7 March 2017

**SQS Software Quality Systems AG**
**("SQS", "the Company" or "the Group")**

**Results for the year ended 31 December 2016**

Software Quality Systems AG (AIM: SQS.L), the leading global specialist in end-to-end software and business process quality solutions, today announces its results for the 12 months ended 31 December 2016.

## Financial Highlights

- Total revenue increased by 2.0% to €327.1m (FY 2015: €320.7m)
  - Focus remains on higher margin customers and those with the strongest potential

- Adjusted** PBT increased by 17.2% to €24.4m (FY 2015: €20.8m)
  - Reflecting improved gross margin and improved operational efficiency

- Adjusted* gross profit increased by 3.7% to €104.7m (FY 2015: €101.0m)
  - Gross margin improved by 50bps to 32.0% (FY 2015: 31.5%)
  - More profitable client engagements

- Adjusted*** EPS increased by 19.7% to €0.47 (FY 2015: €0.40)

- Operating cash inflow of €31.2m (FY 2015: €31.4m), representing another year of strong profit to cash conversion (104% EBITDA to operating cash flow conversion)

- Net debt €12.4m compared to €5.9m at 31 Dec 2015 (30 Jun 2016: €32.9m)
  - Reflecting €10.4m (FY 2015: €22.4m) cash outflow for the acquisition of the final 25% of shares in SQS Pune (India)

- Proposed dividend of €0.15 per share (FY 2015: €0.13 per share)

- Current trading and ongoing strategic developments in line with management expectations following recent significant contract wins

* adjusted for a non-cash amortisation of Bitmedia/Trissential acquired order backlog of €1.1m
** incl. effects under * and adjusted to add back €7.4m of IFRS amortisation of client relationship assets from the Bitmedia/Trissential/Galmont acquisitions, €0.6m pro forma interests mainly arising from purchase price allocation for deferred payments on acquisitions, €0.6m acquisition costs from not executed acquisitions.
*** adjusted to add back effects under ** at actual local GAAP tax rate of 29.1%, less €2.3m on minority interests (mainly for SQS India BFSI)

## Operational Highlights

- Continued progress delivered within operational segments, and ongoing innovation to respond to growing demand for digitisation and automation:
  - Management Consultancy ("MC") increased to 18% share of total revenues (FY 2015: 11%) due to increased demand for delivery of digital transformation services globally, reflecting our strategic focus in this area
  - Significant contract wins – over €152m – secured within Managed Services ("MS")
  - Professional Services ("PS") contributed 29% of total revenue (FY 2015: 31%) and continues to operate under a sustainable managed decline to c. 25%, as the Company focuses on growing higher margin contracts within MS and MC, together accounting for 62% of revenues (FY 2015: 59%)

- Accelerated development and contract wins in both digital transformation and agile market sectors:
  - SQS has established a leading position in digital consulting and industrialised delivery
  - SQS' share from "digital" has almost doubled to c. 40% of revenues
  - Continued enhancement of market position in the US, which is now SQS' second largest geography

- Strong position in Europe maintained, with sustained growth in the UK and Ireland and the rebalanced German speaking countries client base
- Focus in Central European market was on higher value client engagements resulting in migration from less profitable contracts
- Asia shows good momentum and India continues to present multiple future market opportunities which SQS is well positioned to capitalise on

- Acquired the remaining 25% of SQS Pune (SQS India)

- The ongoing execution of SQS' strategy, continued innovation and the successful integration of acquisitions has resulted in a robust and diversified global footprint and broad portfolio of specialist services relevant to future demand

**Diederik Vos, Chief Executive Officer of SQS, commented:**

"SQS has delivered another strong year resulting in continued revenue growth, strong profitability – including the highest PBT margin since the global financial crisis – and strong operating cash flow. Our biggest division by size, MS, continues to offer significant opportunities for the business, and it is encouraging to see the progress we have made in MC (now 18% of Group revenues). This was achieved despite known geopolitical and economic uncertainties and, in some cases, negative currency movements.

"We enter 2017 with confidence. The broader industry trends driving our business remain strong and supportive. We will continue to invest in our intellectual property and services portfolio to ensure they evolve in line with key market developments and remain relevant for future demand.

"We are actively managing changes in the markets we serve to ensure that we are at the forefront of addressing our client's needs. As digital transformation becomes a growing part of a company's business, we expect to see the biggest growth in the coming few years to emanate from MC. MS will continue to be a large market, but with slower overall growth than previous years as companies become more decentralised in project spend and shift investments to shorter term digital projects.

"In line with economic forecasts, we expect to see growth particularly in the German speaking countries, the UK, Ireland and Italy. We expect growth of the overall US market to be relatively subdued following recent policy changes such as on health insurance. The US is, nevertheless, the world's largest IT market, and, given the progress we have made following the integration of our acquisitions there, we are well positioned to address growing our market share there over the next few years. Though it is too early to tell, the well-documented recent issues for a number of large IT outsourcers operating in the US could create opportunities for SQS.

"We are reassured by the continuing momentum within our existing, globally diverse client base. Our evolving product and service offering are also opening up new opportunities for higher margin client engagements. We have a solid pipeline and the Board believes it is well positioned to deliver further growth in the year ahead."

**Enquiries:**


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| SQS Software Quality Systems AG<br>Diederik Vos, Chief Executive Officer<br>Rene Gawron, Chief Financial Officer | Tel. +49 (0) 2203 91 54 0 |
| Numis Securities - Nomad and Joint Broker<br>Simon Willis / Jamie Lillywhite / Mark Lander | Tel +44 (0) 20 7260 1000 |
| Stockdale Securities - Joint Broker<br>Robert Finlay / Antonio Bossi / Fiona Conroy | Tel. +44 (0) 20 7601 6100 |
| FTI Consulting - Financial Media and Investor Relations<br>Matt Dixon / Dwight Burden / Nicola Krafft | Tel. +44 (0)20 3727 1000<br>sqs@fticonsulting.com |

**About SQS**
SQS is the leading global specialist in end-to-end software and business process quality solutions. This position stems from over 30 years of successful consultancy operations. SQS consultants provide solutions for all aspects of quality throughout the whole software product lifecycle driven by a standardised methodology, offshore automation processes and deep domain knowledge in various industries. Headquartered in Cologne, Germany, the company now employs approximately 4,600 staff. SQS has offices in Germany, UK, US, Australia, Austria, Egypt, Finland, France, India, Ireland, Italy, Malaysia, the Netherlands, Norway, Singapore, South Africa, Sweden, Switzerland and UAE. In addition, SQS maintains a minority stake in a company in Portugal. In 2016, SQS generated revenues of €327.1 million.

SQS is the first German company to have a primary listing on AIM, a market operated by the London Stock Exchange. In addition, SQS shares are also traded on the German Stock Exchange in Frankfurt am Main.

With over 10,000 completed projects under its belt, SQS has a strong client base, including half of the DAX 30, nearly a third of the STOXX 50 and 20 per cent of the FTSE 100 companies.

For more information, see www.sqs.com

**Chief Executive's Statement**

**Introduction**

Despite a backdrop of political change and uncertainty, 2016 represented another year of progress for SQS, driven in part by the ever-evolving digital economy: a macro trend which is driving the relevance and importance of our services. We grew our revenues by 2% over the period, which was a good performance given the unfavourable currency movements but, more importantly, we continued to transition the business to higher margin work and improve our own operational efficiencies. This progress can be clearly seen in the achievement of our highest profit before taxes margin performance since the 2008 financial crisis.

A key feature of SQS is our ability to grow profitably and generate solid operating cash flow. Once again, we managed to convert all of our EBITDA in to cash, which allows us flexibility for capital allocation decisions, whether that is investment, acquisitions or dividends. SQS has invested considerably in India over the past decade to ensure that the Company can meet the growing service demands of our global clients, while seeking to drive more efficiency and output from our employee base. During the year, we acquired the remaining 25% shares of SQS Pune (SQS India).

Significant in the 12 month period was the continued growth in Management Consulting, which is a reflection of the digital transformation that is evolving in every industry sector across the globe, and SQS' position as a trusted end-to-end quality solutions provider. During 2016, SQS has worked with some of the biggest companies and best-known brands in the world. These brands engage with us to ensure that they can maximise the digital opportunity open to them whilst also ensuring that the software behind their offerings is robust and their reputation is maintained. SQS' share from "digital" has almost doubled to c. 40% of our revenues

Managed Services, the largest SQS division by revenue and profit, recorded a small decline in turnover year-on-year following a number of contracts coming to the end of their application life cycle. Encouragingly, MS secured significant new contracts through the year. Looking ahead, the outlook for the MS industry is for more agile and decentralised engagements. SQS with its enhanced MC offerings and consultants is well-positioned for this on-going development.

Professional Services remains an area that we are managing for profitability rather than growth as we concentrate on growing MC and MS – both higher margin and longer term contract areas of business – and we continue to see PS being a valued channel to new clients and contributing circa 25% of our revenues over time.

Areas of our business classified as 'Other' contributed c.9% of total revenues, which represented a small decrease in tool licence reselling.

The geographic spread of SQS remains a key strength of the business, and we were particularly pleased with the continued growth we achieved in the world's largest technology market, the US. The opportunity here continues to excite us and we are making good progress in this important market. A significant element of this was in adapting the Galmont (now re-named SQS North America) sales and delivery model to SQS' strategy. A well-defined roadmap continues to be executed.

Elsewhere, the UK, Europe and Asia all showed good momentum.

SQS' overall split of business by industries has not changed materially and we have seen the highest growth in demand in the automotive & manufacturing and energy & utilities sectors, while banking & financial services have slowed.

**New Business**

In the 12 month period, we have seen a continued rise in demand for decentralised digital transformation projects with a more consultancy based approach and, excitingly for SQS, this demand opens up broader, addressable markets in Artificial Intelligence (AI), robotics, machine learning and process automation. SQS, particularly our MC division, is well positioned to help any company (irrespective of size, scale or sector) to industrialise and automate its solutions and drive profitability through more efficient processes.

We continue to focus on higher margin projects, and our clarity of focus across all industry verticals is enabling the business to operate with more efficiency and agility, generating opportunities for new contracts. This has been reflected in some substantial orders on digital transformation programmes in the period across a range of sectors and geographies to be delivered over the next three years, including a global insurance company (€45m); a global automotive company (€30m); an Italian public sector company (€26m); a European banking group (€16m) and work in the UK utilities sector (€15m).

We have continued to grow our market share in the US through new projects, and have greatly benefitted from our strong local US delivery base of on-site consultants and local delivery centres, which sets us apart from some competitors. For the first time a US client has moved up into our global top 10 largest customers. We are also continuing to see more demand across Europe and emerging markets.

**Market & Industry Overview**

Our marketplace and industry dynamics are currently undergoing a period of transformation, which SQS is well positioned to capitalise on. Greater digitisation is creating growing demand geared towards digital transformation and business process automation consulting services. Customers of all shapes and sizes are looking increasingly to migrate from large, monolithic business operations to a series of more nimble, agile processes. Such changes continue to open up broader addressable markets across new geographies and industry verticals, and our technology capabilities and business quality assurance services put SQS in a strong position.

Leading market research analyst, NelsonHall, recently published its annual market report for 2016, conducting in-depth analysis and performance evaluation of the top business quality assurance services providers. SQS was placed in the highest performing quadrant, commanding a leading position in the marketplace. This endorsement of our customer proposition provides us with confidence and clear momentum going into 2017.

**Acquisitions**

Following a busy year of acquisitions in 2015, including in Bitmedia, Trissential and Galmont, 2016 was a period of successful integration. During the year we began to leverage our new capabilities and relationships to grow the SQS offering. The acquisitions have given SQS an increased footprint in key markets, including the US and Europe, and will continue to offer exciting cross-selling opportunities.

During the period, the Company acquired the remaining 25% of the issued share capital of SQS India Infosystems, our Pune based facility, for €10.4m. This further demonstrates SQS' continued commitment to India, from where it continues to drive innovation and service the needs of its global clients. It is also expected to be a growing market, as companies in India continue to rely on quality assurance and testing services to increase output from their employees, whilst leading the charge on IT automation.

**Strategy**

SQS remains committed to its strategy of targeting more profitable, higher margin client engagements, led from its MS, and even more so from its MC divisions. One of the business' key focusses is continuing to expand and enhance its MC offering to meet the growing customer demand for digital transformation services, whether that be for augmented automation, artificial intelligence or robotics, where it can lead the way.

Whilst testing and quality assurance are and will remain a key part of SQS' offering, companies are under constant and increasing pressure to drive efficiencies and move to a more industrialised, automated operation. This opens up huge opportunities for SQS, and we will continue to evolve our offering in this area so we can become the 'go to' for advising companies, across sectors, as they make this transition. SQS will ensure the client's processes and systems are able to cope with the ever growing IT demands. This will be facilitated by continued investment in our growing team of industry, technology sector and pre-sales experts, so we can continue to deepen our expertise and better market our capabilities to help drive new business opportunities.

Although huge in-roads are already being made, the US remains a key opportunity for SQS. The Company begins 2017 well placed to grow through our enhanced offering and route to market, following the two acquisitions in 2015. SQS will also continue to target Europe – and sees longer term potential in Asia – as the digital agenda continues to open up new and exciting opportunities for us to grow our share of the market in existing and new sector verticals. We will consider suitable strategic acquisitions that can accelerate our global expansion and the capabilities we can offer our customers.

**Dividend**

SQS proposes to pay a dividend for the full year of €0.15 per share (2015: €0.13). This is in line with our current policy of paying a dividend of about 30% of adjusted profit after tax. Subject to shareholder approval the dividend will be paid following the AGM (planned for 24 May 2017) with a pay date/post cheques date of 30 May 2017. The record date will be 12 May 2017 and the ex-dividend date 11 May 2017. In accordance with German law, SQS pays one dividend in each financial year.

**Employees**

Total headcount at the period end decreased by 3.3% to 4,466 (31 Dec 2015: 4,619), with a further circa 250 contractors retained during the period. The decrease in headcount results from a growing share of automation and better operational efficiency.

**Board**

Effective 6 September 2016, SQS has appointed Martin Hodgson as an additional Executive Director to the SQS Board to drive the global Management Consulting practice. Martin has spent most of his professional life in management consulting with a particularly strong focus on the automotive industry. He joined SQS in December 2015 and has been promoted from a senior management position in SQS to the Board.

**Summary and Outlook**

SQS has delivered another strong year resulting in continued revenue growth, strong profitability – including the highest PBT margin since the global financial crisis – and strong operating cash flow. Our biggest division by size, MS, continues to offer significant opportunities for the business, and it is encouraging to see the progress we have made in MC (now 18% of Group revenues). This was achieved

despite known geopolitical and economic uncertainties and, in some cases, negative currency movements.

We enter 2017 with confidence. The broader industry trends driving our business remain strong and supportive. We will continue to invest in our intellectual property and services portfolio to ensure they evolve in line with key market developments and remain relevant for future demand.

We are actively managing changes in the markets we serve to ensure that we are at the forefront of addressing our client's needs. As digital transformation becomes a growing part of a company's business, we expect to see the biggest growth in the coming few years to emanate from MC. MS will continue to be a large market, but with slower overall growth than previous years as companies become more decentralised in project spend and shift investments to shorter term digital projects.

In line with economic forecasts, we expect to see growth particularly in the German speaking countries, the UK, Ireland and Italy. We expect growth of the overall US market to be relatively subdued following recent policy changes such as on health insurance. The US is, nevertheless, the world's largest IT market, and, given the progress we have made following the integration of our acquisitions there, we are well positioned to address growing our market share there over the next few years. Though it is too early to tell, the well-documented recent issues for a number of large IT outsourcers operating in the US could create opportunities for SQS.

We are reassured by the continuing momentum within our existing, globally diverse client base. Our evolving product and service offering are also opening up new opportunities for higher margin client engagements. We have a solid pipeline and the Board believes it is well positioned to deliver further growth in the year ahead.

**Diederik Vos**
Chief Executive Officer
7 March 2017

**Financial Review FY 2016**

**Summary**

Revenues grew by 2.0% to €327.1m (FY 2015: €320.7m), including first time consolidation effects from two US acquisitions of €22.1m and a negative impact from translational forex on revenue of €7.1m. Excluding the forex impact would have resulted in revenues of €334.2m.

As part of our Group strategy, SQS has migrated from less profitable contracts that were at the end of their application life cycle, equating to a €14.4m revenue reduction in FY 2016 compared to FY 2015. Organic constant currency revenue growth was broadly flat at (0.2)%, excluding all the above effects of disengagements, first time consolidation and the translational forex movements.

The business units, which represent the accounting segments according to IFRS 8, are:

- **Managed Services (MS)** to meet the demand of clients seeking efficiency in long-term engagements (between 12 months and five years) of which a growing share (in many cases) is delivered from nearshore and offshore delivery centres. This also includes long term engagements for quality assurance services on standard software package products. MS continues to perform well, generating good quality of earnings for the Group;

- **Management Consulting (MC)** (previously called Specialist Consultancy Services (SCS)) to meet the demand of clients seeking transformation and quality through IT Portfolio Programme and Project Management, Digital Transformation Consulting, Business & Enterprise Architecture, Process Modelling and Business Analysis. Our MC services portfolio offers strong opportunities for growth going into this year and to open broader addressable markets;

- **Professional Services (PS)** (previously called Regular Testing Services (RTS)) to meet the demand of more price conscious clients in IT projects who tend to be given a smaller number of consultants on a more local basis and typically contracted for a short term period (e.g. three months);

Alongside these major segments we conduct business with contractors (as far as these have not been included in MS or MC), training & conferences and software testing tools summarised as "**Other**".

**Breakdown by business unit**

**Managed Services (MS)**
Revenue in MS, our largest segment and one of our strategic focus areas, amounted to €146.4m in the period (FY 2015: €153.2m), a decrease of (4.4)% on the prior year, representing a Group revenue contribution of 45%. The decrease in revenue predominantly came from the scope reduction of a few managed services contracts that had entered a later stage of their life cycle.

**Management Consulting (MC)**
Revenue in this segment – our other strategic focus area – saw a strong increase during the period of 56.6% to €57.3m (FY 2015: €36.6m), representing a Group revenue contribution of 18%, up from 11% at FY 2015. Growth for this segment was mainly driven by the contribution from our US business and growth in the UK and Ireland markets.

**Professional Services (PS)**
Revenue in this segment decreased by (5.9)% to €93.4m (FY 2015: €99.3m) on the prior year period, representing a Group revenue contribution of 29%. Our strategy continues to be to reduce the share of this segment to a range of around 25% of our total revenue.

**Other**
Revenue in the "Other" segment amounted to €30.0m in the period (FY 2015: €31.6m), a decrease of (5.1)% on the prior year and representing 9% of Group revenue. A decrease in revenue from tool licences re-selling was the key driver for this development.

**Margins and Profitability**

Adjusted* gross profit improved by 3.7% to €104.7m (FY 2015: €101.0m), with gross margin up to 32.0% (FY 2015: 31.5%). The improvement in gross margin was driven by a greater blended contribution from

MS and MC that deliver higher client value and better margins in the range of 35% and above. Gross margins in the PS segment have remained at 26.4% (FY 2015: 26.5%).

Gross margins in the "Other" segment were at 24.7% (FY 2015: 19.8%) reflecting an improved contractor gross margin and a lower share from tool licences re-selling.

Adjusted** profit before tax for the period was €24.4m (FY 2015: €20.8m), an increase of 17.2%, with the adjusted profit margin at 7.5% (FY 2015: 6.5%). The profit before tax was driven by a blended gross margin above 35% in MS, MC and an increased share of these two strategic business lines of 62% of total revenue (FY 2015: 59% of total revenue), lower interest expenses and €2.8m net realised foreign exchange gains mainly from intercompany transactions between the Group's main currencies.

Adjusted*** earnings per share are at €0.47 (FY 2015: €0.40) resulting from the above outlined improvements in margins and finance results, as well as from a lower blended tax rate of 29.1% on adjusted PBT (FY 2015: 31.8%).

* adjusted for a non-cash amortisation of Bitmedia/Trissential acquired order backlog of €1.1m
** incl. effects under * and adjusted to add back €7.4m of IFRS amortisation of client relationship assets from the Bitmedia/Trissential/Galmont acquisitions, €0.6m pro forma interests mainly arising from purchase price allocation for deferred payments on acquisitions, €0.6m acquisition costs from not executed acquisitions.
*** adjusted to add back effects under ** at actual local GAAP tax rate of 29.1%, less €2.3m on minority interests (mainly for SQS India BFSI)

**Costs**

Total overhead costs (adjusted for the non-interests effects under ** above) moved up to 25.1% of revenue from 24.7% in FY 2015.

General & Administrative expenses (adjusted for the non-interests effects under ** above) for the period were €54.0m (FY 2015: €52.4m). This represents an increase by 0.2 percentage points to 16.5% of revenue (FY 2015: 16.3%). The absolute growth was mainly due to the first time consolidation effects of acquisitions, investment in the build out of the delivery centre infrastructure and the US business.

Sales & Marketing costs for the period were €23.9m (FY 2015: €22.9m), representing 7.3% of revenues (FY 2015: 7.1%). The 0.2% increase as a percentage of revenues was due to investments in pre-sales skills for sector verticals and in technology solutions, both part of our strategy to strengthen our consulting and services portfolio and broaden our addressable markets.

Research & Development expenses during the period were slightly up at €4.2m (FY 2015: €4.0m) representing 1.3% (FY 2015: 1.2%) of revenues. This investment was focused on the development of our proprietary software testing tools, the PractiQ methodology and new platforms around predictive quality analytics.

**Cash Flow and Financing**

Cash inflow from operating activities was at €31.2m (FY 2015: €31.4m inflow). This strong full year operating cash flow results from the second half weighting we have seen in all previous years with a solid full year EBITDA to operating cash conversion of 104%. Debtor days stood at 70 (YE 2015: 69).

Cash outflow from investments reduced to €11.4m (FY 2015: €29.8m outflow), predominantly due to the high outflow of €18.0m from the Bitmedia, Trissential and Galmont acquisitions in 2015. The current level of investment is largely a "normal" level for IT infrastructure and R&D spend and includes €1.6m outflow for the build out of the Pune and the Chennai delivery centres.

Total cash outflow from financing activities was €12.3m (FY 2015: €12.2m inflow) reflecting a net increase in finance loans of €4.2m during 2016, mainly to fund the outflow of €10.4m for the acquisition of the final 25% of shares in SQS Pune (India) and the above mentioned investments. Additionally dividend payments to SQS Group shareholders and SQS India BFSI minority shareholders resulted in an outflow of €6.4m (FY 2015: 6.0m outflow).

**Balance Sheet**

We closed the period with €29.8m (31 Dec 2015: €32.0m) of cash and cash equivalents on the balance sheet and borrowings of €42.2m (31 Dec 2015: €37.9m). The increase in borrowings was mainly due to the cash outflow of €10.4m for the acquisition of the remaining 25% shares in SQS Pune. Cash reserves are increasingly held in a broader range of currencies and the transfer of funds is restricted in some

geographies, such as India. Therefore, the offset between cash and debt positions has become less flexible as we also seek to avoid the realisation of negative exchange rate movements. The resulting net debt position at the period end was €12.4m (31 Dec 2015: net debt of €5.9m).

During the period under review SQS re-arranged its borrowing facilities with its four main banks and additionally continues to have local overdraft facilities in some countries. In total its facilities with the four main banks are now €83m and are in place until 2021. These facilities are subject to customary covenants, are not secured and the borrowing costs are lower than historically.

For acquired companies Bitmedia, Trissential and Galmont intangible assets for client relationships and order backlog with a fair value of €10.2m were recognised in the 31 December 2016 balance sheet, reflecting a further amortisation of €8.5m during the period. On average these intangible assets are amortised over a period of up to nine years.

In total goodwill and intangible assets from the acquired companies came down to €89.1m in the YE 2016 balance sheet (YE 2015: €110.4m) resulting from a reduction of the Galmont goodwill of €5.6m, the aforementioned amortisation and forex adjustments of recognised goodwill. The corresponding earn-out liability for the Galmont acquisition was reduced by €5.5m in line with the expected development of the business.

As these amortisation charges are non-cash-items and do not impact the normal business of SQS, they are adjusted within the PBT and EPS reporting.

**Taxation**

The tax charge of €4.2m (FY 2015: €3.0m) includes current tax expenses of €7.1m (FY 2015: €6.6m) and deferred tax credits of €(2.9)m (FY 2015: €(3.6)m). The tax rate on local GAAP results was 29.1% (FY 2015: 31.8%), the lower tax rate being a consequence of changes in the geographic spread of profits. Going forward, we expect an actual tax rate of c. 30%.

**Foreign Exchange**

Approximately 56.8% (FY 2015: 56.5%) of the Group's turnover is generated in Euros. For the conversion of revenues and costs generated in other currencies into Euros, the relevant official average exchange rate for the twelve-month-period of 2016 was applied. For the conversion of the balance sheet items from other currencies into Euros, the official exchange rate as at 31 December 2016 was used.

Foreign exchange had a €0.6m negative translational impact on earnings for the period. Had the Pound Sterling/Swiss Franc/Indian Rupee/Swedish Krona/Egyptian Pound/US-$/Euro exchange rates remained the same as in FY 2015, our non-Euro revenues for the period would have been €7.1m higher and the EBIT would have been €0.6m higher.

**International Financial Reporting Standards (IFRS)**

The Consolidated Financial Statements of SQS and its subsidiary companies ("SQS Group") are prepared in conformity with all IFRS (International Financial Reporting Standards) and Interpretations of the IASB (International Accounting Standards Board) which are to be applied for those financial statements whose reporting period starts on or after 1 January 2016.

The SQS Group Consolidated Financial Statements for the 12-month period ended 31 December 2016 were prepared in accordance with uniform accounting and valuation principles in Euros.

**Rene Gawron**
Chief Financial Officer
7 March 2017

## Consolidated Income Statement
## for the year ended 31 December 2016 (IFRS)

| €k | (Notes) | Year ended 31 December 2016 audited | Year ended 31 December 2015 audited |
|---|---|---|---|
| Revenue | | 327,103 | 320,716 |
| Cost of sales | (6) | 223,482 | 221,810 |
| **Gross profit** | | **103,621** | **98,906** |
| General and administrative expenses | (6) | 61,981 | 60,411 |
| Sales and marketing expenses | (6) | 23,898 | 22,873 |
| Research and development expenses | (6) | 4,154 | 3,970 |
| **Earnings from operating activities before amortisation (EBITA)** | | **13,588** | **11,652** |
| Amortisation of goodwill | | 5,600 | 0 |
| **Profit before tax and finance costs (EBIT)** | | **7,988** | **11,652** |
| Finance income | | 9,754 | 1,565 |
| Finance costs | | 3,002 | 2,946 |
| **Net finance costs** | (7) | **6,752** | **-1,381** |
| **Profit before tax (EBT)** | | **14,740** | **10,271** |
| Income tax expense | (8) | 4,231 | 3,049 |
| **Profit for the year** | | **10,509** | **7,222** |
| Attributable to: | | | |
| Owners of the parent | | 10,004 | 7,166 |
| Non-controlling interests | | 505 | 56 |
| **Consolidated profit for the year** | | **10,509** | **7,222** |
| **Earnings per share, undiluted (€)** | (9) | **0.32** | **0.23** |
| **Earnings per share, diluted (€)** | (9) | **0.30** | **0.22** |
| **Adjusted earnings per share (€), for comparison only** | (9) | **0.47** | **0.40** |

## Consolidated Statement of Comprehensive Income
## for the year ended 31 December 2016 (IFRS)

| €k | Year ended 31 December 2016 | Year ended 31 December 2015 |
|---|---|---|
| | **audited** | **audited** |
| **Profit for the period** | **10,509** | **7,222** |
| Exchange differences on translating foreign operations | -6,431 | 4,570 |
| Gains arising from cash flow hedges | 86 | 168 |
| *Other comprehensive income to be reclassified to profit or loss in subsequent periods* | *-6,345* | *4,738* |
| Re-measurement losses on defined benefit plans | 1,651 | -561 |
| *Other comprehensive income not being reclassified to profit or loss in subsequent periods* | *1,651* | *-561* |
| **Other comprehensive income for the year, net of tax** | **-4,694** | **4,177** |
| **Total comprehensive income for the year, net of tax** | **5,815** | **11,399** |
| Attributable to: | | |
| Owners of the parent | 4,907 | 10,483 |
| Non-controlling interests | 908 | 916 |
| **Total comprehensive income for the year** | **5,815** | **11,399** |

## Consolidated Statement of Financial Position
## as at 31 December 2016 (IFRS)

| €k | (Notes) | 31 December 2016 | 31 December 2015 |
|---|---|---|---|
| | | **audited** | **audited** |
| **Current assets** | | | |
| Cash and cash equivalents | | 29,824 | 31,990 |
| Trade receivables | | 56,424 | 61,093 |
| Other receivables | | 7,207 | 5,914 |
| Work in progress | | 17,207 | 16,074 |
| Income tax receivables | | 3,261 | 1,321 |
| | | **113,923** | **116,392** |
| **Non-current assets** | | | |
| Intangible assets | (10) | 23,121 | 26,586 |
| Goodwill | (10) | 78,860 | 92,539 |
| Property, plant and equipment | | 16,711 | 15,833 |
| Financial assets | | 30 | 30 |
| Income tax receivables | (8) | 285 | 1,421 |
| Deferred tax assets | (8) | 5,615 | 5,429 |
| | | **124,622** | **141,838** |
| **Total Assets** | | **238,545** | **258,230** |
| **Current liabilities** | | | |
| Bank loans and overdrafts | | 41,119 | 27,064 |
| Finance lease liabilities | | 0 | 62 |
| Trade payables | | 9,834 | 10,518 |
| Tax accruals | (8) | 2,573 | 3,745 |
| Other current liabilities | | 45,294 | 56,374 |
| | | **98,820** | **97,763** |
| **Non-Current liabilities** | | | |
| Bank loans | | 1,058 | 10,825 |
| Finance lease | | 115 | 54 |
| Pension provisions | | 4,034 | 5,682 |
| Deferred tax liabilities | (8) | 6,136 | 8,424 |
| Other non-current liabilities | | 8,845 | 16,145 |
| | | **20,188** | **41,130** |
| **Total Liabilities** | | **119,008** | **138,893** |
| **Equity** | (11) | | |
| Share capital | | 31,676 | 31,676 |
| Share premium | | 56,902 | 56,478 |
| Statutory reserves | | 53 | 53 |
| Other reserves | | -6,469 | 271 |
| Retained earnings | | 29,062 | 21,524 |
| **Equity attributable to owners of the parent** | | **111,224** | **110,002** |
| Non-controlling interests | | 8,313 | 9,335 |
| **Total Equity** | | **119,537** | **119,337** |
| **Equity and Liabilities** | | **238,545** | **258,230** |

## Consolidated Statement of Cash Flows
## for the year ended 31 December 2016 (IFRS)

| €k | Year ended 31 December 2016 | Year ended 31 December 2015 |
|---|---|---|
| | **audited** | **audited** |
| **Net cash flow from operating activities** | | |
| Profit before tax | 14,740 | 10,271 |
| Add back for | | |
| Depreciation and amortisation | 15,824 | 15,752 |
| Loss on the sale of property, plant and equipment | 309 | 45 |
| Other non-cash income not affecting payments | -2,455 | 1,269 |
| Net finance costs | -1,253 | 1,381 |
| Operating profit before changes in the net current assets | **27,165** | **28,718** |
| | | |
| Decrease (Increase) in trade receivables | 4,669 | 7,616 |
| Decrease (Increase) in work in progress and other receivables | -2,276 | -7,873 |
| Increase (Decrease) in trade payables | -683 | -2,073 |
| Increase (Decrease) in pension provisions | 83 | 927 |
| Increase (Decrease) in other liabilities and deferred income | 2,279 | 4,130 |
| Cash flow from operating activities | **31,237** | **31,445** |
| | | |
| Interest payments | -1,386 | -1,260 |
| Tax payments | -8,037 | -8,107 |
| **Net cash flow from operating activities** | **21,814** | **22,078** |
| | | |
| **Cash flow from investment activities** | | |
| Purchase of intangible assets | -8,515 | -5,065 |
| Purchase of property, plant and equipment | -3,299 | -7,288 |
| Purchase of net assets of acquired companies | 0 | -17,982 |
| Interest received | 398 | 507 |
| **Net cash flow from investment activities** | **-11,416** | **-29,828** |
| | | |
| **Cash flow from financing activities** | | |
| Dividends paid | -4,118 | -3,973 |
| Proceeds from non controlling interests on the exercise of stock options | 345 | 295 |
| Payments for the acquisition of non controlling interests | -10,403 | -426 |
| Dividends paid to non controlling interests | -2,274 | -1,979 |
| Repayment of finance loans | -26,152 | -9,764 |
| Increase of finance loans | 30,440 | 28,304 |
| Redemption of leasing contracts | -116 | -252 |
| **Net cash flow from financing activities** | **-12,278** | **12,205** |
| | | |
| **Change in the level of funds affecting payments** | -1,880 | 4,455 |
| Changes in cash and cash equivalents due to exchange rate movements | -286 | 1,238 |
| Cash and cash equivalents at the beginning of the period | **31,990** | **26,297** |
| Cash and cash equivalents at the end of the period | **29,824** | **31,990** |

# Consolidated Statement of Changes in Equity
# for the year ended 31 December 2016 (IFRS)

| €k | Attributed to owners of the parent | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Share capital | Share premium | Statutory reserves | Other reserves | cash flow hedge reserve | Translation of foreign operations | Retained earnings | **Total** | Non controlling interest | **Total Equity** |
| **31 December 2014 (audited)** | **30,563** | **47,446** | **53** | **-1,693** | **-369** | **-1,545** | **19,213** | **93,668** | **10,208** | **103,876** |
| Cash dividends paid | | | | | | | -3,973 | -3,973 | -1,979 | -5,952 |
| *Transactions with owners of the parent* | | | | | | | *-3,973* | *-3,973* | *-1,979* | *-5,952* |
| Business combinations | | | | | | | | 0 | | 0 |
| Capital increase | 1,113 | 8,154 | | | | | | 9,267 | 294 | 9,561 |
| Acquisition of non-controlling interests | | | | | | | -321 | -321 | -104 | -425 |
| Share-based payments | | 878 | | | | | | 878 | | 878 |
| Profit for the period | | | | | | | 7,166 | 7,166 | 56 | 7,222 |
| Exchange differences on translating foreign operations | | | | | | 3,710 | | 3,710 | 860 | 4,570 |
| Re-measurement gains on defined benefit plans | | | | | | | -561 | -561 | | -561 |
| Gains arising from cash flow hedges | | | | | 168 | | | 168 | | 168 |
| *Total comprehensive income* | *0* | *0* | *0* | *0* | *168* | *3,710* | *6,605* | *10,483* | *916* | *11,399* |
| **31 December 2015 (audited)** | **31,676** | **56,478** | **53** | **-1,693** | **-201** | **2,165** | **21,524** | **110,002** | **9,335** | **119,337** |
| Cash dividends paid | | | | | | | -4,117 | -4,117 | -2,274 | -6,391 |
| *Transactions with owners of the parent* | | | | | | | *-4,117* | *-4,117* | *-2,274* | *-6,391* |
| Capital increase | | | | | | | | 0 | 344 | 344 |
| Acquisition of non-controlling interests | | | | | | | | 0 | | 0 |
| Share-based payments | | 424 | | | | | | 424 | | 424 |
| Profit for the period | | | | | | | 10,004 | 10,004 | 505 | 10,509 |
| Exchange differences on translating foreign operations | | | | | | -6,834 | | -6,834 | 403 | -6,431 |
| Re-measurement gains on defined benefit plans | | | | | | | 1,651 | 1,651 | | 1,651 |
| Gains arising from cash flow hedges | | | | | 86 | | | 86 | | 86 |
| Other changes | | | | 8 | | | | 8 | | 8 |
| *Total comprehensive income* | *0* | *0* | *0* | *0* | *86* | *-6,834* | *11,655* | *4,907* | *908* | *5,815* |
| **31 December 2016 (audited)** | **31,676** | **56,902** | **53** | **-1,685** | **-115** | **-4,669** | **29,062** | **111,224** | **8,313** | **119,537** |

# Notes to the Consolidated Financial Statements
**at 31 December 2016**

## 1. Description of business activities

SQS, based in Cologne, Germany, is the world's largest specialist supplier of software quality services by revenue. SQS is independent from software vendors and other IT service suppliers. It can therefore provide unbiased opinions to customers on software products and projects it is engaged to assess and improve. SQS offers services designed to support the quality of software and IT systems from initial project definition through the development stage and up to final implementation and, thereafter, in ongoing maintenance.

For more than thirty years, SQS has been offering a comprehensive range of consulting services for enterprise and technical software systems to its clients who include "blue chip" companies in a variety of sectors, such as financial services, telecommunications, logistics and manufacturing. SQS currently has 4,466 employees at the end of 2016 (previous year 4,619 employees) across Europe, Asia, North America, Africa and Australia. SQS has a strong presence in Germany and the UK and offices in Austria, Egypt, Finland, France, India, Ireland, Italy, the Netherlands, Norway, South Africa, Sweden, Switzerland, Singapore, Australia, Malaysia, Belgium, the United Arabian Emirates and the United States of America. Furthermore, SQS has a minor stake in an operation in Portugal.

SQS is listed on the London Stock Exchange (AIM) and is also traded on Deutsche Börse, Frankfurt.

## 2. Summary of Significant Accounting Policies

***Basis of preparation and statement of compliance***

The Consolidated Financial Statements of SQS and its subsidiary companies ("SQS Group" or "SQS Konzern") are prepared in conformity with all IFRS Standards (International Financial Reporting Standards) and Interpretations of the IASB (International Accounting Standards Board) endorsed by the European Commission and translated into the German language which are to be applied for those financial statements whose reporting period starts on or after 1 January 2016.

The Financial Information has been prepared on a historical cost basis. The Financial Information is presented in Euros and amounts are rounded to the nearest thousand (€k) except when otherwise indicated.

***First-time application of new standards and changes in accounting policies***

SQS has applied the Standards and Interpretations of the IASB as applicable in the EU which are binding for financial years commencing on or after 1 January 2016.

SQS does not apply any further changed or newly passed standards prior to the implementation date stipulated.

The adoption of the following new and amended IFRS and IFRIC interpretations was mandatory for accounting periods beginning on 1 January 2016:

| | |
|---|---|
| IAS 1 | Presentation of Financial Statements - Disclosure Initiative (Amendment) |
| IAS 16, 38 | Intangible assets and property, plant and equipment - Clarification to acceptable methods of depreciation and amortization |
| IAS 16, 41 | Agriculture and property, plant and equipment – Bearer Plants |

## 2. Summary of Significant Accounting Policies (continued)

| | |
|---|---|
| IAS 27 | Separate Financial Statements – Applications of the equity method in separate financial statements (Amendment) |
| IFRS 10/ 12/ IAS 28 | Investment Entities – Applying the Consolidation Exception (Amendment) |
| IFRS 11 | Joint Arrangements – Accounting for acquisitions or interests in joint operations (Amendment) |
| IFRS 14 | Regulatory Deferral Accounts |

The annual Improvements project 2012 - 2014 regarding several improvements of existing standards.

The amendments and improvements did not have any impact on the consolidated financial statements of SQS Group.

The following standards and amendments to existing standards have been published and have been endorsed by the European Commission for the Group's accounting periods beginning after 1 January 2016 or later periods, but the Group has not early adopted them:

| | |
|---|---|
| IAS 7 | Statement of Cash Flows - Disclosure Initiative (Amendment) |
| IAS 12 | Recognition of Deferred Tax Assets for Unrealised Losses (Amendment) |
| IAS 40 | Transfers of Investment Property (Amendment) |
| IFRS 2 | Classification and Measurement of Share-based Payment Transaction (Amendment) |
| IFRS 4 | Applying IFRS 9 Financial instruments with IFRS 4 Insurance Contracts (Amendment) |
| IFRS 9 | Financial Instruments: Presentation - Regulations for the accounting of financial instruments measured at amortized cost or Fair Value |
| IFRS 10/IAS 28 | Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendment) |
| IFRS 15 | Revenue from Contracts with Customers including amendments to the effective date of IFRS 15 and Clarifications |
| IFRS 16 | Leases |
| IFRIC 22 | Foreign Currency Transactions and Advance Consideration |

The annual Improvements project 2014 - 2016 regarding several improvements of existing standards.

Except from IFRS 15 and IFRS 16 none of these standards and amendments will most likely have any material impact on the annual consolidated financial statements of SQS Group. Currently it is checked which effects will have IFRS 15 and IFRS 16 on the SQS Group. Hence, still no statement can be met concerning this.

***Basis of consolidation***

The consolidated financial statements comprise the financial statements of SQS Software Quality Systems AG and its subsidiaries as at 31 December each year. Subsidiary company financial statements are prepared on a basis consistent with those of other SQS Group companies. All companies in the SQS Group have the same accounting reference date of 31 December.

Subsidiaries are consolidated from the date on which control is transferred to SQS Group and cease to be consolidated from the date on which control is transferred out of SQS Group. In general SQS obtains and exercises control through voting rights.

All inter-company balances and transactions, including unrealised profits arising from intra-group transactions, have been eliminated in full.

## 2. **Summary of Significant Accounting Policies** (continued)

As at 31 December 2016, the following subsidiaries have been fully consolidated:

| Consolidated companies | Country of incorporation | 31 December 2016 | | | 31 December 2015 | | |
|---|---|---|---|---|---|---|---|
| | | Share of capital | Equity | Result for the year | Share of capital | Equity | Result for the year |
| | | % | €k | €k | % | €k | €k |
| SQS Group Limited, London | UK | 100.0 | 9,038 | 1,524 | 100.0 | 8,593 | (160) |
| SQS Software Quality Systems (Ireland) Ltd., Dublin | Ireland | 100.0 | 10,571 | 3,369 | 100.0 | 7,202 | 2,782 |
| SQS Nederland BV, Utrecht | The Netherlands | 95.1 | 3,944 | 777 | 95.1 | 3,167 | 768 |
| SQS GesmbH, Vienna | Austria | 100.0 | 10,122 | 1,960 | 100.0 | 12,708 | 10,092 |
| SQS Software Quality Systems (Schweiz) AG, Zurich | Switzerland | 100.0 | 2,679 | 280 | 100.0 | 3,200 | 1,881 |
| SQS Group Management Consulting GmbH, Vienna | Austria | 100.0 | 4,075 | 1,605 | 100.0 | 2,445 | 1,177 |
| SQS Group Management Consulting GmbH, Munich | Germany | 100.0 | (25) | (67) | 100.0 | 421 | (708) |
| SQS Egypt S.A.E, Cairo | Egypt | 100.0 | 2,861 | 1,265 | 100.0 | 2,635 | 688 |
| SQS Software Quality Systems Nordic AB, Stockholm | Sweden | 100.0 | (499) | (14) | 100.0 | 233 | (403) |
| SQS Software Quality Systems Sweden AB, Stockholm | Sweden | 100.0 | 74 | 20 | 100.0 | 57 | (29) |
| SQS Software Quality Systems Norway AS, Oslo | Norway | 100.0 | 250 | 100 | 100.0 | 151 | (18) |
| SQS Software Quality Systems Finland OY, Espoo | Finland | 100.0 | 31 | 23 | 100.0 | 8 | (175) |
| SQS India Infosytems Private Limited, Pune | India | 100.0 | 13,912 | 3,117 | 75.0 | 10,649 | 3,058 |
| SQS France SASU, Paris | France | 100.0 | (252) | (150) | 100.0 | (103) | (123) |
| SQS USA Inc., Chicago (Illinois) | USA | 100.0 | (10,428) | (459) | 100.0 | (8,909) | (3,322) |
| SQS India BFSI Limited, Chennai | India | 53.9 | 16,986 | 4,912 | 54.56 | 16,892 | 4,173 |
| SQS Software Quality Systems Italia S.p.A., Rome | Italy | 90.0 | 4,541 | 721 | 90.0 | 3,820 | 655 |
| Trissential LLC, Waukesha, Wisconsin | USA | 100.0 | 4,545 | 2,623 | 100.0 | 3,649 | 1,056 |
| SQS North America, Chicago (Illinois) | USA | 100.0 | 1,003 | (1,398) | 100.0 | 2,379 | 359 |

SQS AG holds 15% of the shares of SQS Portugal Lda with a book value of € nil (at 31 December 2015: € nil).

SQS India BFSI Ltd. is the sole shareholder of SQS BFSI Pte. Ltd., Singapore, SQS BFSI Inc., USA, Thinksoft Global Services (Europe) GmbH, Germany, SQS BFSI UK Ltd., UK, and SQS BFSI FZE, United Arabian Emirates. None of these companies each has a main impact on the financial data of the Group.

## 2. Summary of Significant Accounting Policies (continued)

**Foreign currency translation**

The Euro (€) is the functional and reporting currency of the parent company and its Euroland subsidiaries. For these entities, transactions in foreign currencies are initially recorded in the functional currency at the exchange rates valid at the date of the transaction. Monetary assets and liabilities denominated in such foreign currencies are retranslated at the rates prevailing on the balance sheet date. All differences arising from translation of monetary items are recognised in profit or loss.

Translation differences on items whose fair value gain or loss is recognised in other comprehensive income or profit or loss are recognised in other comprehensive income or profit or loss, respectively.

The following subsidiaries have their own functional currency:

| Subsidiary | Functional currency |
|---|---|
| SQS Group Ltd. with business activity in UK | £ (Pounds Sterling) |
| SQS Software Quality Systems (Schweiz) AG | CHF (Swiss Franc) |
| SQS India | INR (Indian Rupee) |
| SQS India BFSI Limited | INR (Indian Rupee) |
| SQS USA | USD (US-Dollar) |
| Trissential LLC | USD (US-Dollar) |
| SQS North America (previously: Galmont Consulting LLC) | USD (US-Dollar) |
| SQS Nordic with business in Sweden | SEK (Swedish Crona) |
| SQS Nordic with business in Norway | NOK (Norwegian Crona) |
| SQS Egypt | EGP (Egyptian Pound) |

At the reporting date, the assets and liabilities (including any goodwill) of these subsidiaries are translated into Euros at the exchange rate valid at the reporting date. The items of the income statement of these entities were translated at the weighted average exchange rate for the year 2016. The exchange differences arising on translation are recognised in other comprehensive income and accumulated in a separate reserve in equity.

The functional currency of SQS BFSI Inc., USA, Thinksoft Global Services (Europe) GmbH, Germany, SQS BFSI UK Ltd., UK, SQS BFSI Pte Ltd, Singapore and SQS BFSI FZE, United Arab Emirates is the Indian Rupee as the activities of these foreign operations are carried out as extensions of SQS India BFSI, Chennai. Exchange differences regarding these entities are recognised in profit or loss.

On disposal of a foreign entity, the cumulative amount of exchange differences relating to that particular foreign entity is reclassified from equity to profit or loss when the gain or loss on disposal is recognised.

## 3. Segmental reporting

Based on the organizational structure and the different services rendered, SQS Group operates the following segments:

- Managed Services (MS) to meet the demand of clients seeking efficiency in long-term engagements (between six months up to five years) of which a growing share (in many cases) is delivered from nearshore and offshore delivery centres. This also includes long term engagements for quality assurance on standard software package products;

- Management Consulting (MC) (previously called Specialist Consultancy Services (SCS) to meet the demand of clients seeking transformation and quality through IT Portfolio Programme and Project Management, Digital Transformation Consulting, Business & Enterprise Architecture, Process Modelling and Business Analysis;

- Professional Services (PS) (previously called Regular Testing Services (RTS)) to meet the demand of more price conscious clients in IT projects who tend to be served with a smaller number of consultants on a more local basis and typically contracted for a short term period (e.g. three months).

Alongside these major business activities there is the business with contractors (as far as these have not been included in MS), training & conferences and software testing tools. Each of these minor operating segments represents less than 10% of the Group's revenues and the Group's profit. Thus, all these other segments are presented as "Other".

The Group management board consisting of CEO (Chief Executive Officer), CFO (Chief Financial Officer), COO (Chief Operations Officer) and Executive Director Management Consulting monitors the results of the operating segments separately in order to allocate resources and to assess the performance of each segment. Segment performance is evaluated based on gross profit.

Non-profit centres represent important functions such as Portfolio Management, Marketing, Finance & Administration, IT and Human Resources.

The non-profit centres are not allocated to the operating segments as they provide general services to the whole Group. Their costs are shown under 'Non-allocated costs'.

The assets and liabilities relating to the operating segments are not reported separately to the Group Management Board. Finance costs and income taxes are managed on a Group basis. Therefore they are not allocated to operating segments.

## 3. **Segmental reporting** (continued)

The following tables present revenue and profit information regarding the SQS Group's reportable segments for the years ended 31 December 2016 and 2015.

| 2016 | MS | MC | PS | Other | Total |
|---|---|---|---|---|---|
| | €k | €k | €k | €k | €k |
| Revenues | 146,411 | 57,317 | 93,409 | 29,966 | 327,103 |
| Segment Profit (Gross Profit) | 52,708 | 19,946 | 24,660 | 6,307 | 103,621 |
| Non-allocated costs | | | | | (90,033) |
| Amortisation of goodwill | | | | | (5,600) |
| EBIT | | | | | 7,988 |
| Financial result | | | | | 6,752 |
| Taxes on income | | | | | (4,231) |
| Result for the period | | | | | 10,509 |

| 2015 | MS | MC | PS | Other | Total |
|---|---|---|---|---|---|
| | €k | €k | €k | €k | €k |
| Revenues | 153,201 | 36,644 | 99,251 | 31,620 | 320,716 |
| Segment Profit (Gross Profit) | 55,910 | 12,484 | 26,326 | 6,263 | 100,983 |
| Non-allocated costs | | | | | (89,331) |
| EBIT | | | | | 11,652 |
| Financial result | | | | | (1,381) |
| Taxes on income | | | | | (3,049) |
| Result for the period | | | | | 7,222 |

In 2016, 11.1 % of the SQS Group´s revenue have been generated by one customer.

The following revenue information by geographical regions is based on the location of the customer. The information disclosed for non-current assets relates to property, plant and equipment and intangible assets including goodwill.

| | Revenues from external customers | | Non-current Assets | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| | €k | €k | €k | €k |
| Germany | 98,819 | 97,172 | 6,677 | 6,217 |
| Other | 228,284 | 223,544 | 112,015 | 128,741 |
| Total | 327,103 | 320,716 | 118,692 | 134,958 |

## 4. Group Information on non-controlling interest

The consolidated financial statements of the Group include the following non-controlling interests:

| | | | Non-controlling % equity interest | |
|---|---|---|---|---|
| **Name** | **Principal activities** | **Country of Incorporation** | **2016** | **2015** |
| SQS India BFSI Limited | Regular testing and managed services specialised on customers in the Banking, Financial Services and Insurance - industry | India | 46.10 | 45.44 |
| SQS Nederland BV | Regular testing services and managed services | The Netherlands | 4.9 | 4.9 |

SQS AG issued a puttable instrument to the minority shareholders of SQS Italia. This puttable instrument includes contractual obligations for SQS AG to purchase the outstanding shares of this entity. SQS Group assesses and presents this obligation as a financial liability at fair value. Consequently the consolidated financial statements of SQS do not show any non-controlling interests regarding SQS Italia.

## 4. **Group Information on non-controlling interest** (continued)

| | SQS India BFSI Ltd. | | SQS Nederland BV | |
|---|---|---|---|---|
| €k | 2016 | 2015 | 2016 | 2015 |
| Revenue | 36,938 | 34,354 | 10,440 | 8,636 |
| Profit | 4,912 | 4,173 | 777 | 768 |
| Profit attributable to non-controlling interest | 2,264 | 1,896 | 38 | 38 |
| Effects from intercompany-eliminations | (1,798) | (1,878) | 0 | 0 |
| Non-controlling interest | 466 | 18 | 38 | 38 |
| Other comprehensive income attributable to non-controlling interest | 403 | 860 | 0 | 0 |
| Total comprehensive income attributable to non-controlling interest | 869 | 878 | 38 | 38 |
| | | | | |
| Current assets | 20,384 | 18,708 | 4,029 | 3,352 |
| Non-current assets | 3,763 | 3,795 | 1,358 | 968 |
| Current liabilities | 7,161 | 5,611 | 1,442 | 1,153 |
| Non-current liabilities | 0 | 0 | 0 | 0 |
| Net assets | 16,986 | 16,892 | 3,945 | 3,167 |
| Net assets attributable to non-controlling interest | 7,831 | 7,676 | 193 | 155 |
| Total effect from intercompany-eliminations | 277 | 1,492 | 12 | 12 |
| Non-controlling interest | 8,108 | 9,168 | 205 | 167 |
| | | | | |
| Dividends paid to non-controlling interest during the year | 2,274 | 1,979 | 0 | 0 |

## 5. Exercise of Put-/Call-Options

In May 2016 the shareholders of the remaining 25% in SQS India Infosystems Private Limited and SQS Software Quality Systems AG decided to exercise their mutual Put-/Call-Option regarding the remaining shares of SQS India. In order to receive the remaining shares and in line with the calculation scheme of the Put-/Call-Option contract SQS paid a consideration of INR 785 million (€10.4m). After having completed the transaction SQS now holds the entire shares in this Indian subsidiary. The transaction is accounted for as the payment of a liability as the obligation from the put option right had already been shown under other liabilities.

The exercise of the Put-/Call-Option is a related party transaction under the AIM rules as one of the previous shareholders is a director of SQS India. Considering the profit after tax generated by SQS India, the terms of the transaction have been evaluated to be fair and reasonable.

## 6. Expenses

The Consolidated Income Statement presents expenses according to function. Additional information regarding the origin of these expenses by type of cost is provided as follows:

***Cost of material***

The cost of material included in the cost of sales in the year ended 31 December 2016 amounted to €25,454k (2015: €27,340k). Cost of material mainly relates to the procurement of external services such as contracted software engineers. In addition, certain project-related or internally used hardware and software is shown under cost of material.

***Employee benefits expenses***

| | 2016 | | 2015 |
|---|---|---|---|
| | €k | | €k |
| Wages and salaries | 196,197 | | 190,567 |
| Social security contributions | 23,681 | | 22,962 |
| Expenses for retirement benefits | 5,120 | | 4,542 |
| Total | 224,998 | | 218,071 |

The expenses for retirement benefits include current service costs regarding defined benefit plans and expenses for defined contribution plans.

The average numbers of employees in the operating segments of the SQS Group were as follows:

| | 2016 | | 2015 |
|---|---|---|---|
| | No. | | No. |
| Onshore consultants | 1,648 | | 1,576 |
| Offshore and nearshore consultants | 2,319 | | 2,220 |
| Non-consultants | 617 | | 615 |
| Total | 4,584 | | 4,411 |

***Government grants***
Government grants in the amount of €16k (2015: €37k) have been granted as subsidy from ITIDA (Information Technology Industry Developed Agency) for trainings and have been recognised as income.

***Amortisation and Depreciation***
Amortisation and depreciation charged in the year ended 31 December 2016 amounted to €15,823k (2015: €15,752k). Of this, €3,866k (2015: €3,970k) was attributable to the amortisation of development costs.

***Rentals and leasing***
Operating lease costs in connection with office space and equipment in 2016 amounted to €8,182k (2015: €8,329k).

## 7. Net finance costs

The net finance costs are comprised as follows:

| | 2016 | | 2015 |
|---|---|---|---|
| | €k | | €k |
| Interest income | 397 | | 507 |
| Exchange rate gains | 3,857 | | 1,058 |
| Total finance income | 4,254 | | 1,565 |
| Interest expense | (1,966) | | (2,093) |
| Exchange rate losses | (1,036) | | (853) |
| Total finance costs | (3,002) | | (2,946) |
| Effects from the valuation of financial liabilities at fair | 5,500 | | 0 |
| Net finance costs | 6,752 | | (1,381) |
| *Of which from:* | | | |
| *Loans and receivables* | *4,254* | | *1,565* |
| *Financial liabilities measured at amortized cost* | *(3,002)* | | *(2,837)* |
| *Financial liabilities measured at fair value* | *5,500* | | *(109)* |

Interest expense relates to interest on bank loans, finance lease liabilities and pension obligations.

## 8. Taxes on earnings

SQS Software Quality Systems AG in Germany is liable to corporate income tax, the solidarity surcharge and trade income tax. The German corporate income tax rate amounts to 15 % (2015: 15%). A 5.5 % solidarity surcharge is imposed on the corporate income tax rate being effective with a rate of 0.825 %. The trade income tax amounts to 16.6 % of the taxable income. Consequently the total income tax rate in Germany amounts to approximately 32 %.

Consolidated income tax expense is as follows:

| | 2016 | | 2015 |
|---|---|---|---|
| | €k | | €k |
| Current tax expense | 7,109 | | 8,119 |
| Deferred tax | (2,878) | | (5,070) |
| Taxes on income | 4,231 | | 3,049 |

## 8. **Taxes on earnings** (continued)

A reconciliation between actual tax expense and the product of Group accounting profit multiplied by the tax rate of SQS AG is as follows:

| | 2016 | | 2015 |
|---|---|---|---|
| | €k | | €k |
| Profit before tax multiplied by the standard rate of German income tax of 32 % (2015: 32%) | 4,717 | | 3,286 |
| Impairment of goodwill (no taxable impact) | 1,792 | | 0 |
| Expenses for stock options (no taxable impact) | 136 | | 281 |
| Taxes on dividends paid by subsidiaries | 156 | | 612 |
| Capitalization of tax losses not yet capitalized | 0 | | (1,531) |
| Revaluation earn-out liability | (1,760) | | 0 |
| Current tax regarding prior periods | 800 | | 0 |
| Tax losses occurred in 2016 not capitalised | 136 | | 1,017 |
| Expenditure not allowable for income tax purposes | 58 | | 186 |
| Deviating tax rates of subsidiaries | (1,759) | | (768) |
| Capitalisation of the corporate tax credit | (8) | | (9) |
| Government grants | (5) | | (13) |
| Other | (32) | | (12) |
| At effective income tax rate of 28.7% (2015: 29.7 %) | 4,231 | | 3,049 |

Deferred taxes with an amount of €44k (2015: €86k) were charged to other comprehensive income.

For the assessment of deferred tax assets and liabilities the local tax rates of the respective entities of SQS Group are applied.

Deferred income tax relates to the following financial positions:

| | 31 December 2016 | | 31 December 2015 |
|---|---|---|---|
| | | | |
| | €k | | €k |
| Losses carried forward | 2,720 | | 3,029 |
| Pensions provisions | 875 | | 1,340 |
| Tax credits | 1,449 | | 794 |
| Trade receivables | 371 | | 0 |
| Property, plant and equipment | 150 | | 172 |
| Liabilities from interest swaps | 50 | | 94 |
| Deferred tax assets | 5,615 | | 5,429 |

## 8. Taxes on earnings (continued)

| | 31 December 2016 | | 31 December 2015 |
|---|---|---|---|
| Capitalised development costs | (1,254) | | (1,361) |
| Capitalised customer relationships | (3,609) | | (5,635) |
| Capitalised order backlock | (535) | | (977) |
| Property, plant and equipment | (166) | | (169) |
| Trade receivables and work in progress | (572) | | (275) |
| Other receivables from currency forward contracts | 0 | | (7) |
| Deferred tax liabilities | (6,136) | | (8,424) |
| Net deferred tax assets | (521) | | (2,995) |

Deferred tax assets are recognised when it is considered probable that economic benefit will flow to the entity. The probability of future economic benefits is assessed by management based on the taxable profits realised in the past and on the expectations and planning regarding the foreseeable future.

Where a company has suffered losses, deferred tax assets thereon are recognised if the ability in the future to set off the losses with future income is permissible under the respective national provisions. According to the planning of SQS AG, SQS GMC DE, SQS Norway, SQS USA and SQS France, taxable profits are regarded as probable.

As the entities in Sweden and Finland have not generated any profit yet, the tax losses of these entities and part of the tax losses in Germany and the US with a cumulative amount of €17,916k (at 31 December 2015: €11,168k) have not been used for the capitalisation of deferred tax assets. These tax losses correspond to deferred tax assets of €6,216k.

## 9. Earnings per share

The earnings per share presented in accordance with IAS 33 are shown in the following table:

| | 2016 | | 2015 |
|---|---|---|---|
| | €k | | €k |
| Profit for the year attributable to the equity shareholders | 10,004 | | 7,166 |
| Diluted profit for the year | 10,004 | | 7,166 |
| Weighted average number of the shares in issues, undiluted | 31,675,617 | | 31,003,989 |
| Dilutive effect from stock option programme | 2,074,283 | | 2,270,288 |
| Weighted average number of shares in issues, diluted | 33,749,900 | | 33,274,277 |
| Undiluted profit per share € | 0.32 | | 0.23 |
| Diluted profit per share € | 0.30 | | 0.22 |
| Adjusted profit per share € | 0.47 | | 0.40 |

Undiluted profit per share is calculated by dividing the profit for the year attributable to equity shareholders by the weighted average number of shares in issue during 2016: 31,675,617 (2015: 31,003,989).

Diluted profit per share is determined by dividing the profit for the year attributable to equity shareholders by the weighted average number of shares in issue plus any share equivalents which would lead to a dilution.

Management considers that the stock options given to management board and key employees may have a dilutive effect. On a weighted average basis shares resulting from stock option programmes amounted to 2,074,283 (2015: 2,270,288) shares. The number of potential shares is calculated on a pro rata basis. Instruments that could potentially dilute basic earnings per share in the future are authorised capital and conditional capital.

## 9. Earnings per share (continued)

***The adjusted profits per share 2016 and 2015 are calculated based on the profit before tax:***

| | 2016 | | 2015 |
|---|---|---|---|
| | €k | | €k |
| Profit before tax | 14,740 | | 10,271 |
| Onetime expenses related to: | | | |
| SQS India BFSI Ltd., SQS Italia, Trissential LLC, SQS North Amercia | | | |
| - Amortisation of customer relationships, order backlog and depreciation | 8,466 | | 8,942 |
| - Impairment of goodwill | 5,600 | | 0 |
| - Consultancy expenses ((failed) acquisition costs) | 55 | | 1,193 |
| Adjustment of earn-out liabilities | (5,500) | | 0 |
| One off currency losses and interest | 1,077 | | 439 |
| Non-controlling interests | (2,302) | | (1,934) |
| Current tax expenses | (7,109) | | (6,633) |
| Adjusted profits | 15,027 | | 12,278 |
| | | | |
| Weighted average number of the shares in issues, undiluted | 31,675,617 | | 31,003,989 |
| Adjusted profit per share € | 0.47 | | 0.40 |

## 10. Intangible assets and goodwill

The composition of this item is as follows:

| Book values | 31 December 2016 | | 31 December 2015 |
|---|---|---|---|
| Goodwill | €k | | €k |
| SQS UK including UK, Ireland and South Africa | 28,565 | | 31,459 |
| SQS Netherlands | 555 | | 555 |
| SQS Group Management Consulting | 9,100 | | 9,100 |
| SQS Nordic including Sweden, Norway and Finland | 2,736 | | 2,874 |
| SQS India | 10,778 | | 12,236 |
| SQS India BFSI Limited | 4,535 | | 4,482 |
| SQS Italia | 1,524 | | 1,524 |
| Trissential | 15,713 | | 15,103 |
| SQS North America | 5,122 | | 14,974 |
| Other | 232 | | 232 |
| Goodwill | 78,860 | | 92,539 |

## 10. **Intangible assets** (continued)

| Book values | Remaining useful life | 31 December 2016 | 31 December 2015 |
|---|---|---|---|
| Development costs regarding testing software | | €k | €k |
| Capitalisation 2014 | 0 | 0 | 1,676 |
| Capitalisation 2015 | 1 | 1,036 | 2,018 |
| Capitalisation 2016 | 2 | 1,437 | 0 |
| | | 2,473 | 3,694 |
| Acquired Software | 1 to 7 | 6,242 | 3,381 |
| Right to a design method | 3 | 402 | 0 |
| Other development costs | 4 to 5 | 3,762 | 1,640 |
| Order backlog | 2 | 1,292 | 2,369 |
| Customer relationships | 2 to 9 | 8,950 | 15,502 |
| Intangible assets | | 23,121 | 26,586 |

Development costs regarding testing software were capitalised in the year in the amount of €2,156k (2015: €3,027k). They are amortised over a period of 36 months. The other development costs mainly relate to the methodology "PractiQ®", used by SQS to provide Managed Services. The estimated useful life of this intangible assets covers a period of five years.

The customer relationships were acquired within the business combination of SQS Software Quality Systems Italia S.p.A., Trissential LLC and SQS North America (previously Galmont Consulting LLC). The order backlog was acquired within the business combination of SQS Software Quality Systems Italia S.p.A.

| Amortisation over the expected useful life in years | Customer relationship | Order backlog |
|---|---|---|
| SQS Software Quality Systems Italia S.p.A. | 6 | 3.9 |
| Trissential LLC | 10 | - |
| SQS North America | 4 | - |

The amortisation of software and remaining intangible assets is allocated to the functional costs by an allocation key.

In order to test the recoverability of goodwill SQS conducted impairment tests, comparing the value in use of each cash generating unit with its carrying amounts.

Impairment tests were carried out for the SQS UK based business, for SQS Netherlands, for SQS Group Management Consulting, for SQS Nordic, for SQS India, for SQS India BFSI, for SQS Italy as well as Trissential LLC and SQS North America (previously Galmont Consulting LLC). These are the cash generating units which are relevant for impairment testing as they represent the lowest level at which management of SQS Group monitors the underlying value of goodwill.

All impairment tests are based on the value in use of each cash generating unit. In order to determine the values in use management has set up budgets and forecasts for each cash generating unit. The key assumptions on which management has based its cash flow projections are the future development (growth) of revenues, the development of the gross margin based on the expected capacity of the SQS-consultants and the development of general and administrative costs as well as sales and marketing costs in relation to revenues.

In its budgets and forecasts management projected detailed cash flows over a period of five years. For the periods thereafter constant cash flows were assumed.

## 10. **Intangible assets** (continued)

The determination of the future cash flows is based on the state of knowledge in December 2016. Beside growth rates regarding revenues and profits realised in the past, management considered the recent global economic development, the actual orders on hand, the actual number of SQS-consultants as well as the strategy of SQS for the coming five years. Regarding SQS North America (previously Galmont Consulting LLC) the impairment test, based on the key assumptions on which management based its determination of the unit's recoverable amount, led to an impairment of €5,600k.

The budgets of the cash generating units show a development in revenues for the next year of up to 13% in India, of up to 6% in the US and growth rates between 0 % and 8 % in Europe. In the following four years the Management expects growth rates between 2 % and 5 % each year. Management expects that most of the cash generating units will grow faster than market.

Management expects that most of the entities will be able to increase the gross margin slightly between 0 percentage points and 2 percentage points and that the expense ratio of general and administrative costs as well as sales and marketing costs will only be increased marginally for most of the cash generating units of SQS Group. Management expects Galmont (SQS North America) to reach profitability again.

In accordance with IAS 36, the impairment tests were based on the following assumptions:

- Expenses and income, assets and debts in connection with taxes on earnings, such as deferred tax assets and liabilities, tax reimbursement claims, tax liabilities and tax accruals, were eliminated both from the carrying amount of the cash generating unit and from the value in use.
- The cash flows, either in or out, from financing activities have not been taken into account.
- Trade receivables and trade payables and other liabilities were included in the calculations when estimating the future cash flows and the book value.
- The growth rate in perpetuity was estimated at 1 %.
- Goodwill was allocated entirely to the carrying amount of the cash generating unit in accordance with IAS 36.80 and IAS 36.81.
- The discount rates applied to the cash flow projections were pre-tax interest rates in a range between 8.0 % and 12.3 % which correspond to post-tax interest rates in a range between 5.2 % and 8.6 %.

## 11. **Equity**

***Subscribed Capital***

The subscribed capital amounts to €31,675,617 (at 31 December 2015: €31,675,617). This is divided into 31,675,617 (at 31 December 2015: 31,675,617) individual registered shares with an arithmetical share in the share capital of €1 each. Each share entitles the holder to one right to vote. No preference shares have been issued. The capital is fully paid up.

The movements in the subscribed capital are as follows:

| | Individual shares | | Nominal value |
|---|---|---|---|
| | Number | | € |
| As at 31 December 2015 | 31,675,617 | | 31,675,617 |
| As at 31 December 2016 | 31,675,617 | | 31,675,617 |

SQS had no shares in its ownership as at 31 December 2016.

## 11. **Equity** (continued)

***Conditional capital***
The conditional capital is to be composed as follows:

- the Conditional Capital 3 amounts to €1,300,000,
- the Conditional Capital 4 amounts to €1,050,000,
- the Conditional Capital 5 amounts to €700,000.

The Conditional Capital 3, 4 and 5 serve to grant share options to the management board members and employees respectively.

There are no changes in the Conditional Capital compared to 31 December 2015.

***Authorised capital***

The Authorised Capital amounts to €13,887,062 (at 31 December 2015: €13,887,062).

The authorised capital developed as follows:

| | € |
|---|---|
| As at 1 January 2015 | 15,000,000 |
| Usage of Authorised Capital for the acquisition of Trissential | -737,804 |
| Usage of Authorised Capital for the acquisition of Galmont | -375,134 |
| As at 31 December 2015 | 13,887,062 |
| As at 31 December 2016 | 13,887,062 |

***Share premium***
Additional paid-in capital includes any premiums received on the issuing of the share capital.

Any transaction costs associated with the issuing of shares are deducted or set off from additional paid-in capital, net of any related income tax benefits. Equity-settled share-based employee remuneration is also credited to additional paid-in capital until related stock options are exercised.

***Statutory reserves***
The statutory reserves were created in accordance with Section 150 of the Stock Corporation Act (Germany). SQS AG is not allowed to use its statutory reserves for dividends.

***Other reserves***
Other reserves comprise differences from the translation of foreign operations with an amount of €(4,669)k (at 31 December 2015: €2,165k), IPO and other transaction costs that are accounted for net of taxes in the amount of €(1,685)k (at 31 December 2015: €(1,693k)) and a cash flow hedge reserve regarding the fair values of an interest swap with an amount of €(115)k (net of tax), (at 31 December 2015: €(201)k (net of tax)). In 2016 deferred taxes with an amount of €37k have been allocated to the cash flow hedge reserve.

***Retained earnings***
Retained earnings represent the accumulated retained profits and losses less payments of dividends by SQS Group and the accumulated actuarial losses (re-measurement losses) on pension provisions. At 31 December 2016 a cumulative amount of re-measurement losses of €2,532k (net of tax) (at 31 December 2015: €3,423k) have been recognised within retained earnings.

The General Meeting of 25 May 2016 resolved to pay a €0.13 dividends per share for the business year 2015 in the total amount of €4,117,829.34, that have been paid to the shareholders of SQS AG in 2016.

## 12. Notes to the Statement of Cash Flows

The statement of cash flows shows how the funds of the Group have changed in the course of the business year through outflows and inflows of funds. The payments are arranged according to investing, financing and operating activities.

The sources of funds on which the statement of cash flows is based consist of cash and cash equivalents (cash on hand and bank balances).

Cologne, March 07th, 2017

SQS Software Quality
Systems AG

| D. Vos | R. Gillessen | R. Gawron | M. Hodgson |
|---|---|---|---|