LifeWatch®

Annual Report 2016

USD million	2016	2015	2015 adjusted*	2014
Revenues	113.83	88.63	106.63	98.47
Gross Profit	56.74	37.59	55.59	53.18
EBITDA (LBITDA)	2.15	(3.62)	15.57	5.95
Net income (loss)	(13.40)	(11.95)	1.62	(2.73)
Total Assets	91.96	79.32	71.50	68.98
Current Assets	36.47	22.43	17.90	22.17
Other non-current assets	3.06	0.95	0.95	0.94
Non-current deferred income taxes	17.40	19.16	15.86	14.62
Fixed assets, net	18.36	16.35	16.35	14.92
Goodwill, intangible and other assets, net	16.67	20.44	20.44	16.33
Current Liabilities	33.08	50.21	28.82	22.56
Non-current Liabilities	1.95	3.34	3.34	9.54
Shareholders' equity	56.93	25.77	39.33	36.88
Cash flow from operating activities	(9.64)	9.97	9.97	4.09
Employees	640	612	612	580

* Adjusted for the Highmark award and the write-off of the LifeWatch V inventory

Total revenues Full Fiscal Year 2016:
USD 113.83 million

By business segment

- Services 100%
- Sale of Systems 0%

By region

- USA 100%
- Other 0%

"Following the successful capital increase and the settlement of the major legal cases in 2016, LifeWatch will refocus its efforts towards future growth."
Stephanie Krawetz, CLO

The LifeWatch Share's

Key Data

Number of shares per 31 December	2016	2015	2014	2013
Number of shares issued	18,477,869	13,473,550	13,448,426	13,238,198
Nominal value per share	CHF 1.30	CHF 1.30	CHF 1.30	CHF 1.30
Treasury shares	13,125	15,625	51,817	51,817
Number of shares outstanding	18,464,744	13,457,925	13,396,609	13,186,381

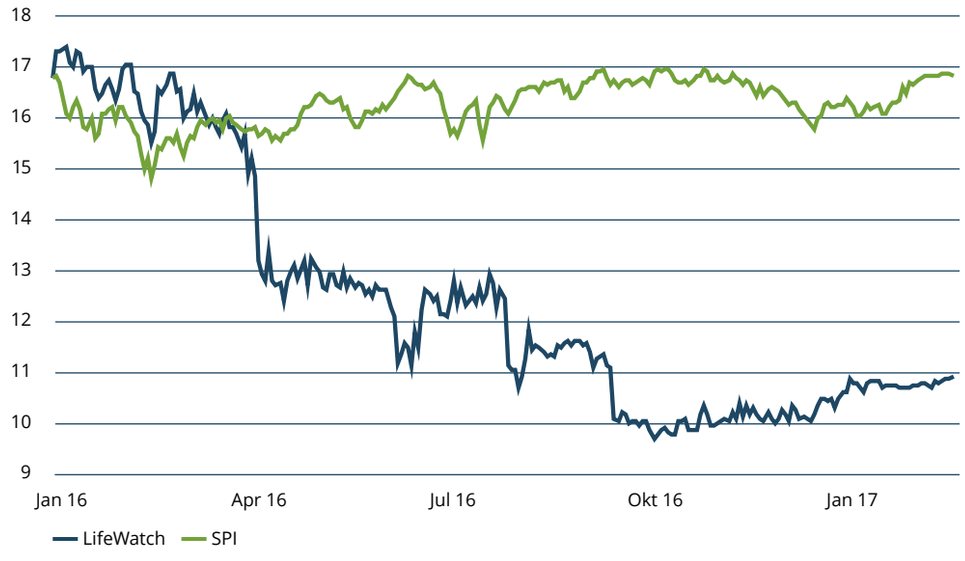
Key Share Information per 31 December	2016	2015	2014	2013
Earnings per share	(0.855)	(0.891)	(0.205)	0.222
Shareholders equity per share	3.081	1.912	2.734	2.915

Share price in CHF	2016	2015	2014	2013
High	18.00	17.50	12.80	8.49
Low	8.81	11.40	7.40	6.55
Year-end price	10.25	16.90	12.30	7.59
Average number of shares traded per day	19,924	34,379	43,882	9,597
Market capitalization (CHF millions)	189.40	227.70	165.42	100.48

Ticker Details

ISIN-No.:	0012815459
SIX Ticker Symbol:	LIFE
Security-No.:	1281545
Indices:	SPI / SPI Extra / SPI ex SLI / SWISS ALL SHARE INDEX
Initial Public Offering:	29 Nov. 1999 SWX New Market SIX Swiss Exchange Main Board since October 29, 2001

LifeWatch – Share Price Performance 2016



Shareholder Structure

Major Shareholders*	Percentage held
Himalaya (Cayman Islands) TMT Fund	15.26%
AEVIS Victoria SA	11.99%
LB (Swiss) Investment AG	10.04%
Martin Eberhard	3.23%

* as of February 20, 2017

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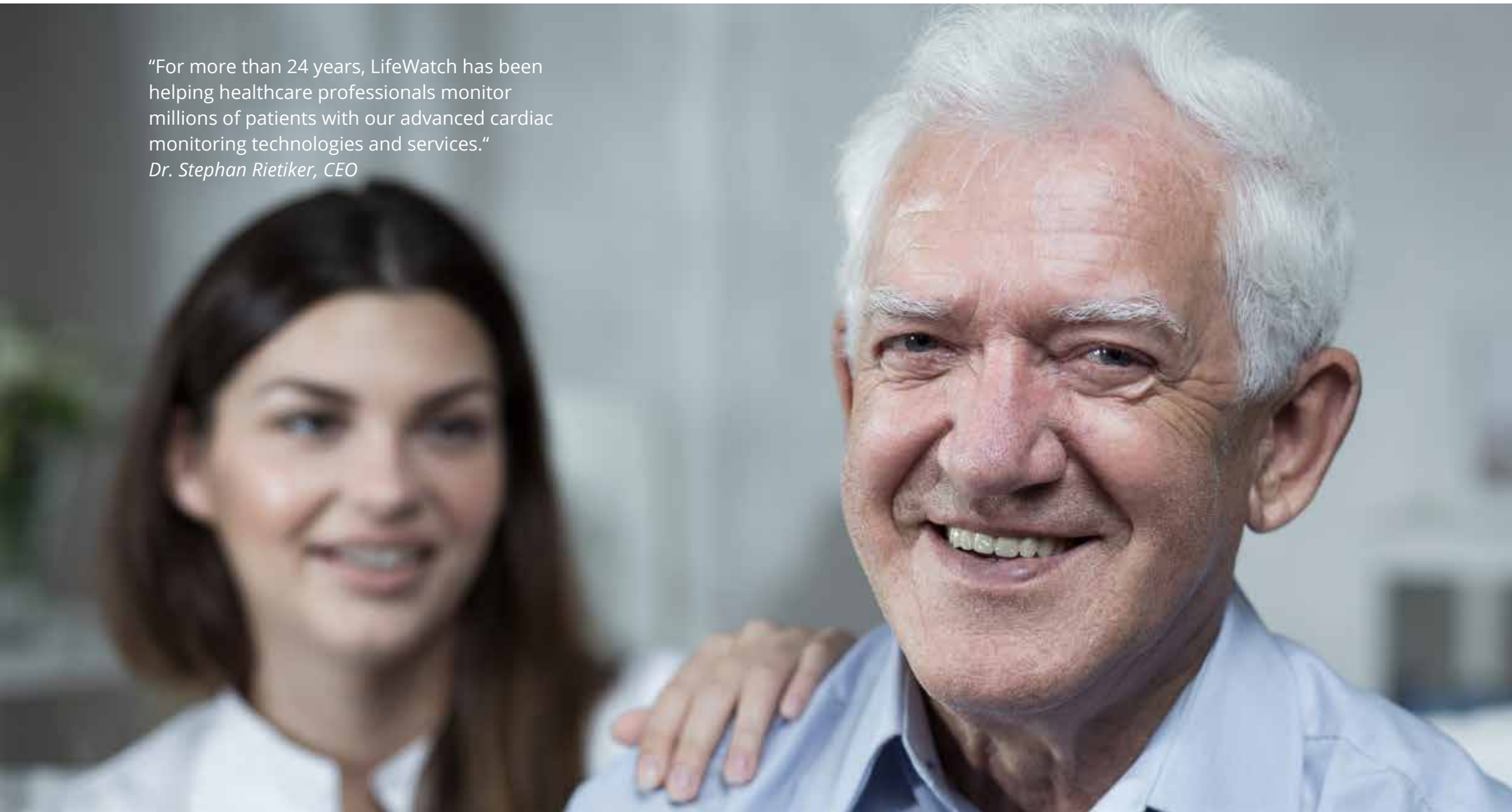


"For more than 24 years, LifeWatch has been helping healthcare professionals monitor millions of patients with our advanced cardiac monitoring technologies and services."
Dr. Stephan Rietiker, CEO

Letter to Shareholders

Dear ladies and gentlemen, shareholders of LifeWatch,

We are pleased to share with you the 2016 Annual Report.

LifeWatch had a mixed year in which several positive developments were overshadowed by two large legal settlements and several one-off items. Revenue grew in 2016 by 6.75% to USD 113.8 million (2015 adjusted revenue: USD 106.6 million). Although this growth was below the originally forecast double digit growth, it is still above the estimated market growth of 4% to 5%. In July 2016 LifeWatch successfully completed a capital increase via a rights issue, in which 83% of existing shareholders participated. This was followed in the fourth quarter by the signing of a Letter of Intent (LOI) with GE Healthcare which, once formalized in a contract, promises to provide significant value in the future and the launch of the LifeWatch Mobile Cardiac Telemetry (MCT) 1-lead patch. These developments set the stage for double-digit revenue growth in our core business in the U.S. in 2017. Furthermore, the project in Turkey continued its successful development and the launch of the company's MCT service in Turkey is scheduled for H1 2017. This project should become cash flow positive in the first half of 2018.

The challenges during 2016 started with the Highmark judgment, which was announced in the USA on March 16, 2016, the day before the company's planned 2015 results announcement and led to a restatement of the 2015 financial results. This case, which originally totaled approximately USD 22 million and involved a dispute about the use of the correct billing codes for the period 2009 and 2010, was later settled for a net amount of USD 13 million and including the release of Highmark from an on-going case against them. A further setback followed in the first half of the year with the settlement of a whistleblower *QuiTam* case, relating to a period up to 2013, resulting in a provision of USD 12.975 million. Other setbacks included several sales leadership issues involving the lack of use of the Customer Relationship Management (CRM) system, an inflexible sales commission plan, a significant backorder situation and a misguided positioning of the MCT 1-lead patch. These events led to a significant loss of sales revenue and resulted in the reduction in the expected revenue growth mentioned above. Significant effort and resources were committed to correct these issues, including new sales leadership, streamlined and improved distribution processes and a new sales commission plan. Other unplanned events included the reversal of a device sale from 2015 and the discontinuance of the Home Sleep Therapy (HST) and International Normalized Ratio (INR) services and the Vital Signs Project (VSP) project. These matters are now behind the company, have been fully addressed and provisioned as necessary and will therefore not impact the company's performance in 2017 and beyond.

In July 2016 LifeWatch announced that it would be transitioning to a pure play service provider and discontinuing the in-house development of medical devices. This led to reduction of staff in R&D during the second half of the year with further reductions planned for 2017.

The consolidation and turnaround of the business mentioned in the 2015 annual report continued into 2016. The two large legal cases in 2015 and 2016 were a considerable set-back and resulted in the need for the capital increase in July 2016. The proceeds of the capital increase enabled the company to settle these two cases, continue the development and improvement of its software and IT systems as well as expand its very successful Electronic Medical Records (EMR) integration project team. Several very important software projects are due for completion in 2017, leading to better reporting to the company's customers and improved efficiency in its call centers.

Strategy

As indicated above LifeWatch's objective is to further enhance its position as a leading provider of remote cardiac monitoring services in the United States, by strengthening its existing remote cardiac monitoring offering and leveraging its remote monitoring expertise into certain international markets. In addition, it is envisioned that the product offering will expand beyond cardiac monitoring with a view towards monitoring of other co-morbidities, such as stroke, blood pressure and sleep apnea.

Letter to Shareholders

The key elements of the strategy by which LifeWatch intends to achieve these objectives include:

- **Primary focus on outpatient services:** LifeWatch will focus its revenue generation on ambulatory monitoring services as well as hospital and clinic outpatients.

- **Transition to a pure play service provider:** LifeWatch strives to become primarily a service provider in its core business and related co-morbidities. LifeWatch aims at ensuring that its technology platform remains state-of-the-art either by developing products through third party providers or by buying off-the-shelf technology. An internal technology innovation team shall ensure a smooth integration into the Group's existing service platform.

- **Increase the demand for LifeWatch's remote cardiac monitoring solutions:** LifeWatch strives to better exploit its existing database and more extensively evaluate current and future data streams in order to demonstrate the value of its monitoring services. Many health care providers are moving towards evidence based medicine and therefore demand reliable outcomes data. LifeWatch is well positioned to utilize its huge database to provide an excellent service to physicians, payors and the health care industry in the areas of pattern recognition, predictive analytics and new indications such as post ablation monitoring as well as for related co-morbidities (stroke, blood pressure management, sleep apnea).

- **Expand into certain international markets:** LifeWatch intends to penetrate certain international markets by either replicating its existing business model or by developing new service offerings (e.g. tele-monitoring) by entering into local partnerships (first example is the planned launch in Turkey).

Outlook

Following the successful capital increase and the settlement of the major legal cases in 2016, LifeWatch's efforts are focused on growth.

The completion of several in-house technology projects is anticipated to improve the efficiency of operations, increase gross profit and contribute to expansion in profitability. Several additional growth initiatives including the commencement of business in Turkey as well as the collaboration with GE Healthcare are also expected to contribute to LifeWatch's business.

In 2017, we anticipate double digit revenue growth and positive operating results even after taking into account the costs associated with solicitation of potential acquirers following the public offer made by Aevis Victoria SA and investments into the Turkish joint venture.

We would like to thank both our old and newer shareholders for their continued support and we look forward to meeting you at the upcoming Annual General Meeting.

Dr. Robert Bider
Chairman of the Board

Dr. Stephan Rietiker
Chief Executive Officer

"Our goal is to become a pure service provider and to open larger market potential in both the USA and internationally."
Dr. Robert Bider, CoB

Core Business & Strategy

Overview[1]

LifeWatch is a leading health care services and technology company, specialized in providing remote wireless diagnostic monitoring services as well as developing and manufacturing advanced digital health systems. It offers a comprehensive range of Mobile Cardiac Telemetry (MCT) technologies and services that can help physicians detect and analyze patient symptoms before they turn into serious health problems. LifeWatch's monitoring services are mainly driven by the need to diagnose, treat and prevent cardiovascular disease (CVD), which include coronary heart disease, congestive heart failure, hypertension, arrhythmia and stroke. Through access to patient's electrocardiography (ECG) data and clinical reports, physicians and care teams can better collaborate, enabling detection and intervention at the earliest sign of a significant health event.

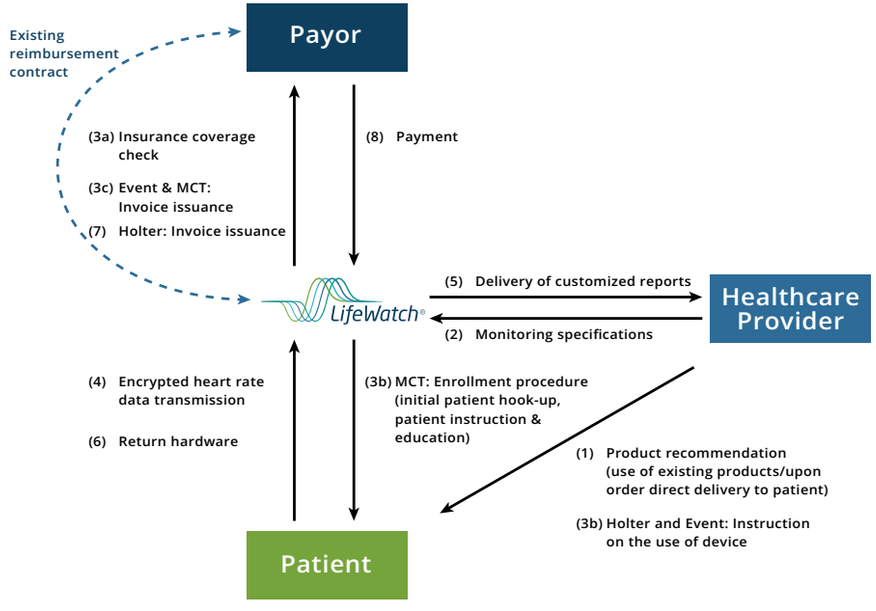
LifeWatch focuses on developing digital health services through the detection of arrhythmia and related co-morbidities. The result of LifeWatch's diagnostic service is a report to the physician providing information on events. This information is provided electronically and can therefore be integrated into advanced electronic medical records (EMR), which allow the secure electronic exchange of patient data to help physicians meet the "Meaningful Use" [2] criteria. The ability to access quickly and conveniently a patient's ECG data and integrate it with other patient information, such as diagnostic procedures, implantable devices, treatment and follow-up, is key to improving care, especially since patients are likely to be treated by multiple physicians. Having access to this data allows physicians to make more timely and informed decisions about the best course of care, and better coordinate with other caregivers.

1 This chapter is an excerpt from LifeWatch's Offering Prospectus dated July 5, 2016 (Manager Bank Vontobel AG) including selected updates.

2 "Meaningful Use" sets specific objectives that eligible professionals and hospitals must achieve to qualify for Centers of Medicare and Medicaid Services (CMS) incentive programs. "Meaningful Use" is the use of certified electronic health record (EHR) to (i) improve quality, safety, efficiency and reduce health disparities, (ii) engage patients and family, (iii) improve care coordination and population and public health, and (iv) maintain privacy and security of patient health information. Ultimately, it is hoped that "Meaningful Use" compliance will result in (i) better clinical outcomes, (ii) improved population health outcomes, (iii) increased transparency and efficiency, (iv) empowered individuals, and (v) more robust research data on health systems.

Management believes that LifeWatch is an industry leader in remote cardiac monitoring and a major contributor to the improvement of the standards in this sector with a commitment to develop technology and information solutions that help improve the health outcomes of patients. LifeWatch has operating subsidiaries in the United States, Switzerland, Israel (recently downsized), Macedonia, Japan (currently being closed), Turkey and India, generating all of its revenues (2015: 98.8%) in the United States. LifeWatch Services is a leading U.S.-based provider of cardiac monitoring services.

The illustration below depicts the operating model of LifeWatch:



Core Business & Strategy

Health care providers typically administer a resting ECG or a stress test in order to record and analyze a patient's cardiac events for evidence of a cardiac arrhythmia. If the physician finds that such tests do not produce a diagnosis or if he would like to monitor a patient for a longer period of time, he will typically prescribe an ambulatory cardiac monitoring device for his patient and enroll the patient with LifeWatch's services. At the time of enrollment, a physician typically specifies the parameters of the clinically significant events he wants monitored as well as the manner and frequency in which he would like to be notified. Subsequently, LifeWatch will check the insurance coverage with the relevant payor based on existing reimbursement contracts and issue an invoice to the payor for reimbursement (i.e. for MCT and event monitoring).

Once enrolled, the patient typically either obtains the monitoring devices from its physician's existing in-house inventory or LifeWatch sends the device by overnight courier directly to the patient. In case of "Holter monitoring" and "event monitoring", the patient would typically be instructed on the device's use by the physician. For MCT, the patient is provided with one-on-one instructions over the phone for connecting the device (i.e. onboarding procedure). It then takes a baseline transmission of the patient's cardiac events in order to be able to distinguish between the patient's normal cardiac events and potential future irregularities.

After the hook-up procedure has been completed, the monitoring period for MCT starts. Monitoring can last up to 30 days but averages around 17 days.

During the monitoring period, the certified cardiac technicians prepare reports for a patient's physician on a daily and episodic basis as well as a final report at the end of the monitoring period. Additionally, physicians are informed immediately upon the occurrence of an event. Results are available to a physician in the form requested. While LifeWatch does not interpret the monitoring results, its certified cardiac technicians monitor the computer-generated (algorithm) analysis to ensure that significant abnormalities are reported with an immediate medical doctor notification (MDN). In addition, any events that fall within certain parameters established by a patient's physician are also treated as MDNs.

As soon as the defined service period has come to an end, the patient returns the hardware to LifeWatch for cleaning, testing and reprocessing.

Key Competitive Strengths

LifeWatch considers that the principal competitive factors in its market include scope and quality of service as well as access to innovative medical devices. LifeWatch is of the opinion that it has achieved a leading market position through the easy access it offers to physicians and patients for its remote cardiac monitoring devices and the service provided thereafter. Its competitive advantages include:

- Quality of service: LifeWatch's three call centers provide patients and physicians with immediate and reliable assistance and support. Regular in-house patient surveys show a high degree of customer satisfaction. The reports provided are customizable according to the physician's needs.

- Brand recognition and customer loyalty: the high quality monitoring services LifeWatch provides have helped to develop brand name recognition and loyalty with its referring physicians. In 2016, LifeWatch had service or product relationships with over 3,100 health care providers, which, as a result of consolidation in the health care industry, was 13% lower than in 2015. Given its 24 years of experience in ECG interpretation and analysis, LifeWatch is widely recognized by cardiologists and electrophysiologists throughout the United States as a premier provider of remote ambulatory cardiac monitoring services.

Core Business & Strategy

- Network of commercial payors: LifeWatch had reimbursement contracts with over 500 commercial payors, including major health insurance companies, which is one of the highest penetration rates in the United States. The contracts are either on a national, regional or local basis.

- Access to advanced technology: LifeWatch is a leader in the development of hardware and software solutions for the remote cardiac monitoring market. This includes advanced algorithms, new wearable sensors (patch technology) and mobile data gateways. Expertise in material and electrical design for miniaturized body-worn sensors and in digital health applications for mobile phone platforms has been developed and integrated over many years.

- Profound Electronic Medical Record (EMR) integration experience: versatile, one-directional or bi-directional integration options, convenient workflow in a paperless process, validation of rhythm interpretation with discreet data elements and waveform images.

- Clinically validated, standardized processes: LifeWatch's workflow processes are overseen by a group of cardiologists and electrophysiologists that are specifically trained to implement the most advanced, effective monitoring methods. Its processes are supported by more than 300 standard operating procedures, more than 300 work instructions and an additional 31 working policies.

Strategy

LifeWatch's objective is to further enhance its position as a leading provider of remote cardiac monitoring services in the U.S., by strengthening its existing remote cardiac monitoring offering and leveraging its remote monitoring expertise into certain international markets. In addition, it is envisioned that the product offering will expand beyond cardiac monitoring with a view towards monitoring of other co-morbidities, such as stroke, blood pressure and sleep apnea.

The key elements of the strategy by which LifeWatch intends to achieve these objectives include:

- Primary focus on outpatient services: LifeWatch will focus its revenue generation on ambulatory monitoring services as well as hospital and clinic outpatients.

- Transition to a pure play service provider: LifeWatch strives to become primarily a service provider in its core business and related co-morbidities. LifeWatch aims at ensuring that its technology platform remains state-of-the-art either by developing products through third party providers or by buying off-the-shelf technology. An internal technology innovation team shall ensure a smooth integration into LifeWatch's existing service platform.

- Increase the demand for LifeWatch's remote cardiac monitoring solutions: LifeWatch strives to better exploit its existing database and more extensively evaluate current and future data streams in order to demonstrate the value of its monitoring services. Many health care providers are moving towards evidence based medicine and therefore demand reliable outcomes data. LifeWatch is well positioned to utilize its huge database to provide an excellent service to physicians, payors and the health care industry in the areas of pattern recognition, predictive analytics and new indications such as post ablation monitoring as well as for related co-morbidities (stroke, blood pressure management, sleep apnea).

- Expand into certain international markets: LifeWatch intends to penetrate certain international markets by either replicating its existing business model or by developing new service offerings (e.g. tele-monitoring) by entering into local partnerships (first example is the planned launch in Turkey).

- Accelerate growth by pursuing strategic partnerships: LifeWatch is actively pursuing strategic partnerships that will enable it to broaden its current service offering or strengthen its existing technology platform. Examples include the Letter of Intent with General Electric Healthcare and the contract with AliveCor.

Digital Health Market

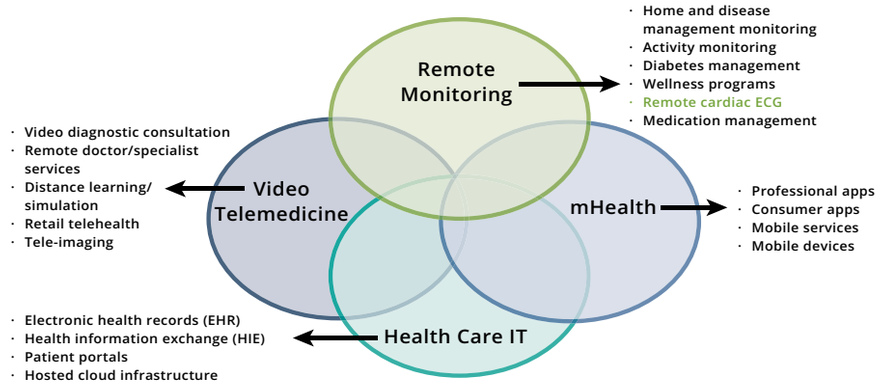
Telemedicine is defined by the World Health Organization as "the delivery of health care services, where distance is a critical factor, by all health care professionals using information and communication technologies for the exchange of valid information for diagnosis, treatment and prevention of disease and injuries, research and evaluation, and for the continuing education of health care providers, all in the interests of advancing the health of individuals and their communities" [3].

Demographic trends, increasing economic wealth and willingness to pay for health care services as well as health care reforms including cost cutting, efficiency and transparency efforts have intensified the interest in digital health technologies and services. In looking to extend capabilities and patient interactions beyond traditional care settings, health care providers are developing integrated strategies for adopting digital health technologies as more payors begin to pay for these services.

3 World Health Organization. A Health Telematics Policy: in support of WHO's Health-For-All Strategy for Global Health Development, Report of the WHO Group Consultation on Health Telematics, 1998.

Core Business & Strategy

According to Frost & Sullivan, the digital health market can be categorized in the key segments (i) remote monitoring (ii) video telemedicine (iii) mHealth and (iv) health care IT as depicted in the figure below [4]:



4 Frost & Sullivan, US Remote Patient Monitoring Market: Is it Finally Ready to Make a Difference?, November 2015.

Core Business & Strategy

Remote Monitoring Market

LifeWatch offers a broad range of services in the remote monitoring market segment, in particular in the remote cardiac monitoring market. The remote cardiac monitoring market can be subdivided into two broad segments, namely non-telemetric services and telemetry. Telemetry services involve the transmission and evaluation of data in near real-time, whereas non-telemetric services do not automatically transmit data and evaluation only occurs either at the end of the service or once data is transmitted. The technology enables patients to be monitored outside of conventional clinical settings, thereby reducing hospital admissions and enabling patients' health to be monitored during their daily lives. The components of the telemetric remote patient monitoring system typically include [5]:

- a sensor-based device that enables by wireless communications the measurement of the physiological parameters;
- a gateway that collects data from the sensor-based device and securely transfers the data to a centralized repository;
- a centralized repository where the patient's data from gateways and diagnostic applications are stored and analyzed; and
- visualization and display software at the monitoring center that can generate customized medical reports and alerts based on analyzed data.

Non-telemetric monitoring would not involve wireless communications and would not need a gateway for the transmission of data; data is simply downloaded from the device, either during the period of service or at the end of service, analyzed and a report is then produced. Furthermore, non-telemetric monitoring does not require call centers operating on a 24/7 basis.

5 Frost & Sullivan, FN 3.

Remote cardiac monitoring generally refers to continuous monitoring of the heart activity, by electrocardiography with assessment of the patient's condition relative to his baseline.

Cardiac arrhythmias are typically classified by both the heart rate as well as the area of the heart in which they originate. The table below describes and provides examples of the two principal forms of cardiac arrhythmias defined by the heart rate:

Type of Cardiac Arrhythmia	Description	Examples
Tachycardia	Heart rate greater than 100 beats per minute	Atrial fibrillation, ventricular tachycardia, ventricular fibrillation, syncope
Bradycardia	Heart rate less than 60 beats per minute	Sinoatrial disease (sick sinus), carotid sinus hypersensitivity, vasovagal syndrome, atrial ventricular heart block, asystole, syncopeventricular heart block, asystole, syncope

Core Business & Strategy

While cardiovascular disease continues to be the world's leading cause of death, the global market size of the cardiac monitoring market is expected to amount to $2.3 billion in 2017 [6]. There are three main market segments based on the monitoring technology [7]:

- Holter monitoring: is one of the most common diagnostic tools, generally providing 24 to 48 hours of continuous ECG monitoring, although longer-term Holter monitoring (up to 14 days) is also increasing being offered. Holter monitoring is normally the first study ordered by cardiologists and electrophysiologists when a patient has suspected ECG abnormalities or symptoms that are not captured with a standard real time 12 Lead ECG. If no symptoms are captured using Holter monitoring, then a physician would order either event monitoring or mobile cardiac telemetry monitoring. Analysis of the data from Holter monitoring occurs at the end of service, i.e. non-telemetric.

- Event monitoring: is a general term to describe longer term cardiac ECG monitoring. Cardiac event monitoring has a variety of forms from patient activated, automatic detection, wireless event monitoring to implantable cardiac event monitoring devices. Event monitoring can either utilize Telemetry or involve periodic data transmissions by the patient.

- Mobile Cardiac Telemetry (MCT) monitoring: is the most advanced and effective form of outpatient ECG monitoring. MCT monitoring automatically detects and transmits cardiac abnormalities via cell phone in near real time to a diagnostic facility (call center).

6 Cardiac Monitoring And Diagnostic Devices – Global Trends, Estimates and Forecasts, 2012-2018, <http://www.prnewswire.com/news-releases/cardiac-monitoring-and-diagnostic-devices---global-trends-estimates-and-forecasts-2012-2018-274504341.html>.
7 Cf. <www.cardiacmonitoring.com>.

U.S. Market

Health care expenditure in the United States increased from 5% of the gross domestic product in 1960 to 17.5% (respectively $3 trillion) in 2014 [8]. The continuous increase in health care spending is mainly driven by an increasing percentage of aging population. While U.S. senior citizens (i.e. age 65+) accounted for 13.7% of the population in 2012, the U.S. Census Bureau forecasts the figure to grow to 20.9% in 2050 [9]:

Year	Age 65 + population (in m)	% of total U.S. population
2012	43.1	13.7
2020	56.0	16.8
2030	72.8	20.3
2040	79.7	21.0
2050	83.7	20.9

Source: U.S. Census Bureau (2012)

As a consequence, the health care industry has started supplying technologies to improve health care delivery for the aging population and to address the prevalence of chronic diseases. According to a 2016 report from the Millennium Research Group [10], the U.S. market for Telemetry will grow to around $1,625 million in 2025, a compound annual growth rate of 19.1% for the period from 2015 to 2025. Growth in 2017 is predicted to be over 30%. Additional factors supporting the ongoing market growth in digital health also include:

8 Centers for Medicare & Medicaid Services, National Health Expenditures 2014 Highlights, 2015; Centers for Medicare & Medicaid Services, National Health Expenditures; Aggregate and Per Capita Amounts, November 2015.
9 Jennifer M. Ortman/Victoria A. Velkoff/Howard Hogan, An Aging Nation: The Older Population in the United States, Current Population Reports, P25-1140, U.S. Census Bureau, May 2014.
10 Millennium Research Group, Inc, Ambulatory Electrocardiography Monitoring Devices ¦ Medtech 360 ¦ Market Analysis ¦ US ¦ 2017.

Core Business & Strategy

(i) cardiovascular disease as major cause of death: cardiovascular disease are currently responsible for nearly 25% of all deaths in the United States each year (i.e. 610,000 deaths p.a.) [11], with estimated direct and indirect costs to diagnose and treat CVD expected to reach $818 billion in 2030 [12];

(ii) trend towards outpatient facility care: the increasing number of patients with cardiac conditions will drive up the utilization of cardiac monitoring services, especially in IDTFs since mid-size and smaller hospital systems are outsourcing services to these ambulatory service firms with an emphasis on reducing hospital days and medical errors [13];

(iii) major insurance coverage expansions under the Patient Protection and Affordable Care Act (ACA): the ACA and health care reform includes the emergence of a value-based payment structure versus the fee-for-service payment models. The ACA is encouraging outcome-based care delivery and end-to-end care coordination, while the Innovation Center at Centers for Medicare & Medicaid Services is piloting new financial models for care delivery. These new pay structures are expected to affect current market business models, and physicians and hospital systems are exploring new avenues to maintain and/or improve margins; and

(iv) nursing shortages: significant time and responsibility required for each MCT study accompanied by an unattractive reimbursement structure for physicians.

11 Centers for Disease Control and Prevention: <http://www.cdc.gov/heartdisease/facts.htm>.
12 Paul A. Heidenreich et al., Forecasting the Future of Cardiovascular Disease in the United States: a Policy Statement from the American Heart Association, January 2011.
13 Frost & Sullivan, FN 9.

Services and Products

LifeWatch offers predominantly in the United States a comprehensive range of diagnostic cardiac monitoring services, such as Holter, event and mobile cardiac telemetry, in combination with technologically advanced monitoring devices. LifeWatch's cardiac monitoring services are prescribed by physicians who use LifeWatch's services to assist in the diagnostic monitoring of their patients' cardiac event data, a key process needed to allow physicians to diagnose cardiac arrhythmias. The services are offered 24 hours a day, seven days a week, 365 days a year and are provided on a multi-lingual basis.

Cardiac monitoring business activities require the operation of at least one facility approved as an Independent Diagnostic Testing Facility (IDTF). An IDTF as defined by the Centers for Medicare and Medicaid Services (CMS) means an entity independent of a hospital or physician's office in which diagnostic tests are performed by licensed or certified non-physician personnel under appropriate physician supervision. LifeWatch operates as of December 31, 2016, three certified IDTFs across different time zones in the United States (i.e. Philadelphia, Rosemont (Chicago) and San Francisco) with approximately 165 certified cardiac technicians. In addition, LifeWatch has a subsidiary in India and utilizes two external contractors in India for technical assistance. All incoming ECG transmissions undergo a technical review and the summary report and computer generated diagnostic monitoring results are posted to an online portal for physician review and interpretation. Alternatively, the report is made available via EMR integration to the physician's electronic medical record system or by fax. An event needing a MDN would be communicated to the physician according to instructions received.

In 2015, LifeWatch completed the update of its MCT software to the technologically advanced Android operating system. FDA clearance was received in September 2015 allowing LifeWatch to use this software with its Universal Gateway.

Core Business & Strategy

In 2015, LifeWatch monitored over 340,000 patient enrollments, which were referred to LifeWatch by over 3,107 cardiology groups. The professionals at the call centers handled over 9.7 million patient interactions and over 400,000 patient telephone calls.

Manufacturing

LifeWatch manufactures all of its products at LifeWatch Israel, except for the DigiTrak XT Holter Monitor, which is purchased from Philips. LifeWatch outsourced some of its patch production to a contract manufacturer in 2016 and expects to fully outsource the production of all products during the course of 2017.

Quality Assurance/Quality Control

LifeWatch places considerable importance on QA/QC since this is essential for companies operating in a highly regulated environment. The quality department is staffed by nine very experienced and highly qualified individuals, who ensure that LifeWatch's quality systems and procedures are well documented, effective and compliant. Their work includes identifying and prioritizing areas requiring improvement, driving product quality improvement, ensuring new product introductions are both successful and compliant with LifeWatch's quality systems, auditing existing QA/QC systems, following up and correcting any compliance issues and ensuring the timely processing of medical doctor reports and complaints.

Government Regulation

The health care industry is highly regulated with no guarantee that the regulatory environment in which LifeWatch operates will not change significantly and adversely in the future. LifeWatch believes that health care legislation, rules, regulations and interpretations will change and it expects to modify its agreements and operations in response to these changes.

U.S. Food and Drug Administration

The medical devices that LifeWatch manufactures and uses to provide patient monitoring services are regulated by the FDA under the Federal Food, Drug, and Cosmetic Act. The basic regulatory requirements that manufacturers of medical devices distributed in the United States must, unless exempt, comply with are Premarket Notification 510(k) or Premarket Approval (PMA) regulations. These regulations include establishment registration, medical device listing, quality system regulation, labeling requirements and medical device reporting.

The devices and the algorithms which LifeWatch uses in the MCT service require FDA 510(k) clearance as a Class II device. On October 28, 2003, the FDA issued a guidance document entitled "Class II Special Controls Guidance Document: Arrhythmia Detector and Alarm". In addition to conforming with the general requirements of the Federal Food, Drug, and Cosmetic Act, including the Premarket Notification requirements described above, all of LifeWatch's 510(k) submissions address the specific issues covered in this special controls guidance document.

Failure to comply with applicable regulatory requirements can result in enforcement action by the FDA which may include certain sanctions such as fines, injunctions and civil penalties; recall or seizure of LifeWatch's devices and intellectual property; operating restrictions; partial suspension or total shutdown of manufacturing; withdrawal of 510(k) clearance of new components or algorithms; withdrawal of 510(k) clearance already granted to one or more of LifeWatch's existing components or algorithms; and criminal prosecution.

The FDA regularly carries out audits of any company subject to its regulation. In 2012, the FDA issued a warning letter to LifeWatch Services notifying it that the FDA, following inspection of LifeWatch Services' U.S. facility in Rosemont (Chicago), considered several of its practices, processes, and other activities to

Core Business & Strategy

be in violation of the Federal Food, Drug, and Cosmetic Act, the rules and regulations that govern LifeWatch Services' actions in the U.S. This resulted from an inadequate QA/QC system. Subsequent inspections in 2013 and 2014 revealed repeated violations. A risk existed that the FDA could issue a consent decree, effectively bringing the business to a standstill, if LifeWatch Services did not take immediate action to build-up a state-of-the-art QA/QC system in order to correct the violations. LifeWatch Services took significant action in late 2014 through the present to correct these violations. The FDA conducted a follow up inspection in June 2016. This inspection revealed correction of the previous observations and no new observations. As a result in the improvement in the situation the FDA closed out the warning letter in 2016.

Health Care Fraud and Abuse

In the United States, there are state and federal anti-kickback laws that generally prohibit the payment or receipt of kickbacks, bribes or other remuneration in exchange for the referral of patients or other health care-related business. In addition, federal law (e.g. the "Stark" law) and some state laws prohibit the existence of certain financial relationships between referring physicians and health care providers and suppliers unless those relationships meet the requirements of specific exceptions to the law. Anti-kickback laws place certain restrictions on LifeWatch's sales, marketing and promotional activities by limiting the kinds of financial arrangements it may have with physicians, medical centers and others in a position to purchase, recommend or refer patients for LifeWatch's cardiac monitoring services or other products or services it may develop and commercialize.

Furthermore, federal and state false claims laws prohibit anyone from presenting, or causing to be presented, claims for payment to third party payors that are false or fraudulent. Violations may result in substantial civil penalties, including treble damages, and criminal penalties, including imprisonment, fines and exclusion from participation in federal health care programs. The Federal False Claims Act also contains "whistleblower" or "qui tam" provisions that allow private individuals to bring actions on behalf of the government alleging that the defendant has defrauded the government. Various states have enacted laws modeled after the Federal False Claims Act, including "qui tam" provisions, and some of these laws apply to claims filed with commercial insurers.

The Patient Protection and Affordable Care Act

On March 23, 2010, the Patient Protection and Affordable Care Act was signed into law and on March 30, 2010, the Health Care and Education Reconciliation Act of 2010 was signed into law. Together, the two measures, collectively known as the Affordable Care Act, make the most sweeping and fundamental changes to the U.S. health care system since the creation of Medicare and Medicaid. The Affordable Care Act includes numerous health-related provisions with various effective dates, including expanded Medicaid eligibility, a requirement that most individuals have health insurance or pay a penalty, new requirements for health plans and insurance policy standards, the establishment of health insurance exchanges, changes to Medicare payment systems to encourage more cost-effective care, and new and expanded tools to address fraud and abuse. Section 6002 of the Affordable Care Act requires manufacturers of medical devices and other products reimbursed by Medicare to report annually to the government certain payments to physicians and teaching hospitals.

As a result of the passage of the Affordable Care Act, manufacturers or importers of certain medical devices are subject to an excise tax, applicable to sales of taxable medical devices beginning January 1, 2013. Several devices that are manufactured by LifeWatch are subject to these taxes. The tax equals 2.3% of the sale price of the applicable medical device. As an importer from LifeWatch Israel, LifeWatch is responsible for remitting these taxes to the federal government. However, on December 18, 2015, the Consolidated Appropriations Act of 2016, among other things, included a moratorium on the medical devices tax commencing on January 1, 2016, and ending on December 31, 2017.

Health Insurance Portability and Accountability Act of 1996 (HIPAA)

The Health Insurance Portability and Accountability Act was enacted by the United States Congress in 1996. Numerous state and federal laws govern the collection, dissemination, use and confidentiality of patient and other health information, including the administrative simplification and privacy provisions of HIPAA. Historically, state law has governed confidentiality issues, and HIPAA preserves these laws to the extent they are more protective of a patient's privacy or provide the patient with greater access to his or her health information. As a result of the implementation of the HIPAA regulations, many states are considering revisions to their existing laws and regulations that may or may

Core Business & Strategy

not be more stringent or burdensome than the federal HIPAA provisions. HIPAA applies directly to covered entities, which include health plans, health care clearinghouses and many health care providers. LifeWatch Services is a covered entity. The HIPAA statute and its implementing rules are concerned primarily with the privacy of protected health information when it is used and/or disclosed; the confidentiality, integrity and availability of electronic health information; and the content and format of certain identified electronic health care transactions. The laws governing health care information privacy and security impose civil and criminal penalties for their violation and can require substantial expenditures of financial and other resources for information technology system modifications and for ongoing operational compliance.

Medicare

Medicare is a federal program administered by CMS and its Medicare administrative contractors. The Medicare program provides qualified persons with health care benefits that cover the major costs of medical care within prescribed limits, subject to certain deductibles and co-payments. The Medicare program has established guidelines for local and national coverage determinations and reimbursement of certain equipment, supplies and services, which are subject to change. The methodology for determining coverage status and the basis and amount of Medicare reimbursement varies based upon, among other factors, the setting in which a Medicare beneficiary receives health care items and services.

The Medicare program is subject to statutory and regulatory changes, retroactive and prospective rate adjustments, administrative rulings, interpretations of policy, Medicare administrative contractor determinations and government funding restrictions. All of these policies may materially increase or decrease the rate of program payments to health care facilities and other health care suppliers and practitioners, including those paid for LifeWatch's cardiac monitoring services.

LifeWatch's call centers in Philadelphia, Rosemont (Chicago) and San Francisco are enrolled in Medicare as IDTFs, which is defined by CMS as an entity independent of a hospital or physician's office in which diagnostic tests are performed by licensed or certified non-physician personnel under appropriate physician supervision. Medicare has set very detailed performance standards that every IDTF must meet in order to obtain or maintain its billing privileges, including requirements to, among other things, operate in compliance with all applicable federal and state licensure and regulatory requirements for the health and safety of patients; maintain a physical facility on an appropriate site meeting specific criteria; have a comprehensive liability insurance policy of at least $0.3 million per location; disclose certain ownership information; have its testing equipment calibrated and maintained in accordance with specific standards; have technical staff on duty with the appropriate credentials to perform tests; and permit on-site inspections. These requirements are subject to change. LifeWatch believes that its facilities are in compliance with the IDTF standards.

Trump Administration

Management believes that possible healthcare reform plans in the United States under President Trump cannot be fully assessed yet. However, management does currently not expect any significant impacts for the Company in the short to medium term.

Core Business & Strategy

Sales and Marketing/Distribution

LifeWatch markets its cardiac monitoring solutions primarily through a direct sales force in the United States to physician practices, home health care providers, outpatient clinics, emergency care centers, hospitals and other cardiac monitoring providers. Typically, the sales representatives visit cardiologists and electrophysiologists at these institutions since these are the physician specialists who most commonly diagnose and manage patients with arrhythmias. LifeWatch currently employs a sales team of approximately 60 individuals, all based in the United States.

In addition, LifeWatch attends shows and medical conferences to promote its various products and services, for example HRS (Heart Rhythm Society) annual conference.

LifeWatch has a distribution department in its Rosemont (Chicago) office and distributes all of its devices via FedEx from this location. FedEx also picks-up and returns the devices for cleaning, recharging, memory erasure, etc. to the distribution department in Rosemont.

Research and Development

LifeWatch announced in July 2016 that it would transition to a pure play service provider. As a result of this decision the R&D activities at LifeWatch Israel have been significantly reduced and currently compose of around 6 FTE's from engineering and software development. This number will be further reduced once production has been fully outsourced.

The company is working with external partners to develop the next generation of the MCT 1-lead patch and to implement the facelift of the 3-lead MCT product.

New Market Entry by Replicating Existing Business Model

Detailed analysis for various markets around the globe has shown that market requirements and regulations are very different per country. Therefore, each new market entry may require an adapted business model. LifeWatch will not be able to simply expand into new markets using the existing U.S. business model.

Turkey has been identified as one of the markets, where the U.S. business model can be replicated. Therefore, the decision was taken to set up a cooperation in Turkey as one of the first large steps out of the U.S. For that purpose LifeWatch signed a Joint Venture agreement in 2015 with a Turkish partner with the goal to start a platform for LifeWatch's products and services in Turkey.

Turkey, being the 16th biggest economy in the world, counts as one of the world's ten "big emerging markets", and is developing into a commercial and medical hub for the region. The population of 80 million, with an estimated 12 million people living with heart disease, promises to be a good entry point for LifeWatch outside the U.S.

In 2016 LifeWatch started the implementation of the Joint Venture that would allow the Turkish company to become a leading provider of digital health solutions in the Turkish market.

Offices were designed to fit our service center needs, the IT platform was developed and tested, and key people were hired and trained both locally as well as in the U.S. A joint project team was established, covering all required areas from software development to devices, quality, regulatory, supply chain and legal. Also the local functions like marketing, sales, finance and HR were built up and strongly supported by the U.S. teams.

The local team has worked very closely with regulatory bodies, customs and various ministries to get the LifeWatch service introduced into the Turkish system. Private as well as public hospitals have shown great interest in the LifeWatch services, which gives confidence in a successful launch.

Final testing started in late 2016, and launch preparations continue into 2017. Certain registrations and reimbursement are still pending, but LifeWatch is positive that this will be received early in 2017 and therefore expects the launch taking place in H1 2017.

Environment

LifeWatch is committed to reducing greenhouse gas emissions, and preventing the release of toxic substances that could harm the environment. Our product packaging is also made of 100%-recycled materials.

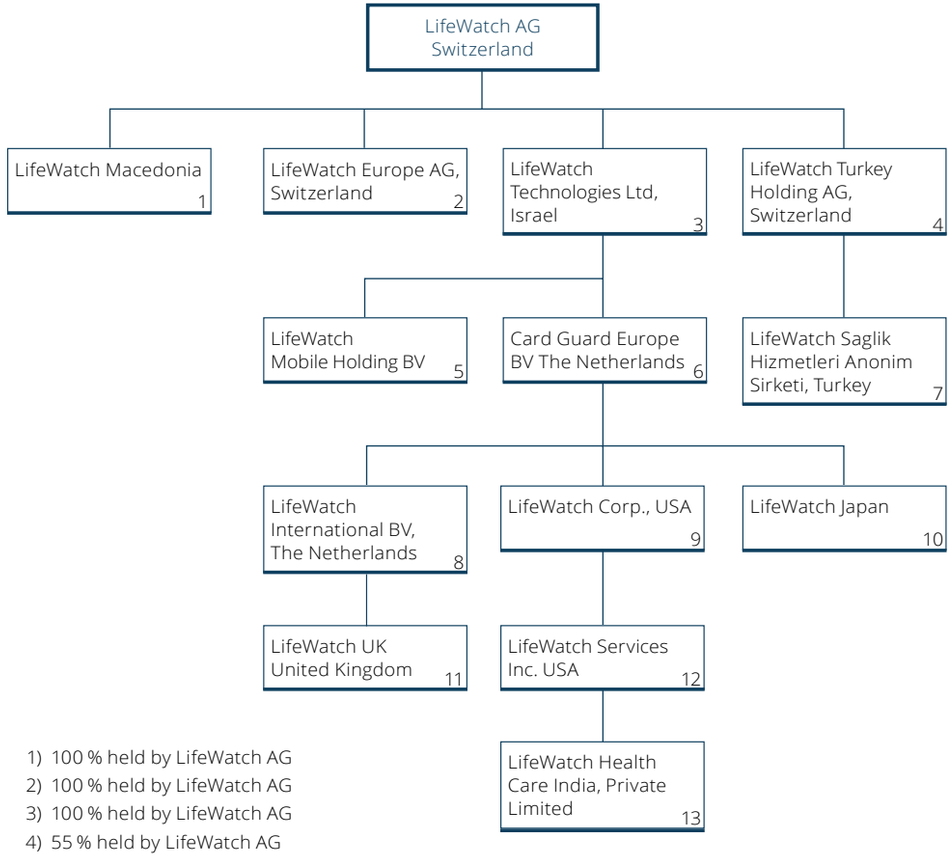
In 2016, we responsibly recycled of a total of 11,253kg of electronics. These actions:

- Reduced GHG emissions equivalent to conserving 27,637 liters of gasoline
- Prevented the release of 744 mg of mercury from being released into the environment
- Prevented carbon emissions equivalent to removing 11 passenger vehicles from the road for a year
- Prevented 9.7 billion liters of water from being contaminated beyond EPA standards due to lead

"LifeWatch is widely recognized as a premier provider of ambulatory cardiac monitoring services by cardiologists and electrophysiologists throughout the United States."
Christoph Heinzen, COTO

LifeWatch in 2016

Corporate Structure



1) 100 % held by LifeWatch AG
2) 100 % held by LifeWatch AG
3) 100 % held by LifeWatch AG
4) 55 % held by LifeWatch AG
5) 100 % held by LifeWatch Technologies Ltd (Israel)
6) 100 % held by LifeWatch Technologies Ltd (Israel)
7) 100 % held by LifeWatch Turkey Holding AG
8) 100 % held by Card Guard Europe BV (The Netherlands)
9) 73.46 % held by Card Guard Europe, BV and 26.54 % held by LifeWatch Technologies, Ltd
10) 80 % held by Card Guard Europe, BV
11) 91.5 % held by LifeWatch International, BV
12) 100 % held by LifeWatch Corp.
13) 100 % held by LifeWatch Services Inc.

LifeWatch in 2016

Corporate Governance

The Executive Management Team and the Board of Directors of LifeWatch AG (the Company) consider corporate governance to be essential for responsible, transparent, efficient and value-driven corporate management. Good corporate governance promotes confidence and trust in the Company by investors, financial markets, business partners, employees and the public. The Executive Management Team and the Board of Directors are continuously trying to improve the principles of corporate governance and actively ensure that they are applied and lived throughout the LifeWatch Group. The central elements of corporate governance are contained in the Articles of Incorporation and organizational regulations, and are based on the guidelines and recommendations set out in the "Swiss Code of Best Practice for Corporate Governance" published by Economiesuisse. For ease of reference, the order and numbering of the individual sections correspond to those used in the "Guidelines concerning information on corporate governance" published by SIX Swiss Exchange. Unless otherwise indicated, all information refers to fiscal year ending December 31, 2016 or the balance sheet date of December 31, 2016. Significant events that have occurred between the year end and the publication deadline for this report have also been included as appropriate.

1 Group Structure and Shareholders

1.1 Group Structure

1.1.1 LifeWatch is a leading healthcare technology and solution company, specializing in advanced digital health systems and wireless remote diagnostic patient monitoring services. LifeWatch's services provide physicians with critical information to determine appropriate treatment and thereby improve patient outcomes. For an overview of the organizational Group structure, please refer to page 43 of this Annual Report.

1.1.2 Listed company

Company	LifeWatch AG, Zug, Switzerland
Listing	SIX Swiss Exchange, Main Segment
Ticker	LIFE
Market capitalization	CHF 189,398,157 as of December 31, 2016
Treasury shares	0.07% held by LifeWatch as of December 31, 2016
Security number	1281545
ISIN number	CH 0012815459

1.1.3 Non-listed companies

For an overview of affiliated and associated non-listed companies, belonging to the LifeWatch Group please refer to note 18 in the consolidated financial statements of this Annual Report.

1.2 Significant shareholders

On December 31, 2016, the Company knew of the following shareholders holding over 3% of the voting stock in LifeWatch AG based on their own declarations. Constantly updated information on significant shareholders is available at www.six-swiss-exchange.com under "Significant Shareholders" when entering LifeWatch's ticker symbol "LIFE" in the product search box.

(Link: https://www.six-exchange-regulation.com/en/home/publications/significant-shareholders.html?companyId=CARDGAG)

Himalaya (Cayman Islands) TMT Fund held 15.33% of the voting rights in LifeWatch AG as disclosed by the shareholder to the company.

LifeWatch in 2016

AEVIS Victoria SA held 11.94% of the voting rights in LifeWatch AG as per the shareholder register and as disclosed in their offering prospectus dated February 20, 2017.

LB (Swiss) Investment AG held 10.69% of the voting rights in LifeWatch AG as per the shareholder register.

Martin Eberhard held 3.50% of the voting rights in LifeWatch AG as per the shareholder register.

Significant changes since the year-end
None.

The rest of the shares are held by public shareholders.

The Company does not have any outstanding shareholders' agreements.

2 Capital Structure

2.1 Share Capital as of December 31, 2016

Ordinary share capital:	CHF 24,021,229.70 18,477,869 registered shares of par value CHF 1.30 (fully paid-in)
Conditional share capital:	CHF 1,300,000 1,000,000 registered shares of par value CHF 1.30 (for bond issues and similar obligations)
Authorized but unissued share capital:	None

2.2 Conditional Share Capital

During the fiscal year ending December 31, 2016 the Company issued 10,300 shares from the conditional capital designated for the exercise of option rights granted to members of the Board, members of the Executive Management Team, employees and consultants. The remainder of such conditional capital was cancelled at the Shareholders Meeting in 2016. In 2015 and 2014 the Company issued 25,124 shares and 210,228 shares, respectively, from such conditional capital.

With respect to option rights granted to members of the Board, members of the Executive Management Team, employees and consultants of the Company or its affiliates, any pre-emptive rights and rights to advance subscriptions are excluded. The issue of such option rights is effected in accordance with one or more option plans to be adopted by the Board of Directors.

The acquisition of shares through the exercise of option rights granted to members of the Board, members of the Executive Management Team, employees and consultants of the Company or its affiliates as well as any subsequent transfer of the shares are subject to the restrictions in the Articles of Incorporation of the Company (see also "Limitations on transferability and nominee registrations" in this section of the Annual Report).

Pursuant to the Articles of Incorporation as of July 13, 2016, the share capital of LifeWatch AG may be raised through the issue of no more than 1,000,000 fully paid-up registered shares having a par value of CHF 1.30 by an amount of up to a maximum of CHF 1'300'000:

a) through the exercise of option and/or conversion rights which are granted in relation to bond issues and similar obligations of the Company or its group companies
b) through the exercise of option rights which are granted to the shareholders of the Company.

The rights of the shareholders to subscribe shares in priority are excluded. The shares, which are issued under this provision, shall be subject to the transfer restrictions in the Articles of Incorporation of the Company. The rights of the shareholders to subscribe in priority in the context of warrants and/or convertible bonds and/or similar financing instruments may be limited or excluded for no more than 1,000,000 of such new registered shares by resolution of the Board of Directors, provided that such option and/or conversion rights are issued:

a) to finance the acquisition of enterprises, participations in such enterprises, divisions thereof or new investments of the Company

LifeWatch in 2016

b) to issue warrants and/or convertible bonds and/or similar financing instruments on the international capital markets.

With reference to warrants and/or convertible bonds and/or similar financing instruments in respect of which the Board of Directors resolves to exclude the shareholders' right to subscribe in priority, the following shall apply:

a) The shares shall be issued in accordance with the prevailing terms and conditions of the conversion and option rights, respectively. The warrants and convertible bonds or similar financing instruments shall be issued in accordance with market conditions.
b) The exercise price for the conversion and option rights for the new registered shares must at least correspond to the market conditions prevailing at the time of the issue of the respective financing instrument.

2.3 Authorized share capital

As of December 31, 2016, the Company does not have any authorized but unissued share capital.

2.4 Changes in Shareholders' Equity Since 2014

CHF	31.12.2016	31.12.2015	31.12.2014
Share capital	24,021,230	17,515,615	17,482,984
Reserve from capital contribution	53,582,618	16,305,675	15,980,590
Other legal reserve	1,048,462		
Retained earnings	-12,741,186	–	2,602,193
Treasury shares	-98,018	-115,242	-367,631

Changes in shareholders' equity during fiscal year 2014
During the fiscal year ending December 31, 2014 the Company issued 210,228 registered shares with a par value of CHF 1.30, amounting to CHF 273,296 of additional share capital due to the exercise of options. The Reserve from capital contribution increased to CHF 15,980,590 due to an amount of CHF 756,050 of additional paid-in capital from the issuance of the shares mentioned above.

Changes in shareholders' equity during fiscal year 2015
During the fiscal year ending December 31, 2015 the Company issued 25,124 registered shares with a par value of CHF 1.30, amounting to CHF 32,661.20 of additional share capital due to the exercise of options. The Reserve from capital contribution increased to CHF 16,305,675 due to an amount of CHF 188,413 of additional paid-in capital from the issuance of the shares mentioned above and CHF 136,673 as a result of profit realized on the transfer of Treasury shares to Board members.

Changes in shareholders' equity during fiscal year 2016
During fiscal year ending December 31, 2016 the company issued a total of 5,004,319 registered shares of a par value of CHF 1.30, amounting to CHF 6,505,614.70 of additional share capital through the issuance of 4,994,019 new registered shares offered for subscription in a rights issue and 10,300 shares due to the exercise of options. The Reserve from capital contribution increased to CHF 53,582,618 due to an amount of CHF 37,276,943 of additional paid-in capital from the issuance of the shares mentioned above.

2.5 Shares

At December 31, 2016 the share capital of LifeWatch AG was divided into 18,477,869 fully paid-in registered shares with a par value of CHF 1.30 each. All shares are entitled to dividends and carry a single vote. The Company maintains a stock ledger, listing the surname and first name (in the case of legal entities, the company name) and address of the holders and usufructuaries. Only persons or legal entities registered in the stock ledger shall be recognized as shareholders or usufructuaries by LifeWatch AG.

2.6 Profit sharing certificates

The Company has neither profit sharing certificates nor bonus certificates outstanding.

2.7 Limitations on Transferability

2.7.1 and 2.7.2 Limitations on transferability and nominee registrations of registered shares

The Articles of Incorporation of LifeWatch AG contain no transfer restrictions (Vinkulierung) with regard to the registered shares. However, pursuant to Art. 7 of the Articles of Incorporation of LifeWatch AG, the Board of Directors of LifeWatch AG may refuse to register an acquirer of LifeWatch AG shares as a shareholder with the registered right to vote if the acquirer, upon request, does not explicitly declare that they acquired the shares in their own name and for

LifeWatch in 2016

their own account. The Board of Directors may cancel the registration retroactively to the time of the registration if such registration was based on false declarations.

2.7.3 Admissibility of nominee registrations

Concerning the voting rights of nominee shares, the following applies: LifeWatch AG shall register in its stock ledger any shares in LifeWatch AG held by a nominee (nominee shares) without voting rights, subject to any nominee shares for which the nominee:

a) discloses to LifeWatch AG the name, citizenship, and address of the ultimate beneficial owner, and the number of nominee shares held by such beneficial owner, or
b) explicitly declares that it acquired the nominee shares in its own name and for its own account.

Nominee shares for which the nominee discloses the above-mentioned information (under a and/or b), shall be registered in LifeWatch AG's stock ledger with voting rights as soon as reasonably possible after LifeWatch AG's receipt of the respective disclosure notice.

2.8 Convertible Bonds and Warrants/Options

LifeWatch AG has no convertible bonds or stock options outstanding as of December 31, 2016. Accordingly, there is no conditional share capital as at December 31, 2016 to cover the exercise of options. However, there is conditional capital for the issuance of not more than 1,000,000 shares through either a) the exercise of options and/or conversion rights which are granted in relation to bond issues and similar obligations of the Company or its group companies; and/or b) the exercise of option rights which are granted to the shareholders of the Company.

3 Directors

3.1 Members of the Board of Directors

The company had seven non-executive members of the Board of Directors as at December 31, 2016. All non-executive members of the Board of Directors are independent and were not previously members of the Executive Management Team of LifeWatch AG or any of its affiliates.

Robert Bider
Chairman of the Board
Chairman of the Executive Committee
Born 1947, Swiss citizen, first elected 2016

Robert Bider holds a PhD in Sciences and a Master in Industrial Management (MIM) from the Federal Institute of Technology, Zurich (ETHZ). Mr. Bider started his career in 1972 as Head of the Organization Department of the University Hospital, Zurich. In 1977, he became Head of the Consulting Department of the Swiss Hospital Institute. From 1985 to 2008, he was Chief Executive Officer of Hirslanden, where he devised and executed the expansion scheme of Hirslanden from a single hospital to the largest Swiss private hospital group with 1300 beds, over 100 centers of competence, 5'000 employees and a turnover of CHF 1.1 billion. He is Chairman of the Hirslanden Research Foundation, the Robert Bider Foundation, member of the Foundation for the Lucerne Symphony Orchestra and President of the Zurich Corporate Tennis Association. Mr. Bider is also Chairman of European Medical Network EMN AG and member of the non-executive Board of Median Kliniken. Further, he is on the board of Pioneer Medical Devices AG, Lumendi Ltd., Embru AG and Montana Capital Partners AG. He was Chairman of the Board of SENIOcare AG, the largest Swiss chain of nursing homes, from 2009 until it was sold to Swiss Prime Site in 2015. He was also a board member of Grand Resort Bad Ragaz, Medi-Clinic Switzerland AG, Medi-Clinic Corporation Ltd. and Rhino-Partners AG.

LifeWatch in 2016

Patrick Schildknecht
Member of the M&A and Investment Committee
Born 1972, Swiss citizen, first election 2013

Patrick Schildknecht is the owner and president of SK Holding AG in Euthal, an investment company with several subsidiaries in retail trading as well as in the property development and building materials sectors. He started his career with the door manufacturer Portico S.A. in San Jose, Costa Rica. After returning to Switzerland in 1999 he worked five years as a strategy consultant with Arthur D. Little in Singapore and Switzerland. In 2004 he directed, as owner and CEO, Sycrilor Industries S.A. in Le Noirmont, a precision forge for the luxury goods and medical industry. Since then Patrick Schildknecht has acted as member of the Board of Directors in several public and private companies. In 1998 Patrick Schildknecht achieved a master of business administration at the University of Zurich.

Antoine Hubert
Chairman of the M&A and Investment Committee
Member of the Compensation Committee
Member of the Executive Committee
Born 1966, Swiss citizen, first election 2014

Antoine Hubert is founder and Delegate of the Board of AEVIS Holding AG as well as one of the two main shareholders of the firm. AEVIS Holding SA invests in the healthcare sector, life sciences and personal care services. AEVIS's main shareholdings are Genolier Swiss Medical Network, the second largest group of private clinics in Switzerland, and Swiss Healthcare Properties AG, a company specialized in medical real estate, Nescens SA, a brand dedicated to better-aging, and AS Ambulances Services SA. Prior to acquiring a stake in Clinique de Genolier in 2002 and founding Genolier Swiss Medical Network in 2004, Antoine Hubert was mainly active in the property and real estate industry and has set up various businesses and served as a director to several companies in different industries.

Thomas Rühle
Chairman of the Compensation Committee
Born 1960, German citizen, first election 2013

Thomas Rühle was Vice President Europe of Sanofi Pasteur MSD from 2005 till 2011. Previously, he acted as Chairman for the region Germany at Sanofi Pasteur MSD. Prior to Sanofi Pasteur MSD he held several marketing positions at leading pharmaceutical companies. Thomas Rühle holds a degree in economics of the BA Karlsruhe. Today he is engaged as a private investor in several health and logistic companies.

Raymond W. Cohen
Member of the Compensation Committee
Member of the Audit and Risk Committee
Member of the M&A and investment Committee
Born 1959, U.S. citizen, first elected 2016

Raymond W. Cohen is an accredited public company director and medical device veteran with over 30 years of operating and board level experience. Mr. Cohen currently serves as the CEO and a board member of Axonics Modulation Technologies, Inc. Irvine, CA, USA. Mr. Cohen is a member of several boards of Directors; he is Chairman of the Board of Lombard Medical Inc. Didcot, UK, Chairman of the Board of BioLife Solutions Inc., Bothell, WA, a Board member of Spectrum Pharmaceuticals Inc., Henderson, NV, a Board member of JenaValve Technology, Irvine, CA, and Chairman of the Board, Syncroness, Inc., Westminster, CO.

LifeWatch in 2016

Antoine Kohler
Vice Chairman
Chairman of the Audit and Risk Committee
Member of the Executive Committee
Born 1956, Swiss citizen, first elected 2016

Antoine Kohler holds a law degree from the University of Geneva. Following postgraduate studies at the Graduate Institute of International Studies, Geneva, Antoine Kohler has been practicing law as a qualified attorney in Geneva since 1983. He is a senior partner of the law firm Perréard de Boccard SA, with offices in Geneva and Zurich. Antoine Kohler is member of several boards of Directors; he is amongst others a board member of AEVIS VICTORIA SA, Fribourg and certain AEVIS group companies, Chairman of the Board of Airopack Technology Group AG, Baar, Deputy Chairman of Mitsubishi UFJ Wealth Management Bank (Switzerland) Ltd., Geneva, and a board member of Sixt Leasing (Schweiz AG), Urdorf, and Sixt rent-a-car AG, Basel. Up until 2015 Antoine Kohler was also Chairman of Cicor Technologies Ltd, Boudry.

Jinsheng Dong
Member of the Audit and Risk Committee
Born 1972, Chinese citizen, first elected 2016

Jinsheng Dong holds an EMBA of China Europe International Business School (CEIBS) 2014 and a bachelor in economics of Bejing Technology and Business University 1996. He began his career with China Oil and Foodstuffs Import and Export from 1996–1999, following which he held leading positions in the marketing area of China Hewlett-Packard. From 2000–2014 he served as Sales Manager, Sales Director and Support Sales General Manager of China Hewlett-Packard. In 2014 he joined the management board of Zhuhai Hokai Medical Instruments Co., Ltd, where he is responsible for the division of mobile health products. He is also a Board member and third largest shareholder of Beijing Hospmail Technology Co., Ltd., a subsidiary of Zhuhai Hokai Medical Instruments.

3.2 Other Activities and Business Connections

Apart from the positions mentioned under each Board Members profile, no members of the Board of Directors acted in any governing or supervisory bodies of important Swiss and foreign organizations, institutions or foundations in 2016.

The Articles of Association of the Company contain the following provision relating to other activities of the Board of Directors and the Executive Management Team:

The members of the Board of Directors and the members of Executive Management shall not occupy or exercise more than the following number of positions in the highest managing or supervising body of other entities that are obliged to be entered into the commercial register or a comparable foreign register and that are neither controlled by, nor that control the Company:

- 4 positions in publicly listed companies whereby positions in several different companies that form part of the same group of companies are regarded as one position; and
- 8 paid positions with other entities, whereby positions in several different companies that form part of the same group of companies are regarded as one position; and
- 8 unpaid positions, whereby mere expense recovery is not deemed to be compensation and positions in several different companies that form part of the same group of companies are regarded as one position.

LifeWatch in 2016

3.3 Elections and Terms of Office

The 2015 AGM took place on April 15, 2016.

Name	Position	First elected	Elected until Shareholders' Meeting
Robert Bider	Chairman [1] Chairman of the Executive Committee Non-executive	2016	2016
Patrick Schildknecht	Member [2] Member of the M&A and Investment Committee Non-executive	2013	2016
Thomas Rühle	Member [3] Chairman of the Compensation Committee Non-executive	2013	2016
Antoine Hubert	Member [4] Chairman of the M&A and Investment Committee and a Member of the Executive Committee and the Compensation Committee	2014	2016
Raymond W. Cohen	Member [5] Member of the Compensation Committee, the Audit and Risk Committee and the M&A and Investment Committee Non-executive	2016	2016
Antoine Kohler	Vice Chairman [5] Chairman of the Audit and Risk committee Member of the Executive Committee Non-executive	2016	2016
Jinsheng Dong	Member [5] Member of the Audit and Risk Committee Non-executive	2016	2016

[1] Elected member of the Board of Directors on the occasion of the Ordinary Shareholders Meeting taking place on April 15, 2016 and appointed Chairman of the Board of Directors

[2] Member of the Board of Directors of LifeWatch AG elected on the occasion of an Extraordinary Shareholders Meeting taking place on January 23, 2013, and Chairman of the Board of Directors until the Ordinary Shareholders' Meeting on April 15, 2016

[3] Member of the Board of Directors of LifeWatch AG elected on the occasion of an Extraordinary Shareholders' Meeting taking place on January 23, 2013

[4] Elected member of the Board of Directors on the occasion of the Ordinary Shareholders' Meeting taking place on January 30, 2014

[5] Elected member of the Board of Directors on the occasion of the Ordinary Shareholders' Meeting taking place on April 15, 2016

According to the Articles of Incorporation, the Board of Directors of LifeWatch AG consists of at least three members. The Shareholders' Meeting will appoint the members of the Board of Directors for a term of office of no more than one year. The Shareholders Meeting shall further elect the Chairman of the Board of Directors from the members of the Board of Directors. Patrick Schildknecht retired as Chairman of the board at the annual general meeting held on April 15, 2016, at which the new Chairman, Robert Bider, and the additional members of the Board of Directors were elected.

Furthermore, the Articles of Association also contain provisions whereby the Shareholders Meeting elects a Compensation Committee consisting of two or more members. The members of the Compensation Committee are elected individually. Only members of the Board of Directors are eligible for election.

In order to ensure that Shareholders can be independently represented at a Shareholders Meeting, the Company's Articles of Association contain the following provisions:

- The Shareholders Meeting elects an independent shareholder representative.
- If the Company has no independent shareholder representative, the Board of Directors designates an independent shareholder representative for the next Shareholders Meeting.

LifeWatch AG was granted, in 2013, exception from compliance with the nationality requirement for the majority of the members of the Board of Directors pursuant to Art. 708 para 1 CO.

3.4 Internal Organizational Structure

The Board of Directors constitutes itself. It shall elect among its members a Vice Chairman and shall appoint a secretary, who need not be a member of the Board. Patrick Schildknecht acted as Chairman of the Board of Directors until the Shareholders' Meeting on April 15, 2016. Robert Bider was elected as a Member and Chairman of the Board at that meeting and held the position for the remainder of the year. Antoine Hubert acted as Vice Chairman up until the Shareholders' Meeting on April 15, 2016. For the rest of 2016 Antoine Kohler acted as Vice Chairman. The Board of Directors has the ultimate responsibility for the business strategy and the direction of the business of LifeWatch AG as well as the issuance of the necessary instructions.

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3.4.1 Allocation of tasks within the Board of Directors

The most important duties of the Board of Directors, according to the Swiss Code of Obligations and the Articles of Incorporation of LifeWatch AG are:

- the strategic direction and the determination of the organization
- the regulation of accounting, financial control and financial planning
- the appointment and removal of the persons entrusted with management and representation of the Company
- the ultimate supervision of the persons entrusted with management of the Company
- the preparation of the business report and the compensation report as well as the preparation of the Shareholders Meeting and the implementation of the resolutions adopted by the Shareholders Meeting
- the examination of the professional qualifications of the qualified auditors

Decisions by the Board of Directors are taken in accordance with the majority requirements set forth in the Swiss Code of Obligations. Board meetings, at which the members of the Board of Directors meet physically, usually last for a day. The duration of Board meetings held by telephone conference depends on the specific items to be discussed during the meetings, but on average they last for about one hour.

The Internal Regulations of LifeWatch AG stipulate that the Board of Directors must meet at least four times a year. During fiscal year 2016 the Board of Directors met 6 times physically for Board meetings with meetings lasting on average 5.2 hours and held 11 telephone conferences which lasted on average 55 minutes. The Chairman determines the agenda and items for discussion at the Board meeting, however, all members of the Board of Directors can request to add further items to the agenda. All Board members receive extensive documents as preparation prior to the meetings. Such documents include particularly, but not exclusively, consolidated financial statements of the Group (balance sheets, statements of operations, statements of cash flows and notes to the financial statements). Members of the Executive Management Team, such as the Chief Financial Officer, or external consultants, such as the independent Group auditors, may be invited to attend the meetings of the Board of Directors.

3.4.2 Committees

In 2016, LifeWatch AG had four committees, a Compensation Committee, an Audit and Risk Committee, an M&A and Investment Committee and an Executive Committee. The members of these committees give specific recommendations to the entire Board of Directors. However, decision authority remains with the entire Board of Directors. The Board of Directors or the committees also engage external consultants, specialized attorneys and/or auditors to address specific topics, whenever required.

3.4.3 Compensation Committee

The Compensation Committee consists of at least two non-executive members of the Board of Directors. At the Ordinary Shareholders Meeting 2014, which took place on April 29, 2015 Thomas Rühle and Antoine Hubert were both re-elected to the Compensation Committee with Thomas Rühle also being re-elected as Chairman of the Compensation Committee by the Board of Directors.

The Compensation Committee proposes to the entire Board of Directors the compensation policy (including option programs) for all employees, including the members of the Executive Management Team, the members of the Board of Directors and consultants of the Company. In addition, the Compensation Committee supervises the administration of the share option plans of LifeWatch AG. The decision authority with regard to compensation remains with the entire Board of Directors. The Committee holds meetings as often as business requires, but at least once a year. In fiscal year 2016, the Committee held one physical meeting lasting 0.75 hours.

3.4.4 Audit and Risk Committee

The Audit and Risk Committee consists of at least two non-executive members of the Board of Directors. At the first physical Board Meeting following the Shareholders Meeting of April 15, 2016 the Board of Directors , elected Antoine Kohler, Raymond W. Cohen and Jinsheng Dong to the Audit and Risk Committee with Antoine Kohler being elected as Chairman. The main activities of the Audit and Risk Committee are the review of risk management and internal controls of the Company, monitoring of financial reporting and audit review. The Audit and

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Risk Committee gives specific recommendations to the Board of Directors. The responsibility for the approval of the financial reporting and the financial statements and the decision authority remain with the entire Board of Directors.

The Audit and Risk Committee shall ensure the follow-up on findings and identified actions of the auditors and report at least once per year its findings and actions undertaken to the entire Board. The Chairman of the Audit and Risk Committee shall upon discovery immediately inform the Chairman of the Board of major findings where the importance of the matter requires attention without delay.

The Committee meets at least once a year. In fiscal year 2016, the Audit and Risk Committee held two telephone conferences and two physical meetings lasting on average 0.5 hours.

3.4.5 M&A and Investment Committee

The M&A and Investment Committee consists of at least two non-executive members of the Board. At the first physical Board Meeting following the Shareholders Meeting of April 15, 2016 the Board of Directors elected Raymond W. Cohen, Patrick Schildknecht and Antoine Hubert to the M&A and Investment Committee with Antoine Hubert being elected as Chairman.

The principal duties of the M&A and Investment Committee are the evaluation of any M&A or investment proposals and is, without limitation, responsible:

a) for evaluating any acquisition or disposal of assets or other investment opportunity, including any takeover or merger proposed by Executive Management, and making an appropriate recommendation to the full board;
b) for evaluating any takeover or merger approach made by third parties and making an appropriate recommendation to the full board
c) for periodic review of the charter of the M&A and Investment Committee

It meets as required, however, typically once a year before a scheduled Board meeting. Apart from the members of the Corporate Management, the M&A and Investment Committee may also seek independent advice from external experts deemed to be appropriate in order to carry out its duties. The M&A and Investment Committee did not meet during 2016.

3.4.6 Executive Committee

The Executive Committee consists of at least two non-executive members of the Board. At the first physical Board Meeting following the Shareholders Meeting of April 15, 2016 the Board of Directors elected Robert Bider, Antoine Kohler and Antoine Hubert to the Executive Committee with Robert Bider being elected as Chairman.

The principal duties of the Executive Committee are the organizing of Board of Directors meetings including settings dates and times, sending an invitation with agenda and ensuring adequate documentation is provided.

It meets at least four times a year, typically well before each, to be scheduled, Board meeting. The Executive Committee met telephonically 8 times in 2016 for an average of 20 minutes.

3.5 Definition of Areas of Responsibility

The responsibility of the Board of Directors with respect to the non-transferable and irrevocable tasks is as defined by the Swiss Code of Obligations. The Board of Directors' main responsibilities are:

- to formulate the general Group strategy and the industrial and service concept behind the Group based on the recommendations of the Executive Management Team
- to decide on any acquisition, sale, foundation or liquidation of subsidiaries
- to define the Group's financing strategy including decisions on collective means of financing as well as to determine accounting, financial control and planning schemes
- to approve the financial statements
- to define the Group's organizational structure and its organizational regulations
- to appoint and dismiss members of the Executive Management Team
- to approve the annual, respectively business, report and the consolidated financial statements, conduct the annual Shareholders Meeting and execute its decisions

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Apart from these main tasks, the Board of Directors delegates the power to manage the Company's day-to-day business activities to the Chief Executive Officer, who together with the Executive Management Team is responsible for the overall management of LifeWatch AG.

3.6 Information and Control Instruments

The Board of Directors is regularly informed of significant matters involving the Company's business and receives regular reports from the Board Committees, the Chairman, as well as from the Executive Management Team. Regular written reports are also provided: LifeWatch runs a Management Information System (MIS), which provides financial information and comparative operational analyses, including monthly, semi-annual, and annual statements, regional revenue breakdowns and employee numbers of all LifeWatch subsidiaries. Every member of the Board of Directors received summary information and analyses on a monthly basis as well as prior to the Board meetings during the fiscal year. In addition, the non-executive Chairman of the Board of Directors, Patrick Schildknecht and subsequently Robert Bider, maintained regular contact with the CEO, Dr. Stephan Rietiker, in order to be kept fully updated on developments in the business, and regularly requested reports containing additional information from the Executive Management Team. In addition, the CEO, Dr. Stephan Rietiker, also regularly briefed the members of the Board of Directors on operations and other activities of the Company and its subsidiaries. The Chief Financial Officer, Mike Turchi and subsequently Andrew Moore, attended all meetings of the Board of Directors at which financial matters were discussed and participated at all meetings of the Audit and Risk Committee, reviewing the Company's financial performance as well as reporting and monitoring the internal and external audit processes and assessing the internal risk management and processes.

4 Executive Management Team

4.1 Members of the Executive Management Team

Details on the members of the Executive Management Team of LifeWatch AG are shown below:

Dr. Stephan Rietiker
Chief Executive Officer
Born 1956, Dual citizen of Switzerland and the United States, joined in 2014, appointed June 1, 2014.

Dr. Stephan Rietiker received his medical doctorate from the University of Zurich in 1982 and also qualified to practice medicine in the United States. He spent five years practicing internal medicine before moving into the Healthcare industry. Dr. Rietiker began his career with Roche in 1987 and thereafter held several senior positions in marketing / general management with Boehringer Mannheim and Schering Plough. Subsequently, he became Vice President and General Manager Europe for Covance Central Laboratory Services. In 2001, he was appointed President and CEO of Sulzer Medica (later Centerpulse) and was instrumental in resolving a landmark legal settlement in a major U.S. litigation. He was also responsible for restructuring the company which ultimately led to its acquisition by Zimmer in 2003. After a year as CEO and Director at Pendragon Medical AG, he took on the role of Executive Director and CEO at IMI Intelligent Medical Implants in 2004. In 2006, Dr. Rietiker left IMI and incorporated AurigaVision AG, a Switzerland based investment platform that focuses on promising developmental-stage healthcare companies. This activity led to his involvement with LifeWatch AG where he initially served as Executive Board Member and Interim CEO. After four months, he permanently was appointed CEO of LifeWatch AG, a position he still holds today. Dr. Rietiker also served as a Senior Advisor to Brown Brothers Harriman's Corporate Finance team from 2006–2014. And, since 2014, Dr. Rietiker has been serving on the Board of Directors for California-based LoneStar Heart, a company developing breakthrough therapies against advanced heart failure.

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Mike Turchi
Chief Financial Officer until March 31, 2016
Born 1960, United States citizen, joined in 2000, appointed June 1, 2014

Mike Turchi joined LifeWatch Services in 2000, and has more than 20 years of experience in the financial and business arena. Prior to LifeWatch, Mr. Turchi served as Controller for Baldwin Cooke. He holds a Bachelor of Science in Accounting from the University of Wyoming, an MBA with Honors from Lake Forest Graduate School of Management and is a member of Illinois' CPA Society and AICPA.

Andrew Moore
Chief Financial Officer from April 01, 2016
Born 1957, Swiss and British national, joined in 2014

Andrew Moore holds a Bachelor's Degree in Statistics and Operational Research from the University of Leeds and is a qualified English Chartered Accountant (FCA), qualified English Tax Advisor (CTA) and a certified European Financial Analyst (CEFA). He started his career with Price Waterhouse before spending more than 20 years in banking, fifteen of which were with Credit Suisse in both London and Zurich. At Credit Suisse he initially acted as the CFO of a subsidiary in London before going on to hold senior positions in both investment and private banking in Zurich. In 2000 Mr. Moore moved into the private equity / venture capital field and focused on the healthcare sector. Following nearly 4 years as the Chief Investment Officer for two stock exchange quoted investment companies, Mr. Moore then held CFO / Managing Director positions in 3 different early stage companies, one of which was listed on AIM in London. Following the sale of the business of the AIM listed company Mr. Moore held several project-based mandates.

Stephanie J. Kravetz
Chief Legal Officer
Born 1966, United States citizen, joined in 2011, appointed June 1, 2014

Stephanie J. Kravetz received her Bachelor's Degree in Psychology and Chemical and Biological Sciences from the University of Minnesota in 1988 and a Doctorate in Jurisprudence from William Mitchell College of Law in St. Paul, Minnesota, in 1991. She is admitted to the bar in both Minnesota and Illinois. Ms. Krevatz spent more than 15 years as a national litigator with the law firm Robins, Kaplan Miller and Ciresi L.L.P., practicing in the areas of medical devices, pharmaceutical, healthcare and biotechnology. Among her clients were Fortune 500 companies, including Medtronic, Inc. as well as individual clients. After leaving private practice, Ms. Kravetz joined the LifeWatch Group of Companies in 2011. She served the company in multiple capacities including Of Counsel and General Counsel for LifeWatch Services, Inc. before accepting her current position in March 2014 as Chief Legal Officer and Secretary at LifeWatch AG, where she is responsible for the company's global legal affairs. Ms. Kravetz also holds certifications in healthcare compliance and corporate business compliance and directs the global governance as well as risk and compliance strategies for the LifeWatch Group of Companies. Ms. Kravetz is also the author of numerous published articles on legal-medical and compliance topics.

Stefan Vogt
Chief Commercial Officer until August 16, 2016
Born 1965, Swiss and German citizen, joined in 2015, appointed in 2015

Stefan Vogt holds a Masters Degree in Economics from the University of Zürich, and a Bachelor Degree of Business Administration from the University in Freiburg i.B. He started his career in telecommunications with AT&T, where for 6 years he held positions in Sales and Marketing both in Europe and the U.S. In 1997 he joined SBC in Switzerland as Product Marketing Director, where he helped build the now 2nd largest telecom company in Switzerland. After working for Swisscom from 2003 to 2005, Mr. Vogt switched to the medical device industry in 2005, joining Institute Straumann as Vice President of Global

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Marketing. After leaving Straumann in 2007 he founded and built several companies in the medical device and dental industries. Mr. Vogt is President of the Board of Directors at the Swiss Dental Group AG (Switzerland), and sits on the Board of Directors at privateCare AG (Switzerland). Stefan Vogt worked for the company on a consulting basis from August 2014 until his appointment as Chief Commercial Officer.

Dr. Christoph Heinzen
Chief Operations & Technology Officer from September 14, 2016
Born 1966, Swiss citizen, joined 2015

Dr. Christoph Heinzen received his PhD in bioprocess engineering from the Technical University ETH of Zurich in 1996 and his postgraduate degree in economics from ETH in Zurich in 1997. He began his career with The Boston Consulting Group in 1997 and managed several projects within the pharmaceutical and healthcare sectors. Subsequently, he became General Manager and CEO of Inotech AG, a start-up biotech company in Basel. He set-up a GMP bio-manufacturing facility and provided, as a contract manufacturer, clinical trial material for biotech and pharmaceutical companies. In 2009, he was appointed Head of Project Management at Spirig AG, a Swiss based dermatological company, where he was responsible for defining a new corporate strategy. After the acquisition of Spirig by Galderma SA (a subsidiary of Nestlé Skin Health) in 2013, he was appointed Head of Development of OTC products and was responsible for well-established Galderma brands such as Cetaphil®, Excipial® and Daylong®. In May 2015, he was appointed Head of the Project Management Office at LifeWatch AG in Zug and was promoted to Executive Vice President of Operations and Technology, responsible for R&D, IT and Operations in October 2015. In September 2016, the Board of LifeWatch AG promoted Dr. Heinzen to the Executive Management Team as Chief Operations and Technology Officer.

4.2 Other activities and functions

None of the members of the Executive Management Team in 2016 acted in any governing or supervisory bodies of important Swiss and foreign organizations, institutions or foundations. Nor do any of the members of the Executive Management Team have permanent management or consultancy functions for important Swiss or foreign interest groups and none of them hold any official functions or political posts. Please also see the limitation on the number of permitted activities of Executive Management Team members included in the Company's Articles of Association and shown in Section 3.2 above.

Management contracts
No agreements pertaining to the provision of managerial services exist between LifeWatch AG and other companies or natural persons outside the LifeWatch Group of companies.

5 Shareholders' Participation Rights

5.1 Voting-rights and representation restrictions

Each share entitles to one vote. A shareholder with the registered right to vote who does not personally participate in the Shareholders Meeting may be represented by proxy. The holder of the proxy need not to be shareholder.

5.1.1 Voting-rights restrictions
LifeWatch AG does not have any special voting rights restrictions. The exercise of rights according to the Articles of Incorporation is the following:

- The Company shall only accept one representative per share.
- The right to vote and rights relating thereto under a registered share may be exercised vis-à-vis the Company only by persons registered in the stock ledger with the right to vote.
- The Board of Directors may refuse to register an acquirer as a shareholder with the registered right to vote if the acquirer, upon request, does not explicitly declare that he acquired the shares in his own name and for his own account.

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- The Board of Directors makes sure that the shareholders may give:
  1. instructions to the independent shareholder representative with respect to each motion contained in the invitation concerning agenda items; and
  2. general instructions to the independent shareholder representative with respect to unannounced motions to agenda items, to new motions pursuant to art. 26d para. 3 of the Articles of Incorporation (dismissed compensation) as well as to new agenda items pursuant to art. 700 para. 3 CO.
- The Board of Directors further makes sure that the shareholder may submit their proxies and their instructions, also by electronic means, to the independent shareholder representative at the latest until 48 hours prior to the start of the Shareholders Meeting as mentioned in the invitation. Compliance with this term is determined based on the receipt of the proxy and the instructions by the independent shareholder representative. The Board of Directors determines the procedures for giving proxies and instructions by electronic means.
- The independent shareholder representative is obligated to vote the shares for which it received proxies in accordance with the instructions given. If he or she has received no instructions with respect to votes, he or she abstains from voting the respective shares.
- If the independent shareholder representative is not in a position to act or if the Company has no independent shareholder representative, the proxies and instructions given are regarded as given to the independent shareholder representative determined by the Board of Directors.

The Board of Directors may cancel the registration retroactively to the time of the registration if such registration was based on false declarations.

5.2 Statutory Quorums

A resolution of the Shareholders Meeting adopted by at least two thirds of the represented share votes and the absolute majority of the represented par value of shares is required for:

1. the change of the purpose of the Company
2. the creation of shares with privileged voting rights
3. the restriction of the transferability of registered shares
4. an increase of capital, authorized or subjected to a condition
5. an increase of capital out of equity, against contributions in kind, or in anticipation of a subsequent acquisition of assets, and the granting of special benefits
6. the limitation or withdrawal of pre-emptive rights
7. the change of the registered office of the Company
8. the dissolution of the Company with or without liquidation Shareholders' Meeting

5.3 Convocation of the Shareholders Meeting

The Shareholders Meeting shall be called by the Board of Directors and, if needed, by the auditors. One or more shareholders with the registered right to vote, who own shares of the Company representing at least 10% of the share capital of the Company may request that a Shareholders Meeting be held. Such request must be submitted to the Board of Directors in writing setting forth the items to be discussed and the proposed motions by the shareholders requesting the meeting.

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5.4 Agenda

Notice to the Shareholders Meeting is given by way of publication of the invitation in the Swiss Official Gazette of Commerce (SHAB) at least twenty days before the day of the Shareholders Meeting. The notice shall state the day, time and place of the meeting, the agenda, the proposed motions of the Board of Directors and the proposed motions of the shareholders who have requested the Shareholders Meeting or that an item be included on the agenda. Registered shareholders will also receive a written invitation to the Shareholders Meeting by the Company. One or more shareholders with the registered right to vote who own shares in the Company representing at least one million Swiss Francs of the share capital of the Company may request no later than 60 days before the day of the meeting that an item be included in the agenda. Such request must be made in writing and specify the proposed motions.

5.5 Inscription into the share register

The record date for registration of the shareholders' voting rights is defined by the Board of Directors. As of the record date, the shareholders' register remains closed for registration of shareholders' voting rights. The record date for registration for the Shareholder Meeting to be held on April 26th, 2017 has been set as April 21st, 2017, i.e. shareholders not registered by April 21st, 2017 will not be able to vote at the Shareholder Meeting.

6 Changes of Control and Defence Measures

6.1 Duty to make an offer

The Company's Articles of Incorporation do not contain any rules on opting-out or opting-up in order to cancel or restrict the obligation to submit an offer pursuant to the Federal Act on Stock Exchanges and Securities Trading.

In the event of a change of control, the five-year blocking period for the shares allotted to members of the Board of Directors will be lifted. Any unvested shares will become vested pro rata temporis. Furthermore, any performance units allocated to the Executive Management Team will vest immediately. There are otherwise no change-of-control clauses included in agreements or compensation plans that benefit members of the Board of Directors, the Company's Executive Management Team, or the LifeWatch Group.

7 Auditors

7.1 Duration of the mandate and term of office of the lead auditor

The auditors are appointed by vote of the Annual General Meeting of Shareholders for a term of one-year. Since fiscal year 2002 and also in fiscal years 2014, 2015 and 2016 the Company has retained the services of PricewaterhouseCoopers AG (PwC), Birchstrasse 160, CH-8050 Zurich, Switzerland as its statutory auditors. Since fiscal year 2008 PwC has also acted as the Group auditors. The lead auditor at PwC, Switzerland, Michael Abresch, has been responsible for the audit mandate since 2010 and will be replaced in 2017 after serving for the maximum period of seven years as required by Swiss law.

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7.2 Auditing and additional fees

During 2016, PwC charged the LifeWatch Group fees of $812,824 relating to auditing services for LifeWatch AG and its subsidiaries and the consolidated financial statements. Additional fees of $207,077 were also charged relating to tax and consulting advice to the various LifeWatch Group companies.

During 2015, PwC charged the LifeWatch Group fees of $587,482 relating to auditing services for LifeWatch AG and its subsidiaries and the consolidated financial statements. Additional fees of $228,496 were also charged relating to tax and consulting advice to the various LifeWatch Group companies.

7.3 External Audit Information

The Audit and Risk Committee of the Board of Directors monitors and periodically assesses the performance, compensation and independence of the external auditors and once a year submits a recommendation to the Board of Directors on whether PwC should be proposed for re-election at the Annual General Meeting. The Audit and Risk Committee of the Board of Directors also annually assesses the extent of the external auditing, the auditing plans and the respective programs. Furthermore, in order to assess the performance of PwC, the Audit and Risk Committee have regular contact with the CEO and CFO. Criteria used to assess the auditors' performance include an evaluation of: their technical and operational competence, their independence and objectivity, the efficiency of the audit process including the communication and coordination with the Audit and Risk Committee and management and their provision of practical recommendations. In fiscal year 2016, the Audit and Risk Committee held two telephone conference calls with the external auditors to discuss such matters.

8 Information policy

LifeWatch is committed to communicating in an open, transparent and effective manner with its shareholders, customers, employees and any other interested parties and will treat all parties equally.

LifeWatch AG publishes its earnings on a semi-annual basis and these earnings reports together with any other potentially market relevant information are available on the website (pull system) of the Company at www.lifewatch.com (under Investor Relations and Financial Publications). The earnings reports contain a detailed summary of events during the reported period as well as condensed consolidated financial reporting including balance sheet, statement of income, cash flow statement, changes in shareholders' equity and segment information. Additionally, LifeWatch publishes any price-sensitive information in accordance with the SIX Swiss Exchange rules for ad-hoc publicity and organizes analyst and media conferences or conference calls with the financial community to further discuss their reported earnings or any other matters of importance. Furthermore any interested party can sign up for customized e-mail alerts a under below mentioned adress (push system). A variety of other information including corporate structure, products, services, press releases, etc. is also provided on LifeWatch's website Official notices by the Company are published in the Swiss Official Gazette of Commerce.

Important Dates

March 22, 2017	Publication of Annual Report 2016
April 26, 2017	Ordinary General Meeting of Shareholders, Zurich
August 24, 2017	Analyst Conference Results HY 2017

For further questions:

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Alert Service: https://www.lifewatch.com/Investor-Relations/Alert-Service.html

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Compensation Report

Unless otherwise indicated, all information refers to the fiscal year 2016 closed on December 31, 2016. This report also follows the recommendations defined in Appendix 1 to the Swiss Code of Best Practice for Corporate Governance published by Economiesuisse, the Ordinance against excessive pay in stock exchange listed companies and complies with Chapter 5 of the Appendix to the SIX "Guidelines concerning information on corporate governance" and the requirements regarding transparency as defined in art. 663c Code of Obligations.

Responsibilities

The Compensation Committee of LifeWatch AG prepares, annually, specific proposals for all compensation to be paid. The basis for the determination of total compensation is a discussion between the members of the Board of Directors of LifeWatch AG at which the Board members evaluate the compensation proposals and determine the compensation for each member of the Board of Directors and each member of the Executive Management Team. The Board of Directors of LifeWatch AG has the ultimate authority to set compensation policy and the compensation for the Executive Management Team. The Executive Management Team then sets the compensation levels for all other LifeWatch employees based on the policy established by the Board of Directors. The shareholders, at the Annual General Meeting, separately approve the total compensation for the Board of Directors and the Executive Management Team for the past financial year and the following year, respectively.

Compensation Policy in General

LifeWatch is a globally active medical devices and service group, moving towards being a pure-play service provider. The Company maintains a compensation policy in accordance with the U.S. market for cardiac monitoring services and employment practices in the various countries in which it operates. Compensation reflects the market and the employment conditions in the relevant country as well as the individual qualifications and requirements needed for the specific position. In order to determine an appropriate compensation level, the Compensation Committee uses the services of external advisors. In 2016 the Compensation Committee used as reference two external surveys, Towers Watson Executive Compensation Survey and Mercer SIRS Benchmark Survey, to evaluate Executive Management Team compensation. These surveys were obtained by the Company's HR department which, with the assistance of an independent compensation consultant in the US, then benchmarked every position in the company including those of the Executive Management Team. The surveys provide information on salary ranges for each position segregated by size of company and company sector.

Section 26 of the Articles of Association of the Company containing the following provisions relating to the compensation of the Board of Directors and the Executive Management Team:

- Loans and credits may only be granted to the members of the Board of Directors or the members of Executive Management at market terms. Outstanding loans and credits to each such member shall not exceed 100% of the yearly compensation of the member concerned.
- Once a year, the Shareholders Meeting votes separately and in a binding manner on the approval of the total compensation the Board of Directors has resolved for:
  1. the compensation of the Board of Directors (including a possible additional compensation for work in committees) for the financial year following the ordinary Shareholders Meeting;
  2. the fixed compensation of the Executive Management for the financial year following the Shareholders Meeting;
  3. the variable compensation of the Executive Management for the financial year that ended prior to the ordinary Shareholders Meeting;
  4. the discretionary compensation (gratification) for the Executive Management for the financial year that ended prior to the ordinary Shareholders Meeting;
- If the total amount approved for the compensation of the Executive Management is insufficient to compensate members of Executive Management nominated after the resolution of the Shareholders Meeting until the beginning of the following approval period, the Company may use per person an additional amount of not more than 40% of the previously approved compensation of the Executive Management during the respective approval period. The Shareholders Meeting does not vote on the used additional amount;

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- If, within the binding vote on total compensation amounts, the Shareholders Meeting refuses the approval of a total amount for the members of the Board of Directors or the members of Executive Management, the Board of Directors may, at the same Shareholders Meeting submit new motions (even several times). If no new motions are submitted or if all motions are dismissed, the Board of Directors may at any time, observing the legal and statutory requirements, call a new Shareholders Meeting.

As a rule, members of the Board of Directors receive a fixed remuneration whereas Executive Management Team remuneration consists of a fixed salary element and a performance-dependent variable element; these two in combination form the target market compensation for a given position. Subject to the approval of the Shareholders Meeting it is the intention of the Compensation Committee to issue share options for members of senior management during 2017.

Compensation for the members of the Board of Directors

Members of the Board of Directors are remunerated in cash for their activities as a board member and receive additional fixed cash remuneration for activities in each of the LifeWatch board committees, except the Executive Committee. Yearly compensation is determined by the Board of Directors upon recommendation of the Compensation Committee. The member of the Board of Directors whose compensation is being determined is not permitted to comment or vote on the motion concerning his own remuneration. The Compensation Committee bases its judgment on industry standards for comparable Swiss industrial companies of similar size and complexity and was, in the past, advised by hkp Switzerland AG. LifeWatch's peer group includes the SIX Swiss Exchange listed companies ACINO HOLDING, BACHEM HOLDING, COLTENE, SHL TELEMEDICINE, SIEGFRIED HOLDING, TECAN GROUP and YPSOMED HOLDING. Recommendations of the advisors were followed for 2014 with allocations of cash and share-based compensation, but the proposals for 2015 compensation presented to the Shareholders Meeting in April 2016 were not approved. As a result of the Shareholders Meeting decision, the Compensation Committee decided to pay the Board of Directors only in cash in future, thereby removing the possibility of variation caused by share-based compensation. The overall compensation for the Board of Directors for 2015 was reduced to within the previously-approved levels and paid out in cash. The compensation for 2016 was set at a level which would be within the total amount approved by the Shareholders Meeting for 2016, i.e. CHF 700,000.

Shares previously allocated to a member of the Board of Directors are blocked and held in escrow for 5 years. If a Change of Control occurs and a member of the Board of Directors is removed from office prior to the end of his term of office, he is entitled to his compensation on a pro rata temporis basis. The blocking periods for all share-based awards shall be lifted, unless the Board of Directors decides otherwise.

Compensation for the Members of the Executive Management Team

The Compensation Committee determines the compensation for all members of the Executive Management Team and regularly benchmarks all components of each member's compensation based on external advice.

The fixed remuneration of the Chief Executive Officer is based on what has been assessed as industry standard for comparable U.S. American and Swiss industrial companies of similar size and complexity based on the Compensation Committee members' experience and after taking into account the results of the benchmarking process mentioned above.

The fixed remuneration for other members of the Executive Management Team is determined by the Compensation Committee based on the market and employment conditions in the relevant medical device industry. Data for this review is provided to the Compensation Committee from the Chief Executive Officer and the Senior Vice President of Human Resources. This data details relevant market rates for executive salaries based on an independent salary survey that has been selected for benchmarks and verified by the surveying body through payroll and public records. The sources for this data include: the Towers Watson Executive Compensation Survey and the Mercer SIRS® Benchmark Survey. The Mercer SIRS survey focuses primarily on the life sciences industry. The variable compensation paid to members of the Executive Management

LifeWatch in 2016

Team is also determined by the Compensation Committee under the Company's Long-term Incentive (LTI) plan, based on actual performance compared with a previously defined objectives in a performance scorecard. The Compensation Committee set up the LTI plan following advice and consultation with the Hay Group. The plan covers the variable component of the Executive Management Teams compensation. The Board of Directors approved a scorecard for the Executive Management Team and the allocation of variable compensation is based on effective results against this scorecard. The scorecard includes the following parameters: revenues, EBITDA margin, RoCE, (each carrying a 25% weighting) and qualitative factors (25% weighting). The plan sets a target bonus for each member of the Executive Management Team, based on their position, at a level between 40% and 100% of fixed remuneration. The target bonus would be paid if all criteria defined in the scorecard were exactly met; the actual bonus can range between 0% and 200% of the target level depending on effective performance. Once the variable compensation has been determined according to the above methodology, 50% would be paid in cash with the other 50% allocated to performance share units (PSU's). Performance share units consist of shares in the company, with the number of shares being determined by using the average share price for the 30 trading days prior to the AGM of the bonus performance year. PSU's are granted following approval of the variable compensation by the Shareholders Meeting and then vest at the end of the third year following that for which the bonus was awarded. In case of a change of control, all performance plan units would immediately vest on a pro rata basis, based on the original vesting period.

The above performance plan was developed for 2015 and continues to be valid for 2016, although for 2016 no variable compensation is foreseen as performance targets were not met.

All members of the Executive Management Team have a notice period of 6 months.

Overview of Compensation for Members of the Board of Directors

The resolution to approve the compensation of the Board of Directors for 2015 was declined at the Shareholders Meeting of 15 April 2016, and therefore the Board referred back to the resolution adopted at the Shareholders Meeting of 28 May 2014 to determine compensation levels for 2015. Accordingly, the non-executive members of the Board of Directors of LifeWatch AG received cash compensation for each of the years 2016 and 2015, representing remuneration for their activities as board members and as members of committees. The Chairman of LifeWatch AG received CHF 92,083 (2015: CHF 129,225, revised amount) for his activities. In total, the Board of Directors remuneration was as follows:

Remuneration (Audited)

	2016				2015			
Board of Directors	Base Cash	Shares [7]	Other [8]	Total	Base Cash	Shares [7]	Other [8]	Total
	CHF	CHF	CHF	CHF	CHF	CHF	CHF	CHF
Robert Bider, Chairman [1]	92,083		–	92,083				
Patrick Schildknecht [2]	105,557		10,139	115,696	10,000	309,000	28,429	347,429
Thomas Rühle [3]	84,477		7,453	91,930	15,000	123,600	13,356	151,956
Antoine Hubert [4]	101,833		4,323	106,156	25,000	154,500	17,134	196,634
Jinsheng Dong [6]	57,375		3,916	61,291				
Antoine Kohler [5], Vice Chairman	57,375		3,916	61,291				
Raymond Cohen [6]	80,042		–	80,042				
Total Remuneration	578,742	0	29,747	608,489	50,000	587,100	58,918	696,018

1) Elected member of the Board of Directors of LifeWatch AG at the Ordinary Shareholders Meeting on April 15, 2016 and appointed Chairman of the Board of Directors
2) Member of the Board of Directors, elected at an Extraordinary Shareholders Meeting on January 23, 2013 and Chairman of the Board of Directors until the Ordinary Shareholders Meeting on April 15, 2016
3) Member of the Board of Directors, elected at an Extraordinary Shareholders Meeting on January 23, 2013
4) Member of the Board of Directors, elected at the Ordinary Shareholders Meeting on January 30, 2014 and Vice Chairman of the Board of Directors until the Ordinary Shareholders Meeting on April 15, 2016
5) Elected member of the Board of Directors at the Ordinary Shareholders Meeting on April 15, 2016 and appointed Vice Chairman of the Board of Directors
6) Elected member of the Board of Directors at the Ordinary Shareholders Meeting on April 15, 2016
7) The share-based compensation proposed and reported for 2015 was ultimately not approved or granted, and the cash component was instead increased to a total of CHF 360,000 for the period between the 2015 and 2016 Shareholders Meetings
8) Other remuneration relates to employer social security contributions

LifeWatch in 2016

Options

No options were granted to the non-executive members of the Board of Directors during 2016 and no options were outstanding as at December 31, 2016 for the non-executive members of the Board of Directors (including closely linked parties).

Share Allotment

The Company had a share-based compensation program for its non-executive Board of Directors under which 38,000 shares of LifeWatch AG were originally proposed as awards for fiscal year 2015. These awards were ultimately not approved or granted and were replaced with cash compensation at levels consistent with the previously approved amount. As a result, no share-based compensation was allocated for 2015, and none is proposed for 2016.

Shareholdings

The non-executive members of the Board of Directors (including closely linked parties) held a total of 2,969,404 shares (2015: 610,178 shares) in LifeWatch AG as of December 31, 2016.

Loans Granted to the Board of Directors (Audited)

As of December 31, 2016, no loans and credits (2015: Nil) were granted to or outstanding with current and former members of the Board of Directors (including closely linked parties).

Compensation for former Memebers of the Board of Directors (Audited)

During fiscal year 2016, LifeWatch AG paid no compensation to members of the Board of Directors who gave up their function.

Overview Compensation for Members of the Executive Management Team

In fiscal year 2016, the members of the Executive Management Team received the following remuneration for their activities:

Remuneration (Audited)

Executive Management Team	2016				2015				
	Base	Variable [1]	Other [2]	Total [3]	Base	Variable		Other [2]	Total
						Cash	Performance Share Units		
	CHF	CHF	CHF	CHF	CHF	CHF	Number	CHF	CHF
Total Remuneration	**1,432,796**	**0**	**324,549**	**1,757,345**	**1,439,816**	**171,915**	**13,368**	**336,259**	**2,156,075**
Highest Total Compensation									
Dr. Stephan Rietiker	425,000	0	105,346	530,346	400,000	100,000	7,776	118,139	739,180

[1] Variable compensation awards are not proposed for 2016 as performance targets were not met
[2] Other remuneration relates to employer social security and pension fund contributions as well as car allowances and expenses
[3] Figures for 2016 include CHF 150,215 paid to a member of the Executive Management Team for the period after he left the company in August 2016

In 2016, there were four members of the Executive Management Team from January 1 to August 16; three members from August 17 to September 14; and four members from September 15 to December 31.

Options

The option scheme issued options to members of the Executive Management Team in earlier years but no new options have been issued since 2012. The option plan for the Executive Management Team was replaced with a share-based variable compensation plan from 2014.

LifeWatch in 2016

As at December 31, 2016 the members of the Executive Management Team and closely linked parties held no options (2015: 9,300) exercisable into shares of LifeWatch AG. The options held in 2015 were exercised in February 2016 at their exercise price of $3.05 per share.

Share Allotment

The Company has a share-based variable compensation plan for members of the Executive Management Team under which 12,995 Performance Share Units (PSU's) of LifeWatch AG were awarded for fiscal year 2015. During 2016 2,916 PSU's lapsed, leaving a total of 10,079 of the 2015 PSU's outstanding at the end of 2016. There is no variable compensation proposed for 2016 as performance targets were not met.

Shareholdings

As of December 31, 2016, the members of the Executive Management Team (including closely linked parties) held 334,000 shares (2015: 304,500 shares) in LifeWatch AG.

Loans Granted to the Executive Management Team (Audited)

As of December 31, 2016, December 31, 2015 and during the year, no loans or credits were granted to or outstanding with current or former members of the Executive Management Team (including closely linked parties).

Compensation for Former Members of the Executive Management Team (Audited)

Excluded from the figures above are amounts paid to a former member of the Executive Management Team from 1. April 2016, from which date he assumed another role within the company. No such compensation was paid in 2015.

Compensation Approach in 2017

Following the rejection by the Shareholders Meeting of the compensation for the Board of Directors in 2015, the Board of Directors decided to simplify the compensation approach and remove any possibility of variability by paying cash compensation in the future. The Board therefore fixed the compensation of a Board Member for 2016 and beyond at CHF 65,000 for each term of office (from AGM to AGM) with an additional amount of CHF 65,000 for the Chairman of the Board. Furthermore, a compensation amount of CHF 16,000 was fixed for each committee membership (except for the Executive Committee of the Board which is not remunerated).

Executive Management Team compensation continues to be a combination of a fixed salary element, a variable, performance-based, cash bonus and a Long-Term Incentive (LTI) program.

Building on the analysis delivered by Hay Group in late 2014, and to assist management and the Compensation Committee in assessing the Company's compensation programs, LifeWatch engaged an outside compensation consultant. Following a careful selection process and final credential review, management selected Morgan HR Consulting, Ltd. to serve as its independent compensation consultant beginning in October 2015. The scope of activities which are being covered by the Company's Executive Vice President of HR with assistance from the Committee's independent compensation consultant include:

- Review and confirm the benchmarks resulting from the competitive market assessment. This will involve using external market data to verify remuneration components such as base salary, total cash compensation (base + bonus) and total direct compensation (base salary, bonus incentives and equity vehicles)
- Partner with compensation consulting firms (Willis Towers Watson & Mercer HR consulting) on identifying competitive salary data
- Development of competitive peer group (comparators) within respective (Life Sciences / Medical Devices) industry
- Manage base pay actively to external market

LifeWatch in 2016

- Reach resolution and deploy a stock option plan for the Executive level to include the Executive Management Team, Vice Presidents, and a select group of high-performers within the organization
- Implement a Compensation Management System; leverage capital expenditures for return on investment (ROI) from system implementation
- Conduct a Fair Labor Standards Audit in the U.S. to assess positions for exempt status and compliance with Federal, State and Local regulations
- Develop job level hierarchy across all business units (i.e. Level I, Level II, Level III)
- Identify opportunities for compensation program refinements, as appropriate, based on industry best practices, talent issues, regulatory guidelines and LifeWatch's mission, values and strategic objectives
- Conduct market assessments in capturing internal equity considerations, recruitment and/or retention challenges and review of U.S. compensation philosophy
- Standardize shift differentials across all business units
- Develop action plan to institute a pay-for-performance culture
- Develop formal organization wide compensation and incentive plan governance approval documentation.
- Prepare for Committee meetings, as requested

The Compensation Committee and the Board of Directors were presented with detailed analysis on the results of benchmarking surveys in Q4, 2016.

Compensation Governance

The Compensation Committee sets the principles underlying compensation for the members of the Board of Directors and the Executive Management Team, supervises compliance with these principles and ensures, during an annual review, that they are still appropriate. The annual review of principles is designed to ensure that they remain in line with LifeWatch's strategy, our Shareholders interests and legal and regulatory requirements.

Within the framework of these compensation principles and upon the recommendation of the Compensation Committee, the Board of Directors determines each year the amount and composition of the compensation for individual members of the Board of Directors and the Executive Management Team. The shareholders at the Annual General Meeting separately approve the total compensation for the Board of Directors and the Executive Management Team for the following year.

The Compensation Committee is responsible for preparing the proposals to be submitted by the Board of Directors to the General Meeting for the approval of the maximum total compensation amounts for the Board of Directors and the Executive Management Team. The Compensation Committee proposes targets for future compensation plans and evaluates achievement against the performance factors for plans that are due to vest.

The Compensation Committee is also responsible for drawing up employment contracts for members of the Executive Management Team.

The Compensation Committee bases its decisions on extensive market evidence and seeks support of the Head of Global HR and an independent compensation consultant (Morgan HR) in formulating its independent judgment and decisions in all compensation-related matters.

In order to build a world-class and more competitive talent base and address talent turnover due to competitive salaries, a survey of compensation levels was undertaken in Q4, 2015 for the entire company using an independent compensation consultant (Morgan HR Consulting, Ltd.). Morgan HR advised that the Company's rapid growth had caused its compensation at all levels to fall

LifeWatch in 2016

well below market-competitive compensation levels of peer companies for salary and incentive pay. In addition, this survey revealed significant gaps in LifeWatch's overall compensation policy, which need to be addressed if LifeWatch wishes to be an attractive employer and be successful in the war for talent. This was partly addressed in 2016 with market adjustments for many staff members and will continue in 2017 with the goal of reaching the market average over the next few years.

Compensation Principles

The compensation system of LifeWatch is built upon four fundamental principles:

1. Compensation shall be market competitive and reflect the individual qualifications and requirements needed for the specific position.
2. Compensation shall contribute to establishing long-term motivation of our employees.
3. Compensation shall promote the retention of talent and the establishment of long-term loyalty of our employees.
4. Compensation shall ensure that the activity of management serves the long-term interests of our shareholders.

Compensation Regime for the Board of Direktors

The compensation system for members of the Board of Directors for 2017 will follow the simplification in 2016 with a fixed cash remuneration of CHF 16,000 for each committee membership (including chairmanship) as well as individually-approved fixed cash remuneration for activities as member of the Board of Directors.

At the Annual General Meeting 2017, LifeWatch AG will seek approval of the maximum total compensation amount for its Board of Directors for the business year 2018. Such approval will be sought at each Annual General Meeting also in the future.

Compensation Regime for the Executive Management Team

The overall compensation of the members of the Executive Management Team will consist of two components:

- Fixed compensation (including the base compensation and other compensation)
- Variable compensation which will consist of:
  - A cash bonus based on achieving pre-defined goals for 2017, as established in a scorecard; and
  - Share options (subject to approval by the Shareholder meeting of the necessary conditional capital)

Base compensation – The guiding principles of the base salary setting process have not changed in comparison to the earlier followed practices.

Other compensation – Other compensation includes car and expense allowances, coverage of expenses related to phone and other communication facilities and contributions to the Pension Fund and Insurance, including social security.

At the Annual General Meeting 2017, LifeWatch AG will seek approval of the maximum fixed compensation amount (including the base compensation and other compensation) of its Executive Management Team for the business year 2018.

Variable Compensation

The members of the Executive Management Team have a target variable cash compensation defined in terms of a percentage of their base salary. The target bonus is determined taking into consideration the duties and responsibility of the recipients. The CEO has a target bonus of 100% in terms of base salary with other Executive Management members having a target bonus of 50% of base salary. The target bonus system is aimed at constructing a more consistent compensation mix, strengthening the link to performance whilst still allowing scope for rewarding outstanding performance achievements.

The annual cash bonus is calculated according to a scorecard-based assessment. The scorecard contains three evaluation criteria, namely Revenues, adjusted EBITDA margin and share price development. The achievement range spans between 0% and 200%. The effective bonus is therefore capped at twice the target bonus.

Long-Term Incentive (LTI)

In order to align the long-term interests of the Executive Management Team with those of our shareholders, LifeWatch AG would like to amend its equity-based Long-Term Incentive plan (LTI) for the Executive Management Team and other senior staff members to an Option Plan. Such a plan is considered essential in order to attract top senior staff namely in the U.S. market, which is where the company currently produces all of its revenues. The Board of Directors has decided to introduce such a plan, if and only if, the Shareholder Meeting approves conditional capital to allow for the exercise of the options. Without such conditional capital, exercised options would need to be either served with shares purchased in the market or compensated in cash. In both cases this would require much needed cash, which the Board of Directors does not wish to commit. Should the Shareholders Meeting approve the issuance of conditional capital for an option plan then the Board would grant options to senior management, including the Executive Management Team. These options would vest after 3 years and any unvested options would be forfeited if the plan participant would no longer be employed by the company. The draft option plan was approved by the Board of Directors, subject to the creation of conditional capital by the Shareholders Meeting, at its meeting held on November 29, 2016.

At the Annual General Meeting 2017, LifeWatch AG will therefore seek approval for the conditional capital required for the option plan. Such approval will be sought at each Annual General Meeting also in the future, e.g. the approval for any options granted in 2017 would be sought at the Shareholder Meeting to be held in 2018.

Report of the statutory auditor
to the General Meeting
LifeWatch AG
Zug

We have audited the information marked as "audited" in the accompanying compensation report of LifeWatch AG for the year ended 31 December 2016.

Board of Directors' responsibility
The Board of Directors is responsible for the preparation and overall fair presentation of the compensation report in accordance with Swiss law and the Ordinance against Excessive Compensation in Stock Exchange Listed Companies (Ordinance). The Board of Directors is also responsible for designing the compensation system and defining individual compensation packages.

Auditor's responsibility
Our responsibility is to express an opinion on the accompanying compensation report. We conducted our audit in accordance with Swiss Auditing Standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the compensation report complies with Swiss law and articles 14–16 of the Ordinance. An audit involves performing procedures to obtain audit evidence on the disclosures made in the compensation report with regard to compensation, loans and credits in accordance with articles 14–16 of the Ordinance. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatements in the compensation report, whether due to fraud or error. This audit also includes evaluating the reasonableness of the methods applied to value components of compensation, as well as assessing the overall presentation of the compensation report.
We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Opinion
In our opinion, the compensation report of LifeWatch AG for the year ended 31 December 2016 complies with Swiss law and articles 14–16 of the Ordinance.

PricewaterhouseCoopers AG

Dr. Michael Abresch
Audit expert
Auditor in charge

Gian Franco Bieler
Audit expert

Zurich, 21 March 2017

Financial Section

"In 2016 we continued to deliver excellent results, as demonstrated by our patient satisfaction score of over 95%."
Andrew Moore, CFO

Overview Financial Statements

Consolidated Financial Statements

Statutory Financial Statements

LifeWatch AG

Consolidated Balance Sheets

USD in thousands	December 31 2016	December 31 2015
Assets		
Current assets		
Cash and cash equivalents	21,376	7,400
Accounts receivable, net (note 12a)		
Trade	12,107	11,580
Other	1,877	1,695
Inventories (note 12b)	1,111	1,750
Total current assets	**36,471**	**22,425**
Other non-current assets		
Marketable securities (note 12c)	–	52
Severance pay funded (note 8)	25	25
Prepaid expenses and deposits	856	870
Investment in Affiliated Company (note 5b)	2,174	–
Total other non-current assets	**3,055**	**947**
Deferred income taxes (note 11d)	17,399	*19,160
Property plant and equipment, net (note 4)	18,361	16,348
Goodwill (note 2f)	14,976	15,859
Intangible assets, net (note 6)	1,695	4,581
TOTAL ASSETS	**91,957**	**79,320**

* Reclassified (note 2h5, 11d)

The accompanying notes are an integral part of these consolidated financial statements.

USD in thousands	December 31 2016	December 31 2015
Liabilities and shareholders' equity		
Current liabilities		
Current portion of long-term loans and other liabilities (note 7a)	2,897	6,508
Accounts payable and accruals		
Trade	5,730	7,733
Provision for settlement (note 3)	12,975	22,284
Other (note 12d)	11,480	13,686
Total current liabilities	**33,082**	**50,211**
Non-current liabilities		
Loans and other liabilities, net of current maturities (note 7)	1,007	1,616
Accrued expenses	463	797
Obligation to affiliate (note 5b)	–	155
Accrued severance and other benefits (note 8)	475	776
Total non-current liabilities	**1,945**	**3,344**
Commitments, contingent liabilities and pledges (note 9)		
Total liabilities	**35,027**	**53,555**
Shareholders' equity (note 10):		
Paid-in share capital including premium (ordinary shares of CHF 1.30 par value; issued and paid: 18,477,869 shares and 13,473,550 shares at December 31, 2016 and 2015, respectively)	194,669	150,422
Accumulated deficit	(137,248)	(123,846)
Accumulated other comprehensive loss	(463)	(765)
Capital reserve	70	70
Treasury shares (13,125 and 15,625 shares at December 31, 2016 and 2015)	(98)	(116)
Total shareholders' equity	**56,930**	**25,765**
Total liabilities and shareholders' equity	**91,957**	**79,320**

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Operations

USD in thousands (except share and per share data)	2016	2015	2014
Revenues (note 16):			
Services revenue, net	114,382	87,561	96,126
Sales of systems (note 16a)	(550)	1,067	2,345
Total revenues	**113,832**	**88,628**	**98,471**
Cost of revenues			
Cost of services	51,313	48,115	42,024
Cost of sales of systems	5,779	2,922	3,263
Total cost of revenues	**57,092**	**51,037**	**45,287**
Gross profit	**56,740**	**37,591**	**53,184**
Operating expenses			
Research and development expenses (note 2k)	5,658	4,140	5,562
Selling and marketing expenses	21,098	18,796	22,682
General and administrative expenses	31,941	26,316	25,139
Legal settlements and other (income) expenses, net (note 3)	5,715	–	(499)
Total operating expenses	**64,412**	**49,252**	**52,884**
Operating (loss) income	(7,672)	(11,661)	300
Financial expenses, net (note 12e)	(1,377)	(3,924)	(484)
Other (expenses) income, net	(17)	(32)	(4)
(Loss) before taxes	(9,066)	(15,617)	(188)
Tax benefit (expense) (note 11)	(2,724)	4,459	(2,540)
Share in losses of affiliate company	(1,612)	(790)	–
Net (loss) income	**(13,402)**	**(11,948)**	**(2,728)**
(Loss) per share (note 2m)			
Basic	(0.855)	(0.891)	(0.205)
Diluted	(0.855)	(0.891)	(0.205)
Weighted average number of shares outstanding used in computation of (loss) per share (in thousands, note 2m):			
Basic	15,680	13,411	13,325
Diluted	15,680	13,411	13,325

The accompanying notes are an integral part of these consolidated financial statements.

LifeWatch AG

Consolidated Statements of Comprehensive (Loss) Income

USD in thousands	2016	2015	2014
Net (loss)	**(13,402)**	**(11,948)**	**(2,728)**
Other comprehensive income (loss):			
Actuary income (loss) from pension fund	302	(328)	(266)
Comprehensive loss	**13,100**	**12,276**	**2,994**

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Changes in Shareholders' Equity

USD in thousands	Number of shares (in thousands)	Paid in share capital including premium	Warrants	Accumulated deficit	Capital reserve	Accumulated other comprehensive loss	Treasury shares	Total
Balance at January 1, 2014	13,238	147,024	1,063	(109,170)	70	(171)	(370)	38,446
Changes during 2014:								
Net loss				(2,728)				(2,728)
Other comprehensive loss						(266)		(266)
Issuance of shares in respect of exercise of options granted to employees	193	1,040						1,040
Issuance of shares in respect of exercise of warrants granted to service providers	17	100						100
Stock-based compensation for board members		254						254
Stock-based compensation expenses related to options granted to employees		25						25
Compensation expenses due to issuance of warrants to service providers			12					12
Cancellation of warrants		1,075	(1,075)					–
Balance at December 31, 2014	13,448	149,518	–	(111,898)	70	(437)	(370)	36,883
Changes during 2015:								
Net loss				(11,948)				(11,948)
Other comprehensive loss						(328)		(328)
Treasury shares		142					254	396
Issuance of shares in respect of exercise of options granted to employees	25	229						229
Stock-based compensation for board members		532						532
Stock-based compensation expenses related to options granted to employees		1						1
Balance at December 31, 2015	13,473	150,422	–	(123,846)	70	(765)	(116)	25,765
Changes during 2016:								
Net loss				(13,402)				(13,402)
Other comprehensive income						302		302
Common stock issued	4,994	44,214						44,214
Issuance of shares in respect of exercise of options granted to employees	10	33					18	51
Balance at December 31, 2016	18,477	194,669	–	(137,248)	70	(463)	(98)	56,930

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Cash Flows

USD in thousands	2016	2015	2014
Cash flows from operating activities			
Net loss	(13,402)	(11,948)	(2,728)
Adjustments required to reconcile net (loss) income to net cash provided by (used in) operating activities:			
Share in affiliate losses	1,612	790	–
Depreciation and amortization	9,817	8,041	5,649
Changes in deferred income taxes	1,761	(4,545)	1,637
Compensation expenses charged in respect of options and warrants granted to employees and service providers	–	–	37
Write-off of INR	1,715		
Write-off of intangible assets	2,393	–	–
Write-off of marketable securities	52	–	–
Change in accrued severance pay	–	87	(12)
Changes in operating assets and liabilities:			
(Increase) decrease in accounts receivable, including non-current portion			
Trade	(527)	(2,292)	1,585
Other	(168)	1,351	336
Decrease in inventories	639	223	37
(Decrease) increase in accounts payable and accruals:			
Provision for settlement	(9,309)	13,911	(1,905)
Trade	(2,003)	1,105	1,324
Other	(2,219)	3,243	(1,871)
Net cash (used in) provided by operating activities	**(9,639)**	**9,966**	**4,089**
Cash flows from investing activities			
Purchase of fixed assets	(8,492)	(8,402)	(6,174)
Investment in intangible assets	(894)	(2,231)	(1,339)
Acquisition of business (see next page)	–	(1,500)	–
Investment and loans to affiliated subsidiary	(3,941)	(635)	–
Restricted bank deposit	–	780	32
Net cash used in investing activities	**(13,327)**	**(11,988)**	**(7,481)**
Cash flows from financing activities			
Common stock issued	44,214	–	–
Issuance of shares in respect of exercise of employee and service providers stock options	51	229	1,140
Proceeds from sale of treasury shares	–	396	–
Proceeds from loans undertaken	1,246	–	1,298
Short-term credit from banks and other	(4,000)	4,000	–
Repayment of long term loans and capital lease obligations	(4,568)	(2,290)	(1,942)
Net cash provided by financing activities	**36,942**	**2,335**	**496**
Translation differences on cash balances of subsidiaries	–	–	(153)
Increase (decrease) in cash and cash equivalents	13,976	313	(3,049)
Balance of cash and cash equivalents at beginning of year	7,400	7,087	10,136
Balance of cash and cash equivalents at end of year	21,376	7,400	7,087

Consolidated Statements of Cash Flows

USD in thousands	2016	2015	2014
Acquisition of business (see note 5a):			
Assets and liabilities at the date of acquisition:			
Account receivable	–	6	–
Account payables and other liabilities	–	(99)	–
Goodwill arising from acquisition	–	883	–
Other intangible assets arising from acquisition	–	1,030	–
Earn-out provision	–	(320)	–
Cash paid	**–**	**1,500**	**–**

USD in thousands	2016	2015	2014
Supplementary disclosure of cash flow information			
Interest paid, net	887	274	323
Income taxes paid	803	92	444
Supplementary disclosure of non-cash activities			
Capital leases of fixed assets	3,102	1,041	2,338

The accompanying notes are an integral part of these consolidated financial statements.

LifeWatch AG

Notes to the Consolidated Financial Statements

Note 1
Formation and Business of the Company

LifeWatch AG (the "Company") was incorporated in July 2001, under the name "Remmedtech AG". On August 14, 2001, the Company changed its name to "Card Guard AG". The Company was incorporated in order to become the parent company of Card Guard Scientific Survival Ltd. and its subsidiaries. On May 26, 2009, the Company changed its name to "LifeWatch AG" and in June 2012, Card Guard Scientific Survival Ltd. changed its name to LifeWatch Technologies Ltd (hereafter – "LWT" or the "Israeli Company").

The Company's shares are traded on the main Board of SIX- Swiss Exchange (hereafter – the "SIX") since October 29, 2001. On December 31, 2016, the Company's closing share price was CHF 10.25 ($10.04).

The Company and its subsidiaries provide monitoring services and develop, manufacture and market advanced telehealth systems for high-risk and chronically ill patients. For segment information, see note 16.

On November 9, 2015, the Company entered into a Stock Purchase Agreement (SPA) to acquire 100% of FlexLife Health Inc., an Ohio corporation (hereafter – "FlexLife"). FlexLife offers international normalized ratio (INR) monitoring services via a proprietary web-based digital health platform, see note 5a. In January 2017, the Company announced its decision to cease INR service for commercial business reasons effective February 20, 2017. See notes 5a and 17a.

In July 2015, the Company established a Joint Venture with IKSIR TEKNOLOJI SAGLIK VE KIMYA SAN. ve TIC. A.S. (hereafter –"JV partner"), a company located in Ankara, Turkey, to provide digital health solutions in the Turkish market. The Company transferred shares of LifeWatch Mobile Switzerland AG to the JV partner and recorded the transaction in the share register of LifeWatch Mobile

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Switzerland AG. In October 2015, LifeWatch Mobile Switzerland AG was renamed LifeWatch Turkey Holding AG. See note 5b.

In November 2015, LifeWatch Saglik Hizmetleri Anonim Sirketi, the Turkish subsidiary which is wholly owned by Lifewatch Turkey Holding AG and is the entity that will conduct business operations, was established and registered in Ankara, Turkey.

Note 2
Significant Accounting Policies

a. General

The significant accounting policies, applied on a consistent basis are as follows:

1) Accounting principles
The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) and comply with Swiss law, applied on a consistent basis, unless otherwise indicated below. All amounts are presented in United States dollars ($ or USD) in thousand unless otherwise stated. The par value of capital stock is denominated in Swiss francs.

2) Use of estimates in the preparation of financial statements
The preparation of financial statements in conformity with U.S. GAAP requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting years. Actual results could differ from those estimates. As applicable to these consolidated financial statements, the most significant estimates are assumptions related to revenue and receivables allowances, deferred taxes, contingencies and valuation of goodwill and other intangibles.

3) Functional currency
The currency of the primary economic environment in which the operations of the Company and most of its subsidiaries are conducted, is U.S. dollars. Thus, the functional and reporting currency of the Company and most of the subsidiaries is the U.S. dollar.

Balances in non-dollar currencies are translated into U.S. dollars using historical and current exchange rates for non-monetary and monetary balances, respectively. For non-dollar transactions and other items (stated below) reflected in the statements of operations, the following exchange rates are used: (i) for transactions: exchange rates at transaction dates or average period rates and (ii) for other items (derived from non-monetary balance sheet items such as depreciation and amortization, changes in inventories, etc.) historical exchange rates. The resulting currency exchange effects are reported as financial income or expenses, as appropriate.

The financial statements of subsidiaries whose functional currency is their respective local currency are translated into U.S. dollars as follows: assets and liabilities are translated using the year-end rate of exchange; results of operations are translated at average exchange rates during the year or at exchange rates at transaction dates if average rate is not a reasonable estimation. The resulting aggregate translation adjustments are reported in shareholders' equity as a component of "accumulated other comprehensive loss".

4) Principles of consolidation
The consolidated financial statements include the accounts of the Company and its subsidiaries (see note 18). Intercompany balances and transactions have been eliminated. Profits from intercompany transactions not yet realized outside the Company have also been eliminated.

The Company includes the results of operation of acquired business from the date of acquisition.

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5) Investee companies
Investments in entities in which the Company has a significant influence, but does not control, are accounted for using the equity method and included within other non-current assets. Under the equity method, the Company generally recognizes its proportionate share of comprehensive income or loss of the entity. The Company also reviews these investments for impairment whenever events indicate the carrying amount may not be recoverable. Impairments on investee companies are recorded in the income statement under share in losses of affiliate company.

6) Basis of presentation
The consolidated financial statements include the accounts of the Company and those of the subsidiaries that it controls due to ownership of a majority voting interest. The Company uses the voting interest entity model and the variable interest entity model (VIEs) to evaluate the inclusion of affiliate financial results using the consolidation or the equity method. The Company's share of earnings or losses of nonconsolidated affiliates is included in its consolidated operating results using the equity method of accounting when it is able to exercise significant influence over, but does not control, the operating and financial decisions of the affiliate.

7) Reclassification
Certain comparative figures have been reclassified to conform to the current year presentation.

b. Cash and cash equivalents

The Company considers all highly liquid investments, which include short-term bank deposits and petty cash (up to three months from the date of deposit) that are not restricted as to withdrawal or use, to be cash equivalents.

c. Inventories

Inventory is stated at the lower of cost or market. Cost is determined using the weighted average basis. Inventory costs include direct materials, direct labor costs and manufacturing overhead.

Allowances are established to reduce the cost of excess and obsolete inventories to their estimated realizable value based on historical information and estimates of excess quantities and obsolescence on a product-by-product basis.

d. Marketable securities

Investments in marketable securities that are to be held to maturity are stated at amortized cost with the addition of computed interest accrued as of the balance sheet date (such interest represents the computed yield on cost from acquisition to maturity). Interest and amortization of premium or discount for debt securities are reported as financial income or expenses.

Investments in marketable securities that are held to maturity are stated at amortized cost, net of write-down for any decrease in value that is not of a temporary nature. The fair value of those investments is based on current value or estimated upon the occurrence of identified events or changes in circumstances that might indicate that a write down of the investments is needed.

During 2016, marketable securities in the amount of $52 thousand were written off (no write-offs were recorded in 2015).

As to the fair value of marketable securities, see note 12c.

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e. Property plant and equipment

Property plant and equipment are stated at cost and are depreciated using the straight-line method over their estimated useful lives as follows

Asset	years
Manufacturing and peripheral equipment	3-15
Office furniture and equipment	7-15
Monitoring units	2-5
Motor vehicles	7

Leasehold improvements are amortized using the straight-line method over the shorter of the term of the lease and the estimated useful life of the improvements.

Property plant and equipment, mainly monitoring units, that are leased by the Company under capital leases are classified as Company assets and are recorded at the inception of the lease, at the lower of the assets' fair value or the present value of the minimum lease payments (not including the financial component).

f. Goodwill and intangible assets

Intangible assets

Intangible assets includes capitalized software costs for internal and external use, acquired technology, licensing agreement, customer list, patents and rights of use and other intangible assets (see note 6).

Assets that represent acquired technology and patents are stated at cost. The intangible assets, except for capitalized software costs, are amortized using the straight-line method over their estimated useful lives (5 to 8 years).

Software costs for internal use

Costs directly attributable to the development of computer software for internal use are capitalized under standard ASC 350-40 as intangible assets when the preliminary project stage is completed, the Company has an intention and ability to complete the project and the software will be used to perform the function intended. Such costs include external direct costs of services and payroll and payroll-related costs of employees directly involved in the project and related to software only. Software costs that do not meet capitalization criteria are expensed when incurred.

Capitalization will cease no later than the point at which a computer software project is substantially completed and the software is ready for its untended use, that is, after all substantial testing is completed.

Software costs for external use

Costs directly attributable to the development of computer software for external use (costs of software to be sold, leased, or marketed) are capitalized under standard ASC 985-20 as intangible assets when technological feasibility of the project has been established and all research and development activities for the other components of the product or process have been completed. Such costs include external direct costs of services and payroll and payroll-related costs of employees directly involved in the project and related to software only. In addition, the Company capitalizes an allocated amount of indirect costs, such as overhead related to programmers and the facilities they occupy.

Capitalization of computer software costs will cease when the product is available for general release to customers.

Capitalized computer software costs are amortized using the straight-line method over a period of 3 to 5 years, unless the software is deemed to be unusable and then costs will be written-off within the current period.

Goodwill

Goodwill represents the excess of the purchase price over the fair value of identifiable net assets acquired in a business combination.

Goodwill is not amortized systematically, but instead the group tests goodwill for impairment at the reporting unit level on an annual basis or whenever circumstances change, which would indicate that impairment may have occurred. If the carrying value of goodwill exceeds its fair value, an impairment loss is recognized.

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Goodwill impairment testing is a two-step process. The first step involves comparing the fair value of the Company's reporting units to their carrying amount. If the fair value of the reporting unit is determined to be greater than its carrying amount, there is no impairment. If the reporting unit's carrying amount is determined to be greater than the fair value, the second step must be completed to measure the amount of impairment, if any. Step two calculates the implied fair value of goodwill by deducting the fair value of all tangible and intangible assets, excluding goodwill, of the reporting unit from the fair value of the reporting unit as determined in step one. The implied fair value of the goodwill in this step is compared to the carrying value of goodwill. If the implied fair value of the goodwill is less than the carrying value of the goodwill, an impairment loss equivalent to the difference is recorded.

For purposes of step one, the fair value of the reporting unit is determined using the income approach, whereby the fair value is calculated based on the present value of estimated future cash flows, applying a discount rate. The cash flow projections are based on revenues and expenses included in the current operating plan as well as a terminal value. The cash flow projections require significant estimates and judgments for variables such as selling price, number of enrollments, sales growth, operating costs, capital expenditures and market and economic conditions. The discount rate represents management's estimate of the weighted average cost of capital, considering the capital structure of the Company and external industry data. For 2016, the discount rate was 13.5%. The fair value exceeded book value by approximately 36.3%. A one percentage increase in the discount rate would reduce the calculated fair value by approximately 10.0%. A one percentage decrease in the terminal value growth rate would reduce the calculated fair value by approximately 4.4%.

Pursuant to the Company's decision to cease INR service, a goodwill impairment of $883 thousand was recorded in the financial statements for the year ended December 31, 2016. No goodwill impairment was recorded in 2015 and 2014.

g. Impairment of long-lived assets

The Company tests long-lived assets, including definite lived intangible assets, for impairment, whenever events or circumstances present an indication of impairment. When required, the Company records charges for impairment of long-lived assets for the amount by which the present value of future cash flows, or some other fair value measure, is less than the carrying value of these assets. Pursuant to the Company's decision to cease INR service, the long-lived assets of FlexLife were impaired and a write-off of $358 thousand was recorded in the financial statements for the year ended December 31, 2016. No impairment losses were recorded in 2015 and 2014.

h. Deferred income taxes

1) Deferred income taxes are determined by the asset and liability method based on the estimated future tax effects of differences between the financial accounting and tax basis of assets and liabilities under the applicable tax law. Deferred tax balances are computed using the tax rates expected to be in effect when these differences reverse. Valuation allowances in respect of deferred tax assets are provided when it is more likely than not that all or a portion of the deferred income tax assets will not be realized. See note 11d for additional information regarding the composition of the deferred taxes.

2) Upon the distribution of dividends from tax-exempt income of "Approved Enterprises" (see also note 11b (1)), the amount distributed will be subject to tax at the rate that would have been applicable had the Israeli Company not been exempt from payment thereof. The Company intends to permanently reinvest the amounts of tax-exempt income and does not intend to cause distribution of such income as dividends. Therefore, no deferred income taxes have been provided in respect of such tax-exempt income.

3) The Company may incur an additional tax liability in the event of an intercompany dividend distribution from foreign subsidiaries; no additional deferred income taxes have been provided, since it is the Company's policy and intention not to distribute dividends in the foreseeable future.

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4) Taxes that would apply in the event of disposal of investments in foreign subsidiaries have not been taken into account in computing deferred income taxes, as it is the Company's policy to hold these investments, and not to realize them.

5) Deferred tax assets and liabilities are classified as noncurrent based on early adoption ASU 2015–17 simplifying the presentation of deferred income taxes.

i. Income tax uncertainties

The calculation of the Company's tax liabilities involves dealing with uncertainties in the application of complex tax regulations. The Company recognizes liabilities for uncertain tax positions based on the two-step process prescribed by applicable accounting principles. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step requires the Company to estimate and measure the tax benefit as the largest amount that is more than 50% likely of being realized upon ultimate settlement. It is inherently difficult and subjective to estimate such amounts, as this requires the Company to determine the probability of various possible outcomes. The Company reevaluates these uncertain tax positions. This evaluation is based on factors including, but not limited to, changes in facts or circumstances, changes in tax law, effectively settled issues under audit, and new audit activity. Such a change in recognition or measurement could result in the recognition of a tax benefit or an additional charge to the tax provision in the period.

j. Revenue recognition

The Company's revenue is derived from rendering services and sale of its systems. The Company recognizes revenue when it is realized or realizable and earned. The Company considers revenue realized or realizable and earned when it has persuasive evidence of an arrangement, delivery has occurred, the sales price is fixed or determinable, and collectability is reasonably assured. Delivery does not occur until services have been provided to the customer or products have been delivered, title has passed to the customer and risk of loss has transferred.

For services provided to patients, the Company principally receives payment from third party payers, such as Medicare, and various medical insurance providers rather than individual customers. The Company records a contractual allowance reserve to account for potential differences in the amount billed and the amount expected to be received from the payer. The Company uses historical information to estimate the contractual allowance. These adjustments are recorded as a reduction of revenue at the time of sale. Accounts receivable are recorded at the invoice amount less these contractual adjustments.

The Company also reduces revenue for product returns and service issues. Revenue is recognized only if these estimates can be reliably determined. The Company bases its estimates on historical results, taking into consideration the type of customer, the type of transaction and the specifics of each arrangement.

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Revenue is recognized as follows:

1) Services revenue
The Company's primary service offerings are cardiac monitoring.

The Company provides cardiac services using six types of monitors: Mobile Cardiac Telemetry (MCT), MCT Patch, Event, Holter, INR and Pacemaker. MCT, MCT Patch and Event monitors are generally worn by the patient for a period of mainly 21 and 30 days, respectively, and revenue for these services is recognized on a straight-line basis over this period (the "wear" period). Straight-line revenue recognition is used because the MCT, MCT Patch and Event monitoring results are delivered to physicians throughout the wear period, the monitoring is continuous during the period, and no other discernible pattern of delivery exists. Holter monitoring services are recognized at the end of the wear period at the time the results are communicated to the physician. The INR monitoring service revenue is recognized upon the completion of four INR blood measurements, not exceeding one test per week. The Pacemaker monitoring service does not require a wear period, and the revenue is recognized at the time the service is performed. MCT, MCT Patch, Event, Holter and Pacemaker services are not typically provided to the same patient at the same time.

The Company's services are generally billed in advance and, where appropriate for MCT, MCT Patch and Event, revenue recognition is deferred and included within "Accounts payable and accruals" in the accompanying consolidated balance sheets.

Billings for services reimbursed by third party payers, including Medicare and Medicaid, are recorded as revenues net of allowances for differences between amounts billed and the estimated receipts from such payers. Adjustments to the estimated receipts, based on final settlement with the third party payers, are recorded upon settlement. If the Company does not have enough historical information regarding the collectability of the agreed proceeds for services or products, revenue is recorded on a cash basis.

Adjustments to the estimated proceeds, based on final settlement with the third party payers, are recorded upon settlement (see also note 9c).

2) Sale of systems
Revenues from sales of systems are recognized when an arrangement (usually in the form of a purchase order) exists, delivery has occurred, title has passed to the customer, the Company's fee is fixed or determinable and collectability is reasonably assured.

k. Research and development

Research and development expenses are charged to the statement of operations as incurred except when software costs are capitalized for internal or external use. (See note 2f.)

l. Allowance for doubtful accounts

For the sale of systems, the allowance for doubtful receivables is determined on the basis of rates that change according to the age of the customers' balances and specific receivables doubtful of collection.

The Company makes judgments as to its ability to collect its receivable balances. The Company uses historical information to estimate the allowance for doubtful accounts. These provision amounts are reflected in general and administrative expenses.

m. Basic and diluted net income (loss) per share

Basic net income (loss) per share is computed based on the weighted average number of ordinary shares outstanding during each year (net of treasury shares). Diluted net income per share includes the potential effect of stock option and warrants outstanding during the year, in accordance with ASC 260 "Earnings per Share", using the treasury stock method.

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The table below sets forth the weighted average number of shares used in the calculation of basic and diluted loss per share.

In thousands	2016	2015	2014
Net loss attributed to LifeWatch AG	(13,402)	(11,948)	(2,728)
Weighted average number of shares used in computation of diluted loss per share	15,680	13,411	13,325
Loss per common share:			
Basic	(0.855)	(0.891)	(0.205)
Diluted	(0.855)	(0.891)	(0.205)

n. Stock-based compensation

The Company accounts for employee's share-based payment awards classified as equity awards using the grant-date fair value method. The fair value of share-based payment transactions is recognized as an expense over the requisite service period, net of estimated forfeitures. The Company estimates forfeitures based on historical experience and anticipated future conditions.

The Company recognizes compensation cost for an award with only service conditions that has a graded vesting schedule using the straight-line method over the requisite service period for the entire award.

o. Comprehensive income (loss)

The Company's comprehensive income (loss) consists of actuarial pension funds income (loss), which is presented net of income taxes.

p. Treasury shares

Company shares held by the Company are presented as a reduction of shareholders' equity at their cost to the Company.

q. Concentration of credit risk

The majority of cash and cash equivalents as of December 31, 2016 and 2015 were deposited with large bank corporations. The marketable securities held by the Company are mainly corporate bonds. The Company believes that the credit risk relating to those balances is low.

Accounts receivable from third party payers potentially expose the Company to credit risk. The Company generally does not require collateral or other forms of security and maintains an allowance for potential credit losses. Management believes this risk is limited due to the large number of doctors and patients that comprise the Company's customer base, supported by a large number of insurance companies – see note 16c.

The Company recorded sufficient allowance for doubtful accounts. As to revenue generated from principal customers in 2016, 2015 and 2014 see note 16c.

r. Fair value of financial instruments

The Company measures fair value and discloses fair value measurements for financial and non-financial assets and liabilities. Fair value is based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

The accounting standard establishes a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels, which are described below:

Level 1
Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

Level 2
Observable prices that are based on inputs not quoted on active markets, but corroborated by market data.

Level 3
Unobservable inputs are used when little or no market data is available. The fair value hierarchy gives the lowest priority to Level 3 inputs.

In determining fair value, the Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible and considers counterparty credit risk in its assessment of fair value.

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s. Contingencies

Certain conditions may exist as of the date the financial statements are issued, which may result in a loss to the Company but which will only be resolved when one or more future events occur or fail to occur. The Company's management assesses such contingent liabilities and estimated legal fees, if any, and accrues for these costs. Such contingencies are recorded as accrued expenses in the financial statements of the Company. Such assessment inherently involves an exercise of judgment. In assessing loss contingencies related to legal proceedings that are pending against the Company or unasserted claims that may result in such proceedings, the Company's management evaluates the perceived merits of any legal proceedings or unasserted claims as well as the perceived merits of the amount of relief sought or expected to be sought. Loss contingencies considered to be remote by management are generally not disclosed unless they involve guarantees, in which case the guarantee would be disclosed.

t. Recently issued accounting guidance not yet adopted

1. In May 2014, the FASB issued ASU 2014-09 "Revenue from Contracts with Customers". Under the new standard, revenue is recognized when a customer obtains control of promised goods or services and is recognized in an amount that reflects the consideration which the entity expects to receive in exchange for those goods or services. In addition, the standard requires disclosure of the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The FASB has recently issued several amendments to the standard, including clarification on accounting for licenses of intellectual property and identifying performance obligations. Early adoption is possible for reporting periods beginning January 1, 2017. The Company is still evaluating the potential impact of ASU 2014-09 on its financial statements.
2. In February 2016, the FASB issued Accounting Standards Update intended to improve financial reporting about leasing transactions. Under the new guidance, a lessee will be required to recognize assets and liabilities for leases with lease terms of more than 12 months. The recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee primarily will depend on its classification as a finance or operating lease. The new ASU will require both types of leases to be recognized on the balance sheet. The ASU on leases will take effect for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018 (early adoption will be permitted). The Company is still evaluating the potential impact of the guidance on its financial statements.

Note 3
Legal settlements and other

During 2016, expenses associated with legal settlements and other included legal settlements expenses of $3.754 million on a net basis, other expenses of $1.811 million for the write of INR business assets and $0.150 million for legal fees (see also note 5).

During 2016, the preliminary settlement of the case of United States, et. al., ex. rel. Cieszynski v. LifeWatch Services, Inc. (qui tam action) was agreed. This case contained allegations related to billing processes for clinical services provided off shore and was filed against LifeWatch in May 2013. While LifeWatch vehemently denies any wrongdoing, the Company nonetheless agreed to a settlement to eliminate any possible unknown exposure and to allow LifeWatch to focus on the future rather than the past. The Relator (whistleblower) and LifeWatch settled the case for $12.75 million pending final approval by the United States Federal Government. Final approval was received in March 2017 and the settlement amount was paid in full – see note 17d.

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During 2015, the Company initiated an arbitration process to settle an overpayment claim by an insurance company and counter claim by the Company for unpaid services. Arbitration occurred in August 2015 and in March 2016, an arbitrator from the International Centre for Dispute Resolution issued a material adverse decision against LifeWatch Services Inc., relating to its dispute with a private health insurer over billing and payment practices. The arbitrator found LifeWatch Services Inc. liable for damages for the years 2009–2010 in the approximate amount of $18.7 million plus 6% per annum simple pre-judgement interest from January 2013. This amount was reduced by approximately $0.7 million in offsets which were previously taken for a net amount of settlement for $18 million, which was recorded as a reduction of service revenue on the consolidated statement of operations and a current liability under provision for settlement on the consolidated balance sheets as of December 31, 2015. In 2016, the Company renegotiated the case with the insurance company with a reduced award of $13 million. As part of the settlement the Company dismissed the insurance company from another pending case.

During 2014, costs associated with legal settlements and other include the net effect of income from reduction of provision for legal settlements of $750 thousand and expenses related to the re-organization process which the Company made following a change of management of the Company in the beginning of 2014 of $251 thousand.

During 2011, LifeWatch Services Inc. was under a civil investigation by U.S. Office of Inspector General (OIG) and U.S. Department of Justice (DOJ) regulatory bodies that audit Medicare and TriCare payments. LifeWatch Services, Inc. cooperated fully with the OIG and the DOJ throughout the investigation. According to the final settlement agreement, the Company was required to pay the United States Department of Treasury the sum $18.5 million plus interest accrued at the rate of 1.625% per annum from October 20, 2011, over six years. During 2016, the final installment of this settlement agreement was paid in full.

The provision for settlement as of December 31, 2016 and December 31, 2015 is $12,975 thousand and $22,284 thousand, respectively.

Note 4
Property plant and equipment, net

a. Composition of property plant and equipment, grouped by major classifications, is as follows:

USD in thousands	December 31, 2016	December 31, 2015
Cost:		
Manufacturing and peripheral equipment	13,333	13,175
Office furniture and equipment	3,303	3,136
Monitoring units	31,264	27,237
Motor vehicles	17	17
Leasehold improvements	1,839	1,600
Subtotal	**49,756**	**45,165**
Less – accumulated depreciation and amortization	31,395	28,817
Property plant and equipment, net	**18,361**	**16,348**

b. Depreciation expenses totaled $9,234 thousand, $8,005 thousand and $5,643 thousand in 2016, 2015 and 2014, respectively.

c. Property plant and equipment as of December 31, 2016 and 2015 include assets, mainly monitoring units, leased under capital lease agreements (see note 7), in the amount of approximately $5,424 thousand and $6,546 thousand, respectively, and the accumulated depreciation in respect of those assets is $3,479 thousand and $3,918 thousand in 2016 and 2015, respectively.

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Note 5
Investments

a. Acquisition of FlexLife Health Inc.

Impairment of FlexLife Health Inc.

In January 2017, the Company announced its decision to cease offering remote INR patient monitoring for commercial business reasons effective February 20, 2017. INR services were added to the Company's service offerings upon the acquisition of FlexLife during the year ended December 31, 2015 as described below. See note 17a.

The following table summarizes the write-off of the assets and liabilities that was recorded in the financial statements for the year ended December 31, 2016:

USD in thousands	
INR devices	358
INR restructuring cost	96
Contingent consideration not earned	(320)
Customer list	131
Software Licensing Agreement	663
Goodwill	883
INR Total write-off	**1,811**

The write-off was recorded as legal settlements and other expenses in the consolidated statement of operations.

Summary of acquisition

On November 9, 2015, the Company entered into a Stock Purchase Agreement (the "FlexLife Acquisition") to acquire 100% of the issued and outstanding voting capital of FlexLife Health Inc., an Ohio corporation (FlexLife). FlexLife offers INR (international normalized ratio) monitoring services via a proprietary web-based digital health platform. Monitoring of the INR is essential for patients taking anticoagulant drugs, which pose a risk of bleeding or clotting if dosing is not properly monitored.

Purchase consideration

The Company acquired FlexLife for a total purchase price of approximately $1.82 million, which was payable in $1.5 million of cash plus an estimated $0.32 million earn-out provision for the achievement of defined future revenue. The acquired assets met the definition of a business combination, and accordingly, was accounted for using the purchase method of accounting prescribed by ASC 805 – Business Combinations.

The following table summarizes the fair value of the assets acquired and liabilities assumed and resulting goodwill for the FlexLife Acquisition, as recorded in the Company's financial statements for the period ended December 31, 2015:

USD in thousands	Acquisition fair value
Net assets acquired	
Accounts receivable	6
Customer list	170
Software licensing agreement	860
Goodwill	883
Total assets acquired	**1,919**
Deferred tax liabilities	(99)
Total liabilities acquired	**(99)**
Net assets acquired	**1,820**

Revenue and profit consideration

Revenue of $87 thousand and $9 thousand was included in the Company's financial statements for period ended December 31, 2016 and December 31, 2015 respectively.

Goodwill consideration

The Company identified the value of customers and the software licensing agreement as finite-lived intangible assets acquired as part of the FlexLife Acquisition, and accordingly, assigned five-year expected useful lives to each asset. Both of these assets were valued based on the projected net present value of future cash flows to be generated from these assets. Goodwill represents both expected synergies and intangible assets that do not qualify for separate recognition, and equals the excess of purchase price over the fair value of the identifiable and tangible assets (net of liabilities assumed) acquired.

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b. Joint Venture

In July 2015, the Company invested a capital contribution of $58 thousand for a 55% equity interest in a Joint Venture. In the initial agreement the Company agreed to provide cash financing to the Joint Venture, if necessary, until the Joint Venture becomes cash-flow positive, limited to CHF3 million. The financing was agreed to be provided as follows: share capital of CHF100 thousand, a loan of CHF1.9 million to LifeWatch Turkey Holding AG to be repaid within a 10 year period and a loan of CHF1 million to LifeWatch Saglik Hizmetleri A.S. to be repaid within a 3 year period.

During 2016, based on the updated timeline for the launch of monitoring services in Turkey, together with the revised budget and forecast of Joint Venture enrolments, operating performance and cash requirements, significantly more funding was required for the Joint Venture to reach breakeven and generate positive cash flows. Based on the developments that occurred, including a contract amendment signed on January 4, 2017, the Company reassessed its interest in the Joint Venture and determined that the financing of the Joint Venture has become a much more significant element and is considered the activity that most significantly affects the operating performance of the Joint Venture. Given the Company, as the sole funding source, has control over this activity, the Joint Venture will be consolidated beginning in 2017. As of December 31, 2016, the Company will provide, if necessary and provided that the updated budget and forecasts are met, the cash financing to the Joint Venture until the Joint Venture is cash flow positive.

As of December 31, 2016 the Company has financed the Joint Venture with a cumulative loan of $4,518 thousand. The Company has recorded 100% of the accumulated operating loss of the Joint Venture of $2,402 thousand since the Company is legally obligated by contract to fund the Joint Venture. The Company's interest in the Joint Venture is recorded in the Company's financial statements using the equity method of accounting.

Composition of the investment and loans to the Joint Venture is as follows:

USD in thousands	December 31, 2016	December 31, 2015
Initial equity investment in Joint Venture	58	58
Loan to Joint Venture	4,518	577
Total	**4,576**	**635**
Accumulated Joint Venture operating loss	(2,402)	(790)
Investment in (obligation to) affiliate	**2,174**	**(155)**

Note 6
Intangible assets, net

a. Composition of intangible assets, grouped by major classifications, is as follows:

	Original amount December 31,		Amortizable balance December 31,	
USD in thousands	2016	2015	2016	2015
Software cost for internal use	2,071	1,494	1,695	1,494
Software cost for external use (1)	–	2,076	–	2,076
Acquired technology and other intangible assets	680	680	–	–
Software licensing agreement (see note 5a) (2)	–	860	–	835
Customer list (see note 5a) (2)	–	170	–	165
Patents and rights of use	158	208	–	11
Total	**2,909**	**5,488**	**1,695**	**4,581**

Amortization expenses totaled $3,780 thousand (including write-off of $3,191 thousand, see (1) and (2) below), $36 thousand and $6 thousand in 2016, 2015 and 2014, respectively.

(1) Pursuant to the Company's decision to discontinue the development of the Vital Signs Patch (VSP) project, the capitalization of software cost for external use was discontinued and a write-off of $2,393 thousand was recorded in the financial statements for the year ended December 31, 2016.

(2) Pursuant to the Company's decision to cease INR service, the intangible assets of FlexLife were impaired and a write-off of $794 thousand was recorded in the financial statements for the year ended December 31, 2016. See also note 5a.

Estimated intangible asset amortization expenses for the years subsequent to December 31, 2016 are as follows:

Year	USD in thousands
2017	502
2018	502
2019 and thereafter	691
Total	**1,695**

b. Capitalization of software development costs

According to U.S. GAAP the Company capitalized its development costs related to internal and external use projects.

The Company started to capitalize its software costs from the beginning of 2014.

The Company capitalized computer software costs for internal use in the amount of $577 thousand and $1,091 thousand in 2016 and 2015, respectively. The Company capitalized computer software costs for external use in the amount of $317 thousand and $1,140 thousand in 2016 and 2015, respectively. Starting in April 2016, the computer software for internal use was completed for its intended use and put into service. Therefore, the Company started to amortize costs capitalized using the straight-line method over a period of 3 years. As of December 31, 2016, amortization expenses of $376 thousand were recorded.

As mentioned in note 6a, in 2016, the Company decided to discontinue the development of the Vital Signs Patch (VSP) project and accordingly stopped capitalizing software costs for external use. A write-off of capitalized software costs associated with software for external use in the amount of $2,393 thousand was recorded as cost of sales of systems expenses in the consolidated statement of operations.

Amortization expenses totaled $376 thousand and $0 for in the years ended December 31, 2016 and December 31, 2015, respectively.

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Note 7
Loans and other liabilities

a. Composition of loans and liabilities are as follows:

USD in thousands	December 31, 2016	December 31, 2015
Loans from bank and other	–	4,000
Obligations under capital leases	3,904	4,124
Subtotal	**3,904**	**8,124**
Less – current maturities:		
Loans from bank and other	–	4,000
Obligations under capital leases	2,897	2,508
Subtotal	**2,897**	**6,508**
Non-current bank loans and obligations under capital leases	**1,007**	**1,616**

b. As of December 31, 2016, aggregate future minimum payments are as follows:

USD in thousands	
2017	3,039
2018	894
2019	142
Total minimum payments	**4,075**
Less – amount representing interest	171
Present value of bank loans and capital lease obligations	**3,904**
Less – current portion	(2,897)
Long-term portion of bank loans and capital lease obligations	**1,007**

c. Loans and other liabilities (net of current maturities) mature in the following years:

USD in thousands	Capital leases
2018	866
2019	141
Total	**1,007**

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d. Line of credit agreement

In February 2016, LifeWatch Services, Inc. entered into an amended and restated one year line and security agreement with a U.S. based financial institution. The restated agreement increased the maximum borrowings under the line of credit to $7.0 million and extended the maturity date to February 2, 2017. This agreement was in default from March until August 2016 with a frozen outstanding balance of $3 million. In August 2016, the Company resolved the default by paying the outstanding balance including interest in full and subsequently cancelled the agreement.

e. Credit facility agreement

In January 2016, the Company entered into a $6.0 million credit facility with a Switzerland-based financial institution, which is intended to be used for and finance general corporate activities. The interest rate for all credit facility advances that are drawn by the Company is determined by the Bank and paid quarterly. The credit facility is collateralized with a $6.6 million first demand guarantee by the Company, and expires on June 30, 2017. As of December 31, 2016, this credit facility is available in full with no outstanding balance.

f. Interest expense on loans from bank and other in 2016, 2015 and 2014 totaled $135 thousand, $37 thousand and $122 thousand, respectively.

g. Obligations under capital leases are denominated in dollars and bear annual interest at rates of 3.47%–5.56% as of December 31, 2016. Interest expense on obligations under capital leases in 2016, 2015 and 2014 totaled $144 thousand, $144 thousand and $178 thousand, respectively.

Note 8
Accrued severance and other benefits

a. In Switzerland

The Company maintains retirement savings plans for its employees as required by law at each of its locations. With the exception of Switzerland, these plans are defined contribution plans and as such no obligation exists for the Company over and above the contributions which are made during the year concerned. In Switzerland, the plan qualifies as a defined benefit plan. The pension plan provides benefits upon retirement based upon the amount held in the fund at retirement.

The Company used the year-end date, December 31 as the measurement date for the Swiss pension plan.

Assumptions

The assumptions used to determine the pension plan obligation and net periodic benefit cost are as follows:

	2016	2015
Discount rate at 1.1	0.90%	1.00%
Expected return on plan assets at 1.1	2.50%	2.50%
Discount rate at 31.12	0.70%	0.90%
Expected return on plan assets at 31.12	1.50%	2.50%
Future salary increases at 31.12	1.00%	1.00%
Future pension increases at 31.12	0.00%	0.00%
Expected average remaining working lives in years at 31.12	9.3	9.4

The discount rate used to measure the pension benefit obligation is based on market yields of high quality corporate bonds at the measurement date. The average duration of the pension obligations in the Company plan is approximately 19 years (2015: 19 years).

As of December 31, 2016 and 2015, the pension plan had 9 and 7 active participants, respectively, and no pensioners.

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The net periodic benefit cost for the pension plan for the years ended December 31, 2016 and 2015 was as follows:

USD in thousands	Defined Benefit Pension Plan December 31, 2016	December 31, 2015
Net periodic benefit cost		
Service cost	200	208
Interest cost	20	12
Expected return on plan assets	(37)	(22)
Actuarial loss recognized in current year	49	14
Prior service cost / (credit) recognized in current year	(12)	–
Amortization of transition obligation	10	10
Net periodic benefit cost	**230**	**222**

The changes in the pension benefit obligation and the fair value of plan assets and the funded status of the plan for the years ended December 31, 2016 and 2015 were as follows:

USD in thousands	Defined Benefit Pension Plan December 31, 2016	December 31, 2015
Change in projected benefit obligation		
Benefit obligation at beginning of period	1,949	707
Interest cost	20	12
Current service cost (employer)	200	208
Plan participants contributions	152	141
Prior service cost (credit)	(384)	(114)
Benefits (paid) deposited	89	592
Actuarial changes	99	409
Other	1	(6)
Benefit obligation at end of period	**2,126**	**1,949**
Change in the fair value of plan assets		
Fair value of plan assets at beginning of period	1,268	441
Actual return on plan assets	2	(44)
Employer contributions	152	141
Plan participants contributions	152	141
Benefits (paid) / deposited	89	589
Other	1	–
Fair value of plan assets at end of period	**1,664**	**1,268**
Funded status at end of period	**(462)**	**(681)**

The net amount recognized in the balance sheet as of December 31, 2016 and 2015 was as follows:

USD in thousands	Defined Benefit Pension Plan December 31, 2016	December 31, 2015
Amounts recognized in the statement of financial position		
Projected benefit obligation	(2,126)	(1,949)
Fair value of plan assets	1,664	1,268
Funded status over- (underfunding)	**(462)**	**(681)**
Current liabilities	**–**	**–**
Non-current liabilities	**(462)**	**(681)**

USD in thousands	Defined Benefit Pension Plan December 31, 2016	December 31, 2015
Amounts recognized in accumulated other comprehensive income		
Net loss (gain)	745	660
Prior service cost (credit)	(487)	(114)
Transition obligation	37	48
Amounts recognized in accumulated other comprehensive income	**295**	**594**

Estimated future benefit payments, reflecting expected future service, as appropriate, are presented in the following table:

USD in thousands	2016
Year:	
2017	5
2018	7
2019	10
2020	13
2021	163
2022–2026	297

Estimated contributions to the defined benefit pension plan in 2017 by the Company are $80 thousand. The Company contributes 50% of the total cost with the employee contributing the other 50%.

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Plan Assets

The plan was started in 2014 and is managed by AXA Winterthur Insurance. AXA Winterthur invests the funds and provides a return each year for the plan, which is fixed by the trustee of the plan after taking into account the statutory minimum interest rate for pension fund plans. The assets are invested into insurance contracts that provide for guaranteed returns. As of December 31, 2016 and 2015, plan assets totaled $1,664 thousand and $1,268 thousand, respectively. See also the table above showing the amounts recognized in the statement of financial position.

In accordance with ASC 715, the initial net liability that was established during the year ended December 31, 2014 was recorded in accumulated other comprehensive income and is being amortized in equal installments over the expected remaining service life of employees, which is approximately 9.3 years (2015: 9.4 years) as of December 31, 2016.

b. In Israel

Israeli law generally requires the payment of severance pay upon dismissal of an employee or upon termination of employment in certain other circumstances. The severance pay liability of the Israeli Company to its employees is recorded as if it was payable at each balance sheet date on an undiscounted basis, based upon the number of years of service and the latest monthly salary. This liability is partly covered by regular deposits with recognized pension funds, deposits with severance pay funds and by purchases of insurance policies. Under labor agreements, these deposits and insurance policies, as above, are in the employees' names and are, subject to certain limitations, the property of the employees.

The severance pay liability covered by the pension funds and by some of the insurance policies is not reflected in the balance sheets as the severance pay risks have been irrevocably transferred to the pension funds and insurance companies.

Most of the Israeli employees agreed to section 14 of the Severance Compensation Act, 1963 (section 14) in their labor agreements. Pursuant to section 14, the Israeli Company's employees are entitled to monthly deposits, at a rate of 8.33% of their monthly salary, made in their name with insurance companies. Payments in accordance with section 14 relieve the Company from any future severance payments in respect of those employees and as such the Company may only utilize the insurance policies for the purpose of disbursement of severance pay. The subsidiary has recorded a severance pay liability for the amount that would be paid if certain of its employees were terminated at the balance sheet date, in accordance with Israeli labor law. This liability is computed based upon the number of years of service multiplied by their monthly salary.

Expenses in respect of severance in 2016, 2015 and 2014 amounted to $317 thousand, $238 thousand and $316 thousand, respectively.

The Israeli Company expects to contribute approximately $109 thousand in the year ending December 31, 2017 to insurance companies in connection with its severance liabilities for its operations for that year.

The Israeli Company expects to pay $88 thousand in future benefits to its employees from 2017 to 2026 upon their normal retirement age. The amounts of such future benefits were determined based on the employees' current salary rates and the number of service years that will be accumulated upon their retirement. These amounts do not include amounts that might be paid to employees that will cease working for the Company before their normal retirement age.

Year	USD in thousands
2017	0
2018	7
2019	12
Thereafter (through 2026)	69

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c. In the U.S.

The U.S. subsidiaries have a 401(k) plan covering substantially all domestic employees. Participants may elect to defer a portion of their eligible compensation. Participants are fully vested in all contributions they make to the plan. The U.S. subsidiaries currently match 50% of contributions up to 6% with vesting annually over a three year period. Contributions by the U.S. subsidiaries are made per the requirements of the 401(k) plan. The U.S. subsidiaries' contributions for 2016, 2015 and 2014 were approximately $725 thousand, $610 thousand and $601 thousand, respectively.

Expenses in respect of severance in 2016, 2015 and 2014 amounted to $230 thousand, $78 thousand and $130 thousand, respectively.

Note 9
Commitments, contingent liabilities and pledges

a. Commitments

Operating lease commitments
The Company leases office space and equipment under operating lease agreements. Those leases will expire on different dates between 2018 and 2021, some with options to renew for additional five year periods. The lease payments are denominated in different currencies depending on the location. In order to secure liabilities of the lease payments to a landlord, the Israeli Company has registered in 2012 a bank guarantee in the amount of 3 months of rental expenses of approximately $78 thousand.

The minimum projected lease payments under operating leases, at rates in effect at December 31, 2016, are as follows:

Year ending December 31	USD in thousands
2017	2,798
2018	2,730
2019	1,331
2020 and thereafter	1,236
Total	**8,095**

Rental expenses totaled $2,648 thousand, $2,602 thousand and $2,421 thousand in 2016, 2015 and 2014, respectively.

b. Litigation

1) In June 2000, two pharmaceutical companies filed a summary procedure statement of claim in the District Court of Tel Aviv, Israel against the Israeli Company. In November 2006 and July 2011, judgments were given, ordering the Company to pay the plaintiffs a total amount of approximately $4.6 million which includes Value Added Tax (VAT), interest, currency adjustments and attorney fees. As of December 31, 2011, the Company paid the total amount to the plaintiffs.

   The Company appealed the Tel Aviv District Court's decision and a hearing in the Israel High Court of Justice took place in September 2013. A decision on the appeal was suspended while the parties attempted court-ordered mediation. The mediation process was unsuccessful and the High Court of Justice was requested to rule. The parties received the decision in June 2015 reversing, in great part, the District Court's decision and entitling the Company to a refund from the plaintiffs in the approximate amount of $3.75 million. Concentrated efforts are underway to reclaim these funds from the plaintiffs. A recovery of $373 thousand was recorded in the Company's financial statements as of December 31, 2016 in legal settlements and other (income) expenses.

   In addition, an amount of approximately $1.6 million, which was restricted by various bodies/authorities in connection with the proceedings was released and returned to the Company in 2015.

2) In November 2007, a former executive of the Company filed a financial claim against the Israeli Company in the amount of approximately $400 thousand together with interest and currency adjustment. In addition to the financial claim, the plaintiff appealed for royalties and options. In July 2009, a corrected claim was filed and the plaintiff has raised its claim to approximately $2.5 million in addition to his claim for royalties and options. The Israeli Company filed a defense in October 2009.

   In 2014, the labor court ruled in favor of the Israeli Company awarding the former executive only a small fraction of the requested damages and the amount of approximately $120 thousand due was paid. The executive ap-

pealed the decision and the Company counter-appealed. A hearing on the matter was held on October 27, 2015 and the court upheld the lower court's decision in its entirety. This former executive filed two new matters alleging similar claims in November 2016: one a labor matter and the other seeking patent royalties. The Company has moved to dismiss both cases and believes there is no significant exposure, but due to the early stage of the process the outcome is still unclear.

3) Following a refund claim from an insurance company and a counter claim by the Company to that insurance company for unpaid services, the parties initiated an arbitration process. Arbitration occurred in August 2015. In March 2016, an arbitrator from the International Centre for Dispute Resolution issued a material adverse decision against the Company, relating to its dispute with a private health insurer over billing and payment practices. The arbitrator found the Company liable for damages for the years 2009–2010 in the approximate amount of $18.7 million plus six percent per annum simple pre-judgment interest from January 2013 which totaled over $21.0 million. This amount was to be reduced by approximately $0.7 million in offsets which had been previously taken. The Company ultimately settled with the healthcare insurer for $13.0 million. As part of the settlement the Company dismissed the insurance company from another pending case. The settlement was paid in July 2016 and the matter has been dismissed from the court with prejudice. See note 3, 9c.

4) A Qui Tam (Whistleblower) action filed under seal in 2013 was unsealed and served upon the Company at the end of 2014. The U.S. federal government and the State of Texas declined to participate in this claim. This matter was settled between the Company and the Relator (Whistleblower), on behalf of the federal and state governments in June 2016, for $12.75 million subject to final approval by the federal government payors, Medicare, TriCare and the Veterans Administration and the state healthcare programs. The approvals were received, payment was made to the U.S. Federal Government and the federal claims were dismissed with prejudice in March 2017. The remaining state claims amounting to approximately $50 thousand will be paid from the approved settlement value once the states determine how they wish to divide up the settlement sum. Upon completion of these payouts, the State Medicaid counts in the Amended Complaint will be dismissed as well. Final payment and dismissal of the state claims is expected to be complete before the end of the second quarter of 2017.

5) In 2014, the Company released its former CFO for cause. In 2015, the former executive filed an action with the Israeli labor court on a theory of wrongful termination and demanded his notice pay as well as other damages amounting to approximately $250 thousand. The parties engaged in mediation in May 2016 and reached a confidential settlement significantly below the demanded amount. The case is now concluded and the matter dismissed from the courts with prejudice.

6) Shareholders in the sale of Flexlife, Inc., filed a Notice of Arbitration in January 2016, alleging that LifeWatch Services, Inc. breached the Stock Purchase Agreement (SPA) and demanding $5.5 million in liquidated damages. LifeWatch answered the allegations and believes there is no significant exposure due to the fact that the Company had a legitimate right to withdraw from the INR market under the terms of the SPA (see also note 3, 5a and 17a). Due to the early stage of the process, the outcome is still unclear. At this point in time, the arbitration is not proceeding due to the shareholders' inaction.

The Company's management, based on the advice of its legal counsel, believes that no provisions needed to be made in the financial statements for items 1, 2, 5 and 6 above.

c. Provision for repayments

Net patient service revenue is reported at estimated net realizable amounts from patients, third-party payors, and others for services rendered and include estimated revenue adjustments due to audits, reviews, and investigations performed by payors. Such revenue adjustments are recorded in the period in which amounts due to contingent claims materialized and are further adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews, and investigations. In March 2016, an arbitrator from the International Centre for Dispute Resolution issued a material adverse decision against the Company, relating to its dispute with a private health insurer over billing and payment practices. The arbitrator found the Company liable for damages for the years 2009–2010 in the approximate amount of $18.7 million plus six percent per annum simple pre-judgement interest from January 2013. This amount will be reduced by approximately $0.7 million in offsets which have been previously taken. See note 3, 9b.

As of December 31, 2016 and 2015, the amount of provision for repayments was $0 thousand and $22,284 thousand, respectively.

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Note 10
Shareholders' equity

a. Share capital

1) Share capital

The Company's ordinary shares confer upon their holders voting rights, the right to receive dividends, if declared, and any amounts payable upon the dissolution, liquidation or winding up of affairs of the Company.

In 2016 the Company increased the registered share capital by issuance of 4,994,019 shares of CHF 1.30 par value. The capital increase provided to the Company net proceeds of approximately CHF 43.8 million, net of related issuance costs of CHF 1.1 million.

In addition, the Company issued 10,300 shares (2015: 25,124 shares) in respect of the exercise of options under the terms of conditional capital.

As of December 31, 2016, the registered share capital of the Company is composed of 18,477,869 shares of CHF 1.30 par value.

2) Conditional capital

As of December 31, 2016, the share capital of the Company may be increased through the issuance of no more than 1,000,000 registered shares of CHF 1.30 par value each, to be fully paid up, by an amount of no more than CHF 1,300,000.

b. Treasury shares

The Board of Directors resolved that the Company may purchase its own shares up to 10% of its share capital.

The treasury shares are exempt from voting.

A reconciliation of opening and closing balances of the number of treasury shares (in thousands) is presented on the right:

Year ended December 31	2016	2015	2014
Balance outstanding at beginning of year	16	52	52
Issue of treasury shares (note 10e)	(3)	(36)	–
Balance outstanding at end of year	13	16	52

c. Warrants

1) Total compensation charged in respect of the warrants during 2016, 2015 and 2014 amounted to $0 thousand, $0 thousand and $12 thousand, respectively, and was recorded as advisory expenses in general and administrative expenses. The fair value of each warrant granted is estimated on the date of grant using the Black-Scholes option pricing model.

During the year ended December 31, 2014, 17,183 warrants to service providers were exercised. No warrants were exercised during the years ended December 31, 2016 and December 31, 2015.

2) Warrants granted to service providers:

Year ended December 31, 2014	Number of warrants	Weighted average exercise price
Outstanding at beginning of year	47,500	$5.86
Changes during the year:		
Cancelled	30,317	$5.98
Exercised	17,183	$5.66
Outstanding at end of year	**0**	**$0**
Exercisable at end of year	**0**	**$0**

d. Stock-based compensation plan

Description of stock-based compensation plan for Board members

Members of the Board of Directors were remunerated in Restricted Share Units (RSU's) for their activities as a board member in 2014/2015 and 2015/2016. This remuneration is shown in the table below. The Company calculates the fair value of the shares at the transfer date and records the related compensation expense over the requisite service period, which is AGM to AGM. Total compensation expense recorded in 2016, 2015 and 2014 was $190 thousand, $537 thousand and $254 thousand, respectively.

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Fair Value of RSU's

Year ended December 31, 2015	Number of warrants	Fair value (*)
Non-vested at beginning of year	12,878	141
Changes during the year:	–	–
Granted	–	–
Vested	12,878	141
Non-vested at end of year	**–**	**–**

(*) grant-date fair value per unit is $10.92.

It was originally intended that the board would be compensated in RSU's for their activities as a board member in 2015/2016 and beyond but the shareholders rejected the board compensation for 2015/2016 at the 2015 AGM held in April 2016. As a result of this shareholder decision, the Board of Directors is now being remunerated entirely in cash. More information on Board Compensation can be seen in the Compensation Report on pages 74 to 88 of this annual report. The AGM rejection of the board compensation for 2015/2016 resulted in the cancellation of awards previously issued, and the awards were subsequently replaced by cash awards totaling $310 thousand. Because the fair value of the cash awards was less than the fair value of the RSUs initially awarded, no additional compensation expense was recorded, and the amount of the cash compensation was deducted from paid-in share capital including premium.

Description of stock-based compensation plan for the Executive Management Team

Members of the Executive Management Team received a portion of their annual variable compensation in Performance Share Units (PSU's) for their activities in 2014 and 2015. No variable compensation has been allocated for 2016.

The 2014 and 2015 PSU's were granted in 2016 and are shown in the table below. The Company calculates the fair value of the PSU's at the grant date and records the related compensation expense over the requisite vesting period, which is typically from the day after the approval of the variable compensation by the shareholders meeting until December 31 of the year 3 years after the year to which the grant relates. Based on the expectation that the performance criteria will not be met and the 2015 PSU's will not vest, the fair value of the 2015 PSU's is zero as at December 31, 2016. Total compensation expense recorded in 2016 was $147 thousand (2015: $0).

	December 31, 2016	
	Number of shares	Fair value
Non-vested at beginning of year	–	–
Changes during the year:		
Granted	31,018	308,146
Vested	–	–
Non-vested at end of year	31,018	308,146

e. Stock option plans

1) In 2012, the Board of Directors of the Company adopted a new share option plan, governed by terms and conditions similar to those that governed of the previous plans.

   As of December 31, 2014 according to the Company's shareholders resolutions, under the current capital structure of the Company and according to this new share option plan or further share option sub-plans to be adopted by the Company in the future, there were no options to grant.

2) The options mentioned above were not marketable and usually vested as follows: 25% – within one year from date of grant and the rest in 12 equal quarterly installments.

   Options not exercised within 10 years from the date of grant would expire. The rights of the shares obtained upon exercise of the options would be identical to those of the other shares of the Company. The Board of Directors had authority to approve deviations from the terms of the plan.

3) The options granted to the Israeli employees under the aforementioned plans were subject to the terms stipulated by Section 102 of the Israeli Income Tax Ordinance.

   With regard to options granted up to December 31, 2002, the Company was allowed to claim as an expense for tax purposes the amount credited to the employees as a benefit upon sale of the shares allotted, upon the exercise of the option.

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As from January 1, 2003, in accordance with the Capital Gain route chosen by the Company and pursuant to the terms thereof, the Company was not allowed to claim, as an expense for tax purposes, the amounts credited to employees as a benefit, including amounts recorded as salary benefits in the Company's accounts.

4) No options to employees were granted during the years ended December 31, 2016, 2015 and 2014.

5) There is no unrecognized compensation cost of employee stock options at December 31, 2016.

6) Total cash received from employees as a result of employee stock option exercises for the years ended December 31, 2016, 2015 and 2014 was $51 thousand, $229 thousand and $1,040 thousand, respectively. Of the $51 thousand received in 2016, $10 thousand relates to employee stock option exercises settled through the issuance of treasury shares, which resulted in a loss of $7 thousand.

	2016		2015		2014	
	Number	Weighted average exercise price USD	Number	Weighted average exercise price USD	Number	Weighted average exercise price USD
Options outstanding at beginning of year	12,800	$3.33	37,924	$7.35	275,672	$5.94
Options granted during the year – at market price	–	–	–	–	–	–
Options exercised during the year*	(12,800)	$3.33	(25,124)	$9.40	(193,045)	$5.43
Options expired and forfeited during the year	–	–	–	–	(44,703)	$6.97
Options outstanding at end of year	–	–	12,800	$3.33	37,924	$7.35
Options exercisable at end of year	–	–	12,800	$3.33	37,086	$7.32
Weighted average fair value of options granted during the year		–		–		–

* The total intrinsic value of options exercised during the years ended December 31, 2016, 2015 and 2014, was $157 thousand, $145 thousand and $991 thousand, respectively.

f. Dividends

1) According to Swiss law, retained earnings, as disclosed in the statutory financial statements of the Company, may be distributed to the shareholders as dividends, except for 5% percent of the net profit per year which must be allocated to the Company's general reserves until such reserves reach twenty percent of the paid in share capital. The general reserve can be freely used to the extent that it exceeds half of the share capital.

2) As of December 31, 2016, the Israeli Company's accumulated deficit includes accumulated earnings from its approved enterprises in the amount of $15.7 million distribution of which as cash dividend would entail payment of tax in Israel at the rate of up to 25%.

   The Company intends to permanently reinvest the amounts of such retained earnings, and it does not intend to cause distribution of such income as cash dividends.

Note 11
Taxes on income

a. The Company

General Corporate Tax System

Switzerland levies corporate income taxes at different levels: the federal, the cantonal and communal level. Therefore, a tax resident company is generally subject to taxes at all levels. The overall effective tax rate largely depends on the yield (cantonal and communal tax rates are generally progressive), the place of business, the level of taxable capital in the company and whether the company qualifies for a privileged tax status at cantonal and communal level (holding company, domiciliary company or mixed company).

Because of the great autonomy of the cantons and the related decentralized structure of the Swiss tax system, administration of the income taxes is the responsibility of each of the 26 cantons. The cantons also administer the direct federal tax on behalf of the federal government.

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The Swiss Federation levies direct federal income tax at a flat rate of 8.5% on after tax profits. Since Swiss corporations may deduct all federal as well as cantonal and communal taxes in the year in which they are due or paid, the effective tax rate on profit before tax is 7.83%. Regarding cantonal and communal income tax, each canton has its own tax law and levies cantonal and communal taxes at different rates. The basis for determining the taxable income of corporate entities is the net income reported as per the statutory accounts. This means that in principle all types of income, including capital gains, are part of taxable income.

For qualifying dividend income and qualifying capital gains on the sale of investments a participation exemption is available which leads to a tax exemption of the respective income or at least to a significant reduction of tax on this type of income.

For dividend income purposes a qualifying participation is defined as either (i) a participation of at least 10% of the equity (capital stock) or a company, or (ii) a participation of at least 10% of profits and the reserves of another company, or (iii) a participation with a current market value of at least CHF 1 million. There is no holding period requirement for dividend income purposes.

The participation deduction is also available for capital gains on the sale of qualifying participations when the sold participations make up at least 10 percent of the stock or share capital or at least 10 percent of the profits and the reserves of another company, and when this investment was in the possession of the corporation or cooperative for at least one year; if the ownership interest falls below 10 percent as a result of the sale, the discount for each subsequent capital gain can only be claimed if the participation rights at the end of the tax year had a market value of at least one million francs before the sale.

Capital taxes are levied on the cantonal level only (there is no capital tax at the federal level). The cantons levy capital tax on the net equity of a legal entity (i.e. share capital, legal reserves, other reserves, inappropriate retained earnings and any provisions that have not been allowed as deductions).

The Company in particular

The Company qualifies for the Swiss holding privilege. For a Swiss holding company to qualify for tax relief at cantonal level, three tests must generally be met. Firstly, the primary purpose of the company must be to hold and manage long-term equity investments in affiliated companies. Secondly, the company must not engage in a commercial activity in Switzerland. Thirdly, the company must pass an alternative asset or income test, whereby either 2/3 of the company's total assets must consist of substantial shareholdings or participations or 2/3 of total income of the company must consist of dividend income from substantial shareholdings or participations.

As the Company meets the requirements of a holding company, no income taxes are levied at the cantonal level.

At the federal level, no special holding privilege is granted. Accordingly, all income is subject to an effective federal income tax rate of 7.83%. However, dividend income derived from and capital gains realized on the disposal of qualifying participations are subject to a participation deduction.

As a holding company the Company is exempt from cantonal and communal corporate income tax. There is a complete exemption on income from dividends, interest, royalties, capital gains etc. This general rule has a few exceptions: any income or capital gain generated from real estate in Switzerland is subject to ordinary taxation; income for which treaty relief is obtained must be subject to ordinary taxation if required by the relevant tax treaty.

In the canton of Zug the capital tax equals to 0.02 per mille of the taxable equity with a minimum of CHF 250.00, multiplied by the current cantonal and communal multiplier (2016: Canton and City of Zug: 149.586%). The equity consists of paid-in equity (share capital, original stock or capital), participation capital, declared and hidden reserves created from taxed profits as well as retained earnings. At the minimum, the paid-in equity, including the paid-in participation capital, is taxable.

LifeWatch AG

b. Subsidiaries

1) LWT Israel

The income of the Israeli Company is taxed in Israel at the regular rate.

In January 2016, the Law for the Amendment of the Income Tax Ordinance (No. 216) was published, enacting a reduction of corporate tax rate beginning in 2016 and thereafter, from 26.5% to 25%.

In December 2016, the Economic Efficiency Law (Legislative Amendments for Implementing the Economic Policy for the 2017 and 2018 Budget Year), 2016 was published, introducing a gradual reduction in corporate tax rate from 25% to 23%. However, the law also included a temporary provision setting the corporate tax rate in 2017 at 24%. As a result, the corporate tax rate will be 24% in 2017 and 23% in 2018 and thereafter.

Deferred taxes were calculated based on the tax rates expected to be in effect when the related deferred income tax asset is realized or the deferred income tax liability is settled.

2) U.S. Subsidiaries

Income derived from operations of the U.S. subsidiaries is taxed at regular federal tax (34%) and state tax (combined rate of 3.0%) rates. On October 26, 2006, LifeWatch Corp. was formed by the contribution of the two operating companies, LifeWatch Services, Inc. and LifeWatch Technologies, Inc. Under IRC section 1502, LifeWatch Services, Inc. was deemed the acquiring company and as such the LifeWatch Technologies, Inc. results from October 27, 2006 forward will be included in the LifeWatch Corp's consolidated tax return. On November 9, 2015 LifeWatch Services, Inc. acquired the stock of FlexLife Health, Inc. Results from the acquisition date forward will be included in the LifeWatch Corp. consolidated tax return.

3) LifeWatch Europe AG

LifeWatch Europe AG is subject to ordinary taxation, as described in note 11a above.

4) Other Subsidiaries

The other subsidiaries are taxed under the laws and applicable tax rates of their countries of residence.

c. Carryforward tax losses

The Company has carryforward tax losses as of December 31, 2016 and 2015 in the amounts of approximately $55 million and $48 million, respectively. Tax losses may be carried forward for a maximum of 7 financial years. These carryforward losses expire between 2017 and 2023. As of December 31, 2016 and December 31, 2015, the Company estimates that it will not utilize the deferred taxes related to these carryforward tax losses and thus has recorded a full valuation allowance thereon.

The U.S. subsidiaries have carryforward tax losses, as of December 31, 2016 and 2015 in the amounts of approximately $39 million and $37 million, respectively that may be used to offset future taxable income. These carryforward losses expire between 2023 and 2036. As of December 31, 2016, a valuation allowance of approximately $85 thousand was recorded with respect to the FlexLife Health, Inc acquired tax losses subject to the IRC Section 382 limitation.

The Israeli Company has carryforward tax losses as of December 31, 2016 and 2015 in the amount of approximately $70 million and $66 million, respectively that may be used to offset future taxable income. These carryforward tax losses can be utilized indefinitely. In addition the Israeli Company has carryforward capital tax losses as of December 31, 2016 and 2015 in the amount of approximately $4.4 million. As of December 31, 2016 and December 31, 2015, the Israeli Company estimates that it will not utilize the deferred taxes related to these carryforward tax losses and capital tax losses, and thus has a full valuation allowance thereon.

LifeWatch AG

d. Deferred income taxes

Composition of deferred taxes is as follows:

USD in thousands	December 31, 2016	December 31, 2015
Computed in respect of the following:		
Accrued related party interest	1,490	2,094
Carryforward tax losses	37,157	44,272
Reserve for accounts receivable (including provision for repayment and settlement)	7,210	3,804
Unrealized gain	5,323	6,362
Property and equipment	(2,591)	(5,176)
Research and development expenses	1,252	1,617
Intangible assets	(4,111)	(4,304)
Other	699	1,167
Subtotal	**46,429**	**49,836**
Less – valuation allowance	(29,030)	(30,676)
Total	**17,399**	**19,160**
Deferred taxes are included in the balance sheet as non-current asset	**17,399**	***19,160**

* Reclassified.

Deferred tax assets of $13,142 thousand were classified as current in the prior year but have been reclassified to noncurrent with the Company's early adoption of ASU 2015–17.

e. (Loss) income before taxes is composed as follows

USD in thousands	2016	2015	2014
Domestic	(8,177)	(7,312)	(8,139)
Foreign	(889)	(8,305)	7,951
Total	**(9,066)**	**(15,617)**	**(188)**

f. Tax benefit (expense) included in the income statements

1) As follows:

USD in thousands	2016	2015	2014
Current			
Domestic	–	–	(771)
Foreign:			
U.S. subsidiaries	(119)	–	–
Israeli Company	(783)	(30)	(83)
Other subsidiaries	(61)	(126)	(49)
Subtotal	**(963)**	**(156)**	**(903)**
Deferred taxes			
U.S. subsidiaries	(1,761)	4,615	(1,637)
Total	**(2,724)**	**4,459**	**(2,540)**

2) A reconciliation of the theoretical tax expense, assuming all income is taxed at the regular rates applicable to income of the top holding company in Switzerland (see 11a above) and the actual tax expense is as follows:

USD in thousands	2016	2015	2014
(Loss) before taxes on income	(9,066)	(15,617)	(188)
Theoretical tax benefit at 7.83% in 2016, 2015 and 2014	710	1,223	15
(Increase) decrease in tax arising from different tax rates applicable to non-Swiss subsidiaries	(4,374)	523	(10,892)
Increase in taxes resulting from permanent differences	(310)	(94)	(191)
Increase (decrease) in uncertain tax position	(150)	(30)	–
Withholding tax	(633)	–	(855)
Changes in valuation allowance	1,646	2,129	9,707
Unrealized gain	329	1,088	(92)
Other – net	58	(380)	(232)
Tax (expense) benefit for the reported years	**(2,724)**	**4,459**	**(2,540)**

LifeWatch AG

g. Tax assessments

1) The Company received final tax assessments up to and including financial year 2014.

2) The Israeli Company received final tax assessments up to and including financial year 2012.

3) U.S. subsidiaries received final federal tax assessments up to and including financial year 2009. The U.S. Company is under IRS examination for the year 2013. As of December 31, 2016, the Company's management cannot evaluate the impact of this examination.

h. Uncertain tax positions (UTP)

Following is a roll-forward of the total amounts of the Company's unrecognized tax benefits at the beginning and the end of the years ending on December 31, 2016, 2015 and 2014 (not including interest or penalties):

	Year ended December 31		
USD in thousands	2016	2015	2014
Balance at beginning of year	**30**	**15**	**15**
Increase in unrecognized tax benefits as a result of tax positions taken during the year	150	30	–
Decrease in unrecognized tax benefits as a result of closed tax positions during the year	–	(15)	–
Balance at end of year	**180**	**30**	**15**

Note 12
Supplementary financial statement information

a. Accounts receivable

1) Trade receivables, classified by geographical markets, are as follows:

USD in thousands	December 31, 2016	December 31, 2015
United States and Canada	12,050	10,904
Europe	57	22
Asia	–	654
Total	**12,107**	**11,580**
The above trade receivables are net of provision for doubtful accounts of	**6,115**	**5,564**

Doubtful account expenses in the amount of $5,362 thousand, $4,548 thousand and $5,179 thousand in 2016, 2015 and 2014, respectively, are included in general and administrative expenses.

2) Other receivables are as follows:

USD in thousands	December 31, 2016	December 31, 2015
Government institutions	243	163
Prepaid expenses	1,121	565
Advance payments	464	225
Sundry	49	742
Total	**1,877**	**1,695**

b. Inventories

USD in thousands	December 31, 2016	December 31, 2015
Raw materials	741	1,668
Finished products and products in process	370	82
Total	**1,111**	**1,750**

Inventory write-off expenses in the amount of $1,346 thousand, $1,584 thousand and $1,388 thousand in 2016, 2015 and 2014, respectively, are included in cost of sales of systems.

c. Marketable securities

The marketable securities are presented in the balance sheets as follows:

USD in thousands	Amortized cost December 31, 2016	Aggregate fair value December 31, 2015
Collateralized Debt Obligation – held to maturity	–	52

In 2016 a write-off of $52 thousand of marketable securities that were held to maturity was recorded.

No marketable securities were sold during 2016, 2015 and 2014.

d. Accounts payable and accruals – other

USD in thousands	December 31, 2016	December 31, 2015
Payroll and related expenses	3,500	3,313
Accrued vacation and recreation pay	1,940	1,876
Accrued expenses	2,598	5,673
Income tax payable	278	262
Deferred revenues	2,693	2,398
Sundry	471	164
Total	**11,480**	**13,686**

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e. Financial (expenses) income, net

Financial (expenses) income, net are comprised of the following:

	Year ended December 31		
USD in thousands	2016	2015	2014
Interest expenses	(943)	(3,737)	(439)
Interest income	55	61	9
Foreign exchange differences	(400)	(218)	(25)
Other	(89)	(30)	(29)
Total	**(1,377)**	**(3,924)**	**(484)**

Note 13
Fair value measurement

Financial assets carried at fair value as of December 31, 2016 are classified in the table below under the category of Level 1, described in note 2r.

USD in thousands	December 31, 2016	December 31, 2015
Cash and cash equivalents		
Money market	–	3,608
Cash deposits and other	21,376	3,792
Total	**21,376**	**7,400**

Note 14
Risk assessment

Risk assessment is a crucial component of any financial planning process. Financial risk assessment and managing that risk is an integral part of the Company processes. The Company provides guidance on the identification of risks and implementation of monitoring procedures. Such monitoring procedures contain regular review of accounting policy assessment including changes in accounting policy, significant accounting matters and items requiring significant management judgment and estimates. The implementation of accounting policies, the adherence to regulations and the monitoring on a day-to-day risk basis are carried out by the relevant accounting and treasury functions. The Company has established an annual process for preparing a financial risk assessment in the areas of accounting complexity and the overall control environment.

LifeWatch AG

Note 15
Related parties

As of December 31, 2016, LifeWatch AG sublet office space and parking lots in Zug from a company in which a member of senior management is a board member. The contract was concluded at arm's length and is at market rates; LifeWatch pays the same rent as contracted between the lessee and the landlord, i.e. there is no mark-up or discount. The total rent paid in 2016 was $32 thousand.

Note 16
Segment reporting

a. The Company's reportable segments consist of:

Sales of Systems
Development, manufacture and marketing of trans-telephonic and wireless diagnostic equipment for the medical industry.

Mobile Health
Mobile medical device platform designed for self-testing of vital signs for the consumer market.

Patient Services
Cardiac monitoring services of MCT, MCT Patch, Event, Holter, INR and Pacemaker.

The results of operations of all the other operations of the Company not assigned directly to any of the above segments are included in "Other" as part of the Company's business segment presentation. The operating segments included in "Other" do not meet the quantitative thresholds required for a separate presentation or the aggregation criteria under segment reporting guidance.

The table below presents information about reported segments.

USD in thousands	Sales of Systems	Mobile Health	Patient Services	Other	Reconciling items	Consolidated total
For the year 2016:						
Revenues from external customers	(550)	–	114,382	–	–	113,832
Inter segments revenues	10,943	–	–	–	(10,943)	–
Total revenues	**10,393**	**–**	**114,382**	**–**	**(10,943)**	**113,832**
Operating (loss) income	(9,487)	–	6,237	(5,747)	1,325	(7,672)
Depreciation and amortization	1,063	–	19,764	62	(11,072)	9,817
Goodwill	–	–	14,976	–	–	14,976
Capital investments	738	–	20,215	56	(9,415)	11,594
Total assets	104,307	–	91,648	27,291	(131,289)	91,957
For the year 2015:						
Revenues from external customers	1,067	–	87,561	–	–	88,628
Inter segments revenues	8,389	–	–	–	(8,389)	–
Total revenues	**9,456**	**–**	**87,561**	**–**	**(8,389)**	**88,628**
Operating (loss) income	(2,095)	–	(8,373)	(5,284)	4,091	(11,661)
Depreciation and amortization	516	–	19,356	40	(11,871)	8,041
Goodwill	–	–	15,859	–	–	15,859
Capital investments	797	–	16,001	66	(7,421)	9,443
Total assets	107,422	–	103,006	2,522	(133,630)	79,320
For the year 2014:						
Revenues from external customers	2,325	20	96,126	–	–	98,471
Inter segments revenues	13,118	2	–	–	(13,120)	–
Total revenues	**15,443**	**22**	**96,126**	**–**	**(13,120)**	**98,471**
Operating (loss) income	7,681	(4,789)	5,283	(7,005)	(870)	300
Depreciation and amortization	400	–	16,350	–	(11,101)	5,649
Goodwill	–	–	14,976	–	–	14,976
Capital investments	680	–	19,100	197	(11,465)	8,512
Total assets	103,456	–	82,901	2,522	(119,895)	68,984

LifeWatch AG

b. The table below shows revenues and long-lived assets classified by geographical location of the customers

USD in thousands	Revenues	Long-lived assets
Year ended December 31, 2016:		
United States and Canada	114,382	17,022
Europe	25	333
Asia	(575) *	–
Other	–	1,006
	113,832	**18,361**
Year ended December 31, 2015:		
United States and Canada	87,563	14,700
Europe	–	318
Asia	1,047	–
Other	18	1,330
	88,628	**16,348**
Year ended December 31, 2014:		
United States and Canada	96,126	13,583
Europe	77	270
Asia	1,960	-
Other	308	1,069
	98,471	**14,922**

* In 2016, revenue was negative due to a customer return of merchandise of $608 thousand.

c. The table below shows revenues of customers comprising more than 10% of revenue

	Year ended December 31		
USD in thousands	2016	2015	2014
Revenue			
company A (services segment)	37.5%	44.6%	39.4%
company B (services segment)	12.6%	12.1%	13.1%

Note 17
Subsequent events

a. On January 9, 2017, the Company announced its decision to cease offering remote patient monitoring services in the area of INR coagulation measurement market for commercial business reasons effective February 20, 2017. As described in note 5a, the assets related to the INR business were written off in 2016.

The sellers of FlexLife initiated an arbitration action against LifeWatch Services, Inc., the U.S. subsidiary of LifeWatch AG on January 5, 2017, seeking $5.5 million in liquidated damages for an alleged default on the terms of the initial purchase agreement. LifeWatch steadfastly denies having defaulted on the initial purchase agreement and intends to vigorously defend its decision to withdraw from the INR market. LifeWatch is also exploring all options in regard to its response to the arbitration action, including bringing its own counterclaims against the seller – see note 5a and 9.

b. On January 24, 2017, Swiss company Aevis Victoria SA (Aevis) launched a public offer for all publicly held registered shares of LifeWatch AG. LifeWatch shareholders can opt for an exchange offer or a cash alternative. For each registered share of LifeWatch, it is foreseen that Aevis will offer 0.1818 registered share of Aevis with a nominal value of CHF 5.00. Alternatively, Aevis offers CHF 10.00 in cash per registered share of LifeWatch. The exchange offer in registered shares of Aevis presents a premium of 19.1% compared to the closing price of a LifeWatch share the day before and 19.1% compared to the 60 day VWAP of LifeWatch, respectively.

c. On February 1, 2017, the Company announced that following the public offer made by Aevis and in the interest of the Company and all shareholders, the Company has decided to solicit additional offers.

LifeWatch AG

d. On March 8, 2017, the Company announced that all U.S. federal government approvals for the qui tam settlement (see note 9b) have been received and the amount was paid in full. Consequently, on March 6, 2017, the U.S. federal court entered an order dismissing, with prejudice, all claims for U.S. federal government payors, Medicare, TriCare and Veterans Administration health-care programs.

Additionally, settlement of the dispute regarding the Medicaid programs for four remaining states has been agreed to, in principle, totaling approximately $50 thousand to be paid out of the same agreed settlement amount. The settlement with these states should be completed in the second quarter of 2017.

Note 18
Company structure

The Company structure as of December 31, 2016 and 2015, comprises of subsidiaries and affiliated companies as follows:

	Place of incorporation	Purpose of company	Authorized capital	Issued capital	Percentage held at December 31 2016 %	2015 %
LifeWatch Technologies Ltd.	Rehovot, Israel	Research and development, manufacturing and trading	NIS 2,000,000	NIS 1,073,494	100	100
LifeWatch Europe AG	Neuhausen am Rheinfall, Switzerland	Sales & Marketing Europe	CHF 100,000	CHF 100,000	100	100
Card Guard Europe BV	Haarlem, Netherlands	Holding company	EUR 90,756	EUR 19,513	100	100
LifeWatch Services Inc.	State of Delaware, U.S.	Monitoring services	USD 700,000	USD 68,060	100	100
LifeWatch Corp.	State of Delaware, U.S.	Holding company	USD 200,000	USD 90,000	100	100
LifeWatch International BV	Haarlem, Netherlands	Holding company	EUR 100,000	EUR 20,000	100	100
LifeWatch Mobile Holding BV*	Haarlem, Netherlands	Holding company	EUR 1	EUR 1	100	100
Lifewatch Japan Ltd.	Tokyo, Japan	Sales & Marketing	JPY 40,000,000	JPY 40,000,000	80	80
LifeWatch UK Ltd.*	London, United Kingdom	Monitoring services	GBP 1,500,000	GBP 384,001	91.5	91.5
LifeWatch MK Ltd.	Skopje, Macedonia	Software design and Quality assurance	–	–	100	100
LifeWatch Healthcare India Private Limited	Villivakkam, Chennai,India	Monitoring services	INR 2,500,000	INR 100,000	100	100
LifeWatch Turkey Holding AG	Zug, Switzerland	Holding company	CHF 100,000	CHF 100,000	55	55
LifeWatch Saglik Hizmetleri A.S.**	Ankara, Turkey	Monitoring services	TRL 5,688,190	TLR 5,688,190	100	100

* Inactive Company
** Subsidiary of LifeWatch Turkey Holding AG

Report of the statutory auditor
to the General Meeting of
LifeWatch AG
Zug

Report of the statutory auditor on the consolidated financial statements

As statutory auditor, we have audited the accompanying consolidated financial statements of LifeWatch AG, which comprise the consolidated balance sheet, consolidated statement of operations, consolidated statement of comprehensive (loss) income, consolidated statement of changes in shareholders' equity and consolidated statement of cash flows and notes (pages 94 to 157), for the year ended December 31, 2016.

Board of Directors' responsibility

The Board of Directors is responsible for the preparation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America (US GAAP) and the requirements of Swiss law. This responsibility includes designing, implementing and maintaining an internal control system relevant to the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error. The Board of Directors is further responsible for selecting and applying appropriate accounting policies and making accounting estimates that are reasonable in the circumstances.

Report on the Consolidated Financial Statements

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with Swiss law, Swiss Auditing Standards and auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers the internal control system relevant to the entity's preparation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control system. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements (pages 94 to 157) for the year ended December 31, 2016 present fairly, in all material respects, the financial position, the results of operations and the cash flows in accordance with accounting principles generally accepted in the United States of America (US GAAP) and comply with Swiss law.

Report on the Consolidated Financial Statements

Report on key audit matters based on the circular 1/2015 of the Federal Audit Oversight Authority

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key audit matter

Revenue recognition valuation, related to the reimbursement environment
We determined the recognition of patient service revenues of $114.4 million to be a key audit matter because of the complexity of estimating the final amounts receivable from the third party payers (insurance companies).

Patient service revenues were mainly derived from cardiac monitoring services, and they are principally invoiced to third party payers. The company enters into agreements with individual third party payers, and the price for services is generally well defined; however, strict insurance coding and documentation requirements can affect the amount ultimately received from the third party payers. The company recognizes revenue net of an allowance for differences between the amounts billed upon the service being performed and the amounts ultimately received. The differences arise due to audits, reviews and investigations performed by the third party payers. While these differences are common in the industry and generally occur in the normal course of business, the allowances involve estimation by way of consideration of voluminous historical claims data.

Refer to pages 16–20 (Core Business & Strategy), pages 111–113 (Significant accounting policies) and page 135 (note 9c).

How our audit addressed the key audit matter

We performed the following work to address the risk identified:

- We performed detailed testing over a sample of revenue transactions recorded throughout the year by tracing individual transactions throughout the cycle from initiation, which occurs upon a notice being received from a patient's physician, to payment.
- We obtained a listing of third party payer contracts, and for a sample of contracts, we traced the contract details, such as price, to the system.
- We performed analytical procedures by type of monitoring service and by month to identify any unusual items or fluctuations. Where applicable, we obtained explanations and supporting evidence such as payer contracts from management.
- We obtained the allowances calculation prepared by management, which consisted of both the contractual allowance and the provision for doubtful accounts. We performed a recalculation and traced amounts to the general ledger. In addition, we assessed the consistency of the methodology employed, obtained an understanding of any unusual items affecting the calculation and compared estimates to the company's historical experience.

The combination of the procedures described above gave us sufficient audit evidence to address the aforementioned risks over the amounts recorded as revenue.

Key audit matter

Goodwill impairment assessment
The goodwill impairment assessment is considered a key audit matter due to the significance of the goodwill balance (created through multiple acquisitions in the U.S. several years ago) in relation to total assets and total equity ($15.0 million, or 16% of total assets and 26% of total equity) as well as the estimation and judgment associated with projecting future business performance and profitability, estimating revenue growth rates and determining an indicative discount rate.

In performing the goodwill impairment assessment on an annual basis, management compares the carrying value of goodwill to the fair value of the underlying business, determined by estimating the value in use. Value in use is calculated by estimating the future cash flows that the business is expected to generate and applying a discount rate. To the extent that value in use is lower than the carrying value of goodwill, an impairment charge is recognised.

Refer to pages 107–108 (Significant accounting policies).

How our audit addressed the key audit matter

We obtained management's value in use calculation and performed the following work to address the risk identified:

- We assessed the methodology and model employed, to determine if it was consistent with prior years and in line with generally accepted valuation techniques. In performing this assessment, we leveraged the expertise of an internal valuation specialist.
- We reperformed the calculations in the model and traced amounts to supporting documentation, as applicable.
- With respect to the projections of future business performance and profitability, we discussed the projections with management in order to obtain an understanding of the key drivers and the initiatives planned to achieve expected results. We compared the current year actual results with the figures included in the prior year forecast to consider whether any forecasts included assumptions that, with hindsight, were optimistic. Current year actual performance was found to be slightly lower than the level forecasted, but management appropriately adjusted projections downward compared to the prior year.
- We assessed management's revenue and long term growth rate assumptions by comparing them to market studies for the Telehealth industry and the discount rate assumption by assessing the cost of capital for the company and other market participants (comparable companies). In addition, we considered the reasonableness of management's margin, depreciation, capital expenditures and changes in working capital estimates by comparing the estimates to actual amounts for previous years.
- We obtained the company's sensitivity analyses around key assumptions to ascertain the effect of changes to those assumptions on the value in use estimate. In addition, we performed our own sensitivity analyses by changing various key assumptions to worst-case scenarios.
- We considered the reasonableness of the value in use estimate in relation to the overall market capitalization of the company.

Report on the Consolidated Financial Statements

Although uncertainties exist in any forecasting exercise, based on the work performed, we found the key assumptions and estimates used by management for the goodwill impairment assessment to be balanced and supportable in light of the current economic environment. Also, given the headroom (significant excess of the value in use estimate over carrying value), we concur with management's conclusion that goodwill is not impaired.

Key audit matter

Contingent liabilities arising from litigation

In 2016 and 2015, the company incurred significant losses due to litigation related charges ($13 million in 2016 and $18 million in 2015). As these amounts are significant to the consolidated financial statements, contingent liabilities arising from litigation is considered a key audit matter.

At the balance sheet date, the provision for litigation exposures is $13 million, reflecting management's estimate of the amount of loss that is probable and estimable for the one remaining significant matter. After the year-end, the settlement for this litigation was approved by the authorities for this amount.

In addition, management has disclosed contingent liabilities relating to other significant pending litigation matters, including the uncertainty associated with the amount and timing of potential losses.

Refer to page 116 (Significant accounting policies), pages 117–118 (note 3) and pages 134–135 (note 9b–c).

How our audit addressed the key audit matter

We performed the following work to address the risk identified:

- We obtained the litigation summary prepared by management, to understand any new matters and obtain an update on existing matters. In addition, where applicable we obtained supporting documents and evidence as described below.
- We obtained legal expense account details and identified external legal counsel engaged by the company during the year. For external legal counsel involved in significant matters, we obtained a written legal letter directly from external legal counsel and assessed the information provided, to check consistency with the information obtained from management and to understand the likelihood of potential loss from a legal point of view.
- In addition, where considered necessary, we held a discussion directly with external legal counsel, which allowed us to ask specific questions and clarify the point of view of external legal counsel.
- Based on the information obtained from management and external counsel, we assessed management's determination for each matter as to whether loss is considered probable and estimable in accordance with the relevant accounting standard. Where loss is considered probable and estimable, we assessed the provision recorded, if any, based on the range of potential loss or the best estimate of potential loss, as applicable.

We found management's assessments and estimates to be reasonable based on information currently available to the Group and after consideration of the legal advice received by the Group.

Report on other legal requirements

We confirm that we meet the legal requirements on licensing according to the Auditor Oversight Act (AOA) and independence (article 728 CO and article 11 AOA) and that there are no circumstances incompatible with our independence.

In accordance with article 728a paragraph 1 item 3 CO and Swiss Auditing Standard 890, we confirm that an internal control system exists which has been designed for the preparation of consolidated financial statements according to the instructions of the Board of Directors.

We recommend that the consolidated financial statements submitted to you be approved.

PricewaterhouseCoopers AG

Dr. Michael Abresch
Audit expert
Auditor in charge

Carrie Rohner

Zurich, March 21, 2017

Statutory Balance Sheet as of December 31

CHF	Note	December 31 2016	December 31 2015
Assets			
Current assets			
Cash and cash equivalents		19,788,011	690,091
Receivables from direct and indirect investments		1,741,502	441,092
Accrued income and prepaid expenses		315,319	641,764
Total current assets		**21,844,832**	**1,772,947**
Non-current assets			
Long-term receivables from direct and indirect investments		9,315,820	577,383
Investments	2	80,000,000	80,000,000
Property, plant and equipment	3	203,378	209,093
Total non-current assets		**89,519,198**	**80,786,476**
TOTAL ASSETS		**111,364,030**	**82,559,423**
Liabilities and shareholders' equity			
Current liabilities			
Trade payables to third parties		452,711	563,945
Payables due to direct and indirect investments		557,260	0
Accrued expenses		744,057	1,691,721
Short-term provisions		69,929	3,431
Total current liabilities		**1,823,957**	**2,259,097**
Non-current liabilities			
Long-term interest-bearing liabilities to direct and indirect investments		43,726,967	51,199,838
Total long-term liabilities		**43,726,967**	**51,199,838**
Total liabilities		**45,550,924**	**53,458,935**
Shareholders' equity			
Share capital	4	24,021,230	17,515,615
Legal reserves	7	607,132,626	568,807,221
Reserve from capital contribution		606,084,164	568,807,221
Other legal reserves		1,048,462	–
Retained earnings		-4,605,560	2,602,193
Accumulated losses		-560,637,172	-559,709,299
Loss brought forward	7	-552,501,546	-552,501,546
Loss for the year		-8,135,626	-7,207,753
Treasury stock	6	-98,018	-115,242
Total shareholders' equity		**65,813,106**	**29,100,488**
TOTAL LIABILITIES		**111,364,030**	**82,559,423**

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Profit and Loss Statement for the Financial Year ended December 31

CHF	Note	P&L by nature of expense 2016	2015
Management fee		1,094,246	1,351,986
Total income		**1,094,246**	**1,351,986**
Expenses			
Staff costs		-2,799,834	-2,872,316
Other operating costs		-3,064,721	-3,011,746
Depreciation		-61,402	-39,292
Total expenses		**-5,925,957**	**-5,923,354**
Earnings before interest and tax		**-4,831,711**	**-4,571,368**
Financial income	8	24,045	101,210
Financial expenses		-3,327,960	-2,735,345
Earnings before taxes		**-8,135,626**	**-7,205,503**
Direct taxes		-	-2,250
Loss for the year		**-8,135,626**	**-7,207,753**

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Notes to the Statutory Financial Statements as of December 31, 2016

Note 1
Accounting principles applied in the preparation of the financial statements

These financial statements have been prepared in accordance with the provisions of commercial accounting as set out in the Swiss Code of Obligations (Art. 957 to 963b SCO).

The financial statements of LifeWatch AG, with registered office in Zug, comply with the requirements of the new Swiss accounting legislation of the Swiss Code of Obligations (SCO).

LifeWatch AG is presenting consolidated financial statements according to US GAAP. As a result, these financial statements and notes do not include additional disclosures, cash flow statement and management report.

Significant items are accounted for as follows:

Recognition of income
Income comprise management fees from other group companies.

Non-current assets and leases
Property, plant and equipment is carried at cost less depreciation.

Cash flows for operating leases are recognised as expense directly at the time of payment.

Depreciation is calculated on the basis of the following useful lives and in accordance with the following methods:

Property Plant and Equipment	Useful life	Method
Office furniture	17 years	6%, linear
Office equipment	7 years	15%, linear
IT equipment	3 years	33%, linear

Treasury Stock
Treasury stock has been valued at the lower of cost or market value.

Foreign Currencies
Monetary and non-monetary items in foreign currency are translated into Swiss francs at the following exchange rates:

Foreign Currency	2016 profit and loss statement	Balance sheet as at December 31, 2016
USD	0.963471	1.016354

The exchange rates used for balance sheet items are the rates prevailing on December 31; the exchange rates used for transactions conducted during the course of the year and for items in the profit and loss statement are average rates for each month of the 2016 financial year.

Note 2
Investments

Investments held directly and indirectly by LifeWatch AG are shown in Note 17 on 155 of the consolidated financial statements.

All investments are tested for impairment annually. For the purpose of preparing annual financial statements the impairment test for the investment in LifeWatch Services Inc. is based on a comprehensive valuation analysis prepared by a third-party valuation expert using the Discounted Cash Flow (DCF) method for LifeWatch's principle business.

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Note 3
Property, plant and equipment

	Fixtures & Fittings	Computer Equipment	Other	Total
Cost				
Balance 1.1.2015	131,645	61,601	980	194,226
Additions 2015	0	66,535	0	66,535
Disposals 2015	0	0	0	0
Balance 31.12.2015	131,645	128,136	980	260,761
Depreciation				
Balance 1.1.2015	4,973	6,424	979	12,376
Charge 2015	12,072	27,220	0	39,292
Depreciation on disposals 2015	0	0	0	0
Balance 31.12.2015	17,045	33,644	979	51,668
Net book value 31.12.2015	**114,600**	**94,492**	**1**	**209,093**
Cost				
Balance 1.1.2016	131,645	128,136	980	260,761
Additions 2016	6,820	48,867	0	55,687
Disposals 2016	0	0	0	0
Balance 31.12.2016	138,465	177,003	980	316,448
Depreciation				
Balance 1.1.2016	17,045	33,644	979	51,668
Charge 2016	5,540	55,862	0	61,402
Depreciation on disposals 2016	0	0	0	0
Balance 31.12.2016	22,585	89,506	979	113,070
Net book value 31.12.2016	**115,880**	**87,497**	**1**	**203,378**

Note 4
Share capital

Share capital comprises 18,477,869 (2015: 13,473,550) registered shares of CHF 1.30 (2015: CHF 1.30) each and amounts to CHF 24,021,229.70 (2015: CHF 17,515,615.00).

During fiscal year 2016 the share capital was increased by an amount of CHF 6,505,615 (2015: CHF 32,661) through the issuance of 5,004,319 (2015: 25,124) registered shares of a par value of CHF 1.30 (2015: CHF 1.30) each. The increase in 2016 results primarily from an ordinary capital increase issue but also includes 10,300 registered shares (2015: the 25,124 registered shares) issued in respect of the exercise of options under the terms of conditional capital (Note 5).

Note 5
Conditional share capital

As of 31 December 2016, the share capital of LifeWatch AG may not be raised by virtue of the exercise of option rights granted to employees, directors, officers, consultants or members of the advisory board of the Company or its affiliates. As of 31 December 2015, the share capital of LifeWatch AG could be raised through the issue of no more than 42,867 registered shares of a par value of CHF 1.30 each, to be fully paid in by an amount of no more than CHF 55,727.10 by virtue of the exercise of option rights granted to employees, directors, officers, consultants and members of the advisory board of the Company or its affiliates.

The share capital of LifeWatch AG may be increased through the issue of no more than 1,000,000 (2015: 1,000,000) registered shares of a par value of CHF 1.30 (2015: CHF 1.30) each, to be fully paid in by an amount of up to a maximum of CHF 1,300,000 (2015: CHF 1,300,000) through the exercise of option and/or conversion rights which are granted in relation to bond issues and similar obligations of the Company or its group companies, and/or through the exercise of option rights which are granted.

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Note 6
Treasury stock, including shares held by subsidiaries (carrying value)

	Number 31.12.2016	Value (CHF) 31.12.2016	Number 31.12.2015	Value (CHF) 31.12.2015
January 1	15,625	115,242	51,817	367,631
Shares purchased	-	-	-	-
Shares transferred to the Board of Directors	-	-	-36,192	-252,389
Shares sold to settle option exercises	-2,500	-17,224	-	-
December 31	13,125	98,018	15,625	115,242

As of December 31, 2016 and 2015, none of the Treasury stock was reserved to secure conversion rights arising from share-based compensation plans of LifeWatch AG.

Treasury stock has been valued at the lower of purchase price or market value (SIX-closing price) as of December 31, 2016.

Note 7
Legal reserves

	CHF
December 31, 2014	**567,377,514**
Additional paid-in capital resulting from the issuance of registered shares under the conditional capital	188,413
Release of reserve for treasury shares	1,104,621
Profit on sale of Treasury shares	136,673
December 31, 2015	**568,807,221**
Additional paid-in capital resulting from the issuance of registered shares	38,332,401
Release of reserve for treasury shares	–
Loss on sale of Treasury shares	-6,996
December 31, 2016	**607,132,626**

The company intends to set off losses of CHF 552,501,546 against reserves, which consists of capital contributions by the shareholders. The losses to be set off against capital contributions are reported separately in the balance sheet. In connection with the introduction of the capital contribution principle the Swiss Federal Tax Administration (FTA) states the view in its Circular Letter Number 29 that losses that have been charged to capital contribution reserves definitively reduce the capital contribution reserves. The Board of Directors does not unconditionally share this opinion, which is why such potential capital contribution reserves are also documented as capital contribution reserves in the balance sheet. However, a considerable uncertainty exists whether and in what amount the caption 'reserve from capital contribution' reported in the balance sheet qualifies for the tax privileges of the capital contribution principle. Out of the total amount of CHF 607,132,626 reported per December 31, 2016, the amount of CHF 13,054,989 has been approved to date by the FTA and is therefore available for withholding tax exempt payout. Under these circumstances, Article 725.1 of the Swiss Code of Obligations with regard to capital losses and over-indebtedness applies. However, this does not result in a potential going concern issue, since losses of CHF 552,501,546 have not been set-off against capital contributions of CHF 607,132,626 for the above-mentioned tax reasons. Should the losses actually be set-off against the capital contributions then this would resolve the situation under Article 725.1. The Board of Directors has therefore concluded that no other measures are required to address this issue.

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Note 8
Financial expenses

Financial expenses include CHF 1,150,462 related to the issuance of capital during the year.

Note 9
Significant shareholders

As per December 31, 2016 the following shareholders held over 3% of the voting stock:

- Himalaya (Cayman Islands) TMT Fund held 2,832,319 shares (15.33%) (2015: 2,020,587 shares, 15.26%)
- AEVIS Victoria SA held 2,207,089 shares (11.94%) (2015: n/a)
- LB (Swiss) Investment AG held 1,974,778 shares (10.69%) (2015: 1,342,345 shares, 9.98%)
- Martin Eberhard held 646,111 shares (3.50%) (2015: n/a)

Note 10
Additional information requested by the Swiss Code of Obligations:

Participations

As of December 31, 2016 and December 31, 2015, the following participations were held by members of the Board of Directors and the Executive Management Team (including persons closely related to these members):

	Number of Shares	
Board of Directors: [10]	2016	2015
Schildknecht Patrick [1]	495,544	478,000
Rühle Thomas [1]	185,593	123,000
Hubert Antoine [2]	2,216,267	9,178
Bider Robert [3]	72,000	n/a
Dong Jinsheng [3]	0	n/a
Kohler Antoine [3]	0	n/a
Cohen Raymond [3]	0	n/a

	Number of Shares		Share options	
Executive Management Team (EMT) [10]	2016	2015	2016	2015
			Expiring 2016	
Rietiker Stephan [4]	330,000	300,000	0	0
Kravetz Stephanie [5]	0	0	0	0
Turchi Mike [6]	n/a	0	n/a	9,300
Stefan Vogt [7]	n/a	4,500	n/a	0
Moore Andrew [8]	4,000	n/a	0	n/a
Heinzen Christoph [9]	0	n/a	0	n/a
Total Board & Management	**3,295,404**	**914,678**	**0**	**9,300**

Explanations:

[1] Appointed to the Board on 23 January 2013
[2] Appointed to the Board on 30 January 2014
[3] Appointed to the Board on 15 April 2016
[4] Appointed to the EMT on 30 January 2014
[5] Appointed to the EMT on 28 May 2014
[6] Left the EMT on 31 March on 2016
[7] Left the EMT on 16 August on 2016
[8] Appointed to the EMT on 1 April 2016
[9] Appointed to the EMT on 14 September 2016
[10] Board and EMT members hold no options in the company

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Significant events occurring after the balance sheet date

In January 2017, LifeWatch AG was informed of a public offer for the shares of the company by an existing shareholder, AEVIS Victoria SA. LifeWatch AG subsequently announced that, in the interest of the company and all shareholders, it has decided to solicit additional offers.

Employee declaration

The number of full-time equivalents did not exceed 10 on an annual average basis.

Pension liabilities

On 31 December 2016, the company had no outstanding liability to the pension scheme.

Contingent assets and liabilities

LifeWatch AG is not involved in any material claims, legal disputes, regulatory and tax audits, investigations or other legal matters.

LifeWatch AG has entered into an agreement under which it has committed to provide the necessary finance for the start-up and initial operations of a joint venture company in Turkey. The commitment is to continue until the company becomes cash-flow positive, provided and as long as the company's progress is in line with, or better than, the 2017 budget and the forecast for 2018 and 2019, as agreed by the parties and approved by the Board of Directors of LifeWatch AG.

Collateral for third-party liabilities

	2016	2015
Guarantee to Bank Leumi USA, NA	-	USD 4,000,000

The credit facilities and related guarantee were cancelled during the fiscal year.

Long-term interest-bearing liabilities (1-5 years)

CHF	2016	2015
LifeWatch Technologies, Ltd	43,726,967	41,201,474
LifeWatch Services, Inc.	-	9,654,648
LifeWatch Europe AG	-	343,716
Due to direct and indirect investments	**43,726,967**	**51,199,838**
Total long-term interest-bearing liabilities (1-5 years)	**43,726,967**	**51,199,838**

Hidden reserves

There was no release of hidden reserves during fiscal year 2016.

Appropriation of available earnings

Retained earnings carried forward

CHF	2016	2015
Retained earnings at the beginning of the period	-4,605,560	2,602,193
Appropriation of retained earnings resolved by general meeting		
Allocated to legal reserves	0	0
Distributed to shareholders	0	0
Loss for the year	-8,135,626	-7,207,753
Retained earnings available to the general meetingmeeting	-12,741,186	-4,605,560

Motion of the Board of Directors on the allocation of retained earnings

CHF	2016 Motion of the Board of Directors	2015 Resolution of the general meeting
Retained earnings available to the general meeting	-12,741,186	-4,605,560
Allocated to legal reserves	0	0
Distributed to shareholders	0	0
Carried forward	**-12,741,186**	**-4,605,560**

Report on the Financial Statements

Report of the statutory auditor
to the General Meeting of
LifeWatch AG
Zug

Report of the statutory auditor on the financial statements

As statutory auditor, we have audited the financial statements of LifeWatch AG (pages 166 to 177), which comprise the balance sheet, income statement and notes, for the year ended December 31, 2016.

Board of Directors' responsibility

The Board of Directors is responsible for the preparation of the financial statements in accordance with the requirements of Swiss law and the company's articles of incorporation. This responsibility includes designing, implementing and maintaining an internal control system relevant to the preparation of financial statements that are free from material misstatement, whether due to fraud or error. The Board of Directors is further responsible for selecting and applying appropriate accounting policies and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Swiss law and Swiss Auditing Standards. Those standards require that we plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers the internal control system relevant to the entity's preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control system. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made, as well as evaluating the overall presentation of the financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements (pages 166 to 177) for the year ended December 31, 2016 comply with Swiss law and the company's articles of incorporation.

Report on key audit matters based on the circular 1/2015 of the Federal Audit Oversight Authority

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Investments in subsidiaries valuation

Key audit matter
The valuation of the investment in subsidiaries balance is a key audit matter due to the significance of the investment balance in relation to total assets (CHF 80 million or 72% of total assets) and because of the estimation and judgment required in projecting the future business performance and profitability, estimating growth rates and determining an indicative discount rate.

As described in Note 2, for the investment in LifeWatch Services Inc., the company leverages the third party valuation analysis prepared for LifeWatch's principle business.

Refer to page 169 of the annual report (Note 2 Investments).

How our audit addressed the key audit matter

We leveraged the audit procedures performed at the level of the consolidated Financial Statements to assess the appropriateness of the valuation of the investment in LifeWatch Services Inc. These audit procedures included:

- Assessment of the key assumptions used in the preparation of the valuation report, including the performance projections and discount rate.
- Comparison and evaluation of the current year actual results with the figures included in the prior year forecast to consider whether any forecasts included assumptions that, with hindsight, were appropriate.
- Assessment of management's revenue and long term growth rate assumptions by comparing them to market studies for the Telehealth industry and the discount rate assumption by assessing the cost of capital or the company and other market participants (comparable companies) as well as assessment of the reasonableness of management's margin, depreciation, capital expenditures and changes in working capital estimates.
- Re-performance of management's calculation in which debt obligations were deducted from total estimated fair value of the enterprise, to arrive at the estimated fair value of equity
- Re-performance of management's calculation of the difference between the estimated fair value of equity and the carrying value of the investments
- Assessment of the methodology and model employed, to determine if it was consistent with prior years and in line with generally accepted valuation techniques. In performing this assessment, we leveraged the expertise of an internal valuation specialist.

Based on our procedures performed, we have not identified a requirement for a valuation adjustment.

Report on other legal requirements

We confirm that we meet the legal requirements on licensing according to the Auditor Oversight Act (AOA) and independence (article 728 CO and article 11 AOA) and that there are no circumstances incompatible with our independence.

In accordance with article 728a paragraph 1 item 3 CO and Swiss Auditing Standard 890, we confirm that an internal control system exists which has been designed for the preparation of financial statements according to the instructions of the Board of Directors.

We further confirm that the proposed appropriation of available earnings complies with Swiss law and the company's articles of incorporation. We recommend that the financial statements submitted to you be approved.

Further, we draw attention to the fact that half of the share capital and the legal reserves is no longer covered (article 725 para. 1 CO).

PricewaterhouseCoopers AG

Dr. Michael Abresch
Audit expert
Auditor in charge

Gian Franco Bieler
Audit expert

Zurich, March 21, 2017

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