yield	0	2.19	4.0	2.0	2.4	1.16
Curr. mkt. value of options (in €)	1.68	2.19	0.97	4.59	4.68	6.83
Share price at issue (in €)	6.46	5.80	4.05	15.21	15.29	31.20

The calculation of the expected volatility was estimated by Funkwerk AG based on the historical share price figures of a six year period (2009: four). The fluctuation was set at 5 per cent.

### Capital reserves

The capital reserves include the revenue generated from the issue of shares (premium) that exceeds the par value per share of EUR 1. It rose by EUR 152k in 2010 (2009: EUR 253k) due to the recorded personnel expenditure for share options. Since no share options could be exercised in the context of the share option plan in the period under review, there was no additional change to the capital reserve above and beyond this. Since the introduction of the share option plans, the capital reserves have increased by EUR 2,287k in total due to exercised options, and by EUR 3,389k when applying IFRS 2. The capital reserves serve to finance the further growth of Funkwerk.

### Earnings per share

The earnings per share are calculated as follows:

	31/12/2010	31/12/2009
Result of the shareholders of Funkwerk AG in € K	-24,880	-40,753
Earnings per share (undiluted) in EUR	-3.09	-5.06
Earnings per share (diluted) in EUR	-3.09	-5.06

The weighted average number of ordinary shares, which was used for calculating the undiluted and diluted earnings per share, can be derived as follows:

	2010	2009
	X 1000	X 1000
Issued shares, 1 January /31 December	8,101	8,101
Own shares, 1 January /31 December	-41	-41
<b>Weighted, average number of ordinary shares used for calculating the undiluted earnings per share</b>	<b>8,060</b>	<b>8,060</b>

The potential ordinary shares with dilution effect should not be considered for the financial year because they would reduce the loss per share for the period.

### Retained earnings (revenue reserve)

The revenue reserve includes the retained prior-year results. It serves to raise the equity capital over and above the subscribed capital, increase the protection of the creditors, and improve the company liquidity.

### Own shares

The resolution passed at the shareholders' meeting on 28 May 2009, authorising Funkwerk AG to acquire its own stock up to a share of 10 per cent of the current capital stock by the end of 27 November 2010, was revoked. By resolution passed at the shareholders' meeting on 27 May 2010, the company was authorised to acquire its own stock up to a share of 10 per cent of the current capital stock by the end of 26 May 2015. At no point in time may the acquired shares together with other own shares in the possession of the company or assigned to the company according to Sections 71a ff. of the German Stock Corporation Law (§§ 71a ff. AktG) account for more than 10 per cent of the capital stock. The time limit only applies to the acquisition, not to ownership of the shares.

The countervalue for the acquisition of these shares must not exceed the unweighted average of the share price in the closing auction in the XETRA trading system (or a commensurate successor system) at the Frankfurt Stock Market on the previous five stock trading days by more than 10 per cent or fall below this price by more than 10 per cent. If the company share price is not established in the closing auction in the XETRA trading system (or a commensurate successor system) at the Frankfurt Stock Market on one or more trading days, then the relevant company share price in the closing auction in the floor trading at the Frankfurt Stock Market will take its place.

If the acquisition is made using a public bid or using a public invitation to submit a bid, then the bid offered or the limit value of the purchase price range per share (without additional acquisition costs) must not exceed by more than 10 per cent the unweighted average of the company share price in the

closing auction in the XETRA trading system (or a commensurate successor system) at the Frankfurt Stock Market on the five stock-market trading days before the day of publishing the bid or of public invitation to submit a bid, or fall below this figure by more than 10 per cent. If, after the publication of a bid and/or after the public invitation to submit a bid, considerable deviations exist to the authoritative price, then the bid or the invitation to submit one such bid, can be adjusted. In this case, the average price of the three stock market trading days before the publication of a possible adjustment will be used. The bid or the invitation to submit one such bid can stipulate further conditions. If the bid is over-subscribed or, in the case of an invitation to submit a bid from several equivalent bids, they are not all accepted, then the acceptance must be made using quotas. A preferential acceptance of low quantities of up to 100 for the acquisition of offered shares per shareholder can be stipulated.

The company is authorised to sell its own shares by methods other than through the stock market or through offers to all shareholders, so as to be able to offer shares of the company to third parties within the scope of mergers with companies or the acquisition of, or investments in, companies. The subscription right of the shareholders is excluded where own shares acquired by the company are used in order to offer shares of the company to third parties within the scope of mergers with companies or the acquisition of, or investments in, companies. This authorisation can be exercised fully or in part amounts, once or on several occasions, in pursuit of one or several of the specified purposes. Finally, the Executive Board is authorised to redeem either entirely or in part the own shares of the company bought on the basis of its authorisation, without the requirement of a further resolution passed by the shareholders' meeting for the redemption.

Funkwerk AG, Kölleda, did not acquire any own shares in the year under review. On the cutoff date, the stock remains unchanged at 41,579 shares and has a value of EUR 1,062k. The own shares are split between securities accounts at three banks.

The own shares are shown as a separate item of the equity capital.

### Minority interests

The minority interests carried on the balance sheet developed as follows:

	2010	2009
	€ K	€ K
01 January	14	11
Minority interests in the consolidated result	0	3
Disposal of foreign currency items due to acquisition	14	0
<b>31 December</b>	<b>0</b>	<b>14</b>

### (12) PENSION OBLIGATIONS

The pension accruals reported on the balance sheet are the result of commitments made to the employees of Funkwerk Security Communications GmbH (FSC), Salzgitter, Funkwerk Electronic Services GmbH, (FES), Salzgitter, Funkwerk Enterprise Communications Italia S.R.L., Milan/Italy, and Funkwerk Information Technologies Karlsfeld GmbH (FITK). This concerns assurances from performance-orientated pension schemes based on company agreements and other agreements. The pension accruals are calculated based on independent actuarial opinions. The scope and level of the pension are essentially governed by the number of years in service.

All pension schemes have been closed.

The valuation assumptions and methods at the beginning and the end of the year under review can be summarised as follows:

	BEGINNING OF YEAR UNDER REVIEW FSC/FES	END OF YEAR UNDER REVIEW FSC/FES	BEGINNING / END OF YEAR UNDER REVIEW FITK
Accounting standards applied	IAS 19		
Valuation standards applied	Projected Unit Credit Method		
Assumptions on mortality	2005 G K. Heubeck reference tables		
Assumed rate of interest p.a.	4.65 %	4.65 %	5.50 %/4.20 %
Expected annual increase of the income threshold	3.00 %	3.00 %	2.50 %/2.50 %
Expected annual increase in income	3.00 %	3.00 %	2.50 %/2.50 %
Expected annual increase in pensions	2.00 %	2.00 %	2.00 %/2.00 %
Average fluctuation	<=1 %	<=1 %	
Average remaining employment period	8.40/10.29	7.88/9.78	12.86/15.39

The actuarial profits and losses are recorded using the method in accordance with IAS 19.92 – 93 (»corridor method«).

The expenditure for adjustment of the pension obligation was recorded in personnel expenses, the interest paid for the obligations was shown in the other financial results.

#### 1. Development of the defined benefit obligation (IAS 19.120 A (c))

	FEC € K	FSC € K	FES € K	FITK € K	TOTAL € K
<b>At 31 December 2009</b>	<b>30</b>	<b>5,928</b>	<b>2,075</b>	<b>3,729</b>	<b>11,762</b>
Service cost	0	78	64	99	241
Interest cost	0	304	106	203	613
Actuarial profits/losses	0	259	145	946	1,350
Benefits paid	-30	-290	-144	-78	-542
Transfer payments	0	25	0	0	25
<b>At 31 December 2010</b>	<b>0</b>	<b>6,304</b>	<b>2,246</b>	<b>4,899</b>	<b>13,449</b>
<b>At 31 December 2008</b>	<b>24</b>	<b>5,419</b>	<b>1,782</b>	<b>4,113</b>	<b>11,338</b>
Service cost	1	88	61	127	277
Interest cost	2	314	107	194	617
Actuarial profits/losses	3	537	125	-636	29
Benefits paid	0	-430	0	-69	-499
Transfer payments	0	0	0	0	0
<b>At 31 December 2009</b>	<b>30</b>	<b>5,928</b>	<b>2,075</b>	<b>3,729</b>	<b>11,762</b>

#### 2. Analysis of the Defined Benefit Obligation (IAS 19.120 A (d))

DBO of plans not financed via a fund: EUR 12,840 k (2009: EUR 11,762 k)

### 3. Planned assets

The consolidated group does not have any reimbursement rights or planned assets.

### 4. Reconciliation to the balance sheet item (IAS 19.120 A (f))

	FEC	FSC	FES	FITK	TOTAL
	€ K	€ K	€ K	€ K	€ K
<b>Defined Benefit Obligation as at 31 December 2010</b>		<b>6,304</b>	<b>2,246</b>	<b>4,899</b>	<b>13,449</b>
Surplus or deficit in the plan as at 31 December 2010		6,304	2,246	4,899	13,449
Actuarial (profits) losses not yet recognised		-842	319	-475	-998
<b>Defined Benefit (Asset) Liability as at 31 December 2010</b>		<b>5,462</b>	<b>2,565</b>	<b>4,424</b>	<b>12,451</b>
<b>Defined Benefit Obligation as at 31 December 2009</b>	<b>30</b>	<b>5,928</b>	<b>2,075</b>	<b>3,729</b>	<b>11,762</b>
Surplus or deficit in the plan as at 31 December 2009	30	5,928	2,075	3,729	11,762
Actuarial (profits) losses not yet recognised	-3	-584	492	482	387
<b>Defined Benefit (Asset) Liability as at 31 December 2009</b>	<b>27</b>	<b>5,344</b>	<b>2,567</b>	<b>4,211</b>	<b>12,149</b>

### 5. Expense components (IAS 19.120 A (g))

2010	FEC	FSC	FES	FITK	TOTAL
	€ K	€ K	€ K	€ K	€ K
<b>A. IN PERSONNEL EXPENSES</b>					
Current service cost		78	64	99	241
Actuarial profits/losses		0	-28	-11	-39
<b>Total personnel expenses</b>		<b>78</b>	<b>36</b>	<b>88</b>	<b>202</b>
<b>B. IN FINANCIAL RESULTS (OPTION RIGHT)</b>					
Interest cost		304	106	203	613
<b>Total financial results</b>		<b>304</b>	<b>106</b>	<b>203</b>	<b>613</b>
<b>Grand Total</b>		<b>382</b>	<b>142</b>	<b>291</b>	<b>815</b>
<b>2009</b>					
<b>A. IN PERSONNEL EXPENSES</b>					
Current service cost	1	88	61	127	277
Actuarial profits/losses	0	0	-47	0	-47
<b>Total personnel expenses</b>	<b>1</b>	<b>88</b>	<b>14</b>	<b>127</b>	<b>230</b>
<b>B. IN FINANCIAL RESULTS (OPTION RIGHT)</b>					
Interest cost	2	314	107	194	617
<b>Total financial results</b>	<b>2</b>	<b>314</b>	<b>107</b>	<b>194</b>	<b>617</b>
<b>Grand Total</b>	<b>3</b>	<b>402</b>	<b>121</b>	<b>321</b>	<b>847</b>

The components of the expenses (IAS 19.120 A (q)) expected for the 2011 financial year are EUR 272 k (personnel expenditure) and/or EUR 592 k (financial results).

### 6. Amounts for the current reporting period and the previous four reporting periods (IAS 19.120 A (p))

	31/12/2010	31/12/2009	31/12/2008	31/12/2007	31/12/2006
	€ K	€ K	€ K	€ K	€ K
Defined Benefit Obligation	13,449	11,762	11,338	11,192	8,415
Deficit in the plan	13,449	11,762	11,338	11,192	8,415

The experience adjustment was not stated because there are no planned assets in the group.

The figures for years prior to 2007 do not relate to FITK because this was only acquired in 2007.

The pension accrual in the annual accounts of Funkwerk Enterprise Communications Italia S.R.L. amounting to EUR 48k (2009: EUR 38k) is an obligation of the employer under Italian law, the calculation of which is based on the age of the employees.

As at 1 January 2010, the accruals for similar obligations essentially include the provision of EUR 819k for union agreed performances upon terminating a contract of employment (PIDR), which is carried as a liability on the balance sheet of Bouyer S.A.S. A final consolidation of Bouyer S.A.S. was made in the 2010 financial year.

The accruals trend is shown in the following table:

	01/01/2010	UTILI- SATION	REVERSA	DECONSO- LIDATION	ALLO- CATION	31/12/2010
	€ K	€ K	€ K	€ K	€ K	€ K
Pension obligations	12,187	517	25	0	854	12,499
Accruals for similar obligations	834	0	0	819	11	26
<b>Total</b>	<b>13,021</b>	<b>517</b>	<b>25</b>	<b>819</b>	<b>865</b>	<b>12,525</b>

The pension accrued has a term to maturity of more than 5 years. Funkwerk does not use any external funds to finance its pension obligations.

#### (13) DEFERRED INVESTMENT SUBSIDIES

The prepaid expenses item developed as follows in the period under review:

	2010	2009
	€ K	€ K
<b>At 1 January</b>	<b>1,151</b>	<b>1,542</b>
Transfer	96	342
Reversa	-235	-733
<b>At 31 December</b>	<b>1,012</b>	<b>1,151</b>

The breakdown into investment subsidies and allowances is shown in the following table:

	INVESTMENT ALLOWANCE	INVESTMENT GRANT
	€ K	€ K
<b>At 1 January 2009</b>	<b>878</b>	<b>664</b>
Transfer	102	240
Reversa	-196	-537
<b>At 31 December 2009</b>	<b>784</b>	<b>367</b>
Transfer*)	-18	114
Reversa	-158	-77
<b>At 31 December 2010</b>	<b>608</b>	<b>404</b>

\* EUR 32k of which concern the correction of the previous year's figure

The prepaid expenses item has the following maturities:

Up to 1 years	EUR 138k (2009: EUR 403k)
1 to 5 years	EUR 482k (2009: EUR 292k)
Over 5 years	EUR 392k (2009: EUR 456k)

The granting of subsidies is fundamentally linked to the observance of certain constraints and/or conditions, some of which may cover several years and extend into the future. On any non-fulfilment, the Funkwerk group could be threatened with an obligation to repay the received subsidies in whole or in part, which would have a lasting effect on the economic position of the company. Regular checks of the granted subsidies have shown no cause for complaint to date.

#### (14) DEFERRED TAXES

The deferred taxes result from deviations between the tax balance sheet and the trade balance sheet II according to IFRS. These were calculated with the respective rates for taxes on income. For domestic (German) companies, the corporate income tax rate in the 2010 financial year was 15 per cent (2009: 15 per cent) plus the solidarity tax of 5.5 per cent (2009: 5.5 per cent). Taking the trade tax rate into consideration, this gives an effective taxation rate of 26 per cent (2009: 26 per cent). Consolidation measures affecting net income and, consequently, deferred taxes were taken into account. We refer here to F.30.

#### (15) FINANCIAL LIABILITIES

The financial liabilities down on the previous year are essentially attributable to an effect from the 2009 consolidate financial statements (payments received from customers for sold trade accounts receivable, which had to be paid to the bank in the context of factoring). There was significantly lower effect of EUR 343k on the cutoff date of 31 December 2010.

#### (16) TRADE ACCOUNTS PAYABLE

The remaining maturities are essentially short term. We refer here to item D.19.

#### (17) ADVANCE PAYMENTS RECEIVED ON ORDERS

This item includes advances from customers where no chargeable service has as yet been rendered.

**(18) DUE TO AFFILIATED COMPANIES**

As in the previous year, there were no liabilities due to the majority shareholder, Hörmann Funkwerk Holding GmbH, or Hörmann Holding GmbH & Co. KG, on the cutoff date of 31 December 2010. The figure of EUR 56k (2009: EUR 58k) is attributable to unconsolidated own companies and/or affiliated companies.

**(19) TAX LIABILITIES**

Taxes and fiscal charges incurred as at the closing date, whose amount has not yet been determined, are covered by the »tax liabilities« item. Typically, Funkwerk is subject to two types of tax on income, i.e. trade tax and corporate income tax. The corporate income tax was subject to a uniform tax rate of 15 per cent plus 5.5 per cent solidarity surcharge, the trade tax on average amounting to 10 per cent.

**(20) ACCRUED LIABILITIES**

The trend of accrued liabilities in the year under review is shown in the following table:

	01/01/2010	UTILI- SATION	REVERSA	DECONSO- LIDATION	ALLO- CATION	31/12/2010
	€K	€K	€K	€K	€K	€K
Warranties	5,621	1,855	648	124	3,450	6,444
Usage fee	2,857	0	0	0	725	3,582
Personnel accruals	1,150	855	26	0	1,547	1,816
Impending losses	761	405	111	0	216	461
Other accrued liabilities	900	445	120	0	1,685	2,020
<b>Total</b>	<b>11,289</b>	<b>3,560</b>	<b>905</b>	<b>124</b>	<b>7,623</b>	<b>14,323</b>

The accrued liabilities are short term.

The accrued liabilities for usage fee were carried as liabilities on the balance sheet under fees and licence fees for the use of know-how. The remaining accrued liabilities essentially contain provisions for penalties and litigation expenses.

**(21) OTHER LIABILITIES**

The other short-term liabilities are composed of the following:

	31/12/2010	31/12/2009
	€K	€K
Other taxes	3,987	2,594
Social security liabilities	228	625
Outstanding holiday entitlements	1,238	1,108
Outstanding overtime entitlements	652	666
Partial retirement	1,437	1,856
Profit-sharing bonus	1,910	1,685
Other personnel liabilities	1,895	2,559
Miscellaneous	2,495	6,370
<b>Total</b>	<b>13,842</b>	<b>17,463</b>

## F. Statement of income and accumulated earnings

### (22) SALES REVENUES

In the 2010 financial year, Funkwerk generated sales totalling EUR 210,968 k. Sales revenues are recorded as net sales after deduction of discounts, rebates, and allowances. The sales revenues are divided by corporate segments and regions.

#### Breakdown into geographic markets

2010	TRAFFIC & CONTROL		AUTOMOTIVE		ENTERPRISE		SECURITY		TOTAL	
	COMMUNICATION		COMMUNICATION		COMMUNICATION		COMMUNICATION		€ K	%
	€ K	%	€ K	%	€ K	%	€ K	%		
Domestic	56,838	55.4	25,173	82.4	21,020	74.2	33,244	67.2	136,275	64.6
EU	33,605	32.7	4,849	15.9	6,675	23.6	12,724	25.7	57,853	27.4
Other foreign countries	12,207	11.9	515	1.7	618	2.2	3,500	7.1	16,840	8.0
<b>Total</b>	<b>102,650</b>	<b>100.0</b>	<b>30,537</b>	<b>100.0</b>	<b>28,313</b>	<b>100.0</b>	<b>49,468</b>	<b>100.0</b>	<b>210,968</b>	<b>100.0</b>

2009	TRAFFIC & CONTROL		AUTOMOTIVE		ENTERPRISE		SECURITY		TOTAL	
	COMMUNICATION		COMMUNICATION		COMMUNICATION		COMMUNICATION		€ K	%
	€ K	%	€ K	%	€ K	%	€ K	%		
Domestic	50,756	48.2	22,374	78.6	20,725	69.8	32,552	59.3	126,407	57.9
EU	42,861	40.7	5,393	18.9	8,385	28.2	7,763	14.1	64,402	29.5
Other foreign countries	11,748	11.1	720	2.5	592	2.0	14,571	26.6	27,631	12.6
<b>Total</b>	<b>105,365</b>	<b>100.0</b>	<b>28,487</b>	<b>100.0</b>	<b>29,702</b>	<b>100.0</b>	<b>54,886</b>	<b>100.0</b>	<b>218,440</b>	<b>100.0</b>

10.6 per cent of the total sales revenues of the Funkwerk group were realised with a single customer (corresponds to EUR 22,470 k, Segment TCC).

### (23) COST OF MATERIALS

In the financial year, the cost of materials consists of expenditure for raw materials and supplies at EUR 80,166 k (2009: EUR 88,506 k) and expenditure for services received at EUR 26,927 k (2009: EUR 25,941 k).

### (24) PERSONNEL EXPENSES

The personnel expenses concern expenditure for wages and salaries at EUR 68,375 k (2009: EUR 77,132 k) and social security contributions, expenditure for retirement pension and benefits at EUR 12,951 k (2009: EUR 15,082 k).

**(25) OTHER OPERATING INCOME**

	2010	2009
	€ K	€ K
Income from sale of shares / licences VTech	0	2,285
Income from reversal of accrued liabilities	905	1,868
Income from reversal of liabilities	1,306	3,009
Income from reversal of prepaid expenses item for investment subsidies and allowances	235	733
Expense subsidies	2,018	1,251
Remuneration in kind	633	664
Income from sale of tangible fixed assets	330	7
Exchange profit	1,751	736
Reversal of value adjustments	370	1,112
Miscellaneous	471	823
<b>Total</b>	<b>8,019</b>	<b>12,488</b>

In regard to the reversal of special items for investment subsidies and allowances, please refer to the explanations under item 13. The expense subsidies relate to supported projects, for example within the scope of research activities, training activities for junior staff («education and research»), and personnel expense allowances.

The income from the reversal of accrued liabilities were recognised where the future outflow of resources is no longer probable.

**(26) OTHER OPERATING EXPENSES**

	2010	2009
	€ K	€ K
Space and building expenses	5,979	6,519
Administrative expenses	7,255	9,083
Selling expenses	7,272	11,139
Allocation to reserve for warranties	1,723	2,347
Operating expenses	3,067	3,272
Current-asset valuation adjustments	442	765
Vehicle expenses	2,781	3,123
Reserves for anticipated losses	25	843
Exchange losses	664	423
Miscellaneous *	2,187	2,291
<b>Total</b>	<b>31,395</b>	<b>39,805</b>

\* Previous year's figures adjusted – please refer to Section B of the Notes.

**(27) IMPAIRMENT CHARGES FROM THE ALGERIAN PROJECT BUSINESS AND INTANGIBLE ASSETS**

The value impairments from the Algerian project business essentially concern value adjustments on receivables from projects in progress amounting to EUR 6,056k, allocations to reserves totalling EUR 900k and elimination of receivables to the amount of EUR 570k.

For information on impairment charges for intangible assets, we refer to the information given in section E.1 of the Notes to the Consolidated Financial Statements and to the consolidated fixed-asset movement schedule.

### (28) RESTRUCTURING COSTS

The restructuring costs in the 2009 financial year essentially concern settlements and expenses for transitional companies (EUR 1,884k). The restructuring costs in the 2009 financial year essentially concerned value adjustments in the inventories (EUR 376k), settlements and expenditure for transitional companies (EUR 4,036k) and other expenditure (EUR 4,452k). The other expenditure included in particular expenditure from the devaluation of assets of the subsidiary Bouyer S.A.S. (EUR 3,854k).

### (29) FINANCIAL RESULTS

	2010	2009
	€ K	€ K
<b>Earnings from financial assets reported using the equity method</b>	<b>-786</b>	<b>-650</b>
Gain from future exchange transactions /currency options	383	54
Interest and similar income	137	243
Write-up of investment classified as current assets	8	31
	<b>528</b>	<b>328</b>
Interest and similar expenses	-1,192	-965
Interest paid for pension obligations	-613	-617
Writedown of financial assets	-858	0
Impairment of financing receivables	-669	0
Write-down of financial assets reported using the equity method	-744	0
Write-down of participating interests	0	-195
Loss from future exchange transactions/currency options	-212	-107
	<b>-4,288</b>	<b>-1,884</b>
<b>Financial results</b>	<b>-4,546</b>	<b>-2,206</b>

The devaluation of the financing receivables concern VTech Funkwerk IAD GmbH, Kiel. The depreciation on financial assets relates to a partial depreciation on the credit balance in Algeria which is not available in the short term or blocked.

### (30) TAXES ON INCOME

Composition of the tax expenditure:

	2010	2009
	€ K	€ K
Current tax expenditure	4,164	713
Deferred tax expenditure (2009: -revenue)	3,402	-4,939
<b>Taxes on income</b>	<b>7,566</b>	<b>-4,226</b>

The taxes on income include a tax expense of EUR 2,844k that is unrelated to the accounting period.

The following deferred tax accruals and liabilities shown in the balance sheet were attributable to differences in methodology and valuation in regard to the individual balance sheet items and to tax losses carried forward:

	31/12/2010		31/12/2009	
	DEFERRED	DEFERRED	DEFERRED	DEFERRED
	TAX	TAX	TAX	TAX
	ACCRUALS	LIABILITIES	ACCRUALS	LIABILITIES
Intangible assets	511	6,155	98	5,128
Tangible assets	7	335	8	348
Financial assets	737	713	1,034	722
Inventories	4,625	92	4,329	131
Accounts receivable and other assets	20	3,232	251	4,379
Advances from customers	0	2,704	0	1,576
Pension accruals	484	0	781	0
Provisions	641	0	781	0
Liabilities	671	28	669	60
Deferred investment subsidies	97	0	73	0
Tax losses carried forward	4,395	0	6,623	0
Balancing out	-12,188	-12,188	-12,344	-12,344
<b>Balance sheet figure</b>	<b>0</b>	<b>1,071</b>	<b>2,303</b>	<b>0</b>

**Transition from the anticipated income tax revenue to the reported income tax expenditure**

	2010	2009
	€ K	€ K
Result before taxes on income	-17,314	-44,976
<b>Rate of taxation of Funkwerk group</b>	<b>26.00 %</b>	<b>26.00 %</b>
<b>Anticipated income tax revenue</b>	<b>-4,502</b>	<b>-11,694</b>
<b>TRANSITION</b>		
Tax rate variances		
a) Effects of tax rate changes / differences	-702	-578
b) Effects from tax rate differences of foreign fiscal regions	-2	-452
Tax effects from variances in the basis of assessment		
a) tax-free income from foreign operations as per DBA	2,783	0
b) Tax-free income from investments and gain on disposal or other transfer	0	-6
c) Disposal losses not recognised for tax purposes	868	59
d) Non-deductible expenditure	257	128
e) Other tax-free income	0	-38
f) Corporate income tax increases or decreases	106	182
Valuation of deferred tax assets		
a) Non-recognition of deferred tax assets	6,442	6,430
b) Utilisation of tax losses carried forward that have not yet accrued deferred tax a	-185	-205
c) Deferral of tax losses carried forward that have not yet accrued deferred tax assets	-272	-747
d) Lapse of tax losses carried forward that have not yet accrued deferred tax assets	16	0
Effects not identified with the specified period		
a) Current and deferred taxes, previous years	2,421	405
Tax effects on consolidation level		
a) Negative goodwill (i.e. badwill)	0	0
b) Depreciation of goodwill	262	2,367
Other	73	-77
<b>Reported income tax expenditure (2009: tax revenues)</b>	<b>7,566</b>	<b>-4,226</b>
<b>Group tax load ratio</b>	<b>-43.7 %</b>	<b>9.4 %</b>

The domestic group companies did not report any deferred tax claims on the tax losses carried forward that totalled EUR 34,851k.

## G. Cash flow statement

### **(31) CASH FLOWS FROM OPERATING ACTIVITIES**

The cash flow from operating activities is an indicator of the extent to which the company managed to generate cash surplus through its operative business.

The item »Other non-cash expenditure and income« includes expenditure in connection with the Algerian project business (EUR 6,626k), depreciations on financial assets reported using the equity method (EUR 744k) and expenditure in the context of reporting the share options as per IFRS 2 (EUR 152k; 2009: EUR 253k).

### **(32) CASH FLOWS FROM INVESTING ACTIVITIES**

This cash flow shows the extent to which expenses for resources were incurred that are to generate future income and cash flows.

### **(33) PAYMENTS FOR THE ACQUISITION OF CONSOLIDATED COMPANIES**

The outgoing payments in the previous year for the acquisition of consolidated companies concerned a subsequent payment of the purchase price for an acquisition made in the 2007 financial year.

### **(34) PAYMENTS FROM THE SALE OF PARTICIPATING INTERESTS**

The previous year's incoming payments from the sale of participating interests were due to the sale of shares at a purchase price of EUR 2,250k less the selling costs amounting to EUR 17k and relate to VTech Funkwerk IAD GmbH.

### **(35) PAYMENTS FROM FINAL CONSOLIDATION**

The payments concern the outflow of liquid funds from the final consolidations of Bouyer S.A.S. (EUR 1,131k) and Funkwerk Ungarn Kft. (EUR 13k).

### **(36) FREE CASH FLOW**

The free cash flow serves as an indicator for company-internal control.

### **(37) CASH FLOWS FROM FINANCING ACTIVITIES**

In the 2008 financial year, a dividend of EUR 0.25 was paid out for the 2007 financial year for each ordinary share bearing dividends. The dividend payout was waived in the subsequent years.

### **(38) CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD**

On the reporting date, the cash and cash equivalent were the same as the liquid funds.

In the context of the factoring programme with a German commercial bank, separated credit balances of EUR 2.5m were invested as per 31 December 2010 as single-month fixed-term deposit investments with limited disposal.

The cash and cash equivalents do not contain restricted-access bank credit balances in Algeria since these are included in the balance-sheet item Financial assets.

Please refer to the explanations under Section 7 in the group management report – Risk report and risk management, Risks from our Algeria business.

## H. Segment reporting

Funkwerk structures its business in clearly separated business segments: Traffic & Control Communication (abbr.: TCC), Automotive Communication (abbr.: AC), Enterprise Communication (abbr.: EC), Security Communication (abbr.: SC).

Consequently, the segment reporting complies with IFRS 8.

	YEAR	TCC	AC	EC	SC	NONALLOCA- TED ITEMS	GROUP
		€ K	€ K	€ K	€ K	€ K	€ K
Intangible and tangible assets	2010	26,270	9,327	5,763	8,522	0	49,882
	2009	26,815	9,455	4,501	8,920	0	49,691
Investment in intangible and tangible assets	2010	3,562	2,778	2,494	3,226	0	12,060
	2009	4,944	3,728	2,922	3,526	0	15,120
Inventories	2010	21,709	5,878	2,936	13,037	0	43,560
	2009	23,697	5,075	2,940	10,856	0	42,568
Trade accounts receivable	2010	21,173	2,212	1,812	10,449	0	35,646
	2009	20,027	1,535	2,300	16,626	0	40,488
Other current assets	2010	0	0	0	0	20,561	20,561
	2009	0	0	0	0	31,201	31,201
<b>Segment assets</b>	<b>2010</b>	<b>69,152</b>	<b>17,417</b>	<b>10,511</b>	<b>32,008</b>	<b>20,561</b>	<b>149,649</b>
	<b>2009</b>	<b>70,539</b>	<b>16,065</b>	<b>9,742</b>	<b>36,402</b>	<b>31,201</b>	<b>163,948</b>
Financial assets reported at equity	2010	0	0	0	0	0	0
	2009	0	0	1,530	0	0	1,530
Other long-term assets	2010	4	7	0	32	0	43
	2009	4	7	24	32	2,303	2,370
<b>Total assets</b>	<b>2010</b>	<b>69,156</b>	<b>17,424</b>	<b>10,511</b>	<b>32,040</b>	<b>20,561</b>	<b>149,692</b>
	<b>2009</b>	<b>70,543</b>	<b>16,072</b>	<b>11,296</b>	<b>36,434</b>	<b>33,504</b>	<b>167,848</b>
Pension obligations	2010	4,424	0	48	8,053	0	12,525
	2009	5,031	0	64	7,926	0	13,021
Advance payments received	2010	6,644	0	7	2,084	0	8,735
	2009	6,795	103	0	451	0	7,349
Trade accounts payable	2010	16,785	3,658	1,194	7,731	0	29,368
	2009	13,232	2,534	1,587	5,910	0	23,263
Accrued liabilities	2010	8,906	2,125	620	2,672	0	14,323
	2009	6,788	2,154	497	1,850	0	11,289
Other debts	2010	0	0	0	0	20,282	20,282
	2009	0	0	0	0	23,811	23,811
<b>Segment liabilities = Total liabilities</b>	<b>2010</b>	<b>36,759</b>	<b>5,783</b>	<b>1,869</b>	<b>20,540</b>	<b>20,282</b>	<b>85,233</b>
	<b>2009</b>	<b>31,846</b>	<b>4,791</b>	<b>2,148</b>	<b>16,137</b>	<b>23,811</b>	<b>78,733</b>
Generated EBIT	2010	2,349	-1,914	540	-13,743	-	-12,768
	2009	-7,096	-11,499	-6,930	-17,245	-	-42,770
<b>EBIT margin (from segment assets)</b>	<b>2010</b>	<b>3.4%</b>	<b>-11.0%</b>	<b>5.1%</b>	<b>-42.9%</b>	<b>-</b>	<b>-8.5%</b>
	<b>2009</b>	<b>-10.1%</b>	<b>-71.6%</b>	<b>-71.1%</b>	<b>-47.4%</b>	<b>-</b>	<b>-26.1%</b>

The long-term assets related to the foreign companies of the group are running at EUR 1,785k (2009: EUR 1,783k) and are shared across the two segments TCC at EUR 1,744k (2009: EUR 1.716k) and EC at EUR 41k (2009: EUR 67k).

#### Calculation of EBIT and reconciliation to the shareholders' results

	YEAR	TCC	AC	EC	SC	GROUP
		€ K	€ K	€ K	€ K	€ K
Total sales revenues	2010	102,682	30,811	28,494	57,508	219,495
	2009	105,515	28,614	30,333	63,493	227,955
Sales revenues with	2010	32	274	181	8,040	8,527
other business segments *	2009	150	127	631	8,607	9,515
External sales revenues	2010	102,650	30,537	28,313	49,468	210,968
	2009	105,365	28,487	29,702	54,886	218,440
Other operating income	2010	3,790	1,713	1,127	1,389	8,019
	2009	4,742	1,651	3,613	2,482	12,488
<b>Segment revenues</b>	<b>2010</b>	<b>106,440</b>	<b>32,250</b>	<b>29,440</b>	<b>50,857</b>	<b>218,987</b>
	<b>2009</b>	<b>110,107</b>	<b>30,138</b>	<b>33,315</b>	<b>57,368</b>	<b>230,928</b>
Inventory changes of finished goods	2010	-585	-61	0	1,036	390
and work in progress	2009	2,376	-397	0	239	2,218
Own work capitalised (development)	2010	2,663	2,167	2,085	2,524	9,439
	2009	2,932	2,829	2,226	2,663	10,650
Cost of materials	2010	49,033	18,919	13,917	25,224	107,093
	2009	49,855	18,267	15,063	31,262	114,447
Personnel expenses	2010	39,339	10,575	9,769	21,495	81,178
	2009	45,653	11,344	10,016	25,201	92,214
Planned depreciation of fixed assets	2010	2,565	1,419	1,030	1,382	6,396
	2009	2,891	1,574	857	1,548	6,870
Planned depreciation of development	2010	336	549	192	1,045	2,122
work	2009	1,603	526	1,500	948	4,577
Other operating expenses **	2010	12,466	3,872	5,929	9,128	31,395
	2009	16,566	4,219	6,327	12,693	39,805
<b>Operating result before impairment</b>	<b>2010</b>	<b>4,779</b>	<b>-978</b>	<b>688</b>	<b>-3,857</b>	<b>632</b>
<b>charges and restructuring costs</b>	<b>2009</b>	<b>-1,153</b>	<b>-3,360</b>	<b>1,778</b>	<b>-11,382</b>	<b>-14,117</b>
Impairment charges Algeria	2010	0	0	0	7,816	7,816
	2009	0	0	0	0	0
Impairment charges intangible assets	2010	1,301	936	0	1,195	3,432
	2009	0	7,144	8,156	4,489	19,789
Restructuring costs	2010	1,129	0	148	875	2,152
	2009	5,943	995	552	1,374	8,864
<b>Operating result</b>	<b>2010</b>	<b>2,349</b>	<b>-1,914</b>	<b>540</b>	<b>-13,743</b>	<b>-12,768</b>
	<b>2009</b>	<b>-7,096</b>	<b>-11,499</b>	<b>-6,930</b>	<b>-17,245</b>	<b>-42,770</b>

	YEAR	TCC	AC	EC	SC	GROUP
		€K	€K	€K	€K	€K
Results from financial assets	2010					-786
reported at equity	2009					-650
Financial results	2010					-3,760
	2009					-1,556
<b>Results from ordinary activities</b>	<b>2010</b>					<b>-17,314</b>
	<b>2009</b>					<b>-44,976</b>
Taxes on income/other taxes	2010					-7,566
	2009					4,226
Results of minority interests/Foreign	2010					0
currency items	2009					-3
<b>Shareholders' results</b>	<b>2010</b>					<b>-24,880</b>
	<b>2009</b>					<b>-40,753</b>

\* The sales revenues with other business segments are eliminated in the consolidated financial statements.

\*\* Previous year's figures adjusted - please refer to Section B of the Notes.

The exchange of payments between the segments is made at normal market terms and conditions, as with external third parties.

The presentation of the financial result corresponds to the management approach of IFRS 8.

For a distribution of sales revenues according to geographically organised markets, please see section E.

## I. Other disclosures

### 1. GUARANTEES

As at the cutoff date, the Funkwerk group had guarantees for the benefit of customers and suppliers and bank guarantees totalling EUR 39,312k (2009: EUR 46,394k). These essentially comprised guarantees for contractual fulfilments (EUR 16,488k) and advance payments (EUR 18,376k). In addition, there were also debt assumption agreements of the subsidiary Funkwerk Security Communications GmbH to the amount of EUR 690k and also of Funkwerk Information Technologies York Ltd. (indirect subsidiary) to the amount of EUR 344k.

### 2. CONTINGENT LIABILITIES AND OTHER FINANCIAL OBLIGATIONS

Other financial obligations exist for:

	TERM		
	UP TO 1 YEAR	UP TO 5 YEARS	OVER 5 YEARS
	€ K	€ K	€ K
Long-term rental agreements	3,590	2,396	0
Long-term leasing agreements	1,667	2,496	124
Long-term leases	134	394	98
Other financial obligations	1,269	113	0

The rental and leasing expenses of the financial year are EUR 5,907k (2009: EUR 6,229k).

### 3. AVERAGE NUMBER OF EMPLOYEES BY CATEGORY DURING THE FINANCIAL YEAR

	2010	2009
Executive Board	2	3
Management	23	24
Administration	96	116
Development	292	368
Sales / project management	300	390
Production	586	656
Other	6	3
	<b>1,305</b>	<b>1,560</b>
Trainees	67	79
	<b>1,372</b>	<b>1,639</b>

#### 4. RELATIONSHIPS WITH RELATED PARTIES

Related parties in the sense of IAS 24 are the Executive Board and the Supervisory Board, cf. I.8.

Relationships with related parties in the sense of IAS 24 exist with affiliated companies not included in the consolidated financial statements and with the majority shareholder, Hörmann Funkwerk Holding GmbH, or Hörmann Holding GmbH & Co. KG (HHKG).

The business relationship of Funkwerk AG to HHKG was limited to passing on insurance expenses amounting to EUR 0.1k (2009: EUR 1k) and other advanced costs of EUR 29k (2009: EUR 0k). The business relationships of the subsidiaries of Funkwerk AG to HHKG also relate to insurance expenses together with legal and consultancy fees and reach a total of EUR 24k (2009: EUR 30k).

The legal transactions between the Funkwerk group and Hörmann Holding Verwaltungs GmbH (HHVGmbH) concern the latter passing on insurance expenditure amounting to EUR 8k (2009: EUR 0k). Furthermore, legal business conducted with Hörmann-Funkwerk Holding GmbH came to EUR 2k (2009: EUR 3k). There were no receivables or liabilities as at 31 December 2010 nor in the previous year.

The exchange of performances between the affiliated companies was conducted under normal market conditions as if between unrelated third parties.

The subsidiaries of Funkwerk AG recorded sales revenues amounting to EUR 3k (2009: EUR 553k) with companies that are affiliates of HHKG. The deliveries were invoiced at market prices or at cost plus an appropriate profit mark-up. The terms of payment granted are those that are usual for the market. At the reporting date, there were no trade accounts receivable from this (2009: EUR 18k).

Furthermore, in the 2010 financial year, the subsidiaries of Funkwerk AG also obtained goods and services from affiliated companies of HHKG amounting to EUR 14k (2009: EUR 220k). The figures invoiced almost exclusively concern material costs and third-party services. The deliveries were based on market prices. Quotes from competitors were usually also obtained when awarding the contracts or placing the orders, which means that competitive prices can be assumed for the pricing. There were no liabilities as at 31 December 2010 nor in the previous year.

A rental agreement amounting to EUR 78k per year exists between Microsyst Systemelectronic GmbH and Grundner Industrie und Beteiligungen GmbH, Kirchseeon.

In addition, there is also a rental agreement between Funkwerk plettac electronic GmbH and the wife of Dr Grundner, totalling EUR 8k per year.

In addition, a lease agreement was signed between Funkwerk Akademie GmbH and Schloss Beichlingen GbR, in which Mr Hörmann holds a majority interest, amounting to EUR 36k p.a. There were no liabilities as at the reporting date.

Funkwerk Enterprise Communications GmbH had accounts receivable from VTech Funkwerk IAD GmbH on the cutoff date totalling EUR 669k (2009: EUR 372k), which were completely depreciated by 31 December 2010.

A business relationship providing goods and services exists with the participating interest Funkwerk ES Iberia S.L. As a result, this subsidiary provided goods and services totalling EUR 733k (2009: EUR 272k). It received services amounting to EUR 70k (2009: EUR 81k). At the reporting date, the resultant trade accounts receivable for the Funkwerk group were EUR 0k (2009: EUR 286k) and the trade accounts payable were EUR 48k (2009: EUR 58k).

#### **5. MAJOR RISKS AND UNCERTAINTIES**

In principle, legal risks are taken into account by setting up reserves to the amount of the expected burden. Besides the risks sufficiently covered by reserves, no other risks or uncertainties are recognisable to date.

#### **6. DECLARATION OF COMPLIANCE WITH THE GERMAN CORPORATE GOVERNANCE CODE IN CONFORMITY WITH SECTION 161 AKTG**

In conformity with Section 161 of the German Stock Corporation Act, the Executive Board and the Supervisory Board have made the required declaration concerning the current and future compliance with the recommendations of the »Government Commission on the German Corporate Governance Code« published by the Federal Ministry of Justice in the official section of the Electronic Federal Gazette, and have made this declaration available to the shareholders on the website at <http://www.funkwerk.com>.

#### **7. EXEMPTIONS UNDER SECTION 264 PARA. 3 OF THE GERMAN COMMERCIAL CODE (HGB)**

The subsidiaries Hörmann-Funkwerk Kölleda GmbH and Funkwerk Dabendorf GmbH exercise the exemption from disclosure of their annual accounts under Section 264 para. 3 of the German Commercial Code.

#### **8. DETAILS ON THE EXECUTIVE BOARD AND THE SUPERVISORY BOARD**

##### **Officiating members of the Executive Board**

- Dr. Ing. Hans Grundner, Anzing, Chairman, Business Development Traffic and Control Communication and Security Communication, Public Relations, Coordination of Executive Board Duties
- Johann M. Schmid-Davis, Masters in Bus. Econ., Munich, Finances, Law, Controlling, Personnel and Investor Relations
- Mr Carsten Ahrens, MEng. Kaarst, Business Development Enterprise Communication and Automotive Communication, Technology and Products (since 01.10.2010)

##### **Remuneration**

The remuneration of the Executive Board members features both a non-performance-based and a performance-based component; its level and structure is determined by the Supervisory Board of Funkwerk AG.

The component which is not related to performance is made up of a fixed salary plus fringe benefits and pension commitments and is not dependent on certain targets being reached; it is paid monthly. In addition to the monthly fixed salary, all board members also receive fringe benefits, which include the private use of the company car and insurance premiums. All Executive Board members are entitled to these remuneration components and each must tax them as appropriate.

For a detailed breakdown of the remuneration components of the Executive Board members, please see the Management Report for the financial year.

### Executive Board pay

The payments due in the short term in the financial year are as follows:

	NON-PERFORMANCE		PERFORMANCE		PENSION		STOCK-BASED		TOTAL	
	RELATED PAY		RELATED PAY		COMMITMENTS		COMPENSATION		REMUNERATION	
	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009
	€	€	€	€	€	€	€	€	€	€
Dr. H. Grundner	231,636	220,015	0	0	24,000	24,000	10,080	13,140	265,716	257,155
J. Schmid-Davis	184,731	41,671	0	25,000	15,000	0	10,080	13,140	209,811	79,811
C. Ahrens	53,315	0	0	0	0	0	10,080	0	63,395	0
N. Gunkler	0	81,465	0	0	0	20,000	0	0	0	101,465
L. Pfister	0	74,536	0	0	0	20,000	0	0	0	94,536
<b>Total</b>	<b>469,682</b>	<b>417,687</b>	<b>0</b>	<b>25,000</b>	<b>39,000</b>	<b>64,000</b>	<b>30,240</b>	<b>26,280</b>	<b>538,922</b>	<b>532,967</b>

The Executive Board members were not able to exercise any share options in the 2010 financial year.

### Supervisory Board

- Mr Christian A. Hufnagl, retired, Hamburg, Chairman (until 27 May 2010)
- Mr Niels Lund Chrestensen, entrepreneur, Erfurt (until 27 May 2010)
- Mr Maximilian Ardel, entrepreneur, Starnberg, Vice Chairman until 27 May 2010 (Chairman since 27 May 2010 until 18 March 2011)
- Mr Alfons Hörmann, businessman, Sulzberg, Vice Chairman since 27 May 2010, Chairman since 18 March 2011
- Prof. Dr. Gerhard P. Fettweis, University Lecturer, Dresden, since 27 May 2010, Vice Chairman since 18 March 2011

In the period under review, Mr Christian A. Hufnagl was not involved in any other supervisory boards.

In the period under review, Mr Niels Lund Chrestensen was a member of the following Supervisory Boards:

- Deutsche Bahn AG, Berlin, until 31 March 2010
- Dresdner Bank AG, Frankfurt am Main (Advisory Board East)
- Thüringer Aufbaubank, Erfurt
- Member of the Advisory Board of public companies/institutions, communities, and savings banks of the Hestia-Thuringia regional bank

In the period under review, Mr Maximilian Ardel was a member of the following Supervisory Boards:

- TechData Corporation, Clearwater/Florida (member of the Board of Directors)
- Tiburon Partners AG, Munich (Vice Chairman of the Supervisory Board)
- Ecommerce Alliance AG (previously Getmobile Europe PLC), Munich (Chairman of the Supervisory Board)
- Stulz Holding GmbH, Hamburg (member of the Supervisory Board)
- Mannstaedt GmbH, Troisdorf (Chairman of the Supervisory Board)
- Technische Universität Graz, Graz, Austria (Vice Chairman of the University Council)
- Neumüller CeWe Color Stiftung (member of the Board of Trustees)

In the period under review, Mr Alfons Hörmann was a member of the following Supervisory Boards:

- Schöck AG, Baden-Baden (Chairman of the Supervisory Board)
- Wilhelm Geier GmbH & Co. KG, Oberstdorf (Chairman of the Advisory Board)
- Scaltel AG, Waltenhofen (Chairman of the Supervisory Board)
- Hörmann Holding GmbH & Co.KG, Kirchseon (member of the Advisory Board); until 30 June 2010

In the period under review, Prof. Dr. Gerhard P. Fettweis was a member of the following Supervisory Boards:

- Qualitytype AG, Dresden (Chairman of the Supervisory Board)
- DEWB AG, Jena (Vice Chairman of the Supervisory Board)
- ZMDI AG, Dresden (Vice Chairman of the Supervisory Board)
- Signalion GmbH, Dresden (member of the Advisory Board)
- Blue Wonder Communications GmbH, Dresden (member of the Advisory Board)

#### Remuneration

The remuneration of the Supervisory Board is governed in Section 12 of the Articles of Incorporation of Funkwerk AG and is divided into a fixed and a variable component plus an attendance fee. Concerning the level of payments, a distinction is made between the Chairman and the remaining members.

#### Pay of Supervisory Board members

	FIXED		ATTENDANCE		VARIABLE		TOTAL	
	REMUNERATION		FEE		REMUNERATION		REMUNERATION	
	2010	2009	2010	2009	2010	2009	2010	2009
	€	€	€	€	€	€	€	€
Christian A. Hufnagl	4,083	10,000	2,600	10,400	0	0	6,683	20,400
Maximilian Ardelt	8,979	7,500	14,950	7,800	0	0	23,929	15,300
Niels L. Chrestensen	2,042	5,000	1,300	5,200	0	0	3,342	10,200
Alfons Hörmann	4,437	0	9,750	0	0	0	14,187	0
Dr. Gerhard P. Fettweis	2,958	0	5,200	0	0	0	8,158	0
<b>Total</b>	<b>22,499</b>	<b>22,500</b>	<b>33,800</b>	<b>23,400</b>	<b>0</b>	<b>0</b>	<b>56,299</b>	<b>45,900</b>

#### 9. Auditor's fees

In the current financial year, the following fees were recorded for the auditor as defined by Section 319 para. 1 of the German Commercial Code, KPMG AG Wirtschaftsprüfungsgesellschaft, Berlin, and companies affiliated to it:

	2010
	TEUR
Audit of financial statements*	504
Other certification and appraisal services	10
Tax consulting	
Other services	3
	<b>540</b>

\* EUR 99k of which relate to the previous year

#### 10. Events after the cutoff date

To ensure lasting financial stability, Funkwerk AG as the borrower and 15 of its direct and indirect subsidiaries as co-debtors concluded a multiyear syndicated loan agreement of EUR 75.5m with three German commercial banks on 24 March 2011, subject to being granted a government indemnity bond.

The syndicated loan is made up of a revolving money market loan in the amount of EUR 17.5m and a guaranteed credit line of EUR 58m. Up to EUR 5m of the money market loan may also be utilised as credit in current account.

Funkwerk AG and its subsidiaries have provided collateral in the form of blanket assignments of trade receivables of individual subsidiaries, assignment of inventories of all companies in the Funkwerk group, and land charges on company property in Dabendorf and Kölleda. The loan has a term of three years with a renewal option of a further two years.

As further collateral for the syndicated loan agreement, Funkwerk is to receive an 80 per cent indemnity bond for EUR 9.0m of cash credit and a 60 per cent indemnity bond for EUR 10.6m of guaranteed credit for a term of five years from the Federal Government/Laender programme »Germany funds«, which is a key condition for being granted part of the loan.

Furthermore, in a contract dated 15 February 2011, Funkwerk Enterprise Communications GmbH sold all 49 per cent of its shares in VTech Funkwerk IAD GmbH, Kiel, at a purchase price of EUR 1 with economic effect from the end of 31 December 2010.

All effects were processed in the 2010 consolidated financial statements, so the net income for fiscal 2011 will not be affected.

No other events of particular importance that were not already reported in the Notes or the Management Report have occurred so far since the conclusion of the financial year.

## Statement of Changes in Consolidated Assets for the 2010 Financial Year (gross presentation)

A. FIXED ASSETS	PURCHASE AND PRODUCTION COST						
	AT 01/01/2010	ADDITIONS	DISPOSALS	DISPOSALS DECONSOLI- DATION	BOOK TRANSFERS	FOREIGN CURR. ITEMS	AT 31/12/2010
	€ K	€ K	€ K	€ K	€ K	€ K	€ K
<b>I. Immaterielle Vermögenswerte</b>							
1. Industrial property rights and similar rights and values, as well as licences thereto	17,825	847	(285)	(143)	(651)	84	17,677
2. Goodwill	19,265	0	0	0	0	0	19,265
3. Development costs	51,831	9,438	0	(247)	638	161	61,821
	<b>88,921</b>	<b>10,285</b>	<b>(285)</b>	<b>(390)</b>	<b>(13)</b>	<b>245</b>	<b>98,763</b>
<b>II. Sachanlagen</b>							
1. Land and leasehold rights and buildings, including buildings on third-party land	11,590	64	(599)	(165)	0	0	10,980
2. Plant and machinery	28,851	635	(181)	(94)	34	12	29,257
3. Other fixtures and fittings, tools and equipment	21,310	964	(770)	(271)	58	16	21,307
4. Plant under construction	119	112	(36)	0	(79)	0	116
	<b>61,870</b>	<b>1,775</b>	<b>(1,586)</b>	<b>(530)</b>	<b>13</b>	<b>28</b>	<b>61,570</b>
	<b>150,791</b>	<b>12,060</b>	<b>(1,871)</b>	<b>(920)</b>	<b>0</b>	<b>273</b>	<b>160,333</b>

\* The additions to depreciations are included in Planned depreciations (EUR 8,518k) and Restructuring costs (EUR 79k) of the statement of income and accumulated earnings.

	DEPRECIATION AND VALUE IMPAIRMENT						BOOK VALUE		
	AT 01/01/2010	ADDITIONS		DISPOSALS	DISPOSALS	FOREIGN	AT 31/12/2010	AT 31/12/2010	AT 31/12/2009
	€ K	DEPRE- CIATIONS*	VALUE IMPAIRMENTS	€ K	DECONSOLI- DATION	CURR. ITEMS	€ K	€ K	€ K
	12,586	2,124	0	(282)	(143)	79	14,364	3,313	5,239
	9,104	0	1,000	0	0	0	10,104	9,161	10,161
	34,344	2,122	2,432	0	(247)	(14)	38,637	23,184	17,487
	<b>56,034</b>	<b>4,246</b>	<b>3,432</b>	<b>(282)</b>	<b>(390)</b>	<b>65</b>	<b>63,105</b>	<b>35,658</b>	<b>32,887</b>
	4,406	472	0	(598)	(165)	0	4,115	6,775	7,184
	24,018	1,820	0	(174)	(94)	10	25,580	3,677	4,833
	16,611	2,054	0	(754)	(271)	11	17,651	3,656	4,699
	31	5	0	(36)	0	0	0	116	88
	<b>45,066</b>	<b>4,351</b>	<b>0</b>	<b>(1,562)</b>	<b>(530)</b>	<b>21</b>	<b>47,346</b>	<b>14,224</b>	<b>16,804</b>
	<b>101,100</b>	<b>8,597</b>	<b>3,432</b>	<b>(1,844)</b>	<b>(920)</b>	<b>86</b>	<b>110,451</b>	<b>49,882</b>	<b>49,691</b>

## Statement of Changes in Consolidated Assets for the 2009 Financial Year (gross presentation)

A. FIXED ASSETS	PURCHASE AND PRODUCTION COST				
	AT 01/01/2009	ADDITIONS	DISPOSALS	BOOK TRANSFERS	AT 31/12/2009
	€ K	€ K	€ K	€ K	€ K
<b>I. Intangible assets</b>					
1. Industrial property rights and similar rights and values, as well as licences thereto	17,106	1,355	479	(157)	17,825
2. Goodwill	19,065	200	0	0	19,265
3. Development costs	41,722	10,665	713	157	51,831
	<b>77,893</b>	<b>12,220</b>	<b>1,192</b>	<b>0</b>	<b>88,921</b>
<b>II. Tangible assets</b>					
1. Land and leasehold rights and buildings, including buildings on third-party land	11,538	132	80	0	11,590
2. Plant and machinery	29,005	1,110	1,285	21	28,851
3. Other fixtures and fittings, tools and equipment	20,489	1,592	781	10	21,310
4. Plant under construction	110	66	26	(31)	119
	<b>61,142</b>	<b>2,900</b>	<b>2,172</b>	<b>0</b>	<b>61,870</b>
	<b>139,035</b>	<b>15,120</b>	<b>3,364</b>	<b>0</b>	<b>150,791</b>

\* The additions to depreciations are included in the items planned depreciations (€11,447k) and restructuring costs (€540 k, of which €192 k for development costs) of the statement of income and accumulated earnings.

AT 01/01/2009	DEPRECIATION AND VALUE IMPAIRMENT						BOOK VALUE	
	ADDITIONS		DISPOSALS	BOOK TRANSFERS	FOREIGN CURR. ITEMS	AT 31/12/2009	AT 31/12/2009	AT 31/12/2008
	DEPRECIATIONS*	VALUE IMPAIRMENTS						
€K	€K	€K	€K	€K	€K	€K	€K	€K
10,761	2,170	0	336	0	(9)	12,586	5,239	6,345
0	0	9,104	0	0	0	9,104	10,161	19,065
19,633	4,768	10,685	670	0	(72)	34,344	17,487	22,089
<b>30,394</b>	<b>6,938</b>	<b>19,789</b>	<b>1,006</b>	<b>0</b>	<b>(81)</b>	<b>56,034</b>	<b>32,887</b>	<b>47,499</b>
3,960	449	0	3	0	0	4,406	7,184	7,578
23,122	2,153	0	1,264	0	7	24,018	4,833	5,883
14,883	2,447	0	706	0	(13)	16,611	4,699	5,606
31	0	0	0	0	0	31	88	79
<b>41,996</b>	<b>5,049</b>	<b>0</b>	<b>1,973</b>	<b>0</b>	<b>(6)</b>	<b>45,066</b>	<b>16,804</b>	<b>19,146</b>
<b>72,390</b>	<b>11,987</b>	<b>19,789</b>	<b>2,979</b>	<b>0</b>	<b>(87)</b>	<b>101,100</b>	<b>49,691</b>	<b>66,645</b>

Kölleda, 28 March 2011  
 — The Executive Board —



Dr. Hans Grundner  
 (Chairman)



Johann Schmid-Davis



Carsten Ahrens

## AUDITOR'S REPORT

We have audited the consolidated financial statements prepared by the Funkwerk AC, Köllda, comprising the statement of financial position, the statement of comprehensive income, the statement of changes in equity, the statement of cash flows and the notes to the consolidated financial statements, together with the group management report for the business year from 1 January to 31 December 2010. The preparation of the consolidated financial statements and the group management report in accordance with IFRSs, as adopted by the EU, and the additional requirements of German commercial law pursuant to § 315a Abs. 1 HGB (Handelsgesetzbuch »German Commercial Code«) are the responsibility of the parent company's management. 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 § 317 HGB and 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 materially affecting the presentation of the net assets, financial position and results of operations in the consolidated financial statements in accordance with the applicable financial reporting framework 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 those entities included in consolidation, the determination of entities to be included in consolidation, the accounting and consolidation principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements and 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 IFRSs, as adopted by the EU, the additional requirements of German commercial law pursuant to § 315a Abs. 1 HGB and give a true and fair view of the net assets, financial position and results of operations 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 and suitably presents the opportunities and risks of future development.

Leipzig, 28 March 2011  
KPMG AG  
Wirtschaftsprüfungsgesellschaft



Huber  
Wirtschaftsprüfer



Dr. Flascha  
Wirtschaftsprüfer

# THE FUNKWERK SHARE

## THE FUNKWERK SHARE: FLUCTUATING ITS WAY TO GAIN

On balance, the share of Funkwerk AG (ISIN DE0005753149) appreciated in value amidst a stock market environment that was dominated in 2010 by strong fluctuations. Starting out with a low valuation, Funkwerk gained over 36 per cent within 12 months and so fared better than its benchmark indices, DAX and TecDAX.

In the preceding year, the international stock markets were firmly in the grip of diverging trends. Surprisingly swift and strong, the recovery of the global economy from the worst depression since the twenties of the 20th century brought with it a positive underlying trend particularly in the first half of the year. Time and again, how-ever, this was spoilt by setbacks whose cause was found in the debt crisis of many European and western industrialised nations. The resulting consequences for the stability of the global currency and financial structure repeatedly overshadowed the trend on the stock markets.

The price performance of Funkwerk’s share largely followed the general pattern. Starting from a quotation of EUR 5.80, the share initially anticipated the announced profit turnaround and was continuously traded higher. By mid-April, Funkwerk’s stock had reached its annual high of EUR 9.65. Profit takings and the general fears of the insolvency of European industrialised nations, however, subsequently led to a pronounced downward adjustment all the way to the EUR 7 mark in early September.

PERFORMANCE FUNKWERK-SHARE (INDICATED TO 100)



By the time of publication of the generally disappointing figures for the third quarter, the share had continuously gained in value again, clawing its way back up to almost EUR 9. The revaluation which followed, however, also had analysts reduce their upside targets. For a brief period, Funkwerk's share even tested the EUR 6 limit before confidence in Funkwerk was finally restored in the course of the general recovery. Funkwerk closed the year 2010 with a price of EUR 7.23, which was up by almost EUR 2 on the end of 2009.

In the preceding financial year, the number of analysts regularly monitoring Funkwerk remained the same. These largely recommend Funkwerk's share as a buy or hold. The margin of upside targets given ranges from EUR 6.50 to EUR 10.50. It is expected that Funkwerk can generate growth and a positive result again in 2011.

Our Investor Relations work focused on explaining the trend of our business and describing the lasting effects of our restructuring measures. The analyst and press conference on our financial statements and the presentations at capital market conferences in Frankfurt met with a good response. At our annual Capital Markets Day, analysts had the opportunity at the two-day event in Potsdam and the subsequent visit to the world's largest trade fair focused on the railway industry (InnoTrans) to learn about the development of Funkwerk AG and, specifically, our Traffic and Control Communication segment. A further focal point of our Investor Relations was intensive personal contact with our minority shareholders.

In 2011, we plan to further spur our Investor Relations efforts to position Funkwerk as a turnaround security that bears good prospects and to renew confidence in our share.

Up-to-date information on Funkwerk's share along with presentations and reports on the company are also available on our website at [www.funkwerk.com/investor-relations](http://www.funkwerk.com/investor-relations).

#### **NEW SUPERVISORY BOARD ELECTED**

The shareholders' meeting of Funkwerk AG held on 27 May 2010 voted a new Supervisory Board for the company. Along with Mr Maximilian Ardelt, who was appointed chairman of the board, the controlling body of Funkwerk AG now comprises Prof. Dr.-Ing. Gerhard Fettweis, holder of the chair of Mobile Messaging Systems at the Technical University in Dresden, and Mr Alfons Hörmann, who is actively involved in the management of Hörmann Holding GmbH & Co. KG.

The shareholders' meeting also renewed the authorisation of the company to acquire its own stock. As a result, the company is able by 26 May 2015 to purchase its own stock up to a share of 10 per cent of the current capital stock (EUR 8,101,241). The time limit only applies to the acquisition, not to ownership of the shares.

The company currently holds 41,579 of its own shares, which corresponds to 0.5 per cent of the capital stock.

#### EMPLOYEE SHARE OPTION PLAN

The shareholders' meeting further approved the proposal of the Executive Board and the Supervisory Board to set up a new share option plan, as existing plans had expired. Under the plan, the existing capital stock of EUR 8,101,241 may be conditionally increased by up to EUR 365,000 through issue of non-par bearer shares to grant option rights. Allottees may be the Executive Board, the management, executives and employees of Funkwerk AG and associated companies.

The majority of the share option plan of up to 197,700 shares is intended for the company's employees. The option rights for the Executive Board are limited to 56,500 shares, for the management to 48,100 shares, and for executives to 62,700 shares.

#### FUNKWERK NOW ABLE TO ISSUE CONVERTIBLE AND WARRANT BONDS

As a new capital procurement instrument, Funkwerk AG can now in principle also issue convertible and warrant bonds. A proposal by the Executive Board and the Supervisory Board to change the company's Articles of Incorporation accordingly was accepted by the shareholders' meeting. Based on this decision, the Executive Board is authorised, with the approval of the Supervisory Board, to issue convertible and/or warrant bonds up to a total nominal value of EUR 30m through a single or repeated issue by 26 May 2015 and to grant the holders or creditors option rights for up to 3,200,000 company shares. To this end, the capital stock of the company may be increased by up to 3,200,000 shares. Shareholders always hold subscription rights to convertible and/or warrant bonds.

This step now also enables Funkwerk AG to make use of this financing instrument, which usually has attractive capital procurement conditions for the issuing company. It considerably increases the scope of financing options available to our company.

#### BASIC SHARE INFORMATION

- Segment: Prime Standard, Frankfurt Stock Exchange
- Class: No-par bearer share at a nominal value of €1
- WKN/ISIN DE: 575 314/DE 0005753149 (code: FEW)
- Reuters: FEWG.DE
- Bloomberg: FEW GR
- Capital stock: EUR 8,102,241
- Market capitalisation: EUR 58.6m (end of December 2010)

#### SHAREHOLDER STRUCTURE

Hörmann Funkwerk Holding GmbH continues to be the majority shareholder with an unchanged share of 52.83 per cent in the capital stock of Funkwerk AG.

In the reporting period, Funkwerk was not notified of any significant changes in the shareholder structure.

## CONTACTS

### INVESTOR RELATIONS

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Further information on the financial communication as well as on actual information can be found in the internet. This annual report is published in German too. The Date of publishing is April 8, 2011.

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# FINANCIAL CALENDAR 2011

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April 8, 2011	Publication of the 2010 annual report
May 13, 2011	Disclosure of quarterly report
May 19, 2011	Shareholder's meeting
August 12, 2011	Disclosure of half-yearly report
September 2011	Analyst-conference
November 11, 2011	Disclosure of nine-monthly report

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$$S(t) = a(t)e^{rt}$$